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# FACTS

*you should know about*

*Investment Companies*



## INTRODUCTION

This booklet, **FACTS You Should Know About INVESTMENT COMPANIES**, is one of a series of **FACT** booklets on business, merchandise, financial and other subjects which business, through Better Business Bureaus, is publishing in the interest of consumer education — to aid consumers in their everyday money management problems and relations with business.

This booklet endeavors to point out the salient features of investment companies, or investment trusts, so that prospective investors may more easily distinguish between the different types of these organizations and recognize the important factors involved. Nothing herein is intended to either predict the future for investment companies in general or to recommend any particular type of investment company in preference to another.

The method used for classifying the various types of investment companies is the same as that developed by the Federal Securities and Exchange Commission for its report to Congress on the status and history of investment companies in the United States. Other information from that source was also used.

Many hundreds of thousands of different individuals own securities in investment companies having combined total resources in the billions of dollars.

While these are impressive estimates, the number of companies was particularly great during the boom period of 1926 to 1930 when many new companies were organized. While many of these companies were formed by thoroughly honest and highly capable men, others were formed by persons lacking in necessary judgment and experience, while still others were organized by unscrupulous promoters for the express purpose of defrauding the public.

Many were destined to fail in any event, but the extreme declines in the securities markets following the crash of 1929 hastened their demise. Scores of so-called investment trusts which were inefficiently managed, not equipped to meet changed conditions, or conceived in fraud, went out of business with tremendous losses to the public. As a result, public confidence in investment companies was largely destroyed. Since that time, a new era of frankness and honesty in financial matters, encouraged in part by federal securities legislation, has come into being. Fraud and inefficiency in the management of investment companies have not been entirely eliminated and probably never will be. There are, however, a large number of investment companies of the better type that have been working to restore the public confidence which they deserve.

## **INVESTMENT COMPANIES AND INVESTMENT TRUSTS**

The term "investment trust" has been used very loosely to describe investment companies of all kinds, including corporations as well as organizations operating by virtue of a deed of trust. Actually, corporations are not trusts. However, all investment trusts come within the general classification of investment companies, and, accordingly, both will be referred to in this booklet by the all inclusive term, investment companies.

To many inexperienced investors, such terms as "investment trust" and, to a lesser extent, "investment company" are associated with the ideas of safety of capital and certainty of return which are the essentials of a sound, conservative investment. This popular misconception should be dismissed at the outset. An investment trust or an investment company, like any other type of financial organization, may represent an investment, a speculation, or a fraud.

Investment companies have been defined by the New York Stock Exchange as: "—such companies as are engaged primarily in the business of investing and re-investing in securities of other corporations for the purpose of revenue and for profit and not in general for the purpose of exercising control." The stocks and bonds or other securities held by these companies are known as "underlying securities" and when taken as a whole are called the "portfolio." Some investment companies are of a private type and are not discussed in this booklet. In the public ones, investors are offered the opportunity to participate in the portfolio securities through buying shares or certificates representing an interest in the investment company itself. This interest may be represented by shares of beneficial interest, common shares, preferred shares, or debenture bonds, depending upon the particular organization.

All investment companies have been founded on the basic principle of diversification of risk by spreading investments over many different securities. They differ widely, however, in (1) their form of organization; (2) their methods of operation; (3) in the degree of discretion allowed the management; (4) in the character of and judgment displayed by the management; (5) in the class and kinds of securities in the portfolio; (6) and in many other ways.

### **ADVANTAGES OF WELL-MANAGED INVESTMENT COMPANIES**

An investment company that is properly and honestly managed, offers a convenient and desirable medium of investment, particularly to those of limited financial means. There are several advantages in buying the securities of such a company. One important advantage is the factor of greater safety made available through diversification of the

portfolio securities. Ordinarily, it would be impossible or impractical for small investors to endeavor to obtain such diversification for themselves.

The privilege of pooling convenient sums of money in a large fund managed by experienced men and thereby eliminating many investment problems of his own, is another advantage the well-managed investment company offers to the small investor. Many such companies have elaborate facilities for research, statistical data and analyses of market trends which enable them to maintain a constant and intelligent supervision of their portfolios, whereas the average investor is neither familiar with stock market matters nor does he have the time or facilities to study them.

The investor who wishes to avail himself of the advantages which an investment company offers should bear in mind that not all investment companies are good investments. He should not place his money with one of these organizations without first securing all pertinent facts concerning it. In the case of companies offering new issues of securities, the Federal Securities Act of 1933 requires that a written prospectus fully and truthfully disclosing all pertinent information be given to any investor who is asked to buy the security. The Securities and Exchange Commission also requires that investment companies desiring to list their securities on registered stock exchanges must file pertinent information with the Commission, not only at the time of listing but at periodic intervals thereafter. Similar information must be filed with the Securities and Exchange Commission under the Investment Company Act of 1940. This detailed information is made open to public inspection by the Commission and, ordinarily, by the exchanges on which these securities are traded. The investor should obtain and study the essential information *before* he invests. If in doubt as to the significance or meaning of any of the data, he should consult someone of financial experience in whom he has confidence.

It is well to remember that prices of securities of investment companies generally fluctuate in accordance with the fluctuation in the prices of securities in their portfolio. Therefore, the element of time in making a purchase is of importance. If investment company securities are purchased when security prices are high and just preceding a downward movement, the purchaser will face a loss if he sells on the lower market. On the other hand, a purchase made on a rising market will, in the event of selling, bring a profit.

Factors to be given particular attention include (1) the trust indenture; (2) the portfolio; (3) the fees, charges, and expenses; (4) the management; (5) the past record.

### **INVESTMENT COMPANY ACT OF 1940**

The Investment Company Act of 1940 is a Federal law administered by the Securities and Exchange Commission. This law requires generally

that companies which principally engage in the business of investing or reinvesting in securities in interstate commerce, must file a registration statement with the Commission containing such detailed information as the Commission prescribes, and must conduct business in accordance with various regulations which the Act sets forth.

The purpose of this law briefly is to mitigate practices which might adversely affect the public interest and the interest of investors in dealing in securities of investment companies without adequate information.

There are some investment companies which are exempt from registration requirements of this Act because they are essentially local in character, or for other reasons. For instance, closed end investment companies are exempt if the aggregate sums received by the company from its outstanding securities plus the aggregate offering price of all securities they propose to sell, are less than \$100,000. Furthermore, the Securities and Exchange Commission is provided with discriminatory powers to exempt any person, security, or transaction from any provision or regulation of this law if such action is in the public interest.

### **THE TRUST INDENTURE**

The trust indenture is important because it defines the limitations within which the company may operate. (In case of a corporation, the charter fulfills the same function.) Shareholders should understand that they will have no rights except as set forth in the trust indenture. For example, not all companies give every investor the right to vote. The trust indenture will set forth what voice, if any, holders of shares or certificates are to have in the management of the company.

It will also define the duties, responsibilities and powers of the trustees and management. Some indentures grant wide authority to the trustees and management, while others definitely limit the field within which they may operate. The trust indenture is the foundation upon which the investment company is erected and its significance should be fully understood.

The Trust Indenture Act of 1939 administered by the Securities and Exchange Commission, requires qualification with the Commission of certain securities issued under a trust indenture and offered for sale in interstate commerce. This law is designed to protect investors from unfair practices and among other things, provides standards for the eligibility of trustees.

### **THE PORTFOLIO**

An analysis of the securities comprising the portfolio of the investment company is important because, actually, an interest in these securities is what the investor is buying. In the case of a fixed invest-

ment trust, of course, the investor knows definitely what the portfolio will be at all times. In the case of a management company, it is reasonable to expect that changes in the portfolio will be made from time to time. Nevertheless, an examination of the portfolio of such a company will furnish clues as to whether it is operating along speculative or conservative lines, whether and how it is diversifying its investments, etc. All investment companies are based on the theory of diversification, a fundamentally sound theory. Diversification, however, is not sufficient for complete safety unless it is represented in sound investments. Therefore, in studying a company's portfolio and record of accomplishment, an important feature to look for is a consistent company policy of diversifying investments among securities of a sound nature.

Most investment companies invest their funds in well selected securities representing diversifications in basic industries of the United States. There are, however, a great many "specialty" investment companies which limit their holdings to the securities of single industries, such as aviation, chain stores, utilities, banks, etc.

The discretionary powers vested in the management to determine what securities may be purchased by an investment company differ widely with different concerns. Some companies restrict themselves to investments in selected securities having a specified dividend record. A number of companies, on the other hand, have practically no restrictions with the result that their management has complete discretion as to investment of funds. A very common investment company restriction is one which limits the portion of the company's assets that may be invested in the securities of any one company or securities representative of any one field. The theory back of this provision is that greater diversification may be obtained by avoiding too much concentration in securities of one company or in securities representing one field. Many companies also restrict their investments to securities listed on recognized stock exchanges. In addition, many companies have restrictions that either limit the amount of money the management may borrow or prohibit borrowing altogether. In the former case, the extent of the borrowing may be such that the company is, in effect, buying its securities on margin.

Also, there are certain organizations known as oil royalty trusts which use all their funds to purchase oil royalties and other interests in oil and gas properties. Oil royalties are generally speculations, frequently hazardous speculations, and oil royalty trusts partake of these hazards, the risk being spread over several royalty interests rather than one.

### **FEES, CHARGES AND EXPENSES**

The investor should understand that there are certain expenses incidental to the creation of an investment company, the offering of

its securities to the public, and its subsequent management. The price which an investor pays for shares in an investment company will usually be a certain percentage more than the market value of his interest in the securities underlying those shares. This difference is known as a "loading charge" and generally, may vary from 3% to as much as 9%, or possibly more. This charge is to cover such costs as legal expenses, taxes, commissions to dealers and salesmen selling the securities, the sponsor's compensation, etc.

There are also certain necessary expenses involved in the management of the company.

From the investor's point of view the important factor is to know how the management is paid and to what extent and whether the method adopted has unduly influenced the management in selection of investments. If any supervisory contract exists with a management company or with a professional investment counsellor concern, the entire provisions of that agreement should be understood. Where the securities are deposited with a trustee banking institution, the trustee banking institution also receives compensation for its services.

The nature of all these fees and charges should be clearly understood by the investor since his investment must earn enough to pay for them before there will be any profit or income for the investor himself.

## THE MANAGEMENT

One frequently hears that the probable success or failure of any investment company depends upon the management back of it. That is generally true but it depends to some extent upon the degree of discretion allowed the management by the company itself. If the management is granted wide powers, the integrity and ability of the men composing it becomes an increasingly vital factor. The fixed type of investment trust, however, minimizes the management element with the major exception that selection of portfolio securities in the beginning is all important. In any event it can be said that the character and ability of the management of any investment company is one of the first things with which prospective investors should be concerned. Most companies have honest and reliable management, but sometimes, the management lacks the specialized training and ability which it needs to discharge its responsibilities properly. In other cases, unscrupulous promoters have organized investment companies with the fundamental idea of enriching themselves at the expense of investors. Good management should meet these tests:

1. The men should be of unquestioned integrity, honesty and reliability.
2. They should be fitted for their work through past experience and research facilities.

3. The management should not have other major business interests which conflict with operation of the investment company.

Dishonest management can ruin any investment company either by substitution of worthless securities for good ones in the portfolio or by other means. There have been cases where swindlers have secured control of hitherto legitimate investment companies and plundered them with subsequent large loss to the public. The investor should accordingly have a continuing as well as an initial interest in the character and ability of the men controlling any company in which he contemplates investing or has invested.

### **INVESTMENT COUNSEL**

The management services of investment companies are frequently supplemented by contract arrangements with professional investment counsellors. In some instances, it is provided that no changes can be made in the portfolio without the approval of the independent investment counsel designated. The advice of competent and independent investment counsel can be of substantial assistance to the management of an investment company. There are many trustworthy organizations engaged in this kind of work. There are others who are incompetent or even dishonest. This is also true of various financial advisory services. The dangers of following the advice of an investment counsel or financial advisory service that is dishonest or incompetent should be obvious. Putting an investment counsel or financial advisory service to the same tests as have already been prescribed for management, will assist an investor to determine the worthiness of a particular organization.

The Investment Advisers Act of 1940 is a Federal law and provides essentially that persons engaged in the advisory business within definition of the Act, must become registered with the Securities and Exchange Commission, and among other things must file information concerning their education and antecedent business affiliations and manner of giving advice, or rendering analyses, the basis of their charges, and information as to whether or not they have ever been convicted of a felony within ten years, or a misdemeanor involving the purchase or sale of any security. Provision is made that information filed by registered investment advisers shall be available to the public unless the Securities and Exchange Commission should deem otherwise in the interest of the public.

### **PAST RECORD**

The past record of any investment company is ordinarily an excellent indication as to the probable safety of the investor's principal, as well as an indication of the possibility of future appreciation or reasonable return. A good idea of past performance can best be obtained



from an examination of former annual reports and financial statements issued by the company, bearing in mind that the company should demonstrate its ability to operate on a basis profitable to shareholders over a period alternately affected by prosperity and depression in the financial field. The investor's study should also include the company's policy in regard to re-investing profits derived from dividends or from appreciation of the value of the securities held. Some companies, of course, are comparatively new and have not as yet had an opportunity to demonstrate their ability. In such cases no detailed past record is available. Whenever possible, however, past records should be considered for several years back or, better still, for the entire period from the time the company was formed. Also, before any definite conclusions are drawn, it is wise to take into consideration any long term stock market trends that existed in that time. In considering the company's own dividend record, the investor should determine whether it has been paying dividends out of income or out of profits realized on the sale of securities and, if the latter is the case, the effect this has had on the capital of the company.

If former annual reports or financial statements are not readily available, most companies will gladly supply them on request.

### CLASSIFICATION ACCORDING TO RIGHT OF REDEMPTION

Depending upon whether or not the shareholder has the right to require the company to purchase or cause the purchase of his shares, investment companies are classified as "closed-end" or "open-end" companies.

**Closed-End Companies**—They are so named because they do not as a matter of policy offer to buy back a shareholder's interest on request. When the shareholder in a closed-end company desires to sell his interest, he must do so through normal financial channels, i.e., through a Stock Exchange if the security is listed, and through a general brokerage concern if it is not.

The capital structure of a closed-end company often consists of more than one class of stock. Another closed-end feature is that, with a few exceptions, these companies arrange for only one general offer of shares to obtain their investment fund. The issue is usually offered about the time the company is formed and once it has been entirely sold, persons desiring to acquire shares must buy those already issued and outstanding through ordinary brokerage circles.

**Open-End Companies**—Open-end companies are distinguishable because they have special provisions for the company to repurchase a shareholder's interest on request. In effect, the open-end company guarantees to maintain a market for its own shares at their net asset price less a nominal fee. The net asset price per share is similar to the liquidating price per share or liquidating value and represents

the figure obtained by subtracting the company's liabilities from its total assets and then dividing by the number of issued or outstanding shares. Open-end companies usually have but one class of stock. Because the open-end company must be prepared to meet repurchase demands, it ordinarily confines its investment to readily marketable blocks of securities. Usually, it makes a continuous offer of shares for sale to the public, either to increase its investment fund or to resell any shares it has been called upon to repurchase.

The distinction between the two types of companies is important. The shareholder in the open-end company always knows that he can dispose of his shares at a price equivalent to their liquidating value less a small fee. The shareholder in the closed-end company who desires to dispose of his shares must accept whatever is bid for them in the open market. The bid price, particularly in the case of unlisted securities, may sometimes be considerably less than the liquidating value.

This disparity, of course, may sometimes make it possible to buy the shares of a closed-end company at a substantial discount and obtain a materially higher yield. It is also true that there have been occasions where shares of closed-end companies have sold at premiums above their liquidating value.

**Mutual Companies**—The open-end company is often called a mutual company. While all mutual companies are open-end companies, it does not necessarily follow that all open-end companies are mutual companies as, under the Federal Revenue Act, an open-end company must, each year, meet other requirements to qualify for consideration as a mutual company. From the investor's standpoint it is important to know the Federal tax provisions that apply differently to the mutual and the non-mutual companies.

### CLASSIFICATION BY CAPITAL STRUCTURE

Depending upon their capital structure, investment companies are further classified as "leverage" or "non-leverage" companies. Non-leverage companies have only one class of securities outstanding, usually common stock.

"Leverage" as used in financing, is a descriptive term applied to certain companies having securities or obligations that are senior to the common stock. Preferred stock, debentures, and bonds, for instance, are known as senior securities because they are entitled to a fixed return before any distribution of income is made on the common shares. In a leverage company, any increase or decrease in the company's assets as a whole will be reflected in the value of the common shares in larger proportion than in the case of the senior securities. Assume, for example, an investment company with total assets of \$2,000,000 equally divided between the holders of common shares and senior securities. If the value of the total assets of the company increased to \$3,000,000, holders

of senior securities would still be entitled to only \$1,000,000 in liquidation, while the value of the equity of the common stock holders would increase to \$2,000,000 or an increase of 100% in asset value of the common stock, although the total value of the assets increased only 50%. Similarly, with a decline in the total value of assets from \$2,000,000 to \$1,000,000, the holders of senior securities would still have their original investment but the equity of the common stock holders would be wiped out, although the value of the total assets of the company declined by only 50%.

The leverage factor can be affected materially by the company's portfolio policy. For example, it would be natural to expect less fluctuation in asset value of common stock in a leverage company whose own investments in fixed income securities approximated, in amount, its own senior securities outstanding, than in a leverage company whose investments were all in non-fixed income securities.

## **DIFFERENT TYPES OF INVESTMENT COMPANIES**

Investment companies differ, not only in their policies and their purposes, but in their structure and in their methods of operation. It is sometimes difficult to distinguish between one type and another. However, the Securities and Exchange Commission has developed a general classification which divides all investment companies into the five following groups:

1. Management investment companies.
2. Fixed or semi-fixed investment trusts.
3. Companies offering installment investment plans.
4. Companies issuing face amount installment investment certificates.
5. Common or co-mingled trust funds.

The first four are described in this booklet.

### **I MANAGEMENT INVESTMENT COMPANIES**

The distinguishing feature of the management type is that power is vested with the management to change portfolio securities at the management's discretion or subject to specific restrictions that have been imposed. These companies usually permit their management a comparatively free hand and make it possible for them to take advantage of what might seem to be attractive stock market opportunities as they arise and to revise their security holdings to meet changing conditions as deemed necessary from time to time. When no restrictions at all have been imposed, these companies have sometimes been described as "discretionary investment trusts." Similarly, when the management is subject to specific restrictions they are often referred

to as investment companies of the restricted management type. Companies which invest principally in the securities of other companies over which they have some management control are designated as management investment holding companies.

## II    FIXED OR SEMI-FIXED TRUSTS

Fixed and semi-fixed trusts, as their names imply, are investment companies wherein the portfolios are rigid or nearly so, and the factor of management is minimized. Fixed investment trusts are composed of "units," each of which consists of a certain number of shares in several designated companies. The names and amounts of each of the securities to be included in the unit is stated or "fixed" in a trust agreement. Money paid into a fixed investment trust cannot be used by the management for trading purposes but must be applied to the purchase of more of the predetermined units.

In the fixed trust proper, there is no provision for making substitutions or changes in the portfolio securities. Semi-fixed investment trusts have some flexibility in a form which permits certain changes to be made in portfolio securities subject to specific restrictions. These restrictions vary. Some semi-fixed trusts provide that a portfolio security may be eliminated if dividends are not maintained. Others allow for changes when the character of securities in the portfolio is altered by mergers or reorganizations. In other cases, where substitutions of securities are permitted, they are generally restricted to securities included in a secondary approved list. As wider latitude is permitted in changing the portfolio securities of a semi-fixed trust it tends to resemble a management company.

Fixed and semi-fixed trusts offer certificates representing a fractional interest in their portfolio securities. These certificates are sold at their net asset value plus a charge. These companies are usually of the non-leverage type. Many of them are open-end companies in that many of them give the certificate holder the right to convert his trust shares into either the underlying property itself or its cash equivalent upon the surrender of such certificates to the trustee.

Some fixed trusts provide for the periodic distribution to certificate holders of income received on the underlying property. They are known as the distributive type of fixed trust. In the cumulative type, such distributions are added to the unit and become a part of the trust property.

There are many persons who advocate the fixed and semi-fixed type of investment trust, contending that they have important advantages over other investment companies because they minimize reliance on human judgment and thereby tend to avoid the unwise purchase and sale of securities. Others disagree with this theory, contending that expert judgment and adaptation of a portfolio to changing conditions and economic trends is an essential investment factor which the fixed and semi-fixed trusts neglect.

### III COMPANIES OFFERING INSTALLMENT INVESTMENT PLANS

During the past ten years, a number of companies have been offering plans whereby investors of limited means may acquire shares in investment trusts or investment companies or interests in investment funds on the time payment plan. In these plans, the investor (sometimes designated "subscriber," "certificate holder" or "founder") enters into an agreement with the company engaged in the creation and sale of the plan (generally designated as "sponsor") whereby the investor undertakes to make regular payments, usually monthly, to a banking institution which acts as custodian or trustee. After deducting certain specified fees, the trustee agrees to apply the balance of the investor's payments to the purchase of securities specified in the agreement. Generally, the specified securities are shares of another designated investment trust or investment company, although in some cases the portfolio securities purchased under the plan are common stocks in which beneficial participations are credited to the investor. In effect, the investor is sold a certificate or security representing an interest in some portfolio securities, such as a security of a fixed trust or of a management investment company or a diversified group of portfolio securities.

The trustee holds the securities purchased in safekeeping and collects the income from them which, ordinarily, is used to purchase additional securities. For these services, the trustee receives a fee which is specified in the agreement. Generally the trustee makes no guarantees to the investor except the safekeeping of funds and acting in accordance with the trust indenture.

The selling company or sponsor, for its service in making the plan available, also receives a fee or "service charge" which is usually deducted during the first year of the operation of the plan. In many cases, other charges are made in connection with the purchase of the portfolio securities for the certificate holder. Most important is the "loading charge" on the underlying fixed trust shares which has already been described. This is called the "secondary sales load" and often includes compensation for some of the expenses to be incurred by the company during the life of the contract, usually ten years. In some cases, certificate holders' funds are subject to management fees or supervisory fees. Other miscellaneous charges which may be made include withdrawal or redemption fees, fees for assignment of certificates, fees for replacement of certificates, fees for transferring from one plan to another, taxes, legal fees and accounting expenses. The types of fees exacted and their amount and method differ considerably with different plans. It is a feature of the plan which the investor should clearly understand, since it is obvious that his investment must earn enough to pay these charges before it can pay a profit to him. The Investment Act of 1940 requires in part that companies offering

installment investment plans within scope of the Act shall not charge a sales load exceeding 9% of the subscriber's total payments. This Act also provides that such companies shall not deduct as a sales load more than  $\frac{1}{2}$  of the subscriber's first 12 month payments or their equivalent.

The agreement under which installment investment plans are offered contemplates that the investor will make regular payments over a substantial period of time, usually ten years or until the value of the investor's interest in the plan has reached a specified sum. It is essentially a long-term plan. While the investor may liquidate his account at any time, he ordinarily could not do so during the early life of the agreement except at a loss because of deductions. Changes in the market price of the trust shares would also affect his equity.

Many installment investment plans include an optional life insurance feature, whereby the life of the certificate holder is insured for an amount equal to the unpaid balance on his certificate. In effect, it provides for completion of the contract if the investor dies. Investors adopting this feature pay a premium for the insurance which is generally deducted from the monthly payments, the amount of the premium decreasing over the life of the plan.

Installment investment plans are offered on the theory that over a period of years the average price of the securities purchased will increase and, therefore, the value of the investor's interest will increase proportionately. The anticipated result is that the investor, through monthly purchases over a period of years, will find that the value of his interest in the securities will increase at a greater rate than the accumulating total of his payments over the same years. Whether one of these plans will prove profitable to an investor over a given period depends, in the case of a fixed trust, primarily on the prosperity enjoyed by the companies whose shares are held in the trust, as reflected by the market value of such shares and the dividends paid by them. In the case of management companies, there is the additional factor of the judgment which the management uses in buying and selling the shares which make up the portfolio.

Those contemplating an installment investment plan should read the contract carefully and be sure that the nature of all deductions is understood. Such plans are not always easy to comprehend. It will help investors to avoid confusion to appreciate that the actual value of their holdings at any time is not the total of what they have paid in but, rather, is based on the market value of the securities that their payments have obtained. The value of these securities in turn depends on the value of the portfolio securities which likewise, in turn, is subject to fluctuation based on advances and declines of the securities market. Installment investment plans do not provide for the purchase of shares representing ownership or participation in the sponsor company or in the custodian institution. They simply arrange for an investor to gradually acquire shares in a specific investment company, investment trust or investment fund.

#### IV COMPANIES ISSUING FACE AMOUNT INSTALLMENT CERTIFICATES

Companies issuing face amount installment certificates should not be confused with those offering installment investment plans as described above. Face amount installment certificates, so-called, are contracts under which the investor agrees to make regular payments, monthly, quarterly, semi-annually, or annually, in consideration of which the company agrees to pay the investor a specific sum of money on a future date. The contract usually runs for ten or fifteen years and instead of providing for the acquisition of shares in an investment company, they constitute, in effect, an agreement by the issuing company to pay the investor on a future date a lump sum of money equivalent to the amount paid in by him plus a certain rate of compound interest on the accumulated payments. The investors' installments are paid directly to the investment company which uses the funds to invest in mortgages and in diversified securities for its own account.

When the investor has completed his payments, he is entitled to receive the face amount of his certificate or contract in cash or he may have the account administered in the nature of an annuity whereby the company will send him regular payments, each of which represents a portion of his principal plus interest until his fund is depleted. Also upon completion of payments, the option may be available to defer settlement for an additional period of years in consideration of an agreement by the company to pay a larger sum.

The investor may withdraw at any time before the maturity date, but should he do this during the first few years, the cash surrender value of his contract would be less than the accumulated payments made. As the contract continues, the cash surrender value eventually equals and then exceeds the accumulated installments until the face value is reached at the maturity date. In studying any face amount installment investment plan, it is especially important to be aware of the provisions and all arrangements concerning investors' rights should installments become in arrears. The Investment Company Act of 1940 provides in part that companies offering face amount installment certificates within the scope of the Act must keep on hand a reserve aggregating 93% of the subscribers payments, and that the cash surrender value of a certificate at the end of the first year or any subsequent year shall never be less than 50% of the reserve. This law also requires that subscribers shall always be entitled to convert their certificates into paid certificates in the amount of their then obtained cash surrender value, unless the certificates contain a provision for payment of the cash surrender value and cancellation if the contract has been in default for 6 months, or if the cash surrender value is less than \$100.

## CONCLUSION

Before committing yourself to an investment in any investment company, decide upon the type of company best suited to your needs and then make a careful study of all pertinent facts. If it happens that the securities you contemplate buying represent new financing, and are registered with the Securities and Exchange Commission, *read the official prospectus*. If the offering does not represent new financing, and no prospectus is available, or if the investment, for some reason is exempt from the necessity of registration, the prudent investor will nevertheless secure the essential facts necessary to making an intelligent decision *before* investing. Remember, many investment companies are required to register with the Securities and Exchange Commission under the Investment Company Act of 1940, thereby filing considerable information with the Commission much of which data is available to the public. Your banker, investment counsel, or broker will generally be convenient sources of information and advice. Also, if you are in doubt about any point or find it difficult to get unbiased facts, consult your Better Business Bureau, an important source of information available to any one, anywhere, at any time.

Further information along these lines is available in another booklet in this series, "FACTS You Should Know About SECURITIES," published by Better Business Bureaus.

## BEFORE YOU INVEST — INVESTIGATE

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