



April 13, 2004

The Honorable Richard Shelby
Chairman
Committee on Banking, Housing
and Urban Development
U.S. Senate
Washington, D.C. 20510

The Honorable Paul Sarbanes
Ranking Member
Committee on Banking, Housing
and Urban Development
U.S. Senate
Washington, D.C. 20510

Dear Chairman Shelby and Ranking Member Sarbanes:

We are writing to correct last Thursday's testimony by SEC Chairman William Donaldson regarding our letter to the Committee dated April 7. Chairman Donaldson dismissed the concerns raised in our letter, suggesting that they reflected a lack of familiarity with SEC proposals already put forward and that those proposals fully address the concerns we have raised. This is incorrect on both counts.

As you know, both Mercer Bullard and Barbara Roper recently provided the Committee with detailed testimony describing the reforms our organizations believe are needed, listing the steps the SEC has already taken, and outlining the areas where the Commission either lacks the authority to enact or has failed to support needed reforms. We believe that testimony, as well as our April 7 letter, reflects a thorough familiarity with SEC rule proposals. We regret that Chairman Donaldson did not reflect a similar familiarity with our positions in his testimony.

Chairman Donaldson suggested that we "should read" the Commission's concept release on portfolio transaction cost disclosure, as it "thoroughly addressed" many of the ideas raised in our letter. In fact, as he should know, we have not only read the concept release, we also sent a detailed comment letter to the Commission on March 16. Our comment letter, which we have attached for your convenience, thoroughly explains our position, including our view that disclosure of fund portfolio transaction costs will not be effective unless these costs are included in the expense ratio.

In addition to reading the concept release, we have also read previous statements by the Commission on this issue, including the memorandum submitted to the House Financial Services Committee by Chairman Donaldson on June 9, 2003. In that memorandum, prepared by Paul

Roye, Director of the Division of Investment Management, the Commission made clear that it opposed including portfolio transaction costs in the expense ratio. Because we recognize the difference between a concept release and a rule, and because the Commission has given us strong reasons to doubt that it will propose a rule that requires inclusion of portfolio transaction costs in the fund operating expense ratio, we continue to believe that legislation is needed to ensure that investors get complete information about the costs of the funds in which they invest.

Chairman Donaldson was also mistaken in suggesting that this and other Commission rule proposals fully respond to the other concerns expressed in our letter. He indicated, for example, that our concerns about mutual fund cost disclosure were addressed in the Commission's point-of-sale release. In fact, that release requires disclosure only of distribution-related costs. It does not require disclosure, on either the point of sale document or the confirmation statement, of mutual fund operating costs or other non-distribution-related fees levied by the funds. This omission is bewildering in light of repeated statements from SEC officials, including Chairman Donaldson, that they believe markets, armed with transparent disclosures, should discipline mutual fund costs. (Our more thorough critique of that proposal will be detailed in a forthcoming comment letter.)

The Commission has also failed to address other cost-related proposals discussed in our letter, such as requiring financial professionals to take costs into account when recommending products. To the contrary, the Commission has taken the position that even brokers who market themselves based on the investment advice they offer do not owe a fiduciary duty to their clients to act only in their clients' best interests. On the issue of cost disclosure in shareholder account statements, the Commission has consistently opposed this approach, a view the Chairman reiterated in his written testimony. Instead, the Commission has adopted a weak rule that puts new cost disclosures in the annual and semi-annual reports, documents few if any investors read before purchasing a fund. Because we believe the Commission's efforts to promote cost competition are completely inadequate, we continue to believe that legislation is necessary to accomplish this goal.

Our April 7 letter also stated that legislation is needed to give the Commission the authority to impose fund governance reforms on all funds, rather than only on those funds that choose to rely on certain exemptive rules. Even these reforms Chairman Donaldson chose not to address, much less support. While we are strong supporters of the Commission's independent governance rule proposals, there is no question that the Commission's inability to strengthen the definition of independent director or impose its requirements directly will undermine their effectiveness. For this reason, we continue to believe legislation is necessary to give the Commission this authority.

A reasoned decision on whether legislation is needed can only be based on an objective review of what the SEC has accomplished to date, what it has failed to do, and where it lacks authority to adopt needed reforms. Chairman Donaldson's testimony did nothing to dispel our conviction that legislation remains necessary to fill gaps in the SEC's regulatory agenda. In fact, his inaccurate assertion that our concerns have already been addressed in SEC rule proposals reinforces our doubts about SEC's willingness to adopt additional needed reforms where it has so far failed to act.

We very much appreciate the actions of Sen. Sarbanes in raising our concerns with Chairman Donaldson. Chairman Donaldson indicated that the Commission would respond to our letter and provide the Committee with a copy of that response. We hope that this will be more thorough and accurate than the response he provided at the hearing.

Respectfully submitted,

Barbara Roper, Director of Investor Protection
Travis Plunkett, Legislative Director
Consumer Federation of America

Mercer Bullard, President and Founder
Fund Democracy, Inc.

Kenneth McEldowney, Executive Director
Consumer Action

Sally Greenberg, Senior Counsel
Consumers Union

cc: Members of the Senate Banking Committee
SEC Chairman William Donaldson
SEC Commissioner Paul Atkins
SEC Commissioner Roel Campos
SEC Commissioner Cynthia Glassman
SEC Commissioner Harvey Goldschmid