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December 23, 1966

Mr. Daniel V. McNamee, Jr.
First Albany Corporation
90 State Street
Albany, New York 12207

Dear Dan:

Thank you for your letter of December 19 about the mutual fund report.

To answer your last question first, our minds are not closed as to possible alternative solutions to the problems raised in the report. In the Commission's letter of transmittal to the Congress it was expressly stated that the Commission "welcomes and indeed solicits" comments from all interested persons with respect to the proposed legislation. I think, however, that the Commission's mind is probably closed to the idea that the problems referred to in the report do not really exist and that nothing need be done about them.

With respect to sales loads for mutual funds shares, our recommendation was not based on any idea that mutual fund dealers make too much money. That is not the kind of judgment we would like to make and in any event it is probably not so. The recommendation rather was based on two main conclusions. First, that the cost of mutual fund shares to investors is just too high and that competition will not remedy this, in part because of the resale-price maintenance provisions of Section 22(d). I might add parenthetically, that before I came to the Commission and when I was a buyer of securities, I never bought any mutual funds because, although I recognized their merits, I felt that they just cost too much. I did not wish to see three years dividends or more consumed by the sales load. This personal feeling, incidentally, was not communicated to the Commission.

The second major reason for the recommendation was the fact that the disparity between the compensation for selling mutual fund shares and that for selling other types of securities has introduced a bias on the part of securities dealers and salesmen in recommending securities to customers.

With respect to economics, it is true that the report's recommendations were not based upon a detailed cost study of securities firms. No doubt, some firms and salesmen make a good deal of money on mutual fund

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shares while others don't, depending upon the efficiency of the business and the nature and extent of the clientele. As you know, we have been handicapped in our effort to be informed as to the economics of the business by the reluctance of securities firms to make available income and expense data.

I think the economic impact of the sales load recommendation would not be quite as simple as you indicate. If sales loads were reduced, presumably salesmen's compensation for selling mutual fund shares would likewise be reduced. To measure the effect of this calls for something resembling a crystal ball. Presumably a number of marginal salesmen would drop out of the field, but it is not altogether clear that this would be contrary to the public interest. Probably sales of mutual fund shares would be reduced to some degree but no one can say how much, particularly in view of the probable offsetting effect of the fact that mutual funds would become attractive to investors, such as I was, who presently are deterred by the costs involved. There is, however, some question as to whether continuation of the present explosive rate of growth in the mutual fund field, out pacing that of other phases of the securities business, is introducing distortions and creating problems in the securities markets. Several commentators have suggested that, although the report raised this question, it should have devoted more attention to it. This was the line taken by the London Economist, for example. On the other hand I hardly see any reasonable and justified direct legislative solution to this question.

Moreover, I have some doubt as to whether the present profitability of mutual fund selling to dealers and salesmen should be the major factor in setting the load level. The sale of mutual fund shares, after all, is not a public utility. It is characterized by extreme ease of entry. For many pure mutual fund sellers the principal item of cost is salesmen's compensation. They carry no inventory, take no risks, have modest offices, and, in the case of contractual plans, even much of the bookkeeping is done by custodian banks. If the sales loads were raised, presumably salesmen's commission rates would rise, more salesmen and dealers would come into the business which would be spread around more, and the profits of individual firms consequently would not show a commensurate increase. It is likely that much the same thing would happen in reverse if sales loads were reduced.

With respect to our understanding of the economics of the securities business, as I mentioned, we are handicapped by the lack of income and

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expense data. I suspect that our understanding may be weaker with respect to Regional Member Firms, such as yours, than it is for most other segments of the business. We are fairly well informed as to the economics of the large member firms since they recognize the value of informed regulation and have sufficient dealings with us to see that, although we may be mistaken we are not malevolent. We also obtain a fair understanding of the economics of small over-the-counter firms, since they are the frequent recipients of our inspections. Any information which you might be able to provide concerning the economics of a firm such as yours would be gratefully received.

We certainly have no purpose of promoting the merger movement, which I suspect is more influenced by the development of electronic data processing and automation together with the increasing institutionalization of the markets, than by anything we have or might do. We do feel that a 5 percent sales load would still permit the active merchandising of mutual fund shares.

Best regards.

Sincerely,

PAL

Philip A. Loomis, Jr.
General Counsel

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