

Can you comment in detail as to the necessity for 22 (d) in the mutual fund industry and the likely effects if it was removed from the law?"

Answer. Section 22 (d) is similar in effect to the fair trade laws which exist in many states. It is also similar to anti-rebate laws dealing with life insurance commissions. Section 22(d) and these anti-rebate laws prohibit fee-splitting and thus prevent discrimination between customers. Every state in the union has such a law with respect to life insurance commissions.

Section 22 (d) does not, of course, prohibit mutual funds from setting different sales charges from each other, and, in fact, sales charges range from those of about 50 funds with no sales charge to funds with sales charges of 8½%.

Moreover, there are reasons for Section 22(d) which are unique to the mutual fund industry. Upon request of the shareholder, his mutual fund shares must be redeemed by the fund at their current net asset value—this is required by law. In no other industry does the consumer have such an absolute right. Thus, to meet redemptions on an orderly basis which currently run on an industry-wide basis at about \$2.5 billion per year, mutual fund underwriters must maintain a national distribution system.

The repeal of Section 22(d) would cripple, if not end, the present system of distribution since the result would be that most transactions would take place in the over-the-counter market. Those who recommend the repeal of Section 22(d) have not even purported to consider whether the over-the-counter market can insure adequate distribution just as they have not considered that a mutual fund shareholder has an interest in preserving a distribution system which makes possible the orderly redemption of his shares. The plain fact is that the over-the-counter market cannot support the distribution necessary to meet redemptions, especially during periods of market stress. (See Special Study of Securities Markets of the SEC, part 2, p. 798).

Although the SEC has conceded that the repeal of Section 22(d) might lead to problems of price discrimination between customers and create competitive advantages for certain mutual fund underwriters, it was not until the House Hearings that Chairman Cohen finally stated: "In the first place, there is some uncertainty as to the consequences of repeal of Section 22(d)." (House Hearings p. 849). Those who have day-to-day practical experience in the mutual fund business believe that the consequences are not uncertain—the effect would be highly disruptive to the mutual fund industry and would be injurious to the investing public.

We enclose herewith a more detailed memorandum of our view of this subject.

Sincerely yours,

ROBERT L. AUGENBLICK, *President.*

[Enclosures]

EXHIBIT A

GASTON, SNOW, MOTLEY & HOLT,
Boston, Mass.,

SULLIVAN & CROMWELL,
New York, N.Y.
October 23, 1967.

INVESTMENT COMPANY INSTITUTE,
New York, N.Y.

DEAR SIR: In connection with the testimony of Chairman Cohen before the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce of the House of Representatives concerning H.R. 9510 and H.R. 9511 and questions asked by various of the Committee members, you have asked us to review generally the standards applied by the courts to advisory fees and the remedies of a shareholder of an investment company who believes that the fees are too high. We have set forth below our view of the present state of the law in these respects.

Before analyzing the position of an investment company shareholder or the principles applied by the courts it is important to emphasize an important fact which puts the possible conflict of interest problems of investment company directors and stockholder remedies into perspective. The possibility of conflict of interest problems is common to all corporations, and the role played by non-interested directors, shareholders and the courts is no different for investment companies than for any other corporation.