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# BLIGHT OR BLESSING?

# THE WHARTON SCHOOL STUDY OF MUTUAL FUNDS

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Director, Division of Corporate Regulation
Securities and Exchange Commission

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May I first make a positive effort to forestall any possible misconception of my appearance in this environment. I will do so by assuring each of you unequivocally that it is not in furtherance of any ambition to become either the President or the Public Relations Vice President of a prominent stock exchange.

Actually I accepted the gracious invitation of Professor Towle to appear before you with particular pleasure, for I have always found the academic atmosphere congenial and stimulating. I lay claim with some pride to having been a teacher of sorts. During my private practice of law I taught a course in Conflict of Laws at New York Law School for some five years. I found that experience highly rewarding -- in the non-financial sense -- and deeply satisfying with one exception, the grading of examinations. Bluebooks were a painful experience for me. I think I know the reason. Modesty has never been one of my virtues, and bluebooks invariably presented to me a moment of truth. Inescapably I was confronted with the humiliating and hard fact of how little of my alleged learning I was able to convey to my students.

This evening, happily, I will not be confronted with the chore of grading upon the completion of this lecture. Most of what I propose to say would not be conducive to the preparation of a factual type of examination anyway, for I would like to raise with you some broad questions in the mutual fund area. These questions will contain an amalgam of social, economic and philosophical implications, and they are not susceptible to easy answers. I will not presume to suggest any sweeping answers this evening, for it is fair to say that the thinking of the Commission and its staff in the mutual fund area at this point of time is in

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the searching and evaluation stage. Answers in the form of specific legislative or rule change recommendations -- or, conceivably, in the form of a determination that no changes are necessary -- are at least months away.

Conceptually and practically, what is a mutual fund? Basically, it is a company in which many persons -- frequently of moderate means -- have pooled their resources for the purpose of investing, reinvesting and trading in securities. This can include common and preferred stocks, bonds, notes, debentures, participation certificates and any combinations of different types of securities. Legally the fund normally has a corporate structure, but the use of a trust is not uncommon.

Inherent in the mutual fund or open-end investment company is its commitment to stand ready to redeem or repurchase its shares at any time at their then net asset value. Net asset value per share is normally computed twice daily by taking the market value of all portfolio securities plus the value of all other assets less all liabilities and dividing the resulting figure by the total number of shares outstanding. Most mutual funds also engage in a continuous offering of their shares for sale to the public at their then net asset value plus a sales load or commission.

These two features -- redemption and continuous offering -- distinguish the mutual fund or open-end company from the closed-end investment company. A closed-end company neither redeems its shares nor engages in a continuous public offering of its shares. If the Board of Directors of a closed-end company deems it advisable to increase the amount of its resources available for investment, it will make a single public offering of its shares or other securities in the conventional way -- the same way an industrial, utility or transportation company obtains public financing. Shares of closed-end companies are readily available to the public investor at any time, however, for the shares of some twenty-five closed-end companies are listed on the New York Stock Exchange, and many closed-end company shares are actively traded in the over-the-counter market. The price you pay or receive will bear some relation but will rarely be identical to the net asset value. Your price will be controlled by supply, demand and other forces at work in the auction market. Both discounts and premiums of net asset value are common, and they can be substantial. The closed-end operation is a pool and mutual operation in a real sense, but for some reason obscure to me industry parlance uses the term "mutual fund" only in relation to open-end companies.

I do not propose to deal further with closed-end companies this evening. This is not to suggest that the Commission has forgotten

closed-end companies, that they have no problem areas or that they are socially or economically insignificant. Indeed, their aggregate assets recently approximated seven billion dollars. However, the Wharton School Study to which I will refer in some detail confined itself to open-end companies, and an admixture of references to closed-end company matters might serve only to create undue confusion.

There are now 338 mutual funds registered with the Commission pursuant to the Investment Company Act of 1940. The Act requires their registration and subjects them to its regulatory provisions. The Act was the outgrowth of the Commission's Investment Trust Study conducted during the late nineteen-thirties. The Act was designed to prevent widespread abuses then prevailing in the investment company industry as disclosed in the Commission's Study. I should emphasize here that we have no evidence to indicate the existence of -- and we do not believe there are -- industry-wide abuses today of the nature documented in the Commission's Investment Trust Study. On the other hand, I do not want to convey the impression that the mutual fund industry is free from problem areas and the potential for abuse or that possible corrective action is not being considered carefully.

I will not attempt to detail the types of regulation and restriction imposed by the Investment Company Act. I will express the opinion, with which many members of the industry will disagree, that it is fair to characterize the overall nature of the regulation provided by the Act as mild. It is certainly less stringent than the original draft of the Act prepared by the Commission. The original draft stimulated not surprisingly a storm of industry protest. It being 1940, Congress had more important things on its mind and had no enthusiasm for extended public hearings on bitterly contested legislation. The result was that the Commission was given to understand that if it expected any legislation in the area it would have to be legislation acceptable to the industry. At that point representatives of the Commission and the industry joined together, and in a period of approximately five weeks put together what is now the Investment Company Act. Obviously the necessity for compromise by both sides was inherent in such a setting.

The objectives and investment policies of mutual funds vary widely. All seek and successfully obtain a broad diversification of their portfolio securities in order to reduce the investor's risk. Few would deny that diversification does in fact reduce -- though it by no means eliminates -- risk. The investor in a share of one hundred different securities is far less likely to have his investment wiped out than the investor in a single security. Conversely, a widely diversified portfolio has fewer possibilities of rocketing into orbit than a fortuitously chosen speculative single security.

From the common denominator of diversification, however, the investment objectives scatter. The most conservative funds seek the largest degree of security by investing solely in corporate bonds. A degree away are funds which invest only in preferred stocks or combinations of bonds and preferred stocks. At the other extreme are funds which invest in highly speculative common stocks, special situations and new ventures. Others concentrate their portfolios in single industries or groups of related industries. Some funds concentrate solely on capital appreciation with income being purely a secondary consideration, while some focus on the income return consistent with relative investment safety. Still others have the announced policy of investing largely in foreign securities. There are several funds which invest heavily in Canadian securities, some whose policy is to invest in Israeli securities, one which confines its investments to the Union of South Africa, one to Japanese securities and others which invest in European securities.

About 86% of the industry, however, can be broadly categorized into two major types -- the common stock fund and the balanced fund. As the name suggests a common stock fund invests all of its resources, except a relatively small amount necessary to meet operating expenses, demands for redemption and other matters requiring immediate liquidity, in common stocks. A balanced fund invests its resources partly in common stocks and partly in preferred stocks and corporate bonds, debentures and other debt securities. A typical ratio of investments by a balanced fund would be 65% in common stocks and 35% in preferred stocks and debt securities. A balanced fund is clearly more conservative than a stock fund, and, accordingly, in a rising market one would not expect it to appreciate in value as rapidly as a stock fund, for the debt securities in a balanced fund are far less volatile and their values remain relatively more constant than common stocks. For the same reason in a falling market the decline in value of a stock fund is likely to be more pronounced than that of a balanced fund. The greater stability of balanced funds in the value appreciation and depreciation sense has been well demonstrated in the generally rising market of the fifties and early sixties and in the downward market since the latter part of May of this year.

I have dwelt upon the varying investment objectives, policies and types of funds, for we consider it vital for the investor to know these things. Before the investor buys mutual fund shares, he should be clearly aware of the investment objectives of the fund he proposes to buy, and he should know that there are many funds with other -- and for him perhaps more suitable -- objectives. He should also be aware that his investment is in no sense guaranteed. He is not obtaining the guarantee

of a savings account by the Federal Deposit Insurance Corporation. He is not buying Government bonds or insurance. His investment may go up. It may also go down. Indeed many funds since the early fifties have had spectacular performances. Their performance charts resemble a tracing of the path of Sigma Seven in the first several minutes after launch. The other side of the coin is that since the recent market break the performance charts of many funds are comparable to the path of Sigma Seven after Commander Schirra ignited the retro rockets. A responsible salesman will make these matters clear to a prospective purchaser. Unhappily we have indications of far too many instances of sales irresponsibility. We hear too often of intense "hard sell" tactics where the advantages -- and there are many -- of mutual funds are overstressed while the risks are either ignored altogether or deliberately glossed over.

The selling of mutual fund shares has been conspicuously successful, particularly in the last decade. At the time of the adoption of the Investment Company Act in 1940 the total net assets of all mutual funds amounted to approximately $448 million, and in aggregate there were approximately 295,000 shareholder accounts. By the end of 1961 total net assets had swelled to over $24.4 billion, an increase of over 5,000%. Shareholder accounts had increased to over 5,300,000, an increase of about 1,700%. In part the almost staggering increase in assets is due to their appreciation in market value, but over 60% of the aggregate increase is attributable to the net new money inflow (that is, the excess of sales, including reinvestment of capital gains, over redemptions), and the addition of each of the new shareholder accounts is attributable to sales.

What accounts for this conspicuous selling success? Probably it is in part due to an increasing general public interest in the stock market in the last decade. Certainly it is partially due to vigorous, indeed intense, selling efforts. But in addition mutual funds are sold on the basis of two genuinely attractive features to an investor, particularly an investor of moderate means. These are diversification and professional management.

As I previously observed, diversification reduces the investment risk. Furthermore, as a practical matter an investor of moderate means cannot achieve the diversification provided by most funds by individual investment in selected stocks. Unless he has substantial funds available, he cannot buy each of the one hundred or more securities which are in the portfolio of the typical mutual fund. Thus, the mutual fund provides the modest investor with an easy and convenient vehicle for achieving diversification.

The selling emphasis on professional management also has merit. Few would deny that the more responsible funds have professional managers of exceptional talent. Again this has special significance for the investor of moderate means. Such an investor can obtain excellent investment advice from a large number of brokerage and investment banking firms. However, this normally is advice on a one shot or periodic, part-time basis for the smaller investor. The advantage of professional management in a mutual fund is that it is full-time, professional management. The investor in a mutual fund literally has his investment watched over and supervised daily.

I must emphasize that the investor does not obtain these advantages for nothing. He pays for them, and some feel that the price is on the high side. First, if he invests in any of the funds representing over 95% of the industry assets he pays an initial sales commission or load. The amount of the load varies, but 8 1/2% of the purchase price of the shares is common. I repeat that this is 8 1/2% of the purchase price and not 8 1/2% of the amount invested in fund shares. While sales loads are generally reduced on substantial purchases, as, for example, on a $10,000 purchase in the case of some funds or on $25,000 in the case of other funds, an 8 1/2% sales load applied to a $10,000 investment means that $850 goes for the load and $9,150 is invested in the fund. The load of $850 amounts to 9.3% of $9,150. Put another way, the portfolio of the fund in which he invests must appreciate by 9.3% before the investor reaches the break-even point (leaving aside the question of ordinary income earned on his investment).

Mutual fund shares are also available on an installment purchase or periodic payment basis. This takes two basic forms. One is the voluntary payment plan where the investor makes specified monthly payments which are invested in fund shares at the regular sales load. The investor is under no obligation to continue the payments and suffers no penalty if he should withdraw.

The other form is the so-called contractual or front-end load plan. Under this type of arrangement, the investor agrees to make specified payments for a period of years -- for example $100 per month for ten years. Unlike the voluntary plan, the investor suffers a definite penalty if he withdraws at any time prior to completion of all payments under the plan. The penalty can be very heavy indeed for a withdrawal during the early years of a front-end load plan.

Section 27 of the Investment Company Act restricts the overall sales load in a contractual plan to a maximum of 9% of the total amount payable under the plan. Thus, an investor who signs up for a ten year

plan at $100 per month would agree to make an aggregate of $12,000 in payments. Of this aggregate, 9% or $1,080 may be deducted for the load. However, Section 27 permits up to one-half of the first twelve monthly payments to be devoted to the load. Thus, $600 of the overall load may be deducted from the first year's payments of $1,200. Should the investor drop out immediately after completion of his first year of payments, he will lose 50% of his investment should the market remain level.

The Act requires that the balance of the load remaining after the first twelve monthly payments be pro rated equally over the remaining payments. Thus, in our example the investor would pay only $53.33 for load in the second year. Should he drop out at the end of the second year, however, he would lose that $53.33 plus the $600 paid for load during the first year. This total of $653.33 amounts to 27.2% of his aggregate payments of $2,400. Should he drop out at the end of the second year he will lose over 27% of his investment if the market remains level. Of course the cost of dropping out will diminish with each year that the plan is continued.

Contractual plans are praised highly by their promoters -- and they are promoted heavily for the obvious reason that richer rewards are available for the salesmen and selling organizations. The sponsors describe the contractual plan concept as a social boon in that it provides an enforced method of saving. The purchaser of a contractual plan will be stimulated to continue it when he knows he will be penalized by an early withdrawal. One might question this social desirability theory, and a skeptic might even regard the advancement of such a theory as a smokescreen to divert attention from or to justify what are heavy selling charges by any securities sales standards.

Compare, for example, the average sales commission rate for securities listed on the New York Stock Exchange. It approximates on the average slightly over 1% on round lot -- that is 100 share -- transactions. For a fair comparison with mutual fund sales loads, you must double the New York Stock Exchange rate, for the mutual fund sales load is typically paid only on the purchase of shares. When you sell -- that is, redeem -- mutual fund shares, normally no charge is imposed, but when you sell a New York Stock Exchange security you pay a commission. Moreover, a fair comparison must point out that a moderate size investor who hopes to achieve even a slight measure of diversity has not enough cash to buy in round lots. He must buy odd lots, something less than 100 shares, and this appreciably increases the sales charges. The fact remains, however, that the purchase of mutual fund shares involving an 8 1/2% sales load is a more expensive proposition for the

typical size of mutual fund shareholding than buying an equal dollar amount of securities listed on the New York Stock Exchange if no more than slight diversity is sought. It follows that it is conspicuously more expensive to purchase a contractual plan if the investor drops out in the early years. And finally, the mutual fund investor should realize that in addition to the sales load he will bear a portion of the commission expense incurred by the fund in its purchases of portfolio securities. When he buys fund shares, the fund does not let the cash received from him lie fallow. It uses this cash together with cash collected from other purchasers to buy additional securities for its portfolio. In so doing and also in changing the composition of its portfolio, the fund pays brokerage commissions which in practical effect are borne by the shareholders proportionately.

Any discussion of sales load would be incomplete without making it clear that there are also no-load funds. These are funds which charge no sales load when one purchases their shares. Thus, every dollar invested goes into the fund, for there is no deduction for sales load. There are at least 30 no-load funds with varying investment objectives, and many have outstanding performance records. No-load funds have only slightly over 3% of the total assets of the industry. This is not surprising, for having no load there is no commission available for a sales force. A salesman having available the inducement to sell from a fund charging a load is not likely to elaborate glowingly to his customers on no-load funds where the selling inducement is non-existent.

Another important feature for the mutual fund investor to understand is that he will normally be paying a management or investment advisory fee whether he owns shares of a load or a no-load fund. With a few rare exceptions, mutual funds are affiliated with separately incorporated management or advisory firms which render advice and management service pursuant to a written contract for a stipulated fee. Typically the fund has no ownership interest in the management company. The most frequent fee charged for the management and advisory services is 1/2 of 1% of the average annual net asset value of the fund. Sometimes the fee is lower, and some -- but not all -- of the advisers to larger funds scale down their fees as the fund assets increase. For example, one large fund adviser charges 1/2 of 1% annually on the first $70 million of fund net assets, 3/8 of 1% on the next $50 million of net assets and 1/4 of 1% on all assets over $120 million.

One-half of 1% can seem deceptively nominal, but as the fund size grows the management fee which is not scaled down can reach a relatively high level. The adviser of a $2 billion fund, for example -- and one fund reached that level prior to the recent market break -- charging a

flat 1/2 of 1% rate would receive an annual advisory fee of $10 million. Moreover, in terms of the fee as a percentage of income, it can amount to a relatively high amount. The advisory fee covers a range from as little as 6% of the fund's annual investment income to as high as 40% and even higher in funds where income is not a prime investment objective.

Management fees have been attacked as excessive in some fifty lawsuits brought on behalf of fund shareholders against management companies and fund directors who authorized the management contracts. Five of these suits have been settled before going to trial by a reduction of the management fee. The only two suits in which the trials have been completed resulted in decisions holding that the subject fees were not excessive. However, the latest of the two, Saxe v. Brady, decided by the Delaware Chancery Court last month, flashed a warning signal. Although the Court did not find that the payment of a flat 1/2 of 1% management fee by a $750 million fund constituted a waste of the fund's assets within common law concepts, it did observe:

> ". . . the profits [from the advisory fee] are certainly approaching the point where they are outstripping any reasonable relationship to expenses and effort even in a legal sense."

The Commission has not participated in any of these lawsuits on the issue of whether or not the fees are excessive. It did participate in two cases as *amicus curiae* or friend of the court to urge, successfully in one instance and unsuccessfully in another, that stockholders had the right to sue under the Investment Company Act. The defendants in each of those cases argued that only the Commission and not private persons had the right to sue under the provisions of the Act at issue.

From what I have said I think it should be clear that the mutual fund industry is an important segment of our economy. It is also significant in the corporation finance sense, for the multi-billion dollar assets of the industry are invested in corporate securities with approximately 75% of the industry assets being invested in common stocks issued by United States corporations. As of December 31, 1961, these common stockholdings were equal to approximately 4 1/2% of the value of all stocks listed on the New York Stock Exchange. The development and operations of such an important industry should be carefully watched and periodically studied in depth so that problem areas can be detected and analyzed. This was the reason which motivated the Commission to retain the Wharton School of Finance and Commerce of the University of Pennsylvania to make a comprehensive study of the industry. Their report to the Commission on the results of their study is entitled "A Study of Mutual Funds" and was released to the public on August 29th of this year.

The Study is the first comprehensive examination of the industry since the Commission's Investment Trust Study which led to the adoption of the Investment Company Act. It thoroughly analyzes the industry structure, its growth, investment policies, investment performance, the impact of funds on the stock market, the extent of fund control of portfolio companies, and the relationship of investment advisers to the funds they serve. The Study does not cover and was not intended to cover certain areas, such as selling practices, but these areas are the subject of current Commission studies.

The Study resulted in a number of interesting conclusions, some of which produced a pronounced reaction within the industry. The public comments attributed to various members of the industry spread through the spectrum from the moderate and thoughtful to the angry and intemperate to the clearly irresponsible. Happily only a few industry comments were in the latter category. That the Study produced an industry reaction was not surprising, for some portions of the Study can be construed as critical of the industry structure and some of its practices. Criticism is seldom palatable to the recipient and seldom accepted with gracious silence.

One conclusion which understandably did not upset the industry was that there is little evidence that size _per se_ of individual companies is a problem at the present time, although it should be pointed out that the Study did find that size problems do exist to the extent that questions arise concerning the allocation between fund shareholders and investment advisers of the benefits accruing from large scale operations. And there are indications in the Study that the aggregate size of the industry has some impact in certain areas. For example, the Wharton School found that there is some but not strong evidence that net purchases by mutual funds significantly affect the month-to-month movements in the stock market as a whole, and there is stronger evidence that fund net purchases significantly affect the daily movements in the stock market.

The Wharton School conclusion which the industry found most offensive related to the performance of mutual funds or their investment success. The Study states that the performance of funds on the average did not differ appreciably from what would have been achieved by an unmanaged portfolio consisting of the same proportions of common stocks, preferred stocks, corporate bonds and other assets as are in the composite portfolio of the funds. About half of the funds performed better and half worse than such an unmanaged portfolio. The authors of the Study reached this conclusion by comparing fund performances with the several Standard and Poor's indexes which were statistically adjusted by the authors to correspond with the varying types of portfolios of the funds.

The industry sharply attacked the comparison with the Standard and Poor's Composite Common Stock Index, based on 500 stocks, as unfair in that it would be impossible for the investor of moderate means to buy shares of all of the stocks comprising that index. This is true, and the Wharton School authors never suggested that they could. But it also begs the question. With its wide coverage, this index fairly closely reflects movements in the market as a whole. As such, and as the Wharton School authors have aptly stated, it affords a reasonable basis for appraising the degree of success realized by the fund managers in their selection of specific securities from among the securities available on the market. Since one who is asked to buy mutual fund shares is assured that one advantage he will obtain is the benefit of professional management, is it inappropriate for him to compare the performance of the professionals with that of the market?

Surely a comparison such as this could not have come as a surprise to the industry. I am confident that the fund managers watch fund performances closely and that they are also aware of the existence of the Standard and Poor's 500 stock index, as well as other indexes, which they must observe with some interest. Just as fund managers make internal comparisons of their own and other fund performances with one or more market indexes, it seems to me that before an individual selects a particular fund for investment he should compare its performance with that of other funds of like investment objectives and thus become aware that there exist marked differences in performance among the many funds.

I do not regard the Wharton School's analysis of the funds' performance as an indictment of the mutual fund industry. Since diversification is an objective and a worthy one, it would seem to follow that the more a fund diversifies the more likely it is that its performance will approach the market average. Moreover, it may well be that many, if not most, investors would be glad to do only as well as the market average. And finally, if you can both diversify broadly and also outperform the market -- as half the funds have -- you have accomplished a feat of which, in my opinion, you can be proud.

To me there are other far more significant conclusions in the Study. One which will certainly require our careful inquiry and study is that where an investment adviser advises both a mutual fund and other clients, for comparable asset levels the advisory fee rates charged mutual funds tend to be substantially higher than those charged by the same adviser to the aggregate of their other clients. This becomes more startling when considered with the corollary conclusion that it is less costly to advise mutual funds than it is to advise the other clients. If this is true, the question is "Why is it true?" Perhaps there is a good

answer, but we must have that answer. Should there be no satisfactory answer, it would be proper to inquire into the effectiveness of the fund directors in negotiating the advisory contracts.

Another significant conclusion is that where the same organization served the fund as both the adviser and the underwriter or selling organization, there were a substantial number of cases where the underwriting or selling expenses were subsidized out of the advisory income. I question the propriety of any portion of the advisory fee being used, in effect, for the selling effort. The shareholder is told that the fee is being paid for advisory services -- not for sales efforts designed to swell the size of the fund which will have the effect of increasing the aggregate fee for the adviser. Furthermore, an increase in the size of the fund has not been found to be of demonstrable benefit to the shareholder.

The Wharton School also found that there was no significant relation between fund performance and the size of the management fee. Thus, the investor cannot assume that the existence of a high management fee implies that he is purchasing superior management ability. Similarly, it found that there was no relation between sales load and performance. Thus, the investor cannot conclude that by paying a higher sales charge he will obtain superior performance.

Although there are many other interesting observations in the Study, time permits me to mention only one more. This is in the conflict of interest area and raises questions as to the structure of the industry. The Investment Company Act specifically contemplates the industry structure as it now exists. It contemplates separate investment advisory organizations and specifically permits representatives of the adviser to have a 60% representation on the board of directors. At least 40% of a fund's directors must be unaffiliated with the adviser, and when the board of directors renews an advisory contract a majority of unaffiliated directors must approve of it. However, the unaffiliated directors are normally chosen by the adviser or its affiliated persons, and in view of this and the intimate connection of the adviser with the fund one might question the degree of genuine bargaining which occurs over the size of the management fee. One might question whether or not those directors who are affiliated with the adviser are so interested in the financial success of the adviser that they cannot act with complete objectivity in the best interests of the fund. If you throw in directors who have affiliations with the underwriting or selling organization, can they act objectively in the best interests of the fund in deciding upon the amount of the sales load?

If the adviser and the underwriter are the same organization, the conflicting position of the affiliated director is compounded, for there is self-interest in the size of the fee and in the size of the sales load in two ways. He might tend to want the load high both in order to have the selling operation more profitable and to increase the size of the fund so that the aggregate management fee will increase. If you add in an affiliated brokerage firm, the affiliated director's conflict is again compounded. He may tend to favor churning of the portfolio of the fund -- that is, engaging in more sales and purchases of securities than are justifiable -- in order to develop additional brokerage commissions for his firm.

All this is not to suggest even remotely that affiliated directors cannot do a good job for their fund or that they would consciously favor their own affiliated organizations to the detriment of the fund. It is only to suggest that humans are humans. An affiliated director would be a remarkable human being if, while acting as a fund director, he could close his mind completely to the interests of his affiliated organization. Certainly this is an area which merits our careful study.

What has been and will be the effect of the Wharton School Study? Is it a blight upon the industry, as the reaction of some fund executives would suggest? Or does it contain elements of a blessing in that it raises questions which will lead to improvements in the industry, either self-administered or governmentally induced, which will be beneficial to the interests of the several million public stockholders. I prefer to think the latter, and I believe I am right.

Some elements of the industry consider the Wharton Study a blight because they disagree with its conclusions, they believe it has misled the public, and they feel it has impaired public confidence in mutual funds. As to the conclusions, they are supported with detailed explanations and statistical tables for us all to evaluate. As to the other complaints, I personally do not believe the public has been misled nor do I believe that public confidence in mutual funds has been impaired. It is true that mutual fund sales have declined since public release of the Study, but a decline had set in in mutual fund sales quite a few months prior to public release of the Study. And, of course, the whole market has experienced a decline as has activity in the market. I think it is important to point out, however, that on the whole redemptions of mutual fund shares have not increased significantly. My interpretation of this latter fact is that those who own mutual fund shares are satisfied that mutual funds offer them a desirable form of investment, notwithstanding the problems raised in the Wharton School Study. Otherwise there would have been a flood of redemptions. I do not interpret the decline in sales to new customers as an indication of lack of confidence in mutual funds as such. Rather I would attribute

it to the prospective purchaser's having become more wary. He will be more thoughtful, demand more information from the salesman, and in general be more searching before committing himself to buy. If I am right in this interpretation and if the Wharton School Study has been a contributing factor, I would score this in the blessing column.

Before concluding, I have one mission to accomplish. I mentioned before that some, but fortunately not much, of the industry reaction was irresponsible. I would like to cite two examples and destroy them. The first is a quotation in the press attributed to a fund executive attacking the release of the Study "as another evidence of the unfair anti-business climate existing in Washington." To suggest that there were political implications involved in the release of the Study is patently preposterous. Actually the Study was authorized in 1958 during the Eisenhower Administration which was not notably hostile to business. Nor, in my opinion, is the present administration. But the fact is that the present Commission is not a political organization. Furthermore, it is my privilege to know personally Edward N. Gadsby, the Republican Chairman of the Commission at the time of the authorization of the Study. From my knowledge of Mr. Gadsby, I am confident that the Commission then under his guidance was not a political institution.

Implicit in a remark of the character I have quoted is the suggestion that the Wharton School Study should not have been publicly released. There are two answers to this, one legal and one practical. The legal answer is that under the statutory authority pursuant to which the Study was prepared, the Commission was required to transmit it to the Congress upon its completion. The practical answer is this. The fact that the Study was under way had been publicized and well known ever since its inception. Assuming we had the power to suppress the Study, had we done so the financial press and the public would certainly have wondered why. Many would have made an understandable assumption that the reason for suppression was that the Study severely condemned the industry and that the findings disclosed widespread misconduct which is conspicuously contrary to the actual findings. And there you would have had a genuine example of impairment of public confidence.

The other example of irresponsible industry reaction lies in the personal attacks made upon the four authors of the Study, both in statements quoted in the press and in a barrage of correspondence received both by the Wharton School and the Commission. They have been characterized as being "anti-profit," which is absolutely absurd. These are men interested in the profit motive and who positively favor it. What they have done is to identify the amount of the profit being earned by fund managers and to raise questions about possible conflicts of interest. Surely this is in the best tradition of full and fair disclosure. The four authors have also been criticized as being professors

qua professors. The relevance of this type of criticism escapes me. It has been suggested that they live in a state of ivory towered naiveté. "More Professorial Nonsense" was the title trumpeted by one elaborate blurb released to the press.

May I respond by saying unequivocally that the Wharton School was selected to do the Study because it is an educational institution of acknowledged and deserved distinction. I am acquainted with each of the four authors, and I admire the talents of each of them. Anyone who considers any one of them naive will have that impression quickly dispelled in two minutes of personal conversation. One may disagree with their conclusions or their methods of reaching them. That is as it should be. Indeed, it is entirely possible that when the Commission completes its evaluation of the Study, it will not concur entirely with all of their conclusions. But to suggest that the four authors undertook and carried out their responsibilities in preparing the Study in any way other than conscientiously, objectively, carefully, thoroughly and with professional competence is totally unwarranted, if not unconscionable.

May I close on this note. There have been indications that some feel that an aura of antipathy toward mutual funds exists within the Commission. This is not the fact. Here I feel that I can speak not only personally but on behalf of the Commission and its staff. We believe that mutual funds serve a useful economic purpose and that mutual funds are a desirable investment medium to be available to the public. I do not, of course, regard the mutual fund industry as the apex of perfection. Nor am I aware of any other human area of endeavor that is not capable of improvement. Our constant drive is toward the raising of standards, not only in the mutual fund industry, but in the securities business generally. We would much prefer the improvement to occur from within without our intervention through additional legislative regulatory powers or otherwise. The Wharton School Study affords the mutual fund industry and the Commission the opportunity for re-evaluation and reassessment of its structure and its operations and practices to determine what, if anything, should be done. The staff of the Commission is currently engaged in such a reassessment in depth. I personally believe firmly that the industry as a whole is responsible and that it will respond in a similar vein.