



Highlights of [GAO-04-799](#), a report to the Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

Why GAO Did This Study

Mutual fund investments represent more than 20 percent of Americans' pension plan assets. Since late 2003, two abusive trading practices in mutual funds have come to light. Late trading allowed some investors to illegally place orders for funds after the close of trading. Market timing allowed some investors to take advantage of temporary disparities between the value of a fund and the value of its underlying assets despite stated policies against such trading. The Securities and Exchange Commission (SEC) has proposed regulations intended to stop late trading and reduce market timing. We were asked to (1) report on what is known about how these practices have affected the value of retirement savings of pension plan participants, (2) describe the actions taken by SEC and the Department of Labor (DOL) to address these practices, and (3) explain how plan participants may be affected by SEC's proposed regulations.

What GAO Recommends

GAO recommends that the SEC Commissioners adopt modifications or alternatives to the proposed regulations that would prevent pension plan participants from being more adversely affected than other investors.

In its response to GAO's draft report, SEC agreed with GAO's analysis and noted that it is considering modifications to the proposed regulations.

www.gao.gov/cgi-bin/getrpt?GAO-04-799.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Barbara Bovbjerg at (202) 512-7215 or bovbjerg@gao.gov.

MUTUAL FUNDS

SEC Should Modify Proposed Regulations to Address Some Pension Plan Concerns

What GAO Found

The cost of late trading and market timing to long-term investors in mutual funds is unclear; however, it does not appear that these abuses affected pension plan participants more than other investors. While individual instances of abusive trading may not have had a noticeable effect on the value of funds held by long-term investors, the cumulative effect of such trading may be significant. Among 34 brokerage firms surveyed by the SEC, more than 25 percent reported instances of illegal late trading at their firms. However, numerous fund intermediaries that are not regulated by the SEC may also have permitted late trading. Trading abuses can be difficult to identify because, among other reasons, fund brokers aggregate the transactions of their clients and often do not share details of individual transactions with mutual fund companies. Ultimately, the effect of trading abuses on the savings of plan participants and other long-term fund shareholders is a function of which funds they invested in and for how long.

SEC and DOL have taken steps to address abusive trading in mutual funds, and SEC has proposed regulations that aim to stop late trading and curb market timing. SEC and DOL are investigating these trading abuses, and SEC has already reached several settlements. DOL has issued guidance to pension plan sponsors and other plan fiduciaries on how they can fulfill their legal requirements to act "prudently" and in the best interests of plan participants who invest in mutual funds. To stop late trading, SEC has proposed that all fund transactions be received by mutual funds or designated processors before 4:00 p.m. eastern time in order for investors to receive the same day's price. To curb short-term trading, including market timing, SEC has proposed regulations that would impose a 2-percent fee on the proceeds of fund shares redeemed within 5 business days of purchase. DOL is not involved in the process of drafting these regulations because it does not regulate mutual funds, but it is considering how the proposals would affect pension plans.

To the extent that SEC's proposed regulations stop late trading and market timing, they would benefit long-term mutual fund investors; however, the new rules could also affect such investors adversely, and pension plan participants more than others. The new regulations are expected to increase costs (e.g., for technology upgrades) that would be passed on to long-term mutual fund investors. In addition, plan participants could be distinctly affected by the late trading proposal because it creates potential complications in processing certain transactions unique to pension plans (e.g., loans). Further, the market timing proposal may result in plan participants paying fees intended to deter market timing, even when there is clearly no intent to engage in abusive trading. SEC officials told us that they are considering changes and alternatives to the proposed regulations that would address these concerns.