Fund Democracy
Consumer Federation of America

April 17, 2008

BY EMAIL AND US MAIL

Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, N. E.
Washington, D.C. 20549-1090

RE: File No. S7-28-07

Dear Secretary Morris:

On behalf of Fund Democracy and the Consumer Federation of America, we are writing to comment further on the Commission's proposal to require mutual funds to create a summary prospectus ("Summary") that could be used to satisfy a fund's prospectus delivery requirement under the Securities Act of 1933. In particular, we object to certain requests contained in the comment letter submitted by the Securities Industry and Financial Markets Association ("SIFMA") dated February 28, 2008, relating to the: (1) placement of fees and costs information, (2) disclosure of commission breakpoints, and (3) annual prospectus update.

Placement of Fees and Costs Information

We disagree strongly with SIFMA's request that fund fees and costs follow information regarding the fund's "investment strategies, risks, and performance" "in order to provide a proper context within which the investor may evaluate the reasonableness of a fund's fees and costs." SIFMA argues that fees and costs should be relegated to secondary status because they are, "to a major extent . . . a function of a particular fund's investment strategies and performance objectives." SIFMA provides no explanation of its claim that fees and costs depend to a "major" extent on a fund's investment strategies and performance objectives. We assume that it is referring to the fact that portfolio management fees vary significantly according to type of fund. For example, international fund managers typically charge more than domestic equity managers, and actively managed funds are typically more expensive than passively managed funds.

We support the goal of providing context for fee information, but SIFMA's proposal would not further this goal. SIFMA provides no explanation as to how simply moving information about strategies, risks, and performance would provide any additional context for fees and costs. It does not make any recommendation about what that information would actually explain about fees and costs. For example, it does not recommend that an actively managed fund's Summary explain that actively managed funds are typically more expensive than passively managed funds. Such disclosure would be helpful, but it not clear why it would not be more effective if presented in the discussion of fees and costs rather than in the general discussion of the fund's investment objectives and strategies.

SIFMA's proposal would have the adverse effect of de-emphasizing the importance of fees. Within any asset category, fees are likely to provide the strongest predictor of future performance. Empirical analysis has demonstrated time and time again that investment performance is highly unpredictable, whereas fees tend to remain generally at the same level year after year. Placing past performance prior to the presentation of fees sends precisely the wrong message.[1]

We also note that SIFMA makes no mention of the most obvious relationship between strategies/objectives and fees/costs, and that is the relationship between frequent trading and portfolio transaction costs. When a fund employs an active management strategy with a high degree of portfolio turnover, its portfolio transaction costs generally will be higher. Portfolio transaction costs are not even included with fund fees and costs, however, which conceals the aspect of a fund's strategies and objectives that has the greatest potential to affect fees. For this reason, we have long supported requiring funds to include portfolio transaction costs in the fund's expense ratio in order that investors might better understand the effect that fund strategies and objectives can have on fees and costs.

We believe that the most effective way to provide helpful context for fees and costs would be to require that they be presented alongside fees and costs for comparable funds. This information would help place the fund's fees and costs in the proper context by enabling investors to make direct comparisons to similar funds. For example, the fees for an international fund would appear alongside the average fees for similar international funds. This disclosure would show that international funds are typically more expensive than domestic funds while also promoting competition by showing that a fund's fees were higher or lower than its competitors' fees.

Breakpoint Disclosure

SIFMA requests that funds be permitted to use "generic language" in describing sale charge discounts (breakpoints) that may be available for large purchases, rather than disclosing the specific discount level. SIFMA's rationale is that the potential complexity

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[1] *See* Letter from Alan Palmiter, Professor, and Ahmed Taha, Associate Professor, Wake Forest University School of Law, to Nancy Morris, Secretary, SEC (Mar. 4, 2008) ("At the heart of the problem is that fund investors believe that past returns are predictive. By and large, they are not. A disclosure regime that continues to highlight past returns as a predictor of future returns (with disclaimers that only intensify the false belief there is a strong correlation between the two) disserves investors."). *See also* Mike Weldon, Advanced Performance Chasing (finding that, of funds that performed in the top quartile in the previous one-, three- and five-year periods, 23% performed in the top quartile in subsequent three- and five-year periods) (on filed with Fund Democracy).

of breakpoint arrangements should excuse brokers' full disclosure obligation and should shift the burden to "investors to inquire further regarding specific information." Shifting responsibility to investors for problems with commissions echoes the industry's shameful response to the breakpoint scandal of 2003, in which regulators found that shareholders were overcharged with respect to 32% of the mutual fund transactions that were eligible for discounts. Indeed, SIFMA has the temerity to use the report that disclosed and documented this egregious fraud to repeat its excuse that "delivering a discount is a complicated endeavor where the discount is based on the right of accumulation." Complexity should not be addressed by requiring investors to "inquire further." If industry members choose to implement complex distribution payment schemes, then that complexity should be fully revealed to shareholders and subjected to the disciplining effect of an informed market.

Annual Prospectus Delivery

SIFMA requests that the Commission eliminate the requirement that shareholders be provided with an annual prospectus update. We strongly oppose this request, as the annual update is likely to provide the most effective opportunity for investors' attention to be directed to changes that have occurred since they last received a prospectus. Indeed, we believe that the annual update can be made more useful not by eliminating its delivery, but by using it to focus investors' attention on a fund's current fees, costs, performance and other information that has changed in the preceding year. For this reason, we recommended in our February 28, 2008 comment letter that the Commission allow the annual delivery requirement to be satisfied by delivering a document that draws shareholders' attention to information that has changed during the preceding year.

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In conclusion, we reiterate our overall support for the Commission's proposal to permit a standardized document that generally includes the most important information that investors should consider when evaluating different funds to be used in place of a statutory prospectus, with certain reservations as discussed above and in our prior letter. We applaud the Commission's efforts to further simplify fund disclosure and reduce costs for investors and appreciate this opportunity to share our views with you.

Respectfully submitted,

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Fund Democracy

Barbara Roper
Director of Investor Protection
Consumer Federation of America

cc: (U.S. Mail only)

The Honorable Christopher Cox
The Honorable Paul S. Atkins
The Honorable Kathleen L. Casey
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