

embarrassing instances where an investment advisory contract of a mutual fund was not renewed as required by the Investment Company Act simply because everybody concerned forgot about it. While such carelessness is uncommon, it is a symptom of the significance assigned to the ritual of approval. As one industry spokesman acknowledged, at most, the unaffiliated director's role is limited to "moral suasion." Apparently, in most such situations the advisers' fees have not suffered as a result of any suasion—moral or otherwise—emanating from the unaffiliated directors.

The attorney who prosecuted most of the shareholders suits involving advisory fees testified:¹

"I said before I know one man—he happens to be associated with a man who is sitting near the door—who operates one of America's largest if not the largest investment company—who to my knowledge really stood up as an unaffiliated director, and when I tried to settle my lawsuit he fought with me because he thought my proposed settlement wasn't adequate.

"And this I must say came with the same kind of shock to me as it did to you. But aside from that one man, in the 14 cases I have run into, involving, as an estimate, something like a hundred or more unaffiliated directors, I have not seen the counterpart of that in any case.

"These men, by and large, go along and rubberstamp.

"The proof of the pudding is that when these funds were growing from \$100 million to \$2 billion and they were getting a flat one-half of 1 percent advisory fee, wouldn't you imagine that somewhere, sometime, somebody among the unaffiliated directors would say, 'Now, look, fellows, this is getting a little out of hand. A \$500,000 fee is not a \$10 million fee. Wouldn't it be nice if we were to sit around the table to talk about reducing it from half a percent to three-eighths percent or some scale-down?'

"That never happened.

"Senator BENNETT. You're sure it never happened?

"Mr. POMERANTZ. It never happened.

"Senator BENNETT. You're sure?

"Mr. POMERANTZ. It never happened at the instigation of an unaffiliated director."

This is not cited as an indictment of the unaffiliated directors. Persons invited to join boards of directors do not normally do so to oppose the management or to bargain at arms length with their fellow directors who are affiliated with management. This is normally not considered their function. When it is necessary to nominate someone to serve as an unaffiliated director, all parties undoubtedly look forward to a harmonious relationship, and the unaffiliated director not unreasonably accepts the position upon that assumption. If an unaffiliated director were to suggest to his fellow affiliated directors that the fund has been charged an unreasonable advisory fee which should be reduced, the harmony of the board would in all probability be seriously disrupted. Unaffiliated directors, of course, know this and it is probably a factor which accounts in considerable measure for their inactivity in the fee area.

(c) *Over three decades of experience contradict the industry claim that stockholder voting is effective in keeping advisory rates reasonable*

The industry also suggests that existing requirements of shareholder approval constitutes an effective control over advisory fees, despite the well-accepted fact that, in most situations, the great majority of shareholders simply send in their proxies when the management requests them to. Shareholders acquiescence is hardly surprising. There is little else they can do. If shareholders should by any chance vote down an investment advisory contract they would leave the company without management and jeopardize their investment. But this possibility is purely hypothetical. It is commonly accepted, and many years of experience with proxy regulation in all areas of corporate life support the conclusion, that in the absence of organized opposition to a proposal, most shareholders either do not return their proxies or mark them in favor of management proposals. In the case of mutual funds the possibility of organized opposition is particularly unrealistic. Advisers do not compete for advisory contracts with funds by organizing proxy contests. And the possibility of a shareholder-initiated contest is also remote.

¹ See hearings before the Senate Committee on Banking and Currency on S. 1659, 90th Cong., 1st Sess. (1967), p. 696.