

MEMO# 13577

June 4, 2001

GAO REVIEW OF THE SEC FEE STUDY

[13577] June 4, 2001 TO: BOARD OF GOVERNORS No. 26-01 PRIMARY CONTACTS - MEMBER COMPLEX No. 38-01 PUBLIC INFORMATION COMMITTEE No. 16-01 SEC RULES COMMITTEE No. 42-01 RE: GAO REVIEW OF THE SEC FEE STUDY As we previously reported, in June 2000, the General Accounting Office issued a comprehensive report on mutual fund fees. The report included several alternative recommendations for requiring personalized fee disclosure in fund quarterly account statements.¹ In December 2000, the Securities and Exchange Commission's Division of Investment Management issued a report on mutual fund fees, which identified approaches the SEC staff proposes to take in response to the GAO's recommendations.² There has recently been a series of correspondence regarding the SEC Fee Study among Representative John D. Dingell, the Ranking Minority Member on the House Committee on Energy and Commerce, the GAO and the SEC. These letters are attached and are summarized below. The GAO's Assessment of the SEC Fee Study Rep. Dingell requested that the GAO evaluate the SEC's findings and recommendations. In its response, the GAO states that the results of the SEC staff report "generally corroborate the findings of our own report," including that the fees charged by the largest funds declined during the periods studied. The GAO also notes that the SEC report included recommendations regarding after-tax returns and fund governance, which have already been enacted, as well as a recommendation that the Commission consider reviewing the requirements of Rule 12b-1 in light of changes in fund marketing and distribution since the rule's adoption in 1980. The GAO states that "these actions should help provide important information to investors and could enhance oversight in the mutual fund industry." ¹ See Memorandum to Board of Governors No. 38-00, Primary Contacts - Member Complex No. 45-00, Public Information Committee No. 26-00, and SEC Rules Committee No. 94-00, dated July 5, 2000 (transmitting GAO Report: "Mutual Fund Fees: Additional Disclosure Could Encourage Price Competition"). ² See Memorandum to Board of Governors No. 5-01, Primary Contacts - Member Complex No. 6-01, SEC Rules Committee No. 3-01, dated January 12, 2001 (transmitting SEC's "Report on Mutual Fund Fees and Expenses"). The GAO then addresses the SEC staff's analysis of the GAO's recommendation calling for additional disclosure of fee information. In its report, the GAO recommended that mutual fund investors' quarterly account statements include the specific dollar amount of the fees they paid, or alternatively, an estimate of the amount of fees deducted from their fund shares. As an additional alternative, the GAO recommended that funds could report to investors the dollar amount of expenses paid by shareholders for preset investment amounts, such as \$1,000. The GAO states that, "[a]fter considering the costs and benefits of the recommendations in our June 2000 report, the SEC staff's report recommends a variation of one of the alternatives we discussed." Specifically, the SEC report proposed requiring funds' annual and semiannual reports to present a table showing the cost in dollars associated with an investment of a standardized amount (such as \$10,000) that earned the fund's actual return and incurred the fund's actual expenses paid during the

period. In addition, the SEC staff suggested that the Commission could require that this table also present the cost in dollars, based on the fund's actual expenses, of a standardized investment amount that earned a standardized return (such as 5 percent). The GAO observes that while the SEC staff's recommendation "will improve fee disclosures . . . it may be less effective in increasing investor awareness and spurring additional price competition among funds because it would be provided to investors less frequently and in reports that may receive less investor attention than account statements." The GAO further suggests that the SEC staff's proposed disclosures will not provide investors with information showing "either precisely or approximately the dollar amount of fees they paid on their own fund shares." The GAO maintains that receiving the account-specific fee information as they recommend would be more likely to increase investors' awareness of the fees they pay. Although the GAO recognizes the high cost of its proposal and that the SEC staff's proposal "is probably the lowest cost option," the letter reiterates the GAO's belief that the SEC staff's option "may not provide as much benefit as similarly low cost alternatives due to the placement in annual and semiannual reports." The SEC Staff's Comment Letter to the GAO The GAO shared a draft copy of its letter to Rep. Dingell with the SEC, and Paul Royce, Director of the Division of Investment Management, responded on April 27, 2001. In its response, the SEC states that their proposed approach "would provide additional information about fund fees, provide it in terms of dollar amounts, and provide it in a standardized manner that would facilitate comparison among funds." The SEC staff "disagrees with the [GAO's] assertion" that this approach would not "provide investors with information showing either precisely or approximately the dollar amount of the fees they paid on their own fund shares." While the SEC staff recognizes that account statements are an important source of information, and are provided more frequently than shareholder reports, the staff maintains that "additional fee information would be more appropriate in shareholder reports, alongside other key information about the fund's operating results, including management's discussion of fund performance." The staff notes that this would allow shareholders to evaluate the costs they pay against the services they receive and "encourage investors to consider information about the dollar amount of fund fees in their decision-making process." 3The staff's letter states that the SEC and GAO both recognize that there are various alternatives for providing additional fee information to fund investors, which would impose varying degrees of administrative difficulties and additional costs on the industry and, ultimately, investors. The SEC letter also notes that both the GAO's initial fee study and its letter to Rep. Dingell acknowledge that the GAO has not gathered comprehensive data on the costs of implementing personalized fee disclosure on account statements. The letter states that the staff will have to take into account the costs and burdens of the various alternatives for improving disclosures of mutual fund fees and expenses. Rep. Dingell's Follow-up Letter to the GAO and SEC Rep. Dingell concludes that while it would be ideal if the SEC could conduct a pilot program that tested both alternatives, realistically "that may not be feasible, given practical considerations and the strong industry opposition to the GAO's proposal." Rep. Dingell therefore determines that the "SEC's variation, with modest enhancements and a strong investor education program would address the intent of the GAO's recommendation and deserves an opportunity to prove that it can be effective." However, he notes that if price competition remains a problem and the complaints continue, the SEC should consider "other approaches, including the GAO's quarterly-report recommendation." Craig S. Tyle General Counsel Attachments Attachment no. 1 (in .pdf format)

should not be considered a substitute for, legal advice.