

Fund Democracy
The Mutual Fund Shareholder's Advocate



Consumer Federation of America

U.S. Public Interest Research Group

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SEC Continues to Ignore Mutual Fund Shareholder Concerns, Nation's Leading Consumer and Investor Groups Charge

Multi-manager Rule Proposal is the Latest in a Series of Post-Scandal
Anti-Investor Actions by the Agency

Even as it weathers criticism for its failure to detect or prevent mutual fund trading abuses, the Securities and Exchange Commission continues to take actions that are harmful to mutual fund shareholders, the nation's leading consumer and investor advocacy organizations charged Monday.

Fund Democracy, Consumer Federation of America, Consumer Action, U.S. Public Interest Research Group, and Consumers Union made the comments in conjunction with their release of a Fund Democracy-CFA comment letter opposing the SEC multi-manager proposal.

The SEC proposal would strip mutual fund shareholders of their statutory right to approve new sub-advisers of multi-manager funds, despite an established record of abuse by many of these funds. For nearly a decade, firms that lack investment advisory expertise and provide no meaningful advisory services have exploited the multi-manager structure by marketing the funds as if they are sponsored by the sub-adviser and by engaging in self-dealing in negotiating sub-advisory contracts. This not only enables the non-advisory firm to keep an undeserved piece of the advisory fee, it allows the firm to increase its own fee indirectly, without shareholder approval.

“For years, the SEC has been on notice regarding well-documented abuses in the multi-manager arena, but instead of proposing a rule that would address this problem, it has proposed to facilitate further investor abuse and to open up this opportunity for exploiting shareholders to an unlimited number of firms,” said Mercer Bullard, founder and president of Fund Democracy and securities law professor at the University of Mississippi School of Law. “What’s most disappointing is that, even in the wake of the biggest scandal in the history of the industry, the SEC continues to demonstrate stunning insensitivity regarding long-standing abuses in the mutual fund industry.”

“The revelation that the SEC allowed abusive mutual fund trading practices to grow unchecked over the course of many years has badly tarnished its reputation,” said Barbara Roper, CFA director of investor protection. “In response, Chairman Donaldson has promised a much needed revamping of the agency’s approach to regulatory matters. Unfortunately, a series of recent agency actions suggests that pro-investor rhetoric is not being matched by pro-investor actions.”

Instead, the proposed multi-manager rule reflects a pattern of disregard for mutual fund investors’ interests that has continued even since egregious and pervasive fraud has been uncovered in the fund industry.

- ! Since the mutual fund scandal broke, observers inside and outside the industry have criticized the SEC’s position allowing funds to direct portfolio transactions to brokerage firms in return for selling fund shares. Even the mutual fund trade association, the Investment Company Institute, has publicly called on regulators to ban directed brokerage, but the SEC has done nothing to crack down on this abusive practice.
- ! On December 18, the SEC issued an unprecedented release attacking the New York Attorney General’s settlement agreement with Alliance Capital Management for forcing the fund company to reduce its fees. The SEC criticism of the settlement ignored the fact that Alliance’s fees were among the highest in the industry and were considered by many to violate the Investment Company Act requirement that fees be “reasonable.” Although the SEC is responsible, under Section 36(b) of the Investment Company Act, for bringing actions against firms that charge excessive fees, it has failed for 30 years to exercise its duty under this provision.
- ! On December 11, the SEC settled charges regarding two Heartland municipal bond funds that lost, respectively, 70 percent and 44 percent of their assets in a single day as a result of mis-pricing. Fund directors are statutorily responsible for ensuring the accuracy of a fund’s price. Yet, despite finding that Heartland’s independent directors ignored numerous red flags, the SEC failed to impose any monetary or equitable penalty on those directors. (Commissioner Campos dissented from the settlement, for which we applaud him.)
- ! On October 12, the SEC issued a letter that permits funds to use the term “government” in their name, even if 100 percent of their portfolios are invested in securities, such as

those issued by Fannie Mae and Freddie Mac, that are not guaranteed by any government body.

Since the mutual fund scandal began, the SEC has promised a wide array of promising and positive reforms, yet time and again it demonstrates an inability to recognize and take decisive action against investor abuses, the groups charged. They called on the SEC to reassess its approach to securities regulation to ensure that investors' interests are not ignored when it formulates policy and enforces the law.

"It's shocking that despite a bull market for fund scandals, the SEC is bearish on shareholder rights," said Ed Mierzewski, consumer program director for U.S. PIRG.

"Congress needs to adopt legislation with meaningful reforms since it's becoming increasingly clear that the SEC is not taking the steps needed to protect the individual shareholders," said Kenneth McEldowney, executive director of Consumer Action.

"Time and again the SEC has failed to fulfill its mandate to protect investors. The agency's multi-manager rule proposal is yet another example," said Sally Greenberg, senior counsel for Consumers Union. "As the mutual fund scandal continues to unfold, we urge Congress in its series of upcoming hearings to take a hard look at the SEC's history of lax oversight and record of inaction. We urge Congress to pass a bill that will require the SEC to implement tough measures to protect investors, the very actions the SEC has so often failed to provide."

The multi-manager comment letter is available on CFA website at http://www.consumerfed.org/multimanager_comment.pdf. Additional background material is available on the Fund Democracy website at <http://www.funddemocracy.com/SupportingMemorandum.pdf>.

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Fund Democracy is an advocacy group for mutual fund shareholders that was founded in 2000.

Consumer Federation of America is a nonprofit association of 300 consumer groups, representing more than 50 million Americans, that was established in 1968 to advance the consumer interest through research, education, and advocacy.

Founded in 1970, Consumer Action is a consumer education and advocacy non-profit organization that works on a broad range of issues through its national network of 7,000 community based agencies.

Consumers Union is the nonprofit publisher of *Consumer Reports* magazine.

U.S. PIRG serves as the national association and national lobbying office for state Public Interest Research Groups. PIRGs are non-profit, non-partisan public interest advocacy organizations.