

unaffiliated directors and shareholder voting are effective controls over the fees.¹ The facts are, as the industry well knows and twenty-seven years of experience amply demonstrates, that there simply is no competition in the advisory fee area, that unaffiliated directors have not been effective in keeping advisory fees reasonable and that shareholder voting has no effect on such fees.

(a) *Advisory fees are not subject to competition*

The industry apparently concedes that investment advisers do not compete for the privilege of serving mutual funds and that mutual funds have no real opportunity to shop around and seek the best terms they can get. If that were otherwise, surely there would be instances where the independent directors have successfully dislodged an adviser who was willing and able to continue. In fact, with one possible minor exception, there have been no such instances in the history of the industry. No proxy contest has ever been waged against, much less has one succeeded in displacing, an incumbent adviser to a mutual fund. Indeed, many independent directors suggested that it might be considered a breach of fiduciary duty to attempt to dislodge the adviser.

It appears from the industry testimony that the type of competition referred to is the competition among funds to sell their shares to investors; at the same time they attempt to establish that the investment advisory fee is insignificant insofar as the average small investor is concerned. The two positions can hardly be reconciled.

The best indication of the role competition in sale of fund shares plays in keeping advisory fees reasonable is how those who sell mutual funds treat the fees in their selling literature. The fact is that even those funds with relatively low fees seldom emphasize that fact. Take, for example, the prospectus of Massachusetts Investors Trust. This fund, which is internally managed, pays its trustees salaries which under any standard of executive compensation is quite handsome; yet their management cost rate of .12 percent of assets is less than one-fourth the traditional .50 percent rate. Its prospectus, however, makes no mention of these facts and indeed makes no mention of its relatively low operating expenses beyond that legally required by Commission rules. If the fees charged are important competitive factors, it is strange that those funds enjoying the lowest fees do not vigorously advertise that fact.

There is one group of internally-managed funds with relatively low management costs that does emphasize this fact in its selling literature. An official of this fund, however, has himself questioned its effectiveness as a sales inducement, except, perhaps, in extremely large transactions.

Although the amount of the advisory fee, which is a recruiting charge, is important to investors, their lack of awareness as to the fees is understandable. In addition to the fact that the amount of the fee when expressed as a small percent of the fund's assets tends to be obscured, it is hardly likely that the relatively small differences among the fees paid by most funds would be a determining factor in his selection of a fund. Nor is it likely that salesmen would invite the attention of the investor to any differences that may exist. They would also be inviting attention to the sales charge, which though paid only once, is more than eighteen times the .50 percent advisory fee.

(b) *The Industry Claim that Unaffiliated Directors are Effective in Keeping Advisory Fees Reasonable is a Myth*

We do not disagree that the unaffiliated directors can make valuable contributions by providing fresh ideas concerning particular industries or securities, trends in the economy and the general operation of the business. We believe, however, based upon the available facts from extensive studies, that the industry is perpetuating a myth when it persists in its contention that the unaffiliated directors represent an important additional factor in the "competitive" process affecting advisory fees. In the fee area, unaffiliated directors have not been effective and, in the nature of things, it is unrealistic to expect otherwise.

As we have said, competition among investment advisers for advisory contracts with mutual funds is generally unknown to the industry. Thus, the unaffiliated directors have no practical alternative but to accept the proposals of the adviser, and, at least in the past, they have tended to regard a renewal of the investment advisory contract as merely a matter of corporate routine, something like approving the minutes of the last meeting. Indeed, there have been a number of

¹ RCI Testimony, 198.