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New Congress May Tackle Thorny Fund Issues

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By Tom Leswing

Congress is expected to address a variety of issued related to the fund industry in 2007, but it is unclear if any substantial legislation will be forged over the coming 12 months.

Indeed, some industry leaders even think that legislators, while addressing mutual fund concerns, will focus on other matters.

The House Financial Services Committee's new chairman, Rep. Barney Frank (D-Mass.), for example, has said he will focus on issues regarding mortgage practices and affordable housing.

"I think of those as being far away from the concerns of the ICI," says Paul Schott Stevens, president of the ICI. "As far as I can tell, at this stage the Financial Services Committee will be talking about issues that are pretty remote from mutual funds."

In the Senate, the Banking Committee's new chairman, Chris Dodd (D-Conn.), has also said he will work to promote affordable housing and fair mortgage sales practices.

Just the same, Stevens says Congress will still wrestle with a variety of matters involving the fund industry. One hot topic will be disclosures regarding fees charged by retirement plan service providers, he says. Representative George Miller (D-Calif.), who will become the new chair of the House Committee on Education and the Workforce, has said he will launch a review of fees and how retirement plan expenses are disclosed to investors.

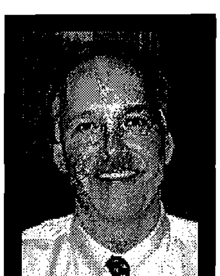
The announcement followed on the heels of a Government Accountability Office recommendation that Congress forge legislation to require employers to clearly disclose retirement plans' fees. The ICI supports the Miller initiative.

"I think it is very positive that Congress will be looking into this," Stevens says. "The ICI has a long tradition of urging the Department of Labor and Congress to improve fee transparency in 401(k) plans."

Stevens says improved disclosures would help investors better understand the retirement fees they pay. Observers add that the initiative could also help the fund industry. Other types of retirement plan investment options, such as certain types of annuities, separate accounts and pooled accounts, may not always disclose their fees with the same level of detail as mutual funds.

So, by improving fee disclosures, it will be easier for investors to compare the merits of different types of investment options. Stevens believes that disclosures in fund prospectuses can serve as a model for how fees and portfolio risk should be disclosed by other types of investment options.

Yet, disclosures should also be improved in regard to fee-sharing arrangements among investment providers and plan recordkeepers and administrators, according to Niels Holch, executive director of the Coalition of Mutual Fund Investors."The issue is broader than just fees that are disclosed in prospectuses," he says.



Niels Holch
Executive
Director
Coalition of

Indeed, fund firms often share a portion of their revenues with retirement plan recordkeepers and administrators. That way recordkeepers and administrators get reimbursed for handling shareholder communications that would otherwise be handled by employees at fund firms. Holch maintains that the revenue-sharing arrangements are inadequately disclosed.

In another matter, the ICI expects to see continued discussions over what has been called the Growth Act. Observers point out that the bill would make mutual funds more attractive for use in accounts outside of retirement plans or other tax-favored programs. Earlier versions of the proposed legislation would allow investors to defer paying capital gains taxes on capital distributions made by funds, assuming investors reinvest the distributions in the funds, Steven says.

Democrats in leadership positions, however, have said they will support tax cuts only if the resulting loss in revenues can be recouped by other programs. With that in mind, Stevens says it's unlikely that Congress will move forward with the proposed tax cut this year.

Interest has been growing in the proposal, Holch says. "Each year, more and more people say it's a good thing. It could affect millions of accounts, so support has been growing over time."

In light of this, Congress could work on finding other sources of revenues so that it can pass the tax cut. "Sometimes Congress can do it by increasing enforcement [of existing tax regulations] or by closing loopholes," he explains.

Yet, with the current budget deficits being experienced by the Federal government, it's unlikely that the tax cut will be passed, even if alternative sources of revenue can be found. If the economy slows down, however, Congress may view the proposal as a way to stimulate the economy, which would increase the likelihood of the legislation being passed.

Stevens adds that the ICI is also expecting Congress to assess the impact of the Sarbanes-Oxley Act. The act requires firms to implement strong internal control procedures regarding accounting practices and to have senior-level executives sign off on the accuracy of financial disclosures, explains Tamar Frankel, a professor of law at Boston University School of Law. Many industry leaders have said fund firms are already heavily regulated and that many of the Sarbanes-Oxley requirements are unnecessary. The question is whether Congress will seek to ease Sarbanes-Oxley requirements or have the SEC address the matter, Stevens says.

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The ICI would also like to see Congress discuss making the capital gains tax rate of 15% permanent. The 15% cap is set to sunset in 2010.

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