



All that's hot in the mutual fund industry

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New Bill Ratchets Up Fund Reforms

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Three senators yesterday introduced the most far-reaching mutual fund reform legislation since the advent of the fund scandal.

The Mutual Fund Reform Act of 2004, introduced by Senators Peter G. Fitzgerald (R-Ill.), Carl Levin (D-Mich.) and Susan Collins (R-Maine), if implemented, would have significant, if not revolutionary, implications for the fund business.

For starters, the bill would do away with 12b-1 fees. "12b-1 fees have largely degenerated into disguised loads" the senators write in their announcement of the legislation.

While there has been much discussion of the purpose 12b-1 fees serve, especially in recent months, no regulator or legislator has proposed doing away with them altogether.

With the abolition of 12b-1 fees, fund firms would pay for distribution out of management fees they earn. The new bill would then require funds to disclose what portion of the fund's management fee goes toward distribution.

The bill would also eliminate directed-brokerage and revenue-sharing practices. In addition, it would prohibit funds from receiving soft dollars. Many, including the ICI, have recommended doing away with directed-brokerage agreements. The reason is that in such arrangements, fund firms are essentially buying distribution by paying higher brokerage fees out of their funds' assets.

But because fund companies make revenue-sharing payments to brokerages out of their own pockets, legislators, regulators and critics haven't been so hard on them. The general consensus is that the proper reform for revenue-sharing agreements is that they be disclosed rather than banned outright.

But revenue-sharing practices were just one of many industry practices to come under fire at a hearing by the Senate Subcommittee on Financial Management, the Budget and International Security late last month. All three senators sponsoring the bill presided over that hearing. Levin especially took a dim view of revenue sharing, saying it should be illegal.

"We don't want to just disclose impropriety, we want to ban impropriety," Levin said.

It's the changes to how funds are sold that make the new bill stand out, says Barbara Roper, director of investor protection at **The Consumer Federation of America**.

The bill addresses the variety of incentives brokers have to make investment decisions that are in their own best interests rather than those of their clients, says Roper. In doing so, the current bill goes well beyond what other bills have proposed, she says.

The **Investment Company Institute**, for its part, expressed concern about the bill in its initial response to it.

Although the ICI wants to work with government officials to restore investors' confidence, the bill runs contrary to the interests of fund shareholders, according to ICI president Matthew Fink.

In a prepared statement he further said the bill "contains many ill-defined new legal standards that could change mutual funds' essential structure."

There are currently three other bills in the Senate, including one sponsored by Fitzgerald. But so far, the Senate Banking Committee has not come out with one. It is expected that the banking committee will be the one to take leadership on this issue and that its bill, if any, will be the one that becomes law.

That being the case, Fitzgerald is still contributing to the terms of whatever legislation the banking committee passes, says Mercer Bullard, founder of **Fund Democracy**.

"He's trying to move the ball forward and influence discussion," says Bullard.

Bullard, along with the Consumer Federation, **Vanguard** founder John Bogle and **The Coalition of Mutual Fund Investors**, endorses the bill. Fitzgerald and the sponsors of the legislation sent early copies of it to those known shareholder advocates to get their endorsements.

"He recognized that this bill wasn't going to get a good reception from the industry," says Roper.

It seems to have worked. Both Bullard and Bogle referred to the bill as the "Gold Standard" of fund reform.

"It's the best bill put out there to date," agrees Niels Holch, founder of The Coalition of Mutual Fund Investors.

In addition to the changes to fund distribution, the bill also addresses governance issues relating to fund trustees. It would require a study into whether directors who serve on the boards of several funds are truly independent. Like many of the other bills being considered, it would require that a majority of directors be independent. It also provides for the protection of whistle-blowers in the fund business.

The bill would also require funds to disclose on each shareholder's statement the dollar amount they annually pay in fees.

Having so many shareholder advocates, including the influential Consumer Federation, may help, says one industry lobbyist. But none of the co-sponsors are on the banking committee, he notes. What's more, Fitzgerald is on the outs, he says.

The senator is not running for reelection, and is sort of an outcast in the Republican Party because of his liberal views, notes the lobbyist. Together, those factors will make his input into assembling fund legislation less important, he says.

Holch, however, insists that Fitzgerald is an important player in the process, despite not being on the banking committee.

The banking committee has yet to address the fund scandal. Its first two hearings have been postponed, first because of a scheduling conflict with a Republican retreat, then because of the ricin scare in the Dirksen Senate building.

The committee intends to take a serious look at fund legislation, says Andrew Gray, press secretary for Senator Richard Shelby (R-Ala.), chairman of the banking committee. Dealing with the fund industry scandal is one of the committee's top priorities, he says. And the committee will run several consecutive days of hearings if necessary, he says.

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