this pursuit of valuable information as the "Theory of Sharks" and rightfully points out that each anomalous return pattern that lacks an equilibrium explanation is doomed to be consumed by the Wall Street sharks. Investors ignore equilibrium concepts such as this, which are at the heart of modern portfolio theory, at their own peril; unfortunately, many investors *do* ignore these core insights.

All good protagonists require a formidable foe, and the foe of modern portfolio theory is behavioral finance. In 1992, many of the ideas of behavioral finance were heretical in mainstream finance. Since then, behavioral finance has blossomed into a respectable subfield of financial economics, and Bernstein describes the work of many in this area including the influential work of Daniel Kahnemann, Richard Thaler, and Robert Shiller. While acknowledging the contributions of behavioral finance, Bernstein clearly professes his love of the simple, elegant, and insightful contributions of mean-variance optimization and the Capital Asset Pricing Model (CAPM). However, Bernstein acknowledges that investors make mistakes, which (in my view) may have important policy and welfare implications that are absent from traditional theory.

Another way this volume extends the 1992 book is that he includes more "war stories" from the frontlines of investment management. These stories are more plentiful for a very simple reason – the ideas of modern portfolio theory have now permeated and blossomed in the investment management business. Bernstein describes the success and evolution of Goldman Sachs Asset Management (GSAM), Barclays Global Investors (BGI), the Yale Endowment, and PIMCO. All of these giants of the investment management business are built on foundations created in the work of capital ideas. In all, this new effort represents a worthy addition to the Bernstein collection. I recommend the book to all serious students of financial markets.

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Competitive Equity: A Better Way to Organize Mutual Funds. Peter J. Wallison and Robert E. Litan. The AEI Press, 2007, ISBN: 978-0-8447-4252-6, 154 pages. doi:10.1017/S1474747207003289

US mutual funds are structured as corporations or equivalent business/statutory trusts with their own boards of directors or trustees. Mutual fund boards, which are largely comprised of individuals who are independent of the fund's sponsor/manager, owe fiduciary duties to fund shareholders, just like directors of any publicly owned company. Among their most important responsibilities is the duty to review, evaluate and approve the fund's service contracts with investment advisers and other service providers. They are specifically charged by statute, regulation and court rulings with assessing the reasonableness of the advisory fees charged to the funds on an annual basis. Under the current regulatory overlay, investment advisers also owe fiduciary duties to fund shareholders, including a duty to refrain from charging unreasonable fee levels.

Co-authors Peter Wallison and Robert Litan are sharply critical of this current system. Essentially, their position is that having an intermediary board actually impairs competition and keeps costs for investors higher than they should be. They propose establishing an alternative structure that would eliminate the independent board, transfer many of its non-fee responsibilities to professional trust companies, and allow the competitive marketplace to control fee levels. They stop short of suggesting that the current structure be eliminated. Rather, they propose that the law be amended to authorize sponsors to establish managed investment trusts (MITs) that could be offered as an alternative to funds structured in the traditional way.

The fundamental premise of their book is that the current structure is akin to rate-making authorities setting public utility fees on a "cost-plus" basis. In the words of the authors,

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"Because there is only one adviser to the fund, *the adviser is in fact in the same position with respect to the fund as a monopoly public utility is with respect to the consumers in its market*." (emphasis in original, p. 78). Based on a line of court rulings, as part of the annual contract renewal process, advisers do provide boards with information about the costs they incur in providing advisory services. These costs include infrastructure costs, as well as portfolio manager and other professional salaries. Boards do review these costs as one part of their assessment of the reasonableness of advisory fee levels.

In support of their position, the authors provide data that shows that US mutual funds have a wider dispersion of total expense ratios than do mutual funds in countries with other systems, most notably the UK, where independent professional trust companies oversee non-fee functions and the competitive marketplace drives advisory fees without independent board oversight. They acknowledge that expense ratios of UK funds tend to be higher than those of US funds, but attribute the differences to economies of scale and the higher cost of doing business in the UK.

Contrary to the authors' fundamental premise, however, mutual fund fees are not set by boards on a mechanical, cost-plus basis. Unlike public utility ratemaking authorities, mutual fund boards do not set a target profit margin and mechanically apply it to the expenses that the adviser discloses to them. Rather, profitability is merely one of many factors reviewed with careful deliberation by fund boards. Indeed, some boards discount the importance of profitability as a factor, as they recognize the same concern as the authors, namely that overemphasizing a reasonable profit margin would reduce an adviser's incentive to reduce costs and reward an inefficient adviser by adding a percentage profit to an inflated cost structure. Instead, fund boards tend to dedicate much of their review efforts to evaluating expense ratio comparability information that is based on industry-wide surveys conducted typically by unaffiliated service providers. The fee setting process is in reality much more nuanced than the authors presume.

Also, a wide dispersion of fee levels is not necessarily an indicator that advisory fees are not significantly influenced by competitive forces. Consider the highly competitive and increasingly transparent commercial airline industry. Travel agent websites allow any web surfer to retrieve multiple airlines' schedules and up-to-the-minute airfares, but search results invariably display a wide dispersion of fares for similar itineraries. Yet overall, airline fares have declined in recent decades due to competitive forces, even though costs have not. The same trend has been observed in mutual fund fees and expenses, as indicated in several recent industry publications. Even though adviser costs have not been declining, the report concluded that reductions in fees and expenses from 2001–2006 continue a trend observed since the early 1980s. The asset-weighted fees and expenses paid by stock and bond fund investors have dropped by more than 50% since 1980. Over the past five years, the average expense ratio of stock funds has dropped 11 basis points as investors shifted their purchases toward lower-cost funds and as expense ratios fell on stock funds they already owned. According to the ICI, stock funds with expense ratios below the simple average of their peer groups have 90% of the assets and capture 90% of new investment dollars. A fund cannot easily change advisers, but an investor can change funds. While there is certainly room for continued progress, the evidence strongly supports the existence of a competitive environment under the current structure, with boards encouraging rather than hindering reductions.

The authors rightly criticize current fee disclosures for being too confusing for many investors to understand. Some industry observers have called for simplifying fee structures by empowering boards to approve a single fee covering advisory, administration, distribution and other services. An all-in fee would allow the fund board to focus on the reasonableness of the total fee paid by investors through the funds, which is ultimately what impacts their net returns, rather than dedicating resources and energy to assessing individual component parts, some of which may be higher and some lower than industry norms. The authors also rightly criticize current tax laws that, among other things, impose friction on investors' ability to

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exchange shares away from a more expensive fund to a similar less expensive one. Such an exchange under current law triggers realization of gain in a taxable account, imposing a toll on a transaction that involves an exchange from one investment into a similar one. Section 1031 of the Internal Revenue Code of 1986 allows deferral of gain recognition for "like kind exchanges" of investment real estate holdings. Amending the tax code to extend Section 1031-type relief to mutual fund investors would foster even greater expense ratio competition, without giving up the real shareholder protections of having a board with important fiduciary duties.

The concept of having a professional trust company monitor and address conflicts ignores the fact that many mutual fund advisers are part of larger organizations with multiple business lines and trust company relationships that could separately conflict with the interests of fund investors. It also suggests that monitoring of conflicts is a mechanical process. There are judgments and nuances that boards bring to light based on their higher level view of the business and bringing their other business and professional experiences to the table that may or may not be brought up by a professional trust company that is charged with managing more of the day-to-day aspects of the business. Many boards can and do benefit from professional staff and counselors. But ultimately, their business judgment is most valuable when focused single-mindedly on the interests of the shareholders they represent. Their role should continue to be enhanced, not curtailed.

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The Handbook of West European Pension Politics. Ellen M. Immergut, Karen M. Anderson and Isabelle Schulze (eds.). Oxford University Press, 2007, ISBN 0-19-929147-0, 968 pages. doi:10.1017/S1474747207003290

Two American political scientists located respectively in Berlin and Nijmegen, Ellen Immergut and Karen Anderson, with Isabelle Schulze (Immergut's doctoral student), have put together a useful handbook on pension politics complementing recent, more technical and policy-oriented compendiums such as *Pensions at a Glance* by Edward Whitehouse and his OECD colleagues. This volume consists of a lengthy introduction and 16 country chapters covering the 15 "old" European Union countries plus Switzerland. An appendix delivers detailed information about coverage, financing, administration, and benefits in each of the national pension systems around the year 2005.

In contrast to Whitehouse and his collaborators, this volume opts for a more traditional research design. Six chapters are either authored or co-authored by Isabelle Schulze; Anderson authors or co-authors three chapters; and Immergut is co-author with Anderson of the chapter on Sweden. The remaining chapters are written by country experts, meaning scholars writing about their home countries. Each country chapter adopts a unified structure, describing the political system, the pension system, and the politics of pension reform since 1980. The country chapters also include five standard overview tables and figures on the political institutions, the party system, governmental majorities, the pension system, and proposed and enacted pension reforms.

As is apparent from this summary, this handbook reports a wealth of information on Western Europe's political systems, pension systems, and the history of reforms. It is, however, left to the reader to draw conclusions and generalizations about the country material. For instance, the book lacks a concluding chapter, so it would have been helpful if the introduction provided an overview of the main findings and discussed key lessons. Instead the rather lengthy introduction by Immergut and Anderson poses a number of big questions and lists many hypotheses, most of which are not taken up or answered. Indeed, the introduction reads

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