CHAPTER II

THE STRUCTURE AND CONTROL OF OPEN-END INVESTMENT COMPANIES [1]

This chapter is concerned primarily with the organizational structure and the types and mechanisms of control of open-end investment companies. The first section is devoted to a brief description of the general pattern of growth of this sector between 1924 and 1961. Attention is then directed to the framework within which open-end companies operate, including the legal forms of open-end investment companies, the rights of shareholders and management groups under existing law and contractual arrangements, and the role of the board of directors or trustees in the management of these institutions. This is followed by a discussion of the types and mechanisms of control of open-end companies, which encompasses an analysis of the distribution of the shares of open-end companies, the extent of separation of ownership and control, and the means by which control is established and maintained in the open-end investment company business.

GROWTH AND STRUCTURAL CHANGE, 1924–61

Origins and development, 1924–52

The open-end investment company, as a distinct form of financial enterprise, came into existence in 1924, when the newly organized Massachusetts Investors Trust (MIT) granted its shareholders the right to require the redemption of their shares at net asset value less $2 per share.[2] This innovation made little impact on financial markets during the decade of its inception. The great investment company expansion of the late 1920's was so completely dominated by the growth of closed-end and other types of investment companies that the proportion of open-end company assets to the assets of all investment companies declined from 3 percent in 1927 to 2 percent in 1929. At the end of 1929, there were 19 open-end investment companies in existence with assets in excess of $500,000, with aggregate assets of $140 million. The largest open-end company at that time was Incorporated Investors, with assets of $41.2 million, or 29.4 percent of all open-end company assets; the largest four companies held 67.4 percent of the assets of all open-end companies.[3]

The stock market collapse and the subsequent decline in security values resulted in a virtual halt in the distribution of the shares of

[1] By Edward S. Herman.

[2] SEC, "Report on Investment Trusts and Investment Companies," pt. I (1939), p. 101. The redemption privilege was also a characteristic of the fixed investment trust, under which the certificate holder was usually granted the right to convert his trust shares into either the underlying trust property or its cash equivalent. The first such trusts in the United States came into existence in 1923, usually in the form of unit trusts which were limited to a predetermined and fixed portfolio structure, and distinguishable from open-end companies primarily in the absence of the continuous investment management characteristic of the latter. See ibid., pp. 29–30; SEC, report, II (1939), pp. 38–39.

[3] SEC, report, pt. II (1930), pp. 34, 56, 112–113. These data on numbers and assets of investment companies prior to 1940 exclude companies with assets under $500,000.

most types of investment companies.[4] Although open-end companies suffered less severely in the depression than did closed-end investment companies, the value of open-end company assets fell from $140 million in 1929 to a low of $64.3 million in 1931. The sale of open-end company shares increased again after that date, however, and soon rose substantially beyond the levels that had prevailed in the period 1927–29. In the 3 years 1933–35 $237 million of shares of open-end companies were sold, as compared with a total of $149 million of open-end company shares distributed in the earlier 3-year period. These increased sales contributed significantly to the almost sevenfold expansion in the assets of open-end investment companies, from $75 million at the end of 1932 to $506 million at the close of 1936.[5] This process of expansion under generally unfavorable economic conditions is indicative of the fact that open-end companies had achieved in the eyes of investors a new status which already pointed toward the significant absolute and relative growth in importance subsequently attained by the industry.

At the end of 1936 the largest open-end company was MIT, which increased in asset size from $14.5 million in 1929 to $130.3 million in 1936. Incorporated Investors, State Street Investment Co., Quarterly Income Shares, and Dividend Shares also had assets in excess of $25 million in 1936, and all of them grew rapidly during the period of general depression extending from 1932 through 1936. The average size of open-end investment companies increased from $7.3 million in 1929 to $12.9 million in 1936. Nevertheless, the growth in total open-end company assets was so rapid that there was a slight decline in the relative importance of the largest firms between those two dates. In 1929 the largest open-end company, Incorporated Investors, had controlled 29.4 percent of all open-end assets. In 1936, the largest company, MIT, held only 25.7 percent of open-end company assets. While the largest four companies in 1929 held 67.4 percent of industry assets, the share of the largest four companies in 1936 had fallen to 60.6 percent. In sum, this period of growth in open-end company numbers and assets was accompanied by a substantial increase in the absolute size of many of the larger open-end companies and a slight decline in the relative importance of the largest companies.

There was a sharp decline in the market value of securities and sales of shares of open-end investment companies during the 1937–38 recession, which was followed by a period of stagnation that lasted up to the entry of the United States in World War II. During the Second World War open-end investment companies entered a new phase of expansion which continued without extended setback into the 1960's. The assets of open-end companies tripled between the end of 1941 and 1945, and tripled again from the end of 1945 to 1952. At the end of 1952 there were over 100 registered open-end companies with assets in excess of $1 million, with aggregate assets of $3.9 billion.

[4] Again an exception must be made of fixed and semifixed trusts, which reached their peak in sales of new certificates in 1930 and 1931. From sales of $88 million in 1929, the distribution of new certificates of fixed and semifixed trusts increased to $336 million in 1930, followed by a decline to $260 million in 1931 and a sharp drop to $74 million in 1932. Thereafter the sales of these certificates dwindled steadily until they virtually ceased. Ibid., pp. 38–39.

[5] Ibid., pp. 112–113.

The largest open-end company in 1952 was still MIT, which had increased in asset size from $130.3 million in 1936 to $512.4 million in 1952. MIT was followed closely by Investors Mutual, a company which had been organized in 1940 and which held assets totaling $435.6 million in 1952. The Wellington Fund, Affiliated Fund, and Fundamental Investors also held assets in excess of $150 million in 1952. Of these five companies, only MIT was among the largest 10 open-end companies at the end of 1936.

Under the conditions of extremely rapid growth which generally characterized the open-end investment company industry from the end of 1936 through 1952, the relative position of the largest open-end companies declined substantially despite impressive growth rates and increases in absolute size.[6] Thus, although MIT increased its asset size almost fourfold during this period, the assets of all open-end companies increased almost eightfold (from $506 million to $3.9 billion), with the result that the percentage share of industry assets held by the largest firm declined from 25.7 to 13.1 percent. Similarly, the percentage of industry assets controlled by the largest four open-end companies fell from 60.6 percent at the end of 1936 to 36.7 percent at the close of 1952.

Growth and structural change, 1952–58

Between December 31, 1952, and September 30, 1958, the period of primary focus for the present study, the market value of the assets of open-end investment companies more than tripled, increasing from $3.9 to $12.2 billion.[7] This rate of growth did not constitute any increase over that which had been in effect in preceding years; what made it remarkable was its mere maintenance with an asset base that had risen to $3.9 billion at the close of 1952.

As was the case during the previous decade, this period was one in which a substantial rise in the market values of common stocks took place, and approximately one-third ($2.6 billion) of the increase in the market value of open-end company assets reflected the market appreciation of industry security holdings. The other $5.7 billion increase in the value of open-end company assets was accounted for by the net inflow of cash into these companies resulting from an excess of sales (including voluntary reinvestment of capital gains) over redemptions of open-end company shares, as well as some merger activity.

Mergers were a distinctly minor factor in the growth of assets and change in size structure of open-end companies between 1952 and 1958. During this period the 156 companies included here absorbed a total of 24 other investment companies, with assets aggregating $119 million. Eight of these, with assets of $31.5 million, were other open-end investment companies; 3, with assets of $22.6 million, were closed-end companies; and the remaining 13 absorptions, with assets totaling $64.9 million, involved a variety of personal holding com-

[6] The phenomenon of a decline in the relative importance of dominant firms under conditions of rapid expansion is a familiar one in American industry. In the present instance, the principal factor underlying the decline appears to have been the great increase in the number of competitors seeking to make a place for themselves in the mutual fund business.

[7] These aggregate values, as well as those that follow, unless otherwise specified, are for the 156 companies responding to the questionnaire sent to the mutual funds at the end of 1958. They therefore exclude the holdings of open-end companies with assets of less than $1 million, and several others, that have little impact on the dollar totals.

panies and private investment companies.[8] Thus, of the $5.7 billion of net inflow during this period, mergers accounted for approximately 2 percent of the total, with the remaining 98 percent attributable to net sales (including reinvested capital gains) of open-end company shares.

The period 1952–58 was also characterized by a substantial increase in the number and rate of formation of new open-end companies. Of the 156 companies included here, 38 came into existence (or became open-end companies in the case of the 2 companies converted from closed-end status) after December 31, 1952. This amounts to an increase of 32.2 percent in numbers between the end of 1952 and September 30, 1958. The more complete Securities and Exchange Commission totals on changes in the numbers of registered open-end investment companies, summarized in table II–1, indicate that between June 30, 1952, and June 30, 1958, the number of open-end companies increased from 163 to 238, or by 46 percent. This represents a substantial increase in the rate of entry of new open-end companies over that of the preceding 6-year period, during which the number of registered open-end companies increased by 35 percent. It is also of interest that the 1952–58 increase in numbers was heavily concentrated in the period extending from June 30, 1955, to June 30, 1958, during which time 56 of the additional 75 open-end companies registered with the Commission.

TABLE II–1.—*Number of open-end investment companies registered under the Investment Company Act of 1940, June 30, 1946, to June 30, 1961*

Year (June 30)	Number of companies	Increase in number from previous June 30	Percent increase in number from previous June 30
1946	121		
1947	125	4	3
1948	134	9	7
1949	140	6	4
1950	150	10	7
1951	154	4	3
1952	163	9	6
1953	166	3	2
1954	174	8	5
1955	182	8	4
1956	201	19	10
1957	222	21	10
1958	238	16	7
1959	261	23	10
1960	290	29	11
1961	330	40	14

Source: Securities and Exchange Commission, annual reports, 1946–61.

Between December 31, 1952, and September 30, 1958, the average size of open-end company more than doubled, increasing from $33.2 million to $78.7 million. The assets of the median-size company

[8] Only 3 of these 24 mergers involved a transfer of assets in excess of $15 million, and 1, the absorption of Canada General Fund, Inc. ($21 million) by Canada General Fund Ltd., was an intragroup merger, since just prior to the merger both companies had the same officers, directors, underwriter, and investment adviser. The other substantial mergers were the absorption of the closed-end company, Pacific-American Investors ($19.8 million) by American Mutual Fund in 1956, and the merger of the private investment company, the Aurora Corp. ($37.7 million) into the One William Street Fund in 1958.

The most active open-end company in respect of merger activity during this period was the Broad Street Investing Corp., which acquired four small investment companies. Broad Street Investing is a member of a larger group organized by and affiliated with the brokerage firm of J. & W. Seligman & Co., which also includes the open-end Whitehall Fund and National Investing Corp., as well as various other closed end, sales, and associated undertakings. Whitehall and National Investing acquired an additional five investment companies during this period, but the assets of all nine of the companies absorbed by the open-end members of the Seligman group totaled only $8.3 million.

also more than doubled during this period, increasing from $8.8 million to $22.5 million. The generality of these increases in asset size is also indicated by the fact that of the 118 open-end companies included here that were in existence in 1952, 4 out of 5 increased in size by 100 percent or more during this period.[9]

Tables II-2 and II-3 describe the distribution of numbers and assets of open-end companies among six size classes, for December 31, 1952, and September 30, 1958.[10] It may be observed from these tables that the class with assets in excess of $600 million, unoccupied in 1952, had three members in 1958 which, taken together, held 26.8 percent of all open-end company assets. MIT was still the largest open-end company, with assets of $1.3 billion; Investors Mutual was a close second, with assets totaling $1.2 billion; and the Wellington Fund was the third member of the largest size class, with assets of $777 million. In 1952, there were only five companies with assets over $150 million, these five controlling 40.5 percent of all open-end company assets. In 1958 there were 21 companies with assets in excess of $150 million, controlling 67.5 percent of the assets of all open-end investment companies.

TABLE II-2.—*Number and assets of 118 open-end investment companies, by asset size, Dec. 31, 1952*

Assets (in millions of dollars)	Companies		Assets	
	Number	Percent	Amount	Percent
Under 10	61	51.7	$202, 385, 727	5.2
10 and under 50	39	33.1	966, 049, 254	24.7
50 and under 150	13	11.0	1, 161, 107, 209	29.6
150 and under 300	3	2.5	638, 953, 128	16.3
300 and under 600	2	1.7	947, 988, 803	24.2
Over 600	0	0	0	0
Total	118	100.0	3, 916, 484, 121	100.0

TABLE II-3.—*Number and assets of 156 open-end investment companies, by asset size, Sept. 30, 1958*

Assets (in millions of dollars)	Companies		Assets	
	Number	Percent	Amount	Percent
Under 10	57	36.5	$298, 529, 959	2.4
10 and under 50	49	31.4	1, 250, 918, 137	10.2
50 and under 150	29	18.7	2, 446, 846, 088	19.9
150 and under 300	12	7.7	2, 508, 494, 567	20.5
300 and under 600	6	3.8	2, 476, 235, 635	20.2
Over 600	3	1.9	3, 290, 629, 454	26.8
Total	156	100.0	12, 271, 653, 840	100.0

The 156 open-end companies included in this study fell into 99 groups, each of which was subject to common investment management (and, in almost every case, common control) in 1958. Twenty-nine

[9] Six of the 118 open-end companies actually declined in absolute size between the end of 1952 and Sept. 30, 1958. Four of these were bond funds, a fifth was the Knickerbocker Fund, and the sixth was American Business Shares, a member, together with the large Affiliated Fund, of the Lord, Abbett group.

[10] The data relative to growth and size distribution contained in this section refer to investment companies and control groups, rather than to funds, as these respective units of analysis were defined in ch. I. Comparable data relative to investment funds, together with a more detailed analysis of assets by type of investment objective, are given in the following chapter.

of these groups were multicompany units, including a total of 86 individual companies.[11] The remaining 70 companies were single company units. Of the 29 multicompany open-end groups in existence in 1958, only 18 had been in that category in 1952. In 10 of the remaining 11 cases, multifirm groups were formed during this period by the establishment of a new open-end company by the management of an already operating independent company. In the final instance, a multicompany group was formed by the negotiation of a management contract with a newly formed open-end company.[12] Thirteen other newly organized open-end companies came under the control of preexisting multicompany groups between 1952 and September 30, 1958: 12 of these were established de novo by such groups, and one was brought in as a conversion from closed-end status by an already dominant management group.[13] Thus, 24 open-end companies came under the control of preexisting open-end management groups during the 1952–58 period.

TABLE II–4.—*Number and assets of 83 open-end investment company control groups, by asset size, Dec. 31, 1952*

Assets (in millions of dollars)	Groups		Assets	
	Number	Percent	Amount	Percent
Under 10	46	55.4	$152, 382, 439	3.9
10 and under 50	16	19.3	364, 171, 032	9.3
50 and under 150	14	16.9	1, 222, 373, 474	31.2
150 and under 300	5	6.0	1, 126, 179, 994	28.8
300 and under 600	2	2.4	1, 049, 388, 124	26.8
Over 600	0	0	0	0
Total	83	100.0	3, 916, 484, 121	100.0

TABLE II–5.—*Number and assets of 99 open-end investment company control groups, by asset size, Sept. 30, 1958*

Assets (in millions of dollars)	Groups		Assets	
	Number	Percent	Amount	Percent
Under 10	33	33.3	$156, 111, 579	1.3
10 and under 50	31	31.3	729, 173, 115	6.0
50 and under 150	12	12.1	1, 205, 852, 719	9.8
150 and under 300	10	10.1	2, 041, 102, 807	16.6
300 and under 600	10	10.1	4, 061, 941, 645	33.1
Over 600	3	3.1	4, 077, 471, 975	33.2
Total	99	100.0	12, 271, 653, 840	100.0

Tables II–4 and II–5 describe the distribution of the assets of open-end company *groups* whose members were subject to common investment management and control, among six size classes for December 31, 1952, and September 30, 1958. It may be seen from these tables that

[11] It should be noted that the groups discussed in the present report are defined in terms of the open-end companies included in this study, so that the number of multifirm groups and members of existing groups would be somewhat enlarged if account were taken of the companies excluded because of small size (and occasionally other reasons).

[12] Missiles-Jets and Automation Fund was organized in 1956 by a management group that entered into an investment advisory contract with Templeton, Dobbrow & Vance, the investment manager and locus of control of the Templeton & Liddell Fund.

[13] The Colonial Fund, a closed-end company under the control of Colonial Management Associates, along with the Gas Industries Fund (now Colonial Energy Shares) and the Bond Investment Trust of America, was changed from a closed-end to an open-end company in 1954.

at the end of 1952, only two groups, with 26.8 percent of industry assets, fell into the classes with assets in excess of $300 million; and only 7 of the 83 open-end investment company groups, with 55.6 percent of industry assets, held assets in excess of $150 million. On September 30, 1958, there were 13 groups with assets exceeding $300 million, controlling 66.3 percent of all open-end assets; and there were 23 groups in the classes with assets over $150 million, controlling 83 percent of all open-end company assets.

It may be seen from tables II-2 through II-5 that a fairly general and substantial increase in the absolute size of open-end companies and groups occurred between 1952 and 1958, which brought about a significant increase in the relative importance of companies and groups of large absolute size. Thus, companies and groups with assets in excess of $150 million increased their proportion of industry assets from 40.5 and 55.6 percent to 67.5 and 82.9 percent for companies and groups respectively. Nevertheless, under the conditions of rapid expansion which characterized the mutual fund sector in this period, the relative importance of the largest company and the four largest companies continued to decline moderately. (See table II-6.) The four largest control groups taken together also declined somewhat in relative importance, but the rapid growth of the Investors Diversified Services system brought with it a slight increase in the relative asset holdings of the largest control group between 1952 and 1958. (See table II-7.)

TABLE II-6.—*Concentration ratios for open-end investment companies, December 1952 and September 1958*

Number of companies (ranked from largest)	Dec. 31, 1952 assets	Percent of all Dec. 31, 1952 assets	Sept. 30, 1958 assets	Percent of all Sept. 30, 1958 assets
1	$512, 365, 938	13. 1	$1, 295, 283, 816	10. 6
4	1, 435, 994, 917	36. 7	3, 783, 031, 555	30. 8
8	1, 960, 565, 861	50. 1	5, 447, 393, 510	44. 4
20	3, 838, 863, 210	72. 6	8, 113, 452, 970	66. 1
50	3, 630, 953, 259	92. 9	10, 722, 205, 774	87. 4
All open-end companies [1]	3, 910, 226, 936	100. 0	12, 271, 653, 840	100. 0

[1] For Dec. 31, 1952, 107 companies; for Sept. 30, 1958, 156 companies.

TABLE II-7.—*Concentration ratios for open-end investment company groups, December 1952 and September 1958*

Number of groups (ranked from largest)	Dec. 31, 1952 assets	Percent of all Dec. 31, 1952 assets	Sept. 30, 1958 assets	Percent of all Sept. 30, 1958 assets
1	$554, 483, 977	14. 2	$1, 807, 429, 676	14. 7
4	1, 576, 165, 835	40. 3	4, 635, 508, 666	37. 8
8	2, 312, 406, 784	59. 1	6, 408, 336, 322	52. 2
20	3, 344, 435, 658	85. 5	9, 693, 982, 618	79. 0
50	3, 848, 549, 576	98. 4	11, 883, 452, 028	96. 8
All open-end groups [1]	3, 910, 226, 936	100. 0	12, 271, 653, 840	100. 0

[1] For Dec. 31, 1952, 76 groups; for Sept. 30, 1958, 90 groups.

A note on the expansion of mutual funds, 1958–61

The mutual fund business continued its rapid advance into the early 1960's. From an asset aggregate of $12.3 billion in September 1958, the assets of the industry expanded to $22.8 billion at the end of

1961.[14] The number of registered open-end companies increased from 238 in 1958 to 330 in 1961, or by 38 percent. It may be seen on table II–1 above that the rate of entry of new mutual funds increased markedly in the 3 years after 1958.

By the end of 1961 the largest four open-end companies, in order of size, were Investors Mutual, MIT, Wellington Fund, and United Funds, each with assets substantially in excess of a billion dollars. The aggregate assets of these four companies, $6,386.9 million, accounted for 28.3 percent of the assets of the mutual funds that were members of the Investment Company Institute. This constituted a slight further decline from the 30.8 percent concentration ratio for 1958 (cf. table II–6). The largest four open-end company groups (or systems) held assets totaling $8,495.9 million at the end of 1961, which represented 37.3 percent of the assets of mutual fund members of the Institute. This was virtually identical with the proportion held by the largest four groups in 1958 (cf. table II–7).

A further noteworthy feature of the expansion of the mutual fund business in recent years has been the growth in importance of accumulation or installment plans in the sale of fund shares. From the third quarter of 1958 to the end of 1961, while the number of shareholder accounts of members of the Investment Company Institute increased by 51 percent, the number of installment plans in force increased by 102 percent; and while the assets of these mutual funds increased by 93 percent, the value of assets accounted for by installment plans increased by 245 percent. Inasmuch as a substantial proportion of installment sales are of the front-end load type, the large inducements to salesmen inherent in such plans have undoubtedly contributed greatly to the notable expansion of installment sales.

STRUCTURE OF OPEN-END COMPANIES

Form of investment company

The 156 open-end investment companies responding to the first questionnaire all operate under a dual authority: First, they are registered with the Securities and Exchange Commission under the Investment Company Act of 1940, and are thus subject to the limitations on corporate structure, affiliations and policy imposed by that legislation. Secondly, they are all trust or corporate entities, with deeds of trust filed with State authorities, or with charters or certificates of incorporation to do business under the laws of the various States or Canada.

One hundred and seventeen of these investment companies are corporations, of which 51 are chartered in Delaware, 25 in Maryland, 11 in Massachusetts, 8 in Canada, 6 in New York, with the remaining 16 distributed among 8 other States. The other 39 companies are trust entities, 27, or 69 percent, of which operate under the laws of Massachusetts. Despite the greater average age of the open-end trusts, there is no clearly discernible relationship between form of organization and size of open-end company (table II–8), although when the 10 Keystone trusts are regarded as a single unit, as is reasonable for this purpose, there are a somewhat more than proportionate number of trusts in the largest size class.

[14] Investment Company Institute, "Mutual Funds, a Statistical Summary, 1940–61" (1962), p. 1. Figures taken from this compilation are for members of the Investment Company Institute, which are roughly comparable with the data used in the main body of this work.

TABLE II-8.—*Form of open-end investment company, for 147 [1] companies, by asset size, Sept. 30, 1958*

Assets (in millions of dollars)	Trust		Corporation		Total	
	Number	Percent	Number	Percent	Number	Percent
1 and under 10	13	23.2	43	76.8	56	100.0
10 and under 50	9	20.9	34	79.1	43	100.0
50 and under 300	5	13.2	33	86.8	38	100.0
300 and over	3	30.0	7	70.0	10	100.0
Total	30	20.4	117	79.6	147	100.0

[1] The 10 Keystone trusts are included in this table as a single company.

The trust form has declined in relative importance in recent years; of the 38 open-end company respondents to the first questionnaire that were organized between 1952 and 1958, only 2 were established as trusts. This decline was a result, in part, of the spread of the industry outside of Massachusetts, a State in which the trust form had been developed and utilized to an exceptional degree. It was also a consequence of the provisions of the Investment Company Act of 1940 that directors and trustees of registered investment companies may not serve "unless elected to that office by the holders of the outstanding voting securities of such company, at an annual or a special meeting duly called for that purpose," and that the term of office of at least one class of directors or trustees shall expire every year. A qualified exception to these requirements was made for common-law trusts organized prior to the date of enactment of the act of 1940, where the indenture did not provide for the election of trustees by the shareholders.[15] However, all newly formed trusts must provide for annual elections of trustees. This has created particular difficulties in regard to the organization of open-end trusts in Massachusetts, where judicial opinion has firmly established the rule that annual elections of trustees are inconsistent with the conditions of a valid trust, and would, if used, bring the shareholders within the ambit of the law of partnerships.[16] Thus, in the prospectus of the Chase Fund of Boston, organized as a Massachusetts trust on April 7, 1958, the management calls attention to the fact that:

> In the opinion of counsel of the Fund, the provisions of the Declaration of Trust, particularly the provision giving to the shareholders the right to vote for the election of Trustees annually and to vote on other matters pertaining to the Fund, bring the Fund within the scope of certain decisions of the Supreme Judicial Court of the Commonwealth of Massachusetts to the effect that, where a trust provides that the shareholders have ultimate control, a partnership among the shareholders is created.[17]

In effect, then, a trust conforming to the Investment Company Act of 1940, and organized after the date of enactment of that legislation, cannot qualify as a valid common-law trust under Massachusetts law.

Shareholder rights

The shareholders of 126 of the 156 open-end investment companies considered here have the power to vote in annual elections of boards

[15] Sec. 16 (a) and (b).
[16] *Frost* v. *Thompson*, 219 Mass. 360 (1914); *Williams* v. *Milton*, 215 Mass. 1 (1913). See also C. W. Gerstenberg, "Financial Organization and Management" (2d ed., New York: Prentice-Hall, 1946), ch. V.
[17] Prospectus, July 2, 1958, p. 5.

of directors or trustees. Such shareholder rights are required of all registered open-end companies organized after the enactment of the Investment Company Act of 1940. The act permits staggered elections of boards of directors, provided that no class of directors is elected for a period of longer than 5 years, and that the term of office of at least one class expires each year.[18] However, provision for staggered elections is a rarity among open-end investment companies, and in practically all cases where elections are held annually they are held for an entire board. The major exceptions to this generalization are the four open-end companies included in the Calvin Bullock group, the Canadian Fund, the Bullock Fund, Ltd., Dividend Shares, and Nation-Wide Securities, each of which has an arrangement for staggered elections.[19]

Of the 39 trusts included in the present inquiry, 9 provide for annual elections of the trustees, 8 give shareholders the right to approve or disapprove annually the renewal of management and/or underwriter contracts, and 22—13 if the 10 Keystone trusts are included as a single entity—afford shareholders no annual voting rights. This last category, which includes MIT,[20] the two sizable Eaton and Howard trusts, the 10 Keystone trusts, and Century Shares Trust held $2.4 billion of assets on September 30, 1958, or 19.6 percent of all open-end investment company assets.

Although the Investment Company Act of 1940 does not require previously organized common-law trusts to provide for the election of trustees by shareholders, it did introduce certain formal procedures whereby shareholder dissatisfaction with the performance of a trustee (who is a natural person) may result in his removal. Specifically, if owners of two-thirds of the shares of a trust vote for the removal of a trustee at a meeting called for that purpose or by written declaration to the custodians of the trust securities, that trustee may no longer serve. A written request for a meeting to consider the removal of a trustee is obligatory on the trustees if made by owners of at least 10 percent of the outstanding shares, and the trustees are required to cooperate with 10 or more shareholders, with assets of $25,000 or 1 percent of the outstanding shares, whichever is less, in their efforts to solicit signatures for a request to call a meeting to consider the removal of a trustee.[21]

It should be noted that these formal protections apply only to the removal of trustees who are natural persons. Nineteen of the thirty-nine trusts (including the 10 Keystone trusts as separate entities), with assets of $888.8 million in 1958, have corporate trustees, and thus fall outside the scope of shareholder protection provided by section 16(b). In a number of these cases, however, the trustee is the custodian and business manager rather than the control or investment managing body, so that shareholder protection is contingent on the power to remove the investment adviser or underwriter rather than the trustee proper. The shareholders of the Massachusetts Life Fund and the Keystone trusts have no power to vote annually on management or underwriting contracts, but in the eight other instances where

[18] Sec. 16(a).
[19] The bylaws of Nation-Wide Securities, e.g., which are typical of all members of this group "provide for the classification of directors into 5 classes, each consisting of approximately one-fifth of the total number, the members of each class to hold office for a term of five years." Prospectus, July 10, 1958, p. 4.
[20] MIT does, however, give shareholders the right to vote approval or disapproval of newly appointed trustees. Prospectus, Feb. 24, 1958, p. 2.
[21] Sec. 16(b).

there are corporate trustees the Investment Company Act requirements relating to the handling of management and underwriting contracts (discussed in the succeeding two paragraphs) necessitate annual shareholder votes for approval of the relevant contracts.

The Investment Company Act of 1940 gives investment company shareholders certain formal rights to participate in decisions involving the initiation and continuance of investment management and underwriting contracts. All investment advisory contracts entered into after March 15, 1940, must be approved by the owners of a majority of shares and must exactly describe the compensation to be paid under the contract; and investment advisory and underwriting contracts may be continued beyond 2 years only if approved annually by the board of directors or the owners of a majority of shares of the company. If a vote of a majority of shares is not obtained for entry into or renewal of an investment advisory or underwriting contract, then it must be approved by a majority of the directors who are not parties to or affiliated with parties holding such contract. In addition, all written investment advisory contracts, unless in effect prior to March 15, 1940, must provide that the board or the vote of a majority of shares of an investment company may terminate such contracts on not more than 60 days' written notice. All investment advisory and underwriting contracts must terminate automatically in the event of assignment.[22]

As regards agreements in effect prior to its enactment, the act of 1940 provided a period of grace extending to March 15, 1945, during which time investment advisory and underwriting contracts either had to be brought into conformity with section 15(a) and (b) or terminated. Common-law trusts were included in this section, so that all contracts entered into by trusts have had to be approved by holders of a majority of the outstanding trust shares. Following initial shareholder approval, the board of directors or trustees need not resubmit a contract for shareholder approval, and very few open-end companies do so. In the late fifties only 18 of 156 companies regularly requested shareholder approval of management contracts, and only 11 sought annual shareholder approval of underwriter contracts.[23] Interestingly, common-law trusts have a disproportionately large number of regular resubmissions for shareholder approval. This results from the fact that the act of 1940 requires the annual approval of advisory and underwriting contracts by a board of directors (or trustees) or a majority of the shareholders of the company. There are 19 trusts that have no board of trustees, but merely a single corporate trustee, so that unless exempted from this requirement (as 11 of these trusts are) they must submit their management and underwriting contracts annually for approval by the majority of outstanding shares, in the absence of the existence of the alternative provided by the act of 1940. In the case of the sizable National Securities Series, for example, there is a sponsor investment-manager-underwriter company that promoted and now controls the trust, National Securities & Research Corp., and a corporate trustee that functions largely as custodian and transfer agent, the Empire Trust Co., but there is

[22] Sec. 15 (a), (b), and (c).

[23] Of the 117 corporate open-end companies only 10 gave shareholders the exclusive right to approve or reject the renewal of the management contract each year and only 4 extended such voting rights to the approval or disapproval of underwriter contracts. The residual figures applicable to trusts were eight and seven for shareholder rights to vote annually on management and underwriting contracts respectively.