

industry for mass participation in the securities market. Mutual funds costs are no more "bargain basement" than the quality of their product. Although mutual funds offer a security of high quality, the high cost of a mutual fund investment places investors at a substantial disadvantage in the achievement of their financial goals.

Justification of advisory fees in terms of the cost to the individual investor is inconsistent with the basic concept of a mutual fund. Mutual funds are created and sold to the public as a "mutual" investment median through the pooling of individual savings for investment in equity securities just as mutual savings banks offer a way to pool savings for investment in home mortgages and other debt securities and mutual insurance companies offer a way to pool premiums and thus, reduce costs of family protection. Our proposal that mutual fund advisory fees be governed by a standard of reasonableness would require that the economies of size be shared with fund shareholders. It would make the operation of mutual funds more consistent with the purposes for which they are created and the basis on which they are sold.

While the industry has created the funds and sold their shares with all the trappings and attractions of "mutual" savings institutions, its representatives attempted to suggest to this Subcommittee that the externally-managed fund is not a mutual savings institution at all, but more comparable to a stock insurance company.¹ But neither stock insurance companies nor a major segment of any other industry are characterized by the externally-managed structure, which compensates its managers not on the value of their services, but on the value of the company's assets. Such a method of compensation, which expresses the compensation as a fraction of one percent of the fund only obscures the many millions of dollars in managerial emoluments that flow from control of a mutual fund. The industry cannot have it both ways, selling shares in a mutual savings institution while abandoning any attempt to operate the institution for the mutual benefit of its investors.

Indeed, even in the ordinary corporate situation, where no attempt is made to create a corporate entity with the trappings of mutuality, the propriety of self-dealing transactions, such as management compensation, is not measured in terms of the cost per shareholder or cost per customer. When a director of a manufacturing company causes his company to deal with a supplier in which he has a financial interest and the supplier over-charges the company, the transaction has never thought to be justified on the grounds that it cost each shareholder only a few cents. Such a transaction is condemned as a breach of fiduciary duty because it contravenes the norms of the business community and the basic tradition of the law.

4. THE INDUSTRY'S ATTEMPT TO SHOW THAT ADVISORY FEE RATES ARE DECLINING IS BASED ON A MEANINGLESS STATISTICAL EXERCISE

Although at times industry representatives have suggested to this Sub-Committee that there is no duty on the part of fund managers to share the economies of size with fund shareholders, at other times they have claimed that advisory fees are declining and the economies of size are being shared with shareholders. They support this claim by statistics which purport to show that since 1946 average advisory fee rates for all mutual funds have declined by 19 percent—from .46 percent of net assets in 1946 to .37 percent of net assets in 1966—and that total operating expenses during this period have declined by 28 percent.²

Advisory fees are almost always paid to the persons in effective control of the fund and constitute by far the major part of the operating expenses of a mutual fund. On the other hand, expenses other than advisory fees, which usually are paid to banks, lawyers, accountants and printers who are unaffiliated with the fund's management, constitute only a small portion of a fund's operating expenses. The industry's own statistics show that any reductions in advisory fees that might have taken place have failed by a wide margin to keep pace with the reduction in the other operating expenses of mutual funds, expenses which usually reflect payments to non-affiliated persons who stand in arm's length relationships with the funds and their managements. Thus, even the industry's own figures raise a serious question as to the adequacy of the sharing of the economies that they allege has taken place.

¹ ICI Testimony, R 213-215.

² ICI Testimony, R. 198; ICI Statement, Exhibit 8.