Boston College Law Review

Volume 13
Issue 5 *A Symposium The Mutual Fund Industry*

Article 1

4-1-1972

AN EDITORIAL NOTE

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Recommended Citation
AN EDITORIAL NOTE, 13 B.C.L. Rev. 955 (1972), http://lawdigitalcommons.bc.edu/bclr/vol13/iss5/1

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AN EDITORIAL NOTE

Thirty-two years ago, after lengthy hearings and substantial debate, Congress adopted the Investment Company Act of 1940 for the purpose of regulating the mutual fund industry in accordance with "the national public interest and the interest of investors."[1] In Section 14(b) of the Act, Congress authorized the SEC, in the event that industry expansion created problems regarding investor protection or the public interest, to investigate the effects of such growth on the industry, the securities markets and the American industrial economy, and to report its recommendations to Congress.[2] Studies focusing directly or tangentially on the mutual fund industry were undertaken in 1962 (Wharton Study[3]), 1963 (Special Study of Securities Markets[4]), 1966 (Public Policy Implications of Investment Company Growth[5]) and 1971 (Institutional Investor Study[6]).

The problems noted and analyzed in these studies have varied greatly, reflecting, to a large degree, the evolution of the mutual fund industry. In 1940, total industry assets approximated $500 million; by December 1970, the industry had total assets in excess of $47.6 billion, or roughly ninety-five times the 1940 figure. Thus the mutual fund has emerged as one of the major financial institutions in the United States today. The problems which the industry now faces are enormously complex, and suggested solutions have ramifications extending well beyond narrow industry concerns. Discussion and analysis of these problems in the legal journals by those interested in and affected by mutual fund regulation can be of considerable value to those charged with evaluating the adequacy of the existing legislative framework and formulating any necessary changes.

A symposium, by drawing together discussions on a number of legal issues in a particular industry, has the advantage of highlighting the fundamental problems existing within the industry while, at the same time, conveying a broad overview of the industry at a particular stage in its development. In organizing this symposium on the mutual fund industry, an attempt has been made to anticipate, analyze and

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[1] 15 U.S.C. § 80a-1 (1970).

[2] 15 U.S.C. § 80a-14(b) (1970).

[3] Wharton School of Finance and Commerce, A Study of Mutual Funds, H.R. Rep. No. 2274, 87th Cong., 2d Sess. (1962).

[4] SEC Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963).

[5] SEC, Public Policy Implications of Investment Company Growth, H.R. Rep. No. 2337, 89th Cong., 2d Sess. (1966).

[6] Institutional Investor Study Report of the SEC, H.R. Doc. No. 92-64, 92d Cong., 1st Sess. (1971).

assess the probable impact of those emerging issues which should be the focus of attention in the years immediately ahead.

One of the most critical areas from the industry point of view is the sale of mutual fund shares. During the last three decades fund organizations have used a variety of price-fixing and commission-rebate devices to promote fund sales. Some of these techniques, such as the customer-directed "give-up" have been abolished; others have been altered or are in the process of change. During periods when net redemptions exceed sales of fund shares, the pressure to stretch the limit of acceptable sales practices is particularly great. The necessity for establishing reasonable, clearly demarcated boundaries in this area, so that new and effective sales techniques may be developed within them, is clear. Various aspects of this sales problem are discussed in this Symposium. Of particular note is the article by Mr. David J. Romanski of the Securities and Exchange Commission on the role of advertising in the mutual funds industry. Mr. Romanski presents an exhaustive treatment of the traditional methods of compensating mutual fund salesmen, notes the past lack of any meaningful advertising, and advocates the increased use of advertising as a sales technique. Mr. Elkins Wetherill and Mr. George S. Hender, the principal officers of the Philadelphia-Baltimore-Washington Stock Exchange, argue forcefully in favor of institutional membership on stock exchanges in light of the favorable P-B-W experience with such members, reduction of negotiated commission rate levels, and the recent decision in *Moses v. Burgin.*[7] Mr. Scott Hodes, a Chicago attorney who has written and spoken widely on the Investment Company Act and particularly on the issue of retail price maintenance, reviews the developments under Section 22(d) and argues for the retention of that section, as well as modification of Rule 22d-1, in order to ensure the continued smooth functioning of the distribution system.

The movement by banks and insurance companies into the mutual fund field through registered investment companies and other equity products has increased the availability of investment opportunities to the average investor. While participation in the mutual fund industry through commingled investment funds has been precluded by the Supreme Court decision in *Investment Company Institute v. Camp,*[8] there is a strong desire within the banking community to continue its participation in another form. Mr. John W. Church and Mr. Richard B. Seidel, attorneys for a large Philadelphia bank, after discussing the history of the commingled investment fund and the implications of the *ICI*

[7] 445 F.2d 369 (1st Cir. 1971), cert. denied sub nom. Johnson v. Moses, 404 U.S. 994 (1971).
[8] 401 U.S. 617 (1971).

decision, address themselves to possible alternative approaches for the banking community, including seeking new enabling legislation, or utilizing common trust funds, closed-end investment funds and investment advisory services. Mr. Paul R. Huard, counsel for the American Life Convention, assesses the insurance industry's involvement in various equity products, including mutual fund shares, variable annuities and variable life insurance. His article describes each of these products, outlines the applicable federal regulatory scheme and discusses the problems and potential for the sale of such equities by the insurance industry.

A different set of problems for the mutual fund industry is raised by Washington, D.C., attorney Mr. Arthur F. Mathews in his discussion of criminal prosecutions under the Investment Company and Investment Advisers Acts. The criminal sanctions in these laws have recently assumed increased importance in light of the decision in *United States v. Deutsch.*[9] The article concludes with suggestions for revisions in the proposed Federal Criminal Code relating to these Acts. Another area of increasing significance and probable future importance to the mutual fund industry is the problem of insider trading. Mr. Clifford J. Alexander, a Boston attorney and former SEC staff member, presents a thoughtful discussion of mutual fund access to information, the application of Rule 10b-5 in the mutual fund context, and the requirements for tippee liability. Partially related to the problem of inside information, and deserving of special note, is an extensive and perceptive student comment by Mr. Paul G. Roberts regarding participation by mutual funds in corporate takeovers. The article analyzes in depth the statutory and administrative measures regulating fund participation in contested transfers of corporate control and concludes with an evaluation of the objectives and effectiveness of existing regulation. Other student comments focus upon the desirability of and the legal problems involved in regulating offshore mutual funds and settlement standards in mutual fund shareholder suits involving a duty to recapture brokerage commissions on business generated by the fund.

In an effort to focus the Symposium primarily upon the emerging issues in the mutual fund field and their future direction and impact, some issues of current interest and significance have had to be omitted. Notably absent are treatments of the impact of the 1970 Amendments to the Investment Company Act, the implications of *Rosenfeld v. Black*[10] for the transfer of advisory organizations and the significance

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[9] 451 F.2d 98 (2d Cir. 1971), cert. denied, — U.S. —, 92 S. Ct. 682 (1972).

[10] 445 F.2d 1337 (2d Cir. 1971), cert. filed sub nom. Lazard Freres & Co. v. Rosenfeld (U.S. Supreme Court 71-771, Dec. 10, 1971).

of the *Rosenfeld* case and *Moses v. Burgin* for the developing standards of fiduciary care required of fund directors and advisers. In spite of these omissions, the range of topics considered by the Symposium is broad and the legal issues discussed are disparate. Considered together, the articles reveal an industry in transition, one stretching to reach a new plateau of stabilization and maturity. One indication of this stage of development is that virtually all the articles either discuss recent legislation or recommend new legislation. Several of the articles propose solutions; others seek only to illuminate and analyze the problems surveyed as a necessary step in their ultimate resolution.

The Board of Editors expresses its appreciation to the writers, published and unpublished, who contributed articles for this Symposium. We also take this opportunity to acknowledge a special debt of gratitude to our Symposium editor, Mr. Bradford J. Powell, the guiding force behind this special issue.

THE EDITORS

BOSTON COLLEGE
INDUSTRIAL AND COMMERCIAL
LAW REVIEW

VOLUME XIII | APRIL 1972 | NUMBER 5

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