

be an encouragement of litigation rather than competition as the main sanction to assure reasonableness of fees.

The counseling firms traditionally have looked at their sponsored funds as a means of extending their counseling business to smaller investors, not as separate entities toward which they were in the position of independent contractors. As a matter of basic policy they make it cost-free for investors to become shareholders of the funds and cost-free to redeem and go elsewhere (except for a minor redemption charge—retained by the fund and not the adviser—in one or two instances). The firms in our group are quite happy to live in a competitive environment. They do not want stockholder-clients to join or stay on unless they are satisfied on the basis of performance and costs. By the same token, they know they must satisfy these stockholder-clients, not outside directors or any other outsider, as to the fairness of their fees in relation to services performed if they are to stay in business and grow.

It is expensive to start any mutual fund, even apart from the cost of creating an advisory staff. In the case of a no-load fund particularly, the sponsor cannot expect to achieve a profitable operation except over a very extended period of time, because there is no selling load to absorb any of the startup or promotional cost and, with no salesmen, growth is typically very slow. The sponsor depends on slow but steady growth in the number of fund stockholders who are satisfied to pay the established fee for what they receive. The whole idea would be very much less attractive to a sponsor if it were expected to deal at arm's length with outsiders and still could be second-guessed and exposed to liability and expense through the kind of stockholder litigation that would be encouraged by the bill.

For these reasons we believe there is a strong likelihood that the proposed amendments would seriously discourage the formation of new no-load funds—a result that we are sure this committee would not favor.

We appreciate very much having the opportunity to be heard by you.

Mr. MURPHY. Thank you, Mr. Lyman, for a very fine statement. I note that you have with you a Cohen, Milton H. Cohen, who was counsel to the Commission on its special study, and of course, made a number of suggestions regarding the improvement of the shareholder's position in mutual funds as well as in the market generally.

Mr. Cohen, one of the things disturbing this committee is the tremendous growth of the investment company industry, and of institutions as a whole and the resulting effect upon free markets as we have known them. Do we have free markets on the exchanges?

Mr. COHEN. We commented in the special study at great length on the growing role of institutions in the securities markets. We devoted part of our chapter VIII as I recall, to the phenomenon of increased purchases by the large institutions, and we talked about their activity as bearing on market mechanisms and the suitability of existing mechanisms to handle all that.

I think we exposed for the first time some problems that needed to be talked about and further studied, and we recommended that they be the subject of continuing studies, and I think those subjects have been receiving more attention in the last 5 years than they had received at the SEC or elsewhere in the preceding period.