

Moreover, exhibit 8 to the Investment Company Institute's testimony, on which the claim of the 19 percent reduction is based, shows a strange and confusing picture. According to this exhibit, mutual fund advisory fees amounted to .37 percent of assets in 1966.

This same chart shows, however, that advisory fees in 1958, when the industry was only a fraction of its present size, amounted to .38 percent of assets—only 1 percentage point higher than the "average" of the 1966 fees. It also shows that in 1949 advisory fees averaged .40 percent of assets, only 3 percentage points more than the "average" 1966 fee rate. In 1949 the industry's assets were less than \$3 billion. According to the industry's statistics, therefore, the economies of size were shared with fund stockholders, long before the funds had grown to the point where they had economies of size to share.

These contradictions in the industry's own data suggest that its claim of substantial reductions in advisory fees is based on an invalid statistical exercise. In fact, it is meaningless as a measure of the regulatory problems before this Congress because it is based on a weighted industry average which gives great weight to the relatively low fees paid by a few very large funds. The funds, including the internally-managed funds, which, as we have noted, pay substantially less for investment advisory services than the externally-managed funds. The plain fact, which the industry does not dispute, is that over one half of the largest funds—those with assets of \$100 million or more—paid advisory fees at the rate of .48 percent or more in 1966. The fact that there has been little deviation from the traditional .50 percent advisory fee rate, which was characteristic of the much smaller investment company industry of the 1940's and 1950's, demonstrates the seriousness of the excessive fee problem.

5. THE INDUSTRY'S ATTEMPT TO DEMONSTRATE THE "MODESTY" OF ITS PROFITS IS BASED ON INVALID COMPARISONS

The industry has attempted to show that the profits of mutual fund management organizations are "modest" by calculating the profits of 14 such companies not as a percent of revenues or shareholder equity but as a percent of the capital of the funds they manage.¹ The industry then compares these profit figures with the profits of the twenty-five largest insurance companies and banks as a percent of the public capital held by these institutions. This is an absurd basis for comparison. It is like determining profitability of a real estate management firm as a percent of the aggregate value of the property it manages or the profitability of a consulting engineering firm as a percentage of the construction costs of the projects it works on. It is the investment adviser, not the fund which receives advisory fees and makes profits. In many cases the pre-tax income of the adviser is very handsome, ranging up to 65 percent or more of their advisory fee revenues.

If a comparison is to be made of the profitability of mutual fund management organizations on the basis of capital, a more appropriate comparison would be profits as a percent of shareholder equity. On the basis of shareholder equity the profits of publicly-held mutual fund management organizations are, indeed, impressive. They show an annual return of 30, 40 and even close to 70 percent. In contrast, the median profit of the twenty-five largest insurance companies and banks selected for comparison by the Investment Company Institute amounts to a 9.8 percent and an 11.1 percent return on shareholder equity.

The Commission believes that the question of whether mutual fund advisory fees are excessive should not be decided solely on the basis of the adviser's profits no matter how computed. It is clear, however, that profits of mutual fund management organizations are hardly more "modest" than are the fees they charge their mutual fund clients. The industry should not be heard to justify its excessive charges by a fallacious statistical presentation as to the "modesty" of their profits.

6. THE INDUSTRY CLAIM THAT ADVISORY FEE RATES ARE EFFECTIVELY CONTROLLED BY COMPETITION, DISCLOSURE, UNAFFILIATED DIRECTORS AND SHAREHOLDER APPROVAL. IGNORES REALITY

Despite the unbending rigidity of the advisory fee structure in the rapidly growing mutual fund industry, the industry claims that competition, disclosure,

¹ ICI Statement, 29-30; ICI Testimony, R. 202-203.