

The high combined lapse and redemption ratios indicate that many buyers are sold who should not have been sold. Not all lapses and redemptions mean losses, however. But all lapses and redemptions point to the high cost of what is bought ranging from a sum equal to the amount of savings actually invested (at 50 percent load) to at a minimum about 10 percent if the full plan is adhered to.

Losses imply an excess of payments over liquidated value. Data from a sample of four funds presented by the industry show that the percentage of plans terminated with a definite loss ranges from 3.5 percent to about 33 percent for these four funds. However, the data understate because the plans listed as still active probably contain some number of plans that eventually will end with a loss. The loss per account is modest, of an order of magnitude of \$100, according to industry statements. Aggregate losses are small, while aggregate realized and unrealized gains are very large. The overwhelming predominance of aggregate gains over losses reflects to some extent the rise in the stock market, a factor that cannot be counted upon with assurance.

The basic question is how far the gainers would be injured by measures designed to protect the losers.

It should be noted that in the front end load area, the Government has already enmeshed itself in regulation, since the Investment Company Act limits the first year load to 50% and the overall load to 9 percent. The issue therefore is not one of favoring regulation in principle or objecting to it. It should also be noted that the industry apparently is satisfied with this regulation and does not in general seem to argue that free unregulated competition could be trusted to take care of this particular problem.

Enough evidence has been presented by the Commission to make plausible that some changes are desirable in the front end load area.

Two possible solutions might be explored as alternatives to, or modifications of, the rigorous approach chosen by the Commission.

1. A reduction of the permissible front end load to 20 percent. This would make the first year's load little more than twice the usual 8.5 percent load. If the dealer puts up another 10 or 20 percent, which he would recover from future installments, the compensation to the salesman would not be much less than at present. The range of prospects who would be given an opportunity to buy mutual funds would be reduced only moderately.

2. Leaving the present load unchanged but requiring some compensation to be made to holders who redeem at a loss. The cost of this could be charged partly to the salesman, which would encourage him to be more selective. The rest would have to be borne by the dealer and perhaps the underwriter, again encouraging a more conservative selling approach.

Concluding remarks

It may be helpful to the present legislative effort to view the stock market and the mutual fund industry in terms of the broader evolution of our financial system.

One of the principal trends in this evolution has been the advance of institutionalization. This has meant the growth of intermediaries that convert the primary obligations of particular borrowers into assets more convenient to hold for particular investors. In the market for corporate bonds, it has made possible the raising of capital with a minimum need for appeal to individuals. The bond market in this way has become a mass production operation functioning with low turnover, low costs, and yet indirectly providing high liquidity to individual savers through depository institutions.

Mutual funds have initiated a similar development in the stock market. The stock market is still predominantly the domain of individual investors, as the bond market once was. The amounts of new money that it raises are minute compared to those raised by the bond market—in 1966, \$2.5 billion of stock against \$15.6 billion of corporate bonds alone. The gross income that the securities business draws from commission business and other activities related to stock transactions probably exceeds the amount of money raised for industry via new stock issues. As a money raiser the stock market is extremely inefficient. Most of its operating cost must be allocated to the provision of liquidity, if indeed it can be said to have a productive function.

Mutual funds in the course of time probably will make the stock market more like the bond market. Perhaps the amounts of new capital raised in it will never be very large, since industrial equity money comes largely from profit retention. But mutual funds can provide liquidity to individual investors much as commercial and savings banks do, without need to turn over primary securities.