A NEW ORDER OF THINGS: BRINGING MUTUALITY TO THE “MUTUAL” FUND

THE 27TH ANNUAL MANUEL F. COHEN MEMORIAL LECTURE

AT THE GEORGE WASHINGTON UNIVERSITY LAW SCHOOL

WASHINGTON, D.C.

FEBRUARY 19, 2008

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I’m profoundly honored by the privilege of delivering the Manuel F. Cohen Memorial Lecture for 2008 here at the National Law Center of the George Washington University. Part of my pleasure comes from the fact that, during the later time of his twenty-seven-year tenure at the Securities and Exchange Commission, I came to know Chairman Cohen (universally known as “Manny”). He had served on the staff from 1942 until 1961 and as a member of the Commission from 1961 until 1969, serving as its Chairman during the final six years of his tenure.¹ I remember him as being wise, smart, blunt, tough, intolerant of beating around the bush, and a pillar of personal rectitude and professional integrity. It should go without saying that I had the highest admiration for this consummate public servant.

He left the Commission in 1969 to enter the private practice of

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law at Wilmer, Cutler and Pickering, but continued to speak out on issues affecting the securities field, lecturing here at the George Washington University Law School. One of his speeches, given while he was SEC Chairman, sets the theme for my own lecture this afternoon. That speech, delivered at the 1968 Federal Bar Conference on Mutual Funds, was entitled simply “The ‘Mutual’ Fund.” And, yes, he put quotation marks around the word mutual. The title—and the theme—of my remarks today follows that same formulation: “A New Order of Things—Bringing Mutuality to the ‘Mutual’ Fund.” Please note that the word mutual is again bracketed by quotation marks.

The fact is that “mutual” remains an inappropriate adjective to apply to our business. The operation of virtually all mutual funds is about as far from the concept of mutuality as one can possibly imagine. Hear Chairman Cohen on this point in that 1968 speech: “The basic idea of a ‘mutual’ fund is deceptively simple,” he said, “[but its] salient characteristics . . . raise[] a serious question whether the word ‘mutual’ is [an] appropriate [description].” While the policyholders of mutual insurance companies and the depositors in mutual savings banks were at least putatively sharing in the profit of their institutions, mutual funds, he said, were different, noting that fund shareholders paid fees to their external managers, corporations in business, to earn profits for their own shareholders, with a completely different, and often opposed, set of interests.

Chairman Cohen pointedly observed that

The [external] fee structure has provided a real opportunity for the exercise of the ingenuity for which fund managers have established an enviable reputation. After all, that is where the money is, and despite the common use of the word “mutual”, the principal reason these funds are created and sold is to make money for the people who sell [them], and those who manage . . . them.

Of course he was right. Virtually all mutual funds are organized, operated, and managed, not in the interests of their shareholders, but in the interest of their managers and distributors. Is there something improper, or wrong, or unethical about having

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4. Id. at 1, 3.
5. Id. at 3.
6. Id. at 5.
funds operated with this purpose? Perhaps not. But even if this structure is not illegal *per se*, there seems to be something about the way in which the industry has evolved that flies directly in the face of the provisions in the Investment Company Act of 1940 that require investment companies to be “organized, operated, [and] managed” in the interests of their shareholders, “rather than in the interest of [their managers and distributors].” (Interestingly, the phrase *mutual funds* does not appear in the statute.)

**A LONE EXCEPTION TO THE CONVENTIONAL STRUCTURE**

Now, when I said that *virtually* all funds operate under this external management structure, please note that I did not say *all*. The creation of Vanguard in 1974 marked my attempt to create a family of mutual funds that was truly mutual, doing away with the conflict of interest that exists between funds and their advisers by returning the enormous profits that accrue to external managers directly to the fund shareholders themselves. The now-150 funds in our group actually own our manager, The Vanguard Group, Inc., roughly in proportion to their share of the Group’s aggregate assets, and share in the total expenses incurred by the funds in their operations in approximately the same proportion. (That is, if a given Vanguard fund represents one percent of our assets, it would own one percent of Vanguard’s shares and assume one percent of Vanguard’s operating expenses.)

The directors of the funds and their management company are identical. Eight of our nine directors are otherwise unaffiliated with the company, and only one (the chief executive) serves as an officer. No director is permitted to be affiliated with any of the funds’ external advisors. Our funds essentially operate and manage

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11. The investment advice for approximately seventy percent of Vanguard’s fund assets—largely index, bond, and money market funds—is provided internally by Vanguard itself. The remaining thirty percent is advised under
themselves on an “at-cost” basis, enabling our shareowners to garner the extraordinary economies of scale that characterize investment management (i.e., the costs of managing $10 billion of assets is nowhere near ten times the cost of managing $1 billion). It is fair to describe Vanguard as the only truly “mutual” mutual fund complex.

This shareholder-first structure has produced enormous savings for investors in the Vanguard funds. For example, in 2007, our composite expense ratio of 0.21% (twenty-one “basis points”) was seventy-six basis points below the 0.97% (ninety-seven-basis-point) composite weighted average expense ratio of our largest competitors. 12 That savings, applied to our average assets of $1.2 trillion during the year came to almost $10 billion for 2007 alone. By 2009, cumulative savings for our mutual fund owners will have crossed the $100 billion mark.

WHENCE “MUTUAL”?

The Vanguard structure is unique in industry annals. While the first mutual fund (Massachusetts Investors Trust, formed in 1924) was managed by its own trustees rather than by an external company—a structure it abandoned in favor of the external structure in 1969—its shares were marketed and financed by a separately-owned distribution company. 13 And while the funds in the Tri-Continental (now Seligman) group were for many years operated at cost by their management company, 14 the manager reaped substantial (if undisclosed) profits by serving as the broker-dealer for the funds’ portfolio transactions. 15 In 1981, this structure, too, was converted into an external manager structure. 16

15. While the funds operated by TIAA-CREF and USAA have a shareholder-oriented structure that is similar in philosophy to Vanguard’s, they differ by being managed, in effect, by insurance/annuity providers that are themselves mutual, owned by their policy holders. While the funds pay fees to the manager in the same way as in the conventional external model, those fees are far below industry norms.
Since the word “mutual” did not appear in the Investment Company Act of 1940, whence did it arise? I’ve looked through those old Investment Companies manuals published by Arthur Weisenberger & Company all the way back to the 1945 edition, and it is not until the 1949 edition, a quarter-century after the industry began, that I find the first mention of mutual funds. But while the derivation of the term remains a mystery, the paradoxical fact is that it first appeared only a short time before the industry began to abandon its early mutual values.

History confirms that from the inception of the first U.S. mutual fund in 1924 until the late 1940s, the predominant focus of mutual fund management was on portfolio selection and investment advice, rather than on distribution and marketing. In fact, the managers who founded not only Massachusetts Investors Trust, but State Street Investment Corporation and Incorporated Investors, the original “Big Three” of the fund industry, put themselves forth as “the twentieth-century embodiment of the old Boston trustee.”

During the industry’s early years, sales of fund shares were often the responsibility of separate underwriting firms financed by distribution revenues from sales loads, and predominately unaffiliated with fund managers. For example,

[T]he primary concern of the State Street [Research and Management Company] partners was that they not be distracted by the sales effort. [As] [t]hey wrote [to] investors [in 1933], “. . . it is our intention to turn over the active selling and the commissions . . . to dealers . . . thereby leaving us free to devote . . . our entire time and effort to research and the study of the problems of investment.”

(The partners were even better than their word; in 1944 the fund entirely ceased the sale of its shares.)

The same spirit was echoed by Judge Robert F. Healy, the SEC Commissioner primarily responsible for the development of the legislation leading to the Investment Company Act of 1940. Here’s

17. ARTHUR WEISENBERGER, INVESTMENT COMPANIES 9 (1900).
19. Id. at 77.
20. See id. at 76–78.
21. Id. at 78 (quoting STATE STREET INVESTMENT CO., Q1 QUARTERLY REPORT (1933)).
22. Id. at 81.
part of his testimony at the hearings for the Act in 1939: “[Given] the evils and malpractices which we uncovered . . . as a whole, the record of the industry is shocking.” “[The solution] is a group of expert . . . trust managers who do not make their profits . . . distributing [trust] securities, styled principally for their sales appeal, but from wise, careful management of the funds entrusted to them.”

As Michael Yogg notes, “The SEC Commissioners were anxious to protect the fund investor from the distorting impact of sales. Products designed for their appeal to the market did not, and do not, necessarily make the best investments.”

Legendary industry pioneer Paul Cabot, one of State Street’s founders and a major force in the drafting of the 1940 Act, agreed with the SEC on this point. Earlier, in 1928, he had described the abuses in the investment-trust movement of the day as “(1) dishonesty; (2) inattention and inability; [and] (3) greed,” which has been interpreted to mean “simply charging too much for the services rendered.” Cabot identified the disadvantages to investors arising out of the movement: “[Even if a fund is] honestly and ably run, [it may be] inadvisable to [own it] simply because there is nothing in it for you. All the profits go to the promoters and managers.”

While the derivation of the term mutual remains obscure, the prudent idealism that undergirded the spirit of the industry when the 1940 Act was drafted arguably justified the use of the term. Yet mutual fund actually came into being just as the industry began to turn away from its original spirit of mutuality, from its early mission of stewardship of investor assets to its modern-day mission of salesmanship, a mission, as Chairman Cohen seemed to be suggesting, that would make the use of the term “mutual” something of a joke.

THE STRAW THAT BROKE THE CAMEL’S BACK

As with any transformation, multiple, doubtless innumerable, factors were responsible for the sea change that gradually subverted the fund industry’s mission. Operating for decades as an industry composed of a group of small firms, entirely privately-owned by the professional managers who were actually providing the advisory services and focused on earning a return on the capital that

24. Id. at 37, 47.
25. Yogg, supra note 18, at 105 (emphasis added).
26. Id. at 104–14.
27. Id. at 125 (quoting Paul Cabot, Testimony to a Committee of the New York Stock Exchange (1928)).
28. Paul Cabot, Testimony to a Committee of the New York Stock Exchange (1928), quoted in Yogg, supra note 18, at 125 (emphasis added).
investors had entrusted to them, the industry gradually morphed into a group of giant firms, largely publicly owned and controlled by corporate executives whose mission was asset gathering and whose focus was on earning a return on the capital of the owners of the management company. But the proverbial “straw that broke the camel’s back” of the traditional industry was when the owners of privately-held management companies gained the right to sell their ownership positions to outsiders, and then to the public, and finally to giant financial conglomerates.

Paul Cabot did not approve of that change. For him, 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.”

Cabot recalled that, during negotiations over the Investment Company Act of 1940, “[b]oth 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 hypothecate it, to sell it, to transfer it, or to make money on the disposition of this contract . . . .” Cabot believed that “[t]he fiduciary does not have the right to sell his job to somebody else at a profit.”

Yet, ironically, in 1982, Paul Cabot’s successors did exactly that: the partners of State Street Research and Management Company sold the firm to the (paradoxically, then-mutual) Metropolitan Life Insurance Company for an astonishing (in those ancient days) profit of $100 million. The stated reasoning of the Fund’s board: “[T]he affiliation of [State Street] with an organization having the financial and marketing resources of Metropolitan Life will result in the development of new products and services which the Fund may determine would be beneficial to [the fund’s] shareholders.” (Mr. Cabot, still a partner, was apparently enriched to the tune of over $6 million, in 1982 dollars.)

It is hard to imagine how such new products and services would be beneficial to the fund’s shareholders, even as they would likely benefit the management company, which became a subsidiary of the insurance behemoth. In fact, the merger hurt the fund

29. YOGG, supra note 18, at 209.
30. Id.
32. See YOGG, supra note 18, at 210, 212.
34. See YOGG, supra note 18, at 210, 212.
35. Id. at 213.
shareholders. “[P]erformance lagged; and the [manager’s] position in the industry declined from tops to average.” By 2005, Metropolitan Life abandoned the fund business, selling State Street Management and Research Company to Blackrock Financial for an estimated $375 million. Among Blackrock’s first moves was to put State Street Investment Corporation out of its misery, merging the industry’s third-oldest fund into another Blackrock fund. I still refer to this event as “a death in the family.”

THE FLOODGATES OPEN

The sale and resale of State Street exemplified what might be called the “trafficking” in fund-advisory contracts that greatly concerned the Commission during the drafting of the 1940 Act. But while the SEC and the industry agreed that the management contract was an asset of the fund, the 1940 Act failed explicitly to articulate this sound principle. It would be only a matter of time until a sale would take place. That sale opened the floodgates to public ownership of fund-management companies.

The date was April 7, 1958, when the United States Court of Appeals for the Ninth Circuit ruled that the 1956 sale of shares in Insurance Securities, Incorporated (ISI), at a price equal to nearly fifteen times its book value, did not constitute “gross misconduct” or “gross abuse of trust” under Section 36 of the 1940 Act. The SEC had gone to court to oppose the sale, on the grounds that the excess price represented a payment for succession to the adviser’s fiduciary office.

The court agreed with the Commission that the “well-established principles of equity” barred a trustee “standing in a fiduciary relationship with another” from either transfer of the office or “exploit[ation of] such [a] relationship for personal gain.” But it weighed even more heavily the fact that the value of the contract, rather than representing an asset of the trust fund,

36. Id.
37. Id. at 214; Frederick C. Ingram, BlackRock, Inc., in 79 International Directory of Company Histories 68 (Jay P. Pederson ed., 2006).
38. Yogg, supra note 18, at 214.
41. SEC v. Ins. Sec., Inc., 254 F.2d 642, 646, 651 (9th Cir. 1958).
42. Id. at 647.
43. Id. at 650.
represented the reality that the manager receives a profit for rendering its services in return for stipulated fees that the fund had contracted to pay.\footnote{Id. at 650–51.}

Well-decided or ill-decided by the Ninth Circuit (I believe the latter),\footnote{A discussion of this case agreed with me, taking issue with the Ninth Circuit’s decision. “If [the Act is] construed to incorporate the basic principles that a fiduciary owes undivided loyalty to the beneficiary and must avoid any conflict of interests, a seller should not be allowed to transfer his fiduciary office for personal gain . . . .” Recent Case, SEC v. Ins. Sec., Inc., 72 HARV. L. REV. 1176, 1178 (1959).} the U.S. Supreme Court refused certiorari.\footnote{SEC v. Ins. Sec., Inc., \textit{cert denied}, 358 U.S. 823 (1959) (No. 152).} And that was that. That narrow legal decision, now almost exactly a half-century ago, played a definitive role in setting the industry on a new course in which manager entrepreneurship in the search for personal profit would supersede manager stewardship in the search for prudent investment returns for fund shareholders.

then an ocean.

Today (continuing that somewhat stretched analogy), the tide of public ownership of fund management companies has come in, and the tide of private ownership is at an all time low. Among the fifty largest mutual-fund-management complexes, only eight have maintained their original private structure—including Fidelity, Capital Group (American Funds), Dodge & Cox, and TIAA-CREF, plus Vanguard, owned by its fund shareholders. Of the remaining forty-one firms on the list, nine are publicly-held (including T. Rowe Price, Eaton Vance, Franklin, and Janus), and thirty-two are owned by banks, giant brokerage firms, and U. S. and international conglomerates. As we shall soon see, this seemingly irresistible tide of public—largely conglomerate—ownership has ill-served mutual-fund shareholders.

VANGUARD GOES THE OTHER WAY

Only a single firm resisted this epic tide. In the context of my theme this evening, the story of its creation is a story worth telling. As you may recall, in 1960, my employer, Wellington Management Company, was among the firms to ride that early wave of industry IPOs. In 1965, when I was given the responsibility of leading the firm, I recognized the challenge involved in serving those two demanding masters whose interests were so often in direct conflict. To state the obvious, we had a fiduciary duty both to our fund shareholders and to our management company shareholders as well. However, when a privately-held management company becomes publicly held, this conflict is exacerbated.

In September 1971, I went public with my concerns. Speaking at the annual meeting of my Wellington partners, I began my remarks with a 1934 quotation from Justice Harlan Fiske Stone
regarding the financial era just drawing to a close:

“[M]ost of the mistakes and its major faults will be ascribed to the failure to observe the fiduciary principle, the precept as old as holy writ, that ‘a man cannot serve two masters’ . . . . [T]hose who serve nominally as trustees, but . . . consider only last the interests of those whose funds they command, suggest how far we have ignored the necessary implications of that principle.”

I endorsed that point of view. Then I revealed

an ancient prejudice of mine: All things considered, . . . it is undesirable for professional enterprises to have public stockholders . . . . Indeed it is possible to envision circumstances in which the pressure for . . . earnings growth engendered by public ownership is antithetical to the responsible operation of a professional organization. Although the field of money management has elements of both, differences between a business and a profession must, finally, be reconciled in favor of the client.

It is a matter of fiduciary principle.

I then explored some ideas about how such a reconciliation might be achieved, including, a “‘mutualization’ whereby the funds acquire the management company . . . [or] ‘internalization’ whereby the active executives own the management company, with contracts . . . negotiated on [a] ‘cost-plus’ basis, [with] incentives for both performance and efficiency, but without the ability to capitalize earnings through public sale.”

Within three years, a situation developed in which I was put in a position in which I would not only talk the talk about mutualization, but would walk the walk. Even before the 1973–74


55. Id. (emphasis added).

56. Id. at 257.

57. Time does not permit me to present the compelling economics of my proposal for fund shareholders, or the story of the tortuous path of the negotiations, under which funds would acquire Wellington’s mutual fund business. (Its counseling business would have been returned to the pre-merger partners.) An expanded version of the transaction can be found in my speech “Re-Mutualizing the Mutual Fund Industry—The Alpha and the Omega.” John C. Bogle, Address at Boston College Law School: Re-Mutualizing the Mutual
bear market began, the investment returns of the Wellington funds had begun to deteriorate (both on an absolute and on a relative basis) and the large cash inflows they had enjoyed had turned into huge cash outflows.\textsuperscript{58} Assets of our flagship, the conservative Wellington Fund, had “tumbled from $2 billion in 1965 to less than $1 billion, on the way to a low of $480 million.”\textsuperscript{59} Wellington Management Company’s earnings plummeted, and its stock price followed suit.\textsuperscript{60} This concatenation of dire events was enough to destroy the happy partnership formed by an unfortunate merger I implemented in 1966, and I “got the axe” as Wellington Management Company’s CEO on January 23, 1974.\textsuperscript{61} But—here’s the catch—I remained as chairman of the mutual funds, with their largely separate (and largely independent) board of directors.

Shortly before the firing, seeing the handwriting on the wall, I submitted a proposal to the mutual fund board of directors under which the Wellington Group of mutual funds would acquire Wellington Management Company and its business assets.\textsuperscript{62} The company would become a wholly-owned subsidiary of the funds and serve as investment adviser and distributor on an ‘at-cost’ basis.\textsuperscript{63} I openly acknowledged that my mutualization proposal was “unprecedented in the mutual fund industry.”\textsuperscript{64} The cautious fund board nonetheless asked me to expand the scope of my proposal and undertake “a comprehensive review of the best means by which the funds could best obtain advisory, management and administrative services at the lowest reasonable costs to the [fund] shareholders.”\textsuperscript{65}

My first report, completed on March 11, 1974, was entitled “The Future Structure of the Wellington Group of Investment Companies.”\textsuperscript{66} It spelled out the ultimate objective for the fund shareholders: Independence. The goal was to give the funds “[an] appropriate amount of corporate, business, and economic

\textsuperscript{58} Id. at 6.
\textsuperscript{59} Id.
\textsuperscript{60} Id.
\textsuperscript{61} Id.
\textsuperscript{62} John C. Bogle, Mutualizing Wellington Management Company 1–2 (Jan. 12, 1974) (on file with author).
\textsuperscript{63} Id.
\textsuperscript{64} Id. at 1.
\textsuperscript{65} See Memorandum #3 from Richard B. Smith, Esq., Davis Polk & Wardwell, Special Counsel to the Independent Directors of the Wellington Fund et al. (Sept. 30, 1974) (quoting the board’s directive from their January 24, 1974 meeting) (on file with author).
independence," under a mutual structure that was clearly contemplated by the Investment Company Act of 1940.  

But, I added, such independence had proven to be an illusion in the industry, with "fund[s being] little more than corporate shells . . . [with no] ability to conduct their own . . . affairs . . . . This structure has been the accepted norm for the mutual fund industry for [more than] fifty years."

On June 9, 1974, perhaps unsurprisingly, the board rejected my proposal to have the funds acquire the manager, and chose a different option, the least disruptive of the seven options that I had offered. We established the funds' own administrative staff under the direction of the firm's operating officers, with my continuing as their chairman and president. We would also be responsible, as the board's counsel, former SEC Commissioner Richard B. Smith wrote, "for monitoring and evaluating the external [investment advisory and distribution] services provided" by Wellington Management. The decision, the counselor added, "was not envisaged as a 'first step' to internalize additional functions, but as a structure that . . . can be expected to be continued into the future."

Since the board agreed that Wellington Management Company would retain its name (and Wellington Fund would also retain its name), a new name would have to be found for the administrative company. I proposed to name the new company "Vanguard" and the board approved, albeit somewhat reluctantly. The Vanguard Group, Inc. was incorporated on September 24, 1974. Without apparent difficulty, the SEC soon cleared the funds' proxy statements proposing the change, which the fund shareholders promptly approved. Vanguard began operations on May 1, 1975.

No sooner than the ink was dry on the various agreements, the situation began to change. The creation of Vanguard, as I've written,

was a victory of sorts, but, I feared, a Pyrrhic victory . . . [and] the narrow mandate that precluded our engaging in portfolio management and distribution services would give Vanguard insufficient power to control its destiny.

Why? Because success in the fund field [was not then, and] is not [now] driven by how well the funds are administered.

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67.  *Id.* at 1.
68.  *Id.* at 7–8.
69.  Memorandum #2 from Richard B. Smith, Esq., Davis, Polk & Wardwell, Special Counsel to the Independent Directors of Wellington Fund et al. (July 23, 1974) (on file with author).
70.  *Id.* at 6 (emphasis added).
Though their affairs must be supervised and controlled with dedication, skill, and precision, success will be determined by what kinds of funds are created, by how they are managed, by whether superior investment returns are attained, and by how—and how effectively—the funds are marketed and distributed.\footnote{\textit{John C. Bogle, Character Counts: The Creation and Building of The Vanguard Group} 5, 6 (2002) (emphasis added).}

We first determined to start a new fund that we would manage internally. Paradoxically (if not disingenuously), it would be a fund that arguably didn’t conflict with our limited mandate, for, technically speaking, it wasn’t managed. It was the world’s first index mutual fund, modeled on the Standard & Poor’s 500 Stock Index. Incorporated late in 1975, its initial public offering was completed in August 1976. While the offering raised a puny $11 million, despite that unhappy start, Vanguard 500 Index Fund is now among the largest mutual funds in the world.\footnote{\textit{The First 50 Years}, supra note 54, at 8.}

Our control over fund marketing came only shortly thereafter. On February 9, 1977, after yet another contentious debate, the funds’ board accepted my recommendation that the funds terminate their distribution agreements with Wellington Management, eliminate all sales charges, and abandon the broker-dealer network that had distributed Wellington shares since its inception in 1929. (I argued that we weren’t violating the memorandum of understanding by internalizing distribution. Rather we were eliminating distribution.) While the board approval was by the narrowest of margins, Vanguard moved, literally overnight, from a seller-driven, load-fund channel we had relied upon for almost half a century to the buyer-driven, no-load channel we maintain to this day. Only twenty-one months after Vanguard began operations, the fledgling organization had become a fully-functioning fund complex. What we called “the Vanguard Experiment” in fund governance was about to begin in earnest.

\textbf{LET'S SEE HOW IT ALL WORKED OUT}

It will soon be thirty-four years since Vanguard began operating under its unique mutual structure, and almost exactly fifty years since that ghastly Ninth Circuit decision opened the door of public ownership to fund managers and led to the age of conglomeration that has now overwhelmed the industry. Surely it must occur to you that the philosophies underlying these two events are diametrically opposite. Outside ownership, in effect, demands that investment
funds be viewed as *products* of their management companies, manufactured (in the current grotesque parlance) and distributed to earn a profit for the company. Mutual ownership, on the other hand views mutual funds, yes, *mutual* funds, as trust accounts, managed under the direction of prudent fiduciaries. It’s high time to look at the record, and compare the results achieved by the firms following these opposing philosophies.

As I’m fond of saying, over the three-plus decades of our existence, Vanguard has proven to be both a *commercial* success and an *artistic* success. It’s a commercial success, because our structure has been proven to be a superb business model. The assets we manage for investors have grown from $1.4 billion at our 1974 founding to some $1.2 trillion today. At this moment, in fact, we may well be the largest firm in our industry. (In fairness, Vanguard, American Funds, and Fidelity have gone back and forth in the lead position for several years now. Each of these giants manages about three times the fund assets of the next largest firms, Franklin Templeton and Barclays Global.)

Of course, the stock market boomed during that period (at least through early 2000), and the fund industry could hardly help but flourish. Nonetheless, Vanguard’s market share of industry assets has soared from a mere 1.8% in 1980 to 10.6% currently, *without a single year of decline.* Let me illustrate the impact of that rise in share: if it had remained at 1.8%, assets of the Vanguard funds today would be $220 billion. Thus, fully $1 trillion of our growth—80% of it—has come from our increased market share: that is, out of the pockets of our competitors. (Not bad, dare I say, for a firm in which I consistently drummed home this philosophy: “market share is a measure, *not* an objective; and market share must be earned, *not* bought.”)

How did we earn that commercial success? By our artistic success, which I define as providing superior investment returns to our shareholders. The data indicate that the performance of the

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73. I intensely dislike the use of the word “product” to describe an investment company, and, early in Vanguard’s history, banned its use at the firm.
75. See *infra* APPENDIX I.
76. See *The First 50 Years*, supra note 54, at 12; Lee Barney, *MME Readers Still in the FRC Sales Data Loop*, MONEY MGMT. EXECUTIVE, May 26, 2008.
Vanguard funds was indeed superior. To the contrary, the financial conglomerates that now dominate this industry generally produced performance returns that were distinctly inferior.

There are, of course, lots of ways to measure fund performance. I’ll use one of the more sensible methodologies, relying largely on the Morningstar system, in which the risk-adjusted returns of each fund are compared with the risk-adjusted returns of its peers over a full decade (albeit with a heavier weighting on the recent years of the decade). For example, a given manager’s large-cap growth fund is compared with other large-cap growth funds, its investment-grade intermediate-term corporate bond fund with other peers, and so on. Under this system, 10% of funds receive five stars (the top rating) and 10% one star (the bottom rating); 22.5% receive four stars and 22.5% receive two stars; the middle 35% receive the average grade of three stars.

My deceptively simple methodology is to calculate, for each fund complex, the percentage of its funds in the four- and five-star categories, and subtract from that total the percentage of funds in the one- and two-star categories. The result: the balance between funds that provided distinctly superior returns and those that provided distinctly inferior returns. While I’ve never seen this done before (although there’s lots of promotional bluster for funds that get four or five stars), my own view is that staying out of the one-and two-star categories is at least an equally important benefit for shareholders.

We measured the returns achieved by the fifty largest fund complexes, defined as the firms managing at least forty individual funds, excluding money market funds. (The complex with the largest number of funds, Fidelity, includes 471 long-term funds.)

78. See infra APPENDIX I.
79. See id.
81. Id. at 1.
82. Id. at 2. By weighting the analysis by number of funds rather than by assets, this procedure has one strength not in evidence in other methodologies, which almost invariably ignore the impact of sales loads. My methodology captures the returns of “B” and “C” shares, usually smaller in assets but which have sales loads built into their expense ratios. This method gives a more realistic picture of the net returns actually delivered to fund shareholders in all share classes.
83. See infra APPENDIX I.
84. See id.
Only one of these firms managed less than about $20 billion. This remarkably representative list includes more than 8800 funds with some $7 trillion in fund assets, 80% of the industry's long-term asset base.

The full study is clearly too extensive to inflict on this audience, but I've presented it in Appendix I as an attachment to the published version of this lecture. What I'll now present to you is a summary showing the scores of six of the top firms, the bottom six firms, and six fairly well-known firms that achieved roughly average performance records for their funds (TABLE 1). The top-ranking fund complex, in terms of providing superior returns to its investors, was Vanguard. With 59% of our funds in the top group and less than 5% in the bottom group, the firm’s performance rating is plus-fifty-four.

Joining Vanguard among the top three are DFA and TIAA-CREF, both at plus-fifty (more than coincidentally, all three firms are focused largely on index-like strategies). At number four is T. Rowe Price (plus-forty-four), followed by Janus (plus-thirty-eight), and American Funds (plus-twenty-six). Honestly, I think most objective observers would agree that over the past decade, at least five of these six firms have been conspicuous in delivering superior risk-adjusted returns, a judgment that confirms the methodology. Again more than coincidently, this six-firm list is dominated by four management companies that are not publicly-owned—Vanguard, DFA, TIAA-CREF, and American—and none are controlled by conglomerates.

On the other hand, each of the bottom six firms are units of giant brokerage firms or financial conglomerates. Their ratings range from minus-forty for Goldman Sachs to an astonishing minus-fifty-eight for Putnam, with only 4% of its funds in the top category and 62% rank in the bottom category. Strikingly, every one of the seventeen lowest-ranking firms on the fifty-firm list is conglomerate-held, while only one of the firms among the top ten can be similarly characterized.

85. See id. TIAA-CREF, the smallest complex in this class, manages approximately $17.8 billion. See id.
86. See id.
87. See id.
88. See infra TABLE 1. Unless noted otherwise, data referenced in the following discussion can be found in TABLE 1.
89. See infra TABLE 1. Full disclosure: two much smaller firms have higher ratings—Dodge & Cox, with four funds, at plus-100; and Royce and Associates, with thirty-one funds, has a score of plus-sixty-five.
90. The success of Neuberger Berman, ranked number eight with a score of plus-nineteen, was largely achieved before its 2003 sale to Lehman Brothers.
The middle group—all producing more or less average scores (mostly less) for their funds—including one publicly-held firm (Franklin, plus-nine), one owned by a giant investment banker (Morgan Stanley, plus-two), one privately-held (Fidelity, minus-three), and three owned by conglomerates (all below par, at minus-four, minus-fourteen, and minus-fourteen). Putting the three groups—high-performing, average-performing, and low-performing—together, it seems patently obvious that the truly mutual structure (which has only a single entrant) and the other three privately-held structures that dominate the top group have provided consistently superior returns for their shareholders, with an average of 54% in the top group and only 10% at the bottom. This positive net score of 44% stands in sharp contrast to the inferior scores that characterize the financial conglomerates at the bottom, with an average of minus 13% in the top group and 59% in the one- and two-star categories.

TABLE 1.

MAJOR MUTUAL FUND MANAGERS: FUND PERFORMANCE*

<table>
<thead>
<tr>
<th>Manager</th>
<th>% of Funds Ranked</th>
<th>Highest</th>
<th>Lowest</th>
<th>Highest minus Lowest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highest Returns</td>
<td></td>
<td>4 or 5 Stars</td>
<td>1 or 2 Stars</td>
<td></td>
</tr>
<tr>
<td>Vanguard</td>
<td>59%</td>
<td>5%</td>
<td>54%</td>
<td></td>
</tr>
<tr>
<td>DFA</td>
<td>57</td>
<td>7</td>
<td>50</td>
<td></td>
</tr>
<tr>
<td>TIAA-CREF</td>
<td>54</td>
<td>4</td>
<td>50</td>
<td></td>
</tr>
<tr>
<td>T. Rowe Price</td>
<td>53</td>
<td>9</td>
<td>44</td>
<td></td>
</tr>
<tr>
<td>Janus</td>
<td>54</td>
<td>16</td>
<td>38</td>
<td></td>
</tr>
<tr>
<td>American Funds</td>
<td>46</td>
<td>20</td>
<td>26</td>
<td></td>
</tr>
<tr>
<td>Average Returns</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Franklin Temp.</td>
<td>31</td>
<td>22</td>
<td>9</td>
<td></td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>32</td>
<td>30</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Fidelity</td>
<td>31</td>
<td>34</td>
<td>-3</td>
<td></td>
</tr>
<tr>
<td>Barclays Global</td>
<td>27</td>
<td>31</td>
<td>-4</td>
<td></td>
</tr>
<tr>
<td>AIM Inv.</td>
<td>20</td>
<td>34</td>
<td>-14</td>
<td></td>
</tr>
<tr>
<td>Columbia Funds</td>
<td>23</td>
<td>38</td>
<td>-14</td>
<td></td>
</tr>
<tr>
<td>Lowest Returns</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Goldman Sachs</td>
<td>15</td>
<td>55</td>
<td>-40</td>
<td></td>
</tr>
<tr>
<td>Dreyfus</td>
<td>12</td>
<td>53</td>
<td>-40</td>
<td></td>
</tr>
<tr>
<td>MainStay Funds</td>
<td>20</td>
<td>60</td>
<td>-40</td>
<td></td>
</tr>
<tr>
<td>John Hancock</td>
<td>17</td>
<td>60</td>
<td>-43</td>
<td></td>
</tr>
<tr>
<td>ING Investments</td>
<td>9</td>
<td>64</td>
<td>-55</td>
<td></td>
</tr>
<tr>
<td>Putnam</td>
<td>4</td>
<td>62</td>
<td>-58</td>
<td></td>
</tr>
</tbody>
</table>

*MORNINGSTAR RATINGS AS OF 12/2007. (LONG-TERM FUNDS ONLY)

PERFORMANCE EVALUATIONS FROM A HIGHER AUTHORITY

While the performance methodology I have chosen is inevitably imperfect, I believe that it is not only entirely reasonable, but a
significant enhancement over most other methodologies. But, let’s not rely only on the statistics to evaluate fund performance. Let’s find out how the fund shareholders themselves regard the funds they actually own. Happily, thanks to a survey done in 2007 by Cogent Research LLC, we have measures of how fund shareholders feel about the mutual fund firms that manage their money. The study focused on shareholders who have mutual fund investments of at least $100,000.

The Cogent study, reported by The Wall Street Journal, measured client loyalty, presenting investors with a scale representing the extent of their trust in their managers—ten the highest rating (“definitely recommend” to other investors), one the lowest (“definitely not recommend”). Each firm was scored by subtracting the percentage of shareholders who rated the firms at three or below (“detractors”) from the percentage who rated the firms at eight through ten (“supporters”). Only eleven of the thirty-eight firms evaluated had positive loyalty scores. “The average score was minus-twelve,” a message about investor confidence in the fund industry that would not seem to be much of a tribute.

Simply put, fund shareholders seem to “get it.” When we juxtapose these loyalty scores for each firm with its performance scores, we see a remarkable, if by no means exact, correlation. In fact, Vanguard’s performance score (plus-fifty-four) and its loyalty score (plus-forty-four), both the highest in the field, were quite similar. Putnam’s scores, also similar (minus-fifty-nine and minus-fifty-four, respectively), were the lowest in the field. Of course there is a relationship between how well one has served investors and how loyal they are!

There were also numerous significant disparities between the two scores. Most of them were explained, I think, because the

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92. Murray Coleman, Few Firms Earn Loyalty of the Wealthy: Well-Heeled Investors Search for Consistency; Vanguard Rates Highest, WALL ST. J., Mar. 15, 2007, at C13. The Wall Street Journal published the ratings for only eight of the firms in the survey. The other ratings were made available for this Article. Many of the firms in the performance survey were not included in the loyalty survey.
93. Cogent Research, supra note 91, at 8 (emphasis added).
94. Id.
95. Coleman, supra note 92, at C13.
96. Id.
97. See infra Table 2 (data from Morningstar and Cogent Research).
98. See infra Table 2.
performance ratings that I presented reflect the returns reported by mutual funds. But such reporting has a major failing. To be blunt about it, fund investors could hardly care less about reported returns when they vastly overstate the returns that they've actually earned. That's often the case in this business, for fund marketers have a seemingly irresistible impulse to promote shares of a fund only after the fund has achieved sterling performance, an impulse, alas, that also seems irresistible to fund investors. Following such superior performance, however, such funds seem to have an almost equally irresistible impulse to revert not only to the market mean, but even below it. What goes up, it seems, must come down.

**Table 2.**

**Major Mutual Fund Managers: Fund Performance and Shareholder Loyalty**

<table>
<thead>
<tr>
<th>Manager</th>
<th>% of Funds Ranked Highest minus Lowest</th>
<th>Client Loyalty Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highest Returns</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Vanguard</td>
<td>54%</td>
<td>44%</td>
</tr>
<tr>
<td>2 DFA</td>
<td>50</td>
<td>n/a</td>
</tr>
<tr>
<td>3 TIAA-CREF</td>
<td>50</td>
<td>n/a</td>
</tr>
<tr>
<td>4 T. Rowe Price</td>
<td>44</td>
<td>21</td>
</tr>
<tr>
<td>5 Janus</td>
<td>38</td>
<td>-30</td>
</tr>
<tr>
<td>6 American Funds</td>
<td>26</td>
<td>12</td>
</tr>
<tr>
<td>Average Returns</td>
<td></td>
<td></td>
</tr>
<tr>
<td>7 Franklin Temp.</td>
<td>9</td>
<td>1</td>
</tr>
<tr>
<td>8 Morgan Stanley</td>
<td>2</td>
<td>-18</td>
</tr>
<tr>
<td>9 Fidelity</td>
<td>-3</td>
<td>12</td>
</tr>
<tr>
<td>10 Barclays Global</td>
<td>-4</td>
<td>n/a</td>
</tr>
<tr>
<td>11 AIM Inv.</td>
<td>-14</td>
<td>-48</td>
</tr>
<tr>
<td>12 Columbia Funds</td>
<td>-14</td>
<td>-47</td>
</tr>
<tr>
<td>Lowest Returns</td>
<td></td>
<td></td>
</tr>
<tr>
<td>13 Goldman Sachs</td>
<td>-40</td>
<td>-32</td>
</tr>
<tr>
<td>14 Dreyfus</td>
<td>-40</td>
<td>-45</td>
</tr>
<tr>
<td>15 MainStay Funds</td>
<td>-40</td>
<td>n/a</td>
</tr>
<tr>
<td>16 John Hancock</td>
<td>-43</td>
<td>-10</td>
</tr>
<tr>
<td>17 ING Investments</td>
<td>-55</td>
<td>-11</td>
</tr>
<tr>
<td>18 Putnam</td>
<td>-58</td>
<td>-54</td>
</tr>
</tbody>
</table>

The most glaring gap between performance rating (plus-thirty-eight) and loyalty rating (minus-thirty) appears for the Janus funds.99 Let's examine their records. During the ten years ending

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99. *See supra Table 2.*
December 31, 2007, the five largest Janus funds turned in an average annual return of 9.3%, a solid margin over the annual return of 5.9% for the S&P 500 index. During the first three years of that period, however, the Janus returns soared far above the Index return, and as the market soared to new heights some $50 billion of investor capital flowed into the funds. In the bear market that followed, the funds collapsed. Result: most Janus investors actually experienced dismal returns.

To summarize the math: for the decade, these Janus funds reported time-weighted returns averaging 9.6% per year, a compound ten-year return of plus-157%. The Janus fund investors, on the other hand, earned dollar-weighted returns averaging but 2.7% per year on the money they actually invested, a compound return of only 38%. That is, the returns actually earned by Janus shareholders for the decade fell fully 119 percentage points behind the returns that the Janus funds reported. That truly remarkable lag doubtless accounts for the gross disparity between the fund’s high scores in reported performance and their low loyalty scores based on what Janus shareholders actually experienced. Such experience also likely characterizes the lack of shareholder loyalty at Morgan Stanley, AIM, and Columbia (Bank of America).

COSTS REAR THEIR (UGLY) HEAD

The data make clear, then, that truly mutual investing has not only reaped rewards for its clients but has also earned their loyalty. Equally clearly, the financial conglomerates have not only failed their investors, but have earned (if that’s the right word) their opprobrium. How do we account for these differences in return? Obviously, there’s a certain amount of luck, skill, and timing in performance ratings, even though much of the impact of those variations evens out over a period as long as a decade, and even more of the disparity is mitigated when the management firms run a hundred funds or more.

It turns out, however, that there is one factor that plays a major role in the relative returns of peer funds. Happily, it is a factor that persists over time: the costs that funds incurred in delivering their returns to investors. It must be obvious that funds with similar objectives, managed by competent and experienced professionals, and compared over an extended period of time are more likely to achieve similar (and inevitably market-like) returns. But only before the costs of investing come into play.

Fund costs come in many guises. The major costs are: (1) the
expense ratio (annual percentage of asset value consumed by management fees and operating expenses); (2) sales loads, representing the cost to acquire fund shares; and (3) transaction costs, the real—but hidden—expenses incurred in the execution of the investment decisions made by the fund’s portfolio managers. Since transaction costs are not publicly available, the “all-in” expense ratios I’m using—including sales loads built into the B and C share classes—are the most satisfactory measure of fund costs.

Now let’s add to our previous chart a column showing the expense ratios for the equity funds in each group (TABLE 3). The three firms with the highest performance ratings are the very same firms—in the very same order—that have the lowest annual expense ratios, averaging 0.31%. For the top-performing group in total, the average ratio is 0.69%. Expense ratios for the middle group average 1.24%, fully 80% higher. The bottom group of performers, on the other hand, have the highest expense ratios, averaging 1.57% per year, 127% above the top-performing group. Together, these data tell us that, when looking to the sources of mutual fund returns, yes, costs matter.

But please don’t take my word for it. In fact, these data merely confirm what industry experts and academics have been saying for decades. Morningstar puts it unequivocally: low costs are “still the best predictors of performance.”

101. See infra TABLE 3. Since the largest variations in fund expense ratios come in equity funds, I have excluded bond fund expense ratios—which are generally lower—from this comparison. This practice also eliminates the distortion that would be created when firms manage different proportions of bond funds to stock funds.

102. The funds managed by Barclays, with a ratio of 0.41%, largely follow lower-cost index or index-like strategies.


2008]  A NEW ORDER OF THINGS

Table 3.

MAJOR MUTUAL FUND MANAGERS: FUND PERFORMANCE,
SHAREHOLDER LOYALTY, AND COSTS

<table>
<thead>
<tr>
<th>Manager</th>
<th>Funds Ranked</th>
<th>Client Loyalty Score</th>
<th>Avg. Eq. Fund Exp. Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highest Returns</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Vanguard</td>
<td>54% 44</td>
<td>0.23%</td>
<td></td>
</tr>
<tr>
<td>2 DFA</td>
<td>50 n/a</td>
<td>0.33</td>
<td></td>
</tr>
<tr>
<td>3 TIAA-CREF</td>
<td>50 n/a</td>
<td>0.37</td>
<td></td>
</tr>
<tr>
<td>4 T. Rowe Price</td>
<td>44 21</td>
<td>0.93</td>
<td></td>
</tr>
<tr>
<td>5 Janus</td>
<td>38 -30</td>
<td>1.12</td>
<td></td>
</tr>
<tr>
<td>6 American Funds</td>
<td>26 12</td>
<td>1.06</td>
<td></td>
</tr>
<tr>
<td>Average Returns</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7 Franklin Temp.</td>
<td>9 1</td>
<td>1.48</td>
<td></td>
</tr>
<tr>
<td>8 Morgan Stanley</td>
<td>2 -18</td>
<td>1.23</td>
<td></td>
</tr>
<tr>
<td>9 Fidelity</td>
<td>-3 12</td>
<td>1.31</td>
<td></td>
</tr>
<tr>
<td>10 Barclays Global</td>
<td>-4 n/a</td>
<td>0.41</td>
<td></td>
</tr>
<tr>
<td>11 AIM Inv.</td>
<td>-14 -48</td>
<td>1.59</td>
<td></td>
</tr>
<tr>
<td>12 Columbia Funds</td>
<td>-14 -47</td>
<td>1.41</td>
<td></td>
</tr>
<tr>
<td>Lowest Returns</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13 Goldman Sachs</td>
<td>-40 -32</td>
<td>1.59</td>
<td></td>
</tr>
<tr>
<td>14 Dreyfus</td>
<td>-40 -45</td>
<td>1.65</td>
<td></td>
</tr>
<tr>
<td>15 MainStay Funds</td>
<td>-40 n/a</td>
<td>1.49</td>
<td></td>
</tr>
<tr>
<td>16 John Hancock</td>
<td>-43 -10</td>
<td>1.40</td>
<td></td>
</tr>
<tr>
<td>17 ING Investments</td>
<td>-55 -11</td>
<td>1.72</td>
<td></td>
</tr>
<tr>
<td>18 Putnam</td>
<td>-58 -54</td>
<td>1.56</td>
<td></td>
</tr>
</tbody>
</table>

Nobel laureate (in Economics) William F. Sharpe is equally unequivocal: “[T]he smaller a fund’s expense ratio, the better the results obtained by its shareholders.”105 He wrote those words in 1966(!), and confirmed them in 1997.106 “If you had to look at one thing only [in selecting a fund], I’d pick expense ratio.”107

Sharpe’s observations have met the test of time, nicely confirmed by the data that I have just presented. Crude data showing the relationship between expense ratios and Morningstar ratings suggests that an extra percentage point of cost means one less star in ratings; a percentage point reduction in cost means one more star. That is, if a three-star fund had an expense ratio one percentage point lower, it would be transformed into a four-star fund; if the same fund had a ratio one percent higher, it would become a two-star fund. Despite this powerful data, however,

107. Id.
despite the opinion of experts,\textsuperscript{108} and despite the common sense that tells us that investment costs are the central element in determining the relative returns of mutual funds within their peer groups, price competition remains conspicuous by its absence from the mutual fund industry.

**PRICE COMPETITION?**

Investors seem to be largely unaware of the direct and causal relationship between fund costs and fund returns. The industry's only three very low cost firms dominate the performance statistics, yet together they constitute a mere 14\% of industry assets.\textsuperscript{109}

How can the industry continue to maintain expense ratios that average 1.5\% per year, five times as high? (Yes, along with Vanguard, T. Rowe Price, American Funds, and Fidelity—with costs that average 1.1\%, somewhat below industry norms, but many times Vanguard's costs\textsuperscript{110}—accounted for about one-third of all industry cash flow last year. But that still leaves two-thirds of the cash flowing largely into high-cost funds.)

The fact is that there are many “signs the mutual fund marketplace may not be performing in a way one would expect in a satisfactorily functioning competitive market.”\textsuperscript{112} That is the opinion of the general counsel of the SEC. One sign, he adds, is “the ‘law of one price,’ [the principle that,] in an efficient, competitive market, nearly identical goods will sell at nearly identical prices. That’s obviously because with full information . . . no rational buyer would pay more.”\textsuperscript{113} Yet the lack of such price convergence in the fund field “may be depriving American investors of the long-term returns they deserve.”\textsuperscript{114}

Put another way, as a University of Washington professor wrote, “As [the] information about a commodity improves, its price variability will decline.”\textsuperscript{115} He quotes the great English economist Alfred Marshall: “[T]he more nearly perfect a market is, the stronger the tendency for the same price to be paid for the same

\begin{footnotesize}
\begin{enumerate}
\item[108.] See infra notes 147–52 and accompanying text.
\item[109.] See infra APPENDIX I (Vanguard, DFA, and TIAA-CREF).
\item[110.] See supra TABLE 3.
\item[111.] See infra APPENDIX I.
\item[113.] Id.
\item[114.] Id.
\item[115.] Dr. Yoram Barzel, Replacing the Law of One Price with the Price Convergence Law 11 (Univ. of Wash., Dep't of Econ., Working Paper No. UWEC-2005-10, 2005).
\end{enumerate}
\end{footnotesize}
thing at the same time in all parts of the market."\(^{116}\) Price variability, then, is a measure of our ignorance about what the make-up of a commodity is, dividing goods into what the author calls "brand-name commodities" and "caveat emptor commodities."\(^{117}\)

The fact is that some kinds of funds—money market funds, for example—are clearly commodities. So are index funds. Investment-grade bond funds and U.S. Treasury bond funds (with comparable maturities) are at least commodity-like. What about managed equity funds? When sorted by objectives (i.e., compared to their peers, as in, for example, large-cap value funds), they are also commodity-like in the short run, even more so in the long run. (And since the various equity investment styles tend to revert to the mean over time, all—or nearly all—equity funds tend to be commodity-like in nature in the very long-term.) When brand-name commodities have different prices, then they quickly become caveat emptor commodities, a lesson fund investors have yet to learn.

Clearly, price ought to be the talisman that drives investor choice, forcing fund managers to reduce costs. But that is simply not happening.\(^{118}\) Yes, money flows (as I have noted) are increasingly directed toward the lower-cost funds, and Vanguard has been a beneficiary of, indeed a creator of, that structure.\(^{119}\) But other fund complexes are not following the lead.\(^{120}\) In short, if price competition is defined, not by the action of consumers, but by the actions of producers, then price competition is conspicuous by its absence in the mutual fund industry. Why don't fund managers compete on costs? Because to do so would be antithetical to their vested financial interests.

The fund industry, of course, argues that it is characterized by vigorous competition.\(^{121}\) To a point that is true: there is competition in the marketplace. Witness the incentives offered to brokers to sell shares and the hundreds of millions spent each year on print and

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116. Id. at 5–6 (quoting ALFRED MARSHALL, PRINCIPLES OF ECONOMICS: AN INTRODUCTORY VOLUME 325 (8th ed. 1920) (1890)).


119. See supra pp. 106–07.

120. I'm often told that Vanguard's demonstrably low costs—increasingly recognized in the marketplace—are responsible for setting an upper limit on prices among our competitors. But that level is still far too high for my taste.

television advertising.\textsuperscript{122} There is performance competition. Witness the ongoing advertising of funds that have had superior past records\textsuperscript{123} or are investing in hot market sectors.\textsuperscript{124} But there is little evidence to suggest that there is price competition. While the most vigorous industry advocates find that “evidence of price competition is clear,”\textsuperscript{125} the data presented by these advocates show that while there were on average 1242 fee decreases per year during 1998–2004, there were even more fee increases—1469 per year, on average.\textsuperscript{126} Even these advocates do not dispute “the empirical fact that mutual fund boards of directors rarely ‘fire’ advisers and do not put advisory contracts up for bids among advisers.”\textsuperscript{127} Without such competition, mutual fund managers are hardly likely to reduce their fees and hence their own profitability.

**RECAP OF THE ISSUES**

Let me summarize here the arguments I’ve made so far. In its early years, the investment company industry had many characteristics that well-served fund investors: the focus was largely on private trusteeship; prudence and diversification were the watchwords of investment policy; fund trustees often were a step removed from fund distribution; and, expense ratios were moderate, and far below today’s levels. Today, public ownership—largely by giant conglomerates—overwhelmingly dominates the fund industry, and it has ill-served fund investors. By way of contrast, the results of that “Vanguard Experiment” in mutual fund governance are now clear. It has been both a remarkable commercial success for the firm itself and an artistic success for its shareholder/owners.


\textsuperscript{123} See id.; \textit{Reuters, Lipper Fund Awards} (2008), available at http://awards.lipperweb.com/us/index.aspx (follow the “Lipper Fund Award Winners” hyperlink); \textit{Barron’s}, Sept. 22, 2008 (containing ten advertisements for funds, eight of which are included in Lipper’s Fund Award Winners list); \textit{Forbes}, Sept. 29, 2008 (containing two advertisements for funds, one of which is included in Lipper’s Fund Award Winners list); \textit{Fortune}, Sept. 15, 2008 (containing seven advertisements of funds, two of which are included in Lipper’s Fund Award Winners list); \textit{see also} Paul R. Carey, Comm’r, SEC, Remarks at SEC Speaks: Mutual Fund Performance Advertising: Is It in Overdrive?, (Mar. 2, 2001), available at http://www.sec.gov/news/speech/spch463.htm.

\textsuperscript{124} \textit{See} \textit{Barron’s}, supra note 123; \textit{Forbes}, supra note 123; \textit{Fortune}, supra note 123; Gould, supra note 122, at 12.


\textsuperscript{126} \textit{Id.} at 173–74.

\textsuperscript{127} \textit{Id.} at 159.
Our central idea was to create a firm honoring the industry’s original values. I expected that becoming the low-cost provider in any industry where low cost (by definition) is the key to superior returns, would force our competitors to emulate our structure. Indeed, I chose the name “Vanguard” in part because of its meaning: leadership in a new trend. But I was wrong. After more than three decades—during which at least one of our industry peers has described us as “the standard by which all of us are judged”—we have yet to find our first follower. We remain unique.

Of course, not everyone shares my view of the positive power of the mutual structure. Hear the American Enterprise Institute (AEI), in a recent book entitled *Competitive Equity—A Better Way to Organize Mutual Funds* (Hint: it doesn’t consider the Vanguard way “a better way”). The authors are skeptical of our claim that we operate on an “at cost basis,” albeit without identifying the basis of that skepticism. They allege that our managers do not accept compensation substantially lower than that paid to other fund advisers, apparently unaware that we fully disclose the rates and fees we pay to the unaffiliated external advisers that manage many of our actively-managed funds. For the record, the average fee paid to the advisers to our Windsor Fund is 0.12% of fund assets; the fee paid to the adviser to our GNMA Fund is 0.01%.

129. *The Industry Oddball Behind Vanguard’s Success*, *Business Week*, June 11, 1990. I had hoped that when Marsh & McClennan decided to sell its Putnam Management Company subsidiary—obviously a deeply troubled firm whose previous management ill-served its investors in so many ways—it would mutualize and internalize its organization. However, my attempts to persuade three directors of the funds (including its then-independent chairman) fell on deaf ears. The fund board approved the sale of the management to a Canadian conglomerate for $4.9 billion. For a further explanation of why and how such a conversion might have taken place, see my speech, John C. Bogle, Founder & Former Chairman, The Vanguard Group, Remarks Before the Corporate Governance Conference: Corporate Governance and Mutual Fund Governance—Reflections at a Time of Crisis (Nov. 21, 2003), available at http://www.vanguard.com/bogle_site/sp20031121.html.
131. *Id.* at 84.
132. *Id.*
one basis point.)

Despite these shortcomings in their argument, their conclusion is unequivocal: “[T]he idea that the mutual form of organization is inherently superior to the external management form . . . is something of an overstatement.”

They also allege that conversion to a mutual form would require buying out the existing shareholders (of the management company), ignoring the fact that Vanguard, as noted earlier, did no such thing. In fact the fund directors have the awesome power to simply terminate the manager’s contract and either manage the funds internally or hire new external advisers. (I note that while this never happens in the fund field, it happens with considerable frequency among corporate pension funds.)

THE TRIUMPH OF CONGLOMERATION

In any event, the mutual model remains stuck, still used by only a single firm, and the conglomerate model has triumphed. Early on, and presciently, Chairman Cohen recognized the serious problems that would be created by this conglomeration. In a 1966 speech, he spoke of the “new and more complex relationships [between] institutional managers [and their] beneficiaries,” and sought “a more adequate scheme of regulation . . . that ultimately [will protect] beneficiaries . . . from unwarranted actions by [their fund managers] and will realize the fullest benefits of their participation” in their funds.

He then noted, prophetically, his concern about “public ownership of . . . investment advisers, and . . . the beginnings of a trend toward [their] acquisition . . . by industrial companies . . . [which] makes it increasingly difficult to define the responsibilities of [institutional] managers . . . who may . . . be obligated to serve the business interests of the very companies in which they invest.”

The snowball that began to roll with the onset of public ownership of management companies in 1958 took a while to gather speed. But during the 1980s and 1990s it came into full flower and, as noted earlier, among the fifty largest firms in the industry only nine remain privately-held. This massive wave of conglomeration

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135. WALLISON & LITAN, supra note 135, at 84, 86.
136. Id. at 87; see supra pp. 110–12.
139. Id. at 8.
140. See supra p. 130.
by what are essentially giant marketing firms led to a wave of, yes, “product proliferation” that carried the number of mutual funds from 564 in 1980 to 12,444 at the end of 2007.\textsuperscript{141}

\textbf{IT'S TIME FOR A CHANGE}

Only two weeks after that 1966 speech by Chairman Cohen, the Commission sent to Congress a massive  report by its staff entitled \textit{Public Policy Implications of Investment Company Growth} (PPI).\textsuperscript{142}

In that report, the SEC noted the burgeoning level of fund fees (then at an annual level of a mere $130 million, as compared to more than $100 billion today).\textsuperscript{143} The Commission also called attention to the effective control advisers held over their funds, and “[t]he absence of competitive pressures, the limitations of disclosure, the ineffectiveness of shareholder voting rights, and the obstacles to more effective action by the [independent] directors.”\textsuperscript{144}

The Commission also noted “the adviser-underwriter permeation of investment company activities to an extent that makes rupture of the existing relationships a difficult and complex step . . . [rendering] arm’s length bargaining between the [fund’s board] and the managers . . . a wholly unrealistic alternative.”\textsuperscript{145} Yet the Commission was “not prepared to recommend at this time the more drastic statutory requirement of compulsory internalization of . . . management” (i.e., mutualization).\textsuperscript{146} Rather, the SEC recommended the adoption of a “statutory standard of reasonableness . . . [a] basic . . . standard [that] would make clear that those who derive benefits from their fiduciary relationships with investment companies cannot charge . . . more for services than if they were dealing with them [at] arm’s length.”\textsuperscript{147}

The SEC described reasonableness as a “clearly expressed and readily enforceable standard”\textsuperscript{148} that “would not be measured merely by the cost of comparable services to individual investors or by the

\textsuperscript{141} \textit{INV. CO. INST., 2008 INVESTMENT COMPANY FACT BOOK} 114, 120–21, 148, 150, 152 (48th ed. 2008) (compiling the end-of-year 2007 totals for long-term mutual funds (8,029), closed-end funds (668), exchange-traded funds (629), funds of funds (723), lifestyle and lifecycle funds (502), and variable annuity mutual funds (1,893) to create the end-of-year total of 12,444).


\textsuperscript{143} \textit{Id.} at 83.

\textsuperscript{144} \textit{Id.} at 132.

\textsuperscript{145} \textit{Id.} at 148.

\textsuperscript{146} \textit{Id.}

\textsuperscript{147} \textit{Id.} at 144 (emphasis added).

\textsuperscript{148} \textit{Id.} at 143.
fees charged [by] other externally managed investment companies . . . [but by the] costs of management services to internally managed [funds] and . . . to pension [funds] and other . . . nonfund clients.\textsuperscript{149}

If the standard of reasonableness does not “resolve the problems that exist in . . . management compensation . . . then more sweeping steps might deserve to be considered.”\textsuperscript{150}

With vigorous lobbying by the Investment Company Institute, the self-anointed representative of fund shareholders but in fact the powerful voice of fund managers, that reasonableness standard was never adopted. Yet, even as fund fees soared and conglomerations gradually took over, transaction after transaction, unchallenged (and, arguably, unchallengeable) after that ghastly 1958 decision by the Ninth Circuit, even as Chairman Cohen’s worst fears were being realized, even after PPI’s warning forty-two long years ago, more sweeping steps have yet to be considered by the SEC.

But some baby steps have been considered. In 2004, the Commission recommended a significant strengthening of fund boards,\textsuperscript{151} only to have its proposal reconsidered and likely watered down under different leadership.\textsuperscript{152} Of course I’d prefer more sweeping steps. Indeed, as I wrote in my book Common Sense nearly a decade ago,

\begin{quote}
[T]he industry’s . . . further evolution [must] take one of two critical turns: a [change in] the status quo that [places] more power in the hands of shareholders or a radical restructuring. The radical restructuring would be the mutualization of at least part of the American mutual fund industry. Funds—or at least large fund families—would run themselves [rather than] contract[ing] with external management companies to operate and manage the[ir] portfolios . . . . Mutual fund shareholders would, in effect, own the management companies that oversee the fund. They would have their own officers and staff, and the huge profits now earned by external managers
\end{quote}

\begin{itemize}
\item \textsuperscript{149} Id. at 145 (emphasis added).
\item \textsuperscript{150} Id. at 149 (emphasis added).
\end{itemize}
would be diverted to the shareholders. [Under such a structure, the character of the industry would return to its traditional roots.] [Funds] wouldn’t waste [their shareholders’] money on costly marketing campaigns designed to bring in new investors at the expense of existing investors. With [markedly] lower costs, they would produce [markedly] higher returns and/or assume [commensurately] lower risks. They would [provide full and candid] disclosure . . . to their shareholder-owners . . . [They’d have no need to organize and market “fund-of-the-moment” funds, and they might even see the merit of market index funds.

[The other choice] would be the rise of more activist independent mutual fund directors . . . . [I]ndependent board members [would] become ferocious advocates for the rights and interests of the mutual fund shareholders they represent . . . . [T]hey would negotiate aggressively with the mutual fund adviser, allowing the management company to earn a fair profit, but recognize that the interests of the mutual fund shareholders must always come first . . . . [Independent directors] would approve only portfolios that are based on sound investment principles and meet a reasonable investment need . . . . [T]he independent directors would [at last] become the fiduciaries they are supposed to be under the law . . . .

And if the creation and encouragement of activist independent directors is a more practicable solution than the wholesale mutualization of the American mutual fund industry, then perhaps it is an objective deserving of our energies and effort. And who knows? As the values of such a refocused organization move toward the values of the mutual organization, full mutualization [for some firms] may be only a step [further] away.

Regardless of the exact structure, mutual or conventional, an arrangement in which fund shareholders and their directors are in working control of a fund—as distinct from one in which fund managers are in control—will lead to funds that truly serve the needs of their shareholders[, meeting the crying need to return this industry to the traditional role of trusteeship that largely characterized its modus operandi through its first three decades]. Under either structure, the industry will enhance economic value for fund shareholders.153

153. COMMON SENSE ON MUTUAL FUNDS, supra note 77, at 395–96.
WHAT'S TO BE DONE?

Given the industry's growth; its sharp turn from stewardship to salesmanship; the army of conglomerates that has swept across it, leaving only a handful of survivors; its failure to produce anything like satisfactory returns to the investors who have entrusted funds with their hard-earned dollars; and, dare I say, the success of the singular, still unique, firm that has, for nearly thirty-four years now, almost unequivocally demonstrated the value of that internalization that the SEC was unprepared to mandate all those years ago, not a single additional moment should elapse before those long-justified, long-awaited “more sweeping steps” are not only considered, but enacted into the law.

My idealism tells me to fight for compulsory internalization,\footnote{This would not be appropriate for all fund complexes, only for complexes that exceed certain thresholds: for example, fund complexes that manage over $25 billion in assets and more than thirty mutual funds.} at long last making it possible to delete those quotation marks around “mutual” that reflected the prescient concerns expressed by Chairman Cohen in the speech he delivered in 1966. But my pragmatism disagrees. Powerful and well-financed lobbyists—led by the Investment Company Institute, the fabulously profitable management companies and their conglomerate owners, and the U.S. Chamber of Commerce (of course!)—would take up arms against such a seemingly radical proposal. The campaign would come with unbridled enthusiasm and virtually unlimited financial firepower—K Street's dreams come true. Given the state of our nation's governance, such opposition, self-interested as it obviously is, would defeat “the national public interest and the interest of investors,”\footnote{Investment Company Act of 1940 § 1, 15 U.S.C. § 80a-1(b) (2000).} the very interests that the 1940 Act was designed to protect.

But hope is not lost. There is a way—not, of course, an easy way—to honor the spirit and letter of the Act so that investment companies are organized, operated, and managed in the interests of their shareholders rather than their managers and distributors. It would take a series of logical steps to achieve this goal, some already in the works, some proposed by an earlier Commission and now seemingly abandoned; new steps that take us even further toward that goal; one simple—if dramatic—organizational change that would create enormous momentum toward fund operational independence from their advisers and a change in federal law.

Here's the plan I propose:

Require that 100% of fund directors be unaffiliated with the management company. There is simply no point in any longer...
subjecting management company officers to the profound conflicts of interest that they face when they also serve as fund directors. It’s time to honor the principle that “no man can serve two masters.” (As noted earlier, since the firm’s inception the Vanguard funds have prohibited representatives of any external adviser from serving on their boards.\textsuperscript{156} It hasn’t seemed to impair the returns we earn for investors.)

Require that the chairman of the fund board be independent of the management company, even if, as under the Commission’s 2004 proposal, only 75% of the board is required to be independent.\textsuperscript{157} Such a separation of powers, ordained for our federal government in the Constitution, is not only a fundamental principle of governance, but simple common sense.

Require the retention by the funds of legal counsel independent of the adviser and a chief compliance officer. Both are already mandated by the Commission, but we must require them to be responsible to the fund board, reporting to the independent fund chairman.

Importantly, require that the fund boards retain advisers and experts necessary to carry out their duties, in order to provide truly objective and independent information to the board. (I’m guessing that few fund boards have seen the kind of comparative performance, loyalty, and cost data that I’ve presented in these remarks.) The SEC recommended language “authorizing” such a staff (or consultants) in its 2004 recommendations,\textsuperscript{158} which now seem to have gone aborning. As I see it, this requirement would apply only to fund complexes of a certain (large) size and scope.\textsuperscript{159} It’s time to face up to the fact that directors who are overseeing 100 funds or more can’t do so without staff support.

Give specific regulatory authorization that enables funds to assume responsibility for their own operations, including administration, accounting, compliance, shareholder record-keeping, etc. Such a structure would cut the Gordian knot that gives fund managers de facto control over the funds they manage.\textsuperscript{160} It is this

\begin{itemize}
\item \textsuperscript{156} See \textit{supra} p. 103.
\item \textsuperscript{158} Id. at 3476.
\item \textsuperscript{159} For example, complexes meeting the standards outlined in note 59. But in my darker moments, I’d consider applying this requirement only to fund complexes in which a majority of the directors are unable to actually name all of the funds on whose boards they serve. If that requirement is too demanding, then only when directors are unable to specify the exact number of funds on whose boards they serve.
\item \textsuperscript{160} It is a curious fact that the operational function was ignored in the 1940
very step that was central to the creation of Vanguard, which (as noted earlier) soon enabled the fledgling firm to extend its reach to investment management and then to distribution.

Enact a federal standard of fiduciary duty for fund directors. The fact is that mutual fund managers, indeed pension fund managers, public and private alike, face serious conflicts of interest in carrying out their duties. In today’s relatively new agency society, in which financial institutions control more than 70% of stock ownership,161 there has been a serious failure to serve their principals—largely fund shareholders and pension beneficiaries. As the Honorable Leo E. Strine, Jr., Vice Chancellor of the Delaware Court of Chancery, has noted, “it would be passing strange if . . . professional money managers would, as a class, be less likely to exploit their agency than the managers of corporations that make products and deliver services.”162 Yes, the world has changed, and we need to redress that imbalance in favor of the principals.

TWO POWERFUL ENDORSEMENTS

Once again, this critical analysis of the mutual fund industry is not mine alone. Listen to Warren Buffett. “[Fund] independent directors . . . [have] been absolutely pathetic . . . . [They follow] a zombie-like process that makes a mockery of stewardship . . . . ‘[I]ndependent’ directors, over more than six decades, have failed miserably.”163 Then, hear this from another investor, one who has not only produced one of the most impressive investment records of the modern era but who has an impeccable reputation for his character and intellectual integrity, David F. Swensen, Chief Investment Officer of Yale University:

The fundamental market failure in the mutual-fund industry involves the interaction between sophisticated, profit-seeking providers of financial services and naïve, return-seeking consumers of investment products. The drive for profits by Wall Street and the mutual-fund industry

Act. It refers solely to the other two functions of fund management, investment advice and share distribution (underwriting).


overwhelms the concept of fiduciary responsibility, leading to an all too predictable outcome: . . . the powerful financial services industry exploits vulnerable individual investors.

The ownership structure of a fund management company plays a role in determining the likelihood of investor success. Mutual-fund investors face the greatest challenge with investment management companies that provide returns to public shareholders or that funnel profits to a corporate parent—situations that place the conflict between profit generation and fiduciary responsibility in high relief. When a funds [sic] management subsidiary reports to a multiline [sic] financial services company, the scope for abuse of investor capital broadens dramatically.

Investors fare best with funds managed by not-for-profit organizations, because the management firm focuses exclusively on serving investor interests. No profit motive conflicts with the manager's fiduciary responsibility. No profit margin interferes with investor returns. No outside corporate interest clashes with portfolio management choices. Not-for-profit firms place investor interests front and center . . .

Ultimately, a passive index fund managed by a not-for-profit investment management organization represents the combination most likely to satisfy investor aspirations.164

I regard these two powerful endorsements of the positions that I hold as a clarion call for action. Yes, it's time to make fund directors aware of their duty to serve the fund shareowners rather than the entrenched fund managers, and to bring independent leadership—real leadership—to fund boards. That is the purpose of the six changes I've delineated. And yes, I'm well aware that, for some firms, these changes may lead to the full mutualization that, in the only case study that exists, has served shareholders so well. Yes, it's also time to overturn the ghastly legacy of the Ninth Circuit's erroneous decision in 1958 that opened the floodgates, first to public ownership and then to conglomerate ownership.165 It's also high


165. Interestingly in light of my recommendations here, the summary in the Harvard Law Review cited in note 45 concludes with this caveat. “However, the [sellers] might . . . be allowed to sell control . . . for any consideration if the fund had an independent board of directors . . . with control of the proxy machinery and the power to select another adviser . . . .” Recent Case, supra note 45, at 1179–80.
time for firms that now place asset gathering at the heart of their mission to return to the industry’s professional roots and again act as true fiduciaries.

So, yes, it’s time for a new order of things. It’s time to facilitate the development of mutualization in the mutual fund industry. It’s time to go back to the future and honor the vision of trusteeship held by Paul Cabot, and the vision of SEC Commissioner Healy to protect investors from the distorting impact of fund sales. And, especially on the occasion of this 27th Annual Manuel F. Cohen Memorial Lecture, it’s time to honor Manny Cohen’s legacy, his implicit demand that we build an industry worthy of deleting those darned quotation marks that he placed around the word “mutual,” at last bringing mutuality back to the mutual fund industry. Only then will we honor the crystal clear spirit of the 1940 Act, and protect the national public interest and the interests of investors.

166. See supra notes 27–28 and accompanying text.
167. See supra notes 23–25 and accompanying text.
## A NEW ORDER OF THINGS

**APPENDIX I**

Includes only managers with more than 40 rated long-term funds.

<table>
<thead>
<tr>
<th>Manager Name</th>
<th>Total Assets (MM)</th>
<th>Total funds</th>
<th>5 stars</th>
<th>4 stars</th>
<th>3 stars</th>
<th>2 stars</th>
<th>1 stars</th>
<th>Loyalty score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vanguard</td>
<td>1,089,489</td>
<td>31</td>
<td>78</td>
<td>67</td>
<td>5</td>
<td>4</td>
<td>185</td>
<td>58.9%</td>
</tr>
<tr>
<td>DFA</td>
<td>108,655</td>
<td>22</td>
<td>15</td>
<td>3</td>
<td>42</td>
<td>71.7%</td>
<td>51.6%</td>
<td>50.0%</td>
</tr>
<tr>
<td>TIAA-CREF</td>
<td>17,998</td>
<td>3</td>
<td>22</td>
<td>19</td>
<td>2</td>
<td>46</td>
<td>54.3%</td>
<td>43.5%</td>
</tr>
<tr>
<td>T Rowe Price</td>
<td>203,424</td>
<td>7</td>
<td>47</td>
<td>38</td>
<td>9</td>
<td>101</td>
<td>33.0%</td>
<td>8.6%</td>
</tr>
<tr>
<td>5 Janus</td>
<td>97,181</td>
<td>14</td>
<td>27</td>
<td>23</td>
<td>9</td>
<td>3</td>
<td>76</td>
<td>53.9%</td>
</tr>
<tr>
<td>Schwab</td>
<td>54,500</td>
<td>3</td>
<td>16</td>
<td>32</td>
<td>2</td>
<td>1</td>
<td>54</td>
<td>35.2%</td>
</tr>
<tr>
<td>American Funds</td>
<td>1,157,019</td>
<td>63</td>
<td>80</td>
<td>106</td>
<td>47</td>
<td>16</td>
<td>312</td>
<td>49.0%</td>
</tr>
<tr>
<td>NubergerLehman</td>
<td>26,000</td>
<td>4</td>
<td>10</td>
<td>15</td>
<td>4</td>
<td>3</td>
<td>36</td>
<td>39.5%</td>
</tr>
<tr>
<td>RHCM/HarborGbl</td>
<td>344,000</td>
<td>40</td>
<td>71</td>
<td>114</td>
<td>56</td>
<td>15</td>
<td>196</td>
<td>37.5%</td>
</tr>
<tr>
<td>Franklin Templeton</td>
<td>331,866</td>
<td>20</td>
<td>66</td>
<td>131</td>
<td>45</td>
<td>17</td>
<td>279</td>
<td>30.0%</td>
</tr>
<tr>
<td>OppenheimerFunds</td>
<td>100,645</td>
<td>15</td>
<td>61</td>
<td>61</td>
<td>42</td>
<td>18</td>
<td>197</td>
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</tr>
<tr>
<td>Waddell &amp; Reed</td>
<td>46,146</td>
<td>27</td>
<td>40</td>
<td>57</td>
<td>34</td>
<td>19</td>
<td>177</td>
<td>37.6%</td>
</tr>
<tr>
<td>Prudential Fnl</td>
<td>34,645</td>
<td>28</td>
<td>34</td>
<td>62</td>
<td>48</td>
<td>2</td>
<td>174</td>
<td>35.6%</td>
</tr>
<tr>
<td>BlackRock</td>
<td>146,025</td>
<td>34</td>
<td>80</td>
<td>138</td>
<td>65</td>
<td>31</td>
<td>346</td>
<td>32.8%</td>
</tr>
<tr>
<td>American Century</td>
<td>76,894</td>
<td>13</td>
<td>44</td>
<td>65</td>
<td>41</td>
<td>8</td>
<td>171</td>
<td>33.3%</td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>60,075</td>
<td>8</td>
<td>61</td>
<td>84</td>
<td>60</td>
<td>5</td>
<td>218</td>
<td>31.7%</td>
</tr>
<tr>
<td>Russell Inst Gp</td>
<td>32,422</td>
<td>11</td>
<td>34</td>
<td>36</td>
<td>6</td>
<td>4</td>
<td>55</td>
<td>20.0%</td>
</tr>
<tr>
<td>Fidelity</td>
<td>526,028</td>
<td>44</td>
<td>102</td>
<td>165</td>
<td>116</td>
<td>44</td>
<td>471</td>
<td>31.0%</td>
</tr>
<tr>
<td>Barclays Global</td>
<td>321,030</td>
<td>4</td>
<td>23</td>
<td>41</td>
<td>20</td>
<td>11</td>
<td>99</td>
<td>27.3%</td>
</tr>
<tr>
<td>AllianzGI</td>
<td>96,236</td>
<td>7</td>
<td>37</td>
<td>95</td>
<td>31</td>
<td>17</td>
<td>194</td>
<td>22.7%</td>
</tr>
<tr>
<td>Principal Funds</td>
<td>54,435</td>
<td>10</td>
<td>50</td>
<td>154</td>
<td>72</td>
<td>13</td>
<td>299</td>
<td>20.1%</td>
</tr>
<tr>
<td>Nuveen</td>
<td>72,537</td>
<td>4</td>
<td>16</td>
<td>24</td>
<td>16</td>
<td>4</td>
<td>59</td>
<td>25.4%</td>
</tr>
<tr>
<td>GE Asset Mgmt</td>
<td>19,666</td>
<td>4</td>
<td>11</td>
<td>24</td>
<td>16</td>
<td>4</td>
<td>59</td>
<td>25.4%</td>
</tr>
<tr>
<td>The Hartford</td>
<td>45,076</td>
<td>10</td>
<td>25</td>
<td>52</td>
<td>42</td>
<td>8</td>
<td>137</td>
<td>25.5%</td>
</tr>
<tr>
<td>Northern Trust</td>
<td>21,035</td>
<td>6</td>
<td>39</td>
<td>13</td>
<td>55</td>
<td>102</td>
<td>224</td>
<td>22.2%</td>
</tr>
<tr>
<td>AIM Investments</td>
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<td>5</td>
<td>37</td>
<td>94</td>
<td>62</td>
<td>7</td>
<td>205</td>
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<td>Columbia Funds</td>
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<td>19</td>
<td>50</td>
<td>115</td>
<td>73</td>
<td>36</td>
<td>206</td>
<td>34.2%</td>
</tr>
<tr>
<td>Roland</td>
<td>42,731</td>
<td>8</td>
<td>25</td>
<td>59</td>
<td>46</td>
<td>11</td>
<td>149</td>
<td>25.6%</td>
</tr>
<tr>
<td>Wells Fargo</td>
<td>45,270</td>
<td>16</td>
<td>52</td>
<td>79</td>
<td>82</td>
<td>29</td>
<td>258</td>
<td>35.4%</td>
</tr>
<tr>
<td>FAF Advisors</td>
<td>20,944</td>
<td>4</td>
<td>20</td>
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Total: 6,947,135

|        | 517 | 1,796 | 3,335 | 2,427 | 817 | 8,896 |

2008