MEMO# 12196

July 10, 2000

GENERAL ACCOUNTING OFFICE REPORT ON MUTUAL FUND FEES DISCUSSES ROLE OF DIRECTORS

[12196] July 10, 2000 TO: DIRECTOR SERVICES COMMITTEE No. 11-00 RE: GENERAL ACCOUNTING OFFICE REPORT ON MUTUAL FUND FEES DISCUSSES ROLE OF DIRECTORS The U.S. General Accounting Office has completed a report on mutual fund fees. The 125-page report, entitled “Mutual Fund Fees: Additional Disclosure Could Encourage Price Competition,” was a response to a September 29, 1998 request from Representative Mike Oxley, Chairman of the House Subcommittee on Finance and Hazardous Materials, and Representative John Dingell, Ranking Member of the House Committee on Commerce. They publicly released the report when they forwarded it last week to SEC Chairman Arthur Levitt. The GAO report addresses a variety of topics related to mutual fund fees, including statistical trends, the nature of competition in the mutual fund industry, disclosure practices, and the role of fund directors. The report includes, as an appendix, a letter submitted in May by the Institute on an earlier confidential draft, the GAO’s responses to the Institute’s comments, and letters on the draft report from the SEC and the NASDR. The report makes one recommendation – that the SEC require that account statements provided to fund investors disclose the amount of fees paid by the investor. The report acknowledges that this recommendation will result in both “one time and ongoing costs,” and suggests that the SEC examine its costs and burdens on the fund industry and investors. In addition, the GAO identifies two alternatives to this recommendation that it believes could also enhance investor understanding of fees. Of specific interest to directors, the report discusses the role of fund directors in reviewing fund fees. It notes that the Investment Company Act requires directors to review fund advisory contracts annually. It also discusses judicial interpretations of Section 36(b) of the Act, which have established current expectations for fund directors in reviewing fees. The report notes that these involve consideration of several factors, such as the nature and quality of an adviser’s services, the adviser’s costs, and economies of scale. Fund officials interviewed by the GAO reported that their directors conduct a rigorous review of fund fees. In addition, a GAO review of SEC examinations revealed few deficiencies in this area. Others, however, criticized the role of directors. For example, one individual stated that, because directors base fees on those charged by similar funds, fees are higher than necessary. The report also discusses recent industry and SEC initiatives to strengthen the role of fund directors, but states that they are unlikely to “significantly affect the level of fees in the mutual fund industry.” The Institute’s letter to the GAO stated that mutual fund directors have contributed to broad- based fee reductions. We noted that a variety of research studies, including the GAO’s own statistical analysis, had found that a significant majority of funds had reduced their fee levels. We also noted that 2fund directors have unique governance

responsibilities that go well beyond the duties of typical corporate directors, which are specifically designed to safeguard the interests of fund shareholders. Copies of the Executive Summary of the report, the chapter of the report relating to directors' roles, the Institute's letter on the confidential draft and the GAO's response to that letter are attached to this memorandum. The full report is available on the GAO's web site (http://www.gao.gov/new.items/gg00126.pdf). Marguerite C. Bateman Associate Counsel Attachment Attachment (in .pdf format)
