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The SEC Must Step into the Breach

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It's long past time to fix the broken processing fee framework for delivering information to fund investors. Only the SEC can get it done.

Securities and Exchange Commission (SEC) rules require US-regulated funds to ensure that investors, including retail investors saving for retirement or their children's education, receive a wide range of important materials about their investments. These materials include prospectuses, shareholder reports, and proxy materials.

When investors access funds through broker-dealers—the primary way that investors put money into funds—funds typically cannot see the identity of the individual investors and therefore cannot deliver key investment materials to them. As a result, funds must depend on the broker-dealers to deliver these materials, and SEC rules entitle the broker-dealers to charge the funds for "reasonable" expenses in carrying out this service. SEC rules do not define what constitutes "reasonable."

We have a problem today. Broker-dealers and the vendors they use are charging unreasonable "processing fees" to provide this service. Funds are being forced to pay *three to five times more* to deliver materials through these firms and their vendors than they pay to deliver the same materials directly.

An ICI survey found that the median fund pays 5 cents to send a shareholder report—whether by US mail or email—to accounts it holds directly. Yet the leading vendor used by broker-dealers charges 15 cents to send the identical shareholder report by mail and an even higher 25 cents to send it by email! These unreasonable fees cost fund investors *more than $220 million a year*.

A Broken Regulatory Framework Permits Broker-Dealers to Charge Unreasonable Fees

These unreasonable fees are the product of a broken, outdated regulatory framework. Overseen by the SEC, the framework relies on the New York Stock Exchange (NYSE) to set a fee schedule to govern what processing fees broker-dealers and their vendors can charge funds for delivering materials to fund investors.

Unfortunately, the NYSE fee schedule neither is fit for purpose nor has been updated in many years. The NYSE originally designed the schedule for public companies, whose document delivery obligations differ from those of funds. As a result, the fee amounts set by the NYSE bear little relation to the actual cost of delivering fund materials and are higher than necessary to compensate broker-dealers for reasonable delivery expenses.

Here's the state of play: SEC rules allow broker-dealers to select a vendor to deliver fund materials, and the vendor—on behalf of broker-dealers—typically charges funds the maximum rate allowed under the fee schedule. With no incentive to secure fair rates for fund investors, broker-dealers often profit by negotiating with the vendor to deliver the materials for less than the actual maximum rate charged to funds. The two parties then determine how to split the profits.

Even worse, the NYSE fee schedule allows broker-dealers to charge funds a premium to *not* mail fund materials. This "preference management fee" was originally designed to help broker-dealers cover the cost of switching to electronic delivery, back when it was a novel method of communication. Yet even though they've already done the work necessary to make the switch—and even as electronic delivery has become a regular part of modern life—broker-dealers still charge this premium, preventing fund investors from saving money through electronic delivery.

Seeking a Solution from the SEC

The NYSE no longer wants responsibility for overseeing the fee framework, and the Financial Industry Regulatory Authority—which regulates broker-dealers—doesn't want the job either. The SEC needs to step in to protect investors.

In a **letter** sent in May, ICI urged the Commission to take both near- and long-term action. In the near term, the SEC should issue a statement reminding broker-dealers and their vendors that SEC rules require that these processing fees be "reasonable" and that simply charging funds the maximum fees allowed under the flawed NYSE schedule doesn't satisfy that commonsense standard.

Longer term, the SEC should take steps to enable funds to select their own vendor and directly negotiate their own pricing, which would eliminate the need for any fee schedule. Unlike broker-dealers, funds have the strongest incentive to negotiate the lowest fees for fund investors.

Alternatively, the Commission could replace the NYSE fee schedule with a new fee schedule—taking into account funds' disclosure delivery obligations, eliminating unreasonable billing practices, engaging an independent third party to review the reasonableness of the fees, and creating a robust regulatory oversight framework. Either approach would be a win for fund investors, potentially saving them hundreds of millions of dollars.

Only the SEC has the authority and perspective to independently assess the current framework—and make the judgments necessary to reform it—consistent with the Commission's legal mandate to protect investors. In doing so, the SEC can ensure that fund investors are paying fair, market-driven prices for information about their investments. The time to act is now.

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