

MEMO# 16399

August 1, 2003

CONGRESSIONAL LETTER URGING SEC ACTION ON MUTUAL FUND MEASURES

[16399] August 1, 2003 TO: BOARD OF GOVERNORS No. 39-03 DIRECTOR SERVICES COMMITTEE No. 16-03 CLOSED-END INVESTMENT COMPANY MEMBERS No. 66-03 FEDERAL LEGISLATION MEMBERS No. 15-03 PRIMARY CONTACTS - MEMBER COMPLEX No. 62-03 PUBLIC INFORMATION COMMITTEE No. 26-03 SEC RULES MEMBERS No. 102-03 SMALL FUNDS MEMBERS No. 41-03 UNIT INVESTMENT TRUST MEMBERS No. 26-03 RE: CONGRESSIONAL LETTER URGING SEC ACTION ON MUTUAL FUND MEASURES As we previously informed you, last week, the House Committee on Financial Services approved a substantially amended version of H.R. 2420, the "Mutual Funds Integrity and Fee Transparency Act of 2003."¹ Yesterday, Committee Chairman Michael Oxley (R-OH) and Capital Markets Subcommittee Chairman Richard Baker (R-LA) sent a letter² to the Securities and Exchange Commission urging the SEC to use its existing regulatory authority to implement, as quickly as possible, the provisions of H.R. 2420 that do not require legislative action, including the following: 1. Improve mutual fund fee and expense disclosures, specifically including: • the estimated amount, in dollars for each \$1,000 of investment in the fund, of the operating expenses that are borne by shareholders; • a legend on account statements explaining that investors have paid fees on their fund investments; • the structure of the fund's portfolio manager compensation; • portfolio turnover rate and implications of high turnover; and • information about soft dollar and directed brokerage arrangements, revenue sharing payments, and breakpoint discounts. 2. Improve board governance of soft dollar, directed brokerage, and revenue sharing arrangements, specifically: 1 See Institute Memorandum [16346], dated July 25, 2003. 2 See <http://financialservices.house.gov/news.asp?FormMode=release&id=384&NewsType=1> for a copy of the letter. 2 • require the fund's adviser to submit an annual report to the board detailing such arrangements; • subject the board to a fiduciary duty to review such arrangements; • provide investors with an annual summary of the report to the board; and • require the portfolio manager to maintain records with respect to soft dollar arrangements. 3. Strengthen mutual fund governance by decreasing the maximum number of "interested" directors to one-third of the board. 4. Clarify the use of the term "no-load" as used with respect to funds that charge a 12b-1 fee. 5. Require funds to inform directors of significant deficiencies identified by the SEC in an inspection. 6. Implement the proxy voting transparency rules that the SEC approved this year. 7. Approve the SEC's rule proposal requiring funds to have a chief compliance officer, and require that funds adopt a code of ethics. 8. Fight conflicts of interest in fund sales practices by requiring brokers to disclose information about differential compensation and conflicts of interest associated with the sale of a particular fund, along with information about commissions that may be charged based on the class of shares purchased. The letter requests that the SEC address the following additional issues that arose during the Committee's consideration of H.R.

2420 by rulemaking or further study, and provide legislative recommendations where necessary: • a concept release examining improved disclosure of transaction costs; • a study of the use of soft dollar arrangements; and • a study of the increased rate of arbitration claims involving mutual funds. The letter states that at the markup of H.R. 2420, Committee Members noted during a discussion of a provision regarding fund boards of directors that mutual funds should not be treated differently from other companies. Referring to a recent SEC staff report discussing alternatives for increasing shareholder participation in the proxy process regarding the nomination and election of directors, which may form the basis for rulemaking, the letter asks the SEC to indicate what steps it intends to take “to ensure that mutual fund shareholders are given the same rights as other corporate shareholders pursuant to this expected rulemaking.” The letter requests a report by October 1 on the progress the SEC has made and what steps it plans to take to effectuate the items listed in the letter. Matthew P. Fink President

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