little from the SEC proposal which is subject to exemptions. To the extent that it is more vaguely worded, it would be less apt to give the investor the advantages hoped for, and it could easily involve the NASD in substantial administrative problems in policing the activities of firms and salesmen in charging "reasonable" sales loads. Also, for these broker-dealers not members of the NASD, presumably the SEC would have to formulate its own rules so that non-NASD members would not have certain advantages in freely fixing sales loads while NASD members remain subject to some type of industry-imposed restraint. I have no doubts that the NASD would act in good faith in formulating a standard and in effectively administering it, but I do not see that it would produce a better result than the proposed 5% ceiling (subject to SEC exemptive power).

6. *Alternative 4: Sliding Scale.*—If it believed that an immediate drop to a 5% maximum sales load would be too great an economic hardship on retailing mutual funds, consideration might be given to a gradual downward adjustment. For instance, the maximum load might be 7% for the first year after effective date, then 6% for one or more years, and then 5%. This would permit gradual enhancement of efficient sales practices to adjust to possibly lower revenues. If adopted in principle, either Congress could specify the sales load levels, or it would vest the SEC with discretion to determine when the several downward steps should be taken. However, I believe that Congress should make these specific determinations as a matter of legislative policy. An analogy is the two-staged application of the Securities Acts Amendments of 1964 to over-the-counter issuers required to register with the SEC under Section 12(g) of the Securities Exchange Act of 1934 (as amended), by which the new rules applied first to issuers with at least 750 shareholders, and then the following year to those with at least 500 shareholders.

Statement of Edward S. Herman, Associate Professor of Finance, Wharton School, University of Pennsylvania

I. Introduction

This statement deals only with the regulation of the management fee rate and the sales charge. These two areas are treated here in terms of the basic economic rationale of the SEC legislative proposals, with only a minimum of attention being given to the details of the various proposals.

The basic point of this statement is that strengthened regulation along the lines suggested by the SEC is desirable because competition either has not worked or has worked perversely in the determination of both the management fees and sales charges of mutual funds. Moreover, it would not be easy to make competition work satisfactorily in these areas, even with drastic structural reorganization of the industry. The SEC recommendations must therefore be regarded as a conservative compromise between nothing in an area where the market mechanism has worked badly, and more radical changes of uncertain effect.

II. The Management Fee Rate

The evidence is clear that management fees charged mutual funds have been substantially higher than those charged other investors of comparably-sized portfolios.[1] In the *Study of Mutual Funds* we tested the standard industry explanations of these high rates, and found that neither their level overall, nor the differentials found within the industry, could be explained in terms of performance, services rendered, or expenses. The industry has also relied heavily on the argument that the individual mutual fund investor would not pay a lower management fee rate if he chose the alternative of private counseling. This may be true, but if advisory expenses per dollar of assets decline with increases in fund asset size (as is the case), and if the fund is paying a substantially higher rate than other clients of similar size, can the fund's directors, who have a fiduciary responsibility to the shareholders, justify a high and inflexible rate on the ground that the shareholders cannot do better elsewhere? This would reflect a peculiar conception of directorial obligations!

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[1] Full documentation may be found in *A Study of Mutual Funds*, H. Rept. No. 2274, 87th Cong., 2d Sess. (1962), pp. 480–95; Edward S. Herman, "Mutual Fund Management Fee Rates," *Journal of Finance*, May 1963, esp. pp. 368–74; and for developments subsequent to the Wharton Report, S.E.C., *Public Policy Implications of Investment Company Growth*, H. Rept. No. 2337, 89th Cong., 2d Sess. (1966), Chapter III.