

This is not to say that proxies and the proxy statements are not meaningful. They are very useful as a disclosure device; but they do not and cannot control mutual fund management fees. Indeed, requirements of shareholder approval have only impaired existing controls. In the absence of such action courts will inquire into the reasonableness of advisory fees. But, as industry representatives have conceded, ratification by stockholders or approval by independent directors has caused some courts to require any shareholder who challenges a management fee in court to prove not merely that the fee is unreasonable, but as Judge Friendly has put it, that the fee is "excessively excessive" so as to constitute a waste of corporate assets.¹ This has heretofore proven to be an insuperable burden in management fee cases and has seemed to defeat the very purposes of the Congress in 1940 in providing the "few elementary safeguards" to deal with a problem that had not yet developed but now looms large on the horizon.

7. THE INDUSTRY WANTS TO REMAIN AS THE SOLE JUDGE OF THE REASONABLENESS OF ITS OWN FEES

The industry's own testimony indicates that it does not believe its protestations that competition, disclosure, unaffiliated directors and shareholders approval are "important" factors in reducing advisory fees. The statement of the Investment Company Institute asserts that "most of these management companies which have achieved their entrepreneurial goals have progressively reduced the rate of their fees over the years."²

The question might well be asked, who determines whether a management company has achieved its entrepreneurial goal from the fees paid by the funds it manages? Certainly not the unaffiliated directors of the funds! Time after time unaffiliated directors have stated that the profits of the investment adviser was no concern of theirs in evaluating the reasonableness of the fee and that it would be improper to suggest that the adviser disclose to them their profits from the management of the fund. Nor are the shareholders in a position to determine whether the management of their fund have "achieved their entrepreneurial goals." Indeed, the industry has strongly protested on each occasion where the Commission has suggested that the profits of investment advisers should be disclosed to shareholders as information material to evaluation of the reasonableness of the fees.

What the industry is therefore saying is that reductions in advisory fees should depend on whether an adviser has made enough money from the management of the fund it controls and the determination of that question should rest solely in the discretion of the investment adviser. Mutual fund shareholders should not rely upon adherence to the basic fiduciary standards of fairness in dealing with their advisers but must depend on the largess of the adviser. We do not think that such baronial self-determination is a substitute for a readily enforceable statutory standard of reasonableness where the trusteeship of people's money is involved.

8. THE INDUSTRY ADMITS ITS "VERY DEFINITE" RESPONSIBILITY TO SEE TO IT THAT THE FEES ARE "REASONABLE" BUT OPPOSES EFFECTIVE ENFORCEMENT OF THIS RESPONSIBILITY

The industry has conceded in testimony before this Committee that an investment adviser has a "very definite responsibility to see to it that the fees it charges are reasonable". Nevertheless, it complains that enactment of an express standard of reasonableness would "drastically" change existing law. Such a view is based on a misconception of the purpose of the bill.

As Judge Friendly has pointed out and the industry apparently concedes, the courts traditionally have held that those who manage or control a corporation have a fiduciary obligation to deal fairly with it.³ Courts normally will inquire into self-dealing transactions between a corporation and its insiders and will upset such transactions unless the insiders can sustain the burden of proving fairness.

Mutual fund advisory contracts with affiliated persons are a classic example of a self-dealing transaction. In the shareholder litigation involving advisory fees,

¹ Testimony of Judge Henry J. Friendly, R. 690.

² ICI Statement, 25.

³ Testimony of Judge Henry J. Friendly, R. 689, 704.