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ICI Reaffirms Its Study of Mutual Fund and Pension Plan Fees, January 2004

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New York Attorney General Spitzer's Comments Reinforce Key ICI Findings and Highlight Limitations of Flawed Freeman-Brown Article

Washington, DC, January 8, 2004 - The Institute reported this week that the average fees mutual funds pay to "subadvisors" to manage stock portfolios are "quite similar" to the fees pensions plans pay for the same service. Among other things, the ICI study refuted a 2001 article by Professors John Freeman and Stewart Brown that addressed the same subject.

"The ICI examined mutual fund subadvisory fees for just one reason, because those fees are, by far, the most analogous to the advisory fees incurred by pension funds" said Matthew Fink, President of the ICI. Fink noted that Attorney General Spitzer, who issued Tuesday a release criticizing parts of the ICI study, appeared to acknowledge that average mutual fund subadvisory fees are, in his words, "closer to the advisory fees paid by pension funds."

Sean Collins, a senior economist at the ICI, explained, "Our analysis makes two contributions to ongoing discussions about mutual fund fees. First, we identified a way to provide an "apples-to-apples" comparison of portfolio management fees incurred by both mutual funds and pension plans. Second, we documented serious errors in Freeman and Brown's 2001 article. That article committed a methodological double sin by including mutual fund expenses unrelated to portfolio management while omitting highly relevant pension plan portfolio management expenses."

Fink and Collins addressed four additional points. Fink said "the figure Freeman and Brown cite as the average for public pension plans is based on about 8 percent of the assets those plans have invested in stocks." Other averages used by Freeman and Brown are similarly limited. Fink suggested that anyone concerned that the ICI's analysis of mutual fund subadvisors is based on a "small corner" of the industry should first consider the limitations of the pension plan averages used by Freeman and Brown.

Collins said there was no empirical evidence to support the view that portfolio management fees of subadvised mutual funds are unrepresentative of the fund industry as a whole. "Our study found average overall fee levels for mutual funds that use subadvisors are about the same as for funds that do not use them. This suggests that portfolio management expenses are likely to be quite similar too."

Fink said criticism of mutual fund companies for receiving fees beyond those charged by subadvisors is "mystifying." A key point of the ICI study, he said, was to show "the numerous duties and shareholder services fund managers are responsible for beyond portfolio management that have no parallel among pension plans."

Finally, Fink said he was "confident that the fundamental flaws underlying the Freeman-Brown article would be better recognized and understood by those who have relied on it" because of the ICI's study. He added that comments from academic and the investment communities were welcome.

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This site includes audio clips from Fink and Collins concerning the study.

The Iowa law journal study was co-authored by John Freeman and Stewart Brown and is entitled "Mutual Fund Advisory Fees: The Cost of Conflicts of Interest," 26 Journal of Corporation Law 609 (Spring 2001).
