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Channel Anger at Wall Street Pay, Not Fund Fees

Opinion - Channel Anger at Wall St. Pay, Not Fund Fees

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Americans are outraged over bloated executive pay — and rightly so. When a Richard Fuld (Lehman Bros.), Stanley O'Neal (Merrill Lynch) or Chuck Prince (Citigroup) rakes in millions of dollars from a firm spiraling downward, employees, shareholders and lawmakers have every reason to question how public corporations are governed.

The distinguished Judge Richard Posner of the 7th Circuit Court of Appeals nailed the problem when he wrote last year: "Executive compensation in large publicly traded firms often is excessive because of the feeble incentives of boards of directors to police compensation."

But what does this have to do with mutual funds?

The answer: Nothing. While corporate shareholders watched more and more of their potential dividends flow to top executives, fees and expenses that mutual fund investors pay fell by about 60% over the last three decades.

And while some irresponsible corporate boards fueled a cycle of can-you-top-this CEO pay packages, independent mutual fund directors were scrutinizing the performance, costs, and competitiveness of fund advisers, driving better deals for the shareholders they represent.

Unfortunately, Judge Posner chose to unleash his anger in an opinion he wrote on Jones v. Harris Associates LP. At issue in Jones: the legal standards used to weigh whether a mutual fund's advisory fees are excessive. Posner's comments were manna from heaven for trial lawyers, who are eager to turn unfounded allegations about fund fees into a steady stream of lucrative lawsuits.

So as Jones moves to the Supreme Court, with arguments scheduled for next Monday, Nov. 2, the plaintiffs bar gloats whenever gullible commentators use this case to hammer on padded paychecks.

The real story of mutual fund fees is far different.

The fund industry is virtually a textbook case of a competitive market. More than 8,000 mutual funds vie daily for the dollars of cost-conscious investors. If investors are happy with the price, performance, and service of their fund, they stay and invest more. If not, they walk — because it only takes a couple phone calls or a few clicks of the mouse to move to another fund.

There's plenty of evidence that investors do just that: In any given year, 25% to 70% of mutual fund advisers experience net outflows.

Funds have no choice but to compete, because investors have ready access to a wealth of information on every fund — and all of its competitors. Investors can mine a rich vein of fund data on fund Web sites, investing Web sites, and easy-to-use rating services like Morningstar and Lipper.

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