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OFFICE OF THE DEPUTY ATTORNEY GENERAL
WASHINGTON, D.C. 20530

NOV 25 1969

Honorable Harley O. Staggers
Chairman, Committee on Interstate
and Foreign Commerce
House of Representatives
Washington, D. C. 20515

Dear Mr. Chairman:

This is in response to your request for the views of the Department of Justice on H.R. 8980 and S. 2224, bills to amend the Investment Company Act of 1940 and the Investment Advisers Act of 1940. These bills address problems described in a 1962 Wharton School of Finance and Commerce study of mutual funds, and subsequent studies and reports by the Securities and Exchange Commission. They follow a series of similar bills introduced in former Congresses. This Department commented on a predecessor bill, H.R. 9510, on October 18, 1967, favoring enactment, but suggesting further consideration of means of assuring that management and advisory fees charged funds be reasonable, and suggesting consideration of altering Section 22(d) of the Investment Company Act so as to permit competitive pricing in the sale of securities.

S. 2224 proposes to prevent unreasonable management compensation by imposing a statutory fiduciary duty on specified classes of persons who receive compensation or payments from mutual funds or their shareholders. H.R. 8980 would provide that management and distribution agreements be approved annually, and that approval of such agreements by all the affiliated and independent directors and two-thirds of the shareholders would raise a conclusive presumption that the agreements are fair and equitable. We believe the approach embodied in S. 2224 is preferable. It allows sufficient scope for private management of funds, but measures such management by a wholly appropriate test. Further, the use of the fiduciary standard instead of the standard proposed by H.R. 8980 would permit check on management fees when only a portion of interested investors are aware of excessive compensation. This is desirable, since many investors are not thoroughly versed as to the details of the legal and financial arrangements under which funds operate.

We note that the Senate Banking and Currency Committee's report on S. 2224 (Report 91-184, May 21, 1969) takes account of the fact that Section 22(d) of the Investment Company Act prescribes a unique scheme of retail price maintenance for the sales charges levied in distributing mutual fund shares to the public. That report also points out that mutual fund sales charges are much higher than sales charges prevailing in other portions of the Securities Industry. However, because the Committee felt that it lacked adequate information on the abolition of Section 22(d), it has asked for an early report by the SEC on the consequences of deleting Section 22(d) from the Act, and proposed that at this time Section 22 be amended to permit associations of securities dealers registered with the SEC to adopt rules prohibiting excessive mutual fund sales charges.

These steps are not inappropriate as interim measures. However, the Department believes that continued attention should be given to the abolition or amendment of Section 22(d). The arguments advanced for retaining Section 22(d) have not appeared persuasive to us, and we continue to think it likely that close examination of them will reveal that price competition in sales commissions can be allowed with advantage to investors.

The Department generally supports the objectives of S. 2224 and H.R. 8980. In our view, the provisions of S. 2224 relating to those issues on which we have expressed views are preferable to relevant provisions of H.R. 8980. We defer to the Securities and Exchange Commission concerning other, detailed, provisions of these bills.

The Bureau of the Budget has advised that there is no objection to the submission of this report from the standpoint of the Administration's program.

Sincerely,

Richard G. Kleindienst

Richard G. Kleindienst
Deputy Attorney General