



April 14, 2004

The Honorable William Donaldson
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Chairman Donaldson:

We are writing in response to your testimony last Thursday before the Senate Banking Committee in which you dismissed out of hand the points raised in our April 7 letter to Chairman Shelby and Ranking Member Sarbanes about the need for mutual fund reform legislation. We regret that you dismissed our arguments so summarily, for there is much that we agree on, and our groups have publicly and repeatedly applauded actions proposed by the SEC in response to the mutual fund scandals.

Unfortunately, as our letter to the Banking Committee reflected, we do not believe the SEC has adequately addressed the serious lack of complete and timely information offered to investors about mutual fund operating costs. It is our view that, until the SEC does so, cost competition will not function well in the mutual fund industry, and high costs will continue to deplete the retirement savings of millions of working Americans. It is primarily to fill what we see as a serious gap in the SEC reform agenda, and to provide the agency with needed authority in other areas, that we have advocated legislation.

In your testimony, you dismissed our arguments about the need for legislation on the grounds that they are already thoroughly addressed in existing Commission rule proposals. This is simply not accurate. For example, you indicated that "most" of the points raised in our letter are addressed in the Commission's concept release on portfolio transaction costs, and you suggested that we "should read" that release. Our organizations have not only read the concept release, we submitted a detailed comment letter in response. However, the fact is that the concept release on transaction cost disclosure is relevant to just one of the many points raised in our letter.

Furthermore, a concept release is a far cry from a rule proposal, let alone a final rule. It leaves open the possibility of any number of different outcomes. As such, it offers no assurance that the SEC will take the approach we believe is necessary to ensure that investors get complete information about mutual fund costs – by including commissions and spreads in the expense ratio. Past SEC statements – including the memorandum you submitted to the House Financial Services Committee last June – have given us cause for serious doubts that this is likely to be the case. While we would be delighted to be proven wrong, we are unwilling to simply trust that the SEC will have a change of heart. This was the basis of our recommendation that legislation is necessary to ensure the best outcome for mutual fund investors.

You also indicated in your testimony that our point about the need for pre-sale cost information was addressed in the SEC's proposal on point-of-sale disclosure. Our letter, however, refers specifically to mutual fund operating costs, which are not covered by the SEC rule proposal. In our view, there is a very real danger that the proposal put forward by the SEC will actually cause mutual fund investors to focus *less* on operating costs than they already do, since those costs will be omitted from the pre-sale and confirmation disclosures that purport to cover all the costs of buying a fund. Given the stated preference of you and other Commission members that markets be allowed to discipline operating costs, it is inexplicable to us that the Commission would pass up this opportunity to provide pre-sale operating cost disclosure, an absolute prerequisite in our view to effective market discipline of costs.

Even if the SEC reversed itself and required inclusion of fund operating costs in these disclosures, the current proposal would not fully address our concerns about the inadequacy of pre-sale cost disclosure. Although we applaud the SEC for proposing pre-sale disclosure, the proposed timing of those disclosures comes too late in the process – right before the order is entered, rather than at the point when the fund purchase is recommended – to make it likely that it will have much if any influence on the purchase decision. Similarly, we appreciate that the SEC has made an effort to provide a concise listing of costs and conflicts. However, we believe the sample disclosure documents provided by the SEC need a great deal of work to ensure that they provide the appropriate information in a way that is likely to be read and understood by average investors. The proposal does not even require that the disclosures be provided in writing, making it more likely that they will be ignored, and does not require that they be made in every instance. (Our concerns about the rule will be further detailed in a forthcoming comment letter.)

None of the SEC's outstanding proposals address the other points raised in our letter either. These include points about the need for dollar amount cost disclosure on account statements, an approach you once again rejected in your written testimony, the need to supplement improved disclosure with a requirement that brokers and investment advisers consider costs when they recommend products, and the need to expand the fiduciary duty of fund directors to cover the entirety of fund fees, not just the management fee.

While you may disagree with some or all of the recommendations included in our letter, it is simply not accurate to dismiss them on the grounds that they have already been addressed in Commission rule proposals. We have written to members of the Senate Banking Committee to make this point. In order to ensure that they assess our recommendations on their merits, and do

not simply dismiss them on the basis of your statements that they have already been addressed in SEC rule proposals, we would ask that you also to write to members of the Committee and acknowledge that your testimony was mistaken in this regard.

Finally, you indicated in your testimony that you planned to respond to our letter. We look forward to receiving your response. We hope this letter has been helpful in clarifying our concerns. More importantly, we hope it will help to convince you to adopt the cost disclosure and other recommendations we have put forward, a step that would significantly reduce the need for mutual fund reform legislation.

Respectfully submitted,

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