

more closely and positively related to the size of the sales charge than the investment performance of the fund. This indicates an irrational element in the market, based on buyer ignorance and its exploitation by salesmanship. This is what has led to an upside-down competition.

It should be pointed out that buyers of fund shares have not generally been damaged as a result of their investments. On the contrary, many of them have done quite nicely. In principle, however, it seems unwise from the standpoint of both stability and equity to encourage large numbers of relatively uninformed small investors into a risky investment medium on the basis of intensive person-to-person selling. It has been suggested that a reduction in inflow, which might follow a curtailment of incentives to salesmanship, may make the funds more vulnerable in times of weakness (and high rates of redemption), thus forcing the sale of portfolio securities and a disruption of capital markets. This sort of argument can be levied against any change (including the original securities legislation), which almost invariably has some short term disruptive effects. What it disregards is the fact that stability and the continuity of growth of markets in the longer run depend in large part on their basic soundness. This will determine their ability to withstand real stress.

If it is argued that a ceiling on the sales charge is an arbitrary and paternalistic device for handling this problem, the reply must be that the alternatives seem unpromising. To do nothing is to forego governmental paternalism of a limited kind in favor of a statutory umbrella for the unrestricted private exercise of significant monopoly power. An alternative to the SEC proposal for the 5% ceiling on the sales charge would be the elimination of the resale price maintenance provisions of section 22(d),<sup>3</sup> which might inject some price competition into selling at the retail level. Apart from the fact that the industry strongly supports this form of price regulation, it runs up against the previously discussed reluctance of dealers to compete on price. Thus there is a distinct possibility that by itself the abolition of 22(d) would have little or no effect on retail price competition. It is also argued with some cogency that if retail price competition did develop it would tend to strengthen the position of the large complexes that engage in direct selling, because they would be insulated to some extent (but by no means entirely) from the damage stemming from dealer disaffection with "cut" shares.

A further alternative action that might be taken, either alone or in conjunction with those previously mentioned, would be a relaxation of restrictions on fund advertising. It is one of the paradoxes of the "disclosure" rules that a no-load fund cannot push very aggressively the fact that it imposes a zero sales charge; when it goes beyond a "tombstone" and it easily runs afoul of the SEC's tendency either to require full disclosure or to permit virtually nothing in the way of publishing advertising. The situation might be significantly improved in terms of true investor knowledge if an intermediate ground for stressing important facts were opened up.

It is also suggested that mutual funds be required to disclose more fully the sales charge alternatives to the investor, perhaps on the front of the Prospectus. As noted earlier in regard to the suggestion of a need for more extensive disclosure in connection with the management fee, I feel that there are saturation limits in using disclosure as a means of creating a more informed market. The problem of deciding on the appropriate comparative information under full disclosure would involve serious regulatory problems, although in principle they are not beyond resolution.

Thus, while the abolition of resale price maintenance and improvements in disclosure (including comparative information) would tend to increase competition on the sales charge, and are thus desirable in their own right, I am skeptical about their adequacy. The 5% ceiling has the virtues of simplicity, effectiveness in limiting a perverse competition, and equity in fixing a rate on the high side of security market selling costs.

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My name is Donald E. Schwartz and I am an Associate Professor of Law at Georgetown University Law Center. Prior to my becoming a law professor in 1966, I was engaged in private law practice in New York City for five years and

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<sup>3</sup> It should be pointed out that the elimination of the resale price maintenance provisions of section 22(d) is not in conflict with the 5% ceiling proposal and could be combined with it.