

# Money Management Executive

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Covering Mutual Funds, SMAs, 401(k)s, 529s & More

The Newsweekly of Insight & Strategies

## At Deadline

### Skippers Favor Companies With University Ties

Because managers of mutual funds and corporate executives who attended the same university frequently run in the same social circles or maintain their friendships well past graduation, the corporate executives tend to share key information about their firms with the portfolio managers, a new study found.

As a result, the managers tend to invest in those companies, which commonly deliver strong performance because of the quality of the information being shared.

The study, called "The Small World of Investing: Board Connections and Mutual

**Mutual Funds**

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## 401(k) Plans Need to be Straight Shooters

### Effective 401(k) Communications Means Being Realistic

By Hannah Glover

401(k) retirement isn't always a straightforward choice and realistic views given by employers who do provide plans are commonly overlooked, defined contribution plans. Not even a 401(k) plan with a full company match can solve the retirement crisis. The time workers do spend preparing to retire is better spent on a dose of reality.

Not only for plan participants, but also for plan sponsors, according to analysts at Insight, the new "Effective 401(k) Communications" forum has a track record.

What we have been doing as an industry has not worked," said Wendy Wong, vice president of marketing for New York Life Investment Management in New York. "There's still a need for communication."

So far, much of the communication plan sponsors are utilizing remains unhelpful, such as handing out brochures, making bicycles, down a path or standing on a porch waving and waves crash against the shore.

The problem is that retirement is not always so easy, said Warren Gorman, founder and president of the Boston Research Group of Hopkington.

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Only Two-Thirds Saving for Retirement  
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## Researchers: Banish the Boards

### Say Fund Directors Boost Expenses, Hamstring Competition

By Hannah Glover

The question may not be how independent mutual fund boards should be, but whether investors would be better off without fund boards altogether.

That's because mutual fund boards, which bear the responsibility of overseeing and setting fund expense ratios, impede competition, said Peter J. Wallison, a senior fellow at the American Enterprise Institute, and Robert E. Litan, a senior fellow at the Brookings Institute, both in Washington.

The result is a wide disparity in shareholder costs among similar funds and the erosion of returns, they said.

"Eliminate rate regulation by boards and allow advisors to set their own fees

**Governance**

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## Data Points

### Virtual Fund Family Net Flows (\$ in Millions)

A virtual fund family is comprised entirely of funds that are sub-advised. Access to institutional management that might otherwise be inaccessible to investors has contributed to their rise in popularity. Further, the arrangement allows managers and distributors to concentrate on their respective core competencies, making them more efficient.

Source: Financial Research Corp.

## 5.1% Earnings for 1Q07 Disappoint

### Analysts Initially Projected S&P 500 to Gain 9.2%

By Jessica Papini

Mutual fund analysts may have set their hopes too high for the first quarter of 2007, as company earnings didn't reach the levels they had hoped, experts said during Lipper's first quarter fund performance review and outlook webcast last week.

Earnings of companies in the Standard & Poor's 500 Index are now expected to grow 5.1% for the quarter, compared to a 9.2% projection when the quarter first started, said Ashwani Kaul, a senior markets analyst with

Tom Roseen

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## **BANISH** from page 1

and expenses,” said Wallison last week during a discussion on “Competitive Equity: A Better Way to Organize Mutual Funds.”

Wallison and Litan compared the rate-setting role of mutual fund boards as defined under the Investment Company Act of 1940 to that of monopolistic public utilities.

The duo presented a chart that showed that among 811 Class A U.S. equity funds, expense ratios ranged from as low as 60 basis points to as high as 170. Even among index funds, commonly considered lean and mean, the difference in expenses ranged from 12 basis points to 70.

“In most competitive industries, prices converge,” Wallison said. “That has not happened in the mutual fund industry.”

In part, Wallison and Litan argue, that’s because there is no pressure from boards or investors to do so. Even those companies with expenses lower than their peers don’t always adequately communicate those savings to the public. Wallison cited a report from the **Government Accountability Office** that reviewed 45 mutual funds’ advertisements and found only two that said anything about the cost of investing.

The way to push prices closer together, they argued, is to replace the current U.S. mutual fund structure with something they called the “managed investment trust.”

Under the current regulatory framework, advisors have such complex fee structures that even they have a difficult time identifying their own costs, Wallison said. As a result, the funds’ true margins are likewise an enigma to the board.

Advisors, he argued, lack any incentive to examine their margins too closely or look to trim costs because if they demonstrate potential

savings, the board will likely shave the expense ratio, and therefore their compensation, Wallison said.

A managed investment trust, on the other hand, would allow advisors to set expense ratios. Under this model, the advisor would be able to cut costs, in a way that benefits both the firm and investors. Suddenly running leaner funds would be more attractive to advisors, and therefore more heavily promoted as a selling point to the public.

Competition will naturally ensue, Wallison and Litan argue.

The trust would also replace the part-time, appointed board “with no particular expertise to oversee conflicts of interest between advisors and investors” with a full-time, professional staff dedicated to monitoring compliance and operations of a fund, Wallison said.

The U.K. uses a similar mechanism, the research team noted, and the spread between expense ratio there is roughly 60 basis points, compared to 110 here.

However, the average expense ratio in the board-free British market is also much higher. In fact, of the 456 U.K. funds, the least expensive costs investors 1.27%, while the most expensive fund charged 1.97%.

Although Wallison and Litan acknowledged the high price of U.K. funds, they did not study the reason why. They hypothesized, however, paying a premium for non-British stocks, the somewhat small size of the market, and even the high cost of doing business could be factors.

But **Susan Ferris Wyderko**, executive director of the **Mutual Fund Directors Forum** in Washington, offers a different cause for the high cost of U.K. funds: no boards.

Wyderko also suggested that the true disparity in prices in the U.S. is actually driven, at least in part, by the retirement industry, which accounts for 40% of the \$10 trillion invested in U.S. mutual funds. As a

result, often plan sponsors, not end investors, choose the funds, she noted. Sometimes funds with higher expense ratios provide lower administrative costs, or other perks, making them more attractive to sponsors than low-cost, bare-bones options.

For a sense of what happens to price in the absence of boards, there’s no need to look to Britain, said **Niels Holch**, executive director of the **Coalition of Mutual Fund Investors** of Washington. Domestic hedge funds are proof enough, he said. Hedge fund investors pay advisors between 100 and 300 basis points in management fees plus 20% of gains. “I would advocate that a regulated environment pushes fees down,” he said.

And the more independent the board, the lower those fees go, according to **Laura Pavelnko Lutton**, a senior mutual fund analyst and director of the mutual fund stewardship program at Chicago-based **Morningstar**.

Wyderko did endorse the authors’ call for a more simplified fee structure, or “all-in” fees, which would make it easier to compare funds and families, she said. Directors could then more easily evaluate whether the advisor with whom they work, is truly competitive and determine whether it is in investors’ best interest to renew the management contracts.

Wallison purported that boards were too far removed from the daily operations of funds to detect wrongdoing during the market-timing and late-trading scandals.

But Wyderko disagreed: “The bank that is holding the money and that is paid to be holding the money has exactly the same conflicts of interest. I find it mystifying to think why a bank staff acting as a transfer agent with the same conflicts and the same interests in sticky assets would have ever revealed the late trading.” MMIE