

enterprise system. The Federal government, together with the industry, shares responsibility for the excessive charges now being made to the American public for investment in mutual funds. Unfortunately, the industry has not seen fit to meet this responsibility. The arguments that have been advanced before this Subcommittee opposing H.R. 9510 ignore both the undisputed facts and the realities of 27 years of experience under the Investment Company Act. The Federal government must meet that responsibility by restoring a proper balance between the interests of the public and the interests of the industry.

I should like to turn now to a discussion of the particular issues involved and deal with the major contentions advanced by the industry.

1. THE BILL REFLECTS MODERATE CHOICES AMONG THE ALTERNATIVES AVAILABLE TO DEAL WITH THE PROBLEMS OF EXCESSIVE ADVISORY FEES AND SALES LOADS

Despite the industry charge that provisions of the Bill with respect to advisory fees and sales loads are "drastic",<sup>1</sup> they represent a moderate and conservative approach towards resolution of the serious problems in these areas. The problem of excessive advisory fees, for example, results from the conflicts of interest built into the external management structure of the mutual fund industry, a structure alien to the American way of doing business. The simplest way to deal with these conflicts of interest would be to eliminate them. This could be done by requiring the mutual funds be internally managed by their own officers and directors in the same way that most other companies, including financial institutions such as banks and insurance companies, are managed. Managers of investment companies, like those of other corporations, would then receive compensation for their services primarily in the form of salaries and other readily disclosed remuneration subject to conventional limitations instead of receiving gross management fees in a manner which obscures the excessive nature of these fees. The Commission, however, has rejected this approach as being too drastic at this time and instead has chosen to recommend only that the conflicts of interest inherent in the present industry structure be subjected to meaningful controls in the form of an express, readily enforceable standard of reasonableness. We know of no other means which on the one hand would deal adequately with the problem of excessive fees and on the other hand would disturb less the established structure of and ways of doing business in the mutual fund industry.

The need for controls over sales loads arises from the anticompetitive effects of Section 22(d) of the Investment Company Act, which interferes with the freedom of dealers to compete for customers by offering mutual fund shares at a price lower than that fixed by the principal underwriters of the funds. The industry claims that the present level of sales charges is reasonable and required by competitive conditions in the industry. However, when repeal of Section 22(d) was suggested to persons within the industry, they reacted with expressions of deep, and indeed almost violent, concern that the mutual fund industry could not survive the test of meaningful price competition. Nevertheless, it was not necessarily persuaded as to the basis for this concern. Nevertheless, it determined to adopt an approach which would deal fairly with the situation and which the industry would regard as a more moderate and conservative position. It determined not to recommend that existing restraints on competition in the sale of mutual fund shares be eliminated. It urged that investors be protected by a statutory ceiling on sales loads which would be subject to upward revision by the Commission when the public and investor interests seem to require such action.

With respect to front-end loads in the sale of contractual plans the Commission has recommended the abolition of this method of investing in mutual fund shares which for many purchasers has proved to be extraordinarily costly. It took this step, however, only because of the failure of the industry to develop meaningful alternatives which would protect adequately the substantial number of investors who, in fact, do not complete the payments on their plans. Many of these investors pay sales charges amounting to more than one dollar for every dollar invested in fund shares. Many of them, because of these unconscionable sales charges, have lost money on their mutual fund investments despite the rapidly rising securities market of recent years. Even so, the Commission did not

<sup>1</sup> See e.g., Statement of the Investment Company Institute, pp. 17-32. (Hereinafter referred to as "ICI Statement, —").