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SEC Update

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SEC Probes Fund Section 15(c) Process

The Staff of the Securities and Exchange Commission (SEC), last spring, sent letters (SEC Staff Requests) to selected mutual funds (funds) requesting specified written information about their process for evaluating and approving investment advisory contracts (advisory contracts) under Section 15(c) of the Investment Company Act of 1940[1] (1940 Act) (Section 15(c) process).

The SEC Staff Requests did not explain their purpose or context. However, William A. Birdthistle, Director of the SEC's Division of Investment Management, last March expressed[2] concern about the efficacy of the Section 15(c) process regarding funds with low investment performance (poor returns) and/or high fees, particularly poor returns over long periods. Director Birdthistle then spoke[3] informally about this concern before professional groups during 2022.

This article begins with a summary of Director Birdthistle's expressed concern. The article then: summarizes the Section 15(c) process, SEC enforcement actions, and the SEC Staff Requests; notes that the SEC Staff did not announce the process as an exam priority; explains how the SEC Staff Requests may reflect the views of SEC Chair Gary Gensler and Director Birdthistle as expressed in their respective books; and addresses the downward trend in fund expense ratios perhaps due to price competition spurred by SEC disclosure requirements.

Current Situation

The SEC Staff appears satisfied that the Section 15(c) process is working well enough for most funds, but not all. As Director Birdthistle has observed:

> Some portions of this very large market enjoy a great deal of movement in response to economic competition. Others don't. We see inflows of money into funds with low costs and high performance, as economists would expect, but we also see a dearth of outflows from funds that underperform the market while charging relatively higher fees.[4]

The SEC Staff notes that fund shareholders are generally free to redeem out of a fund. As Director Birdthistle has said, "there are few legal impediments" to shareholders' exiting a fund "with poor returns or high fees."[5]

Nevertheless, the SEC Staff does not believe that some fund shareholders are looking out for their best interests, because they are not redeeming out of funds with poor returns and/or high fees. As Director Birdthistle has observed, "sometimes in our least exemplary funds, we see less exit than we might expect."[6]

Director Birdthistle has attributed this situation to the inability of fund shareholders to protect themselves. First, he points to "inertia," explaining that "[i]nvestors lead busy lives" with jobs of their own, loved ones to care for, and pandemics to navigate."[7] Second, he points to the limited "scope" of fund shareholder awareness, explaining that "a substantial portion of costs are being drawn out of investment companies through revenue sharing, soft dollar, and other practices with little visibility and even less familiarity."[8] In this regard, he says, "[i]t's striking to me that investors do not receive a uniform statement explicitly identifying the dollars they paid in the past year."[9]

Director Birdthistle has concluded that "individual investors, . . . even sophisticated investors . . . lack the resources to conduct eternal vigilance" and that "vigilance is simply beyond the scope of a reasonable investor."[10] His bottom line is that it is not "reasonable" to expect "that investors should know when to exit"[11] a fund with poor returns and/or high fees.

If this is so, what can the SEC do to protect fund shareholders from themselves? SEC enforcement actions described below have not brought about a situation wholly satisfactory to the SEC Staff. An SEC rule is arguably not the solution, because a fiat does not fit the Section 15(c) process, which the courts have characterized in terms of a negotiation[12] based on the business judgment of fund directors.[13] SEC litigation under Section 36(b)[14] is arguably not the solution, because private litigants have failed to win under the statutory standard as interpreted by the courts.[15] Finally, an SEC legislative recommendation to amend Section 36(b) is arguably not the solution, because Congress is unlikely to welcome such a recommendation as a top priority.

Under these circumstances, the SEC Staff seems to be turning to fund directors to bring pressure on advisers to improve poor returns and/or lower high fees by hewing more closely to the Section 15(c) process described immediately below.

Section 15(c) Process

Section 15(c), together with Section 15(a), provides as follows.

It is unlawful for a person to serve or act as adviser to a fund, except pursuant to a written advisory contract approved by shareholders.[16] The advisory contract can continue so long as the continuance is specifically approved at least annually by the board.[17]

The advisory contract must: precisely describe all compensation;[18] provide that it can be terminated at any time without the payment of any penalty by the board or shareholders upon specified notice;[19] and provide for its automatic termination in the event of assignment.[20]

It is unlawful for a fund to enter into, renew or perform an advisory contract, unless the contract has been approved by a majority of the independent directors who are not parties to the contract or interested persons of any such party, based on votes cast in person at a meeting called for the purpose of such vote.[21]

It is the duty of the directors to request and evaluate such information as may reasonably be necessary to evaluate the terms of an advisory contract.[22] It is the duty of an adviser to furnish such information (whether or not the directors request that information).[23]

Section 15 does not specify what information is "reasonably necessary" for fund directors to request and evaluate or for an adviser to furnish. A federal court has found,[24] and the US Supreme Court has agreed,[25] that the information includes at least:

- the adviser's cost in providing the services;
- the nature and quality of the adviser's services;
- the extent to which the adviser realizes economies of scale as the fund's assets increase;

- the adviser's profitability from the advisory contract;
- fee rates for comparable funds; and
- the adviser's so-called "fall-out" benefits.

The courts also look at the board's independence, expertise, care, and conscientiousness.[26]

SEC Enforcement

The SEC has brought enforcement actions involving the Section 15(c) process described immediately above. Two actions[27] involve fund independent directors (as well as fund service providers), and one action[28] involves only fund service providers.

The two actions involving fund independent directors are similar in: expressly referring to the Section 15(c) process;[29] naming the individual independent directors as respondents;[30] finding violation of Section 30(e) and Rule 30e-1 in failing to provide the required disclosure of the Section 15(c) process or in not having all of the information requested from the adviser;[31] and ordering the independent directors to cease and desist their violations.[32]

At the same time, the two actions differ in a number of ways regarding the independent directors:

- In one action, the SEC found that the independent directors violated Section 15(c) itself[33] (as well as related sections).
- In one action, the SEC found that the independent directors violated Section 34(b)[34] in approving untrue or misleading disclosure of their Section 15(c) evaluation and approval of an advisory contract, and Rule 38a-1 in failing to implement fund policies and procedures.[35]
- In one action, the SEC fined each independent director $3,250.[36]
- In one action, the SEC required[37] the independent directors (and other respondents) to hire, and adopt the recommendations of, an independent compliance consultant.

SEC Staff Requests

The SEC Staff did not make its Requests public. Information about them circulated by word of mouth from the recipients and their counsel, as well as statements by Director Birdthistle.[38]

The SEC Staff Requests sought the following materials during the period from January 1, 2018, to the dates of compliance with the Requests:

- meeting materials for fund board of directors (board) meetings;
- board meeting minutes;
- documents and communications regarding board approval of advisory contracts;
- policies and procedures required by Rule 38a-1, including Section 15 policies and procedures; and
- director evaluations under Rule 0-1(a)(7)(v).[39]

No Exam Priority

The SEC Staff Requests from the Division of Enforcement came as a surprise to the industry, because the Division of Examinations had not announced that the Section 15(c) process would be an examination priority for 2022.

The Division of Examinations announced that its 2022 significant focus areas would be: private funds; environmental, social, and governance (ESG) investing; standards of conduct, including regulation best interest, fiduciary duty, and Form CRS; information security and operational resiliency; and emerging technologies and crypto-assets.[40] That Division's explanation of its focus on "fiduciary duty" did not include the Section 15(c) process.

The Division of Examinations also announced a 2022 adviser and fund examination program. This program covers "perennial areas," including "among other topics, disclosures to investors, accuracy of reporting to the SEC, compliance with the new rules and exemptive orders (including exchange traded-fund (ETF) rules and exemptive orders for nontransparent, actively managed ETFs, and custom baskets)."[41]

Chair Gensler Views

The SEC Staff Requests did not come as a surprise to the industry in light of the fact that SEC Chair Gary Gensler has written a book[42] questioning excessive investment advisory fees (advisory fees) and fund director oversight of advisory fees.

Chair Gensler, in his book, frets about high advisory fees. He warns that fund shareholders may not know that the "company managing your mutual fund does not share your interests," "has its own shareholders and profits to consider," and "wants to charge high management fees that come directly from your returns."[43]

He shows little confidence that fund directors will protect fund shareholders against high advisory fees. He believes that "[m]any directors view their role as simply auditing the performance of the adviser and making sure there is no malfeasance or accounting problems, rather than acting as the shareholders' advocate."[44] He believes the result is that shareholders "pay significantly higher fees" than they would if "shareholders actually ran the company."[45]

Chair Gensler attributes the limited protection that fund directors provide to shareholders to both legal and cultural sources.

As to legal sources, he acknowledges that the 1940 Act "was designed to place unaffiliated fund directors in the role of independent watchdogs, to furnish an 'independent check upon the management of investment companies.'"[46] He observes, however, that this legal standard "has never been interpreted very stringently."[47] The result, he quotes former SEC Chair Arthur Levitt as saying, is that fund "[d]irectors don't have to guarantee that a fund pays the lowest rates. But they do have to make sure that fees fall within a reasonable band."[48] This approach, he says, would be anathema in the "real world."[49]

Chair Gensler goes on to state that "the problem with mutual fund management is cultural, not regulatory."[50] He explains that "directors have a difficult time striking a proper balance between working with the adviser and vigorously pursuing investors' interests."[51] He believes that this difficulty "[t]oo often" leads directors to "acquiescence to whatever the adviser proposes."[52]

Director Birdthistle's Views

The SEC Staff Requests also did not come as a surprise to the industry in light of the fact that Director Birdthistle has written a book[53] questioning excessive advisory fees and fund director oversight of the fees.

Director Birdthistle's point of departure has been that "the level or magnitude of fees is the most direct source of peril for the fund investor."[54] "[O]rdinary investors," he has said, "are largely unaware of their complexity and peril" and do not "appreciate their hidden dangers."[55] He does not believe that investors can protect themselves against high fees, because funds "remain a curious species of financial instrument whose inner workings are alien to many Americans."[56]

Some fund shareholders have sought to protect themselves against high fees by bringing private lawsuits under Section 36(b). But Director Birdthistle notes that these private lawsuits have not "proved to be very salutary to mutual fund investors for the simple reason that they rarely target the worst offenders."[57] He explains that private lawsuits have been brought "against the biggest mutual fund families with the most investors because the large net asset values in those cases tend to produce larger settlements."[58]

At the same time, Director Birdthistle has not had much faith that fund directors can protect all fund shareholders against high fees. "[F]und trustees," he has said, "are expected to police the interests of the fund's shareholders," but history has demonstrated that "some trustees have performed that role better than others."[59]

Moreover, Director Birdthisle has not had much faith that the SEC can protect fund shareholders against high fees. He has claimed that "the SEC has been disappointing" in its "inaction."[60] He recognizes that "[p]erhaps the SEC's inaction meant only that the legal standard for proving excessive fees is too cumbersome and unwinnable," because "no plaintiff has ever prevailed under the *Gartenberg* standard."[61] But he has argued that the SEC "should bring suit . . . to challenge truly stratospheric fees" and "against outlier advisers that charge the most outrageous fees."[62]

Disclosure Enhancing Competition

To keep this matter in perspective, it is useful to recognize the Investment Company Institute (ICI) findings that average fund expense ratios continue to fall[63] and fund shareholders continue to tend to invest in funds with below-average expense ratios.[64]

As Director Birdthistle has observed: "Some portions of this very large [fund] market enjoy a great deal of movement [of investors in and out of funds] in response to economic competition."[65] Arguably, this movement is attributable, in part, to the SEC's continuing efforts to assure that disclosure of fund expenses and fees, including advisory fees, contributes to competition and, in turn, to what the ICI finds to be falling expense ratios.

The SEC has traditionally believed that the fund industry lacks sufficient price competition.

A 1966 SEC study, for example, stated that "[f]aced with the choice of appealing to price-conscious investors or to compensation-conscious fund retailers, most load fund underwriters have followed the latter course.[66] A 1974 SEC Staff study stated that "[g]reater investor understanding and more meaningful comparisons of past investment returns, risks, and costs, and their effect upon investment returns could lead to greater *competition* to improve the features which make up the mutual fund package—by improving management services, reducing costs and offering additional ancillary services."[67]

A 1992 SEC Staff study considered "eliminating impediments to vigorous price *competition*"[68] and recommended that "the Commission pursue several legislative and rulemaking proposals designed to enhance *competition* and improve investor understanding of investment costs."[69] A 2000 Staff study looked at various steps that the SEC could take to "promote additional *competition* among funds on the basis of fees."[70]

Last fall, the SEC adopted[71] changes to shareholder reports, prospectus disclosures, and fund advertisements that could enhance price competition among funds. In doing so, the SEC stated that these changes "will enable investors to compare fees and expenses and other information more easily across funds, and between funds and other financial products, and could therefore affect *competition* among funds by making it easier for lower-fee funds to distinguish themselves from other funds."[72]

This, the SEC says, could lead:

- "investors to shift their assets from higher-fee funds to lower-fee funds,"[73]
- "funds, in anticipation of this, to lower their fees or otherwise take steps to draw investor flows away from *competing* funds or avoid outflows to competing funds,"[74]
- "funds to exit that are not as easily able to compete on the basis of fees and expenses,"[75] and
- "other funds to enter and *compete* for shareholder assets more efficiently than is currently occurring."[76]

Conclusion

The SEC Staff is apparently conducting an inquiry of some funds with poor returns and/or high fees, particularly with poor returns over long periods. Director Birdthistle has indicated concern about fund shareholders who, for whatever reason, do not redeem out of such funds for their own benefit. The SEC Staff appears to have concluded, at least for the moment, that neither SEC enforcement action, rule, litigation, nor legislative recommendation is the answer. Instead, the SEC Staff seems to be pressuring directors of such funds to hew more vigorously to the Section 15(c) process in order to achieve higher returns and/or lower fees in the best interest of fund shareholders who may not be able to protect themselves.

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NOTES

1 All references in this article are to sections of the Investment Company Act of 1940 and rules thereunder. This article is dated January 13, 2023.

2 William Birdthistle, Director, SEC Division of Investment Management, Remarks at the ICI Investment Management Conference (Mar. 28, 2022) [hereinafter Birdthistle Speech], available at *https://www.sec.gov/news/speech/birdthistle-remarks-ici-investment-management-conference-032822.*

3 For example, Director Birdthistle answered questions at the American Bar Association Business Section Meeting held on September 22-24, 2022 and the ALI CLE Conference on Life Insurance Products held on November 3-4, 2022.

4 Birdthistle Speech, *supra* n.2. Neither Director Birdthistle nor the SEC has made available empirical information regarding funds with poor returns and high fees. Ignites, a fee-based subscription service, has published a revealing three-part report on its identification and investigation of funds with poor returns and high fees and their directors, including: Greg Saitz, "High Fees, Poor Performance. That'll Be 10B in Advisory Fees," *Ignites.com* (Sept. 20, 2022); Greg Saitz, "'Widows and Orphans'? Who Owns High-Fee, Poor-Return Funds," *Ignites.com* (Nov. 1, 2022); and "Years of Poor Returns and High Fees? Look at Director Tenure," *Ignites.com* (Dec. 13, 2022).

5 Birdthistle Speech, *supra* n.2.

6 *Id.*

7 *Id.*

8 *Id.*

9 *Id.*

10 *Id.*

11 *Id.*

12 The Second Circuit said that "the test is essentially whether the fee schedule represents a charge within the range of what would have been *negotiated* at arm's-length in the light of all of the surrounding circumstances" and that "the Trustees were aware of or could obtain the essential facts needed to *negotiate* a reasonable fee." Gartenberg v. Merrill Lynch Asset Mgmt., 694 F.2d 923 (2d. Cir. 1982) (emphasis added) [hereinafter *Gartenberg II*], available at *https://www.casemine.com/judgement/us/5914c325add7b049347c43c6*, (*aff'g* Gartenberg v. Merrill Lynch Asset Mgmt., 528 F. Supp. 1038 (S.D.N.Y. 1981) (identifying the essential facts needed to negotiate a reasonable fee) [hereinafter *Gartenberg I*], available at *https://law.justia.com/cases/federal/district-courts/FSupp/528/1038/1765368/)*.
In upholding the Second Circuit's decision quoted above, the US Supreme Court said:

> In *Gartenberg*, the Second Circuit noted that Congress had not defined what it meant by a "fiduciary duty" with respect to compensation but concluded that "the test is essentially whether the fee schedule represents a charge within the range of what would have been *negotiated* at arm's-length in the light of all of the surrounding

circumstances." 694 F.2d, at 928. The Second Circuit elaborated that "[t]o be guilty of a violation of §36(b), . . . the adviser-manager must charge a fee that is so disproportionately large that it bears no reasonable relationship to the services rendered and could not have been the product of arm's-length *bargaining*."

Jones v. Harris Assoc., 559 U.S. 335, 344 (2010) (holding that the appropriate standard for determining whether a fund's adviser violated its fiduciary duty under Section 36(b) is the standard set forth in *Gartenberg I* and *II, id.*) (emphasis added) [hereinafter *Jones*], available at *https://supreme.justia.com/cases/federal/us/559/335/*.

13 The US Supreme Court said:

Where a board's process for negotiating and reviewing investment-adviser compensation is robust, a reviewing court should afford commensurate deference to the outcome of the bargaining process. See *Burks,* 441 U. S., at 484 (unaffiliated directors serve as "independent watchdogs" . . .). Thus, if the disinterested directors considered the relevant factors, their decision to approve a particular fee agreement is entitled to considerable weight, even if a court might weigh the factors differently.

Jones, 559 U.S. at 351.

14 Section 36(b) provides for a fiduciary duty, as follows:

[T]he investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser.

Section 36(b) goes on to provide for the enforcement of that fiduciary duty, in relevant part as follows:

An action may be brought under this subsection by the Commission, or by a security holder of such registered investment company on behalf of such company, against such investment adviser, or any affiliated person of such investment adviser, or any other person enumerated in subsection (a) of this subsection who has a fiduciary duty concerning such compensation or payments, for breach of fiduciary duty in respect of such compensation or payments paid by such registered investment company or by the security holders thereof to such investment adviser or person.

15 Director Birdthistle has said: "To enforce this [adviser fiduciary] duty, fund shareholders or the Commission may bring an action under this subsection [of 36(b)]. No plaintiff has yet won a 36(b) case, but if no adviser can ever lose one—and none has, so far—one wonders whether the duty enacted in the statute is truly being honored." *Id.* For a discussion of the SEC's general hesitancy to initiate litigation, *see* Gary O. Cohen, "SEC's Hesitancy to Intervene in Litigation to Correct Misstatements Regarding the Federal Securities Laws," *The Investment Lawyer,* Vol. 27, No. 4 at 39, 40 (Apr. 2020). For a report on private lawsuits brought under Section 36(b) since 2010, *see* ICI Mutual, Section 36(b) Litigation Since Jones v. Harris: An Overview for Investment Advisers and Fund Independent Directors (2016), available at *https://www.icimutual.com/system/files/Section%2036%28b%29%20Litigation%20Overview.pd.*

16 Section 15(a). Industry practice is for approval to be by the sole initial shareholder who provides the minimum seed capital of $100,000 required by Section 14(a). Rules 15a-1, 15a-3, and 15a-4 provide exemptions in specified situations.

17 Section 15(a)(2). The Section provides that continuance after *initial* approval may continue for two years without board approval. The Section also provides that continuance may be by shareholders, but this has not been industry practice because of the effort

and expense of the shareholder meeting and proxy process. Rule 15a-2, in effect, defines what constitutes annual approval.

18 Section 15(a)(1).

19 Section 15(a)(3). The Section provides that advisory contracts cannot require notice of more than 60 days.

20 Section 15(a)(4). The term "assignment" is defined in Section 2(a)(4).

21 Section 15(c).

22 *Id.* Section 15(c) does not *expressly* require the minutes of a fund's board meeting to describe the factors considered and the basis for the decision to adopt or continue an advisory contract. In contrast, Rule 12b-1(d) refers to an SEC discussion of possibly relevant factors and requires that "minutes describing the factors considered and the basis for the decision to use company assets for distribution must be made and preserved" for specified periods. *Gartenberg I,* 528 F. Supp at 1059-1065, and *Jones*, 559 U.S. at 344 and n.5, address the factors relevant to a fund board decision to adopt or continue an advisory contract. Prevailing industry practice is for a fund or its independent trustees to submit a written request to its adviser for information regarding those and other factors and receive a written response that become part of the fund board meeting materials. In addition, the SEC has adopted requirements for disclosure, in fund shareholder reports, proxy statements, and statements of additional information of how their boards evaluate and approve, and recommend shareholder approval of, advisory contracts. The SEC requires disclosure regarding the material factors and the conclusions with respect to those factors that formed the basis for the board's approval of advisory contracts. *See Disclosure Regarding Approval of Investment Advisory Contracts by Directors of Investment Companies,* Securities Act Release No. 8433, Exchange Act Release No. 49909, Investment Company Act Release No. 26486 (June 23, 2004), available at *https://www.sec.gov/rules/final/33-8433.htm#IIA.*

23 Section 15(c).

24 *Gartenberg I*, 528 F. Supp. at 1059-1065.

25 *Jones*, 559 U.S. at 344 and n.5. Regarding the extent to which the minutes of board meetings are required to record these factors, *see supra* n.22.

26 *Gartenberg I,* 528 F. Supp at 1059-1065, and *Jones*, 559 U.S. at 344 and n.5.

27 *In the Matter of Commonwealth Capital Management, et al,* SEC Investment Company Act Release No. 31678 (June 17, 2015) [hereinafter Commonwealth Order], available at *https://www.sec.gov/litigation/admin/2015/ic-31678.pdf*, and *In the Matter of Northern Lights Compliance Services*, Investment Company Release No. 30502 (May 2, 2013) [hereinafter Northern Lights Order], available at *https://www.sec.gov/litigation/admin/2013/ic-30502.pdf*.

28 *In the Matter of Kornitzer Capital Management, et al.*, Investment Company Act Release. No 31560 (Apr. 21, 2015), available at *https://www.sec.gov/litigation/admin/2015/ic-31560.pdf#:~:text=INVESTMENT%20COMPANY%20ACT%20OF%201940%20Release%20No.%2031560,April%2021%2C%202015%20ADMINISTRATIVE%20PROCEEDING%20File%20No.%203-16503.*

29 Northern Lights Order, *supra* n.27, at 7; Commonwealth Order, *supra* n.27, at 7.

30 Northern Lights Order, *supra* n.27, at 1, 3; Commonwealth Order, *supra* n.27, at 1,3.

31 Northern Lights Order, *supra* n.27, at 13; Commonwealth Order, *supra* n.27, at 14.

32 Northern Lights Order, *supra* n.27, at 16; Commonwealth Order, *supra* n.27, at 14.

33 Commonwealth Order, *supra* n.27, at 13.

34 Northern Lights Order, *supra* n.27, at 12.

35 *Id.*

36 *Id.*

37 Northern Lights Order, *supra* n.27, at 14.

38 *See supra* n.3 and accompanying text.

39 Rule 0-1(a)(7)(v) requires, as one of the seven specified "Fund Governance Standards," that "[t]he board of directors evaluates at least once annually the performance of the board of directors and the committees of the board of directors, which evaluation must include a consideration of the effectiveness of the

committee structure of the fund board and the number of funds on whose boards each director serves."

40 US Securities and Exchange Commission, 2022 Examination Priorities Division of Examinations 11-16 (Mar. 2022), available at *https://www.sec.gov/files/2022-exam-priorities.pdf.*

41 *Id*. at 18.

42 Gary Gensler, "The Great Mutual Fund Trap" (2002) [hereinafter Chair Gensler's Book]. For a summary and discussion of the book, *see* Gary O. Cohen, "SEC Chair Gensler's Mutual Fund Views Revealed in His Book," *The Investment Lawyer*, Vol. 28, No. 11, at 21 (Nov. 2021), and Gary O. Cohen, "SEC Chair Gensler and IM Division Director Birdthistle Books Show Imprecise Knowledge of Variable Insurance Contracts," *The Investment Lawyer*, Vol. 29, No. 6, at 26 (June 22, 2022) [hereinafter Cohen articles].

43 Chair Gensler's Book, *id*. at 115.

44 *Id*. at 112-113.

45 *Id.* at 113.

46 *Id.*, *quoting* US Supreme Court Justice William Brennan from Burks v. Lasker, 441 U.S. 471, 484 (1979), available at *https://supreme.justica.com/cases/federal/us/441/471/).*

47 Chair Gensler's Book, *supra* n.42, at 112.

48 *Id.*

49 *Id.*

50 *Id.*

51 *Id.*

52 *Id.*

53 William A. Birdthistle, "Empire of the Fund" (2016) [hereinafter Director Birdthistle's Book]. For a summary and discussion of the book, *see* Gary O. Cohen, "SEC IM Division Director William Birdthistle's Mutual Fund Views Revealed in His Book," *The Investment Lawyer,* Vol. 25, No. 4 (Apr. 2022), and Cohen Articles, *supra* n.42.

54 Birdthistle's Book, *id.* at 72.

55 *Id.* at 17 (footnote omitted). Funds "can carry hidden dangers." *Id.* at 9.

56 *Id*. at 30 (footnote omitted).

57 *Id.* at 215.

58 *Id.* (footnote omitted).

59 *Id*. at 37. Fund "trustees" are the equivalent of fund "directors" for funds organized as a Delaware statutory trust or a Massachusetts business trust.

60 *Id*. at 216.

61 *Id.*

62 *Id.*

63 The ICI has found as follows:

> Mutual funds provide investors with many investment-related services, and for those services, investors incur two primary types of expenses and fees: ongoing expenses and sales loads. *Average expense ratios (i.e., ongoing expenses) paid by US mutual fund investors have fallen substantially over time*. For example, on an asset-weighted basis, average expense ratios for equity mutual funds fell from 0.99 percent in 2000 to 0.47 percent in 2021, a 53 percent decline.

Investment Company Institute, 2022 Investment Company Fact Book 98 (2022) (emphasis added) [hereinafter ICI Fact Book], available at *https://icifactbook.org/*. Director Birdthistle has endorsed the ICI Fact Book, but has noted the absence of standalone information about advisory fees, as follows:

> For many years, I have been an avid consumer of the ICI's Fact Book, which really is well named—it's filled with hundreds of pages of facts and extraordinary data, some of which I cited earlier. Thank you, ICI, for publishing it, and bravo on the excellent work. But one datum that's hard to find in that remarkable almanac is a single number of great public interest: what does the industry make each year in fees? In my view such information could inform the general discussion about competition in the industry.

Birdthistle Speech, *supra* n.2.

64 The ICI has found, with emphasis added, as follows:

> *[S]hareholders tend to invest in mutual funds with below-average expense ratios* (Figure 6.3). The

simple average expense ratio of equity mutual funds (the average for all equity mutual funds offered for sale) was 1.13 percent in 2021. The asset-weighted average expense ratio for equity mutual funds (the average shareholders actually paid) was far lower, at 0.47 percent. Another way to illustrate the *tendency for investors to gravitate to lower-cost funds* is to examine how the allocation of their assets across funds varies by expense ratio. At yearend 2021, equity mutual funds with expense ratios in the lowest quartile held most (78 percent) of equity mutual funds' total net assets (Figure 6.4). This pattern holds for both actively managed and index equity mutual funds. Actively managed equity mutual funds with expense ratios in the lowest quartile held 70 percent of actively managed equity mutual funds' net assets at yearend 2021, and lower-cost index equity mutual funds held 84 percent of index equity mutual funds' net assets.

ICI Fact Book, *supr*a n.63 (emphasis added).

65 Birdthistle Speech, *supra* n.2 and accompanying text.

66 SEC, Report on Public Implications of Investment Company Growth, Report of the Committee on Interstate and Foreign Commerce Pursuant to Section 136 of the Legislative Reorganization Act of 1946, Public Law 601, 79th Congress, and House Resolution 35, 89th Congress, 2d Sess. 209 (1966) (footnote omitted), available at *http://3197d6d14b5f19f2f440-5e13d29c4c016cf-96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1960/1966_InvCoGrowth_CH5A.PDF.*

67 SEC Division of Investment Management Regulation, Mutual Fund Distribution and Section 22(d) of the Investment Company Act of 1940 at 86 (1974) (emphasis added), available at *https://www.sec.gov/divisions/investment/report-mutual-fund-distribution-22d.pdf.*

68 SEC Division of Investment Management, Protecting Investors: A Half Century of Investment Company Regulation 297 (May 1992) (emphasis added), available at *https://www.sec.gov/divisiions/investment/guidance/icreg50-92.pdf.*

69 *Id.* at 345 (emphasis added).

70 SEC Division of Investment Management, Report on Mutual Fund Fees and Expenses I.A. (Dec. 2000) (emphasis added), available at *https.//www.sec.gov/news/studies/feestudy.htm.*

71 *Tailored Shareholder Reports for Mutual Funds and Exchange-Traded Funds; Fee Information in Investment Company Advertisements,* Securities Act Release No. 11125, Exchange Act Release No. 96158, Investment Company Act Release No. 34731(Oct. 26, 2022), available at *https://www.sec.gov/rules/final/2022/33-11125.pdf.*

72 *Id.* at 265 (emphasis added; footnote omitted).

73 *Id*.

74 *Id*.

75 *Id*. at 265-256.

76 *Id*. at 266 (emphasis added).

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