

with Section 22(d) since 1940. On April 15, 1960, a unanimous Commission endorsed the concept and purpose of Section 22(d) :

"Section 22(d) of the Act prohibits a registered investment company, its principal underwriter or a dealer from selling its redeemable shares to any person except at a current public offering price described in the prospectus. *The purposes of the section are to prevent discrimination among purchasers and to provide for an orderly distribution of such shares by preventing their sale at a price less than that fixed in the prospectus.*" (Emphasis supplied.) (Investment Company Act Release No. 3015.)

The Necessity for Orderly Distribution

As the Committee is aware, a mutual fund is redeemable at the request of the shareholder. A mutual fund stands ready to buy back the investor's shares at the then current net asset value. This is a right of the shareholder, and there are no sales commissions payable on redemption.

As a result of the redeemability feature shareholder redemptions, which stem from the completion of the investor's long range goals or other circumstances, are currently running about \$2.5 billion per year, or about 6 percent of industry assets. Although mutual funds generally have sufficient cash or other liquid assets to meet current redemptions, the major source of funds for this purpose is new money obtained through sales to new or existing shareholders. Were it not for this source, the mutual fund would have to keep a degree of liquidity which might not be consistent with the fund's investment appraisal of the market at a particular time. Stated another way, the shareholders would suffer in terms of investment performance if the mutual fund was forced to keep a large portion of assets in liquid form to meet redemptions.

The retail price maintenance provisions of Section 22(d) assure an orderly and continuous system of distribution which would not otherwise exist. For a proper understanding of this point it is necessary to examine the alternatives. Those who argue for repeal of Section 22(d), state that following such a repeal there would be a secondary market in mutual fund shares since the shares of a particular fund are "fungible" commodities which would be subject to "free market pricing."

The Alternatives to Section 22(d)

1. Reduction in Sales

Undoubtedly, were Section 22(d) to be repealed, there would be a secondary market in mutual fund shares. Such shares would be traded in much the same way and by the same firms that handle over-the-counter securities generally. Various trading firms would "make markets" in mutual fund shares, and over-the-counter retailers would acquire shares from these wholesalers to meet customer demand. Firms would not tend to specialize in mutual fund shares since the salesman's income would be highly unstable where competitors not specializing in mutual funds could under-cut the firm attempting to specialize in funds. This is exactly the situation which Section 22(d) was designed to prevent. Since mutual fund shares are sold as long-term investments there is little speculative interest in acquiring this form of equity investment. If the mutual fund share became merely another security on the dealer's shelf there would be relatively little demand for it and it would not be sold—especially since it would be competing with a hot \$2 uranium stock or the latest speculative electronics issue.

This is the reason that mutual fund shares, unlike other securities which hold forth the promise of short-term growth, must, like life insurance, depend on selling effort. Furthermore, such selling effort depends on trained salesmen devoting their time with prospective customers in their homes and offices. The sales charge basically compensates the salesman for this time and effort. A salesman who devotes himself to this kind of selling effort is not likely to remain in a business if after he has made a successful sales presentation the customer he has convinced can simply go elsewhere and acquire shares at bargain prices from a dealer's shelf. In this situation the salesman has provided a costly service, in terms of his time, and someone else who does not have similar costs profits from the salesman's work. As mutual fund salesmen tend to leave the field, the over-the-counter dealer will find his sales dropping off since he would not have a sales force specializing in funds. The traditional over-the-counter market cannot insure wide distribution of mutual fund shares. Aside from the fact that this could tend to reduce sales below