Statement for the Record

on

"Mutual Fund Industry Practices And Their Effect On Investors"

before the

United States House of Representatives
Committee on Financial Services
Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises

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Introduction

Fidelity Investments commends Chairmen Oxley and Baker, Ranking Members Frank and Kanjorski and other distinguished Members of the Subcommittee for their review of mutual fund industry practices. We are pleased to have this opportunity to address the issue of fees and disclosures in the mutual fund industry. Given that nearly half of the nation's households (54.2 million) own shares of mutual funds, this is an issue that deserves to be addressed openly, fully and fairly.

Fidelity Investments is one of the largest providers of financial services in the United States, with managed assets of $759.6 billion at the end of January 2003. Fidelity provides investment management, retirement planning and brokerage services to 18 million Americans, directly or through financial intermediaries. Fidelity Investments is the largest mutual fund company in the United States, managing the investments of 286 U.S. mutual funds, and is the No. 1 provider of workplace retirement savings plans in the country. Fidelity employs more than 28,000 people in various locations throughout the United States.

The U.S. Mutual Fund Industry is Highly Competitive

Over the past generation, America's mutual fund industry has played a leading role in enabling the majority of American households to become investors in our securities markets through stock, bond and money market funds. During the decade of the 1990s, helped by popular investor education and a strong bull market for U.S. stocks, total customer assets managed by our nation's mutual fund industry grew from $1 trillion to almost $7 trillion. Similarly, the number of Americans who own shares of mutual funds rose from approximately 40 million in 1990 to nearly 95 million today.

Along the way, the American mutual fund industry democratized securities investing in this country, bringing to working families across America professional money management skills, broad diversification and a range of services once enjoyed only by wealthy investors. The industry also has become fiercely competitive, with more than 600 firms offering over 8,000 different mutual funds (or classes of funds) that compete for customer assets based on the strength of their investment performance, shareholder services and cost.

No single company or group of companies dominates the U.S. mutual fund market and the costs of entry into the market are low. One important result of industry competition and growth, as borne out in studies undertaken by the General Accounting Office and Securities and Exchange Commission completed in 2000, is that average mutual fund fees have been declining for many years, and that economies of scale realized over the years through asset growth have played an important part in reducing fund expenses for the industry.

As the Investment Company Institute has reported, when expenses paid by mutual fund investors and by funds themselves are together taken into account, since 1980, the average cost of equity mutual funds has decreased 43%, bond fund costs have decreased 41% and money market fund costs have decreased 34%.[1] This has occurred alongside the introduction of a host of new services and conveniences for investors, as well as dramatic growth of new types of investment products and choices for investors, such as international and asset allocation funds that are generally more costly to manage.

At Fidelity, we offer customers a basic value proposition: above-average investment performance and service, and below-average fees. Fidelity's mutual fund fees are consistently below industry medians. Morningstar, Inc., a leading mutual fund research firm, has referred to Fidelity as one of three "low-cost shops" that "deserve credit for keeping their expenses down,"[2] a point the SEC also noted in its December 2000 report on mutual fund fees and expenses. Along with being low-cost, Fidelity offers high performance. For example, for the year ended December 31, 2002, Fidelity funds beat 70% of their Lipper Inc. peers, on an asset-weighted basis, compared with 66% for the previous year, while for the three-year period ended December 31, 2002, Fidelity's funds beat 64% of their peers, besting the 61% three-year performance figure as of the end of 2001. Similar performance, putting Fidelity funds in the top two quartiles of performance against peers, was recorded for each of the past 10 years.[3]

Generally, the fee for managing funds is reduced as fund assets increase. At Fidelity, many of our investors also benefit from our "group fee" structure. Under this plan, as overall managed assets at Fidelity in a group increase, the group fee rate declines. This way, Fidelity funds pass along the benefits of economies of scale to our shareholders. Of course, if fund assets decline, our management fees will rise, measured as a percentage of assets.

Fidelity also is proud to be among the minority of U.S. mutual fund companies that adjust the level of management fees for many equity funds, up or down, determined by the extent to which a fund's investment performance over a rolling 36-month period exceeds or lags behind the performance of a benchmark group of securities over the same period. This performance adjustment ties management fees to fund performance so that when a fund beats its benchmark, we receive higher fees, and when the fund trails its benchmark, our fees are lower. Either way, our investors benefit.

However, not even low fees, group rates and performance adjustments can offer protection against prolonged downturns that are part of the natural cycle in the stock markets -- such as those we have seen for the past three years in a row. Many investors have been disappointed at investment returns during this period. Mutual fund fees are based upon the costs of building and maintaining an investment research organization, the range and quality of services offered to

investors, and the expense of transactions necessary to carry out the functions of the fund. Fees cannot be blamed for lower returns in a down market any more than they can be cited when there are higher returns in an up market.

During this bear market, the core value proposition of mutual funds -- diversification of investments and professional money management at a reasonable cost -- has been validated. Roughly half of the $8 trillion in lost equity market capitalization from February 2000 to September 2002 was concentrated in just 25 stocks[4] -- a very powerful argument for the diversification that is intrinsic to mutual funds.

In fact, while most U.S. stock funds have suffered losses during the bear market since the year 2000, mutual fund investors' losses have, overall, been lower than losses among holders of individual securities. This is particularly true for holdings that were concentrated in some of the hottest stocks of the recent market bubble. The ICI reported the results of a Morningstar study[5] that contrasted the percentage of individual stocks that lost more than 66% of their value in the year 2001, to the number of equity mutual funds that suffered the same losses. Results showed that while no less than 20% of *individual* U.S. stocks -- one in five -- experienced that sort of loss, among U.S. *equity mutual funds*, just 1% had losses that deep.

This would suggest that the benefit of investment diversification is a more important determinant of fund investors' results than the level of fees. Of course, it also is important to test the fairness of fees being charged to mutual fund shareholders. However, the core question for mutual fund investors is broader: *Are mutual fund investors receiving fair value in return for the fees they pay?*

In the intensely competitive world of mutual funds, "value" is measured two ways: the investment performance of the mutual fund, and the value added by the administrative, recordkeeping and other services an investment company provides to its customers. For some funds, these services are provided only by the fund company. For most funds, however, these services are paid for by the fund, but provided through a broker, advisor or other financial professional selected by the investor.

The investment return of a mutual fund is an objective, empirical fact that fund companies are required to make public every business day. Investors can follow the performance of their funds on a daily basis by checking the Net Asset Values (NAVs) of mutual funds published in their newspapers or online. The key word here is "net," because the reported returns must, by law, be calculated *after* deducting all fees and expenses, including trading costs. What investors see, then, is what they get.

This daily focus on investment performance, net of fees and expenses, compels mutual fund companies to align their investors' economic interests with their

own. The logic is simple, and very powerful: *Fund companies that deliver competitive performance tend to attract more investment – and, by this increase in asset size, earn greater fees over time. Fund companies that don't perform well tend to lose assets – and the fees that go with them.* It is hard to imagine any incentive structure that could more closely align the interests of mutual funds and their investors.

Mutual Funds Offer an Array of Beneficial Services

Competition in America's mutual funds industry isn't limited to performance. Investors today are demanding a wide array of choices on how to invest. As a result, mutual fund companies compete to provide a range of products, technology innovation and services. At Fidelity, serving our customers means striving not only to deliver the best investment performance for our funds, but also to provide our customers with an ever-expanding range of services. While services vary from company to company, this trend can be seen in the industry as a whole, leading to increased choice and sophistication of products, greater ease of access, and more comprehensive information and analytical tools available to consumers.

Specific products and services include, but are not limited to, support services that allow customers to process their transactions more efficiently; ready access to high-quality information and highly trained professionals in person, via the telephone or online via a Web site; investment and retirement planning tools and tax information; simplified account statements; ability to rapidly execute fund transactions; and -- perhaps most importantly -- the peace of mind that comes from knowing that investments are managed by a secure institution, regulated by the SEC, and overseen by independent auditors and boards of directors or trustees elected directly by the mutual fund shareholders.

The U.S. Mutual Fund Industry is a Model for Disclosure and Transparency

The U.S. mutual fund industry is one of the most highly regulated, scrutinized and transparent industries in the world. In fact, many of the reforms in the recent Sarbanes-Oxley Bill were modeled after laws that have governed mutual funds since the Investment Company Act of 1940.

By law, funds must publish their results, price their shares daily, offer accurate and empirical comparisons with their relative index benchmarks, and disclose all fees. This information, plus other details on funds, including their performance, their fees, their independent oversight and their investment policies is readily available to customers. For example, the advertisements of mutual funds publicly sold to individuals are highly regulated and show performance comparisons over a number of years. Such comparisons, based on uniform methodologies, allow mutual fund customers to easily compare the price and performance of competing funds. In addition, customers have ready access to more detailed fee, expense and performance information set forth in

mutual fund prospectuses and shareholder reports (each carefully regulated by the SEC); through third-party analytical and ratings services (such as Lipper and Morningstar); and through Internet Web sites, daily newspapers and dozens of periodicals that focus on mutual funds and investing.

Mutual Fund Boards of Directors Protect the Interests of Investors

The Investment Company Act of 1940 requires that U.S. mutual funds be governed by a board of directors. This board is elected by the fund's shareholders and acts in a fiduciary capacity to protect their interests. The majority of this board must be "disinterested," that is, not affiliated with the fund's adviser. The board and the disinterested directors are required to review fund management and distribution/service (12b-1) fees annually, and to consider carefully a range of factors before renewing the adviser's management contract. It is also important to bear in mind that *no increase* in investment management fees can occur without approval by a vote of the fund's shareholders themselves. This shareholder approval requirement, and the right of any shareholder to redeem shares on any business day throughout the year, together impose a cost discipline on the mutual fund industry unlike that governing any other financial services industry in this country.

Conclusion: Mutual Fund Fees are Highly Competitive and Well-Disclosed

Investors in America can chose to invest in more than 8,000 mutual funds offered by over 600 companies. Each fund provides comprehensive public information on its investment performance and its fees and expenses. Each company also provides consumers with information on the various types of related services it offers. Investors, then, are fully informed and free to make their own decisions about whether a fund offers the right combination of investment performance and service that justifies the fee being charged -- or not. As in any competitive, free-trading market, the ultimate power rests -- as it should -- with the judgment and wallets of mutual fund shareholders.

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[1] Investment Company Institute Research in Brief, September 2002
[2] Morningstar, Inc.
[3] Lipper Inc. cited FMR Corp. 2002 Annual Report
[4] Fidelity Investments Fund Analysis and Research Group, 10/16/02
[5] Morningstar, Inc., data cited February 15, 2000, *The Wall Street Journal*