

CHAPTER VIII

INVESTMENT COMPANY RELATIONSHIPS WITH PORTFOLIO COMPANIES

Chapters VI and VII of this report examined the relationship between mutual fund size and investment performance and considered the impact of mutual fund growth on the securities markets. This chapter examines another aspect of investment company size—its effect on the companies in which investment companies have become substantial shareholders.

Part A discusses the question whether investment company managers have used the sizable pools of investment capital under their control to obtain dominant positions in portfolio companies to the possible detriment of the portfolio companies and their shareholders. The remainder of this chapter discusses the problems created by the emergence of investment companies whose portfolios consist entirely or in large part of securities issued by other investment companies and presents legislative recommendations for the resolution of those problems.

A. RELATIONSHIPS WITH PORTFOLIO COMPANIES OTHER THAN INVESTMENT COMPANIES

1. *The question raised*

Relationships between investment companies and the enterprises in whose securities they invest raise a significant question respecting existing regulatory controls: Are they adequate to protect portfolio company shareholders from possible overreaching on the part of their large investment company shareholders?

Although the Investment Trust Study that preceded passage of the Act had made an intensive examination of investment company-portfolio company relationships,¹ neither the Commission nor the Congress of 1940 saw any need to preclude investment companies from acquiring dominant positions—if their managers chose to do so—in the enterprises in which they invest.² Accordingly, the Act in general imposes no restrictions on the capacity of investment companies to control the enterprises in which they invest. With respect to investment companies that hold themselves out as “diversified,”³ however, the Act does limit the extent to which such companies can concentrate their investments in portfolio companies. But even a

¹ Investment Trust Study, pts. 4 and 5.

² A company that invests in securities for the primary purpose of controlling and operating businesses is not an “investment company” within the meaning of the Act. See note 9 on p. 34, supra. However, a company that is primarily an investor in securities and is therefore a statutory investment company may as a secondary phase of its activities engage in business enterprises on its own account and control subsidiary companies. The direct entrepreneurial activities of a large investment company can become quite substantial. See e.g., *Electric Bond & Share Co.*, Investment Company Act Release No. 4590 (May 6, 1966).

³ The overwhelming majority of mutual funds represent themselves in their prospectuses as diversified. Moreover, even the small minority of mutual funds that are registered under the act as nondiversified are in fact diversified to a considerable extent for the purpose of availing themselves of the benefits that subch. M of the Internal Revenue Code confers on regulated investment companies. See ch. II, pp. 40-41, supra, and appendix thereto at pp. 79-82, supra.

diversified investment company can have controlling positions in portfolio companies.

The Act divides the portfolios of diversified companies into two segments, only one of which need be diversified. The non-diversified segment, which may amount to as much as 25 percent of the diversified company's total assets, can be invested in the securities of a single issuer and can be used to acquire controlling positions in or even complete ownership of portfolio companies. And even within the diversified segment of the portfolio as much as 10 percent of the outstanding voting securities of an issuer can be acquired. In many large publicly held companies a stock interest of far less than 10 percent is significant enough to give its holder a powerful voice in the affairs of the enterprise.

The Act imposes controls over some of the more significant relationships between investment companies and the businesses in which they invest. It defines any company five percent or more of the outstanding stock of which is held by an investment company as an "affiliated person" of that investment company.⁴ This definition is significant because most transactions between investment companies and affiliated persons require prior Commission approval.⁵ Such approval can be granted only if the Commission finds "that the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned."⁶

2. *Mutual fund participation in portfolio company affairs*

The Wharton Report examined the nature and extent of relationships between mutual fund managers and portfolio companies during the period 1952 to 1958. It found that in 1958 there were at a minimum 39 holdings that 'clearly were large enough, either by themselves or in connection with interlocking management relationships, to permit the influencing of portfolio company affairs.' Although the Wharton Report found that the three largest fund groups accounted for only one of the holdings with control potential,⁸ these three groups accounted for a total of 338 separate holdings consisting of one percent or more of the voting shares of a portfolio company. Over half of these holdings exceeded two percent of the voting shares.⁹

Although holdings of one or two percent of a company's outstanding stock seldom confer working control, the Wharton Report recognized that the managers of mutual funds with such holdings can sometimes exert substantial influence over portfolio companies.¹⁰ The Report, however, found that mutual fund managers participated in the affairs of portfolio companies only in very limited ways and did not utilize

⁴ Sec. 2(a)(3).

⁵ Secs. 17(a)-17(d). Sec. 17(c) provides two relatively minor exceptions to the general rule for merchandise transactions in the ordinary course of business and for lessor-lessee relationships.

⁶ Sec. 17(b)(1). The Commission also must find that "the proposed transaction is consistent with the policy of each registered investment company concerned * * * and * * * with the general purposes of the [act]". Sec. 17(b)(2).

⁷ Thirty-four of the 39 holdings amounted to ten or more percent of the voting stock of the portfolio company. The five other holdings constituted voting stock ownership of 5 to 9 percent and were accompanied by one or more portfolio company interlocks. Wharton Report 25.

⁸ Twenty-one of these holdings were held by Insurance Securities Trust Fund and eight by a Single fund complex—the Axe-Houghton complex.

⁹ Wharton Report 26.

¹⁰ *Id.* at 26-27.

Cf. sec. 2(a)(9) of the Act which defines "control" as "the power to exercise a controlling influence over the management or policies of a company" and the discussion of that section in *Investors Mutual, Inc.*, Investment Company Act Release No. 4595, pp. 5-6 (May 11, 1966).

fund stockholdings to any significant extent for purposes of controlling the affairs of the portfolio companies. It concluded that "as of late 1958 neither the extent nor character of mutual fund influence over portfolio companies appeared to be such as to warrant serious concern."¹¹

These conclusions as to the effect of mutual fund size on relationships with portfolio companies during the period 1952-58 are not determinative of these questions in today's \$38 billion mutual fund industry, which is more than triple its 1958 size. The substantial growth of individual mutual funds and fund complexes since 1958, accompanied by significant increases in the number of large common stockholdings in mutual fund portfolios, has made mutual funds more important as shareholders in publicly held companies.¹²

Mutual funds are sufficiently important as shareholders to persuade managements of portfolio companies to give a favorable hearing to views of fund managers on company policies. However, many fund managers attempt as a matter of policy to avoid entanglements in the affairs of portfolio companies. While managers of the larger funds and fund complexes on occasion give advice on dividend policy, financing, mergers, and selection of officers and directors, they generally shy away from interfering with portfolio company operations. They tend to limit their concern to matters which affect investment income or possible dilution of investment values through mergers or new equity financing.

Nor do investment companies generally initiate shareholder movements for management changes in portfolio companies. On the other hand, where contests for control of a portfolio company have been initiated by others, the votes of investment companies, like those of other substantial shareholders, are often actively solicited by both sides to the contest. But investment companies tend to exercise their shareholder vote in favor of existing management. They evidence disapproval of management and its policies primarily by disposing of their holdings.

In recent years there has been some evidence, perhaps because the funds are less mobile and flexible with respect to changes in large portfolio positions, that funds have tended to play more active stockholder roles. In one notable instance, a mutual fund successfully sued to enjoin a portfolio company from issuing nonvoting stock—a step that would have caused the New York Stock Exchange to delist the company's common stock.¹³ In another, a large mutual fund stockholder determined to exercise its voting rights in a contest for control of the portfolio company, despite the fact that such action might have prejudiced its suit against the portfolio company for rescission of its purchase of the portfolio company's stock on the ground of fraud. In still others, managements of fund complexes have actively urged portfolio company managements to change certain financial policies such as those relating to dividend distributions. And only recently two large investment companies have figured prominently in

¹¹ Wharton Report, 424-427.

¹² See pp. 294-298, *supra*.

¹³ *United Funds, Inc. v. Carter Products, Inc.*, CCH Fed. Sec. L. Rep. par. 91, 288 (Balt. Cty. Ct., May 16 1963). Cf. *Cherner v. Transiron Electronic Corporation*, 211 F. Supp. 48 (D. Mass., 1963) where five mutual funds joined with other public investors in a settlement of private suits under the antifraud provisions of secs. 11 and 12(a) of the Securities Act. The \$5,300,000 settlement was for the benefit of all investors filing claims who had suffered losses from the alleged fraud committed by the defendants.

a contest for control of one of the larger companies in the motion picture industry.

In the mutual fund industry as a whole, however, there is no evidence as yet of any widespread departure from the traditional policy of evidencing disapproval of portfolio company management by liquidating holdings.

3. *Conclusions*

In considering the impact of investment company size on portfolio companies, active participation in the affairs of portfolio companies by investment company managements in the role of interested shareholders should not be confused with the managers' use of mutual fund assets to control portfolio companies. In some important respects, the shareholder interests of investment companies coincide with those of public investors generally. Thus the assumption by investment company managements of an active stockholder role in the affairs of portfolio companies could yield significant benefits to all investors. As the Commission's Investment Trust Study noted in 1940:

Investment companies may serve the useful role of representatives of the great number of inarticulate and ineffective individual investors in industrial corporations in which investment companies are also interested. Throughout the course of the existence of such industrial corporations, various problems are presented to their stockholders which require a degree of knowledge of financial and management practices not possessed by the average stockholder. Investment companies by virtue of their research facilities and specialized personnel are not only in a position to adequately appraise these situations but also have the financial means to make their support or opposition effective. These investment companies can perform the function of sophisticated investors, disassociated from the management of their portfolio companies. They can appraise the activities of the management critically and expertly, and in that manner not only serve their own interests but the interest of the other public stockholders.¹⁴

Questions concerning the impact of size on portfolio companies are not peculiar to investment companies but are common to institutional investors generally. Indeed, as stockholders, investment company managers are probably less influential than many commercial banks which manage much larger amounts of portfolio securities on behalf of personal trusts, noninsured pension plans and nonprofit institutions. Other institutions, such as life insurance companies, universities and foundations also hold substantial amounts of stock. When a number of institutional investors hold significant amounts of a company's securities, no single investment company group or other institution is able to wield a dominant influence over a portfolio company. However, groups of large stockholders, including investment companies, have on occasion, been able to play a decisive role in portfolio company affairs.¹⁵

¹⁴ Investments Trust Study, pt. 5, 371:
¹⁵ See Wharton Report 427-428.

Hence investment company influence over portfolio companies cannot be considered in isolation from the broader question of the influence of all substantial investors in companies in which they hold sizable positions. Detailed examination of that question calls for a broader inquiry than the one that has been made for the purposes of this report. In this connection, it must be remembered that other forms of influence may be as important as—and in some cases more important than—stock ownership. The commercial departments of banks, the loan departments of insurance companies and investment bankers through whom new capital is raised may exert significant influence on companies that look to them for capital even in the absence of actual stock ownership.

The Act's requirements of fairness with respect to transactions between investment companies and portfolio companies in which they hold five percent or more of the outstanding voting securities gives these portfolio companies a measure of protection against overreaching by investment companies that they do not have in their relationships with other large shareholders. These provisions of the Act are a check on the power of investment companies to use their positions as large stockholders to the detriment of portfolio companies and the noninvestment company shareholders of such companies.

On the basis of its observations of investment company-portfolio company relationships, the Commission does not believe that this area (apart from the special questions raised by investment companies that invest in other investment companies) presents problems that call for legislation at the present time.

B. MUTUAL FUND HOLDING COMPANIES

1. Introduction

One of the most striking developments in the investment company industry in recent years has been the emergence of the "fund holding company," a mutual fund whose portfolio consists wholly or largely of stock issued by other investment companies. While the basic concept of one investment company superimposed on other investment companies—a "fund on funds"—is not a novel one, the form such holding companies have taken and their emergence as an important factor in the industry is quite recent.¹⁶ It is therefore appropriate, at this early stage in the growth of fund holding companies, to examine their potential effect on investors, the investment companies in which they invest, and the securities markets.

The ownership by one investment company of the shares of other investment companies is not prohibited by the Investment Company Act." However, section 12(d)(1) of the Act prohibits a registered

¹⁶ Prior to 1940, several investment companies invested in the shares of other investment companies. This was discussed at some length in the Investment Trust Study. In every case, however, the pre-1940 investment companies that invested in other investment companies acquired only the shares of closed-end companies. Investment Trust Study, pt. 2, 414. Six of those companies were found to have invested 50 percent or more of their assets in the shares of other investment companies. Of the six, five were themselves closed-end. Investment Trust Study, pt. 2, 654 and 655. The single open-end investment company organized specifically to invest in a diversified list of investment company securities was Investing Company Shares, one of several series of shares issued by Group Securities, Inc. Investment Trust Study, pt. 2, 562. Its total assets as of Dec. 31, 1940, approximated only \$80,000. In 1954, when that company's assets were less than 51 million, its investment policy and name were changed and another series was merged into it so that it is no longer a fund holding company.

These fund holding companies should be distinguished from the typical registered unit trust for the accumulation of shares of a specific registered investment company, which is, in form, a fund on a fund. See P. 38, *supra*.

¹⁷ Indeed, see. 5(b)(1) of the Act defines a "diversified company" as including a company which may have at least 75 percent of its total assets in, among other things, "securities of other investment companies."

investment company from purchasing more than five percent of the total outstanding voting stock of any other investment company which concentrates its investments in a particular industry or group of industries or more than three percent of the total outstanding voting stock of any other type of investment company.

Section 12(d)(1) applies only to the purchase by a registered investment company of the stock of another investment company—it does not apply to purchases by an unregistered investment company of the stock of registered investment companies.¹⁸ Nor does the section apply to the sale by a registered investment company of its stock to another investment company regardless of whether registered or not. Thus, a fund holding company organized under the laws of a foreign country and not subject to registration under the Act because it does not use the mails or instrumentalities of interstate commerce in the sale of its securities,¹⁹ is free to acquire the stock of registered investment companies without regard to the percentage limitations of section 12(d)(1).

There are several foreign based fund holding companies now in operation. By far the largest is the Fund of Funds, Ltd. ("FOF"), an unregistered open-end investment company incorporated in Ontario, Canada, and located in Geneva, Switzerland.²⁰ FOF is sponsored by I.O.S., Ltd. (S.A.) ("IOS"), a Panamanian corporation headquartered in Geneva, Switzerland.²¹

The portfolio of FOF consists primarily of stock issued by registered domestic mutual funds and, to a lesser extent, of stock of mutual fund management and sales companies. It is managed by a wholly owned subsidiary of IOS and IOS itself acts as the distributor of FOF throughout the world.

This fund holding company has grown rapidly since 1962 when it was first offered to the public, allegedly only outside of the United States. As of June 30, 1966, the net assets of FOF were stated to be

¹⁸ Sec. 12(d)(1), of course, applies to illegally operating unregistered investment companies which are required to be registered under the Act.

¹⁹ Sec. 7(d) of the Act prohibits the offeror sale of interests in an investment company organized under the laws of a foreign country, by use of the mails or any means or instrumentality of interstate commerce. However, the Commission has discretionary authority to permit a foreign investment company to register under the Act.

²⁰ In addition to FOF, other foreign based unregistered fund holding companies known to exist include among others the following:

Unregistered foreign based fund holding company: Adviser:

- | | |
|--|--|
| 1. Capital Growth Fund, Bahamas. | New Providence Securities Ltd, Bahamas. |
| 2. Capital Security Fund, Bahamas. | New Providence Securities Ltd, Bahamas. |
| 3. North American Investment Fund
N.Y., Netherlands Antilles. | North American Fund Management Corp.,
Panama. |
| 4. Selected American Funds Enterprise,
Luxembourg | Selected American Funds Enterprise Management Corp., Limited, Liechtenstein. |

²¹ At the time of its incorporation in 1960 IOS registered with the Commission as a broker-dealer in compliance with sec. 15(b) of the Securities Exchange Act of 1932. Its business was then principally that of an overseas distributor of shares of registered investment companies.

On February 3 1966 the Commission directed the commencement of public administrative proceedings to determine whether to revoke or suspend IOS's broker-dealer registration. The order, file No. 3497, states that the staff alleges, *inter alia*, that IOS has used the mails and instrumentalities of interstate commerce in the offer and sale of interests in FOF. These proceedings are pending. Prior to the commencement of proceedings by the Commission, IOS brought an action in the United States District Court for the District of Puerto Rico, *Pontaine and IOS v. S.E.C.*, Civ. No. 525-65, for an injunction restraining the commencement of the proceedings on the ground that the Commission does not have jurisdiction under the Exchange Act to conduct such proceedings, and for a declaratory judgment that IOS could withdraw its registration without prejudice or the imposition of terms and conditions by the Commission. On Oct. 3 1966, the District Court denied IOS's motion for a preliminary injunction and granted the Commission's motion for summary judgment and dismissed the complaint. IOS has filed a notice of appeal.

in excess of \$420 million.²² Table VIII-1 lists, as of June 30, 1966, the total net assets of each registered investment company in the FOF portfolio, the market value of each such POF investment, the percentage owned by FOF of the outstanding stock of each such registered investment company, and the percent that each such holding is of FOF's total claimed portfolio.

TABLE VIII-1.—*Investment company holdings of the Fund of Funds, Ltd., as of June 30, 1966*

Percent of FOF portfolio	Investment company	Total net assets (millions)	Market value of FOF holding (millions)	Percent owned by FOF
9.4	The Alger Fund, Inc.	\$39.6	\$39.6	100.0
5.4	American Investors Fund, Inc.	68.6	22.7	33.1
2.3	Chemical Fund, Inc.	437.3	9.6	2.2
2.2	Convertible Securities & Growth Stock Fund, Inc.	22.9	9.2	40.2
3.3	Delaware Fund, Inc.	298.6	13.7	4.6
3.5	The Douglas Fund, Inc.	14.6	14.6	100.0
2.2	The Dreyfus Fund, Inc.	1,539.8	9.2	.6
7.3	Fidelity Capital Fund, Inc.	403.0	30.7	7.6
7.8	Fidelity Trend Fund, Inc.	954.4	32.9	3.4
3.3	Financial Institution: Growth Fund, Inc.	14.0	14.0	100.0
4.5	Fund of America, Inc.	41.5	19.0	45.8
1.4	Keystone Low-Priced Bond Fund (series B-3)	59.3	6.0	10.1
4.7	Keystone Growth Fund (series K-2)	215.8	19.7	9.0
4.7	Keystone Growth Common Stock Fund (series S-3)	153.7	19.8	12.9
5.1	Keystone Lower Priced Common Stock Fund (series S-4)	276.7	21.5	7.8
4.4	Manhattan Fund, Inc.	428.5	15.6	4.3
1.8	Oppenheimer Fund, Inc.	74.8	7.4	9.9
2.5	Research Investing Corp.	57.1	10.6	18.6
2.2	The Value Line Special Situations Fund, Inc.	31.4	9.4	29.9
8.8	The York Fund, Inc.	37.1	37.1	100.0
	Total		365.3	

Table VIII-2 lists, with respect to each mutual fund management company whose stock was owned by FOF on June 30, 1966, the total shares of each such company's outstanding stock, the market value of FOF's holdings, the percentage owned by FOF of the total outstanding stock of each such company, the aggregate investment company assets managed by each such company, and the percentage of FOF's portfolio represented by such investment.

²² Its stated assets consisted of the following (in millions):

Shares of registered investment companies	\$365.3
Stock of mutual fund management companies	19.4
Cash and receivables	35.4
Total net assets claimed	420.1

TABLE VIII-2. — Mutual fund management company holdings of the Fund of Funds, Ltd., as of June 30, 1966

Aggregate investment company assets managed (millions)	Percent of FOF portfolio	Management company	Total shares of management company stock outstanding	Market value of FOF holdings (millions)	Percent of outstanding stock owned by FOF ^a
\$6,192.5	0.5	Alleghany Corp.-----	^b 6,735,826	\$1.9	2.6
1,581.1	.7	Anchor Corp., class B.-----	^c 852,745	2.8	14.6
1,539.8	1.1	The Dreyfus Corp.-----	^d 2,580,000	4.7	10.2
1,061.0	.3	Insurance Securities Inc.-----	^e 10,655,400	1.5	1.7
1,162.0	.5	Keystone Custodian Funds, Inc., class A	^f 1,056,615	2.0	8.3
167.2	.1	Lexington Research & Management Corp., class A-----	^g 347,800	.5	18.8
2,239.8	.7	Waddell & Reed, Inc., class A-----	"933,103	3.1	11.7
	.1	Waddell & Reed, Inc., class A-option (35,000 shares)-----	^h 888,000	2.9	11.4
2,050.4	.7	Wellington Management Co., class A-----			
		Total-----		19.4	

^a On the assumption that the outstanding stock as of the dates indicated in notes *b* to *h* below did not vary between such dates and June 30, 1966. All management company stock owned by FOF, with the exception of stock of Alleghany Corp., Insurance Securities, Inc., and The Dreyfus Corp., is nonvoting.

^b Alleghany Corp. is the controlling stockholder of Investors Diversified Services, Inc., investment adviser to and distributor of 4 registered mutual funds with combined assets in excess of \$5,000,000,000, 2 face-amount certificate companies with combined assets in excess of \$1,000,000,000 and a unit trust with about \$5,700,000 in assets.

^c As of Nov. 30, 1965. In addition there were 3,999,000 shares of class A voting shares and 537,500 shares of nonvoting class C outstanding.

^d As of Dec. 31, 1965.

^e As of June 30, 1965.

^f As of Dec. 31, 1965. In addition there were 32,514 shares of class B voting shares outstanding.

^g As of Dec. 31, 1965. In addition there were 33,000 shares of class B voting shares outstanding.

^h As of Aug. 31, 1968. In addition there were 11,390 shares of class B voting shares outstanding.

ⁱ On July 29, 1966, FOF exercised its option to purchase the 35,000 shares of Waddell & Reed class A.

^j As of Oct. 31, 1965. In addition there were 10,000 shares of class B voting shares outstanding.

In addition to permitting a foreign based unregistered fund on funds to acquire unlimited holdings of the stock of registered investment companies, section 12(d)(1) of the Act also permits registered investment companies to acquire, within the three percent and five percent limitations, portfolios consisting entirely of stock issued by other registered investment companies. At the present time, two fund holding companies, First American Fund of Funds, Inc.²² and Pooled Funds, Inc., have actually registered under the Act.²³

The recent emergence of fund holding companies raises the question whether the public interest is adequately protected so long as such companies are free to acquire large blocks of stock of registered investment companies. In addition, fund holding companies present other problems of serious regulatory concern to the Commission, including the broad questions of the utility of a fund on funds as an investment vehicle and the justification of the duplicative costs inherent in its operation. This section considers whether the provisions of section 12(d)(1) are adequate to deal with the several problems of fund holding companies as they have evolved.

2. Control of portfolio companies

The Investment Trust Study described fund holding companies as a device for pyramiding control in the hands " * * * of an individual

²² This company is not connected in any way with I.O.S., Ltd. (S.A.) or The Fund of Funds, Ltd. In July 1966, these companies commenced an action against First American Fund of Funds in the New York State Supreme Court to restrain the use of its name.

²³ Both have also filed registration statements under the Securities Act of 1933 for the sale of their securities but neither registration statement has yet been declared effective.

or group of individuals whose financial stake in all of the constituent companies of the group is comparatively nominal.”²⁴ The Act itself declares that “the national public interest and the interest of investors are adversely affected” when investment companies are organized and operated “* * * in the interest of other investment companies * * * rather than in the interest of all classes of such companies’ securities holders,”²⁵ or when “control of investment companies is unduly concentrated through pyramiding or inequitable methods of control * * *”²⁶ The three percent and five percent limitations of section 12(d)(1) were intended to guard against such abuses.²⁷ However, fund holding companies—even registered domestic companies against which the statutory limitations are operative—pose a real potential for the exercise of undue influence or control over the activities of portfolio funds. The basis of this threat is the possibility of large-scale redemptions inherent in the ownership of large blocks of mutual fund shares by a fund holding company. Although the problem of control over portfolio companies is to some extent present whenever large institutional investors acquire ownership of the equity securities of public companies, in the case of fund holding companies this problem is compounded and made more acute for a number of reasons.

An unregistered foreign based fund holding company, free of any statutory limitation on the percentage of the outstanding stock of mutual funds which it may purchase for its portfolio, can acquire very substantial or even controlling interests in its portfolio funds. In the case of FOF, for example, by June 30, 1966, it had acquired in excess of 25 percent²⁸ of the outstanding stock of four registered investment companies.²⁹ The managements of portfolio funds in such circumstances must be continually aware that a possible large redemption carries with it a loss of advisory fees in approximate proportion to the percentage of the fund redeemed. Thus, assuming an advisory fee based on a flat percentage of net assets, redemption by a fund holding company of 20 percent of the stock of a registered mutual fund means a 20 percent reduction in the adviser’s fee. Further, to the extent that managements of the portfolio funds derive income from brokerage

²⁴ Investment Trust Study, pt. 3, 2734. See also Senate Hearings 180.

²⁵ Sec. 1(b)(2).

²⁶ Sec. 1(b)(4).

²⁷ In the original version of the bill, sec. 12(c)(1) (now sec. 12(d)(1)), would have flatly prohibited any purchase by any registered investment company of the securities of any other investment company. S. 3580, 76th Cong., 3d sess., sec. 12(c)(1) (1940). In relaxing the prohibition to permit such purchases within the percentage limitations provided by sec. 12(d)(1), Congress did not have before it the problems presented by a number of large open-end investment companies whose portfolios consist essentially of stock of registered investment companies. As previously noted, the investment company holding companies found to exist in 1940 were basically not of this nature. There was also some concern that a registered investment company should not be precluded from availing itself of a good investment opportunity just because the prospective investment would have involved shares of another investment company and that it might be advantageous for one investment company, desiring to invest in the stock of issuers in a particular industry, to purchase the stock of an investment company whose portfolio is concentrated in that industry. See House Hearings 112-113.

²⁸ Pursuant to the statutory definition of “control” in 2(a)(9) of the Act, ownership of 25 percent or more of the voting securities of a company is deemed presumptive control.

²⁹ The registered investment companies and the percent of FOF’s interest in each are—

	Percent
American Investors Fund, Inc. -----	33.1
Convertible Securities & Growth Stock Fund, Inc. -----	41.8
Fund of America, Inc. -----	45.8
The Value Line Special Situations Fund, Inc. -----	29.9

^a It is to be noted that IOS itself owns in excess of 80 percent of the outstanding stock of Investors Planning Corp. of America, Inc., of which Fund of America Management Corp., the adviser to Fund of America, Inc., is a wholly owned subsidiary.

As table VIII-1 at p. 313, supra, indicates, IOS has also created four wholly owned investment companies. These “captive” companies—The Alger Fund, Inc., The Douglas Fund, Inc., Financial Institutions Growth Fund, Inc., and The York Fund, Inc.—were registered with the Commission under the Act as of June 30, 1966.

transactions for their funds, redemption and the corresponding reduction in net assets would also decrease the opportunity to realize such income in the future.

A registered domestic fund holding company is, of course, subject to the three and five percent limitations of the Act. However, even under these limitations a single management group could attempt to organize several related fund holding companies. If each held three percent of the outstanding voting securities of the same registered mutual fund, the management of that portfolio fund, aware of the possibility of simultaneous liquidation, might find itself in a difficult position. Moreover, if a single registered fund holding company acquired the maximum allowed by the Act of the outstanding stock of several funds in a single management complex, that management, if faced with a substantial loss of aggregate advisory fees by threatened redemption of all such holdings by the fund on funds, could no doubt be subjected to substantial pressures. In such a situation, the impact of the fund holding company would not necessarily be limited to the registered funds in the complex whose stock it had acquired—it could extend to even those funds in the complex in which it owned no stock at all.

This potential for control, basic to the fund holding company structure, carries with it obvious dangers to investors in registered investment companies. The management of a fund holding company may, by threat of redemption, induce deviations from the investment program or policy of registered companies subject to its influence. Should such influence be exercised, and to the extent it is so exercised, the management of the portfolio companies concerned would pass to persons other than those chosen by the stockholders to perform that function.

In addition to the potential for the exercise of influence or control inherent in a fund holding company, the redemption threat may also disrupt the orderly management of the portfolio funds themselves. Section 22(e) of the Act generally requires that, upon demand for redemption, a mutual fund make payment for its shares within seven days except in certain extraordinary situations. Consequently, in anticipation of large redemptions, management of a fund might be required to maintain excessive cash balances or to redeem in kind.³⁰ In a letter to the Chairman of the Commission dated June 13, 1966, the Investment Company Institute outlined its views with respect to the management problems created by large redemptions:

A mutual fund is generally able to make sound plans for inevitable redemptions, with the knowledge of its own redemption record and the fact that in the past 10 years redemptions have averaged from 4.6 percent to about 6.9 percent of assets annually for the industry. If, however, a portfolio fund must face the prospect of a large redemption by a "fund of funds" at any time, the portfolio fund either would have to keep excessive sums uninvested and in cash,

³⁰ IOS has assured managements of the FOF portfolio funds that in the event of a decision to redeem, redemption will be requested in a manner acceptable to them and over as long a period of time as they may reasonably feel to be necessary. Such assurances are, however, only informal understandings and may be contrary to the obligation IOS has to investors in FOF to promptly redeem unsatisfactory investments. Moreover, assurances of redemption over an extended period of time are not enforceable, since restrictions on the right of redemption are contrary to the provisions of sec. 22(e) which require redemption within seven days. Any waiver of redemption rights would be void under sec. 47(a) which prohibits waivers of any protection afforded by the Act.

or it would have suddenly to liquidate or distribute a portion of its assets to meet its statutory duty of prompt payment.

Retention of excessive cash balances would be inconsistent with the interest of other shareholders of the portfolio fund to have their assets as fully invested as is reasonable.

If excessive cash balances are not maintained, the portfolio fund might satisfy its obligations to redeem either by sale of portfolio securities to provide for a cash redemption or by the rather unusual procedure of redeeming in kind. In either case, the consequences to other shareholders of the portfolio fund is likely to be damaging.

If the portfolio fund sells off a substantial portion of its assets to provide cash for the redemption this not only might interfere with the ordinary management of the fund, but might also saddle other shareholders with the burden of unnecessary capital gains. Moreover, the compulsory sale of a large block of a security within the 7-day payment period not only might force the fund to take a price lower than it would receive in a more orderly disposition over a longer period, but might also depress the market value of the balance of the security held in the fund's portfolio. The potential loss to other shareholders would appear even more extreme when the market for the security is thin. In addition, since the dollar amount which the "fund-of-funds" would be entitled to receive on tender for redemption would generally be fixed at the latest at the close of business on the day following tender, and since as a practical matter the liquidation of substantial assets to provide cash will not occur before the close of business on such following day, the brokerage costs on subsequent sales of portfolio securities to meet the redemption would largely fall on the other shareholders.

Should the portfolio fund elect to redeem in kind by distributing certain securities, this might obviate the saddling of other shareholders with the burden of capital gains but would still be likely to result, to the detriment of other shareholders, in depressing the market value of the balance of the securities of the same issuer retained in the portfolio fund's portfolio.

Although all of these effects on the underlying portfolio funds and their investors are serious enough in themselves to require action, the problems arising from the threat of redemptions reach much further and may well affect the underlying securities of the portfolio funds and thus the securities markets. A foreign unregistered fund holding company, owning controlling interests in several registered funds each of which owns interests in the same underlying portfolio security, may in the aggregate possess a controlling interest in the issuer of the security. For example, a fund on funds in control of 10 registered funds each of which owns five percent of the same stock could control 50 percent of that issuer's outstanding stock. Accordingly, the leverage which may be exerted by the fund holding company extends through its portfolio companies to the companies whose shares they hold and affects not only each tier of the pyramid but the market itself.

The impact of the control threat inherent in the fund holding company situation is accentuated because the holding company may in certain circumstances have no control over the pace or amount of its redemptions. It too is required to redeem its shares upon demand and if, for reasons of lack of confidence (whether justified or not), market judgment, or otherwise, investors in the holding company demand liquidation of their interests, it might be compelled in turn to redeem its own portfolio holdings regardless of what the preferences or investment judgment of its management may be. The redemption danger is thus compounded not only by the size of the holdings of the unregistered fund on funds, but also by the open-end structure of the holding company itself.³¹

The situation is more critical where the stockholders of the fund-holding company reside outside the United States since redemptions could be unduly escalated by the instability of certain foreign economies, political upheaval, currency reform, or other factors which are not really relevant to investment in domestic mutual funds. Should such redemptions occur, it is entirely likely that they would involve several foreign based fund holding companies at once. A number of the underlying funds in the portfolio of these fund holding companies would undoubtedly be the same—and many of the underlying securities held by such portfolio funds would also be duplicated and reduplicated. Thus, any effects of redemptions which may occur would be multiplied as fund holding company operations grow and their structures become more complex. This, of course, discounts any deliberate attempt by foreign interests or particular foreign governments to undermine the confidence of the world financial community in, or the stability of, registered investment companies or the United States securities markets.

3. Layering of costs to investors

Inherent in the fund holding company structure is a layering of costs including advisory fees, administrative expenses, sales loads, and brokerage fees, all of which serve to make a fund on funds a particularly expensive investment vehicle.

(a) *Advisory fees*

All fund holding companies, whether registered or not, subject their investors to two layers of advisory fees. At the level of the registered portfolio funds, as noted in chapter III of this report the annual advisory fees charged the portfolio funds cluster around one-half of one percent of net assets. At the holding company level, advisory fees are also imposed.³²

³¹ Although under sec. 22(e)(3) the Commission can under certain conditions postpone the redemption date, such action would not affect the causal factors involved. While easing particular management problems created by large redemptions, it would not reach the basic problem posed by the existence of substantial redemption power in the fund holding company.

³² Management of one registered fund holding company, First American Fund of Funds, Inc., whose Securities Act registration statement is currently being processed by the Commission's staff, intends to charge investors a quarterly fee of one-eighth of one percent of net assets (one-half of one percent per annum). This quarterly advisory fee will be paid only if the performance of the fund during the particular quarter exceeds the performance of the Dow-Jones Industrial Average by a specified percentage. Management of the second registered fund holding company whose Securities Act registration statement is now being processed by the Commission's staff, Pooled Funds, Inc., proposed to charge investors a monthly advisory fee equal to the difference between one-sixteenth of one percent (three-fourths of one percent on an annual basis) of the company's net assets and the weighted average of the advisory fees paid by its own portfolio funds. In the case of FOF, the IOS subsidiary set up as adviser to FOF charges the monthly equivalent of an annual fee of one-half of one percent of average net assets.

Thus, an investor who commits his money to a fund on funds must not only bear his share of the advisory fees paid by each of the portfolio funds, he must also bear his share of the advisory fee paid by the holding company to its adviser.

(b) Two layers of administrative expenses

In addition to two advisory fees, investors in fund holding companies are also subjected to a layering of administrative expenses including stock transfer, dividend disbursements and custodial fees and the cost of shareholder communications. Although it is difficult to assess the extent to which such expenses will affect the operating costs of registered fund holding companies not yet in operation, the experience of the unregistered FOF suggests that they will not be lower than those of the portfolio funds. As stated in the current FOF prospectus, the ratio of "aggregate expenses to the average market value of the Fund's net assets (expense ratio) was .62 of one percent for the year ended December 31, 1965." This expense ratio, based upon a portfolio which grew from \$111 million at the start of 1965 to \$317 million on December 31, 1965, is about on par with industry averages.³³

Accordingly, to the extent that the experience of FOP is indicative of the costs of operating a fund holding company, registered domestic holding companies may be expected to have substantially equivalent, if not higher, expense ratios. And, just as in the case of the layered advisory fee, because these expenses are over and above administrative expenses of the portfolio funds, an investor in a fund on funds incurs more expenses than he would incur simply by investing directly in any one, some, or all of its portfolio funds.

(c) A sales load on a sales load

All investors in load funds—including fund holding companies—must pay a sales charge which, depending upon the size of the investment, ranges from 1 percent to 8½ percent of the public offering price.³⁴ Investors in a holding company are in turn subjected to a second layer of sales charges on their purchases of shares of the holding company.³⁵ The investor is subjected to the dual sales load only where both the fund holding company and its portfolio investment companies are open-end, load funds.³⁶

In the fund holding company situation, the sales loads paid by the holding company in acquiring its portfolio are, basically, brokerage costs. If viewed in this light, the problem of layered sales loads does not, of course, exist. This does not, however, cure the problem of duplicative portfolio acquisition expenses, for the total of such ex-

³³ See table III-3 at p. 98, supra.

³⁴ Pooled Funds, Inc., for example, represents that the sales charges it anticipates paying on portfolio purchases may be as much as 6 percent. FOF represents that on its portfolio purchases it generally pays a sales load of no more than 1 percent.

³⁵ Pooled Funds Inc., is however, intended to operate as a no-load fund.

In the case of the unregistered FOF, investors can acquire an interest in FOF only by participating in the IOS investment program. Participations in the program, available on a fully paid or periodic payment basis, in amounts less than \$10,000, are subject to an 8½ percent sales load which, in the case of periodic purchases, is front-end loaded. The sales load incurred on the purchase of portfolio funds, represented to be generally no more than one percent, is paid by FOF on all acquisitions of mutual fund shares for its portfolio, including stock issued by its wholly owned captive companies. IOS acts as the dealer of record for FOF's purchases of mutual fund shares and receives back the dealer's share of the one percent sales load incurred by FOF in such transactions (generally eight-tenths of the one percent). Thus each \$100 investment in FOF under \$10,000 is subject to a total sales load of \$9.42 of which IOS retains \$9.23. (The \$9.42 total sales load represents a 10.4 percent sales charge on the amount put to work for the investor). See ch. V, pp. 9-10. If registered under the Act, FOF would be expressly prohibited by sec. 27(a) from selling its periodic payment plan certificates at such a sales load and such a load might also be deemed grossly excessive or unreasonable under secs. 22(b) and 22(c) of the Act.

³⁶ As previously noted, the nature of the investment company holding companies found and examined by the Commission in the Investment Trust Study did not raise this problem.

penses includes not only the sales load (i.e., brokerage) paid by the holding company but also the cost of customary and normal brokerage commissions incurred by the portfolio funds themselves in the purchase and sale of their portfolio securities.

Thus, whether the label is brokerage or sales load, it is clear that these layered costs of a fund holding company are significantly higher than the costs of an ordinary mutual fund company which is itself substantially higher than the cost of direct investment in securities.

4. *The utility of the fund holding company as an investment vehicle*

Whether additional costs of investing in mutual funds through a fund holding company can be justified depends essentially upon whether such a vehicle offers the investor any special benefits not otherwise available. It is claimed that the fund holding company provides investors with necessary diversification, and that it serves a management function in choosing the most suitable funds and providing the facility to switch investments at sales charges lower than those that would be payable by the individual investor.

(a) Diversification of investment

The added value of diversification offered by a fund on funds is largely illusory. A mutual fund itself offers diversification in spreading its investments over a number of companies in different industries. A fund management will generally select the industries which it believes will perform best in the future and the best performing companies in those industries. Some funds invest in 30 or 40 companies, others in many more. Thus, the diversification afforded by an ordinary mutual fund substantially reduces the risk of putting one's money in the one, two, or five stocks which an individual investor may buy.

What does a fund on funds add to this diversification? Theoretically the risk is spread further since all the investor's "eggs" are not in the one "basket"—one fund. Practically, however, diversification upon diversification does not result in greater safety in proportion to the number of layers imposed on the original investment. Moreover, to the extent that greater diversification may be sought by spreading a single investment among several portfolio funds, the likelihood increases that the management of one portfolio fund will be buying for its portfolio the same securities the management of another will be selling, thereby subjecting the holding company's overall assets to brokerage fees for what are, in effect, wash transactions which achieve no investment purpose.

A fund holding company vehicle so duplicates and reduplicates the diversification achieved by the investment in a single fund that the expenses incurred defeat the investor's objective. Presumably a fund holding company investing in other fund holding companies (a fund on funds on funds), would provide even greater diversification, but the costs would obviously be out of proportion to whatever benefits the greater diversification may achieve. The comment in the Investment Trust Study in this regard is still, today, very much in point:

To argue that diversification of investments is effected through the medium of the subsidiary is merely to question the necessity for the holding company.³⁷

³⁷ Investment Trust Study, pt. 3, 2730.

(b) *An informed choice*

It is also argued that the fund holding company is a desirable investment vehicle because the proliferation of mutual funds, with varying records of performance, makes it difficult for the investor to choose the best performing funds. While this proposition would perhaps at first appear plausible, closer analysis indicates the contrary.

A mutual fund investment offers professional management of a diversified portfolio. Once an investor elects this method of investing, he must, of course, make an investment decision in which he selects a professional investment manager (i.e., a specific mutual fund). It is the investor alone who must make this investment decision. If it is true that "professionals" are needed to choose among a group of professionally managed mutual funds, it is equally true that professionals will be needed to in turn choose the professionals. If funds on funds are permitted to proliferate, how would an investor decide among the many such companies seeking his investment dollar? Would he not need *a fund on funds on funds* to make this decision?

Furthermore, although management of the fund holding company is charged with selecting the best performing funds for acquisition (only a limited number of such funds can qualify), the opportunities for investment must shrink in proportion to the growth of the top fund. Once the "best" funds are selected, only ("secondbest" remain. Particularly is this so in the case of a fund holding company subject to the three-percent and five-percent limitations of section 12(d)(1) of the Act which, after choosing the "right" funds for investment, is sharply limited in the amounts it may invest in such funds. Thus, the concept of a fund holding company intended to select the better performing registered mutual funds for investment appears to be self-defeating. Assuming the management of the fund on funds to be capable of making such informed investments, continued growth will require the holding company to find new outlets for its investment capital or to invest in lesser performing portfolio funds.³⁸

Moreover, to the extent that the managers of a fund on funds exercise review and supervision over the professional management of their portfolio companies by redemption and new investment, they may seriously disrupt the operations of the registered portfolio funds. Finally, it is not at all clear that investors in a fund on funds profit from any more "informed choice" than is offered by management of an ordinary investment company. In order to reach a sound investment decision, management of a fund on funds must itself make much of the very same analysis and study of underlying securities necessary to operate any mutual fund and to this extent could operate their fund not as a holding company but rather as an ordinary mutual fund. Duplication of fees and expenses under such circumstances, in the absence of any clear benefits, can hardly be justified.³⁹

³⁸ As already noted, by June 30, 1966 FOF had invested in four wholly-owned investment companies organized by IOS for investment by FOF. The four companies had combined assets of reportedly more than \$105.3 million as of June 30, 1966. Three of the four have investment advisers which are wholly-owned subsidiaries of IOS. The fourth company's adviser is a 50-percent owned IOS subsidiary. These four companies were specifically created to serve as investment vehicles for FOF in lieu of making their portfolio management functions a direct part of the overall FOF organization. In effect, however, they are only separate compartments of their parent fund holding company. This structure not only enables the FOF investment structure itself to remain consistent with the concept of a fund holding company, it also enables IOS to benefit directly from the layered advisory fees and sales loads charged to the top and bottom funds.

³⁹ Particularly is this so in the case of a fund holding company with captive companies whose portfolios could easily be collapsed into the portfolio of the holding company itself.

(c) Avoidance of restrictive investment policies

The ease by which a fund holding company can circumvent investment restrictions, through its portfolio funds which themselves do not have such restrictions, is clear. As the Investment Trust Study stated:

The investment in the securities of other investment companies also provides a means by which managements of investment companies with restricted investment policies may avoid such restrictions.⁴⁰

The unregistered FOP demonstrates the facility with which this can be accomplished. Under the caption "Investment Restrictions," the current FOF prospectus states that "the Fund may not borrow money, purchase any securities on margin, or sell securities short." Nevertheless, certain of the captive funds created by IOS, whose stock is wholly owned by FOF, engage in such activities on an extensive basis.

5. Conclusions and recommendations

While the concept of a fund holding company as an investment vehicle is not new, no large-scale activity occurred in the area of fund holding companies until 1962. The growing operations of FOF and other similar funds have focused attention on the fund holding company as an investment vehicle and the absence in section 12(d)(1) of satisfactory protections against fund holding companies, both domestic and foreign.

The recent growth of such companies has, up to this point at least, been confined to foreign situations. Although several proposals seeking their establishment in the United States have been made, only two fund holding companies have registered as investment companies under the Act. Neither of these companies has as yet sold its securities to the public. Thus, if the regulatory gap is filled now, before further harm is done, there will be no significant disruption of established business relationships.

It is clear that the statute fails to take adequate account of the interests of investors in the domestic fund holding company situation. The three and five percent limitations of section 12(d)(1) permit the operation of a registered fund holding company, the portfolio of which consists entirely of the stock of other investment companies, so long as the percentage limitations are observed. While it may seem desirable, within the statutory limitations, not to deprive investors in a registered investment company of an investment opportunity simply because it involves acquisition by their company of an interest in another investment company, the organization and operation of a registered fund holding company whose primary purpose is the acquisition of shares of other registered investment companies, even within the percentage limitations presently permitted by section 12(d)(1), raises issues of substantial concern. The compounded sales load, advisory fees and other duplicated costs inherent in the structure of such a fund holding company cannot be justified. Further, it is doubtful whether a fund holding company serves any really useful function for the investor.

⁴⁰ Investment Trust Study, pt. 3, 2726.

With respect to foreign based, unregistered fund holding companies, where, if anything, the problems are sharper and the potential dangers far greater, the Act does not provide even minimal protections. Foreign entities, not registered under the Act, are now free to acquire controlling interests in registered investment companies and, in the case of FOF, this has already occurred in several instances. The control of large blocks of stock of portfolio funds by unregistered foreign fund holding companies and the absence of restrictions against influencing the policies and operations of portfolio funds or intensifying reciprocal business pressures on such funds by these fund holding companies, present a situation of vital concern and potential danger to American investors and our securities markets.

A further aspect of this concern is the fact that anonymity is basic to the successful operation of such foreign companies. The foreign based fund on fund is another device available to those investors who seek to hide their identities.⁴¹ In addition, the anonymity available to a fund on fund operation which can easily be structured through entities organized or resident in jurisdictions with conveniently strict secrecy laws, may mask the control of registered investment companies. At present, not only may large blocks of fund shares be controlled by foreign, unregistered fund holding companies, the control of such holding companies themselves may be easily concealed.⁴²

The BOB experience indicates that foreign based funds on funds will continue to exist and grow. Such funds will, through affiliated entities (which may be foreign or domestic broker-dealers) continue to purchase (and redeem), on a regular and continuous basis, substantial blocks of shares of registered mutual funds. In view of the excessive costs to investors resulting from the layering of advisory fees, sales loads and other charges; the lack of utility and useful investment purpose of the fund holding company as an investment vehicle; and the very serious problems of control and influence over registered investment companies, their portfolio companies and the securities markets, which the redemption power in such companies creates, appropriate statutory protection must be provided.

The Commission therefore recommends that section 12(d)(1) of the Act be amended so as to prevent the creation and operation of fund holding companies.⁴³

⁴¹ The current FOF prospectus assures investors, in italicized type, "[T]he names and addresses of all investors are held in strictest confidence at all times."

⁴² As a consequence, for example, the problems involved in directed reciprocity and influence are aggravated where such factors have a foreign origin which makes discovery and tracing very difficult, if not impossible. Thus, where reciprocity is directed to a person or entity in a foreign country with strict secrecy laws it would be difficult to ascertain the reasons and nature of such reciprocity without the cooperation of the foreign entity. Regulation can be further obstructed by the use of not one, but multiple, foreign jurisdictions with strict "secrecy" laws.

⁴³ One unique type of foreign based unregistered fund holding company presents none of the problems discussed above and should not necessarily be prohibited. The sponsors of several registered mutual funds have organized foreign unregistered unit trusts for the accumulation of shares of such funds in order to provide foreign investors with a vehicle for the purchase of such funds without any U.S. estate tax problem. See Internal Revenue Code of 1954 sec. 2104(a).

For example, the Dreyfus Corp. has organized Dreyfus Fund International, Ltd. A wholly-owned subsidiary of The Dreyfus Corp., The Dreyfus Corp. of Canada, Ltd., sponsors Dreyfus International Investment Programs for the accumulation of shares of Dreyfus Fund International, Ltd. Dreyfus Fund International is a Bahamian corporation, all the assets of which are invested in shares of Dreyfus Fund. Dreyfus International investment programs are offered only to nonresidents of the United States who are not United States citizens. From an investment standpoint such persons have essentially the same investment and pay essentially the same charges as they would pay if they were buying directly, Dreyfus investment programs for the accumulation of shares of Dreyfus Fund. However, because their interest is in Dreyfus Fund International, a non-United States corporation, it is not subject to United States estate tax. Although the structure of such foreign unit trusts is nothing more than a fund on a fund, they present no threat of control because both are organized, operated by, and under the control of, the same management. Accordingly, to the extent that such trusts do not involve a significant layering of costs and do serve to attract foreign investment in the underlying funds, the reasons which require prohibition of fund holding companies generally are not applicable here.

The recommended statutory prohibition should be applicable regardless of whether the fund holding company acquires stock of an open-end or of a closed-end company. Although the acquisition of the stock of closed-end companies does not pose the same problem of control through the right of redemption, the power to vote a significant block of stock of a closed-end company may represent potential for exercise of control. Furthermore, a fund whose portfolio consists of closed-end registered funds involves many of the same duplicative costs to investors with little useful value provided in return.⁴⁴

By precluding the operation of both domestic registered and foreign based unregistered investment company holding companies, whose portfolios consist of shares of registered investment companies, the recommended amendment would protect investors from an investment vehicle which offers no benefits that justify its duplication of fees and charges. The recommendation would also protect registered investment companies and their investors, and the securities markets themselves, from the control and problems inherent in fund holding companies.

⁴⁴ It is argued that an open-end fund holding company designed to invest only in closed-end investment companies would serve a useful investment function in that such a holding company would provide investors with a vehicle for acquisition of interests in closed end companies whose shares sell at significant discounts from net asset value. However, the opportunity to buy at a discount is balanced by the fact that sales by such a holding company of its stock in the closed-end companies might also very well have to be made at the same, or even a greater, discount.