



Securities Industry Association

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VIA FEDERAL EXPRESS

Paul F. Roye, Esq.
Director
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street N.W.
Washington, D.C. 20549

Re: Government Accounting Office (“GAO”) Report Concerning Dollar
Specific Disclosure of Mutual Fund Fees¹

Dear Mr. Roye:

The Securities Industry Association (“SIA”)² is aware that the staff of the Securities and Exchange Commission (the “Commission”) is presently considering the GAO’s recommendation, contained in the above referenced report, to mandate disclosure in periodic account statements provided to mutual fund investors of the dollar amount of a fund’s operating expenses attributable to shares owned by such investor.³ The periodic statements containing such disclosures would be issued by funds, in the case of shares held directly with a fund, or by financial intermediaries, such as broker-dealers,⁴ when fund shares are held by a broker-dealer on behalf of the underlying investor.

¹ United States General Accounting Office Report to the Chairman, Subcommittee on Finance and Hazardous Materials, and the Ranking Member, Committee on Commerce, House of Representatives, entitled “Mutual Fund Fees: Additional Disclosure Could Encourage Price Competition” (June 2000).

² The Securities Industry Association brings together the shared interests of more than 740 securities firms to accomplish common goals. SIA member firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of more than 50-million investors directly and tens of millions of investors indirectly through corporate, thrift, and pension plans. The industry generates more than \$300 billion of revenues yearly in the U.S. economy and employs more than 600,000 individuals. (More information about the SIA is available on its home page: <http://www.sia.com>.)

³ This letter focuses specifically on the GAO recommendation concerning dollar-specific account statement disclosure, and does not address certain other possible disclosure alternatives referenced in the GAO Report. SIA will defer comment on alternatives pending the SEC’s response to the GAO Report.

⁴ Recent studies reflect that over the past decade, 82 percent of new sales of long-term mutual funds were made through (and presumably held by) financial intermediaries, such as broker-dealers. See Investment Company Institute “Perspective,” Vol. 6, No.3, July 2000, p.11.

While SIA firmly believes that meaningful disclosure of fund fees is critical to making informed investment decisions, for the reasons set forth below, it also believes that:

- (1) The GAO's recommendation is premised on questionable or erroneous assumptions.
- (2) The implementation of dollar-specific disclosure would be an extremely complex undertaking, requiring intricate systems modifications and enhancements, and the resulting disclosure would be unlikely to enhance investors' understanding of fund expenses or their ability to make meaningful comparisons across funds .
- (3) The complexity and logistics of producing such dollar-specific disclosures may lead to information that will confuse and mislead investors and possibly cause the delivery of statements to be delayed beyond the five-day regulatory deadline.
- (4) The existing fee disclosure regimen already well serves the needs of fund investors.

GAO Analysis

The GAO report appears to suggest that many funds promote their performance returns to avoid competing primarily on the basis of price (fees and other expenses borne by investors). To support this, the GAO cites the fact that index funds, money market funds, and to some degree bond funds, which are less able to differentiate themselves on the basis of performance, generally have the lowest expenses. This analysis appears to be both overly simplistic and inaccurate. In the first instance, it fails to acknowledge that such funds have lower expenses because they have less transactional activity and require less active management (and fundamental research) than most categories of equity funds. Moreover, mutual funds compete on performance to an extent almost unknown in other products--financial or otherwise -- and the performance presented is required by law to reflect all shareholder fees and fund operating expenses, not just those fees charged by the manager or adviser.⁵

The GAO also errs in minimizing the role of fees and other expenses in price competition among funds. In fact, as stated above, fund expenses contribute to (or, more

⁵ In addition, the requirements governing prospectuses and advertisements mandate performance presentations over prescribed time periods as well as against certain benchmarks. In the near future, mutual funds will also have to provide after-tax performance numbers, which virtually no other financial product is currently required to do. We believe, this extensive disclosure about fees and other expenses and the strictly mandated presentation of mutual fund performance combine to provide one of--if not the--purest and most effective forms of competition known in the financial industry.

accurately, detract from) overall performance under all measures, including those mandated under applicable Commission and other regulatory rules. Rather than being hidden from fund investors, as the GAO's disclosure recommendation would seem to suggest, investors receive extensive disclosure about fees and other expenses as well as the impact of those fees and expenses on fund performance. In this regard, we believe that the fee table in the mutual fund prospectus provides what may be the most comprehensive and straightforward expense disclosure available for any financial product. Its prescribed contents, coupled with the requirement that it be placed in the front of the prospectus, belies the idea that investors are not fully informed as to the expenses they pay in a mutual fund and enables investors to make meaningful direct comparisons of fees. Given this extensive disclosure about fees and other expenses and the strictly mandated presentation of mutual fund performance, we believe that additional disclosure recommended by the GAO is unnecessary.

Complexities of Implementing Account Specific Dollar Disclosure of Fund Fees

SIA has queried a number of its members regarding the systems modifications that would be required to implement dollar-specific fund expense disclosure on customer account statements, and the possible difficulties that might be encountered. The systems modifications described below (which may vary slightly from one firm to another) would apply regardless of whether the subject fund was proprietary or non-proprietary. However, where non-proprietary funds are involved and positions are carried at the fund on an omnibus (bulk) basis for the broker-dealer, the fund would not only have to implement similar systems to track and allocate fees, but also develop an interface to transmit the expense information to the broker-dealer, which would then have to allocate the expenses to individual customer accounts. The modifications necessary to accomplish all of this include the following:

The daily fund accounting price and rate file must be modified to include an expense factor for each share class of funds supported. Edits must be developed to support accuracy.

A system and process supporting manual entry for late/missing factors (share, price and expense) must be developed for nightly processing.

Modifications to systems are required to calculate the asset value on all clients accounts nightly, apply the expense factor and calculate the daily expense amount.

A system must be developed to store the client daily expense amount and then roll up to client statements having numerous statement end dates.

Systems must be developed to add new statement pages containing expense information on fund holdings and message text advisory.

Systems must be enhanced to track assets that are in the account for a portion of the month/quarter and to report only on the period that the funds were held in account (i.e., for transfers and exchanges).

Systems with the ability to change expense factors both before and after reporting periods must be developed. If an adjustment is received after the reporting period, the system must be able to note the adjustment in the next statement in a trailer message.

Systems must be developed to recalculate the expense amount when a price change is processed.

Systems must be developed to recalculate the expense amount when a trade correction is processed.

Links must be established to download expense data from non-proprietary funds.

Storage capacity must be expanded to keep records of factors and amounts calculated and to retain such records for 7 years.

An on-line expense simulator screen must be developed so that representatives may respond to service calls and inquiries (i.e., enter fund, share quantity and to form dates and have the system respond with expense amount based on historical expense factor and NAV).

Systems must be developed to display expenses for on-line services.

Modifications to the voice response systems are required to provide expense information.

Furthermore, firms would be required to:

Provide training to processing personnel and service representatives.

Develop a communication campaign to educate both sales and service representatives and customers.

Include the new reporting process in audit and control review systems.

Our members have expressed concerns that given the number and complexity of the steps involved in establishing such a reporting system, the potential for errors in statement processing may increase, despite the employment of sophisticated technology. The problems may be particularly acute for smaller self-clearing firms, who nonetheless may carry significant fund holdings for their customers. There is also substantial industry concern about its capacity to produce timely and accurate client statements within five days of the end of the statement period,⁶ if additional mutual fund fee disclosure is

⁶ See Rule 10b-10(b)(2), Securities Exchange Act of 1934.

required. Any delay in receiving a data feed from even one of the thousands of non-proprietary funds could cause firms to miss a statement distribution deadline.⁷ Additionally, inclusion of this information may potentially mislead customers into believing that such expenses represent an additional charge (since no comparable disclosure applies to other similar investment vehicles) even though the expenses are already reflected in the net asset value of the fund as it appears in the statement.

Lack of Investor Benefit

As noted above, inclusion of a dollar-specific expense amount in account statements may lead customers to erroneously conclude that they are being subjected to an additional charge, rather than costs already reflected in the net asset value of their fund position. One of the reasons they could be so misled is that there is no “context” for the disclosure, and no meaningful way, without referring to information already disclosed in the prospectus or shareholder reports, to determine from the disclosure how it compares to other funds even within similar investment categories. Assuming that a customer held two index funds in the same account, the one with the higher expense ratio might actually reflect a lower dollar-specific expense amount on the statement if it were held for less time during the period covered by the statement. Furthermore, even if both funds were held for the full statement period, the higher dollar-specific expense amount of one fund might be attributable to it utilizing an index containing a larger basket of securities which requires more transactional activity to maintain. If this index fund were most consistent with the customer’s investment objectives, the customer would indeed be ill-served by disclosure that might discourage him or her from considering other critical factors pertaining to his or her investment. One cannot and should not ignore the fact that while certain funds have similar characteristics, each is a unique investment, and fees and other expenses are but one of numerous factors that investors should evaluate when purchasing and holding mutual funds. While we do not disagree that even a fee differential of less than 1% can make a significant difference in total return over time, ignoring, or failing to give due consideration to other material factors, may very well have a far greater (and negative) impact on investment returns. Furthermore, for the reasons described above, dollar-specific expense amount disclosure will not achieve the objective of enabling investors to make informed judgments regarding expenses incurred among comparable funds. All it will lead to is the creation of complex systems modifications, the costs of which are likely to be borne by investors.

Current Fee Disclosure Methodology

We believe the fee tables that appear in every fund prospectus already contain an extensive amount of fee and expense information in a user friendly format. Furthermore, this format enables investors to receive the information within the context of a fund document that also provides other important information which should be considered in conjunction with their investment decisions.

⁷ Data obtained from respondents in conjunction with a recent SIA Fund Portability Survey indicates that broker-dealer members carry an average of 2,285 mutual funds on behalf of investors. Some carry more than 10,000.

Conclusion

We believe that implementation of the GAO recommendation would impose significant administrative and cost burdens on funds and broker-dealers without providing any meaningful benefit to investors. Contrary to GAO's intent, implementation of the recommendation may confuse investors, or even deter them from fully considering all factors which may be critical to making the best investment choices. Therefore, we would encourage the Commission to reject the GAO's recommendation regarding dollar-specific expense disclosure. The current fee disclosure framework already provides information which is more useful to investors, without imposing a complex disclosure regimen of little utility, the cost of which may ultimately be borne by investors. Should the Commission nonetheless conclude that the current fee disclosure regimen should be supplemented, it should clearly seek an approach other than the GAO recommendation.

We trust you will find this letter helpful in your consideration of the GAO recommendations. If you have any questions, please do not hesitate to contact Michael D. Udoff of SIA at 212-618-0509.

Very truly yours,

Colette D. Kimbrough, Chair
SIA Investment Company
Committee

cc: The Honorable Arthur Levitt – SEC
Cynthia Fornelli, Esq. – SEC
The Honorable Tom Bliley – U.S. House of Representatives
The Honorable Edolphus Towns – U.S. House of Representatives
The Honorable John D. Dingell – U.S. House of Representatives
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