

internal price maintenance. While this might imply a major competitive readjustment, it is not clear that the gains to investors would not make it worthwhile.

It is claimed further that reduction of the sales load would encourage investors to switch among funds. This could of course happen whether the load was reduced by removal of price maintenance or by regulation. Funds with unfavorable investment results would suffer net redemptions. They would be impelled to improve their performance by more active trading with the attendant greater instability of markets. While these results are possible, the magnitude and gravity of the consequences seem to add only very moderately to the case against ending price maintenance.

The issues in the area of sales load may be summarized as follows:

1. The mutual fund industry now enjoys a partial shelter from competition, i.e. at the retail level, through price maintenance. This creates a prima facie case for regulation of the sales load, although the case must be buttressed by evidence that profits of the underwriter, adviser and broker, often the same party, are excessive, or that costs are unreasonable compared with the cost of other means of buying securities, and in terms of the service rendered by the seller.

2. Removal of price maintenance would end the case for regulation. This solution would be far preferable to regulation, if it does not produce excessively harmful repercussions.

3. Both regulation of the sales load and termination of price maintenance may reduce the volume of mutual fund sales, although the extent is very uncertain and would depend, in case of regulation, on the maximum sales load fixed. If the reduction is large, the injury to investors who no longer receive the attention of salesmen and cease to buy mutual funds would have to be counted up against the gain to those who continue to buy. If the reduction should be so large as to materially influence the level of stock prices, this broader implication for the welfare of stockholders and the economy would also have to be considered.

In my personal judgment, an alternative approach that would be worth examining is to remove retail price maintenance. If this is judged too severe, or too fraught with uncertainties, the level of retail price maintenance might be cut to, say five percent. Flexibility might be allowed for subsequent further reductions.

Front end load

The Commission's recommendation that the front end load be abolished raises the same issues discussed in connection with the regular sales load, but in a much intensified form. The basic issue again is whether a whole group of potential buyers of a useful service or product should in effect be deprived of the opportunity to acquire it because a minority of this group is subject to exorbitant selling costs and possibly to more serious abuses.

The front end load is a means of selling mutual funds to "investors" on so small a scale as to justify the salesman's time only if periodic subsequent purchases are made without further selling effort. Since the salesman's work is done at the beginning, he must be paid at that time. Potentially the payment could be financed by the salesman's employer. This, however, would require working capital which some employers do not have, who would then have to drop the business. Alternatively, the salesman's compensation can be taken out of the early installments. In that case the cost becomes wholly disproportionate to what the investor buys during this period.

A similar situation exists in life insurance. To many persons, however, the value of insurance is likely to be higher than the advantages of mutual fund ownership. A certain analogy can be seen also with respect to small loans, where very high interest charges have been made legal in many states. Again, however, the benefits of these loans in many instances will be greater than fund ownership.

The purchase of a contract may induce individuals to save who otherwise would not do so. This seems broadly desirable. The front end load, by imposing a penalty on discontinuance, strengthens the incentive. The high lapse and redemption ratios presented by the Commission nevertheless indicate that these inducements have only limited power. There are other ways, moreover, in which an individual can impose upon himself an even more powerful discipline to induce saving, such as insurance or savings bond payroll deduction.

Given the modest circumstances of most buyers of front end load plans there is a question how many of them ought to be stock owners in any event. Insurance and some fixed dollar savings come before stock ownership.