

Statement by Fund Democracy on Zero Alpha Group study on hidden fund transaction costs (Jan. 23, 2004):

Shareholder advocates have made the policy argument for years that the mutual fund expense ratio is misleading because it excludes fund portfolio transaction costs.

Today's study reminds us that an ounce of data can be worth a pound of policy. Professors Karceski, Livingston and O'Neal have definitively answered, with data, the policy question of whether the fund expense ratio should continue to be used in its current form. The answer is an emphatic no.

The study shows that, for a typical fund, portfolio transaction costs – commissions and spread costs – equal 43% of the fund's expense ratio. This means that for every dollar you know you spend on fund costs, another 43 cents is hidden from view. Even more shocking is the finding that in many cases portfolio transaction costs can be 400% or more of the expense ratio – in other words, for every \$1 you pay, \$4 or more is not disclosed.

This study also further demonstrates the failure of the SEC's electronic data system – EDGAR – as a means of providing information to the public. The authors of this study concluded that the way that portfolio transaction information was presented in EDGAR created significant impediments for their research. How can EDGAR provide useful information to average investors, when sophisticated financial professionals have such difficulty using it? Over three years ago, 16 consumer, employee, professional and investor groups petitioned the SEC to provide fund data in a more useable, downloadable format. The Commission has yet to respond.

The fund industry and the SEC often argue that markets are the best regulator of fees, and I agree, but they fail to recognize that markets cannot operate efficiently when the true costs of fund ownership are hidden from investors. The problems with EDGAR and fund expense ratios have been with us for too long. It is time for legislation requiring that fund expense ratios include all fund costs, and that information filed electronically be presented in a useable, downloadable format.