

J.K. 11945
OH

MEMORANDUM

November 12, 1969

To : The Commission
From : Division of Corporate Regulation *S.F.*
Re : H.R. 11995 - Questions submitted by Congressman Stuckey

At the conclusion of the hearings this morning on H.R. 11995 Mike Taylor, the Subcommittee's counsel, delivered to the staff the questions prepared by Mr. Stuckey. All told there are 67 questions covering seven pages.

A copy of the questions is attached for the Commission's information. The handwritten notations were on the copies delivered to us. The work has been parceled out and proposed replies are now being prepared. We will submit the answers to the Commission as soon as possible.

Attachment

QUESTIONS RELATING TO MUTUAL FUND LEGISLATION

H.R. 11995 (Moss Bill) H.R. 14737 (Stuckey Bill)

Hearings on November 12, 1969
Subcommittee on Commerce and Finance

Perf. fees

1. As I understand it, H.R. 11995 would prohibit investment advisers of mutual funds from entering into contracts providing for compensation based on performance unless fees increase and decrease proportionately. To what extent would this affect existing mutual funds?

2. Are investment advisers of mutual funds now exempt from the Investment Advisers Act of 1940?

3. Is my understanding correct that investment advisers of mutual funds are now regulated under the Investment Company Act of 1940 and will be specifically brought under the fiduciary obligations of mutual funds themselves in H.R. 11995?

4. What affect will H.R. 11995 have on registered U.S. advisory companies who have performance fee contracts with non-U.S. mutual funds, the so-called "offshore funds"?

5. Would there be any objection to eliminating from H.R. 11995 that section which would prohibit performance fees unless they increase and decrease proportionately, since there are many funds now who would be apparently seriously hurt by the proposed change?

6. Would the SEC agree to exercise its exemptive powers to authorize registered U.S. investment advisers of offshore funds as well as domestic funds to contract for advice on the basis of performance, provided the fees were not in violation of the fiduciary requirements of H.R. 11995?

7. Does the SEC have any evidence of wrong doing or of other abuses which would require deletion of the existing exemption from the Investment Advisers Act of 1940 for investment advisers?

QUESTIONS RELATING TO MUTUAL FUND LEGISLATION

H.R. 11995 (Moss Bill) H.R. 14737 (Stuckey Bill)

add for

Hearings November 12, 1969
Subcommittee on Commerce and Finance

1. As I understand it, H.R. 11995 proposes to delete the existing exemption from the Investment Company Act of 1940 for oil and gas drilling programs. To what extent would this interfere or prohibit the operation of existing companies distributing these programs?

2. Since oil and gas programs deal in the management of leases, how can they be put under the mutual fund law which is structured to regulate companies investing in the securities of other corporations?

3. I understand this provision would put some oil and gas drilling companies out of business because they cannot be structured to operate like a mutual fund. Has the SEC made any study of the problem?

4. Am I correct that all oil and gas drilling programs selling securities must register under the Securities Act of 1933 and the Exchange Act of 1934 the same as the other 26,000 publicly owned companies in the United States when they sell securities to investors?

5. Why is it not possible to regulate these oil and gas companies under the 1933 Act and 1934 Act the same as the SEC regulates other issuers?

6. Why would it not be better to remove this proposed deletion of the existing exemption of the 1940 Act from H.R. 11995 until the SEC can make a study and report to Congress on the numbers of such funds, their method of operation, and the reasons why they cannot be adequately regulated the way other issuers of the securities are regulated under the Securities Act of 1933 and the Exchange Act of 1934?

QUESTIONS RELATING TO MUTUAL FUND LEGISLATION

H.R. 11995 (Moss Bill) H.R. 14737 (Stuckey Bill)

Hearings November 12, 1969
Subcommittee on Commerce and Finance

1. Can you give us the gross volume of mutual fund sales by different size broker-dealers, so we can get some idea of the impact on their gross income of any reduction in sales load?

2. Does the SEC have any statistics which would indicate that mutual fund salesmen are making excessive profits with an 8 1/2% sales load?

3. Does the SEC have any statistics showing whether broker-dealers are making excessive profits with an 8 1/2% sales load?

4. Am I correct that mutual fund shares are in continuous registration with the SEC and are a continuous "new issue"?

5. Is my understanding correct that most "new issues" under NASD policy carry a 10% underwriting commission plus 10% in warrants for the underwriter?

6. Will mutual funds be able to compete with other "new issues" with a sales load reduced from 8 1/2%?

7. How many mutual funds are now registered with the SEC?

8. How many of these reduce the sales load on volume sales? Please supply us with the present break points and reduced sales loads, so we have an idea of the situation as it exists.

9. Am I correct that mutual salesmen generally are paid about 1/2 of the broker-dealer commission on mutual fund sales?

10. How is an 8 1/2% sales load divided among the underwriter, the broker-dealer and the salesman?

QUESTIONS RELATING TO MUTUAL FUND LEGISLATION

H.R. 11995 (Moss Bill) H.R. 14737 (Stuckey Bill) *salesmen*

Hearings November 12, 1969
Subcommittee on Commerce and Finance

1. If the NASD or SEC reduce the existing sales load, will the salesmen suffer a significant loss of income? What is their average income now?

2. Under present law, is each salesman required to give each prospective investor a prospectus?

3. Is the sales load prominently set forth in the prospectus?

4. Can the SEC under present law require a more prominent disclosure of the sales load?

5. Why can we not leave it to the prospective investor to judge whether a sales load is too high?

6. "No load" funds are widely advertised, are they not?

7. How are "no load" funds sold?

8. How many "no load" funds are there?

9. How many "low load" funds?

10. To what extent do these funds allocate portfolio brokerage business to broker-dealers who sell their "no load" funds?

Callahan
r. Smith

QUESTIONS RELATING TO MUTUAL FUND LEGISLATION

H.R. 11995 (Moss Bill) H.R. 14737 (Stuckey Bill)

Hearings November 12, 1969

Subcommittee on Commerce and Finance

1. Am I correct that under H.R. 11995 and H.R. 14737 the NASD is given the power, under SEC oversight, to determine whether mutual fund sales loads are excessive?
2. There is no maximum or ceiling on sales loads in the Investment Company Act of 1940 at present, is there?
3. Does the SEC have any control over sales loads under present law? Explain.
4. Has the SEC ever used this existing authority to challenge excessive sales loads?
5. Will the SEC use the oversight authority proposed in H.R. 11995 and H.R. 14737 to force the NASD to reduce sales loads to a maximum of 5%, the ceiling originally proposed by the SEC?
6. How many mutual fund salesmen, both full time and part time, are there in the U.S?
7. How many mutual fund broker-dealers, as distinguished from broker-dealers conducting a general securities business, are there?
8. What is the breakdown among the 4000 broker-dealers registered with the SEC as to those in the small business category?
9. Does the SEC have any breakdown on the numbers of salesmen for each broker-dealer? Can you tell us how many have 10 or less, 25 or less, 50 or less and so on?
10. Can you give us a breakdown on broker-dealers as to net capital, so we can get an idea of the number of small dealers?

QUESTIONS RELATING TO MUTUAL FUND LEGISLATION

H.R. 11995 (Moss Bill) H.R. 14737 (Stuckey Bill)

Sullivan

HEARINGS NOVEMBER 12, 1969
Subcommittee on Commerce and Finance

1. In January of 1968 the SEC proposed Rule 10b-10 to prohibit customer directed commission-sharing ("give-ups") among brokers executing portfolio transactions for mutual funds. What is the status of that rule now? Explain how a "give-up" works and why the SEC is opposed to them?
2. To what extent do existing mutual fund shareholders have an interest in continuing sales of shares to new investors?
3. What percentage of the gross income of broker-dealers income on mutual fund sales come from "give-ups" before the SEC asked the New York Stock Exchange to prohibit "give-ups"? What impact has this had on mutual fund sales?
4. What impact has the prohibition against "give-ups" had on small broker-dealers?
5. Is my understanding correct that the large brokers who specialize in mutual fund portfolio transactions now keep 100% of the commissions they formerly shared with small dealers who sell the shares of the funds?
6. The sales of fund shares by many small dealers is what makes a mutual fund grow, and this in turn gives rise to the portfolio business the big brokers now get from mutual funds?
7. Does the SEC now allow several brokers to participate in and share a commission on a transaction on the stock exchange floor?
8. To what extent can several brokers share a commission in the over the counter market?
9. Can you outline the difference in SEC policy and the reasons for it respecting commission-sharing among brokers as to so-called listed business, i.e., shares listed on an exchange, listed business in the third market, over the counter securities, and mutual fund shares?
10. What is the reason there is no minimum commission rate in the over the counter market?

See Encls.

1. What are the differences between the SEC and the Justice Department as to the New York Stock Exchange minimum rate?
2. What will happen if the stock exchange minimum rate is found to be a violation of the anti-trust laws?
3. What is "interpositioning"? Is every case where more than one broker participates in or shares a commission in the over the counter market a case of interpositioning?
4. Can the SEC set out some rules where various brokers who perform valuable services in connection with a mutual fund portfolio transaction in the over the counter market can be compensated within the framework of a single commission, so small dealers who sell fund shares, but who haven't the net capital or ability to execute large block transactions, can share in the portfolio business they help generate through sales of fund shares?
5. Am I correct that most mutual fund prospectuses clearly set out that portfolio purchases and sales will be allocated to dealers who sell a fund's shares?
6. What is "reciprocity"? Does the SEC approve of it? How does it work respecting mutual fund portfolio business?
7. How does the Justice Department view "reciprocity"?
8. To what extent does the stock exchange rule prohibiting customer directed commission sharing, compared with its rule against access for non-members, violate the group-boycott prohibitions of the anti-trust laws?