

feel free to reject a submitted transaction without fear of disrupting the corporation. If the mutual fund shareholders reject an investment advisory contract, the fund is left with no management at all. Most important, of course, in an uncontested election, it is common knowledge that he who controls the proxy machinery can obtain the approval of anything he seeks; at least, there is no record of any experience to the contrary. That important legal consequences as to the meaning of the vote should flow from this exercise is the sheerest of legal casuistry.

Third, the bill provides that the role of independent directors is to be enlarged. There is imposed upon them and spelled out with some care the affirmative responsibility which they have in selecting the investment adviser and in negotiating and determining the fee to be paid to the investment adviser. Moreover, the added detachment of the persons who are to perform this function, as a result of the amendment defining interested directors, increases the likelihood that independent judgment will be brought to bear on the question, particularly when coupled with the other provisions of the bill regarding compensation.

The safeguards of the bill are not as strong as I think conditions in the industry warrant, but they are a vast improvement over existing law. I believe the bill will work because I believe that the enactment of a federal standard spelling out guidelines, both for interested and unaffiliated directors of mutual funds, will have a most salutary effect on the industry. I believe that those investment advisory fees which are not at the present time reasonable will become reasonable, more as a result of voluntary action initiated by the industry than by litigation. But to encourage that result and to emphasize the continuing nature of the management's duties, I believe it is important to remove some of the temptations that exist under the present law for mutual fund managers to aggrandize themselves at the expense of the shareholders and the funds.

When this proposal is labelled as modest, consider how much more drastic could have been the proposal to reform advisory fees. As mentioned earlier, I believe it would be appropriate for the bill to provide that the burden of justifying the reasonableness of the management fee should be imposed upon the managers of the fund. Plaintiff's task, while not insuperable under this bill, is nonetheless difficult. Further, the bill could provide that the liability for charging an excessive fee would be imposed, not just upon those who received it, but upon those who approved it, that is, the so-called independent directors. The bill specifically provides that the liability shall be limited to those who receive the excessive compensation. More drastic than either of the above, the bill could have insisted that all mutual funds be managed internally and not by an outside investment advisor, in the same manner as other corporations. This is already the pattern of a number of mutual funds, including the oldest of the funds, Massachusetts Investors Trust. Such management has proven to be less expensive to the fund and its shareholders and, if for no other reason, it would commend itself on that basis alone. I believe that if such a proposal had been made, it would merit serious consideration. I think the proposed § 15(d) is the very least which we can expect in a bill which considers itself Mutual Fund Reform legislation.

I shall not comment in detail upon the provision in the bill which would impose a 5% limitation on sales loads. There are large economic questions at stake in that issue on which I do not feel myself qualified to speak. However, I do wish to point out that the existing state of the law and pattern of mutual fund selling leaves investors defenseless against spiralling sales charges, which have the effect of making mutual fund shares increasingly expensive.

Mutual fund shares are, as is commonly known, not bought but sold. Indeed, the industry has repeatedly argued that the effect of the load limitation would be to decrease the number of shares of mutual funds sold because the sellers would receive smaller compensation. It seems ironic that people will buy less of a good product when, without loss of quality, it becomes less expensive. The reduction of the sales load would not make mutual funds any less attractive to own, only cheaper. But the industry's arguments are undoubtedly correct in that they recognize that the sale of fund shares depends upon the eagerness of the mutual fund salesman.

A fund desirous of growing finds that the easiest way to achieve such growth is by adding extra inducement to the salesman to sell the shares of the fund. Growth serves the investment adviser whose fee is enlarged; whether growth helps the fund or its shareholders has, at least, not been shown. This growth is accomplished by increasing, not decreasing, the sales load and, thereby offering a greater reward to the salesmen. So, for competitive purposes, mutual funds