The Mutual Fund Industry Today:
“Conflicts, Conflicts Everywhere”*

John C. Bogle
United States Securities
And Exchange Commission
Asset Management Unit
April 28, 2015

*Title of a speech by Julie Riewe, Co-Chief of Asset Management Unit, Division of Enforcement

NOTE: The views I express in this speech and the visuals that follow are my own and do not necessarily reflect the views of Vanguard’s present management.

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2. A Tiny Industry Grows into a Behemoth

![Graph showing growth of mutual fund assets from 1951 to 2015.]

Total Assets
March 2015
- Equity: $9.9T
- Bond: $3.7T
- Money Market: $2.5T
- Balanced: $740B
- TOTAL: $16.9T

Total Assets
December 1951
- Equity: $2.45B
- Balanced: $680M
- TOTAL: $3.13B

Annual Growth Rate 1951-2015: 15%

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3. Mutual Fund Industry Leaders:
Then and Now

<table>
<thead>
<tr>
<th>Rank</th>
<th>1951 Fund Name</th>
<th>1951 Total Assets (Millions)</th>
<th>2015 Manager Name</th>
<th>2015 Total Assets (Billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>M.I.T.</td>
<td>5472</td>
<td>Vanguard</td>
<td>$2,988</td>
</tr>
<tr>
<td>2</td>
<td>Investors Mutual</td>
<td>365</td>
<td>Fidelity</td>
<td>1,615</td>
</tr>
<tr>
<td>3</td>
<td>Keystone Funds</td>
<td>213</td>
<td>BlackRock</td>
<td>1,230</td>
</tr>
<tr>
<td>4</td>
<td>Tri-Continental</td>
<td>209</td>
<td>American Funds</td>
<td>1,216</td>
</tr>
<tr>
<td>5</td>
<td>Affiliated Funds</td>
<td>209</td>
<td>JPMorgan Funds</td>
<td>519</td>
</tr>
<tr>
<td>6</td>
<td>Wellington Fund</td>
<td>194</td>
<td>State Street</td>
<td>497</td>
</tr>
<tr>
<td>7</td>
<td>Dividend Shares</td>
<td>186</td>
<td>T Rowe Price</td>
<td>493</td>
</tr>
<tr>
<td>8</td>
<td>Fundamental Investors</td>
<td>179</td>
<td>Franklin Templeton</td>
<td>480</td>
</tr>
<tr>
<td>9</td>
<td>State Street Investment</td>
<td>106</td>
<td>PIMCO</td>
<td>375</td>
</tr>
<tr>
<td>10</td>
<td>Boston Fund</td>
<td>106</td>
<td>Federated</td>
<td>272</td>
</tr>
</tbody>
</table>

Total 1951: $2,239 Total 2015: $9,686
Percentage of Industry 1951: 72% Percentage of Industry 2015: 57%

Total industry assets: $3.1 billion.
Total industry assets: $16.9 trillion

*Includes associated funds.

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4. Huge Growth in the Number of Funds

![Graph showing growth in the number of mutual funds from 1951 to 2015.]

Huge Growth
7.5% annual growth rate 1951-2015

1951: 103 Funds
1960: 160 Funds
1970: 564 Funds
1980: 3,824 Funds
1990: 9,001 Funds
2000: 10,000 Funds
2015: 10,000 Funds
Note: 12 of today’s 20 largest firms did not exist (or did not manage mutual funds) in 1951, including BlackRock, PIMCO, State Street Global, and JP Morgan.

<table>
<thead>
<tr>
<th>Original Name</th>
<th>M.I.T.</th>
<th>Investors Mutual</th>
<th>Affiliated</th>
<th>Eaton &amp; Howard</th>
<th>Wellington</th>
<th>Fidelity</th>
<th>Putnam</th>
<th>American</th>
<th>T. Rowe Price</th>
<th>Dreyfus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assets (Millions)</td>
<td>$472</td>
<td>365</td>
<td>209</td>
<td>194</td>
<td>90</td>
<td>64</td>
<td>52</td>
<td>27</td>
<td>1</td>
<td>0.8</td>
</tr>
<tr>
<td>No. of Funds Managed</td>
<td>2</td>
<td>3</td>
<td>3</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Current Name</td>
<td>MFS</td>
<td>Columbia</td>
<td>Lord Abbett</td>
<td>Vanguard</td>
<td>Eaton Vance</td>
<td>Fidelity</td>
<td>Putnam</td>
<td>American</td>
<td>T. Rowe Price</td>
<td>Dreyfus</td>
</tr>
<tr>
<td>Total Assets (Billions)</td>
<td>$180</td>
<td>165</td>
<td>108</td>
<td>2,988</td>
<td>101</td>
<td>1,615</td>
<td>81</td>
<td>1216</td>
<td>493</td>
<td>248</td>
</tr>
<tr>
<td>No. of Funds Managed</td>
<td>78</td>
<td>116</td>
<td>37</td>
<td>140</td>
<td>130</td>
<td>321</td>
<td>77</td>
<td>35</td>
<td>116</td>
<td>151</td>
</tr>
<tr>
<td>Average</td>
<td>Total/Average</td>
<td>$1,475</td>
<td>1.7</td>
<td>Total/Average</td>
<td>$7,195</td>
<td>120</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Ownership types: (C) Conglomerate, (SH) public shareholders, (P) private, (M) mutual


<table>
<thead>
<tr>
<th>Major Mutual Fund Groups</th>
<th>1951</th>
<th>2015</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>MIT/MFS (C)</td>
<td>0.42%</td>
<td>1.29%</td>
<td>+208%</td>
</tr>
<tr>
<td>Investors Mutual/Columbia (C)</td>
<td>0.56%</td>
<td>1.15%</td>
<td>+105%</td>
</tr>
<tr>
<td>Eaton Howard/Eaton Vance (SH)</td>
<td>0.64%</td>
<td>1.27%</td>
<td>+99%</td>
</tr>
<tr>
<td>Putnam (C)</td>
<td>0.66%</td>
<td>1.31%</td>
<td>+98%</td>
</tr>
<tr>
<td>Fidelity (P)</td>
<td>0.63%</td>
<td>1.06%</td>
<td>+68%</td>
</tr>
<tr>
<td>T. Rowe Price (SH)</td>
<td>0.50%</td>
<td>0.84%</td>
<td>+68%</td>
</tr>
<tr>
<td>Affiliated/Lord Abbett (P)</td>
<td>0.75%</td>
<td>1.12%</td>
<td>+49%</td>
</tr>
<tr>
<td>American (P)</td>
<td>0.84%</td>
<td>0.99%</td>
<td>+17%</td>
</tr>
<tr>
<td>Average</td>
<td>0.62%</td>
<td>1.13%</td>
<td>+80%</td>
</tr>
</tbody>
</table>

Ownership types: (C) Conglomerate, (SH) public shareholders, (P) private, (M) mutual

7. Changing Composition by Asset Class 1945-2015

8. Equity Funds—Less Predictability

<table>
<thead>
<tr>
<th>Relative Volatility*</th>
<th>1951-56</th>
<th>2009-15**</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over 1.11</td>
<td>0%</td>
<td>18%</td>
<td>+18%</td>
</tr>
<tr>
<td>0.95-1.11</td>
<td>34</td>
<td>53</td>
<td>+19</td>
</tr>
<tr>
<td>0.85-0.94</td>
<td>30</td>
<td>16</td>
<td>-14</td>
</tr>
<tr>
<td>0.70-0.84</td>
<td>36</td>
<td>10</td>
<td>-24</td>
</tr>
<tr>
<td>Below 0.70</td>
<td>0</td>
<td>4</td>
<td>+4</td>
</tr>
</tbody>
</table>

* S&P 500 = 1.00
** Sample of the 200 largest equity funds.
Then, Long-Term Shareholders, Now . . . ?

Equity Fund Redemption Rates

Redemptions and Exchanges Out as a Percentage of Average Net Assets

Source: Investment Company Institute

Challenges Faced by Investors in Active Funds

1. High Costs—2% annual cost = 63% of the 50-year return on stocks.
2. Critical erosion (60%+) of dividend income.
4. High Turnover—130% of assets (purchases and sales).
5. Marketing—“We make what will sell.” Fund failure rate 50% per decade.
6. Investor (and salesman) focus on past returns.
7. Outside ownership of managers (39 of top 50).
RESULT: Stewardship descends, salesmanship ascends

Redemption Rates

U.S. and International Equity Funds

U.S. and International Equity Funds

Do Costs Matter? A Powerful Example

Growth of $1—1924-2014

Annual Return

$13.69
$10.99
0.39

Relative Return: MIT / S&P 500: -61%
“The Arithmetic of All-In Investment Expenses”

Financial Analysts Journal

<table>
<thead>
<tr>
<th>Actively Managed Fund</th>
<th>Index Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expense Ratio</td>
<td>1.12%</td>
</tr>
<tr>
<td>Transaction Costs</td>
<td>0.50</td>
</tr>
<tr>
<td>Cash Drag</td>
<td>0.15</td>
</tr>
<tr>
<td>Sales Charges/Fees</td>
<td>0.50</td>
</tr>
<tr>
<td>All-In Expenses</td>
<td>2.27%</td>
</tr>
<tr>
<td>Tax Inefficiency</td>
<td>0.75</td>
</tr>
<tr>
<td>Total Costs</td>
<td>3.02%</td>
</tr>
<tr>
<td>Gross Return (assumed)</td>
<td>7.00%</td>
</tr>
<tr>
<td>Net Return</td>
<td>3.98%</td>
</tr>
<tr>
<td>Loss in Annual Return</td>
<td>-2.66%</td>
</tr>
</tbody>
</table>

Note: Counterproductive investor behavior (buying high and selling low) has historically reduced returns to active fund investors by another 1.5-2.0% annually according to Morningstar.

The Miracle of Compounding Long-Term Returns Without the Tyranny of Compounding Long-Term Costs

Growth of $10,000 over a 50-year investment lifetime

Impact of Compounding Costs on Wealth:
- Loss in Capital Accumulation: 75%

Dividend Yields and Expense Ratios

Percent of Income Consumed: Active Funds vs. Index Funds

Better than the Morningstar Rating System?

“Investors should make expense ratios a primary test in fund selection. They are still the most dependable predictor of performance.”

Russel Kinnel
Morningstar, August 2010
It’s Not Just Me… Fama French, 2010

“The 3% Solution”
“…[G]oing forward we expect that a portfolio of low cost index funds will perform about as well as a portfolio of the top three percentiles of past active winners, and better than the rest of the active fund universe.”

Source: “Luck versus Skill in the Cross-Section of Mutual Fund Returns,” The Journal of Finance, October 2010

Lack of Persistence in Performance of Active Mutual Funds

<table>
<thead>
<tr>
<th>Quintile</th>
<th>5-Year Return*</th>
<th>Number of Funds</th>
<th>Where they ranked in the subsequent 5 years</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Highest Quintile</td>
</tr>
<tr>
<td>1</td>
<td>Highest</td>
<td>1,091</td>
<td>14%</td>
</tr>
<tr>
<td>2</td>
<td>High</td>
<td>1,083</td>
<td>12</td>
</tr>
<tr>
<td>3</td>
<td>Medium</td>
<td>1,084</td>
<td>15</td>
</tr>
<tr>
<td>4</td>
<td>Low</td>
<td>1,085</td>
<td>14</td>
</tr>
<tr>
<td>5</td>
<td>Lowest</td>
<td>1,032</td>
<td>14</td>
</tr>
<tr>
<td>Total</td>
<td>5,375</td>
<td>14%</td>
<td>14%</td>
</tr>
</tbody>
</table>

*Excess return vs. benchmark.
Note: Number of failed funds—1,499

Aren’t There Mutual Funds That Avoid These Problems?

Yes, but not very many.

Typical characteristics these funds share:
1. Managers, not marketers.
2. Reasonable expense ratios.
3. Low portfolio turnover.
4. Self-imposed stern limits on size.
5. Interim returns that may vary sharply from the market’s return.
6. Investment professionals own and operate the management company.
### “The Colossal Failure”

“[T]he colossal failure of the mutual fund industry; resulting from [its] systematic exploitation of individual investors . . . extract[ing] enormous sums from investors in exchange for providing a shocking disservice. … Thievery, even when dressed in the cloak of SEC-approved governance, remains thievery . . . as the powerful financial services industry exploits vulnerable individual investors.”

*David Swensen, manager of Yale University’s endowment fund*

### Mutual Funds Are the Only Practical Option for Individual Investors

“The vast majority of American families are sentenced to a lifetime of investing in the existing mutual fund penal system. But if they’re smart, they’ll do their time in an index fund.”

*John Bogle*

Grant’s “Great Debate”

April 7, 2015

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### Enter Vanguard

“The Vanguard plan actually furthers the objectives [of the Investment Company Act of 1940] by ensuring that the Funds’ directors … are better able to evaluate the quality of services rendered to the funds … improved disclosure to shareholders … promotes savings from economies of scale … clearly enhances the Funds’ independence … provides them with conflict-free control over distribution … and promotes a healthy and viable fund complex within which each fund can better prosper.” (Unanimous decision, 1981)

### Strategy Follows Structure

<table>
<thead>
<tr>
<th>MUTUAL STRUCTURE</th>
<th>INDUSTRY STRUCTURE</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>STRATEGY</strong></td>
<td><strong>STRATEGY</strong></td>
</tr>
<tr>
<td>Prioritize fund shareholders</td>
<td>Prioritize management company</td>
</tr>
<tr>
<td>Leads to Pricing</td>
<td>Leads to Pricing</td>
</tr>
<tr>
<td>Lower costs for fund owners</td>
<td>Higher costs for fund owners (e.g., 108 bps)</td>
</tr>
<tr>
<td>Leads to Impact to investors</td>
<td>Leads to Impact to investors</td>
</tr>
<tr>
<td>Index Funds Equity 5 bps</td>
<td>Greater Risks</td>
</tr>
<tr>
<td>Leads to Offset Costs</td>
<td>For Fund Owners to Offset Costs</td>
</tr>
<tr>
<td>Higher profits for fund investors</td>
<td>Leads to Lower profits for fund investors</td>
</tr>
</tbody>
</table>

<table>
<thead>
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<td>For Fund Owners to Offset Costs</td>
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</tr>
<tr>
<td>Leads to Impact to investors</td>
<td>Higher costs for fund owners (e.g., 108 bps)</td>
</tr>
<tr>
<td>Higher revenue and profit</td>
<td>Leads to Impact to investors</td>
</tr>
</tbody>
</table>

Long-term result

- Increasing market share
- Lower revenue and no profit
- Higher revenue and profit
- Decreasing market share

For Fund Owners to Offset Costs | Lower profits for fund investors
25. Vanguard Cash Flow Growth

Cumulative Net Cash Flow into Vanguard Funds

Billions of Dollars

$-250M $8B $106B $547B $993B $1.6T


5-Year Average Annual Cash Flow/Assets

-0.7% 26.2% 20.0% 15.8% 13.9% 7.3% 7.9% 7.0%

26. Vanguard’s Market Share of Stock and Bond Funds

Previous Industry Leaders

MIT 15% (1924-1953)
IDS/Columbia 14% (1954-1978)
Fidelity 13% (1979-2005)
Vanguard 20% (2015e)

19.7% 14.6% 11.8% 9.8% 6.6% 6.6% 4.1% 5.9%


27. Vanguard Dominating Industry Cash Flow

Mutual Fund Industry Net Cash Flow First Quarter 2015

Vanguard accounted for 133% of the mutual fund industry’s net cash flow in 1Q 2015

Industry Total $63 Billion

Vanguard +$83 Billion

All Other Firms -$20 Billion

28. Vanguard’s Key Strategy: Indexing

Initial Reaction

1975—First Index Investment Trust

*Name changed to Vanguard 500 Index Fund in 1980.
Index Funds Dominate Vanguard’s Assets

Percentage of Assets Under Management

- Equity: 82% (Active), 56% (Virtual Index), 18% (Index)
- Bond: 15% (Active), 23% (Virtual Index), 26% (Index)
- Balanced: 21% (Active), 56% (Virtual Index), 19% (Index)
- Total: 72% (Active), 56% (Virtual Index), 19% (Index)

Note: “Virtual Index Fund” – R-Squared of 0.96 or higher relative to its best-fit index.

U.S. Equity Fund Cumulative Net Cash Flow, 2006-2014
Passive Index Funds versus Actively Managed Funds

Cumulative Net Cash Flow into Index and Active Mutual Funds and ETFs

- Index: $917 Billion
- Active: -$597 Billion

Source: Strategic Insight Simfund

Indexing Market Share

Index Strategies as a Percentage of Total U.S. Institutional Equity Assets

- Mutual Funds: 31% (2004), 37% (2014)
- Pension Funds: 18% (2004), 26% (2014)

Total Indexing Assets and Market Share

- 2004: 24%
- 2014: 32%

Source: Strategic Insight Simfund, Empirical Research Partners

Growth of Equity Index Fund Assets

- Active: $49B to $1.5T, Annual Increase: +19%
- Index: $48B to $1.1T, Annual Increase: +45%
- Total: $49B to $3.3T, Annual Increase: +23%

Total Index Fund Assets

- 1995: $48B
- 2015: $1.63T
- 2014: $1.5T

Source: Strategic Insight Simfund
Convergence!

John C. Bogle
“The Art of Indexing” Conference
Washington, DC
September 30, 2004

First Index Mutual Fund (1974)—Principles
• Own the U.S. stock market
• Diversify to the Nth degree
• Minimize transaction costs
• Tiny expense ratio—500 Index: 0.05% (Admiral)
• Bought to be held “forever” (redemption rate 10%)

Exchange-Traded Index Funds (1993)—Principles
• Pick your own index (1,100 now available)
• Diversify within sector you chose
• Lower expenses … but not too low (0.50%)
• Bought to be traded (average annual turnover of large ETFs: 1244%)

ETF Turnover

<table>
<thead>
<tr>
<th>ETF</th>
<th>2014 Dollar Turnover as a Percentage of Average Annual Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>SPDR S&amp;P 500 ETF</td>
<td>2724%</td>
</tr>
<tr>
<td>iShares Core S&amp;P 500</td>
<td>337%</td>
</tr>
<tr>
<td>iShares MSCI EAFE</td>
<td>524% Asset-Weighted Turnover, 20 Largest ETFs: 1244%</td>
</tr>
<tr>
<td>Vanguard Total Stock Market ETF</td>
<td>144%</td>
</tr>
<tr>
<td>Vanguard FTSE Emerging Markets ETF</td>
<td>319%</td>
</tr>
<tr>
<td>Vanguard S&amp;P 500 ETF</td>
<td>274%</td>
</tr>
<tr>
<td>iShares Russell 2000</td>
<td>725%</td>
</tr>
<tr>
<td>SPDR Gold Shares</td>
<td>725%</td>
</tr>
</tbody>
</table>

ETFs—The New Way to Speculate

2014 Trading Volume
100 Largest Stocks: $18.6 Trillion
100 Largest ETFs: $15.7 Trillion

2014 Turnover Rate
100 Largest Stocks: 179%
100 Largest ETFs: 1428%
Costs and Indexing—More Important than Ever

<table>
<thead>
<tr>
<th>Historical Returns</th>
<th>Prospective Active Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Return</td>
<td>Net Return</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>9%</td>
<td>8%</td>
</tr>
<tr>
<td>4%</td>
<td>4%</td>
</tr>
<tr>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>-3%</td>
<td>2%</td>
</tr>
<tr>
<td>-4%</td>
<td>3.95%</td>
</tr>
</tbody>
</table>

- Dividend Yield 4.5%
- Earnings Growth 2%
- Speculative Return 4%

What’s a Competitor to Vanguard to Do?

What’s a race car driver to do when he’s in last position?
- Increase speed—i.e., improve performance, more aggressive marketing, more money to distributors (a la life insurance)
- Reduce friction—i.e., cut fees, cut staff, cut research
- Copy the car in front—i.e., more indexing, less innovation
- Get a new car—i.e., focus on other lines of business, recordkeeping, benefit plans, venture capital, limousine services, etc.

The “Golden Rule” of the ’40 Act

Put the Shareholder First!

“... the national public interest and the interest of investors are adversely affected ... when investment companies are organized, operated [and] managed ... in the interest of directors, officers, investment advisers ... [or] underwriters ... rather than in the interest of ... such companies' security holders ...”

*Investment Company Act of 1940, Section 1.B.2.*

Copernicus Turned Upside-Down

Average Mutual Fund Group
Total Net Assets $25 Billion

Why isn’t the sun—500 times the size of the planet—at the center of this universe?

Average Fund
Management Company
Total Net Assets $50 Million

1993 data from *Bogle on Mutual Funds: New Perspectives for the Intelligent Investor*
**Tiny Transaction Transforms Giant Industry**

**Transaction**: Owners of ISI (book value $300,000) sold the manager to other investors for 14 times book value ($4.2 million).

SEC v. Insurance Securities, Inc., 1958

The Ninth Circuit Court of Appeals ruled that ISI could sell its fiduciary obligation to its fund shareholders, opening the floodgates to IPOs, mergers, “trafficking” in management contracts, and acquisitions of fund management companies.

By the mid-1960s, a score of fund management firms went public, including industry leaders Wellington, Vance Sanders, Dreyfus, Franklin and Putnam. Later, MFS, T. Rowe Price, State Street, American Century, Oppenheimer, Alliance, AIM, Delaware, and many others.

**It Wasn’t Supposed to Be That Way…**

For Paul Cabot, president of State Street Investment Trust, the private ownership of fund managers was essential. Indeed it represented a moral imperative for him, and he sharply criticized firms that would sell out to insurance companies and other financial institutions.* In 1971, he recalled the negotiations over the Investment Company Act of 1940: “Both the SEC and our industry committee agreed that the management contract between the fund and the management group was something that belonged … to the fund … and therefore the management group had no right to sell it … or to make money on the disposition of this contract … the fiduciary does not have the right to sell his job to somebody else at a profit.”

*In 1982, the private owners of State Street Management sold their company to the (ironically then-mutual) Metropolitan Life Insurance for a profit of $100 million.

**Ownership of 50 Largest Mutual Fund Management Companies—2015**

- **Privately Owned (10)**
- **Plus Mutual (1)**
- **Publicly Owned (11)** (Includes 3 largest firms)
- **Conglomerate (28)**

Total Firms with Public Ownership: 39

**Public Ownership and Professional Organizations**

From my 1971 speech to the partners of Wellington Management Company:

I reveal an ancient prejudice of mine: All things considered ... it is undesirable for professional enterprises to have public stockholders ... The pressure for earnings and earnings growth engendered by public ownership is antithetical to the responsible operation of a professional organization.

Note: Wellington, now private, was then publicly-owned.
Fiduciary Duty
A Precept as Old as Holy Writ

No man can serve two masters: for either he will hate the one, and love the other; or else he will hold to the one, and despise the other.

Matthew 6:24

What’s To Be Done?

1. Reduce Conflicts
2. Disclose Conflicts

Reducing Conflicts: Structural Changes

• Funds’ board chairman must be an independent director*
• Board must have independent staff, reporting to the chairman*
• Regulation should move its focus from individual funds (industry, 1924-1940) to fund complexes (today’s industry)
• Ultimately, mutualization (full or partial)

*Applicable only to managers supervising assets of long-term funds of $25 billion or more, and operating 20 or more funds. In 2015, the 50 largest fund managers have aggregate assets of $12.4 trillion, 86% of the industry’s long-term assets.

Sunlight—Disclosing Conflicts

Improvements in Prospectus Disclosure
All investors should have access to these data:
• Redemption Rate—Redemptions + exchanges out as a percentage of average fund assets
• Fund expenses—percentage of investment income
• Fund return (time-wtd) vs. investor return (asset-wtd)
• Long-term vs. short-term capital gains distributions
• Turnover—Total purchases + total sales as a percentage of average fund assets
• All-in compensation of 5 highest-paid fund officers (comprehensive)
• Investment Advisory Fees—Rates and dollars (10-year history of each) Jones v. Harris Associates
What’s All This about “Basis Points?”

Jones v. Harris Associates
Brief for John C. Bogle as Amicus Curiae
in Support of Petitioners

It is important to distinguish between the already-high rates (as a percentage of assets) that advisers charge and the even more excessive dollar amounts that are produced by those fee rates. It was the huge increase in mutual fund assets and, therefore, the amount of mutual fund fees, that concerned the SEC in 1966, since the cost of providing advisory services (essentially, managing an investment portfolio) rises far more slowly than the fees generated by taking a percentage of the increase in assets. Yet courts have generally acceded to the advisers’ desire to frame any debate about fees in percentage—not dollar—terms, thereby giving advisers a license to charge fees that are unjustifiable by any standard.

High-Priced Index Funds and Fiduciary Duty

<table>
<thead>
<tr>
<th>Fund</th>
<th>Assets</th>
<th>Expense Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal Large Cap S&amp;P 500 Index</td>
<td>$4.7 B</td>
<td>0.74%</td>
</tr>
<tr>
<td>Voya US Stock Index</td>
<td>4.6 B</td>
<td>0.66</td>
</tr>
<tr>
<td>Columbia Large Cap Index</td>
<td>3.7 B</td>
<td>0.83</td>
</tr>
<tr>
<td>MM S&amp;P 500 Index</td>
<td>3.6 B</td>
<td>0.68</td>
</tr>
<tr>
<td>Dreyfus S&amp;P 500 Index</td>
<td>2.9 B</td>
<td>0.50</td>
</tr>
<tr>
<td>JP Morgan Equity Index*</td>
<td>1.9 B</td>
<td>1.20</td>
</tr>
<tr>
<td><strong>Total (87 Funds)</strong></td>
<td><strong>$19.3 B</strong></td>
<td><strong>0.85%</strong></td>
</tr>
<tr>
<td>Vanguard 500 Index-Admiral Shares</td>
<td>$143 B</td>
<td>0.05%</td>
</tr>
<tr>
<td>-Institutional Plus Shares</td>
<td>$85 B</td>
<td>0.02%</td>
</tr>
</tbody>
</table>

What were directors of these funds thinking?
S&P 500 Index Funds with Expense Ratios of 0.40% or More

The Wisdom of Warren Buffett

About Mutual Fund “Independent” Directors:

“Companies are not looking for Dobermans on the board; they are looking for cocker spaniels. Then they make sure their tails are wagging.”

“Negotiating with oneself seldom produces a barroom brawl.”

Warren Buffett

Corporate Pensions: The Elusive 8%

Corporate pension funds make unreasonable assumptions about future returns.

Pension de-risking and high expected returns are not compatible.

<table>
<thead>
<tr>
<th>Asset Allocation</th>
<th>Asset Allocation</th>
<th>Required Return</th>
<th>Reasonable Assumptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds</td>
<td>56%</td>
<td>3.75%</td>
<td>3%</td>
</tr>
<tr>
<td>Stocks</td>
<td>25</td>
<td>13.6</td>
<td>4</td>
</tr>
<tr>
<td>Others (Hedge Funds, Private Equity, etc.)</td>
<td>19</td>
<td>18.5</td>
<td>10</td>
</tr>
<tr>
<td>Total/Gross Return</td>
<td>100%</td>
<td>9.0%</td>
<td>4.6%</td>
</tr>
<tr>
<td>Less Investment Costs</td>
<td></td>
<td>-1.0%</td>
<td>-1.0%</td>
</tr>
<tr>
<td>Net Return</td>
<td>8.0%</td>
<td>3.6%</td>
<td></td>
</tr>
</tbody>
</table>
### The Road to Fiduciary Duty

1. **Price Competition**
   - Investor experience
   - Investor awareness
   - Complete disclosure

2. **Awaken the Independent Directors**
   - Awareness
   - Board structure
   - Mutualize?

3. **Lawmakers/Regulators**
   - DOL—Retirement Plans
   - SEC—Mutual Funds
   - Dodd-Frank

Believe me—WE WILL GET THERE!

### The Wisdom of Adam Smith

“The consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to only so far as it may be necessary for promoting that of the consumer. The maxim is so perfectly self-evident that it would be absurd to attempt to prove it.”

*The Wealth of Nations*

*1776*