The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 16271

July 8, 2003

ACTION ON H.R. 2420, MUTUAL FUNDS INTEGRITY AND FEE TRANSPARENCY ACT OF 2003

[16271] July 8, 2003 TO: BOARD OF GOVERNORS No. 34-03 CLOSED-END INVESTMENT COMPANY MEMBERS No. 54-03 DIRECTOR SERVICES COMMITTEE No. 12-03 FEDERAL LEGISLATION MEMBERS No. 11-03 PRIMARY CONTACTS - MEMBER COMPLEX No. 53-03 PUBLIC INFORMATION COMMITTEE No. 22-03 SEC RULES MEMBERS No. 86-03 SMALL FUNDS MEMBERS No. 30-03 RE: ACTION ON H.R. 2420, MUTUAL FUNDS INTEGRITY AND FEE TRANSPARENCY ACT OF 2003 At this writing, it is expected that the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, chaired by Richard Baker (R-LA) will act on HR 2420, “The Mutual Funds Integrity and Fee Transparency Act” (see Institute memo dated June 11, 2003)1 on Thursday, July 10. The Institute and its members have been working to effect changes in the legislation, as described in Institute testimony (see Institute memo dated June 20, 2003)2in the following areas: o Independent Chair - It is neither necessary nor appropriate to require mutual funds to have an independent chairman of the board. In many cases, a person needs to be intimately familiar with the operations of a company in order to be an effective chairman, and a management representative is often in the best position to do this. In addition, the combination of regulatory mandates and industry corporate governance best practices make an independent chair unnecessary. o Location of Disclosure - The specifics of how certain items should be disclosed, and in which document they should appear should not be dictated by legislation. We are particularly concerned with the legislation’s presupposition that prospectus disclosure is not sufficient for any of the items covered. Under the securities laws, the prospectus is the legal document required to include all of the important information that is necessary to assist an investor in making an investment decision. Congress should not 1 See !"# $ 2 See % !"# $ 2 inadvertently discourage investors from viewing the prospectus as the most important disclosure document. o o Estimated Operating Expenses - The provision in the bill relating to fund operating expenses seems to contemplate disclosure of expenses on an individualized basis. The SEC’s report noted that there were serious problems with this approach, including significant costs and logistical complexity, lack of comparability and lack of an effective context for investors to evaluate the expenses shown. While a requirement to disclose estimated fund expenses might reduce the costs and complexities associated with individualized cost disclosure, albeit to a relatively small extent, it would run the risk of confusing and misleading investors by including an imprecise number in a document that otherwise contains very exact and precise numerical data. And, it still would result in disclosure of information that would make it difficult for investors to make meaningful comparisons. o Board Oversight of Revenue Sharing - While the Institute believes that it is

entirely appropriate for directors to review soft dollar and directed brokerage arrangements, we do not believe that it is necessary or appropriate for boards to review revenue sharing arrangements. These payments are, by definition, not made by the fund. They are made by a fund’s underwriter or adviser out of its own resources to compensate financial intermediaries who sell fund shares. In addition, fund directors are not permitted to take distribution expenses into account when determining whether a fund’s advisory fee is reasonable. Since certain provisions in the legislation have proved controversial, it is possible that the Subcommittee markup will be delayed until agreement is reached. We will keep you informed of further developments. Matthew P. Fink President

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