

Honorable John E. Moss
Chairman, Subcommittee
on Commerce and Finance
Committee on Interstate
and Foreign Commerce
House of Representatives
Washington, D. C. 20515

Dear Mr. Moss:

Thank you for forwarding for comment Mr. Carroll H. Payne's letter concerning the Commission's recommendations that mutual fund sales charges be reduced from the current typical rate of 9.3% to a 5% maximum on lump sum purchases and that the front-end load be eliminated in the sale of so-called contractual plans.

Congress has entrusted this Commission with grave responsibilities for the protection of investors and the safeguarding of the public interest. Those responsibilities sometimes require us to balance long-run benefits to the investing public against possible short-run detriments to certain sectors of the securities industry. On occasion we are constrained to conclude that the impact a particular course of action might have on some people in the securities business is outweighed by the advantages that it will produce for the public as a whole.

As you may know, the Commission's recommendations respecting mutual fund sales loads do not represent an intrusion by the Federal Government into an area in which it was heretofore absent. The Investment Company Act permits mutual fund managers to fix sales charges, so long as they are not "unconscionable or grossly excessive", and prohibits any dealer from selling securities issued by the fund at less than the offering price established by the fund managers. A dealer who wishes to sell shares of a fund at less than the fixed sales charge does not merely face the prospect of a private lawsuit to enjoin him from continuing to engage in price competition. If he engages in price competition, he will have violated a Federal law for which there are penal sanctions. Moreover, this Commission might have to prohibit him from engaging in the securities business.

Mutual fund managers believe that mutual funds are sold, not bought, and have competed for the favor of dealers and salesmen rather than appealing to investors through lower sales charges. Because it found that mutual fund sales charges very substantially exceed the costs of investing in listed and unlisted securities of comparable quality and because of reservations expressed in its Report about the effects of complete price competition, the Commission recommended that Congress provide for a maximum 5% sales charge. This 5% maximum still would exceed by a substantial margin the sales charges that investors pay in almost all other securities transactions.

The recommendation that the front-end load be eliminated on the sale of mutual fund securities was made only after the Commission found from statistics submitted to it by the industry that less than half -- in the case of some companies, substantially less than half -- of the persons who were sold front-end load plans completed their payments on schedule. As a result of the front-end load (which is the deduction of up to one-half of each of the installments scheduled to be paid in the first year of these plans), a great number of investors pay effective sales loads which are 2, 3, 4 and as much as 6 times the sales load which they would have paid for the very same fund shares under a level-load investment plan. It is almost too much to expect a salesman, who stands to earn about 6 times as much from the first year's payments on a front-end load plan, to explain that the customer can invest in the same fund shares through a plan under which the normal sales load is deducted from each payment and that the customer, thus, will have more of his total payments invested.

I am constrained to disagree with some of Mr. Payne's remarks comparing the front-end loaded sale of mutual funds and the sale of life insurance. The front-end load on mutual fund shares should be compared to the acquisition costs of mutual fund shares themselves and other equity securities, not with life insurance. As you know, life insurance is primarily sold to provide for one's family when the assured dies. The savings element in life insurance is a secondary feature which results from the need to provide a level premium for level coverage for the duration of the policy. Thus, in Mr. Payne's example, the "Net Cost Risk Coverage" may be only \$38 in the first two years of a policy if the assured is a young man. As he grows older, the risk coverage is likely to become prohibitively expensive unless a portion of the premiums paid while he is relatively young are set aside to reduce the amount of risk coverage necessary for him in later years. The amount set aside, plus a guaranteed rate of interest on it, can be obtained by the assured as the cash value of his policy. But this, as noted, is secondary to the main purpose of the policy -- to provide life insurance. And despite the front-end load in life insurance, the life insurance purchaser immediately receives the full measure of the contemplated death protection.

In contrast, when the first-year payments have been completed on a front-end loaded mutual fund plan, a majority of the sales load the investor will pay on the entire plan has been deducted; yet only about 5% to 6% of the total net investment contemplated under his plan has been made.

While the foregoing views may not convince Mr. Payne that the Commission's recommendations are desirable, I hope that they will persuade him that the Commission has not acted without regard for the public interest and the interest of investors.

Sincerely,

Manual F. Cohen
Chairman

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