

Answer. The corporate law that applies to the conflicts of interest which exist in the mutual fund industry is the same as that which applies to all other corporations, as shown by the attached opinion of Gaston, Snow, Motley & Holt, and Sullivan & Cromwell.

Question No. 1(d). Are the remedies available to stockholders of mutual funds with respect to abuses which may occur in connection with "conflicts of interest" any different from the remedies available to stockholders of corporations generally?

Answer. The remedies available to stockholders of mutual funds with respect to conflicts of interest are the same as those available to stockholders of other corporations, as shown by the attached opinion of Gaston, Snow, Motley & Holt, and Sullivan & Cromwell.

Question No. 2. Chairman Cohen has said that the investment adviser of an investment company controls the investment company would you comment on this?

Answer. We think that Chairman Cohen is wrong in his assertion that the investment adviser controls the fund. This claim is not supported.

A glance at the list of representative independent directors which we have furnished for the record shows them to be successful industrialists, executives, public officials, educators and administrators, attorneys and military men, who on the very face of it are hardly susceptible to control or domination by others.

A strong indication of the unsupportability of Chairman Cohen's claim is that over the years the SEC has not, to our knowledge, taken action in this area, as it would have had a duty to do. If the claim that the investment adviser controls the funds were true, the SEC would have been derelict in the responsibility imposed on it by law to rectify the situation.

These legal responsibilities imposed on the SEC arise from Section 10(a) of the 1940 Act which requires that at least 40% of the fund's directors be independent of the investment adviser, and from Section 10(b) which requires that a majority of the fund's directors be independent of its principal underwriter. Since the investment adviser and the principal underwriter is usually the same person, a majority of the fund's directors are required to be independent of the investment adviser. The SEC has a plain duty to enforce these requirements for independent directors which prohibit an investment adviser from controlling the fund.

Section 2(a)(9) of the 1940 Act contains explicit provision for procedures whereby the SEC on its own motion can determine whether a director of a fund is "controlled." So far as we know, the SEC has never availed itself of these procedures to determine whether in fact the fund's directors are controlled and the board of the fund improperly constituted under Section 10(a) or 10(b). Its failure to do so is inconsistent with its Chairman's assertion now that the fund's directors are controlled by the investment adviser. Section 2(a)(9) is also available to individual shareholders as well as the SEC.

Question No. 3. Has Chairman Cohen or any of the other Commissioners ever stated what they consider to be reasonable compensation to be paid by a company of a given size and performance?

Answer. No. The SEC has never stated what it believes to be a reasonable fee in any given case or what is a reasonable level of fees generally. During the hearings in the House and the Senate, the Chairman restricted himself to a number of very general statements on this point, such as: "* * * there are fee situations here that are excessive." (House Hearings, p. 874). "* * * while we by no means suggest that all investment advisory fees are unreasonable, or even that most of them are, it would be singular indeed, * * * if all fees have always been and always will be reasonable." (p. 833). "* * * we are not suggesting that anyone is too high or anyone is too low * * *". (p. 837).

Even though the SEC is seeking authority to proceed in court against an adviser whose fee it considers unreasonable, it has not stated the extent to which, or the circumstances in which it plans to use this power if granted. It has asked Congress for the power to sue and has given no one any idea of what it would do with this power. Without knowing what the Commission will do, industry has a somewhat better idea of what so-called strike suit lawyers will do. A change in the law as significant as the one proposed by the SEC would be an open invitation to widespread litigation which will involve fund officials in time-consuming and costly lawsuits, thus diverting their energies from their main job of serving their shareholders.