Professor Folk also states that if the Congress is not disposed to place the burden of proving reasonableness on the defendant, the Bill should provide that the burden of proof would not shift to the plaintiff as a result of shareholder ratification but only if the contract is approved by a majority of the disinterested directors who are not interested persons of the investment adviser. We believe that the provisions of the Bill in conjunction with existing requirements of the Investment Company Act achieve substantially the same result. Under the provisions of the Bill the plaintiff would have the burden of proving unreasonableness only if the compensation is paid pursuant to a contract or other arrangement approved or authorized in accordance with the requirements of the Act. The Act now requires that a contract be initially approved by shareholders and thereafter renewed either by shareholder vote or by vote of a majority of the unaffiliated directors. While it is theoretically possible to avoid a vote of approval by directors by submitting for shareholder vote, as a practical matter, the submission to shareholders is accompanied by recommendations of the directors. In this connection, the Bill places a duty on directors of an investment company to request and evaluate the information material to the reasonableness of advisory fees.

8. This proposal would permit the continued existence of mutual fund-holding companies which do not acquire more than 3 per cent of the total outstanding stock of any other registered investment company and which sell their shares at a public offering price which includes a sales load of no more than 1½ per cent. The proposal contains other restrictions, apparently designed to meet the problems of a mutual fund-holding company. The restrictions would permit any registered investment company, the shares of which are held by such a fund-holding company, to refuse to accept for redemption from such a company in excess of 1 per cent of its shares in any 30-day period. The restrictions would also require the fund-holding company to either pass through to its stockholders the right to vote securities held in its portfolio or to vote such securities in the same proportion for and against as all other holders of such securities vote.

The proposal also suggests a "grandfather" clause to permit only the operation of the two fund-holding companies now in existence. This is an unacceptable alternative since, if the restrictions suggested by the proposal are adequate, there would be no need for such a "grandfather" clause. If, on the other hand, the restrictions are not adequate, the public interest would not be served by legislation designed to permit the continued existence of even just a limited number of fund-holding companies. In other words, if the concept is good, there would be no reason to prohibit it at all, and if it is bad, any prohibition should apply across the board.

Upon analysis it is clear that the proposal falls short of solving the problems inherent in a fund-holding company operation. It would not protect against the layering of advisory fees nor would it protect against the layering of administrative expenses. Furthermore, the limitation of a 1½ per cent sales load masks the problem of cumulative sales load that would exist upon the turnover of portfolio securities by the fund-holding company. The proposal also fails to answer problems inherent in a fund-holding company operation such as the fact that restrictions in its investment policy could easily be avoided by investments in mutual funds with contrary investment policies.

The restrictions on redemption and voting suggested in the proposed amendment would themselves create new problems and require special comment.

The restriction on redemption is a recognition of the danger inherent in the threat of potential redemption which would be available to a fund-holding company. A restriction such as that proposed—maximum assured redemption of 1 per cent of a portfolio fund's outstanding securities during any 30-day period—would appear to protect a registered mutual fund whose securities are owned by a fund-holding company from this threat. At the same time, however, it would expose the investors in the registered fund-holding company to undue risk. Assuming, for example, a registered fund-holding company with its assets fully invested in 3 per cent of the outstanding stock of several registered mutual funds, if each of those portfolio funds are obligated to redeem only 1 per cent of their outstanding securities within any 30-day period, only ⅓ of the total assets of the registered fund-holding company would be liquid and available within a period of no more than 30 days, to meet the redemption needs of its own investors.

The proposed restriction with respect to voting rights is also unsatisfactory. The restriction contemplates two alternatives—the registered fund-holding com-