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NEW YORK
CHICAGO
LOS ANGELES

January 31, 1967

To Editors and Columnists:

Enclosed is a statement which we have prepared as a rebuttal to certain sections of the December 2nd, 1966 Report of the Securities and Exchange Commission on Investment Companies.

This statement was mailed over the weekend to main offices and branch offices of investment dealers who are members of our Selling Group. In the opening paragraph we have told our dealers that the communication was prepared to provide them with factual information by which they could correct any misconceptions which might exist in the minds of their customers as a result of reading newspaper and magazine accounts of the S.E.C. Report. As you will see at the top of the cover page, we have asked dealers not to release the document to the press. Also you will note near the end of the Report we have explained our reasons for urging dealers to limit the use of the information contained in the Report exclusively to correcting the misconceptions referred to above. Perhaps it was naive to think that dealers would respect our request. Be that as it may, the story was leaked to a Boston newspaper and coverage was given the story in the Tuesday morning edition of that newspaper.

We regret this happening, but under the circumstances it appears that the best we can do at this point is to give the story widespread distribution as promptly as it is possible for us to do so.

Whether or not you decide to make any use of this material, I hope you will find time to read what we have to say. It is factual and has been carefully documented, and as you will see, it is in sharp contradiction to certain of the statements made in the S.E.C. Report.

Sincerely yours,

Not for Release to the Press

THE S. E. C. INVESTMENT COMPANY REPORT

AN EMPHATIC REBUTTAL

INDEX:

To Investment Dealers and Their Registered Representatives:

This communication has been prepared to provide you with factual information by which you can correct any misconceptions which may exist in the minds of your customers as a result of reading newspaper and magazine accounts of the December 2, 1966 Report of the Securities and Exchange Commission on Investment Companies.

We believe that in certain important respects this Report is inaccurate in that it fails to support certain of the conclusions with appropriate and meaningful facts and is therefore misleading.

ADVISORY OR MANAGEMENT FEES

The Report states: "Publicly held, externally managed mutual funds pay substantially higher advisory fee rates than registered investment companies which are operated exclusively for equity investment vehicles for banks and other institutions. . . They are also substantially higher than the fees that banks charge for managing the investments of pension and profit sharing plans. . . . Mutual fund advisory fee rates also are substantially higher for comparable asset levels than the rates that private individuals pay for investment advice."

What does this mean? According to the New York Times, which is the most widely circulated newspaper in the country and broadly regarded as sophisticated, intelligently edited and reliable, it means what a featured article in the December 3, 1966 edition says: "Nearly all mutual funds charge their customers 'excessive' fees, and extensive new legislation is needed to protect the investing public from such 'unjustified' costs, the S.E.C. said today." The article adds: "The Commission said . . . (mutual fund) money — management fees . . . were 'substantially higher' than those charged by banks for similar investment-management services."

The fact is that mutual fund management fees range from 0.12% to 0.50% with a few minor exceptions and for the year 1965–1966 the *average* management fee paid by *all* mutual funds having assets of over $100,000,000 (over 80% of the total assets of the industry) was 0.37% — i.e. 37/100 of 1% of average net assets annually. Compare this figure with the "traditional", "usual", "flat", "basic", "standard", "commonly charged", "historical", 0.50%, or 50/100 of 1% ***as so described and stated no less than twenty times in the 32 pages of the S.E.C. Report dealing primarily with management or advisory fee rates.***

The fact is that the 0.50% mutual fund advisory fee rate repeatedly mentioned in th S.E.C. report is ***35% higher*** than the 0.37% average of mutual fund management fees

With reference to the first sentence of the paragraph from the S.E.C. Report previously quoted, the substantiation offered consists of a discussion of five mutual funds organized by mutual savings banks for the purpose of permitting these banks to pool that small portion of their assets permitted by state law to be invested in common stocks. ***No private individual owns shares of any of these funds. The saving banks in the rich and populous state of New York have, over a period of years, contributed a total of $128.8 million to the Institutional Investors Mutual Fund, Inc., the New York state Fund which is cited as the prime example. The Fund is in effect a cooperative operated exclusively for the convenience of mutual savings banks which otherwise could not obtain adequate diversification and management individually with the relatively small amounts of money each bank is able to contribut to the Fund under the State banking law.***

The implication of the S.E.C. quoted statement is strong, however, that mutual funds charge substantially more for management than do banks generally for similar services. (Note quote from N. Y. Times above.) This, we believe, is an inappropriate and distorted comparison, as witness the following:

The second largest bank in New York City and the third largest bank in the United States, with total resources of nearly $15 billion, currently operates a mutual fund registered with the S.E.C. for the offering of its shares to private individuals. The investment advisory fee rate for this bank-managed fund is 0.50%, or 50/100 of 1% of average net assets annually with ***no provision*** for reducing advisory fee rates as the fund increases in size as is the case with virtually all mutual funds. This flat 50/100 of 1% management fee for a bank-operated mutual fund which, according to the S.E.C. Report has "essentially the same characteristics as mutual funds", is indeed comparable to management fees charged by other publicly owned mutual funds. The bank fee, however, is 35% ***higher*** than the average management fee of 37/100 of 1% for the mutual fund industry.

The fact that the First National City Bank charges 0.50% is disclosed in a short footnote to a nine-line paragraph among several hundred paragraphs in the chapter of the Report which discusses management fees and related subjects! ***The footnote, which is in 6 point closed type,*** reads as follows: " . . . . it (FNCB) charges an advisory fee of 0.50% on the average net assets in the account". Here is the footnote in the Report as it appears in this photographic reproduction — the relevant excerpt is in the third line from the top:

[illegible] First National City Bank of New York is the only bank which as yet has registered a commingled account under the Act. Although participation in National City's commingled account is being offered without sales charges, it charges an advisory fee of 0.50 percent on the average net assets in the account.

[illegible] Includes office rental and occupancy, clerical, bookkeeping, accounting and auditing services, stationery, supplies, and printing and determination of offering and redemption prices. See p. 104, supra.

[illegible] IIMF shareholders do not pay a sales load for the purchase of their shares. The fund does charge, however, a fee of 0.60 percent on all purchases and redemptions of fund shares. This fee is designed to offset brokerage commissions and other costs, such as transfer taxes, caused by the flow of capital in or out of the fund.

[illegible] Savings Banks Trust Co. also serves as investment adviser to M.S.B. Fund, a mutual fund organized for employees of member banks. On June 30, 1966, this fund had net assets of $2.8 million. On occasion, the trust company also performs analyses of individual portfolios for its member banks.

The S.E.C. requires registered mutual funds to disclose in their prospectuses all material facts in not less than 10 point leaded (10 on 12) type and failure to do so can result in an injunction or stop order against the issuing company.

The main point, however, is that the $15 billion First National City Bank charges a ***flat*** 0.50% management fee, which is 35% ***higher*** than the average fee for the mutual fund industry for similar services.

This fact is both enlightening and in sharp contradiction to the New York Times quotation from the S.E.C. Report: "The Commission said . . . . (mutual fund) money-management fees . . . . were 'substantially higher' than those charged by banks for similar investment management services".

With reference to the second sentence of the quotation from the S.E.C. Report which appears on the first page of this statement as follows: " . . . . They are also substantially higher than the fees that banks charge for managing the investments of pension and profit sharing plans", the substantiation offered is a general discussion of pension and profit sharing plan advisory fees charged by banks drawing the conclusion that the annual fee amounts to about 0.06% of asset value—"a rate less than one-eighth of the 0.50% rate ***commonly charged*** to mutual funds . . . " (Emphasis ours).

In its general statement, however, the S.E.C. notes that banks may receive "other business benefits from the management of pension and profit-sharing plan assets that do not inure to mutual fund advisors". The Report does not explain either the nature or the magnitude of the "other business benefits".

"Moreover", the S.E.C. Report states "the responsibility of mutual fund advisers for the operation of the funds is more comprehensive than that normally assumed by advisers to pension or profit-sharing plans. In addition to investment advice and most of the administrative services provided by banks to pensions and profit-sharing plans under their management, the mutual fund adviser is usually concerned with administering the fund as a corporate or trust entity. This involves the adviser in various aspects of shareholder relations, including the preparation of proxy material and arrangements for annual meetings and it must assume the responsibility for compliance with record keeping and reporting requirements and other aspects of Federal and State regulation. As previously noted, these services are usually provided by the mutual fund investment adviser and paid for by the advisory fee."

The S.E.C. Report adds, . . . "Mutual fund portfolios tend to be more heavily invested in common stock than pension and profit-sharing plan portfolios. Since common stock investments generally require more intensive analysis and surveillance than investments in bond and preferred stocks, the management of mutual fund portfolios may be somewhat costlier than the management of pension or profit-sharing plans."

Nonetheless, these considerations do not fully explain or account for "the extent of the disparity in the advisory fee rates charged by the two investment media", says the Report.

Of course they don't. The reason is that the S.E.C. has *failed to state certain material facts necessary to make the facts stated not misleading* †.

These material facts deserve considerably more attention than the vague and brief acknowledgment that "banks may receive other business benefits from the management of pension and profit-sharing plan assets" as stated in the S.E.C. Report.

These "other business benefits" usually come in the form of substantial additional income to the banks for various services and functions performed *for the corporations* whose pension and/or profit-sharing plan assets the banks manage.

Among them are:

1. Corporate trust work
2. Transfer agent work
3. Registrar work
4. Depository for substantial cash deposits from the corporation
5. Granting loans *to the corporations*
6. Depository for substantial cash deposits from brokers who are favored with purchase and sales orders generated by the banks in managing plan assets
7. Management of pension plan assets also inures to the financial benefit of banks in the form of profitable business from other sources because of the

† *Paraphrase of Section 11, (6) (3) of the Securities Act of 1933 as amended.*

prestige acquired from having the management responsibility for plan assets of big name corporations and institutions.

Income earned and other benefits realized for performing these services and functions dwarf to insignificance the advisory fees charged for managing pension and/or profit-sharing plan assets. Indeed, the acceptance of responsibility for the management of plan assets might critically be described as a loss-leader to attract profitable business in other areas and from other sources.

Where these "other business benefits" are not available, the fees charged, such as for managing common trust funds and individual trust accounts, are substantially higher.

The third sentence of the quotation on page 1, which reads, ". . . Mutual fund advisory fee rates also are substantially higher for comparable net asset levels than the rates that private individuals pay for investment advice." is again substantiated by vague and irrelevant or confusing observations, such as the following: "The lower fee rates which the Wharton Report found were charged to the non-fund clients of mutual fund advisers ***correspond to the rates reflected in the fee schedules of banks for individual accounts*** and those filed with the Commission by registered investment advisers. Although the ***basic annual fee rate usually is 0.50% or more,*** this rate is usually halved for portfolios ranging from $1 million to $2 million." (Emphasis ours.)

So, if you are a private individual with up to $1 million to invest you can get investment advice at the basic annual fee rate of "usually 0.50% or more", ***which is 35% or more higher than the average management fee charged by mutual funds.***

Then the S.E.C. Report says: "The fact that mutual funds tend to pay more for investment management than do other types of advisory clients does not mean that mutual fund ***shareholders*** are charged more for investment advice than they would be if they had individually sought to obtain professional management services for their investment capital. Most investment advisers do not accept accounts of less than $100,000. Those that do often set a minimum fee which would be ***prohibitive*** to the average mutual fund shareholder." (Emphasis ours.)

These excerpts from the S.E.C. Report are obviously confusing largely because rates for "comparable asset levels" are oranges and rates that "private individuals pay for investment advice" are apples. One cannot meaningfully compare the two. We have demonstrated how this and other such statements in the Report – accurately reported by the N. Y. Times and, we might add, Time Magazine – have confused the public.

But to get to the heart of the point which the S.E.C. has introduced, let us first rephrase the above quotation which says that mutual fund rates are higher for comparable asset levels than rates paid by private individuals for investment advice.

We suggest that the following rephrasing puts a ***valid*** point in clear and appropriate perspective:

Mutual fund shareholders pay far less in fees for investment management than most private individuals pay for investment advice or investment management with respect to comparable amounts of money invested.

There is available to the S.E.C. and anyone else who wishes to examine the subject, clear-cut, simple and incontrovertible proof of the immediately foregoing statement which, in its entire 346 pages, the S.E.C. Report failed even to mention!

Here is the way it goes. There are 1,016 common trust funds (the bank version of a mutual fund) having total assets of $7.5 *billion* managed by 464 banks and trust companies throughout the United States.

The assets of these commingled, diversified common trust funds are owned by individuals under trust indentures and managed by banks.

How do the management fees paid by these individuals compare with the management fees paid by shareholders of mutual funds? The table below gives the answer.

COMMON TRUST FUND VS. MUTUAL FUND
FEES CHARGED AS A PER CENT OF ASSETS

Size of Account	Old Colony Trust* Boston	Manufacturers Hanover** Trust Co. New York	Mutual Funds***
$ 1,000	6.70%	25.00%	0.37%
5,000	1.50%	5.00%	0.37%
10,000	.85%	2.50%	0.37%
15,000	.63%	1.66%	0.37%
20,000	.53%	1.25%	0.37%
25,000	.46%	1.00%	0.37%
50,000	.34%	0.50%	0.37%
100,000	.34%	0.375%	0.37%

*Assumes a 3½% yield.

**Minimum fees published in "Commissions for Executors and Trustees in New York State", by Manufacturers Hanover Trust, August 1966.

***Average of mutual fund management fees — see page 1.

The Old Colony Trust Company is the "trust department", in effect a subsidiary, of the First National Bank of Boston, the largest bank in New England. The fees shown in the table are those published by the Trust Company. They are typical of fees charged by other banks in the area. Fees charged by banks in New York would appear to be even higher.

In the case of the New England banks, the management fee charges range from *18 times* the mutual fund charges for small ($1,000 amounts) to about even for large ($100,000 amounts). Note that for the average size mutual fund shareholder account ($5,000)† the ***bank*** charge (in New England) is ***over 4 times higher*** than the mutual fund charge; and in New York, judged by the figures above it is ***more than 13½ times higher.***

These figures do not constitute extravagant selected samples of bank charges. They are published fee schedules and constitute typical ***examples*** of advisory fee schedules which we have obtained from eight other leading banks in New York, Chicago and St. Louis.

It is amazing to us — perhaps shocking is the better word — that after eight years of research (Wharton School of Finance and Commerce of the University of

† Since most shareholders have several mutual fund accounts their average *holding* is $10,000.

Pennsylvania and the S.E.C. Staff) the S.E.C. was unable to find these readily available figures — (or was unwilling to disclose them).

But let us move on to another area of bank investment advisory fees to which the foregoing comment applies with equal force

According to the monthly publication TRUSTS & ESTATES, August 1966 issue, page 822, and attributed to the Comptroller of the Currency, there are ***$115 billion*** of "Investment Responsibility Accounts"†, including the $7.5 billion of Common Trust Funds managed by banks, in the United States. This is over three times the total assets of ***all*** mutual funds.

No mention of this huge sum of bank-managed trust assets is contained in the S.E.C. Report, nor is any specific or complete information given about the advisory or management fee charges made by the banks Perhaps the answer to this enigma may be found in the table below, which compares published fee schedules with the average management fee paid by mutual funds.

TRUST ACCOUNTS (EXCLUDING COMMON TRUST FUNDS)
VS. MUTUAL FUND FEES CHARGED AS A PER CENT OF ASSETS

Size of Account	Old Colony Trust * Boston	Manufacturers Hanover ** Trust Co. New York	Mutual Funds***
$ 5,000	5.00%	7.50%	0.37%
10,000	2.50%	3.75%	0.37%
20,000	1.30%	1.88%	0.37%
25,000	1.08%	1.50%	0.37%
50,000	.64%	0.75%	0.37%
100,000	.48%	0.38%	0.37%

*Assumes a 3½% yield.

**Minimum fees published in "Commissions for Executors and Trustees in New York State", by Manufacturers Hanover Trust, August 1966.

***Average of mutual fund management fees - see page 1.

Note that the bank fee charged on a $5,000 account, the average size of mutual fund shareholder accounts, is ***13½ times*** the mutual fund fee for the New England bank and ***20 times higher*** for the New York bank; at $10,000 the bank fee is almost 7 times and 10 times the mutual fund fee respectively, etc. And for the highest amount of assets at the lowest bank fee, the bank charge in one case is 30% higher than the mutual fund fee, and in the other it's about the same.

It seems timely at this juncture to repeat the New York Times quote from the S.E.C. Report to demonstrate how utterly misleading the unsubstantiated hypotheses stated in the Report are. The quote — "Nearly all mutual funds charge ***'excessive'*** fees. . . . The Commission said . . . (mutual fund) money-management fees . . . were 'substantially higher' than those charged by banks for similar investment-management services." (Emphasis ours.)

In face of the incisive, clear-cut facts given in the above table, the S.E.C. Report "concludes that mutual fund shareholders need protection against incurring excessive costs in the acquisition and management of their investments. . . ."

† Trusts under fully discretionary investment management.

A WORD ABOUT BANKS

Banks and Trust Companies perform desirable, useful and constructive services and functions. They constitute a bulwark of strength in our economy and an exceptional versatility and efficiency in many facets of the financial sector of our economy and of our private affairs. No criticism of banks, their charges or their activities is intended in this emphatic rebuttal to the S.E.C. Report.

Our concern is with the Report which inappropriately uses bank figures among others in an attempt to make a case against mutual fund management fees.

SALES CHARGES OR SALES LOADS

Again we approach a matter introduced in the S.E.C. Report with a quotation from the N. Y. Times article referred to earlier and echoed by Time Magazine in its December 9, 1966 issue. Incidentally, the Times and Time Magazine reported accurately on what we believe to be an inaccurate and misleading report by the S.E.C. in that the Report did not substantiate statements made therein with appropriate relevant and valid evidence. Moreover the Report *fails to state facts necessary to make the facts stated not misleading.*

The quotation is: "The Commission said that the 'excessive costs' incurred by most of the nation's 3.5 million mutual fund shareholders included . . . sales commissions, which were 'much higher' than those charged on the purchase and sale of ordinary stocks . . ." Time Magazine, translating from the Report, adds: "Commissions on a $4,000 order of mutual funds, for example, now run about nine times as high as on a $4,000 round-lot order of common stock."

With respect to the $4,000 S.E.C. selected sample, the Stock Exchange commission indicated is incurred for the purchase of a 100 share round lot, whereas the mutual fund sales charge covers both purchase and sale. Thus, to make the comparison even mildly appropriate, it is necessary to double the Stock Exchange commission from about 1% to about 2%. As a result the mutual fund sales charge amounts to about 4½ times, not 9 times, the Stock Exchange commission. But this is purely academic in the context of costs to investors of buying and selling a diversified portfolio of common stocks as against the purchase of mutual fund shares.

The S.E.C. fails to recognize that mutual fund shares do not constitute "a security" as such. They constitute a diversified and managed portfolio consisting typically of a hundred or so securities. A mutual fund offers a ***program*** of investing with a specific stated investment objective aspired to by experienced professional investment managers. And the industry offers many different investment objectives such as, in an overly simplified description, Income, Growth, Balance, etc. As investment ***programs*** they do not entail the same degree of speculative risk as does the ownership of any one individual stock.

We have no intent whatsoever of implying any criticism of the practice of buying and selling stocks by individuals. Millions of shares are so traded every business day by investors. We are all in favor of this for those who want to and are reasonably qualified financially and otherwise to do it. The breadth and liquidity of the market is enhanced. Individuals satisfy their personal wishes and propensities. The Stock Exchanges, through their facilities and personnel and the varied and complex services and functions they perform provide economically, efficiently and quickly the means for accommodating the tremendous volume of trading in securities, which is of such great importance to the financial sector of our economy and, of course, in turn to the U. S. economy as a whole.

But in the relatively small area of mutual fund activities, we think it is only sensible to make it perfectly clear that mutual funds are carefully and ingeniously designed for the ***small*** as well as the large investor to whom an investment ***program***, offering long-term aims and objectives which coincide with his own, appeals. Such objectives generally come within the borders of living estate planning and after life disposal of wealth.

Thus to compare in this context the cost of purchasing one stock with the in-and-out cost of mutual fund shares seems to us inappropriate and misleading.

If, however, an investor acting independently were to purchase a diversified list of stocks affording ***only one-half*** the degree of diversification typically provided by mutual funds (and do his own managing), his costs will compare with those of mutual funds for varying amounts of money, as shown in the table below.

COST OF BUYING AND SELLING INDIVIDUAL STOCKS VS. MUTUAL FUNDS
(Expressed as a Percent of the Amount Invested)

Approximate Amount of Investment	50 Individual Stocks	Mutual Funds***
$ 4,000 *	13.50% **	8.50%
5,000	9.60%	8.50%
10,000	6.20%	8.50%
15,000	5.00%	7.50%
25,000	4.40%	5.75%
50,000	3.50%	4.00%
100,000	3.00%	3.25%
250,000	2.20%	2.50%
500,000	2.10%	2.25%
1,000,000	1.90%	1.75%

*Dollar amount used in S.E.C. example.

**New York Stock Exchange commissions on transactions of this size are by mutual agreement. Assumed minimum of $6.00 is used in this illustration on purchase and sale, which is below estimated brokers' cost of $10 per trade.

***Sponsored by Vance, Sanders & Company, Inc.

In the above table the following assumptions are made regarding the investments in individual stocks:

(1) All stocks purchased at a price of $40 (price used in S.E.C. Report.)

(2) Selling costs based on New York Stock Exchange commissions and include odd lot fees where applicable. (Commissions on round lot purchase — 100 shares — are, of course, less; but round lot buying requires a great deal of capital to obtain adequate diversification) i.e. 100 shares each of just fifty stocks at $40 a share would cost $200,000.

The above cost comparison obviously is a far cry from the S.E.C. comparison, but so are the facts of life.

The cost of buying and selling a single stock does not properly lend itself to comparison with the in-and out cost of a mutual fund which represents a diversified and managed portfolio of many stocks.

Of special importance with respect to the above comparison of costs is the fact that the Wharton School, which conducted a four year study of the mutual fund industry — costs, practices, size, etc. — for the S.E.C. at a cost of some $90,000.00, stated clearly (not in a 6 point closed-type footnote) with respect to its findings regarding mutual fund sales charges the following: ***"Since perhaps the major function effectively served by mutual funds is the provision of diversification, a feature particularly important to small investors who can ill afford large risks, it is important to point out that such an investor who attempted to achieve a comparable degree of diversification by direct purchases might incur acquisition costs in excess of the 8 percent sales charge typically imposed by the funds."*** (Emphasis ours)

The Wharton School report provides the statistical and research basis for much of the S.E.C. Report. It is referred to and quoted scores of times in the Report. It is the "independent authority" on which the S.E.C. leans heavily for support of its conclusions. But nowhere in the 346 page Report of the S.E.C. to Congress does the above highly significant statement appear.

Frequent reference is made in the S.E.C. Report to the figure 9.3% as the "sales load" paid by purchasers of mutual fund shares. This figure is determined by relating the dollar amount represented by the sales charge of 8½% of the purchase price to the net amount of money invested. For example, on a $1,000 purchase, the sales charge of 8½% of the purchase price amounts to $85. Subtracting the $85 sales charge from the $1,000 purchase price, the figure of $915 is determined to be the "net amount actually invested". By relating the $85 sales charge to $915, the S.E.C. Report says that the "sales load" is 9.3% as indeed it is on that basis of figuring and as so reported in the N. Y. Times and Time Magazine, among many other newspapers and magazines.

The industry, however, argued for years and finally won its point with the S.E.C. that the expression of the sales charge ***as a per cent of the dollar amount invested*** by the purchaser of mutual fund shares is a fair and proper way of stating the sales charge in a prospectus or other descriptive material — the purchaser invests $1,000, of this amount 8½% is deducted to cover the costs of selling shares to investors and to provide compensation to the investment dealer, the salesman and the "principal underwriter" or national distributor.

This way of expressing sales commissions is neither unique nor uncommon in the sale of most products. If you buy a house priced at $30,000, you pay $30,000. The real estate dealer, however, retains, say, 6% of the purchase price or $1,800. You don't buy the house for $28,200 and pay $1,800 to the real estate dealer or a "sales load" of 6.4% of the amount left after the deduction of the sales commission. If you buy an automobile for $3,000, you pay $3,000. The automobile dealer retains, say, 20% of the purchase price or $600. You don't buy the automobile for $2,400 and pay the dealer $600 or a "sales load" of *25%* of the amount after deduction or retention of the sales commission.

But what is most interesting to us and significant as to the character of much of the Report is that in computing its own "examples" of the Stock Exchange commission cost of buying and selling a single stock, the S.E.C. expresses the dollar amount of commissions involved both as a percent of the amount involved including brokerage commissions as do mutual funds when they express the sales charge properly ***and*** as a percent of the amount involved not including brokerage commissions. But what the Report stresses is that the "sales load" is 9.3% whereas the S.E.C. examples of the cost of buying and selling one individual stock use both methods in arriving at a round-trip cost figure which compares favorably (to their advantage) with the round-trip cost of purchasing mutual fund shares.

PROFIT MARGINS OF MUTUAL FUND ADVISORY ORGANIZATIONS

The S.E.C. Report contains a table showing pretax profit margins of fourteen mutual fund advisory organizations. The table is accurate; it was prepared and is presented in conformity with generally accepted accounting principles. The gist of this table appeared in the December 9, 1966 issue of Time Magazine.

Accurate as the tables are, they have little, if any, meaningful significance as a basis of judging the degree of profitability of advisory organizations. These are ***service*** organizations. They have no bricks and mortar, no plant or equipment, no inventories, no raw materials, etc. The commonly accepted rules of accounting referred to above are designed to apply to industrial and manufacturing types of companies, not to service organizations in which the principal assets are human beings. Other service organizations whose "profit margins" would be as meaningless include insurance agencies, accounting firms, law firms, manufacturers' representatives, etc. No investment analyst would attempt to judge the profitability of a typical service organization on the basis of such a table as that presented by the S.E.C. To the average member of the public, however, the S.E.C. table is likely to be very misleading.

The S.E.C., in other chapters of its Report, has stated that management fees and sales charges are ***excessive*** and ***unwarranted.*** In this chapter on profit margins the S.E.C. attempts to "prove" the case by means of the meaningless pretax profit margin table referred to above.

We think they have failed to "prove" anything in these areas except that their statements, contentions and implications are, in certain important respects, inaccurate and misleading in that they are unsupported by appropriate and meaningful facts and that they have *failed to state material facts necessary to make the facts stated not misleading.*

LIMITED USE OF THIS STATEMENT

We urge that for the time being use of information contained in this statement be limited exclusively to correcting misconceptions which your customers may have as a result of having been misled by news accounts generated by the S.E.C. Report. Important work is being done by the entire securities industry to combat the injurious effects that the Report is having and to win our just case before the Congress. We think that it would be unwise at this point to invite further controversy in the press.

We take this opportunity to commend the Investment Bankers Association of America for its firm and thoughtful statement objecting to various provisions of the S.E.C. Report to Congress and to endorse the positions it has taken.

William F. Shelley

President
VANCE, SANDERS & COMPANY, INC.

January 26, 1967