

Mutual Fund Leaders Take Hard Stand on Soft Dollars, December 2003

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ICI Asks SEC to Dramatically Curtail Soft Dollars and Ban Directed Brokerage

Washington, DC, December 15, 2003 - Following decisions by the Investment Company Institute's Board of Governors, ICI Chairman Paul G. Haaga, Jr. [announced](#) that the ICI would urge the Securities and Exchange Commission to dramatically curtail the use of soft dollars by all investment advisers, including mutual fund managers, and to ban mutual funds' use of "directed brokerage." Haaga said the ICI is seeking "major structural reforms to change mutual funds' relationships with firms who execute their portfolio transactions and market and sell their funds." ICI President Matthew P. Fink said the actions reinforce mutual funds' "commitment to putting the interests of fund investors above everything else." According to Fink, "the ICI Board has been concerned about how these practices were evolving and whether existing regulations remained adequate."

Restrict the Use of Soft Dollars

The ICI took two actions with respect to soft dollars. First, the Institute called on the SEC to significantly curtail the research that can be acquired with soft dollars. The ICI proposed that virtually all products and services that are otherwise available in the marketplace be eliminated from the SEC's definition of permitted research. "The current definition is overly expansive," Fink said, "and thus has been susceptible to abuse. For example, soft dollars can currently be used for routine expenses like computers, software and investment publications. The ICI is convinced a much narrower definition will help eliminate the potential abuses most often associated with the questionable use of soft dollars."

Eliminate Soft Dollars for Third Party Research

In addition, the Institute urged the SEC to prohibit all investment advisers, including fund managers, from using soft dollars to acquire any research products and services from third parties. Eliminating this outlet for soft dollars would forcefully address an area that some believe has been most prone to problematic conflicts. While a special 1998 SEC inspection sweep found no soft dollar abuses by mutual funds in this area, Haaga pointed out that "questions about the appropriateness of using soft dollars for third party research have cast a pall over all investment advisers, no matter what they actually do in practice."

The Institute urged the SEC to limit the use of soft dollars to the narrow category of proprietary research that reflects unique intellectual content. Haaga said the ICI is not questioning the value of third party research, just the manner in which it is paid for. "The ICI Board acted to make sure that most research is paid for directly by investment managers from their management fees, not from shareholder assets."

Ban Directed Brokerage

The ICI also called on the SEC to end the practice of "directed brokerage." While this practice is subject to strict regulations, the rules permit fund companies to consider the fact that a brokerage sells their mutual funds when choosing a broker to execute their portfolio trades. The ICI concluded that "directed brokerage" raises questions about whether fund managers' trading decisions are affected by considerations other than shareholders' best interests. If the SEC were to abolish directed brokerage, as the ICI suggests, a significant potential conflict of interest would not just be regulated, it would be eliminated.

"These are substantial reforms," Haaga said. If enacted, they "will benefit fund investors by substantially diminishing potential conflicts of interest and strengthening the operating integrity of mutual funds."

Today's reform proposals build upon initiatives the Institute announced in October to combat recently discovered abuses. To combat late trading, the ICI proposed that all mutual fund trades be reported to the fund company by 4 pm to obtain the current day's price. To deter abusive market timing, the ICI urged the SEC to require a minimum mandatory 2 percent redemption fee (payable to the

funds' long term shareholders, not fund managers) on sales of shares held for five days or less.

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