

same as saying: "If X commits a harmful act, Y should be permitted to do the same." It relegates all to the same common denominator. Further, it ignores the facts. Mutual funds, not pension funds, are the more active traders, and consequently suffer the most from a rigid portfolio position. And, it must be emphasized, mutual funds have a history of government regulation which has given to them the imprimatur of a quasi-fiduciary in the eyes of the fund shareholders.

B. Fund shareholders

There is a premium paid by those who invest their monies in mutual funds. Some would call it a premium for experience; others would term it a payment for safety; both are correct. Indeed the Commission report does not deny the premium; only the amount is brought into question. We believe the Commission has recommended too little; it has not faced an underlying problem: Fund shareholders, particularly in the larger funds for reasons already stated, may not be getting either the benefit of experience or safety. How can they? If a fund manager in the exercise of his experience business judgment spots weak factors in a portfolio holding and decides to sell but cannot because of the amount held, surely the fund shareholder suffers. Can it be denied that in such a situation the fund shareholder is in much the same posture as one who holds for speculation? His fund manager hopes for investment growth, but is limited in what he can do to insure it; the securities ride the wave of chance.

V

The Commission's report makes a fundamental assumption: The structure of the mutual fund industry is basically sound. The agency's recommendations are designed to improve that structure. The thrust of these comments questions the Commission's basic assumption.

STATEMENT OF ERNEST L. FOLK, III, PROFESSOR OF LAW, UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL*

I. COMPENSATING MANAGERS AND ADVISORS OF INVESTMENT COMPANIES

(Section 8 of the Investment Company Amendments of 1967, amending Section 15 of the Investment Company Act of 1940)

Section 8 of the Investment Company Amendments of 1967 deals with the critical problem of the level of management fees charged by investment advisors and principal underwriters to the mutual funds which they serve under contract. The proposed rewriting of Section 15(d) imposes a statutory standard of "reasonable" compensation, impliedly grants a private right of action to enforce the standard, and places the burden of demonstrating reasonableness upon the objector. I favor enactment of this provision with one reservation.¹

1. I first point out that the proposal is a very moderate one. First of all, it declares, in the context of mutual fund management fees, a criterion which has been universally applied to compensation of managerial personnel in corporation law, namely that aggregate compensation must be reasonable and reasonably related to the services performed for the paying entity. It is hardly radical to suggest that such a well established standard of fairness should explicitly apply to mutual funds as well. Secondly, the proposal is designed to overcome the effect of several decisions which have invoked certain restrictive rules of state corporation law so as to make it extremely difficult to give effect to a "reasonableness" test. It seems to me quite appropriate that in a field, subject to comprehensive federal regulation, Congress should adopt federal rules whose prime purpose is to undo limitations derived from state corporation law which are primarily relevant to entirely different sorts of enterprises. Finally, the proposal places upon the objector the burden of proving reasonableness by a "preponderance of evidence that such compensation is unreasonable." Although I think this unduly favors management.

I cite it as a clear instance of the bill's notable restraint in regulating advisor-underwriter fees. The conservatism of the proposal is further underscored by

*The views presented in this statement are personal and should not be attributed to the University of North Carolina or to its School of Law.

¹ *Infra*, pp. 803-804.