INVESTMENT COMPANY INSTITUTE

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New York Attorney General Publishes Report on Mutual Fund Fees and Active Share

[31156]

April 10, 2018 TO: Chief Compliance Officer Committee
SEC Rules Committee RE: New York Attorney General Publishes Report on Mutual Fund Fees and Active Share

On April 5th, the Investor Protection Bureau of the New York Attorney General's Office (NYAGO) published a report, *Mutual Fund Fees and Active Share*.[1] According to NYAGO, the report summarizes the findings and outcome of an investigation the NYAGO recently conducted of 14 "major mutual fund firms in New York and elsewhere" regarding their fees and disclosures. This investigation was the result of concerns that "[t]he Trump administration and Congress have taken steps to roll back federal investor protections that heighten the duty of care owed to investors and address conflicts of interest; . . . and, although the U.S. Securities and Exchange Commission ('SEC') has said that it will propose a rule to address these issues, it has not yet done so."[2]

The report notes that actively managed mutual funds "typically charge significantly higher fees than passively managed or index funds."[3] As part of its investigation, the NYAGO "wanted to understand if a fund's fees reflect a fund's opportunity to outperform the benchmark, as measured by the degree of overlap between the holdings in the fund and the holdings in the fund's benchmark index" -- *i.e.,* as solely measured by an Active Share metric.[4]

According to the "key findings" from the NYAGO's investigation:

1. Fees on an actively managed fund cost an investor almost 4.5x more per year than fees on an investment in a passive fund.
2. Investors cannot necessarily assume that a higher fee charged by an actively managed fund means that the fund will have a higher level of active management.
3. The Active Share metric varies widely for actively managed equity funds with a high fee or expense ratio.
4. While funds provide Active Share information to institutional investors, "many of the firms surveyed" do not regularly disclose it to retail investors.

The report also notes that "all the mutual fund firms surveyed in the [NYAGO's] investigation use Active Share to some extent in managing their investment portfolios."[5] We understand that neither this statement nor (4) above is accurate. Notwithstanding the report's extensive discussion of the Active Share metric, it concedes that "Active Share may be more or less relevant depending on the type of mutual fund in question."[6]

Following the NYAGO's investigation, 13 mutual fund firms voluntarily agreed to publish quarterly, on their website, the Active Share metric for actively managed equity funds available to U.S. investors.[7] It should be noted that, pursuant to Section 18(b) of the Securities Act of 1933, states lack lawful authority to require any fund to make *any* disclosure not required under Federal law, regardless of the disclosure vehicle. Pursuant to Section 18(b), the SEC alone has authority to impose disclosure requirements on mutual funds. After the NYAGO published its report, the Institute issued the following press statement:

Mutual funds are among the most transparent, fully disclosed, and analyzed investment product in financial markets today. Since 1996, Congress has reserved for the Securities and Exchange Commission (SEC) the authority to regulate mutual fund disclosure, recognizing the national nature of the mutual fund industry and its investors. The SEC does not require disclosure of 'active share'; as even General Schneiderman's report acknowledges, 'active share is not relevant for many funds or investors.' To ensure that mutual fund investors receive uniform disclosure wherever they are located, we strongly believe state authorities should not arrogate to themselves the authority to impose inconsistent disclosure requirements.

Should any member hear of other states attempting to impose on mutual funds disclosure requirements that are inconsistent with Federal law, please let us know by contacting the undersigned at tamara@ici.org.

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endnotes

[1] The report is available at: https://ag.ny.gov/sites/default/files/ny_ag_report_on_mutual_fund_fees_and_active_share.pdf (the "report.") In conjunction with the report's publication, New York Attorney General Eric Schneiderman issued a press release, *A.G. Schneiderman Releases New Report On Mutual Fund Fees, Announces Agreement By 13 Major Firms To Make New And Enhanced Disclosures To Retail Investors Following Industry-Wide Investigation*. This press release is available at: https://ag.ny.gov/press-release/ag-schneiderman-releases-new-report-mutual-fund-fees-announces-agreement-13-major.

[2] Report at p. 1.

[3] Report at pp. 1-2.

[4] Report at p. 2. The report did not mention any other metric. As explained in the report, "'Active Share' measures the degree of overlap between the holdings in a fund and the

holdings in the fund's benchmark index." *See* report at fn. 1.

[5] Report at p. 10.

[6] Report at p. 8.

[7] The report notes that the 14th fund that was part of the investigation was already publishing the Active Share metric for investors.