

section 10(a) required at least 40 percent of nonaffiliation between an investment company and its adviser, and to that extent, through section 15(c), fostered arm's-length bargaining in connection with advisory contracts. But in the case of no-load funds, as mentioned before, Congress said that a single outside director was enough—obviously because the need was seen to be quite different. Section 10(d) amounted to a recognition by Congress of three essential points:

- (1) That, contrary to what is often said about fund shares, no-load fund shares are "bought" by investors rather than "sold" to them;
- (2) That an investor is really selecting the advisory firm when he decides to buy shares of a particular no-load fund; and
- (3) That there would be no point in fostering arm's-length bargaining as to the terms of advisory contracts with no-load funds because competition works freely and effectively: by hypothesis there is no deterrent to the investor's changing no-load funds if he is dissatisfied with the adviser or its fee.

We believe that Congress clearly intended, through section 10(d), to foster and encourage this type of fund. We believe, unhappily, that enactment of the present bill would inhibit and discourage them, notwithstanding that section 10(d) itself would remain virtually unchanged.

One reason lies in the crucially different roles that the outside directors play under the present law and would be expected to play under the proposed law. Under present law and practice they serve the valuable function, as in any corporation, of bringing an outside perspective to all aspects of management's handling of corporate affairs. They keep the management constantly "on its toes"; they raise questions and express viewpoints that may not occur to members of management. But, while those with whom I am personally acquainted are men of high caliber and ability and perform their role seriously and conscientiously, these outside directors hardly conceive themselves as having a special, personal responsibility to negotiate the terms of an investment advisory contract at arm's length.

Under the proposed bill, on the other hand, apart from the new requirement that an outside director be "disinterested" as distinguished from "unaffiliated," there would be a drastic change in his function and responsibility. He would have a large new burden of inquiry and judgment before he could agree to an advisory fee as "reasonable." The law would set forth a very broad, yet we think rather unbalanced, list of "factors" or criteria to be considered, plus all others that might be "appropriate and material." As to all these criteria it would be the outside director's duty to request and evaluate pertinent data and reach his conclusion as to reasonableness. In performing this complex task he would be entirely dependent on his own resources except for the adviser's furnishing data to him.

In the case of a no-load fund the required number of outside directors—that is, only one—would not be changed, but for all practical purposes the distinction written into section 10(d) in 1940 would be wiped out, even though superficially left there. I say this because it seems very doubtful that any outsider would be willing, all alone, to take responsibility for carrying out the new and burdensome functions imposed by section 15, and hence the no-load funds would be forced to ask several outsiders to share the responsibility.