

MEMO# 21311

June 28, 2007

SEC Commissioners Testify Before House Financial Services Committee

[21311]

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TO: SEC RULES COMMITTEE No. 55-07
EQUITY MARKETS ADVISORY COMMITTEE No. 35-07
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 17-07
INST. MONEY MARKET FUNDS ADVISORY COMMITTEE No. 17-07
CLOSED-END INVESTMENT COMPANY COMMITTEE No. 21-07
SMALL FUNDS COMMITTEE No. 25-07 RE: SEC COMMISSIONERS TESTIFY BEFORE HOUSE FINANCIAL SERVICES COMMITTEE

On June 26, 2007, the House Financial Services Committee ("Committee") held a hearing at which all five Commissioners from the Securities and Exchange Commission were present.

[\[1\]](#) Lasting four hours, the hearing covered a wide range of topics. Following is a short summary of some of the issues most relevant to the mutual fund industry.

12b-1 Fees

In his opening statement, Chairman Cox said that investors were charged \$12 billion in 12b-1 fees last year and that the Commission is conducting a thorough review of mutual fund fees and disclosure. He stressed several times that the Commission gained valuable insight at the SEC's June 19 roundtable on Rule 12b-1. Rep. Mike Castle (R-DE) said that 12b-1 fees have evolved from their initial purpose and should be reformed, as investors are unclear of their purpose. He acknowledged that they are now used primarily to compensate brokers, but emphasized the need for greater transparency. Several members of the Committee defended 12b-1 fees and even extolled their virtue. Rep. Gregory Meeks (D-NY) noted that mutual fund fees have declined since the advent of Rule 12b-1 and questioned the need for reform. Rep. Meeks stressed the importance of 12b-1 fees in paying for broker costs while another member stated that 12b-1 fees have been extremely

effective in enhancing mutual fund distribution.

Soft Dollars

Chairman Cox mentioned in his opening statement that the Commission has "intensified" its focus on soft dollars. Ranking Member Spencer Bachus (R-AL) asked Chairman Cox what had changed since Mr. Cox's remarks about Section 28(e) a year ago, when the Commission adopted its most recent soft dollar guidance. He expressed surprise that Chairman Cox would now suggest the need for major reform and possible repeal of the soft dollar safe harbor. Mr. Cox stressed that his letters to Congress about soft dollars represent his view alone. He also stated that, other than disclosure, changes to the soft dollar regime would require Congressional action.

Money Market Funds

Rep. Meeks raised H.R. 1171, his bipartisan legislation with Rep. Pat Tiberi (R-OH), which would enhance the use of the most highly rated money market funds as a substitute for Treasuries to satisfy broker-dealer net capital and customer protection requirements. [2] Chairman Cox deferred to Commissioner Nazareth to answer this question. She noted that the Commission is seeking public comment on the issue [3] and said that AAA rated money market funds (a reference to language in H.R. 1171) could invest in securities other than the highest rated securities, and that "nothing was quite like Treasuries" for security and customer protection.

Proxy Access

Proxy access was a theme repeated by a number of the Members who believe that shareholders should have access to the ballot and to the board in both binding and non-binding matters. In answering various Members, Chairman Cox said that the Commission hopes to issue a proposal for public comment by the end of next month and to finalize that proposal in time for the next proxy season. Rep. Mel Watt (D-NC) referenced the New York Stock Exchange's amended rule proposal preserving discretionary broker voting for funds, and said it made sense. [4]

Competitiveness (*Sarbanes Oxley Act ("SOX") and Securities Lawsuits*)

Members criticized frivolous securities litigation and SOX for jeopardizing the competitiveness of U.S. capital markets and offered as evidence, among other anecdotal information, the decline in U.S. based IPOs as compared to overseas markets. Chairman Barney Frank (D-MA) praised the SEC for acting to ease implementation of Section 404 of SOX. Chairman Cox noted that, while it is true that recently many of the largest IPOs were brought overseas, a high number and large overall volume of foreign companies conducted IPOs in the U.S. last year. Rep. Meeks discussed his legislation, co-sponsored by Rep. Tom Feeney (R-FL), to reform SOX, particularly Section 404. [5]

A number of members expressed concern about frivolous securities litigation. In particular, Reps. Richard Baker (R-LA) and Melissa Bean (D-IL) questioned the need for "scheme" liability and took the Commission to task for recommending an amicus brief supporting the plaintiffs in *Stoneridge Investment Partners v. Scientific-Atlanta, Inc., et al.* Chairman Cox

defended his decision to support “secondary” liability in the Commission's 3-2 vote in favor of the plaintiffs. He said the Commission had taken a similar position in 2004 and that he was deferring to precedent to help ensure the predictability of regulation. [6] The various recent studies of global competitiveness of the U.S. capital markets were mentioned several times, [7] especially with regard to spurious securities litigation and the need to reform such in order to maintain U.S. international competitiveness.

Regulatory Reform

Capital Markets Subcommittee Chairman Paul Kanjorski (D-PA) asked whether after 75 years it is time to take a look at reforming /overhauling the securities regulatory framework. Chairman Cox said any effort would have to be multi-committee and bicameral. As a former Member of Congress he said he understands that the current system evolved over the course of time.

Blackstone Group IPO

Rep. Paul Hodes (D-NH) said Blackstone should have to register under the Investment Company Act of 1940. Chairman Cox answered that the Division of Investment Management closely scrutinized the deal and that it did not meet the thresholds for 1940 Act registration.

Cost Benefit Analysis

Rep. Feeney took the Commission to task for failing to adequately perform cost-benefit analysis. [8] He used cost estimates conducted by the Commission on Section 404a of SOX as an example. According to Rep. Feeney, the SEC was off by thirty fold on just that one section. He said such efforts were “simply unacceptable even for government work.”

If you have questions or would like additional information about the hearing, please contact Dean Sackett at 202-326-8319 or dsackett@ici.org or Don Auerbach at 202-326-5894 or auerbach@ici.org.

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endnotes

[1] The Commission’s statement can be found at <http://www.sec.gov/news/testimony/2007/ts062607sec.htm>.

[2] See H.R. 1171, 110th Cong., 1st Sess. (2007).

[3] See Securities Exchange Act Release No. 55431 (March 9, 2007), 72 FR 12899 (March 19, 2007). The ICI recently commented on this proposal. For a summary of the letter, see [Memorandum](#) to Inst. Money Market Funds Advisory Committee No. 16-07, Money Market Funds Advisory Committee No. 16-07, and SEC Rules Members No. 67-07 [21298], dated June 25, 2007.

[4] See [Memorandum](#) to Board of Governors No. 14-07, Closed-end Investment Company

Members No. 29-07, SEC Rules Members No. 54-07, and Small Funds Members No. 33-07 [21185], dated May 29, 2007.

[5] See H.R. 1508, 110th Cong., 1st Sess. (2007).

[6] The Solicitor General disregarded the Commission's recommendation and elected against filing an amicus brief on behalf of the plaintiffs.

[7] See, e.g., "Report and Recommendations" by the Commission on the Regulation of U.S. Capital Markets in the 21st Century (established by the U.S. Chamber of Commerce), dated March 2007; "Sustaining New York's and the U.S.'s Global Financial Services Leadership," by Michael Bloomberg, Charles Schumer and McKinsey & Company, dated January 2007; and, "Interim Report" by the Committee on Capital Markets Regulation, dated November 30, 2006.

[8] The ICI is actively championing enhanced cost-benefit analysis by regulators. See, e.g., [Memorandum](#) to Board of Governors No. 6-07, SEC Rules Members No. 12-07, Closed-End Investment Company Members No. 9-07, Equity Markets Advisory Committee No. 3-07, ETF Advisory Committee No. 3-07, Compliance Members No. 5-07, Pension Members No. 4-07, Tax Members No. 5-07, and International Members No. 2-07 [20838], dated February 2, 2007.

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