

TABLE II.—SHAREHOLDER SUITS INVOLVING MUTUAL FUND ADVISORY FEES INSTITUTED SINCE PUBLICATION OF COMMISSION REPORT

| Fund involved                                | Name of suit                                              | Date brought  | Disposition |
|----------------------------------------------|-----------------------------------------------------------|---------------|-------------|
| 1. Manhattan Fund, Inc.-----                 | White et al. v. Auerbach et al.---                        | Jan. 10, 1967 | Pending.    |
| 2. Dreyfus Fund, Inc.-----                   | Schlusberg v. Weissman et al.---                          | -----do-----  | Do.         |
| 3. Keystone Custodian Funds, Series S-3----- | Schlusberg v. Investors Overseas Services, Ltd. et al.--- | -----do-----  | Do.         |
| 4. American Investors Fund-----              | Fogel, et al. v. Chestnutt, et al.---                     | Jan. 6, 1967  | Do.         |
| 5. United Funds, Inc.-----                   | Horenstein v. Waddell and Reed, Inc.---                   | Oct. 26, 1967 | Do.         |
| 6. Fidelity Capital Fund, Inc.-----          | White v. Johnson-----                                     | Jan. 10, 1967 | Do.         |
| 7. Affiliated Fund-----                      | White v. Driscoll-----                                    | Jan. 19, 1967 | Do.         |

3. Why are the expenses of internally managed funds apparently lower than those of externally managed funds?

Internally managed funds are operated by their own officers and employees who, like most corporate executives, are compensated directly by their company through salaries and other readily disclosed forms of remuneration. For this reason, the management costs of the internally managed funds are subject to the restraints imposed by disclosure and conventional limitations on executive salaries that govern executive compensation in most areas of the economy.

These restraints are not present in the case of externally managed mutual funds, which usually pay for most management services by means of a fee based on a percent of the fund's assets, rather than by salaries and other common forms of executive remuneration. Appraisal by shareholders or directors of the fairness of these fees is far more complex than the appraisal of the reasonableness of the compensation paid to individual executives.

Even in the case of internally managed investment companies, the restraints of disclosure of and conventional limitations on executive salaries may have been weakened by the pattern of fees paid by externally managed companies. For example, the five trustee-directors of Massachusetts Investors Trust and Massachusetts Investors Growth Fund, Inc., received combined compensation in 1966 for their personal services to the funds in the amount of \$2.2 million, an average of \$450,000 per year for each of the five managers. Although this compensation is quite handsome by any standard, one of the two funds, MIT, has the lowest management expense ratio of any fund in the industry. As noted in the Commission's Report, a national magazine has reported that in 1951 when the funds managed by the MIT trustee-directors were much smaller and their compensation much less than today, the MIT trustees voluntarily imposed a limitation on their own salaries, because: "They decided that they were, or soon might be, making an embarrassingly good living from the trust."

In 1952 this limitation was dropped and the compensation of the MIT trustees has since increased in amounts that are closely proportionate to the growth of the funds under their management. The shareholders of Massachusetts Investors Trust, however, have been able to enjoy some of the economies available from the growth of their fund because management and other operating costs except those relating to trustee's compensation have not risen proportionately to the growth of the fund. MIT's management cost ratio in 1966 amounted to .12 percent of average net assets.

In contrast, the shareholders of externally-managed funds in many cases, have not received a fair share of the economies of size available from the growth of their funds. Over one-half of the externally-managed funds with assets of \$100 million or more in 1966 paid advisory fees amounting to .48 percent or more of average net assets.

4. Section 22(d) of the Investment Company Act of 1940 precludes price competition between two salesmen selling the same fund. It does not preclude price competition between these salesmen and the salesmen of another fund which may have a lower load or no load. How can this existing competition be made more effective?

Given the present requirement for retail price maintenance in Section 22(d), we know of no way of significantly enhancing the effectiveness of price competition between funds.

As your question recognizes, most mutual fund transactions are initiated by salesmen. Accordingly, the only mutual fund prospectuses that the ordinary