was either the account of the investment adviser, Neuberger & Berman, or its senior partner, Roy R. Neuberger, who was responsible for the investment decision for the fund in each of its transactions in these stocks. Most of the securities involved were well-known NYSE-listed stocks, although 7 were issues traded over the counter. Trading by access persons or firms was seldom in odd lots and usually involved more than one round lot.

The fund and the investment adviser state their unwritten policy on insider transactions to be the following:

> Where investment advisory or research information is supplied to the investment company, any purchases or sales of portfolio securities are carried out before others having access to this information may use it for their own purposes. Specifically, persons having access to information * * * may not effect similar transactions until the investment company has completed its transactions.

Neither the fund nor the investment adviser, however, has a procedure for implementing the policy.

The insider trading in connection with this fund again raises questions about the possible gap between articulated policies and their enforcement, particularly, perhaps, in the active-trading situation of an investment adviser which is also a broker-dealer. It would appear that the fund priority established by the policy is usually observed, or at least that in most cases the cost of securities purchased by the fund was the same as or less than their cost to the insiders, while the price of securities sold by it was the same or higher. In some cases, however, the priority appears not to have been strictly followed. On December 4, 1960, for example, Neuberger purchased 400 shares of Chas. Pfizer & Co., Inc., at 30, and the following day the decision was made by him to have the fund purchase 500 shares for which it paid 30½.[283b] Another 1,000 shares were acquired by the fund on December 13 at 31¼. Similarly, on January 17, 1961, thedecision was made to have the fund purchase shares of Mack Trucks, Inc., and it purchased 600 shares on January 17 at 38 and 38¼, 300 on January 18 at 38½, 100 on January 19 at 39, 500 on January 23 at 38½, and 500 on January 27 at 38⅛. On January 26, meanwhile, Neuberger had purchased 100 shares at 37⅞ and 400 shares at 38, and Neuberger & Berman had purchased 500 shares at 38. These transactions involve 2 out of 7 of the 28 securities where insider trading on or immediately prior to fund trading dates show at least a fractional price advantage to the insider over the fund, and may involve a failure to observe fund priority.

d. The One William Street Fund

An analysis of trading by persons and companies with access to inside information on the investment decisions of this $247.4 million mutual fund reveals the complex network of conflicting interests which can arise when the fund has a large brokerage firm as an investment adviser which is also the investment adviser to another investment company (in this case a closed-end investment company) and to various individuals, and in addition underwrites issues purchased by the fund. The reports to the Special Study show trading in 14 of the

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[283b] Since the publication of the multilith edition of this report, Neuberger & Berman has informed the Commission that through a clerical error Neuberger's purchase was incorrectly reported to the Special Study. The purchase was actually made on December 5, 1960, after that of the fund.

mutual fund portfolio securities, on or immediately prior to the fund's trade dates, by Lehman Bros., an NYSE member firm and the fund's investment adviser and principal underwriter; the Lehman Corp., a closed-end investment company for which Lehman Bros. is also investment adviser; 7 of the 24 partners of Lehman Bros., some of whom were acting in some instances for their wives or as trustees; and one director of the fund not otherwise associated with Lehman Bros.

The fund's unwritten policy concerning trading in portfolio securities, adopted at the inception of the fund in June 1958, provides that—

> * * * [I]nformation with respect to current actual portfolio transactions * * * is required to be kept confidential. No officer, director, or employee may take personal advantage of any investment or research information supplied by Lehman Bros. to the fund nor any information concerning prospective or actual portfolio transactions in any manner which might prove detrimental to the interest of the fund. * * * If any director, officer, or employee desires to purchase securities of an issuer, and the fund desires to purchase securities of the same issuer, purchases by the fund take precedence. The same is true with respect to sales.

The prospectus of the fund also states:

> When investment opportunities occur which are consistent with the investment policies of the fund and the Lehman Corp., a closed-end investment company managed by Lehman Bros., each participates equitably.

Lehman Bros., as investment adviser to the fund, has a policy on trading in fund portfolio securities similar to the fund's. For purposes of enforcement all officers and employees of the fund and all partners and employees of Lehman Bros. are required to execute all personal securities transactions through Lehman Bros.

From a review of the One William Street Fund transactions one may conclude that, in a large organization involving many people and a number of different relationships, there are numerous possibilities of conflict. However, from the data obtained by the study and without detailed examination of each situation it is not possible to distinguish readily between those situations where related transactions may have been coincidental and those in which an insider's transactions may have been related to and in anticipation of further transactions. For example, one partner of Lehman Bros., acting for himself, his wife, and as trustee, purchased 3,000 shares of Outboard Marine Corp. in January 1961 at 22½ on the same day that the Lehman Corp. (but not the fund) was buying 24,000 shares at the same price. On May 16 the partner sold the 3,000 shares at 22¾ to 23, 9 days before the fund determined, in a decision in which he did not participate, to commence a program of selling such shares, which it carried out over a period of several weeks, disposing of over 25,000 shares at prices of from 20 to 22. In another instance, a different partner sold 1,000 shares of Winn-Dixie Stores, Inc., for himself and his wife at prices ranging from 36 to 36¾. Two days later the fund decided to sell 1,000 shares on which it realized 36.

By and large the fund and the Lehman Corp., when purchasing or selling the same securities, were given either identical treatment or subsequent balancing treatment when one or the other got a better position on a given day. Thus, for example, when on May 25, 1961, the fund bought 1,300 shares of Outboard Marine Corp. and the Lehman Corp. bought only 1,200 shares at 22, on the following day the fund bought only 3,700 shares at 21 while the Lehman Corp. acquired 3,800 at that price.

There were three striking instances, however, of the fund's and the closed-end company's traveling in opposite directions, with sales between the two possible in at least one case, but again, without detailed examination of each situation, it is impossible to say where the transactions were merely coincidental, where they were motivated by different investment objectives and portfolio needs, or where they might have been otherwise motivated. Thus, between February 3 and May 1, 1961, the fund sold 70,000 shares of Ideal Cement Co. at prices which declined from 30¾ to 26. Of the 70,000 shares, 50,000 were sold between April 20 and May 1 at 26,[284] pursuant to an investment decision made on April 18. On the other hand, between April 26 and May 10, the Lehman Corp. acquired 24,700 shares of Ideal Cement Co. stock, of which 20,000 shares were acquired on April 26 at a price of 26. Similarly, between June 8 and June 28, 1961, the Lehman Corp. purchased 25,000 shares of Thatcher Glass at prices ranging from 25 to 25⅝, the largest purchase having been a block of 18,100 shares at 25 on June 28, while between June 14 and June 28 the fund disposed of 20,000 shares at prices ranging from 25 to 28½, including the sale of 18,200 shares on June 28 at 25. Finally, between December 20, 1960, and March 17, 1961, the fund sold a total of 20,000 shares of Westinghouse Electric, realizing proceeds with a range of 44¼ and 52½, while 2 days before the end of this period the Lehman Corp. commenced a program for the acquisition of shares of the same company, purchasing 41,400 shares by July 27, 1961, at prices ranging from 42½ to 46.[284a]

The fund portfolio security which involved the greatest number of potential conflicts of interest was Maryland Cup Corp., an issue offered to the public for the first time on February 8, 1961, at a price of $25 by an underwriting syndicate of which Lehman Bros. was managing underwriter.[285] On February 2, 1961, the decision was made to purchase 20,000 shares for the fund and 10,000 shares for the Lehman Corp. However, the Investment Company Act prohibits the purchase by an investment company during the existence of an underwriting syndicate of any security the principal underwriter of which is the fund's investment adviser, except as the Commission may by rule or order exempt transactions or classes of transactions.[286] The Commission by rule has exempted such transactions under certain conditions,[287] including requirements that the securities purchased by two investment companies having the same investment adviser not exceed 3 percent of the offering and that the investment company not purchase the securities directly or indirectly from its investment adviser.[288] Consequently, only 3,500 shares were allocated to the fund and to the Lehman Corp.

The price of Maryland Cup Corp., one of 1961's "hot" issues, immediately jumped from its offering price of 25 to a premium, with bids

[284] 100 shares were sold at 26¼.

[284a] Since the publication of the multilith edition of this report, Lehman Bros. has informed the Commission that through a clerical error it incorrectly reported to the Special Study that these transactions of the Lehman Corp. in the shares of Ideal Cement Co., Thatcher Glass, and Westinghouse Eletric were purchases. These transactions should have been reported as sales.

[285] See profile of this new issue in ch. IV, app. A, pp. 668–670 (pt. 1).

[286] Investment Company Act, sec. 10(f).

[287] Investment Company Act, rule 10f–3.

[288] Although Lehman Bros. as managing underwriter had allocated shares to selling group members and had suggested to some of these members that they make their entire allocation available to the fund, it claims that the transaction was exempt under rule 10f–3, and the transaction was reported to the Commission within 30 days after completion, as required by rule 10f–3(h).

on the effective date ranging from 33 to 35. Under the provisions of the Investment Company Act and the Commission rule thereunder, neither the fund nor the Lehman Corp. could purchase additional shares until the termination of the underwriting syndicate. Between February 23 and March 20 each of them added its purchasing power to the aftermarket for the issue, by purchasing a total of 6,500 shares at prices ranging from 37 to 41. In the meantime, three Lehman Bros. partners purchased a total of 3,900 shares between February 9 and February 13 at prices ranging from 34½ to 36, while one fund director purchased 250 shares at the original issue price of 25. The fund acquired an additional 1,000 shares on June 29 and June 30, 1961.

e. The Value Line Special Situations Fund, Inc.

The Value Line Special Situations Fund, Inc., a $16.1 million fund, is a member of a substantial complex of organizations affiliated with Arnold Bernhard & Co., Inc., investment adviser and principal underwriter to the fund and two other mutual funds with aggregate assets of $94.9 million, publisher of an investment advisory service, and consultant to private and institutional investors. In January 1961, Bernhard & Co. adopted a written policy for its employees which is among the most definite and strict of those reviewed by the study. Nevertheless, a review of the trading of persons with access to inside information on fund transactions show trading by eight employees of the investment adviser in eight securities during the 7-month period covered. The eight traders included seven security analysts and a statistician. None of them was an officer or director of the fund or of Bernhard & Co. Two of the more active traders were later said by Bernhard & Co. to have "left our employment."

Bernhard & Co.'s elaborate six-page written policy for its employees takes cognizance of the diversity of the organization's functions, refers to the special problems which conflicts of interest in the organization may cause, and notes management's duty—

> * * * to take all practicable steps to insure that the private financial * * * transactions of all employees are invariably conducted in such a way as not to conflict with the interests of the subscribers, shareholders, and individual clients with whom the company is in a relationship of trust * * *.

The statement also sets forth clear and precise rules as to trading in recommended securities and requires employees to report monthly on security transactions of themselves and their families. As to mutual funds managed by the investment adviser, the statement provides:

> * * * an employee who is aware, or who has reason to believe, that a security is being, or is about to be, or is likely to be, bought or sold by one of the mutual funds shall not buy or sell that security until the transactions of the fund in question have been completed.

Of the eight employees shown to have been trading, the transactions of seven would appear on their face to raise questions of violations of the investment adviser's policy. Such questions arise for one analyst, for example, in his transactions in three different securities: American Bowling Enterprises, Inc. (Bowling); Sheraton Corp. of America (Sheraton); and Decca Records, Inc. (Decca). On March 2, 1961, he purchased 1,000 shares of common stock of Bowling at prices of 6⅜ and 6½, when units of Bowling consisting of one share and one warrant were quoted in the pink sheets at 7¾ to 8½. He also recommended the issue to the fund, which determined on March 6 to buy 5,000 units and commenced a purchase program under which it bought

4,500 units by March 29 at prices of 9⅝ to 13.[289] Since the analyst himself recommended the security, it might be assumed that, in the language of the policy, he had "reason to believe" that the security was "likely" to be purchased. As to Sheraton, he served on a committee which recommended purchases on May 10 and May 24, 1961, and purchased 300 shares on May 17 and May 24 at prices of 18⅜ to 19¾. A fund decision to purchase 5,000 shares was made on May 25, and the fund purchased that number of shares between May 25 and June 2 at prices of 18¾ to 20½. In the case of Decca, as to which he was analyst-in-charge, he sold 1,200 shares at prices of 37½ to 38¼ on January 3, 1961, "on or about" the same day that the Special Situations Fund Subcommittee, which consulted with him, recommended that the fund sell its entire holding at the current market of 38. There were 3 actual fund decisions involving Decca: on January 4, to sell 5,000 shares at 38 or better; on January 12, to sell the entire holding at 36½ or better; and on January 19, to reduce the selling price to 35¾ or better. The fund disposed of its shares between January 4 and March 9 at prices ranging from 38¼ to 33.

Another analyst who also traded in three portfolio securities was a member of the subcommittee which recommended the sale of Decca on January 3, 1961. On January 4, following his committee's recommendation, he sold 100 shares of Decca short at 37¾. Six days later he covered his short position at 34⅝. The other portfolio securities in which he traded were Fireco Sales, Ltd. (Fireco), and Gulf Life Insurance Co. (Gulf). He individually recommended the purchase of Fireco, a new issue, on May 3, and as a member of the subcommittee also recommended purchase of up to 10,000 shares on May 18 and again on June 8, 2 days after the fund had acquired 5,900 shares of the new issue. On the latter date he purchased 100 shares at 13. The fund determined on June 15 to buy 4,100 additional shares, and acquired them between June 15 and June 26 at prices from 15¼ to 16. As to Gulf, in whose recommendation he was not involved, he purchased 300 shares on February 17 at 20⅞, selling 100 on February 20 at 23⅜ and making other purchases and sales in April and May. On the basis of an oral recommendation, the fund decided on February 20 to purchase 10,000 shares, all of which it purchased on that date at prices of 22½ to 22⅞.

While the analysts referred to above were no longer employed by Bernhard & Co. in July of 1962, five other analysts and a statistician who remained in its employ also engaged in transactions during the period in question. Typical of these transactions was one involving Burgmaster Corp., a new issue recommended by one of the analysts on May 8, 1961, and again on June 8.[290] On May 9 the fund had determined to acquire 10,000 shares. The recommending analyst placed orders for the purchase of 150 shares on June 16 and 17, which he acquired for 12. The fund acquired 4,400 shares on June 19 at 12, and 600 more shares on June 21 for 13¼ and 13½.

5. MUTUAL FUND AND INVESTMENT ADVISER POLICIES ON INSIDER TRADING

Each of the 51 mutual funds which received questionnaire IC-1, as well as their investment advisers and principal underwriters, was asked

[289] On Mar. 6 shares of Bowling common were quoted in the "pink sheets" of the National Quotation Bureau at 8½ to 9¾.

[290] The issue first came to the market on May 15, but its registration statement was withdrawn and prior transactions canceled on May 25. It was again issued under a revised registration statement on June 19.

to supply information concerning its written or unwritten policies respecting the use of investment advisory or research information supplied to the mutual fund, and the use of information concerning prospective or actual portfolio transactions of the fund. They were also asked to give the dates on which the policies became effective, to describe any procedures for implementing or enforcing such policies, and to furnish details on any known violations of the policies. The evaluation of the responses set forth below is limited to 39 of the 51 funds (including all of the 28 discussed in pt. C. 3 above), after eliminating duplications where 2 funds were part of the same fund complex.[291]

Overwhelmingly the funds and their advisers indicated the existence of policies which reflected in one way or another their awareness of the ethical problem of a potential conflict of interest. In only one case was there no policy in effect for the fund, its investment adviser or principal underwriter. In two instances the funds themselves reported no policies in effect, but the investment adviser of each had a policy in effect. It must be borne in mind that the policy of the investment adviser is generally as important as or more important than the policy of the fund. A fund commonly has no personnel other than its officers and directors, and except for the independent directors, these are customarily officers and directors or employees of the investment adviser. Since the fund relies upon the personnel of its adviser for services with respect to its portfolio, the principal effect of the lack of a fund policy where an investment adviser's policy exists is to exempt only independent directors. These are sometimes excused from the application of policies in any event, since as a practical matter they have limited access to inside information, and the funds do not wish to impose unnecessary burdens on them. One fund reporting a written policy, for example, noted:

> With respect to independent directors and advisers the general policy but not the specific rules are considered applicable.[292]

Apart from the occasional express or implied exclusion of nonaffiliated directors from the operation of the policies, they all apply to all personnel, including officers, directors, and employees in general. In one investment adviser, however, a distinction is drawn in the obligations imposed on different categories of personnel. "Investment officers" are required to defer personal transactions until after fund action, but research staff members, though required to report proposed transactions in securities upon which they are working, are ordinarily permitted to purchase and sell such securities without delay except when the fund is "engaged in a program of purchase or sale."

Despite the widespread existence and application of policies, there are substantial variations in the policies themselves and the manner in which they are enforced. Of the 38 separate policies of funds or their advisers which were reviewed, 22 were in written form. However, the fact that a policy is written or unwritten may be less significant than the provisions of the plan itself and the mechanics of its implementation. Some were vague, broad, equivocal and ambiguous, while others were firm and clear. Only 10 had established procedures to implement their policies; 2 of these 10 had unwritten policies in effect.

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[291] E.g., Axe Science & Electronics Corp. and Axe-Houghton Fund B, Inc.

[292] Although the policy statement refers to "independent directors and advisers," the fund advisers stand on a different basis from independent directors and the failure of the specific rules to apply to them does not appear justified.

In the process of classifying the reported policies as vague or clear, consideration was given to the extent to which they would supply guidance to any individual who might be contemplating a transaction in a portfolio security. The policy set forth in the Investment Company Institute "Guide to Business Standards,"[293] was considered in the former category, and it should be noted that the institute has neither powers to compel compliance with the guide nor sanctions to be imposed in the event of violations. Three funds rely on the ICI policy only. One investment adviser distributed the guide to all personnel, noting that it "sets forth further basic principles which should govern all officers, directors, and employees of our company in relationship to their inherent fiduciary capacity to the interests of our * * * investors." The president added: "I expect everyone to conduct themselves accordingly." An additional 17 policies were couched in similarly general or equivocal language, such as:

> * * * such information [must] be used only in a manner entirely consistent with the best interests of the investment company * * *.

On the other hand, some 16 funds or their investment advisers have articulated policies which can be described as firm or strict. These firms face and attempt to resolve a dilemma which one of them states to its personnel in the following language:

> The firm is most anxious to give every member of the organization reasonable freedom with respect to his/her own and family's investment activities. The firm, furthermore, believes that it will be stronger and its product better if the members of the organization have a personal interest in investing and the courage of their convictions with respect to investment decisions. At the same time, we recognize that in a profession such as ours, it is possible to abuse the trust which has been placed in us and there could be a conflict of interests between our clients and our personal investment activities. In many cases such conflicts might be somewhat theoretical, with little practical effect. On the other hand, we are in a position where in a matter of this nature we must be almost as careful of appearances as we are of the actual facts. * * *
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> This condition inevitably places some restriction on freedom of investment for members of the organization. * * *

The firms which squarely face this dilemma seek its solution through one of two general approaches. Some set forth distinct and arbitrary prohibitions. The partners and employees of the investment adviser whose statement is quoted immediately above, for example, may not purchase for their own accounts or those of their families any new issues of common stocks until 4 business days after the public offering date, or purchase or sell any security added to the firm buy list or sell list for 2 weeks after the list has been distributed, and no purchase of a security on the buy list can exceed 10 percent of family investment funds. Short selling is also prohibited. Another adviser, recognizing "that loyalty to the interests of clients * * * inevitably restricts our own freedom of action as to our personal investments," forbids each member of the organization from engaging in "any transaction in a security which to his knowledge is being bought or sold, or considered for purchase or sale, by or on behalf of a client" and "active short-term trading in securities," or to "subscribe to public or private offerings * * * until the fifth business day after the offering date, and then only at the prevailing market price and for bona fide long-term investment."

A somewhat more flexible approach along the lines of disclosure is followed by other firms. One such investment adviser notes that:

[293] See pt. C.3.b, above.

[A]lmost without exception good analysts trade and have their own trading accounts and through these accounts gain valuable experience, thus becoming better analysts. * * * We do not want our analysts to refrain from maintaining accounts nor do we want to limit the securities in which they trade. * * * It is important, however, that we keep completely informed of all trading done by our analysts to be certain that no one is taking advantage of his position.

The firm states the general principle that no one should engage in any "transaction which he has reason to believe will jeopardize the fund's interests in any way," and prohibits the purchase and sale of a security when the fund is engaged in a program of purchase or sale of that security. More significantly, however, the adviser requires all research personnel proposing to purchase or sell a security to obtain approval in advance of the transaction.

Whatever the policy, its teeth, if any, must come from reporting of transactions, though only a minority of the policies surveyed contained express requirements along this line.[294] Among these, the most common provision is a requirement of monthly reporting of transactions in portfolio securities; one firm requires a report within 10 days of every transaction. In the case of four advisers who were also NYSE members, the requirement that all securities transactions be carried out through the firm was intended to accomplish the same end. One of them requires that all orders of staff members, including orders for wives and minor children, be reviewed by a partner prior to execution for consistency with firm policy, and that all such orders pass through the hands of the senior member of the firm's stock order department, who is charged with halting the execution of any order which, through inadvertence, might constitute a deviation from the policy.

The best policies and reporting requirements must be limited in their usefulness by the ease in which they can be deliberately evaded. Nevertheless, they have a prophylactic and policing value. It is somewhat surprising, however, in view of the extent of trading by insiders reported to the study, that only one fund indicated knowledge of any violation of its policies, and that was inadvertent.

6. EVALUATION OF SURVEY OF INSIDERS' TRADING AND POLICIES

The Special Study's survey of insiders' trading and policies demonstrates, in the first place, broad industry awareness of the problem raised by the conflict of interest which may exist when an individual or entity privy to a mutual fund's investment recommendations and decisions engages in trading for his or its own account in securities purchased or sold by the fund. The almost universal existence of policies aimed at dealing with the problem and the adoption of such a policy in 1962 by the industry's principal trade organization, the Investment Company Institute, are evidence of this awareness. At the same time the vagueness of some of these policies and the variety of others also suggest considerable disagreement in the industry as to the nature and extent of obligations in the area. For some, even the suggestion of use by the insider for personal advantage of information

[294] The Commission's policy concerning member and employee securities transactions not only contains strict prohibitions on trading but also provides reporting requirements. For example, transactions can be made only "for bona fide investment purposes," and a purchase held for less than 1 year is presumed not to be for investment purposes. Margin transactions, short sales, and purchases of shares of registered public utility holding companies or investment companies subject to Commission jurisdiction are prohibited, and no member or employee can purchase a new issue until 60 days after its registration statement has become effective. All transactions, including transactions of husbands and wives, must be reported to the Commission within 5 days. Violations may be cause for removal or for disqualification from appearing and practicing before the Commission.

which may benefit the fund is to be avoided. For others, the problem apparently exists only when there may be insider profit which is demonstrably at the expense of the fund.

The disagreement stems in part from a dilemma which is inherent in (but not confined to) the mutual fund industry. On the one hand, the existence, if not the extent, of a fiduciary obligation to mutual fund investors is recognized. On the other, the industry cannot ignore the obvious fact that an investment which is good or bad for the fund will be equally good or bad for an individual investor, and temptations to capitalize on fund information are inevitable. Some investment organizations go further and encourage investment by those responsible for fund investments, on the theory that the man most qualified to give investment advice is the man with personal experience and a stake in the outcome.

However the dilemma is resolved by individual firms, it is clear that fairly extensive trading in mutual fund portfolio securities does take place. The survey of a large number of persons and firms having access to fund investment recommendations and decisions for a substantial and representative group of mutual funds showed trading in portfolio securities over a brief 7-month period by at least 30 percent of the respondents. In an individual firm as many as 11 different people traded in at least 28 different securities during that period. Much of the insider trading revealed by the survey, of course, may have been consistent with the best interests of the funds themselves. However, the substantial number of insiders executing transactions before or during the funds' trading date range gives evidence of the existence of some trading which, consciously or unconsciously, was inconsistent with the best interests of the funds.

To a major extent, the insider trading disclosed by the survey involved modest numbers of shares and dollars. Such insider transactions inevitably raise the question of whether the doctrine of de minimis should apply in the conflict-of-interest situation. Even where the price differentials were small and the number of shares involved almost nominal, trades might involve a situation of conflicting interests. On the other hand, the difficulties of drawing lines and measuring injury suggest that even minor instances of advantaging the insider should not be condoned by the industry. If the mutual fund industry, like Caesar's wife, is to be above suspicion, it cannot fail to be concerned with the extent of insider trading shown, regardless of the petty amounts involved in some of it, and with the extent to which industry's announced policies appear to be ignored.

The situation with respect to insider trading appears to call both for clarification and implementation of standards. Here the best standards and best procedures already promulgated by some funds and investment advisers point the way for the industry to follow. As to standards, it seems obvious that all funds, their investment advisers, and their principal underwriters should have policies to guide their officers, directors, employees, partners, and certain stockholders, that such policies should not only be written, but as concrete and specific as it is possible to be. It seems clear, too, that the policies should prohibit insider trading not only while a fund is actually engaged in a buying or selling program, but for a period preceding and following such a program. An insider, having recommended purchase or sale of a security, would then be required to delay execution of an order on his own account until some time after the fund has followed the recommendation or until it has determined that it will not do so. The disadvantage under which he thereby labors is the price which must be paid by those who seek the rewards and benefits of the fiduciary position which they enjoy.

As to procedures, it would appear that a requirement of regular reporting by insiders of securities transactions is an essential element of an effective program. Even a clear policy coupled with such reporting will not necessarily avoid all questions of conflicts,[295] but only where transactions are reported can the fund officers and directors and the investment adviser's management discharge their duty to the fund investors to insure that their operations are consistent with the fund's best interest. In addition, reporting serves the function of a continuous reminder of the policy and ethical problems involved.

The independent director presents a special problem. The benefits derived from serving in such a position are generally small in relation to the burdens and responsibilities involved, but the importance to the industry of independent directors is a cornerstone of the Investment Company Act itself. Certainly additional burdens should not be imposed which might discourage able persons from accepting independent directorships. While the principles underlying the fund policy statements should be applicable to all access persons alike, no independent director should be held acountable for a security transaction made without knowledge of fund action or intention, and consideration should be given to exempting them from reporting requirements.

The standards which are called for should be common to the entire industry, and their adoption and implementation should not be left to the individual companies themselves. In the opinion of the study, each mutual fund, its investment adviser, and principal underwriter should be required to adopt written policies covering insider trading and provisions for their implementation which meet minimum standards established by the Commission, and to report any violations of such policy to the Commission.

7. SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS

The nature and extent of trading by those having access to inside information on mutual fund portfolio transactions, the policies of the investment company complexes concerning such trading, and the implementation of such policies were examined by the Special Study in relation to the portfolio transactions of 28 representative mutual funds whose assets at December 31, 1961, aggregated $5.2 billion. In its survey of insider trading the study attempted to determine the extent to which situations of potential conflict exist in the industry, without for the most part characterizing the manner in which they have been resolved. In the light of the high position of trust of the persons and companies covered by the survey, however, the overall industry figures on industry insider trading are significant. As many as 14.4 percent of all persons and companies included in the survey had traded in securities during the same period as the fund, and 8.0 percent traded within 15 days prior to the fund. Over a brief 7-month period, at least 30 percent of the access persons and companies traded in fund portfolio securities.

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[295] In one of the funds analyzed in detail, even with a reporting requirement, situations arose which appear to have violated a clear policy of the fund and its adviser.

From a more detailed discussion of the transactions relating to five out of eight funds selected for more intensive study, it also becomes clear that fairly extensive trading in mutual fund portfolio securities by insiders takes place. The specific situations described vary considerably in quantities and relative prices, degree of relationship between fund transactions and individual transactions, and possible motivations or explanations. There are, however, several instances where insiders' transactions seem to have been clearly designed to benefit from related fund transactions.

The survey demonstrates broad industry awareness of the problems raised by the conflict of interest which may exist when an individual or entity privy to the mutual fund's investment recommendations and decisions engages in trading for his or its own account in securities purchased or sold by the fund. Taking advantage of inside information in advance of fund transactions for personal gain is widely regarded in the industry as unethical. Overwhelmingly, the funds and their investment advisers reported the existence of policies which reflected in one way or another their awareness of the ethical problems involved.

However, despite widespread existence and application of policies, there are substantial variations in the policies themselves and the manner in which they are enforced. Some of those examined were vague, broad, and equivocal, while others were firm and clear. It was somewhat surprising, in view of the extent of trading by insiders reported to the study, that only one fund indicated knowledge of any violation of its policies, and that was said to be inadvertent. The vagueness of some policies and the variety of others suggest considerable disagreement in the industry as to the nature and extent of obligations in this area.

The results of the survey indicate that considerably more attention to the subject of insider trading is called for on the part of the mutual fund industry and the Commission. The situation calls both for clarification and implementation of higher standards for the industry.

The Special Study concludes and recommends:

1. Each registered investment company should be required to adopt a written policy covering insider trading, and provisions for its implementation, which are satisfactory to the Commission, and should be required to report any violations of policy to the Commission. The minimum standards for such a policy which would be acceptable to the Commission should include: (*a*) coverage of all officers, directors, substantial stockholders, and advisory employees of the investment company, its investment adviser, and principal underwriter, but with appropriate recognition of problems of independent, unaffiliated directors; (*b*) prohibition of purchases or sales of securities, directly or indirectly by any person covered by the policy, within 30 days prior to or following the date of a portfolio transaction in the same security issue, subject to reasonable exceptions, as in the case of hardship or with respect to such types of securities as the Commission might exempt from application of such policy; (*c*) a requirement that persons covered by the policy report to the investment company on transactions in issues in its portfolio, such reports not to be made public but to be available for Commission inspection, and (*d*) appropriate provision for sanctions in the event of violations of the policy.

TABLES

TABLE XI-1.—*Percent of gross income derived from sales of mutual funds by broker-dealer firms classified by type and size (fiscal year ending on or before Mar. 31, 1962)*

[Percent of total number of firms in each group]

Percent of gross income from mutual fund sales	All firms	Mutual fund firms [1]				Other firms			
		All	Large	Medium	Small	All	Large	Medium	Small
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
0	9.1					14.7	3.8	21.8	12.7
0.1 to 20.0	42.9					69.1	96.2	70.9	54.5
20.1 to 40.0	7.8					12.5		5.5	25.5
40.1 to 60.0	6.4	10.8		31.6	6.1	3.7		1.8	7.3
60.1 to 80.0	5.0	13.3			22.5				
80.1 to 100.0	28.8	75.9	100.0	68.4	71.4				
Average percent	36.8	87.0	95.7	77.9	88.5	9.7	4.2	5.7	14.4

[1] A mutual fund firm is defined as a firm which derived more than half of the gross income which it received from securities transactions from the sale of mutual fund shares.

NOTE.—Firms have been classified as "large," "medium," or "small" according to the size of their gross income. Data are estimates based on a sample of broker-dealers, primarily NASD members, employing 3 or more registered representatives. This table is based on reports of 83 mutual fund firms and 136 other firms. See ch. II, app. A, for the method of selection of the sample and the method of estimating the percentages for all firms.

TABLE XI-2.—*Percent distribution of annual incomes of salesmen of mutual fund firms* [1] *classified by size*

[Percent of total salesmen in each group]

Annual income	All	Large	Medium	Small
Total	100.0	100.0	100.0	100.0
$1,000 or less	67.3	64.2	73.4	76.9
$1,001 to $5,000	22.0	22.9	19.4	19.9
$5,001 to $10,000	7.8	9.4	4.6	3.0
$10,001 to $15,000	2.0	2.5	1.6	.2
$15,001 to $25,000	.7	.8	.8	
Over $25,000	.2	.2	.2	

[1] A mutual fund firm is defined as a firm which derived more than half of the gross income which it received from securities transactions from the sale of mutual fund shares.

NOTE.—Firms have been classified as "large," "medium," or "small" according to the size of their gross income. Data are estimates based on a sample of broker-dealers, primarily NASD members, employing 3 or more registered representatives. This table is based on reports of 82 mutual fund firms. See ch. II, app. A, for the method of selection of the sample and the method of estimating the percentages. The figures may include the incomes of salesmen who worked for only part of the year, and do not distinguish between the incomes of full- and part-time salesmen.

TABLE XI-3.—*Percent distribution of annual incomes of salesmen of general securities firms*[1] *classified by size*

[Percent of total salesmen in each group]

Annual income	All	Large	Medium	Small
Total	100.0	100.0	100.0	100.0
$1,000 or less	13.1	1.7	17.2	45.0
$1,001 to $5,000	20.2	18.6	20.1	26.4
$5,001 to $10,000	25.3	28.0	25.7	16.2
$10,001 to $15,000	16.9	18.9	17.3	7.2
$15,001 to $25,000	15.0	19.3	12.9	4.0
Over $25,000	9.5	13.5	6.8	1.2

[1] A general securities firm is defined as a firm which derived one-half or less of the gross income which it received from securities transactions from the sale of mutual fund shares.

NOTE.—Firms have been classified as "large," "medium," or "small" according to the size of their gross income. Data are estimates based on a sample of broker-dealers, primarily NASD members, employing 3 or more registered representatives. This table is based on reports of 134 general securities firms. See ch. II, app. A, for the method of selection of the sample and the method of estimating the percentages. The figures may include the incomes of salesmen who worked for only part of the year, and do not distinguish between the incomes of full- and part-time salesmen.

TABLE XI-4.—*Status each month to August 1962 of 1,437 sampled contractual plan accounts opened in February 1959*[1]

[Percent of all 1,437 accounts]

	Month	Making a payment	Active throughout	Reactivated	Completed	Lapsed	Redeemed
	1959						
1	February	100.0	99.9				0.1
2	March	71.0	99.0		0.2		.8
3	April	70.3	98.6		.4		1.0
4	May	72.5	98.4		.4		1.2
5	June	72.7	98.0		.5		1.5
6	July	70.0	97.7		.6		1.7
7	August	68.1	97.5		.6		1.9
8	September	68.5	97.0		.8		2.2
9	October	66.0	96.6		.9		2.5
10	November	65.2	96.2		1.1		2.7
11	December	64.6	96.0		1.2		2.8
	1960						
12	January	64.4	95.7		1.2		3.1
13	February	65.1	89.4		1.3	6.0	3.3
14	March	64.6	87.8	0.2	1.6	6.9	3.5
15	April	59.2	86.2	.3	1.7	8.1	3.7
16	May	60.2	84.8	.4	1.7	8.9	4.2
17	June	58.7	83.5	.6	1.7	9.7	4.5
18	July	57.0	82.0	.6	1.7	10.9	4.8
19	August	57.1	80.7	.8	1.8	11.7	5.0
20	September	56.0	79.1	.9	2.0	12.7	5.3
21	October	57.7	77.8	1.1	2.1	13.3	5.7
22	November	56.2	76.7	1.4	2.1	13.8	6.0
23	December	52.7	75.1	1.4	2.2	15.1	6.2
	1961						
24	January	55.8	73.8	1.6	2.5	15.7	6.4
25	February	53.7	72.0	1.9	2.6	16.3	7.2
26	March	54.8	70.7	2.2	2.6	16.6	7.9
27	April	52.0	69.7	2.4	2.7	16.9	8.3
28	May	53.0	68.3	2.6	2.8	17.7	8.6
29	June	51.6	67.5	2.7	3.1	18.0	8.7
30	July	49.4	66.4	2.8	3.1	18.2	9.5
31	August	50.4	65.6	3.1	3.3	17.7	10.3
32	September	47.9	64.9	3.5	3.3	17.6	10.7
33	October	49.3	63.4	3.6	3.6	18.1	11.3
34	November	47.1	61.6	3.7	3.8	18.8	12.1
35	December	45.2	60.6	3.8	3.9	19.1	12.6
	1962						
36	January	48.6	59.4	4.1	4.0	19.7	12.8
37	February	43.2	58.3	3.9	4.1	20.5	13.2
38	March	44.3	57.6	3.8	4.2	20.9	13.5
39	April	41.9	57.0	3.8	4.3	21.3	13.6
40	May	43.8	56.4	3.9	4.4	21.3	14.0
41	June	42.5	55.4	3.8	4.7	21.8	14.3
42	July	40.7	54.9	4.1	4.7	21.9	14.4
43	August	39.8	54.2	4.2	4.7	22.1	14.8

[1] Excludes 14 accounts completing payments in February 1959. See ch. XI, sec. 7.g.(1) for description of status classifications.

TABLE XI-5.—*Status on Aug. 31, 1962, of 1,437 sampled contractual plan accounts opened in February 1959* [1]

[Percent of all accounts in each group]

	All	Insured	Uninsured
All accounts	100.0	100.0	100.0
Completed	4.7	1.8	5.6
By planholders	4.6	1.2	5.6
By insurance	.1	.6	
Inactive	36.9	25.4	40.3
Redeemed	14.8	13.3	15.2
Sales charge returned	1.3	1.2	1.3
Sales charge not returned	13.5	12.1	13.9
Lapsed [2]	22.1	12.1	25.1
Never reactivated	20.5	10.9	23.4
Reactivated and relapsed	1.6	1.2	1.7
(Excluding subsequent redemptions by)	(3.2)	(2.1)	(3.5)
Active	58.4	72.8	54.1
Reactivated	4.2	3.0	4.6
Active throughout	54.2	69.8	49.5
Total number of accounts	1,437	331	1,106
Percent of all 1,437 accounts	100.0	23.0	77.0

[1] Excludes 14 uninsured accounts completing payments in February 1959. See ch. XI, sec. 7.g.(1) for description of status classification.
[2] Excludes 6 accounts lapsed and later completed.

TABLE XI-6.—*Number of months in which payments were made by 1,437 sampled contractual plan accounts opened in February 1959 (as of Aug. 31, 1962)*[1]

[Percent of all accounts in each group]

Number of months	All	Insured	Uninsured	Cumulative			
				Number of months	All	Insured	Uninsured
1	6.2	3.9	6.9	1	6.2	3.9	6.9
2	3.0	1.2	3.5	2 or less	9.2	5.1	10.4
3	3.0	2.4	3.2	3 or less	12.2	7.5	13.6
4	3.2	3.7	3.0	4 or less	15.4	11.2	16.6
5	2.4	1.8	2.6	5 or less	17.8	13.0	19.2
6	1.9	.9	2.2	6 or less	19.7	13.9	21.4
7	1.6	.3	2.0	7 or less	21.3	14.2	23.4
8	2.8	1.8	3.2	8 or less	24.1	16.0	26.6
9	1.4	.6	1.6	9 or less	25.5	16.6	28.2
10	2.1	.9	2.4	10 or less	27.6	17.5	30.6
11	1.8	.9	2.1	11 or less	29.4	18.4	32.7
12	1.3	1.2	1.4	12 or less	30.7	19.6	34.1
13	1.5	1.8	1.4	13 or less	32.2	21.4	35.5
14	1.5	.9	1.6	14 or less	33.7	22.3	37.1
15	1.2	1.2	1.2	15 or less	34.9	23.5	38.3
16	.7	.4	.7	16 or less	35.6	23.9	39.0
17	1.1	.6	1.3	17 or less	36.7	24.5	40.3
18	1.5	.9	1.7	18 or less	38.2	25.4	42.0
19	1.3	1.2	1.3	19 or less	39.5	26.6	43.3
20	1.3	1.2	1.4	20 or less	40.8	27.8	44.7
21	1.3	.9	1.4	21 or less	42.1	28.7	46.1
22	1.6	.6	2.0	22 or less	43.7	29.3	48.1
23	1.3	.6	1.4	23 or less	45.0	29.9	49.5
24	1.0	1.5	.8	24 or less	46.0	31.4	50.3
25	1.5	.9	1.7	25 or less	47.5	32.3	52.0
26	2.3	.9	2.7	26 or less	49.8	33.2	54.7
27	1.7	.9	2.0	27 or less	51.5	34.1	56.7
28	1.0	.6	1.1	28 or less	52.5	34.7	57.8
29	1.2	.9	1.3	29 or less	53.7	35.6	59.1
30	2.3	1.2	2.6	30 or less	56.0	36.8	61.7
31	1.9	1.6	2.0	31 or less	57.9	38.4	63.7
32	2.1	2.7	1.9	32 or less	60.0	41.1	65.6
33	1.6	2.4	1.4	33 or less	61.6	43.5	67.0
34	1.9	2.7	1.6	34 or less	63.5	46.2	68.6
35	1.6	2.7	1.4	35 or less	65.1	48.9	70.0
36	2.3	3.3	1.9	36 or less	67.4	52.2	71.9
37	2.1	3.3	1.7	37 or less	69.5	55.5	73.6
38	2.7	4.6	2.1	38 or less	72.2	60.1	75.7
39	2.8	5.2	2.2	39 or less	75.0	65.3	77.9
40	3.2	6.3	2.2	40 or less	78.2	71.6	80.1
41	4.7	4.2	4.9	41 or less	82.9	75.8	85.0
42	6.2	7.9	5.8	42 or less	89.1	83.7	90.8
43	10.9	16.3	9.2	43 or less	100.0	100.0	100.0

[1] Excludes 14 uninsured accounts completing payments in February 1959.

TABLE XI-7.—*Status on Aug. 31, 1962, of 1,437 sampled contractual plan accounts opened in February 1959 by number of installments paid in February 1959* [1]

[Percent of all accounts in each group]

	Number of installments paid in February 1959					
	1	2	3 to 5	6 to 10	11 to 19	Over 19
All accounts	100.0	100.0	100.0	100.0	100.0	100.0
Completed	1.7	1.8	5.7	9.9	5.9	21.0
By planholders	1.2	1.8	5.7	9.9	5.9	19.7
By insurance	.5					1.3
Inactive	38.3	40.3	36.8	27.3	32.8	31.6
Redeemed	17.8	18.3	13.4	5.8	12.3	4.0
Sales charge returned	2.7	1.2	1.5		.5	1.3
Sales charge not returned	15.1	17.1	11.9	5.8	11.8	2.7
Lapsed [2]	20.5	22.0	23.4	21.5	20.5	27.6
Never reactivated	20.0	20.5	22.2	18.2	19.4	22.3
Reactivated and relapsed	.5	1.5	1.2	3.3	1.1	5.3
(Excluding subsequent redemptions by)	(3.2)	(4.4)	(3.1)		(2.2)	(1.3)
Active	60.0	57.9	57.5	62.8	61.3	47.4
Reactivated	3.8	3.6	3.5	4.9	7.0	5.3
Active throughout	56.2	54.3	54.0	57.9	54.3	42.1
Total number of accounts	185	608	261	121	186	76
Percent of all 1,437 accounts	12.9	42.3	18.2	8.4	12.9	5.3

[1] Excludes 14 accounts completing payments in February 1959. See ch. XI, sec. 7.g.(1) for description of status classifications.
[2] Excludes 6 accounts lapsed and later completed.

TABLE XI—8.—*Average number of installments per payment made by 1,437 contractual plan accounts opened in February 1959* [1]

Payment period	Average number of installments per payment	
	All accounts	Active accounts
February 1959 to August 1962 (total payments)	1.7	1.4
February 1959 (initial payment)	5.9	5.4
March 1959 to August 1962 (subsequent payments)	1.5	1.3

[1] Excludes 14 accounts completing payments in February 1959.

TABLE XI-9.—*Number of installments and average sales charge paid by 1,437 sampled contractual plan accounts opened in February 1959 (by status as of Aug. 31, 1962)*[1]

[Percent of all 1,437 accounts]

Number of installments paid	Completed	Inactive			Active		All accounts [2]	Effective sales charge as percent of amount paid [3]
		Redeemed [2]	Lapsed	Total [2]	Reactivated	Active throughout		
1		.6	.6	1.2			1.2	50.0
2 or less		2.0	2.2	4.2			4.2	50.0
3 or less		2.4	3.5	5.9			5.9	50.0
4 or less		2.8	4.4	7.2	.1		7.3	50.0
5 or less		3.3	6.1	9.4	.2		9.6	50.0
6 or less		3.5	6.5	10.0	.2		10.2	50.0
7 or less		4.2	7.2	11.4	.3		11.7	50.0
8 or less		4.5	7.8	12.3	.3		12.6	50.0
9 or less		4.8	8.5	13.3	.3		13.6	50.0
10 or less		5.1	9.2	14.3	.3		14.6	50.0
11 or less		5.3	10.1	15.4	.3		15.7	50.0
12 or less		5.8	11.0	16.8	.4	.1	17.3	50.0
13 or less		5.9	11.6	17.5	.5	.1	18.1	50.0
14 or less		6.5	12.4	18.9	.7	.1	19.7	46.7 or more.
15 or less		6.8	12.9	19.7	.7	.1	20.5	43.9 or more.
16 or less		7.1	13.3	20.4	.9	.1	21.4	41.4 or more.
17 or less		7.2	13.7	20.9	1.0	.1	22.0	39.2 or more.
18 or less		7.6	14.0	21.6	1.1	.3	23.0	37.2 or more.
19 or less		7.9	14.3	22.2	1.3	.4	23.9	35.5 or more.
20 or less		8.3	14.6	22.9	1.5	.5	24.9	33.9 or more.
21 or less		8.4	15.3	23.7	1.6	.7	26.0	32.5 or more.
22 or less		8.6	15.6	24.2	1.8	.8	26.8	31.2 or more.
23 or less		9.0	15.8	24.8	1.9	.8	27.5	30.0 or more.
24 or less		9.2	16.3	25.5	2.2	1.0	28.7	28.9 or more.
25 or less		9.4	16.5	25.9	2.3	1.0	29.2	27.9 or more.
26 or less		9.6	17.0	26.6	2.4	1.1	30.1	27.0 or more.
27 or less		9.9	17.2	27.1	2.4	1.4	30.9	26.1 or more.
28 or less		10.2	17.4	27.6	2.4	1.8	31.8	25.4 or more.
29 or less		10.4	17.7	28.1	2.4	2.2	32.7	24.6 or more
30 or less		10.9	18.0	28.9	2.5	2.4	33.8	23.9 or more.
31 or less		11.4	18.2	29.6	2.6	3.0	35.2	23.3 or more.
32 or less		11.6	18.4	30.0	2.7	3.4	36.1	22.7 or more.
33 or less		12.1	18.5	30.6	2.7	3.8	37.1	22.1 or more.
34 or less		12.2	18.8	31.0	2.8	4.3	38.1	21.6 cr more.
35 or less		12.5	19.2	31.7	2.9	4.8	39.4	21.1 or more.
36 or less		12.7	19.2	31.9	3.0	5.5	40.4	20.6 or more.
37 or less		12.8	19.5	32.3	3.0	6.2	41.5	20.2 or more.
38 or less		12.8	19.6	32.4	3.1	6.7	42.2	19.7 or more.
39 or less		12.9	19.6	32.5	3.1	7.6	43.2	19.3 or more.
40 or less		13.0	19.8	32.8	3.2	8.8	44.8	19.0 or more.
41 or less		13.0	19.8	32.8	3.3	10.4	46.5	18.6 or more.
42 or less		13.3	19.9	33.2	3.4	12.9	49.5	18.2 or more.
43 or less		13.6	20.0	33.6	3.4	18.7	55.7	17.9 or more.
44 or less		13.6	20.1	33.7	3.4	26.9	64.0	17.6 or more.
45 or less		13.6	20.2	33.8	3.5	29.9	67.2	17.3 or more.
46 or less		13.8	20.2	34.0	3.5	31.4	68.9	17.0 or more.
47 or less		13.8	20.2	34.0	3.5	33.7	71.2	16.7 or more.
48 or less		13.9	20.2	34.1	3.6	35.8	73.5	16.4 or more.
49 or less		14.0	20.3	34.3	3.6	36.8	74.7	16.2 or more.
50 or less		14.0	20.6	34.6	3.6	37.6	75.8	16.0 or more.
51 or less		14.0	20.6	34.6	3.6	38.6	76.8	15.7 or more.
52 or less		14.1	20.7	34.8	3.7	39.3	77.8	15.5 or more.
53 or less		14.3	20.8	35.1	3.7	40.4	79.2	15.3 or more.
54 or less		14.3	20.8	35.1	3.7	41.5	80.3	15.1 or more.
55 or less		14.3	20.9	35.2	3.7	43.0	81.9	14.9 or more.
56 or less		14.3	21.0	35.3	3.8	44.4	83.5	14.7 or more.
57 or less		14.3	21.0	35.3	3.9	45.0	84.2	14.5 or more.
58 or less		14.3	21.0	35.3	3.9	45.3	84.5	14.3 or more.
59 or less		14.3	21.0	35.3	3.9	45.6	84.8	14.1 or more.
60 or less		14.3	21.4	35.7	3.9	46.0	85.6	14.0 or more.
61 or less		14.3	21.4	35.7	3.9	46.3	85.9	13.8 or more.
62 or less		14.3	21.5	35.8	3.9	47.2	86.9	13.6 or more.
63 or less		14.3	21.5	35.8	3.9	47.5	87.2	13.5 or more.
64 or less		14.3	21.5	35.8	4.0	47.7	87.5	13.3 or more.
65 or less		14.3	21.5	35.8	4.0	47.7	87.5	13.2 or more.
66 or less		14.3	21.5	35.8	4.0	47.8	87.6	13.1 or more.
67 or less		14.3	21.5	35.8	4.0	48.2	88.0	12.9 or more.
68 or less		14.3	21.6	35.9	4.0	48.5	88.4	12.8 or more.
69 or less		14.3	21.6	35.9	4.0	48.6	88.5	12.7 or more.
70 or less		14.4	21.6	36.0	4.0	48.7	88.7	12.5 or more.

See footnotes at end of table, p. 262.

TABLE XI-9.—*Number of installments and average sales charge paid by 1,437 sampled contractual plan accounts opened in February 1959 (by status as of Aug. 31, 1962)* [1]—Continued

[Percent of all 1,437 accounts]

Number of installments paid	Completed	Inactive			Active		All accounts [2]	Effective sales charge as percent of amount paid [3]
		Redeemed [2]	Lapsed	Total [2]	Reactivated	Active throughout		
71 or less	----------	14.4	21.6	36.0	4.0	48.9	88.9	12.4 or more.
72 or less	----------	14.4	21.6	36.0	4.0	49.1	89.1	12.3 or more.
73 or less	----------	14.4	21.6	36.0	4.0	49.1	89.1	12.2 or more.
74 or less	----------	14.5	21.6	36.1	4.0	49.3	89.4	12.1 or more.
75 or less	----------	14.5	21.6	36.1	4.0	49.5	89.6	12.0 or more.
76 or less	----------	14.5	21.6	36.1	4.0	49.7	89.8	11.9 or more.
77 or less	----------	14.5	21.6	36.1	4.0	50.0	90.1	11.8 or more.
78 or less	----------	14.5	21.6	36.1	4.0	50.3	90.4	11.7 or more.
79 or less	----------	14.5	21.6	36.1	4.0	50.5	90.6	11.6 or more.
80 or less	----------	14.5	21.7	36.2	4.1	50.6	90.9	11.5 or more.
81 or less	----------	14.5	21.7	36.2	4.1	50.7	91.0	11.4 or more.
82 or less	----------	14.5	21.7	36.2	4.1	51.0	91.3	11.3 or more.
83 or less	----------	14.5	21.7	36.2	4.1	51.1	91.4	11.2 or more.
84 or less	----------	14.5	21.7	36.2	4.2	51.4	91.8	11.1 or more.
85 or less	----------	14.5	21.7	36.2	4.2	51.6	92.0	11.0 or more.
86 or less	----------	14.5	21.7	36.2	4.2	51.7	92.1	11.0 or more.
87 or less	----------	14.5	21.7	36.2	4.2	51.9	92.3	10.9 or more.
88 or less	----------	14.5	21.7	36.2	4.2	52.0	92.4	10.8 or more.
89 or less	----------	14.5	21.7	36.2	4.2	52.1	92.5	10.7 or more.
90 or less	----------	14.5	21.7	36.2	4.2	52.2	92.6	10.6 or more.
91 or less	----------	14.5	21.7	36.2	4.2	52.3	92.7	10.6 or more.
92 or less	----------	14.5	21.7	36.2	4.2	52.3	92.7	10.5 or more.
93 or less	----------	14.5	21.7	36.2	4.2	52.4	92.8	10.4 or more.
94 or less	----------	14.6	21.7	36.3	4.2	52.5	93.0	10.4 or more.
95 or less	----------	14.7	21.7	36.4	4.2	52.6	93.2	10.3 or more.
96 or less	----------	14.7	21.7	36.4	4.2	52.7	93.3	10.2 or more.
97 or less	----------	14.7	21.7	36.4	4.2	52.7	93.3	10.2 or more.
98 or less	----------	14.7	21.7	36.4	4.2	52.8	93.4	10.1 or more.
99 or less	----------	14.7	21.7	36.4	4.2	52.8	93.4	10.0 or more.
100 or less	2.2	14.7	21.9	36.6	4.2	53.0	96.0	10.0 or more.
101 or less	2.2	14.7	21.9	36.6	4.2	53.1	96.1	9.9 or more.
102 or less	2.2	14.7	22.0	36.7	4.2	53.2	96.3	9.9 or more.
103 or less	2.2	14.7	22.0	36.7	4.2	53.2	96.3	9.8 or more.
104 or less	2.2	14.7	22.0	36.7	4.2	53.2	96.3	9.8 or more.
105 or less	2.2	14.7	22.0	36.7	4.2	53.2	96.3	9.7 or more.
106 or less	2.2	14.7	22.0	36.7	4.2	53.2	96.3	9.6 or more.
107 or less	2.2	14.7	22.0	36.7	4.2	53.2	96.3	9.6 or more.
108 or less	2.2	14.7	22.1	36.8	4.2	53.2	96.4	9.5 or more.
109 or less	2.2	14.7	22.1	36.8	4.2	53.3	96.5	9.5 or more.
110 or less	2.2	14.7	22.1	36.8	4.2	53.3	96.5	9.4 or more.
111 or less	2.2	14.7	22.1	36.8	4.2	53.3	96.5	9.4 or more.
112 or less	2.2	14.7	22.1	36.8	4.2	53.3	96.5	9.3 or more.
113 or less	2.2	14.7	22.1	36.8	4.2	53.4	96.6	9.3 or more.
114 or less	2.2	14.7	22.1	36.8	4.2	53.5	96.7	9.2 or more.
115 or less	2.2	14.7	22.1	36.8	4.2	53.5	96.7	9 2 or more.
116 or less	2.3	14.7	22.1	36.8	4.2	53.5	96.8	9.2 or more.
117 or less	2.3	14.7	22.1	36.8	4.2	53.6	96.9	9.1 or more.
118 or less	2.3	14.7	22.1	36.8	4.2	53.6	96.9	9.1 or more.
119 or less	2.3	14.7	22.1	36.8	4.2	53.7	97.0	9.0 or more.
120 or less	3.6	14.7	22.1	36.8	4.2	53.9	98.5	9.0 or more.
140 or less	3.6	14.8	22.1	36.9	4.2	53.9	98.6	8.5 or more.
141 or less	3.6	14.8	22.1	36.9	4.2	54.0	98.7	8.5 or more.
143 or less	3.6	14.8	22.1	36.9	4.2	54.1	98.8	8.5 or more.
150 or less	4.6	14.8	22.1	36.9	4.2	54.1	99.8	8.5 or more.
170 or less	4.6	14.8	22.1	36.9	4.2	54.2	99.9	8.5 or more.
200 or less	4.7	14.8	22.1	36.9	4.2	54.2	100.0	8.5 or more.

[1] Excludes 14 accounts completing payments in February 1959. See ch. XI, sec. 7.g.(1) for description of status classifications.
[2] Includes 1.3 percent of accounts redeemed with sales charge returned.
[3] Calculated on the basis of 50-percent sales charge on the first 13 installments and 4-percent sales charge on subsequent installments. While this approximates the predominant practice, it should be noted that the various sampled plans require from 100 to as many as 200 installments to complete payment and achieve the 8.5-percent load level.

TABLE XI-10.—*Status on Aug. 31, 1962 of 1,437 sampled contractual plan accounts opened in February 1959 by denomination of monthly payments unit* [1]

[Percent of all accounts in each group]

	Denomination of monthly payments unit					
	$10	$15 to $20	$25	$30 to $40	$50	Over $50
All accounts	100.0	100.0	100.0	100.0	100.0	100.0
Completed	3.6	2.0	7.5	3.8	5.5	4.5
By planholders	3.6	2.0	7.5	3.8	5.5	3.2
By insurance						1.3
Inactive	42.0	35.0	39.5	39.9	34.9	26.9
Redeemed	16.4	16.1	11.4	22.8	14.5	9.6
Sales charge returned	1.2	.8	.9	2.5	1.4	1.3
Sales charge not returned	15.2	15.3	10.5	20.3	13.1	8.3
Lapsed [2]	25.6	18.9	28.1	17.1	20.4	17.3
Never reactivated	24.8	18.9	24.5	17.1	19.0	14.1
Reactivated and relapsed	.8		3.6		1.4	3.2
(Excluding subsequent redemptions by)	(3.2)	(2.4)	(3.0)	(7.0)	(2.8)	(1.9)
Active	54.4	63.0	53.0	56.3	59.6	68.6
Reactivated	2.4	2.8	5.7	2.5	5.1	6.4
Active throughout	52.0	60.2	47.3	53.8	54.5	62.2
Total number of accounts	250	249	334	158	290	156
Percent of all 1,437 accounts	17.4	17.3	23.2	11.0	20.2	10.9

[1] Excludes 14 accounts completing payments in February 1959. See ch. XI, sec. 7.g.(1) for description of status classifications.
[2] Excludes 6 accounts lapsed and later completed.

TABLE XI-11.—*Redemption and lapse records of 1,437 sampled contractual plan accounts sold with or without 30-day refund privilege (as of Aug. 31, 1962)* [1]

[Percent of all accounts in each group]

Plans sold	All accounts	Redeemed with refund	Redeemed without refund	Lapsed	Neither redeemed nor lapsed
Total	100.0	1.3	13.5	22.1	63.1
With refund privilege	100.0	1.5	12.8	23.8	61.9
Without refund privilege	100.0	.5	15.4	17.5	66.6

[1] Excludes 14 accounts completing payments in February 1959. See ch. XI, sec. 7.g(1) for description of status classifications and sec. 6.a(3) for description of 30-day refund privilege.

TABLE XI-12.—*Open-end investment companies which received questionnaire IC-1 and their net assets*

[In millions of dollars]

	Net assets at market value, Dec. 31, 1961
*Aberdeen Fund, Inc	23.9
Affiliated Fund, Inc	815.2
*Allen, Leon B., Fund, Inc	1.9
*American Mutual Fund, Inc	179.2
*Apache Fund, Inc	1.4
*Atomics, Physics & Science Fund, Inc	58.6
Axe Houghton Fund B, Inc	186.9
Axe Science & Electronics Corp	22.7
*Capital Life Insurance Shares and Growth Stock Fund	66.9
*The Chase Fund of Boston	44.1
Chemical Fund, Inc	313.7
Diversified Growth Stock Fund, Inc	149.4
*The Dreyfus Fund, Inc	310.7
Financial Industrial Fund, Inc	261.9
*Florida Growth Fund, Inc	5.0
*Fundamental Investors, Inc	732.5
*Guardian Mutual Fund Inc	17.4
*Hamilton Funds, Inc	272.1
*The Income Fund of Boston, Inc	45.6
*Institutional Shares, Ltd	202.2
Insurance Securities Trust Fund	842.4
Investors Mutual, Inc	1,915.1
*Investors Stock Fund, Inc	1,025.0
Keystone Custodian Funds, Series K-2 Growth Fund	104.4
Keystone Custodian Funds, Series S-4 Low-Priced Common Stock Fund	178.4
The Lazard Fund, Inc	126.9
*Loomis-Sayles Mutual Fund, Inc	105.6
*Massachusetts Investors Growth Stock Fund, Inc	575.1
Massachusetts Investors Trust	1,799.9
*Morton, B. C., Fund, Inc. (growth series)	2.8
Morton, B. C., Fund, Inc. (insurance series)	4.3
*Mutual Shares Corp	2.1
*Mutual Trust	11.3
National Investors Corp	291.7
National Securities Series (growth)	137.9
National Securities Series (stock)	226.9
*Nucleonics, Chemistry & Electronics Shares, Inc	14.4
*The One William Street Fund	311.5
*Pioneer Fund, Inc	51.5
The George Putnam Fund of Boston	295.7
The Putnam Growth Fund	240.9
Scudder Fund of Canada, Ltd	57.7
Scudder, Stevens & Clark Common Stock Fund, Inc	52.4
*Television-Electronics Fund, Inc	455.3
*United Funds, Inc. (accumulative)	601.4
United Funds, Inc. (science)	211.8
The Value Line Fund, Inc	10.2
*The Value Line Special Situations Fund, Inc	20.0
*Wellington Equity Fund	85.5
Wellington Fund, Inc	1,419.1
*Winfield Growth Industries Fund, Inc	7.7
Total	14,896.2

* 28 companies so marked were selected to give more detailed information on insider transactions.

APPENDIXES

APPENDIX XI–A

SURVEY OF MUTUAL FUND INVESTORS

(Prepared by the Securities Research Unit, Wharton School of Finance and Commerce, University of Pennsylvania)

UNIVERSITY OF PENNSYLVANIA,
WHARTON SCHOOL OF FINANCE AND COMMERCE,
SECURITIES RESEARCH UNIT,
Philadelphia, April 29, 1963.

Mr. MILTON COHEN,
Director, Special Study of Securities Markets,
Securities and Exchange Commission, Washington, D.C.

DEAR MR. COHEN: We are transmitting herewith a Survey of Mutual Fund Investors made by the Securities Research Unit of the Wharton School of Finance and Commerce of the University of Pennsylvania at the request of the Securities and Exchange Commission. The study was conducted under my general direction by Dr. Andrew F. Brimmer, assistant professor of finance, and Dr. Arthur Freedman, assistant professor of finance. We should like to express our gratitude to Dean Willis J. Winn for his contributions and assistance in the preparation of the study.

Sincerely,

IRWIN FRIEND, *Director.*

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Appendix Tables

I. INTRODUCTION

A. Purpose, sponsorship, and nature of the survey

1. *Purpose and sponsorship.*—The purpose of this study was to obtain information about the general characteristics, expectations, and motivations of mutual fund investors, representations made by mutual fund sales representatives, and investors' use and understanding of the prospectus.

The survey of mutual funds investors was part of the Special Study of Securities Markets which the Securities and Exchange Commission made at the direction of Congress. In this broad study of the Nation's securities industry, numerous institutions, companies, securities, and rules and practices were examined.

The growing importance of mutual funds as an investment medium led the Commission to desire more general information about the conditions under which fund shares are sold to the public. At the same time, however, the Commission made clear that the decision to study mutual funds was not to be interpreted as a criticism of mutual funds generally or of particular funds, or of the salesmen or broker-dealers through whom shares were sold.

This study was carried out on behalf of the Special Study of Securities Markets of the Securities and Exchange Commission by members of the Securities Research Unit of the Wharton School of Finance and Commerce, University of Pennsylvania.

2. *Nature of the survey.*—The survey, conducted in October 1962, was based on a nationwide sample of investors who purchased or redeemed mutual fund shares in mid-March and mid-June 1962. The basic lists of purchasers included all those who opened new accounts with 28 mutual funds and 14 contractual plan sponsors on given days in March and June, and the lists of those who redeemed shares included all those who liquidated shares, totally or partially, from the same organizations on the same days. The selection of individual funds and plan sponsors was designed to provide a representative cross-section of the industry by type, size, and location of these organizations.

A stratified random sample of 450 purchasers was selected for personal interviews. In addition mail questionnares were sent to random samples of 500 investors who purchased and 500 investors who redeemed shares. (Almost half of the mail questionnaires were returned in usable form.) The investors were divided into two basic groups—namely, those who acquired or redeemed "regular" accounts, and those who acquired or redeemed "contractual plans." Sixty percent of each sample was drawn from lists of regular accounts, and 40 percent from contractual plans. The allocation of 40 percent of each sample to contractual plans overstates the relative quantitative importance of these plans in the mutual funds industry, but the relatively large weight given to contractual plans was necessary to permit collecting a number of responses large enough to allow for significant subclassification. The characteristics of the samples are discussed more fully in appendix I.

The survey was discussed widely in the press immediately before the interviewing began, but to avoid possible damage to the reliability of the findings the texts of the questionnaires used were not made public. Likewise, the names of the mutual funds and plan sponsors from whom lists of investors were compiled were not published.

The questionnaires used were constructed by members of the Securities Research Unit, but numerous discussions of their form and content were held with staff mmbers of the Special Study of Securities Markets of the Securities and Exchange Commission. In addition, conferences were held with representatives of the Investment Company Institute and other individuals associated with the mutual funds industry. These conferences resulted in various changes in the form of the questionnaires, though other suggested changes were not adopted. A detailed summary of responses is shown in appendix II, and copies of the questionnaires are included as appendix III.

National Analysts, Inc., a Philadelphia based marketing research and survey firm, was employed by the Securities Research Unit of the Wharton School to conduct the personal interviews. The completed questionnaires were processed and analyzed by the Securities Research Unit.

B. Characteristics of mutual funds [1]

1. *Mutual fund organization.*—A mutual fund is one kind of investment company. In general, an investment company pools the funds of a large number of investors and invests them in securities for the benefit of the participants. Each share in the investment company represents a claim to a proportionate share of the total assets of the company less any obligations. This is the underlying asset value or net asset value per share.

Investment companies of the management type take basically two forms: open end and closed end. "Mutual fund" is the colloquial name for an open-end investment company.[2] The open-end company is so described because the number of its shares outstanding is open. It stands ready to redeem its shares at net asset value (sometimes less a small discount). In addition, the open-end company ordinarily engages in a continuing effort to sell its own shares. The offering price is based on net asset value plus, in most cases, a sales charge. In contrast, the closed-end investment company has a given number of nonredeemable shares outstanding, which are traded in the market in the same way as those of other corporations. Accordingly their prices reflect both general movements in security values and the public's appraisal of the particular company. While the prices of all investment company shares will move with changes in the values of the underlying securities held by the companies, the prices of closed-end companies may change in addition because they may move above or below net asset value.

As indicated above, the money received by the mutual fund from the sale of its shares is invested in a variety of securities, with particularly heavy concentration for most funds in common stocks. Mutual funds thus provide a medium through which a large number of small investors participate in the ownership of a diversified list of common stocks and other securities.

The majority of mutual funds (about three-fourths of the total) are chartered as corporations and the rest under some form of trust. Industry assets are distributed between the two types in roughly the same proportion. More than 90 percent of mutual funds have contracts with one or more organizations outside the fund which function as investment advisers, administrative managers, or both. While all mutual funds organized under the corporate form give shareholders the opportunity to vote annually for members of the board of directors, mutual funds are generally subject to management control based on a wide distribution of fund ownership, the specialized services offered fund shareholders, the redemption privilege, and management control of the proxy machinery. The shares of most mutual funds are distributed through a firm (typically called a principal underwriter) which may be wholly or partly owned by the management group controlling the fund.

2. *Growth of mutual funds.*—Mutual funds were launched in the United States in 1924 in Massachusetts, but their rise to significance on the national scene began after 1940. Between 1941 and 1945 their assets tripled. The sustained expansion of general business over the early postwar years brought a further tripling of assets, and at the end of 1952 mutual fund assets were nearly $4 billion.

By 1958, mutual fund assets had grown to $12 billion, or three times the 1952 figure. Of this increase of over $8 billion, two-thirds represented a net inflow of money from the sale of mutual fund shares (including the reinvestment of capital gains), and about 31 percent resulted from appreciation in the market value of securities held in their portfolios. By the end of 1961 mutual funds' assets had climbed to a record of $24 billion. Slightly more than half the advance came from new money supplied by shareholders, while the remainder was accounted for by capital appreciation. The market value of the funds' holdings declined somewhat in the early months of 1962, but the sharp decline in stock market prices in the late spring of 1962 reduced their assets by approximately 11 percent between April and July. However, the partial recovery of stock prices and continued sales increased their total assets to about $22 billion by the end of the year. In the favorable environment prevailing through most of the last decade, the number of open-end investment companies increased to over 300 in 1962.

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[1] This section is based substantially on the earlier Wharton study of mutual funds. See "A Study of Mutual Funds," prepared for the Securities and Exchange Commission by the Wharton School of Finance and Commerce, report of the Committee on Interstate and Foreign Commerce, Washington, U.S. Government Printing Office, 1962.

[2] Technically, however, "open-end company" may be a broader category than "mutual fund." Some open-end companies comprise several separately registered classes of shares or mutual funds, so that while fund and company are usually the same, there is a difference in the case of multifund companies.

3. *Management, portfolio policy, and investment objectives.*—Under the typical contract between the fund and its investment adviser, the latter is paid a fee which averages about one-half percent of the fund's net assets on an annual basis. Some contracts specify a reduction in the percentage after total net assets reach a certain size. In return the adviser engages to provide investment advice and to supply or pay for a variety of services required by the fund (such as office space and clerical services, to mention but two).

Mutual funds have a variety of investment objectives. A large number of companies emphasize *growth* of capital, while a smaller number emphasize relatively high and steady *income* to investors. Still other companies pursue a *mixed* objective involving elements of growth, income, preservation of capital value, and other considerations. But whatever the investment objective, it must be specifically stated in the prospectus and can be changed only with the stockholders' approval.

To achieve their stated investment targets, mutual funds follow a number of different portfolio policies. For example, funds which stress growth or capital gains typically invest primarily in common stocks. Income funds (which also invest in common stocks) usually hold a substantial share of their assets in relatively low-price, high-yield corporate bonds as well as preferred stocks. U.S. Government and state and local government bonds normally constitute a small porportion of mutual fund assets. Some mutual funds follow a strategy in which they shift the proportions of assets classes according to changing market conditions. A few funds (known as specialty funds) concentrate on a partiular industry or other narrow sector of the economy.

4. *Sales of mutual fund shares.*—As indicated above, fund shares are typically channeled through a principal underwriter, who is roughly analogous to a wholesaler. Some underwriters also distribute shares at retail through their own sales organizations. Other principal underwriters arrange for the retail distribution of fund shares through independent dealers.

While a sizable number of mutual fund shares is sold at retail by traditional brokerage firms, a large proportion also is distributed by salesmen employed by sales organizations specializing in fund securities. Moreover, many mutual fund salesmen appear to be part-time agents. Some salesmen may also sell insurance, but more frequently they are employed in another job entirely outside the field of investments. There is evidence suggesting that much of the growth in mutual funds in recent years has been closely related to the spurt in selling efforts—which in turn was stimulated by the emergence of firms which specialize in sales of mutual fund shares.

The sales charge paid by investors in new acquisitions of fund shares appears to be a strong inducement to this selling effort. While shares of the so-called "no load funds" can be acquired by mail and without a sales charge, the typical industry practice is to rely on salesmen. In regular accounts (outright purchases), the sales charge will normally vary between 7.5 to 8.75 percent of the offering price, including the sales charge, with downward graduations for investments in excess of $25,000. While the Investment Company Act does not fix a specific ceiling on the amount of the sales charge for regular accounts, the Commission is authorized to make rules and regulations designed to prohibit unconscionable or grossly excessive sales loads. However, in contractual plans (popularly known as "front-end load" plans), there is a statutory limit of 9 percent of the total planned investment. Moreover, the maximum sales charge is set at 50 percent of the first 12 monthly payments.[3] The residual part of the sales charge must be distributed proportionately over the remaining years to the plan's maturity. Since the typical contractual plan maturity is about 10 years, this means that during the last 9 years of the plan, the sales charge averages about 4 percent.

Investors turn to mutual funds for a number of reasons of which the following seem to be the most important: first, the fund provides an opportunity for individuals to participate in a form of investment activity which they might otherwise have considered beyond their means. Shares of mutual funds can be purchased in relatively small amounts, and purchases can also be arranged through relatively long-term accumulation plans. The mutual fund also en-

[3] It may be noted that the concentration of sales charges in the early months of the plans has the effect of making the effective rates of sales charges greater than the nominal rates, even when the plans are carried to completion. This result occurs because the investor subject to a front-end load has a relatively small equity in the early years on which a return may be earned. From another view, by prepaying sales charges he pays in the early years the full dollar amount of sales charges rather than their discounted value.

ables the shareholder to diversify his holdings; through the securities held in the typical mutual fund portfolio, the investor indirectly participates in the ownership of shares of a number of different corporations and claims against a variety of governmental units.

5. *Regular accounts versus contractual plans.*—Mutual funds offer their shares under a variety of arrangements, but the so-called "regular" accounts and "contractual plans" are the most common types. The regular account is simply an outright purchase in which the investor pays the standard sales charge (unless he acquires shares from "no load funds") and obtains possession of his stock certificates shortly after the transaction is completed. The most significant aspects of regular accounts have already been described in the general discussion of mutual funds.

Investment programs administered by contractual plan sponsors embrace essentially two types of plans—namely, periodic and single payment. The typical characteristics of periodic plans are: (1) the purchase of shares by regular periodic payments which are expected to be kept up over the period of the plan; (2) a heavy sales charge deducted in the first year; (3) retail distribution by salesmen who call in person on their customers; (4) automatic reinvestment of dividends and capital gains and (5) optional completion insurance. Single-payment plans, being essentially similar to outright regular purchases, were excluded from the survey. Thus, in the present study the term "contractual plan" refers exclusively to periodic payment plans issued by contractual plan sponsors.

Periodic payments (some of which involve as little as $10 per month) permit investors of modest means to budget their investment in funds as they may budget their household expenditures. Thus, the kinship between contractual plans and the purchase of durable goods and other items through a small initial down payment with the balance paid off in installments should be readily evident. As a rule, about 50 percent of the payments made by contractual planholders during the first year is deducted as a sales charge. This sizable deduction penalizes investors who discontinue their plans in the early years, because such a cancellation almost certainly results in a sizable capital loss. The heavy "front-end load" (together with the opportunity of salesmen to share in sales charges during the life of the plan) creates a strong incentive for the selling organization to press the distribution of contractual plans. A few contractual plans are offered by underwriters affiliated with mutual funds; most of the others are sold by companies ("plan sponsors") organized for this specific purpose. While the majority of plan sponsors give shareholders the option of completion insurance, about three-fourths of the plans are not insured. Completion insurance is basically term life insurance. The holder of an insurance plan is insured for the amount he would have paid in if he had lived to complete the plan.

In addition to single purchases on regular account and contractual plans, a sizable number of mutual funds also sell shares through "voluntary accumulation plans." The latter investment plan contains elements of both outright purchases and contractual plans. Like the contractual plan, the voluntary accumulation plan emphasizes the accumulation of an estate by means of a sequence of mutual fund purchases over time. It includes the option of automatic reinvestment of dividends and capital gains, but (like outright purchases) it does not involve the heavy sales charge in the first year of the plan's life. (In the present survey, holders of voluntary accumulation plans have been classified as regular account holders.)

6. *Regulation of mutual funds.*—The vast majority of both open-end and closed-end investment companies have qualified as "regulated" investment companies under the provisions of the Investment Company Act of 1940 and the Internal Revenue Code.

As regulated companies, they enjoy several benefits, but they must also operate under a variety of constraints. Perhaps the most significant benefit is the exemption of investment income from Federal taxation at the company level. Generally, this exemption applies if the investment company during the tax year distributes to shareholders at least 90 percent of the income received as interest and dividends. To the extent that net capital gains are similarly distributed to shareholders, the same tax exemption applies. On the undistributed part of their income and capital gains, investment companies pay, respectively, the regular corporate rates applicable to each type of receipts. The tax treatment of investment companies rests on the view that they are simply pipelines through which interest and dividends are channeled from paying corporations and Government units to owners of investment company shares.

The Investment Company Act of 1940 imposes several constraints on the operation of mutual funds. A fuller discussion of these constraints and their limitations appears in the earlier Study of Mutual Funds. At least two-fifths of the board of directors must be selected from among persons unaffiliated with the fund or its investment adviser, and a majority of the board cannot consist of persons affiliated with a regularly employed broker, principal underwriter, or investment banker of the investment company. Stockholders must approve a variety of management actions, including investment advisory or management contracts. The Commission has also adopted rules prescribing detailed recordkeeping requirements for all registered investment companies. All regulated investment companies must file annual and interim financial statements with the Securities and Exchange Commission, and they are subject to periodic examination by the latter's staff. While the companies' investment practices are not controlled by SEC, the Commission does have responsibility to see that certain provisions of the 1940 act are not violated. These include the power to prohibit securities trading on margin and short sales. Finally, the SEC has specified the form and content of the prospectus as well as the type of sales literature which the companies can employ.

PART I. THE MUTUAL FUND INVESTOR

II. CHARACTERISTICS OF MUTUAL FUND INVESTORS

A. Profile of the typical investor

A profile of the typical mutual fund purchaser covered in the survey can be sketched roughly as follows: He is a man in his middle to late forties, who is married, and has about three dependents. His formal education probably stopped after high school graduation; but there is a fair chance that he has done a small amount of college work. Moreover, he is employed most likely in a capacity involving specialized skills—but somewhat short of formal professional training. His annual income falls in the $5,000 to $10,000 range. Chances are 9 in 10 that he is covered by life insurance, the median face amount being between $10,000 and $15,000.

The majority of respondents were venturing into mutual funds for the first time, but almost one-third had previously purchased fund shares. In addition, more than two-fifths of them had acquired corporate stock other than mutual funds. Half of those reporting owned Government bonds, and a few also owned other types of bonds. Well over one-quarter said they owned real estate other than their own homes. Eighty percent or more of those who replied had savings accounts. The proportion of purchasers holding other financial assets is somewhat higher than that reported for the population as a whole, particularly for those reporting ownership of real estate other than their own homes.[4] Among the public at large, slightly more than one-sixth owned real estate other than their own homes. However, some respondents may have misinterpreted the question.

B. Similarities and differences in investor personal characteristics

However, this overall view of mutual fund investors masks significant variations among individuals and between purchasers of regular accounts and periodic contractual plans. The similarities and divergences among the investors covered in the survey are highlighted in table II–1. It should be observed that regular account respondents represented about 63 percent and contractual plan buyers about 37 percent of the total replies.

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[4] Survey Research Center, "1960 Survey of Consumers' Finances" (Ann Arbor: University of Michigan, 1961), p. 122.

APPENDIX XI–A: TABLE II—1.—*Selected characteristics of mutual fund investors*

[Percentage distribution or medians]

Investor characteristics	Total respondents	Regular accounts			Contractual plans		
		Total	Personal interview	Mail survey	Total	Personal interview	Mail survey
1. Number of respondents	684	432	261	171	252	180	72
2. Sex:							
Male	66	60	59	60	78	77	81
Female	34	41	41	40	22	23	19
3. Age (median years)	45	52	50	53	39	39	38
4. Education (median years)	12	13	13	13	12	12	13
5. Employment status:							
Employed by others	60	53	55	50	71	71	72
Self-employed	21	19	19	19	23	22	25
Unemployed	1	1	1	0	1	1	0
Retired	7	11	10	13	1	1	1
Housewife	11	15	15	16	4	6	1
No answer	0	1	0	1	0	0	0
6. Occupation:							
Professional and executive	45	44	45	50	47	43	56
Nonprofessional	55	56	54	50	53	57	43
No answer	1	1	1	0	0	0	1
7. Income range:							
Less than $5,000	20	20	19	23	19	20	15
$5,000 to $9,999	38	32	30	34	48	48	50
$10,000 to $14,999	20	21	18	25	19	18	22
$15,000 to $24,999	13	15	18	9	9	9	8
$25,000 to $49,999	4	6	6	5	2	2	1
Over $50,000	1	1	1	1	0	1	0
No answer	5	5	7	3	3	3	3
8. Ownership of selected assets:							
Other mutual funds	31	39	36	42	17	18	14
Other corporate stock	46	57	57	57	25	24	28
U.S. Government bonds	51	54	51	60	45	45	44
Other bonds	13	16	15	16	8	10	4
Savings accounts	86	88	92	83	83	90	68
Real estate (other than own home)	29	33	28	40	21	17	31
9. Life insurance coverage:							
None	9	10	4	18	8	7	10
Covered	91	90	96	82	93	93	90
Face amount:							
Less than $5,000	19	21	21	21	16	19	8
$5,000 to $9,999	16	12	13	11	21	22	18
$10,000 to $14,999	16	12	12	12	22	22	24
$15,000 to $24,999	12	11	10	13	14	12	20
$25,000 to $49,999	12	12	11	13	13	13	13
Over $50,000	10	13	15	11	6	4	8
No answer	6	9	15	1	1	1	0
10. Marital status:							
Married	71	68	67	70	75	73	78
Widowed	13	17	17	16	6	7	4
Single	16	14	15	14	19	20	18
11. Family status:							
Head	70	68	71	62	74	73	76
Other	30	32	29	38	26	27	24
12. Size of family:							
Total number (median)	3	3	3	2	4	4	4
Number of dependents (median)	3	2	2	2	3	3	3

There were clear differences in the preferences of men and women for contractual plans compared with regular accounts. Women represented about one-third of all purchasers, and about three-quarters of the women purchased shares through regular accounts. They constituted two-fifths of those who acquired shares through regular accounts, but only slightly more than one-fifth of contractual plan buyers. As indicated below, this pattern of purchases appears to be greatly influenced by the investment behavior of widows. The sizable role of women as purchasers of regular accounts and the dominant role of men as purchasers of contractual plans may be of considerable importance in explaining some features of the market for mutual funds. For example, differences between men and women are clearly evident in the great degree to which women relied on the sales representative as a source of investment information and guidance, in their lesser knowledge of mutual funds, and in several other areas.

With respect to marital status, there were several interesting differences among the groups. Married investors constituted about 71 percent of respondents, widowed about 13 percent, and single about 16 percent. But over four-fifths of widowed purchasers in the survey were concentrated in regular accounts. Among married and single purchasers, the proportions in regular accounts were 60 and 55 percent, respectively.

Contractual plan purchasers are considerably younger than purchasers of regular accounts. The median age for the former group was about 39 years. Only about 21 percent were over 50, and only 2 percent were 65 and over. Among regular account investors, the median age was around 52, about 53 percent were over 50, and 21 percent were 65 or older. Reflecting this higher average age, about 11 percent of the respondents in this group were retired, while less than 1 percent of the contractual plan holders were so classified. There were apparently no appreciable differences between the two groups in the size of the typical family.

The median education for regular and contractual plan investors was quite close, but the overall range of formal education was substantially different. For contractual plan purchasers, the median was 12 years, roughly equivalent to a high school education. However, almost 40 percent had some college education, and over one-sixth were college graduates. While about 13 percent had done some postgraduate work, about 12 percent did not go beyond grade school. Within the contractual plan group, the level of education among purchasers who were interviewed was slightly below that for similar purchasers who answered the mail questionnaire, but the difference was especially marked in the lower levels: about 16 percent of respondents in the interview sample attended only elementary school while this was true for 4 percent of the respondents in the mail sample. This difference may partly be attributed to the tendency for persons with relatively low levels of formal education not to respond to mail surveys. The level of formal education achieved by regular account investors was slightly higher than that for contractual planholders. The median educational level was approximately 1 year of college. Over 50 percent of all regular account respondents had attended college, over one-third were college graduates, and about one-sixth pursued graduate studies in some field. About 10 percent of regular account holders did not go beyond elementary school.

C. Employment, income, and assets

When mutual fund investors are classified by employment status, a few differences are discernible between those who acquired regular and contractual plans. While three-fifths of all investors were employed by others, the proportions in this category were 53 percent and 71 percent, respectively, for regular and contractual plan buyers. Approximately one-fifth of all respondents were self-employed; a slightly larger percentage of contractual plan purchasers were so classified. As mentioned above 11 percent of regular account investors were retired, but less than 1 percent of contractual plan buyers were in the same position. Housewives were about 11 percent of all mutual fund purchasers responding in the survey. Yet, they were 15 percent of regular account buyers and only 4 percent of those who opened contractual plans. In passing, it might be noted that just under 1 percent of respondents in both categories were unemployed at the time they made their investments.

There were some variations in the purchase of shares via regular accounts and contractual plans by investors in different broad occupational groups. The pattern is shown in table II–2. About 63 percent of the respondents holding professional and executive positions acquired mutual funds through regular accounts; this was the same as the ratio of regular to total purchasers reporting in the survey. The preference for regular accounts appeared to be strongest among those professional and executive people—accountants, lawyers, bankers, and securities' brokers and dealers—whom one might assume to be more familiar with financial matters. For example, about 90 percent of the investors in the above categories acquired regular accounts, and about 10 percent purchased contractual plans. In contrast, respondents classed as semiskilled and service workers represented about 31 percent of those employed in nonprofessional occupations; two-thirds of the investors in the semiskilled and service worker group bought contractual plans.

APPENDIX XI–A: TABLE II–2.—*Distribution of mutual fund purchases by occupation*

[Percentage distribution]

	Total purchasers	Regular accounts	Contractual plans
All respondents	100	63	37
Professional, executive and administrative:			
All professional, executive and administrative	100	63	37
Accountants, bankers and brokers, and lawyers	100	90	10
Self-employed	100	56	44
Nonprofessional:			
All nonprofessional	100	46	54
Clerical and sales	100	61	39
Skilled craftsmen	100	53	47
Semiskilled and service workers	100	34	66

The divergent patterns among these groups highlights a general tendency for the proportion of contractual plan purchasers to rise as levels of education, income, and occupational skills decline—from 37 percent for professional and executive, to 44 percent for self-employed, to 47 percent for skilled craftsmen, and to 66 percent for semiskilled and service workers. Only clerical and sales occupations were somewhat out of line with the trend, for here the proportion buying contractual plans was 39 percent.

The annual incomes of mutual fund investors exhibited considerable variation when examined in terms of the method used to purchase shares. The median income for all investors in each group was in the range $5,000 to $10,000, but that for regular account purchasers in the personal interview survey was between $10,000 and $14,999. On the other hand, the proportions of all investors in each income class differed markedly among the groups. Although about one-fifth of both regular account and contractual plan buyers had incomes below $5,000, the people involved were quite dissimilar. A fairly large number of regular account investors with relatively low incomes were retired while another sizable number were young, single individuals. In contrast, many of the contractual planholders in the same income class were heads of families employed in jobs paying less than $5,000 per year. Nearly half of all contractual plan purchasers reported incomes between $5,000 and $10,000, while one-third of regular account holders reported incomes in this range. Only 11 percent of contractual plan investors had incomes of $15,000 and over compared with 22 percent for regular account buyers. Finally, although the proportion of married respondents did not differ much between groups, the proportion of wives contributing to family income was much higher for the contractual planholders.

There were no significant differences in the percentage of investors covered by life insurance among the various sample groups. About 90 percent of the respondents in each group had life insurance, and the median amount in each case was between $10,000 and $15,000.

As one might have expected, the proportion of regular account purchasers who already owned a variety of financial assets was considerably higher than for contractual plan buyers. About 31 percent of all investors already owned mutual funds before they purchased the shares included in the survey. However, the incidence was much higher for regular account buyers (39 percent) than for contractual plan buyers (17 percent). Essentially the same pattern prevailed with respect to the ownership of corporate stock other than mutual funds—except the percentages were higher: 46 percent for all investors, 57 percent for regular account buyers, and 25 percent for contractual planholders. More than half of regular buyers, and over two-fifths of contractual plan purchasers, held U.S. Government bonds, but the proportions holding other types of bonds were 16 and 8 percent, respectively. Some 86 percent of all respondents had savings accounts, and the differential percentage spread between groups was narrow. About one-third of regular account purchasers, compared with one-fifth of contractual plan buyers, owned real estate (other than their own homes). However, in both groups the extent of ownership was considerably smaller among those reporting in the interview survey than for investors reporting by mail.

The investor characteristics sketched above should be kept in mind when appraising the investors' objectives, their knowledge of mutual funds, and their expectations about the future performance of their investments. Moreover, these same characteristics, as strategic elements in the market for mutual funds, may have had a considerable role in shaping the sales techniques which have emerged in this section of the securities market.

III. SIZE AND FINANCING OF MUTUAL FUND PURCHASES

A. Size of transactions [5]

1. *Relative size of regular account and contractual plan purchases.*—Data from the survey confirm the description of mutual funds as primarily a vehicle for mobilizing small-to-medium savings flows. This function is clearly illustrated in tables III–1 and III–2. These show the percentage distribtuion of purchases by size and by type of account. For the moment, the distinction between outright purchases and voluntary accumulation programs under regular accounts, shown in table III–1, may be neglected.

Taking regular accounts as a whole, more than half of such investors made outlays of less than $1,000. More than half the contractual plan buyers invested initially less than $100. Some of the regular account acquisitions were substantial. About 16 percent of these exceeded $5,000, and 6 percent were above $10,000. A fair number of those relatively large purchasers were financed in atypical ways, however. The matter is examined further in section IV.

APPENDIX XI–A: TABLE III–1.—*Size of purchases, by type of regular accounts*

[Percentage distribution]

Size of purchase	Outright purchase	Voluntary accumulation	Regular accounts, total
0 to $49	3	17	7
$50 to $99	5	4	5
$100 to $199	5	8	6
$200 to $499	15	20	16
$500 to $999	21	13	18
$1,000 to $1,999	17	17	16
$2,000 to $4,999	21	9	16
$5,000 to $9,999	8	8	10
$10,000 to $19,999	3	3	4
$20,000 to $49,999	2	1	2
Total	100	100	100

Returning to voluntary accumulation accounts, it may be recalled from section I that fund shares can be acquired on a periodic basis through so-called voluntary accumulation arrangements. Under these programs, the investor normally can initiate a plan by buying shares with net asset values at least equal to some minimum—usually between $100 and $300—and subsequently may add to his investment amounts of $50 or so at his discretion. Under these plans dividends and capital gains distributions are ordinarily reinvested automatically. Purchases and additions are acquired at sales charges comparable to those of regular purchases in general. The distinction between the two types of regular accounts which has significance in the present context is this: voluntary accumulation plans permit the acquisition of shares by a sequence of purchases over time as determined by the investors. In this sense, then, voluntary accumulation plans are somewhat comparable to contractual plans. However, there is a fundamental difference in that voluntary accumulation programs do not involve the heavy sales charges in the early years of the period; on the other hand, they require higher initial investments.

[5] The data and analysis in this section are based only on the personal interview responses. The mail replies were not used in the detailed analyses, partly because some mail respondents misinterpreted a number of questions and partly because of a lack of control to insure that the proper person completed the questionnaire.

APPENDIX XI-A: TABLE III-2.—*Payments and maturities of contractual plans*

[Percentage distribution]

a. Initial payment:													*Total*
Amount	\$10–\$19	\$20–\$39	\$40–\$59	\$60–\$99	\$100–\$149	\$150–\$199	\$200–\$299	\$300–\$399	\$400–\$499	[1] \$500			
Percent	1	14	28	14	17	3	12	4	0	7			100
b. Monthly payment:													
Amount	\$10	\$15	\$20	\$25	\$30	\$40	\$50	\$60	\$75	\$100	\$300		
Percent	9	3	19	24	11	4	20	1	1	7	1		100
c. Advance payments:													
Number	1	2	3	4	5	6	8	10	12	13	[1] 15		
Percent	10	56	7	2	8	2	1	3	2	4	5		100
d. Length of plan:													
Years	5.0	7.0	7.5	8.0	8.5	9.0	10.0	11.0	12.0	12.5	15.0	20.0	
Percent	1	1	1	5	1	1	59	2	2	20	6	1	100

[1] And over.

The size distribution of purchases of regular accounts through voluntary accumulation programs in table III-1 may be compared with the size distribution of initial payments under contractual plans in table III-2. The substantially larger size of voluntary accumulation accounts is clearly evident. In fact, while more than 90 percent of initial contractual payments were under \$500, less than one-half of the voluntary accumulation purchases were below this figure. Moreover, only one-fifth of the latter purchasers were at the low end of the size scale (below \$100); but almost three-fifths of the initial contractual plan payments were in the same size category. If the bulk of these small voluntary accumulation payments were eliminated (e.g., those below \$100), the average size of the remaining purchases of this type would be well above the average size of initial outlays by contractual plan buyers. In fact, the median size of voluntary accumulation accounts would be approximately the same as for regular accounts as a whole.

Most voluntary accumulation arrangements have a minimum initial payment requirement. A figure in excess of \$200 seems to be typical—although some funds set the minimum much below that amount. This factor partly explains the rather sharp break in the size distribution of purchases in the neighborhood of the \$200 to \$500 class interval exhibited in table III-1. An additional feature frequently encountered is the requirement that a specified minimum amount must be invested during each year to keep the account active. This amount is normally no larger than the periodic payments involved in contractual plans. Besides, funds apparently make little, if any, attempt to see that the minimum amount is invested each year. In view of these considerations, if investors were more familiar with the voluntary accumulation arrangement, this type of program might be expected to appeal to some who would otherwise buy shares through contractual plans.

The variety of arrangements among contractual plans in this survey is illustrated in table III-2. The amount of the initial payment in contractual plans is normally twice the size of the subsequent periodic payments. Moreover, the minimum initial payment permitted under the Investment Company Act is \$20, so that for \$10 and \$15 monthly plans the minimum initial payment must be twice the size of subsequent periodic payments. In view of this limitation, the 1 percent of initial payments in the range \$10 to \$19 may be due to errors in reporting the original data received from investment companies in the survey. The median initial payment was approximately \$80, or more than three times the median periodic payment of \$25. All the plans covered in the survey called for monthly payments, although plans occasionally are sold involving quarterly or annual payments. In the typical transaction, two monthly payments were made in advance as required by most of the plans. But in one-third of the cases, the initial outlay represented a larger number of periodic payments. In view of the fact that salesmen's commissions usually absorb half of the periodic payments during the first year of the contract, the incentive is strong to collect in advance as many periodic payments as possible. In about 10 percent of the transactions reviewed here, sales representatives received initial amounts sufficient to cover a year or more of monthly payments.[6]

The median length of contractual plans was 10 years, and three-fifths of the plans were of this maturity. Another popular maturity, 12½ years, accounted

[6] The payments of the first 2 years were settled in advance in a few cases. Moreover, in one instance, half of the payments due under a 12½-year plan were made in advance.

for one-fifth of the cases. No plan involved a commitment for less than 5 years, and only a scattering of them fell between 5 and 10 years. Seven percent extended to 15 years or more.

2. *Income and size of purchase.*—For investors as a whole, the mutual fund purchases described above represent a relatively modest commitment in terms of buyers' annual incomes. However, for some of those in the lower income range, the ratio of purchase to income was rather high, especially in the case of contractual plans. Several interrelations among respondents' incomes, size of purchase, and type of accounts are shown in tables III-3, III-4, and III-5.

APPENDIX XI-A: TABLE III-3.—*Investor responses, by annual income and type of purchase*

[Percentage distribution]

Annual income	Regular accounts	Contractual plans
0 to $4,999	18	17
$5,000 to $9,999	31	46
$10,000 to $14,999	18	18
$15,000 to $24,999	18	9
$25,000 to $49,999	7	2
$50,000 and over	1	1
No answer	7	7
Total	100	100

Some of the differences between regular and contractual plan buyers in the relative importance of the financial commitment implied in the purchase of shares can be explained by corresponding differences in incomes. Among regular account investors, median annual incomes were in the range $10,000 to $14,999, and for contractual plan investors the median was between $5,000 and $9,999. Moreover, as shown in table III-3, about three-fifths of contractual plan investors had annual incomes below $10,000, while nearly one-half of regular account buyers were below this figure. The proportions in the $10,000 to $14,999 class were the same in both groups.

A rough index of the relative importance of the financial stake investors acquired when they bought the fund shares in the survey is provided by expressing the size of the purchase as a percentage of annual income. Among all regular accounts, as indicated in table III-4, the median ratio of purchase to annual income was between 5 and 9 percent. For incomes below $5,000, the median ratio was 25 percent or greater; it was less than 10 percent in the $10,000 to $14,999 class, which was the median income class for regular account buyers. The somewhat random pattern of the ratio should be noted; this reflects the investment of money received as gifts or inheritances, as well as other asset transfers which are essentially unrelated to income.

APPENDIX XI-A: TABLE III-4.—*Relation between purchase and annual income, regular account investors*

[Percentage distribution]

Ratio of purchase to annual income (percent)	Annual income class						
	0 to $4,999	$5,000 to $9,999	$10,000 to $14,999	$15,000 to $24,999	$25,000 to $49,999	$50,000 and over	All respondents
0 to 4	13	28	42	61	75	0	38
5 to 9	8	18	21	11	13	67	15
10 to 14	8	24	15	4	6	33	13
15 to 19	8	6	4	4	0	0	5
20 to 24	4	0	4	4	6	0	3
25 to 49	12	14	14	6	0	0	11
50 to 74	6	4	0	6	0	0	4
75 to 99	4	0	0	2	0	0	1
100 and over	37	6	0	2	0	0	10
Total	100	100	100	100	100	100	100

For contractual plan investors as a group, the median ratio of monthly payments to monthly income was between 3 and 4 percent. However, the ratio was particularly large in the lowest income class and shrank rapidly as one progressed up the income scale. Contractual plan periodic payments (assuming that the payments established in the plans are made) are somewhat analogous to installment payments for consumer goods. Thus, one could compare the relative incidence of the two types of periodic payments. There are no hard-and-fast standards defining the "proper" level of installment payments, but a reasonable rule of thumb might be that payments in excess of 12 percent of income may be "high."[7] Alternatively, the rate of saving through contractual plans might be compared with the rate of saving through acquisition of financial assets by households in general. Such a rate in excess of 10 percent may be considered "high"[8] for households with incomes below $10,000.

APPENDIX XI–A: TABLE III–5.—*Relation between monthly payment and monthly income, by annual income class, contractual plan investors*

[Percentage distribution]

Ratio of monthly payments to monthly income (percent)	Annual income class						
	0 to $4,999	$5,000 to $9,999	$10,000 to $14,999	$15,000 to $24,999	$25,000 to $49,999	$50,000 and over	All respondents
1 to 2	0	16	71	56	100	100	28
3 to 4	0	38	9	25	0	0	23
5 to 6	13	17	11	19	0	0	16
7 to 8	0	25	0	0	0	0	12
9 to 10	33	1	9	0	0	0	9
11 to 12	19	1	0	0	0	0	5
13 to 14	16	0	0	0	0	0	2
15 and over	19	2	0	0	0	0	5
Total	100	100	100	100	100	100	100

By either of these criteria, the monthly payments undertaken in the contractual plans included in the survey seem "high" for respondents in the income class below $5,000.[9] For more than half of the investors in this class the ratio of payments to income exceeded 10 percent, and for another third it was near the margin. The ratio declined as the size of the income increased. In the median income range for contractual planholders, the median ratio was 3 to 4 percent, the same as for plan buyers as a whole. Because of the structure of sales charges (to which attention has already been called) and the long maturities, the considerable financial commitment represented by the periodic payments in contractual plans becomes significant. Nevertheless, as shown in section X, a substantial number of the respondents apparently did not fully appreciate some of the implications of their decision to purchase contractual plans.

B. Financing of mutual fund purchases

1. *Primary sources of funds.*—A substantial majority of investors paid for their mutual fund shares out of current income or by withdrawals from savings accounts. A fair number, however, switched from other financial assets into fund shares, and still others put essentially windfall receipts in mutual funds. Regular account buyers used sources other than current income or savings accounts somewhat more than purchasers of contractual plans. The latter group relied almost wholly on current income and savings accounts for the initial payment. Moreover, virtually all planholders expected to make future payments out of current income. The sources are shown in tables III–6 and III–7. It should be noted that some respondents employed two or more sources; the tables thus indicate the proportions relying on particular sources—which may have been used in combination with others.

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[7] Board of Governors of the Federal Reserve System, "Consumer Instalment Credit, Growth and Impact" (Washington, 1957), pt. I, vol. 1, p. 200.

[8] Irwin Friend and Stanley Schor, "Who Saves," "The Review of Economics and Statistics," vol. XLI, No. 2, pt. 2 (May 1959), table 2, p. 217.

[9] It may be recalled that most of the contractual plan purchasers with incomes below $5,000 were heads of families regularly employed in jobs providing annual incomes below this figure.

APPENDIX XI–A: TABLE III–6.—*Financing of mutual fund purchases, by type of account*

[Percentage distribution][1]

Source of funds	Regular account	Contractual plans initial payment
Current income	39	65
Withdrawal from savings accounts	40	31
Reduced spending on durable goods or other personal household items	0	3
Life insurance benefits	4	1
Gift, inheritance	9	1
Loan on life insurance policies	1	2
Conversion of life insurance policies	0	3
Sale or redemption of U.S. bonds	4	1
Sale or redemption of mutual fund shares	2	0
Sale of other corporate stock	13	1
Some other source	7	2

[1] Percentages will not add to 100 because some investors used several sources to finance their purchases.

APPENDIX XI–A: TABLE III–7.—*Sources of future payments, contractual plans*

[Percentage distribution][1]

Source of funds:	Percent
Future income	92
Withdrawal from savings accounts	2
Reduced spending on durable goods or other personal household items	6
Some other source	1

[1] Percentages will not add to 100 because some investors used several sources to finance their purchases.

The substantial reliance on sources which allow an easy shift into mutual funds is quite evident. Current income and withdrawal from savings accounts were used by two-fifths of regular account buyers; these sources were used by three times as many regular respondents as reported any other source. Two-thirds of contractual plan purchasers made their initial payments from current income. About half this number financed these payments from savings accounts.

From this summary it appears that regular account buyers, with proportionately a much greater variety of assets, were much more likely to view mutual funds as a means of changing the composition of their assets. Contractual plan buyers apparently employed mutual funds as a means to invest relatively small sums in excess of current expenditures.

No regular account investors reported that they paid for fund shares by reducing spending on durable goods or other personal household items; i.e., by increasing their rate of saving. But about 3 percent of contractual plan respondents indicated they obtained money for the initial payment in this way, and 6 percent said they intended to reduce current expenditures in order to make future payments. But it may be noted that, in view of redemptions and lapses in purchases, such intentions may not always be carried out. All except one of these investors said they purchased shares because mutual funds provide a means of disciplining themselves to save.

Life insurance benefits, gifts, and legacies provided the funds for 13 percent of regular account buyers, but for only 2 percent of those who acquired contractual plans. Moreover, 2 percent of contractual planholders borrowed against life insurance policies and 3 percent converted such policies into cash. One percent of the regular accounts was financed by borrowing against life insurance policies, but none surrendered their policies to shift the accumulated savings into mutual funds.

2. *Financing of purchases by sale of other assets.*—As mentioned above, a fairly large number of investors financed the acquisition of mutual funds by the sale of other assets. One-fifth of regular account buyers were in this category, but only 2 percent of contractual planholders (see table III–6). Two percent of regular account investors switched from other mutual funds and 4 percent sold or redeemed government bonds. However, the major switch was from corporate stock other than mutual funds. Proceeds from such sales financed 13 percent of all transactions by regular account buyers, or two-thirds of the purchases financed by the sale of assets already owned. It should

be noted that 80 percent said they still owned such stock. Thus only one-fifth of those who owned corporate stock switched from these assets entirely. The characteristics and motivations of investors making this shift are examined further in section IV. In the few cases of regular account investors who switched from one mutual fund into the fund covered in the survey, the sales representative reportedly played an important role in either initiating the transaction or choosing the particular fund. Although there is no indication in these few cases of whether the salesman's recommendation was made for the purpose of stimulating sales commissions, it may be noted that recommendations for that purpose are highly improper.

IV. INVESTORS' OBJECTIVES AND THE CHOICE OF MUTUAL FUNDS

A. *Investors' objectives*

1. *General investment targets.*—Investors were asked to report the general savings objectives they had in mind and the motives which induced them to purchase mutual funds. In both cases a number of options were provided, to which investors could add others. The majority of investors indicated they purchased mutual funds without specific savings objectives in mind. Moreover, where specific targets were reported, there appeared to be a clear tendency for certain kinds of investors to select particular types of objectives and to eschew others. Overall, the least specific objective, general saving, was selected in greater than average frequency by single persons, young people, those who did not go beyond high school, those in nonprofessional occupations, and those in the lower-to-middle income range. In contrast, the most specific objectives, such as higher current income, provision for retirement, financing college education, or accumulating an estate, were indicated by widowed persons, middle-age people, those who attended college, the self-employed, and those in the upper-middle income classes.

The general pattern of response by investors is shown in table IV–1.[10] It will be noted that general saving as an objective was reported by nearly half the respondents. Among the specific targets, the provision for retirement was well in the lead. It was about twice as popular as the next most frequent objectives, which were the accumulation of an estate and the financing of children's college education. Apparently few investors acquired mutual funds with the hope of enjoying larger current income. A small number bought shares to save money with the ultimate desire of purchasing a business or home.

APPENDIX XI–A: TABLE IV–1.—*Investors' objectives, by type of purchase*

[Percentage of respondents selecting each option][1]

Investor objective	Regular accounts	Contractual plans
General saving	41	59
Provide for retirement	45	44
Children's college education	16	38
Accumulate an estate	26	21
Current income	20	(2)
Purchase business or home	1	7
Other objectives	5	6

[1] Percentages represent the proportion of respondents who selected each option indicated; many respondents selected more than 1 option.
[2] Not asked.

For the most part, there was little difference in specific objectives between regular account and contractual plan purchasers. The contrasts which did appear can be readily explained by differences in the characteristics of the two groups discussed in section II. The one outstanding divergence was in the intention to finance children's college education; the proportion of contractual plan purchasers who indicated this aim was more than twice that of regular account buyers. This is not surprising when one recalls the sizable difference in the age pattern between the two groups. Since regular account buyers were typically

[10] Data and analyses in this section are based only on the personal interview responses. The mail replies were not used in these detailed analyses, partly because some mail respondents misinterpreted a number of questions and partly because of a lack of control to insure that the proper person completed the questionnaire.

in their early fifties, it is probable that most of them no longer faced the task of planning ahead for the higher education of their dependents. The reverse was most likely true of contractual plan buyers, who were considerably younger.

On the other hand, there was virtually no difference in the much longer range savings goals set by investors in each group. About the same proportion of regular and contractual plan purchasers selected the accumulation of an estate or the provision for retirement as a major objective. Only regular account buyers were asked whether they invested for current income, and about one-fifth answered in the affirmative.

2. *Investors' objectives and personal characteristics.*—When one examines investors' objectives somewhat more closely, a number of additional insights emerge. However, the interrelation among investors' objectives and personal characteristics such as sex, marital status, age, education, occupation, income, and assets are entirely in line with what one might expect on the basis of the evidence presented so far. The interrelations are shown in tables IV–2 and IV–3.

Men exhibited little differentiation among specific goals, except both regular and contractual plan buyers selected the financing of college education at slightly above average frequency. Women were only barely ahead of men in stating specific savings objectives, but the frequency with which they selected any particular goal was well below that for all respondents. A small percentage of women buyers who acquired regular accounts were seeking higher current income, but the ratio was much larger than that for men with the same aim. A sizable proportion of these women were widows in the upper age bracket.

APPENDIX XI–A: TABLE IV–2.—*Investment objectives and selected characteristics of mutual fund purchasers, by type of purchase*

[Percentage distribution]

Investor characteristic	Investment objective and type of purchase								
	General saving		Retirement		Financing of children's education		Accumulation of estate		Current income
	Regular	Contractual	Regular	Contractual	Regular	Contractual	Regular	Contractual	Regular
All respondents	41	59	45	44	16	38	26	21	20
Sex:									
Male	38	57	42	41	20	43	34	23	14
Female	44	60	49	45	12	24	19	10	20
Marital status:									
Married	40	55	40	45	22	46	32	19	14
Widowed	30	67	52	50	7	17	16	0	30
Single	54	67	59	31	5	17	21	31	13
Age:									
Under 30	46	70	31	25	15	35	31	20	0
30 to 39	47	58	22	35	41	60	35	21	10
40 to 49	57	29	48	47	21	33	27	22	3
50 to 59	35	43	61	70	11	17	31	20	13
60 to 64	36	50	68	50	0	50	20	0	36
65 and over	21	67	36	40	6	20	23	0	38
Education:									
Elementary school	73	43	42	54	12	75	27	85	23
High school	60	45	49	48	16	63	20	86	21
College	54	35	58	69	14	62	29	71	11
Postgraduate	60	53	68	76	30	35	43	71	13
Occupation:									
Professional and executive	52	48	51	64	17	47	29	76	6
Self-employed	57	60	75	50	32	57	35	89	14
Nonprofessional	66	79	55	56	14	61	26	34	24
Income:									
Under $5,000	39	58	47	56	10	31	16	3	37
$5,000 to $9,999	47	57	49	40	14	44	19	20	14
$10,000 to $14,999	35	69	46	41	23	31	38	31	10
$15,000 to $24,999	44	56	44	31	25	50	40	25	8
$25,000 to $49,999	31	67	31	33	25	33	44	33	0
$50,000 and over	67	0	33	0	33	0	0	100	0

One would normally expect substantial differences in investors' objectives by marital status, but the variations by type of purchase are also sizable. General saving again was the most important objective for all respondents who bought contractual plans; this was true only for single purchasers of regular accounts. Among the specific objectives, all married purchasers put considerable weight on financing college education. However, the proportion of contractual plan investors doing so was twice that for married regular account buyers, and three times that for widowed and single persons. For the most part, widowed respondents were seeking ways to supplement their current income; the latter was selected by almost one-third of the widowed respondents who purchased regular accounts. Only 16 percent of the widowed regular purchasers (compared with one-third of married and one-quarter of single respondents) were trying to accumulate an estate; none of the widowed contractual plan purchasers reported the latter objective.

Age is unmistakably one of the most important determinants of the savings objectives reported by respondents. On the other hand, age is interrelated with income, and it is difficult to unravel their joint effects. Investors over 50 were especially interested in retirement, which was in first place for both regular and contractual plan buyers. Investors under 50 in both groups put general savings first and considerably ahead of the second place objective—which was retirement for regular account purchasers and the financing of children's college education for contractual planholders. Expanded current income was sought by a fair number of older investors in regular accounts, but it was of virtually no importance for those in the younger age bracket.

Systematic investment planning among mutual fund purchasers shows a mixed pattern with respect to the level of formal education. Among regular account buyers, there seems to be a strong tendency for investment objectives to become more specific the higher the level of education. In contrast, the association between education and investment planning was not pronounced among investors with little formal education. With respect to particular objectives, the provision for retirement was selected by a much higher proportion of both regular and contractual plan buyers who had college or postgraduate work than by respondents with only elementary or high school education. Financing of college education was a main goal for contractual plan buyers at all educational levels, although the importance varied inversely with education. While it was a minor objective for regular purchasers, the incidence was highest for those who had done postgraduate studies; here the ratio was just under the lowest registered among contractual plan buyers, which was also for those who had done postgraduate studies. The objective of accumulating an estate was mentioned by an exceptionally large percentage of contractual plan purchasers with only elementary school education.

Occupational status seems to play some role in shaping specific savings goals, but the overall pattern is difficult to unravel. Those in professional and executive jobs have the highest proportion of definite objectives, and the self-employed have the next highest incidence. The proportion of regular account buyers who emphasized retirement was about 1½ times that for the other two employment categories. Moreover, the relative number planning to finance college education was about twice as large for self-employed. Retirement as an objective was selected in approximately the same proportions by professional people and executives who bought regular and contractual plans. On the other hand, contractual plan buyers among those holding the higher level jobs put considerably more emphasis on accumulating an estate and financing college education. Nonprofessional jobholders placed relatively more emphasis on current income and financing higher education for their children.

3. *Investors' objectives, income, and assets.*—An analysis of investor objectives by income size suggests that the lower the level of income the more immediate or pressing the savings goals. For all investors with income below $5,000, retirement and higher current income were primary targets. In contrast, those with incomes in the upper brackets put relatively more weight on mutual funds to finance college education of children and to accumulate an estate. Among buyers with incomes in the middle ranges, college education was a major aim, and the accumulation of an estate was emphasized rather lightly.

Given the specific investment objectives which investors set for themselves at the time they acquired mutual funds, regular account holders as a group seem to have already made somewhat more preparation to achieve their ends. This is suggested by the pattern of asset ownership within the two groups. When investors were classified by specific savings goals and asset ownership, the percentage of regular account respondents who reported they already owned a variety of assets was considerably higher than that for contractual planholders with the same specific investment objectives. Only in the case of savings accounts were the ratios about the same. However, the pattern varied markedly with respect to particular assets. (See table IV-3.)

APPENDIX XI-A: TABLE IV-3.—*Percentage distribution of mutual fund investors, by type of purchase, particular objective, and pattern of asset ownership*

Investor objective	Type of purchase and asset ownership											
	Mutual funds		Other stock		Government bonds		Other bonds		Savings accounts		Real estate	
	Regular	Contractual	Regular	Contractual	Regular	Contractual	Regular	Contractual	Regular	Contractual	Regular	Contractual
General saving	33	20	57	26	54	48	16	6	93	92	40	20
Retirement	29	24	50	29	53	43	14	11	90	92	24	22
Financing college education	48	19	61	23	52	38	20	9	98	84	32	15
Accumulation of estate	42	19	61	39	46	50	21	16	95	87	29	19
Current income	0	(1)	56	(1)	40	(1)	14	(1)	86	(1)	16	(1)
All investors	39	17	57	25	54	45	16	8	88	83	33	21

[1] Not asked.

This result is not unexpected in view of the higher age and income of regular account buyers—which imply, respectively, a longer period of asset accumulation and greater capacity to save. The proportion of regular account purchasers with the goal of general savings who reported they already owned mutual funds at the time of the transactions covered in this survey was less than that for all investors; the reverse was true for contractual plan buyers. The percentage of both groups who held other stock and government bonds was about the same as for all respondents. Among contractual planholders making preparations for retirement, a sizable proportion had included mutual funds in their investment planning, but this was true for a smaller proportion of those holding regular accounts. The relation was similar for other stocks.

Investors in the two groups who anticipated the financing of their children's college education had previously planned to achieve their ends in substantially different ways. The proportion of regular account holders who had already invested in mutual funds and other corporate stock was greater than for all investors combined, but the percentage owning government bonds and real estate was in line with that for investors as a whole. In contrast, a much smaller proportion of contractual plan purchasers reported they had previously acquired mutual funds, other stocks, and other bonds. The percentage holding government bonds and real property was even smaller. For investors attempting to accumulate an estate, corporate stock other than mutual funds played a relatively large role for both regular and contractual plan purchasers. However, the percentage of both groups reporting holdings of mutual funds was about the same as for the whole sample.

B. Factors influencing choice of mutual funds

1. *Primary determinants of choice.*—A wide range of reasons was given to explain why mutual funds were chosen to achieve the objectives stated above. The overriding impression is that the expectations of gaining from professional investment management and the diversification of financial assets were the prime motives inducing most investors to acquire mutual funds. The availability of professional management was the most important influence, and it was the only one of overriding influence for both regular account and contractual plan buyers. However, it is also clear that a sizable proportion of purchasers looked upon their funds as a vehicle for capital appreciation rather than the accumulation of wealth for the purpose of receiving current dividends.

In identifying the chief influences underlying their investment decisions, few sharp differences appeared between purchasers of regular accounts and contractual plans. The opportunity to obtain professional investment management seemed to have had the same appeal for both regular account and contractual plan purchasers. In both groups, nearly three-fifths of the respondents assigned first choice to this possibility. Of course, the pattern of response is by no means surprising—given the attention devoted to this feature of mutual funds by the funds themselves as well as by the sales representatives with whom investors had contact. The prospect of benefiting from diversification apparently exerted less influence than the promise of expert supervision on investment decisions. Yet, about one-half of regular account and one-third of contractual plan buyers cited diversification as partly shaping their choice. Almost one-half of contractual plan buyers cited discipline in saving as a chief reason for acquiring this type of investment. This reference is undoubtedly a reflection of the emphasis placed on this feature by distributors of contractual plans.

APPENDIX XI–A: TABLE IV–4.—*Factors influencing choice of mutual funds, by type of purchase*

[Percentage of respondents selecting each option]

Factors influencing choice	Regular accounts	Contractual plans
Benefit from professional investment management	57	57
Benefit from diversification	48	32
Benefit from economic growth	35	36
Hedge against inflation	21	20
Benefit from rise in stock prices	17	19
Discipline in saving	11	45
Protection of capital	13	8
Higher return on investment	8	12
Other reasons	7	9

The expectation of capital gains was an incentive for a sizable proportion of regular and contractual plan investors. Actually, somewhat less than 20 percent of respondents in each group indicated that they became owners of mutual funds to benefit from a rise in stock prices. But three other influences (which are essentially variations of capital appreciation) together accounted for a much higher percentage of reponses. The expectation of harvesting the gains of economic growth was an underpinning for more than one-third of both regular and contractual plan investors. The belief that mutual funds provide a hedge against inflation was a consideration for one-quarter of each class of respondents. This link seems to be more evident in the case of contractual plan buyers than in the case of regular account holders. Moreover, an expectation of capital appreciation may well have been a motivation for those investors (13 percent of regular account and 8 percent of contractual plan buyers) who indicated they purchased mutual funds to protect capital.

Investors who acquired contractual plans reported with a relatively high frequency that they chose this mode of investment because of the discipline it imposes on savings habits. The percentage of such investors who claimed this motive (45 percent) was substantially below the proportion (87 percent) who reported that the sales representative had called their attention to it. However, it was virtually the same as the percentage (50 percent) who said that they had been influenced in the decision to purchase shares by the sales representatives' reference to mutual funds as a means of encouraging saving. Also, as expected, a much smaller proportion of regular account buyers saw the same advantage in owning fund shares. Protection of capital and the expected return on the investment were elements which attracted a relatively small number of both regular account and contractual plan investors.

2. *Investor characteristics and choice of mutual funds.*—The availability of professional management and portfolio diversification lose a great deal of their dominant influence on investors' choices when the latter are examined in detail. The strategic motivations for a sizable proportion of respondents seem to spring from a mild temptation to speculate on capital gains. While this prospect is by no means alluring to all purchasers, it emerges rather clearly in the responses of the following investor groups: the most optimistic include proportionately more men than women, young people, those with higher education, professionals and executives, the middle and upper income groups, and investors who had previously purchased mutual funds or other corporate stocks.. Among investors with more conservative aims, professional management, diversification, and disciplining in saving retain the strongest appeal as reasons for purchasing fund shares. These incentives were cited primarily by women, older people, those with less education, employees in nonprofessional occupations, lower income groups, and new investors in equities of any kind. This mosaic is evident from the cross-tabulation of investors' characteristics and choice of mutual funds exhibited in table IV–5.

APPENDIX XI-A: TABLE IV-5.—*Factors influencing choice of mutual funds and selected investor characteristics by type of purchase*

[Percentage distribution]

Investor characteristic	Professional management		Diversification		Economic growth		Hedge against inflation		Rise in stock prices		Discipline in saving		Percent of total responses	
	Regular	Contractual	Regular	Contractual	Regular	Contractual	Regular	Contractual	Regular	Contractual	Regular	Contractual	Regular	Contractual
Sex:														
Male	63	84	63	83	66	85	70	85	63	79	62	70	59	77
Female	37	16	36	16	34	15	30	15	37	20	38	30	41	23
Marital status:														
Married	70	81	69	75	76	75	76	81	78	83	65	71	67	73
Widowed	14	2	16	0	10	3	10	0	7	7	15	7	17	7
Single	15	17	14	25	14	22	14	19	15	10	18	22	15	20
Age:														
Under 30	4	16	3	25	5	30	0	15	2	17	9	24	5	22
30 to 39	21	34	21	34	26	28	28	33	32	24	18	29	19	29
40 to 49	25	32	23	18	25	25	22	30	15	28	24	26	24	28
50 to 59	21	15	21	20	21	13	24	15	29	21	26	18	21	17
60 to 64	10	2	12	2	8	2	8	4	7	7	9	1	10	1
65 and over	15	0	18	2	13	2	18	4	12	3	15	2	20	3
Education:														
Elementary	8	7	7	10	8	13	2	7	7	14	12	16	11	16
High school	30	48	35	36	32	30	26	26	27	34	50	51	35	46
College	42	31	40	45	37	47	48	52	46	38	32	24	38	29
Postgraduate	20	13	18	9	24	10	24	15	20	14	6	10	16	9
Occupation:														
Professional and executive	46	32	44	34	38	35	46	44	32	31	26	33	34	28
Self-employed	11	13	6	16	11	3	12	11	12	21	12	13	12	16
Nonprofessional	28	48	21	41	32	48	22	37	24	34	38	47	54	56
Retired	7	0	11	0	9	0	10	0	10	0	15	0	10	1
Other	8	6	17	9	11	13	10	7	22	14	9	7	16	7
Income:														
Under $5,000	14	11	15	11	13	13	4	7	7	14	26	27	19	20
$5,000 to $9,999	29	53	30	52	33	50	32	44	39	41	35	46	30	48
$10,000 to $14,999	19	24	19	14	25	18	22	26	27	21	9	16	18	18
$15,000 to $24,999	25	10	20	14	18	12	24	15	17	14	15	9	18	9
$25,000 to $49,999	6	1	6	2	4	3	14	0	7	3	6	0	6	2
$50,000 and over	1	0	2	2	2	2	2	0	2	0	3	0	1	1
No answer	6	2	7	5	4	2	2	7	0	7	6	2	7	3
Assets:														
Mutual funds	38	18	42	25	37	25	34	30	34	24	29	21	36	18
Other stocks	60	29	69	37	55	32	54	56	63	38	44	20	57	24
Government bonds	52	46	57	45	48	42	54	52	54	41	47	46	51	45
Other bonds	17	11	22	20	11	13	18	19	17	10	21	6	15	10
Savings accounts	93	96	94	95	92	92	90	100	95	90	85	89	92	90
Real estate	31	20	26	16	28	17	28	19	32	7	18	18	28	17

Among all men purchasers, the search for a hedge against inflation and the possibility of sharing in the gains from economic growth drew the heaviest response by a slight margin; but the gap was largest for men who acquired regular accounts. While professional management and portfolio diversification were also in the front ranks of reasons reported, the frequency of selection was heaviest for contractual plan buyers. It should also be noted that the pull of discipline in saving was relatively weaker for men than for women who opened contractual plans. For women in general, the reason for choosing funds were quite diffuse, but a minor concentration is evident. A below-average proportion of women regular account buyers was attracted to funds on the assumption that they provided a hedge against inflation. On the other hand, a slightly above-average percentage of women contractual planholders opened accounts to benefit from a rise in stock prices; an even larger proportion thought they discerned a way to enhance disciplining in saving.

Married respondents, far more than widowed or single persons, seem to have selected mutual funds with a view toward capital appreciation. While two-thirds of regular account purchasers were married, three-quarters of them reported their decision was affected by expectation of capital gains. More than four-fifths of married contractual plan investors attributed some influence to such expectation, although they constituted just over 70 percent of all contractual plan investors. In contrast, widowed and single people among both classes of purchasers deemphasized the speculative potential of mutual funds in favor of the more conservative targets of portfolio diversification, expert supervision, and settled saving habits.

There seems to be a modest differentiation by age of respondent among reasons given for buying mutual funds. As mentioned above, proportionately more young people were attracted to fund shares in anticipation of capital gains. This was particularly true of contractual plan buyers for some of whom the prospects of an advancing economy was a strong inducement. Moreover, as one might expect, there was some tendency for older investors to rely on mutual funds as a source of professional supervision and diversification of their assets. Investors in the middle-age brackets displayed no sharply distinguished pattern in reported reasons for choosing mutual funds.

The linkage between different levels of education and particular inducements to buy mutual funds is clearly demonstrated. The more sparkling incentives with an aura of speculation were emphasized rather heavily by investors with college and postgraduate education. The frequency was especially marked among contractual planholders. In this group, persons with some college training accounted for just over one-quarter of the total respondents; however, about one-half of them cited economic growth and hedge against inflation as motives for purchasing funds. Roughly the same proportion of college-educated regular account purchasers identified those two motives and also added the hope of benefiting from a rise in stock prices; yet, they represented under two-fifths of regular account investors. A similar pattern was evident among investors who pursued postgraduate studies. At the lower ends of the educational scale, there was an equally marked tendency to relate purchase decisions to less glamorous attractions. Discipline in saving was mentioned by approximately half of regular and contractual plan buyers; this rate was well above average for regular accounts but only slightly above average for contractual planholders. Professional management also received a relatively high proportion of citations.

A similar pattern is traceable among investors classified on the basis of occupation. Professional and executive jobholders who bought regular accounts reported the hedge against inflation motive at a frequency about one and one-third times their percentage representation among all regular purchasers. For contractual planholders in the same occupational categories, the corresponding figure was one and one-half times. Diversification and professional management were also especially above average for regular account investors, but this was not the case for those entering contractual plans. Among the self-employed respondents, no clear delineation appeared in the factors affecting choices. Investors engaged in nonprofessional occupations cited a rather wide scattering of motives, and the frequencies in each category were relatively low. However, the relative bias in favor of conservative, rather than speculative, aims is discernible.

The distribution of respondents by income class and investment motive is also characterized by a modestly optimistic view of capital gains among middle and high income groups and its absence among those with low incomes. For example, both regular and contractual plan buyers in the lowest income bracket stressed only the hope of becoming more disciplined savers, and the more sophisticated motives relating to capital gains were scarcely mentioned. On the other hand, for regular respondents in the middle income ranges, the frequency expecting to benefit from a rise in stock prices or from economic growth was about 50 percent above average; the proportion seeking a hedge against inflation was approximately one-third above the average ratio. Contractual planholders in the same income ranges cited these motives to a somewhat lesser extent, but here also there was more than average concern with capital gains. In high income brackets, there seemed to be some interest in acquiring mutual funds as a hedge against inflation, but the pursuit of other aspects of capital gains was less evident.

The correspondence between investors' motives in fund purchases and their financial planning in general is somewhat meager. However, a high degree of consistency is implied in a few categories. These are shown in the pattern of asset ownership in table IV–5.

Overall, those investors who were attracted to funds because of professional management reported the previous acquisition of financial assets at about the same frequencies indicated by all investors in the survey. In contrast, among contractual plan buyers who specified some variant of the capital gains motive, the percentage who already owned mutual funds was from one and one-third to one and one-half times that for all contractual plan investors. The relative ownership of other corporate stock was twice as large. The frequency of government bondholdings in this group was below average—except for the unexpected case of those seeking a hedge against inflation. Among regular account purchasers, with an eye on capital gains, there was also some evidence of equity investment prior to the survey. Those expecting a rise in stock prices reported the ownership of corporate stock with above-average frequency; however, reports of mutual fund holdings were about equal to their proportion among all such owners. Investors with somewhat more conservative motives who owned government and other bonds and real estate represented about the same proportions of these groups among all respondents.

3. *Choice of mutual funds by sellers of other corporate stock.*—As mentioned in section III, a substantial proportion of investors switched from other corporate stock into mutual funds. Proceeds from such sales were used in 13 percent of all regular account purchases, or two-thirds of the transactions financed by the sale of assets already owned. (But, as noted below, some 16 percent of those who redeemed regular account, mutual fund holdings used the proceeds to acquire other corporate stocks.) The median transaction by those doing the switching was between $2,000 and $5,000, compared with under $1,000 for regular account buyers as a group. However, about 80 percent of those selling corporate stock said they still owned such stock; thus, only one-fifth of those who held corporate stock switched from these assets entirely.

Since these sales represent a clear preference for mutual funds over other corporate stock, the investors making the switch were looked at somewhat more closely. (Only regular account buyers were considered because there were so few switches among contractual planholders.) The aim was to appraise the characteristics, objectives, and motivations of these sellers compared with regular account buyers as a group. Some thought was also given to the possibility that these switches may have been related to the sizable decline in general stock prices in May 1962. (The comparisons are shown in table IV–6, pp. 25–27.)

A far smaller proportion of those who sold corporate stock (one-fifth) than regular buyers in general (one-half) initiated the purchase of fund shares. On the other hand, the sales representative took the lead in three-fifths of the transactions involving sales, compared with less than one-third of all regular accounts. Moreover, among investors making the switch in June, salesmen initiated the purchase of mutual funds in three-quarters of the cases; they did so in half the shifts which occurred in the March–April period.

The choice of a particular mutual fund originated with brokers or sales representatives in over three-fifths of the cases. This proportion was nearly twice that for all regular account respondents. Only 15 percent of the sellers, against 30 percent of regular purchasers taken together, decided to buy a particular fund on the basis of their own appraisal. This heavy reliance on the sales representative was, for many investors who switched into mutual funds, another transaction in a continuing customer-client relationship. About two-thirds of those who sold corporate stock and purchased mutual funds had previously bought other types of securities from the same salesman. This was true for only one-quarter of all regular account investors.

Moreover, in more than half the cases (versus one-third for regular buyers as a group), those selling corporate stock to buy mutual funds transacted their business through members firms of the New York Stock Exchange. Another 10 percent dealt with members of other exchanges. In only 6 percent of the cases involving switching were the transactions handled by dealers specializing in mutual funds, whereas firms in the latter category handled 23 percent of all regular account purchases.

Because sales intermediaries played such a significant role in the decision to sell corporate stock and buy mutual funds, some attention was given to the sort of considerations which may have been involved. The first task was to examine investors' objectives and the influences on their investment decisions. A few substantial variations are evident when those selling corporate stock are compared with all regular account buyers. Provision for retirement was a popular target for both groups, but it was far in the lead for the sellers—more than twice the next most popular goal. In contrast, general savings (which was almost equal to retirement in the percentage of all regular purchasers reporting it) was mentioned by less than one-fifth of those selling corporate stock. This pattern of objectives is not unexpected in view of the relatively advanced age of sellers and high proportion of widows among them.

The factors and influences inducing sellers and all regular purchasers to acquire mutual funds also diverge in a few important cases. Overall, investors in both groups assigned about the same relative weight to factors such as professional investment management, diversification of assets, higher return on investment, the expectation of benefiting from a rise in stock prices, and the prospect that mutual funds may provide a hedge against inflation. However, among those selling corporate stock the search for disciplining in saving was important for only about half the buyers who bought mutual funds for this purpose. On the other hand, the proportion of sellers who reported they shifted into funds to protect capital was one and one-half times that for regular account investors considered collectively. Finally, about one-quarter of the sellers, compared with more than one-third of all regular purchases, thought mutual funds would enable them to benefit from economic growth.

Given these objectives and motivations of investors who switched into mutual funds, an effort was made to see whether they could be traced to the salesmen who played such an important role in this set of transactions. As explained in detail in section VII, investors who met with sales representatives were asked which items, included in a list of statements salesmen may have made during the sales presentation, influenced their decision to buy mutual funds. Without going into the general responses at this point, it may be mentioned that a few noticeable differences are evident between those who sold corporate stock and regular account investors as a group. About one-third of the sellers, compared with one-quarter of the entire set of regular account buyers, said salesmen's statement that mutual funds provided professional investment management affected their decision. Reported statements suggesting fund shares were safe and like savings accounts were listed by one-quarter of the sellers; the corresponding proportions were one-fifth and one-seventh, respectively, for all regular purchasers.

But, in spite of the relatively greater contact the sellers had with salesmen, they apparently did not gain greater understanding of mutual funds. In fact, in terms of the knowledge criteria explained in detail in section X, they seem to know much less about this subject than regular buyers as a group. This is especially true of most of the older women (mainly widows) who were so prominent among those making the switch.

In order to appraise the influence on investors' decisions of the drop in stock prices in May 1962, those who purchased in the early period (March-April) were separated from those who purchased in the later period (June). A separate tabulation was made of the two sets of responses to questions relating to investors' objectives and factors influencing the choice of mutual funds. On the whole, there was no important distinction between the investment objectives of the early and late purchasers—except a slightly larger percentage of buyers were seeking higher current income in the March-April period.

On the other hand, a rather sharp distinction was evident when the replies were analyzed by factors which partly induced investors to acquire shares. Among all sellers of corporate stock, about three-fifths reported professional investment management, and just under one-half reported diversification of assets as affecting their decisions. Both proportions were essentially the same as for all regular account buyers. However, two-thirds of those citing professional management were among the early purchasers and only one-third among those who bought after the sharp decline in stock prices. Similarly, the early-late division for those citing diversification was 60 percent to 40 percent. These divergencies stand out rather clearly against the almost identical early-late distribution of transactions for the selling group as a unit and for all regular account buyers: the respective divisions were 53 percent to 47 percent and 55 percent to 45 percent. A few sold corporate stock and acquired mutual funds in the later period with the expectation of a higher rate of return on investment; none reported this aim in the early months. Finally, the protection of capital was a motivation for a slightly higher proportion of those switched to fund shares in June compared with March–April.

Those who sold corporate stock to switch into mutual funds were, as a group about as optimistic about the future performance of funds as were all regular account purchasers. However, in the light of comments made in the interviews, apparently the downtrend in market prices in May 1962, evidently dampened somewhat the sellers' expectations about the prospects for the stock market in general. But it seems to have had less effect on their belief that a professional management group, controlling a diversified portfolio, might produce exceptional benefits in the future. The general pattern of expectations held by investors in the survey is examined in detail in section XI and need not be explored here.

However, in passing it might be noted that essentially no difference was evident in the level of expectations of all regular investors (which was generally high) concerning management performance among those who purchased before or after the market decline. Among sellers, on the other hand, a sharp dichotomy was evident. Only one-fifth of those who switched in the early period expected their fund to perform better during the next 10 years or so than it did in a similar period in the recent past. Yet, one-third thought funds would perform better than the stock market as a whole. In the later period, almost the exact opposite pattern of expectations was observable among those switching from corporate stock into mutual funds: two-fifths expected funds to improve their performance while one-fifth expected them to fall short of the market.

In conclusion, the above analysis suggests that, after the market decline, a fairly sizable proportion of regular account investors became somewhat pessimistic about the outlook for corporate stocks and decided (a substantial number with the help of fund salesmen) to shift some of their assets into mutual funds. In so doing some of them may have been motivated, at least partly, by unsatisfactory experiences with corporate stock. Still others may have decided to realize capital gains on the stock sold. Moreover, the acquisition of mutual funds may have reflected a search for defensive issues to hold during a declining market. But, whatever the specific motivation underlying the decision, it seems evident that a considerable proportion of regular account investors decided (or were advised) to switch into fund shares because they expected professional management in mutual funds to yield benefits superior to what they could have acquired by retaining the corporate stock they sold.

APPENDIX XI–A: TABLE IV–6.—*Sellers of other corporate stock compared with all regular account respondents*

[Percentage distribution]

Type of information	Corporate stock sellers	All regular account respondents
Size of purchase:		
Less than $50	0	7
$50 to $99	0	5
$100 to $199	0	6
$200 to $499	6	16
$500 to $999	12	18
$1,000 to $1,999	26	16
$2,000 to $4,999	26	16
$5,000 to $9,999	18	10
$10,000 to $19,999	6	4
$20,000 to $49,999	6	2
Period of purchase:		
March–April 1962	53	55
June 1962	47	45
Investor objectives:		
General saving	18	41
Provide for retirement	53	45
Children's college education	12	16
Accumulate an estate	24	26
Current income	24	20
Purchase business or home	0	1
Other objectives	0	5

(Continued)

APPENDIX XI–A: TABLE IV–6.—*Sellers of other corporate stock compared with all regular account respondents*—Continued

[Percentage distribution]

Type of information	Corporate stock sellers	All regular account respondents
Factors affecting choice of funds:		
Benefit from professional management	59	57
Benefit from diversification	44	48
Benefit from economic growth	24	35
Hedge against inflation	21	21
Benefit from rise in stock prices	18	17
Discipline in saving	6	11
Protection of capital	18	13
Higher return on investment	9	8
Other reasons	12	7
Initiation of purchase:		
Respondent	20	20
Sales representative	62	30
Friend or relative	9	14
Some other person	0	1
No answer	9	5
Most important influence on choice of particular fund:		
Broker or sales representative	62	34
Advertising or sales literature	0	5
Independent appraisal	15	30
Friend or relative	17	22
Business adviser	0	3
Other influence	3	5
No answer	3	1
Investor characteristics:		
Sex:		
Male	53	59
Female	47	41
Marital status:		
Married	59	67
Widowed	29	17
Single	12	15
Age:		
Under 30	3	5
30 to 39	24	19
40 to 49	9	24
50 to 59	18	21
60 to 64	12	10
65 and over	35	20
Education:		
Elementary school	15	10
High school	24	35
College	50	38
Postgraduate	12	15
No answer	0	2
Occupation:		
Professional and executive	29	32
Self-employed	6	11
Nonprofessional	21	30
Retired	21	12
Other	24	15
Income:		
Under $5,000	18	19
$5,000 to $9,999	29	31
$10,000 to $14,999	18	18
$15,000 to $24,999	12	18
$25,000 to $49,999	9	6
$50,000 and over	3	1
No answer	12	7
Assets owned:		
Other mutual funds	41	36
Other corporate stock	80	57
Government bonds	56	51
Other bonds	15	15
Savings accounts	94	92
Real estate	35	28
Life insurance coverage:		
None	32	14
Covered	68	86
Face amount:		
Less than $5,000	18	21
$5,000 to $9,999	9	13
$10,000 to $14,999	15	11
$15,000 to $24,999	12	10
$25,000 to $49,999	3	11
Over $50,000	12	15
None or no answer	0	19

Part II. The Role of Mutual Fund Sales Representatives

V. INVESTOR CONTACT WITH SALES REPRESENTATIVES

A. Methods of distributing mutual funds

The distribution of mutual fund shares takes several basic forms. The primary technique of distributing regular accounts is through principal underwriters who sell to independent broker-dealers. About three-quarters of the funds in the survey chiefly rely on independent broker-dealers. Just over 10 percent distribute directly through fund-controlled selling organizations, and the rest sell by mail. The relative importance of each kind of arrangement among funds in the sample is virtually identical with that for the industry as a whole.

One-quarter of the firms in the survey which sponsor contractual plans offer them primarily through sponsor-controlled selling organizations. Somewhat over one-third rely mainly on independent broker-dealers, and more than two-fifths use a combination of controlled selling arrangements and independent broker-dealers. Furthermore, a substantial proportion of the independent broker-dealers handling contractual plans specialize in the distribution of mutual funds rather than in issues traded generally in the securities market.

Later in this section, an attempt is made to trace differences in the extent of regular account investors' contact with sales representatives by focusing on the type of dealer handling the transaction. For this purpose, dealers have been classified under four headings, of which the first three consist of firms doing a general securities business: (1) All member firms of the New York Stock Exchange (NYSE), regardless of their membership in other exchanges; (2) members of exchanges other than NYSE; (3) members of the National Association of Securities Dealers (NASD) who are not members of any exchange and do not not specialize in mutual funds; and (4) NASD member firms specializing in the distribution of mutual funds.

For 80 percent of regular accounts in the survey, the identity of the dealers who distributed the shares was known. Member firms of the New York Stock Exchange handled one-third of the transactions. Members of other exchanges accounted for 5 percent, and nonexchange members of NASD who do not specialize in mutual funds were responsible for 6 percent. Member firms of NASD specializing in mutual fund shares handled 23 percent, and 13 percent of the regular purchases were by mail.[11]

B. Characteristics of sales representatives

For the purpose of analyzing the activities of sales representatives, it would be helpful to classify them under a number of headings: (1) In terms of the kind of organization they represent, e.g., as affiliated with a general securities' dealer or specialized mutual fund selling organization; (2) in terms of employment status, e.g., as employed full or part time; and (3) in terms of their relationship to buyers, e.g., close friends or relatives, or as neither.

Since the survey focused on the mutual fund investor, only rough impressions were obtained about the sales representative or his organization. The impressions about the sales representative are based primarily on information obtained in the personal interviews. All respondents (including those who answered the mail questionnaires) were asked: "How would you describe the person you dealt with when you made your purchase—was he a salesman, broker, dealer, customer's representative?" The respondent's own description was recorded. However, in the personal interview survey, interviewers were instructed to inquire further to determine, as far as possible, the sales representative's employment status and his relation to the respondent. The outcome was somewhat mixed. Respondents generally had only vague notions about the occupation and employment status of the person who handled the transaction. On the other hand, purchasers were able to provide a better indication of their personal relationship to the salesman.

Thus, while it is impossible to characterize the sales representative with precision, a rough sketch can be drawn from several pieces of information. In a number of cases, especially with respect to regular accounts, it is clear that the transaction occurred in the office of a general broker-dealer firm as usually

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[11] Virtually all of the mail purchases were accounted for by no-load funds. As explained in app. I, the 3 largest no-load funds were selected for inclusion among the 28 funds in the survey in order to provide enough responses in this category to permit significant subclassifications and comparisons. The effect of this selection is to give greater weight to mail purchases in the survey than they actually have in the industry.

defined in the securities' industry. The salesman in these cases was probably a registered representative as defined by the National Association of Securities Dealers. It is also clear, especially with respect to contractual plans, that a considerable proportion of the transactions occurred in the investors' homes or places of employment; a fairly large percentage of these transactions probably involved sales representatives—many of them working on a part-time basis—whose sole concern with securities was the distribution of mutual funds. In this study, the term "sales representative" refers to persons in both of these capacities.

Sales representatives could influence the decision to buy mutual funds at two stages: (1) the initiation of the transaction and (2) the choice of a particular fund. It should be noted that the concept of "initiation" in the present context lacks precision, and therefore permits differences of interpretation by respondents. In addition, some investors may have a tendency to enhance their role in the transaction. On balance, salesmen appear to have been far more important in the investment decisions of contractual plan buyers than in the decisions of regular account purchasers. Sales representatives reportedly initiated half of the contractual plan transactions, and in one-third of the cases they were identified as the most important influence in the choice of the particular fund. One-third of regular account investors assigned the strategic role to salesmen in each phase of the investment decision. Half of regular account buyers indicated that they took the initiative, and one-third said they selected their own fund. Two-fifths of contractual plan investors took the first step, and less than one-fifth chose their own funds. Furthermore, well over two-fifths of contractual plan buyers (compared with one-seventh of regular purchasers) reported the advice of friends and relatives as the most important influence on the choice of the particular fund.

As shown in table V-1, it seems that about one-fifth of regular account transactions were handled by a sales representative who was also a close friend or relative of the purchaser. For contractual plan purchasers, the salesman appeared to be a close friend or relative in approximately one-third of the cases. The important place of close personal relationships between buyers and sellers has significance not only for the market structure in which mutual funds are sold but also for the character of responses at many points in the questionnaires. While respondents generally were not reluctant to discuss other aspects of their mutual fund transactions, a considerable number apparently were reluctant to provide interviewers with information which might reflect adversely on the performance of the sales representative. Moreover, there is reason to believe that this close personal relationship may have led some respondents to attribute certain statements or actions to the sales representative on the assumption that such statements or actions were required by securities regulations. This point should be kept in mind when interpreting answers concerning statements allegedly made by the sales representative during his presentation.

APPENDIX XI-A: TABLE V-1.—*Relationship of sales representatives to respondents as inferred in personal interviews*

[Percentage distribution]

Relation to respondent	Regular accounts	Contractual plans
Close friend	17	30
Relative	3	5
Neither above	33	35
No answer or don't know	47	30
Total	100	100

C. Meetings with sales representatives

About one-quarter of regular purchasers reported no meetings with the sales representative, but virtually all contractual plan buyers reported that such meetings did occur. (See table V-2.) A number of factors may explain this different pattern of contact with the sales representative. For regular accounts, it may imply that orders were given over the telephone, respondents relied on business advisers, and it may reflect the important role of the traditional broker-dealer firm in selling regular accounts. These possibilities are examined more closely at a later point in this section. Greater contact between contractual plan