buyers and sales representatives is probably a reflection of the basic method of retailing such plans—personal calls on prospective clients in their homes or places of business.

The heavy incidence of visits to clients' homes or places of business is evident in table V-2. While about four-fifths of the meetings with contractual plan purchasers occurred in this setting, the similar proportion was about three-fifths for regular accounts. The more striking difference, however, is indicated in the fact that well over one-quarter of regular account respondents (but little more than 5 percent of contractual plan buyers) reported that the meetings took place in the sales representative's office. The majority of the latter meetings were undoubtedly in the offices of traditional broker-dealer firms.

APPENDIX XI-A: TABLE V-2.—*Meetings with sales representatives*

[Percentage distribution

Aspect of meeting	Regular		Contractual	
	Interview	Mail	Interview	Mail
Met with sales representative:				
Yes	75	82	97	94
No	25	18	3	6
Total	100	100	100	100
Place of meetings:				
Respondent's home	48	50	63	62
Respondent's office or place of business	16	13	25	18
Sales representative's office	28	30	5	12
Some other place	8	7	5	3
No answer	0	0	2	5
Total	100	100	100	100
Number of meetings:				
1	25	20	26	8
2	22	23	28	24
3	17	23	25	24
4	5	6	11	28
5	1	2	4	5
6	4	0	2	4
7	2	0	1	0
8 or more	2	1	1	0
No answer or no meetings	22	26	2	7
Total	100	100	100	100
Time spent during all meetings (hours):				
0 up to ½	10	8	2	0
½ up to 1	18	12	7	2
1 up to 2	23	24	17	18
2 up to 3	17	22	20	22
3 up to 4	12	15	22	16
4 up to 6	7	10	18	27
6 up to 8	3	6	5	9
8 up to 10	4	0	3	6
10 and over	6	3	3	0
No answer	0	0	3	0
Total	100	100	100	100

For those who met directly with sales representatives, the median number of meetings for each type of purchase was approximately the same—three times. While the median time spent in these meetings by regular purchasers was between 1 and 2 hours, that for purchasers of contractual plans was between 3 and 4 hours. This relatively longer time which contractual plan buyers spent with the sales representatives may reflect a number of considerations: (1) the greater complexity of the contractual plan instrument, (2) the greater role of the salesman in initiating the purchase of shares in the case of contractual plans, (3) the greater sales incentive provided by the sales commission, (4) a possibly larger relative financial commitment, and (5) the somewhat lesser experience and knowledge of financial matters.

A further indication of differences in sales techniques employed by traditional broker-dealer firms and mutual fund specialists is provided when replies by regular account purchasers are regrouped according to the type of dealer through which the transaction was handled. The results are shown in table V-3.

APPENDIX XI-A: TABLE V-3.—*Classification of regular account purchases by type of dealer*

[Percentage distribution]

Meetings with sales representative	Classification by type of dealer: Member firm, stock exchange: Member NYSE	Member other exchange	Member NASD (Except exchange members)	Mutual fund specialist	Mail transactions	Not classified
1 or more meetings with sales representative:						
Yes	65	100	71	78	11	57
No	29	0	29	20	2	26
No answer	6	0	0	2	87	17
Total	100	100	100	100	100	100
Place of meetings:						
Respondent's home	32	41	33	65	75	52
Respondent's office or place of business	5	17	20	10	0	23
Sales representative's office	46	25	40	20	25	19
Some other place	16	17	7	5		6
Total	100	100	100	100	100	100
Time spent in meetings (hours):						
0 up to ½	19	9	21	2	0	
½ up to 1	24	37	0	13	50	
1 up to 2	19	18	15	31	0	
2 up to 3	20	9	43	13	0	
3 up to 4	4	18	7	13	0	
4 up to 6	6	0	7	10	0	
6 up to 8	0	9	7	4	50	
8 up to 10	4	0	0	4	0	
Over 10	4	0	0	10	0	
Total	100	100	100	100	100	

One inference which can be drawn from data classified by type of dealer is that sales representatives working through firms specializing in mutual funds seem to make the greatest selling effort. They typically had direct contact with a larger percentage of their clients than did representatives of firms engaged in a general securities business. They spent considerably more time with prospective clients; they spent between 2 and 3 hours, in contrast to between 1 and 2 hours for representatives of member firms of organized exchanges. Finally, the home-oriented selling techniques typically followed by mutual fund specialists are clearly evident. Among respondents who dealt with representatives of mutual fund specialists, the proportion reporting that meetings took place at their homes was twice that for purchasers who acquired shares through NYSE member firms or NASD members. If respondents' offices or places of business are included, the greater reliance of mutual fund specialists on salesmen who travel among potential clients is even more marked. Furthermore, while almost one-half of the transactions through NYSE member firms occurred in the sales representative's office, the corresponding figure was one-fifth for mutual fund specialists.

D. Respondents who did not meet with sales representatives

About one-fifth of regular account buyers who bought through dealers and who responded in the personal interview reported they did not meet with a sales representative before or during the time they purchased mutual fund shares. An analysis was undertaken to determine whether this group differed appreciably from other regular account purchasers with respect to several aspects of the sales process. The results are shown in table V-4.

On balance, a fairly large proportion of those regular account investors who did not meet with a sales representative during the transaction included in this survey seem to have had previous contact with the salesman. These investors initiated a much larger proportion of the transactions; and in deciding to purchase the particular fund, they relied on their own independent appraisal to a greater degree than regular account investors as a group. The sales representative played a far weaker role in initiating the purchase, and his influence on the decision in favor of a particular fund was less. A relatively larger proportion of the no-meeting respondents than of those who met with sales representatives transmitted their orders through NYSE member firms, although about the same proportion originated with mutual fund specialists. The percentage of no-meeting respondents who reported they did not receive the prospectus of the fund they bought was about twice that for all regular account buyers. Half of those who did not receive the prospectus dealt with NYSE member firms.

APPENDIX XI–A: TABLE V–4.—*Comparison of all regular account respondents and those who did not meet with sales representative*

[Percentage distribution]

Type of information	All regular respondents	Respondents who did not meet with sales representative
Initiator of purchase:		
Respondent	50	66
Sales representative	30	14
Friend or relative	14	20
Some other person	6	0
Total	100	100
Most important influence on decision to purchase particular fund:		
Respondent's independent appraisal	30	41
Sales representative	34	29
Friend or relative	22	18
Advertising or sales literature	5	2
Business adviser	3	2
Other influence	5	6
No answer	1	2
Total	100	100
Dealer classification:		
Member firm, New York Stock Exchange	32	43
Member, firm, other exchange	5	0
Member, NASD (excluding exchange members)	7	9
Mutual fund specialist	23	21
Mail transaction	13	2
Not classified	20	25
Total	100	100
Receipt of prospectus:		
Yes	76	56
No	19	40
Don't remember	5	4
Total	100	100

The suggestion that the transaction under study was not, for many respondents, the initial contact with the sales representative is supported by several bits of additional evidence. About 55 percent of the respondents already owned mutual funds, and about two-fifths of them had previously purchased mutual funds from the same sales representative. Moreover, about 29 percent had previously bought securities other than mutual funds from the same salesman. This pattern of behavior implies that, for many of these respondents, the transaction may have been simply another phase in a continuing business relationship. If this were so, they may well have settled their business by telephone or mail without the necessity of meeting with a sales representative who was already known to them.

E. Respondents who did not receive the prospectus

A significant percentage of mutual fund purchasers (20 percent of regular and 10 percent of contractual plan buyers) reported that they did not receive the fund's prospectus. In addition, another 5 percent of regular purchasers did not remember. It should be noted that a failure to deliver a prospectus in connection with the purchase of mutual fund shares is a violation of law.

Those who reported that they received no prospectus were examined separately. In educational background, they were indistinguishable from other buyers in their respective groups as a whole. However, their knowledge of mutual funds (in its various dimensions as discussed below) was somewhat lower than that of buyers as a whole. Whether they were poorly informed because they did not receive prospectuses, or whether their reported failure to receive prospectuses is simply evidence of ignorance of the prospectus itself, clearly cannot be determined.

Among sales representatives associated with investors who reported they had not received prospectuses, close friends or relatives of the purchaser appeared with less than average frequency. Among buyers of the no-prospectus group who met with salesmen, regular investors spent less time with the salesmen than the typical investor in the sample, and contractual buyers spent substantially less. None of the no-prospectus contractual buyers indicated that the salesmen had previously sold them mutual funds or other securities. Among regular buyers, a percentage significantly higher than for regular buyers as a whole indicated that the same sales representative had previously sold them both mutual funds and other securities—thus reflecting a continuing business relationship.

Finally, when dealers handling these accounts were classified according to the categories shown above, regular buyers in the no-prospectus group appeared with above-average frequency as customers of member firms of the New York Stock Exchange. These firms accounted for about 40 percent of regular account respondents for whom dealers could be classified. But they accounted for about 50 percent of the no-prospectus group as a whole, and about 65 percent of the no-prospectus customers of all classified dealers.

A part (about 40 percent) of the higher incidence of no-prospectus buyers associated with members of the New York Stock Exchange seems to be centered in the 25 percent of all respondents who bought through broker-dealers and who reported they did not met with sales representatives. But the remaining group still constitutes a higher proportion of buyers dealing through these firms than through others.

For contractual plan buyers, data were not available to make a dealer classification, but over 80 percent of the respondents reported meeting the sales representative in their homes or places of business, the remainder in other places. None occurred in offices of the selling agency. Only about 5 percent of contractual respondents who said they did not receive the prospectus also reported they initiated the transaction themselves; half said it was initiated by sales representatives, and the remainder said some other person took the initiative. In contrast, among contractual buyers who said they received the prospectus, over 40 percent also reported initiating the transaction themselves. Finally, the failure of contractual plan buyers to receive the prospectus cannot be readily explained on the basis of a continuing business relationship established in the past, since about 95 percent of this group reported they had not owned mutual funds before.

For regular account buyers, little distinction appears in initiation, place of transactions, or the role of friends or relatives between those receiving and not receving the prospectus. But about half of the no-prospectus group were new purchasers, compared to 60 percent of all buyers of regular accounts included in the survey.

VI. INVESTMENT COUNSELING

Investment counseling involves (1) a knowledge of the objectives and preferences of the investor, (2) a knowledge of his financial position—his assets, obligations, and income, and (3) a broad knowledge of the characteristics and prospects of the diverse financial instruments which provide alternatives for the prospective investor, including tax and other legal provisions which may influence choices. Finally, where the art of counseling is practiced by selling intermediaries in the distribution of securities as well as goods and services in general, a nice balance is required between the self-interest of the sales representative and the needs and interests of the buyer.

It was already noted that salesmen initiated from a third to a half of all purchases of mutual funds, and in addition were the most important influence in selecting the particular funds acquired by purchasers in one-third of the cases. Thus the salesman played a major role in determining both the entry of mutual funds into the portfolios of investors and the particular funds selected. This substantial reliance on salesmen for counsel is to be expected where many investors are relatively uninformed about the characteristics of different funds, the terms under which they may be acquired, and their suitability for their needs.

A number of questions in the survey were directed toward this broad problem of investment counseling by sales representatives of mutual funds. While it is clear that the answers to these questions cannot reveal in detail the quality of advice received, they do provide a broad impression of the extent of counseling and the kind of evidence on which it was based. In this survey no examination was made of salesmen's knowledge of instruments or investment markets, but it did deal with inquiries made by the sales representative which might have furnished materials to provide the basis for investment advice. Questions also covered elements of investment counseling that were initiated by the salesmen. In addition to summarizing these responses, attention is given to a small but significant proportion of mutual fund buyers who owned no other assets.[12]

A. Activities of salesmen in investment counseling

The inquiries of salesmen about the financial positions of their customers are shown in table VI–1, which is confined to responses from those who reported one or more meetings with a sales representative. Apparently, sales representatives made inquiries about the incomes, financial assets, and financial obligations of about one-third of regular respondents, and a somewhat higher proportion of contractual planholders. These responses seem to indicate that in about 60 percent or more of the cases the sales representative made no inquiry into these matters.

It may be noted that the Rules of Fair Practice of the National Association of Securities Dealers requires that in recommending to a customer the purchase of any security, a broker-dealer must have reasonable grounds for believing that the security is suitable for the customer on the basis of the facts, if any, disclosed by the customer as to his financial position and needs, and the NASD has taken the position that the failure of a purchaser to volunteer information does not relieve the salesman of his duty to inquire. While in many cases prior information which the salesman may have gained through continuing customer-client relationships or close personal ties may satisfy his obligation, the proportion of transactions in which the salesmen seemingly made no inquiry into investors' financial positions would appear inevitably to involve some violations of the rule.

APPENDIX XI–A: TABLE VI–1.—*Inquiries of salesmen about financial positions of investors*

[Percent of those meeting with salesmen]

	Regular accounts			Contractual plans		
	Yes	No	Don't remember	Yes	No	Don't remember
Did the salesman make any inquiries concerning investor's—						
Income	31	67	2	40	54	6
Financial assets	35	62	3	38	58	4
Financial obligations	28	70	2	33	61	6

The failure to inquire into these areas would seem of particular importance in the case of periodic contractual plans because of the specialized role of this investment instrument in financial planning. The concentration of sales charges in early periods of such plans makes them appropriate investment media only if there is a high probability that they can be carried through to completion; but they are questionable choices for contingency or rainy-day savings which the purchaser may need to fall back on to meet various emergencies.

Table VI–2 summarizes the extent to which sales representatives apparently initiated discussions of a variety of topics relating to investment counseling. Salesmen initiated discussion of the tax treatment of payments from the fund with a little more than half of regular account investors with whom they met and with somewhat fewer contractual plan buyers. This was supplemented by discussions of the general income tax problems of investors in perhaps one-third of the cases. About 40 percent of respondents reported that salesmen initiated discussions of the quality of their other investments or securities. About one-

[12] Data for this section were derived exclusively from the regular and contractual plan interview samples.

quarter of purchasers reported that salesmen discussed matters relating to taxes on investors' estates in the event of death, and with about one-third they also initiated discussions relating to wills and trusts.

APPENDIX XI-A: TABLE VI-2.—*Reports of activities of salesmen in investment counseling*

[Percent of those meeting with salesmen]

	Regular accounts			Contractual plans		
	Yes	No	Don't remember	Yes	No	Don't remember
Initiated discussion of—						
Tax treatment of payments from the fund	52	35	13	42	41	17
Respondent's general income tax problems	36	58	6	32	59	9
Quality of investor's other investments	43	54	3	49	55	5
Taxes on investor's estate in the event of death	29	63	8	28	65	7
Wills and trusts	31	65	4	33	60	7
Offered to do estate planning	9	85	6	8	83	9
Offered to do portfolio analysis	36	61	3	23	74	3
Offered other services	19	78	3	23	72	5
Compared other funds with the fund he was selling	59	34	7			
Compared securities in the stock and bond markets with fund shares				46	33	21

Overall, between 80 and 90 percent of these respondents reported that salesmen had initiated one or more of the topics indicated above. But despite this substantial attention to a number of complicated legal and financial topics, fewer than 20 percent of respondents said that the salesmen advised them to consult an attorney or financial adviser.

On other related topics, fewer than 10 percent indicated that salesmen had offered to do estate planning; but a larger proportion—about one-quarter for contractual plan buyers and more than one-third for those buying on regular account—reported that salesmen had offered to do portfolio analysis.

Regular account buyers were asked whether the sales representative had compared other funds with the fund he was selling. About 60 percent reported that he had made such a comparison. When asked about the content of these comparisons, a few themes virtually exhausted the subject. Salesmen had commented broadly on the suitability of the particular fund to the investor's needs, had referred to investment objectives of different funds, or had made general statements indicating that the particular fund was best. Clearly, these comments embrace a substantial amount of investment counseling. But on such significant topics as comparative sales charges, comparative expenses, or comparative performance, the responses indicated only negligible attention.

Contractual plan buyers were asked a somewhat different question: whether sales representatives had compared other securities with fund shares. Almost one-half of those meeting salesmen indicated that such a comparison was made. Here discussions apparently were confined to statements emphasizing that small amounts invested in securities' markets involve risk, that fund shares are predominantly invested in large, well-known companies, and that mutual fund shares generally move with the market.

As noted above, over a third of buyers of funds covered in this survey already owned mutual fund shares. When this group was asked whether sales representatives had advised them to sell shares in one fund and to buy another, about 10 percent of regular shareholders and a considerably smaller percentage of contractual plan buyers reported such recommendations. Beyond reporting the simple incidence of the advice to shift from one fund to another, the questionnaires shed little light. They do not disclose whether the recommendations reflected changes in circumstances of shareholders which might have indicated shifts to funds with different objectives, or were motivated by changed estimates of prospective performance, or were motivated by the self-interest of sales representatives.

Finally, about 20 percent of respondents indicated that salesmen offered other services. As a rule, however, these apparently encompassed little of importance beyond the elements of investment counseling already mentioned. Generally, salesmen indicated their availability for advice and consultation, and in a negligible percentage of cases they offered to arrange personal loans if needed.

B. The mutual fund investor without other financial reserves

Some information was collected in the course of the survey regarding the portfolios of mutual fund shares purchasers. These data were limited to qualitative indications of the presence or absence of certain asset holdings at the time of purchase of mutual funds. They do not, therefore, reveal much detail on the holdings of mutual fund buyers. Nevertheless, they disclose some interesting qualitative information relating to the asset positions of mutual fund buyers that may have some significance in appraising the investment counseling received by these purchasers. This is particularly true of those buyers who apparently hold no assets other than mutual fund shares.

These exclusively mutual fund investors constituted only about 3 percent of buyers on regular account, but included about 10 percent of all contractual plan buyers in the study. The characteristics of these contractual plan buyers are of some interest. They had incomes generally concentrated at the low end of the $5,000 to $10,000 range. Typically, they were males, married, and heads of families, of early middle age, with three or four dependents. Their coverage by life insurance was at the low end of the $5,000 to $10,000 range.

Significantly, about two-thirds of the purchases of this group were reported as initiated by mutual fund salesmen, as compared with a little less than half for contractual plan buyers in the sample as a whole. Given the weaknesses of the contractual form of mutual fund buying as a means for establishing contingency reserves, a serious question is raised as to the propriety of recommending this form of asset acquisition to this group.

It must be borne in mind in assessing the quantitative significance of this finding that the 10-percent figure for contractual plan buyers with no assets other than mutual funds is a figure disclosed from the responses of those who indicated they held *no* other assets of the listed types—no savings bonds, no savings accounts, and no other securities. Clearly it excludes those who may have held some of these assets, but in relatively minor amounts.

VII. DESCRIPTION OF FUND SHARES

A. Statements in sales presentations

To obtain an impression of the sales representative's general description of mutual fund shares, investors were asked a series of questions concerning statements which might have been made during the discussion of the transaction covered in the survey. The statements and responses are shown in table VII–1.

In interpreting these tabulations, several points should be kept in mind. First, the percentages apply only to those investors who met with sales representatives. Excluded are (1) investors who purchased their shares by mail (about 16 percent of all regular account respondents) and (2) investors who acquired shares through personal contact (perhaps by telephone) but who also replied they did not meet with a sales representative before or at the time of the purchase. Second, respondents were asked to recall, after a number of months, whether specific statements were made during meetings which lasted for an average of 2 to 3 hours. Consequently, some of the respondents' recollections perhaps had faded somewhat by the time they completed the questionnaire.

Moreover, aside from these difficulties, it is impossible to tell whether respondents obtained the information reported from sales representatives, other sources subsequent to the transaction, or even whether they had absorbed it in the general environment prior to their initial contact with salesmen. These and other uncertainties limit the analytical burden which can be placed on the respondents' accounts of the sales representatives' activities.

APPENDIX XI-A: TABLE VII-1.—*Description of mutual fund shares by sales representatives as reported by respondents in personal interviews*

[Percentage distribution]

Statement by sales representative	Regular accounts			Contractual plans		
	Yes	No	Don't know	Yes	No	Don't know
1. That fund shares could decrease in value	76	16	8	72	23	5
2. That the investment was safe	85	9	6	74	21	5
3. That fund shares were like insurance	26	64	10	35	57	8
4. That fund shares were like savings accounts	51	41	8	60	38	2
5. That fund shares could be cashed in easily	84	8	8	77	19	4
6. That fund shares provide a hedge against inflation	45	34	21	35	49	16
7. That fund shares encouraged you to save regularly	59	36	5	87	12	1
8. That fund shares provided professional management	94	(1)	6	87	10	3
9. That fund shares provide diversification	94	(1)	6	75	14	11
10. That shares of the fund were registered with the Securities and Exchange Commission	59	10	31	60	12	28
11. That the management of the fund, or its investment policies or practices were supervised or controlled by the Securities and Exchange Commission or other agency of the Federal Government	50	22	28	41	28	31
12. That fund shares offered tax benefits	26	43	31	18	57	25
13. That there were other advantages	25	53	22	10	65	25
Average of responses	59	26	15	56	31	13

[1] Negligible.

While these limitations apply to both mail and personal interviews, they do so with less force in the case of personal interview responses. Interviewers had been introduced to the terms used, and the objectives of the survey, and could aid respondents in their interpretation of the questions. The divergences between the personal interview and mail replies for both regular and contractual plans suggest that mail respondents may have had some difficulty in dealing with some of the points raised in the questions. Finally, in the case of the mail responses, no control could be maintained to insure that the appropriate person answered the questionnaire under the conditions intended. For these reasons, the following summary of statements made by the sales representative is based on the personal interview responses.

The overall image which emerges about investors' conception of mutual funds as derived from sales representations seems to be as follows: mutual fund shares are safe, relatively liquid assets which simultaneously provide the benefits of professional management and diversification. While a large majority of respondents indicated they were told fund shares could decrease in value, about half also reported that sales representatives said that shares were like savings accounts. Finally, a substantial proportion of all purchasers reported receiving an erroneous account of the extent of the Securities and Exchange Commission's supervision or control of mutual fund operations.

Apparently, a substantial proportion of the salesmen distributing mutual funds told investors that their shares could decrease in value. About three-quarters of both regular and contractual plan respondents reported such a warning was given. Approximately 85 percent of the purchasers of regular accounts and 74 percent of contractual plan buyers also reported that salesmen said the investment was safe. The percentage of investors who reported that sales representatives suggested that mutual fund shares were like insurance was relatively small, but the proportion was heavier among buyers of contractual plans than among regular purchasers. The slightly greater margin of positive reports among contractual plan buyers may well be explained by the option to buy insurance which is frequently associated with contractual plans. A slightly larger proportion of contractual plan investors (about three-fifths) than regular account purchasers (about one-half) reported that the sales representative told them mutual fund shares were like savings accounts. It should be noted that the Securities and Exchange Commission's Statement of Policy on mutual fund selling material forbids any representation or implication that shares of an investment company are similar to savings accounts. The relative positions of the two groups were reversed with respect to the ease with which mutual funds shares could be redeemed. Nevertheless, more than four-fifths of regular account buyers and over three-fourths of contractual plan purchasers indicated they were told their shares could be easily liquidated.

About one-fifth of regular account and one-sixth of contractual plan investors did not remember whether the sales representative discussed mutual funds as a possible hedge against inflation. Among those who did recall, affirmative replies accounted for over half of the total for regular account respondents and for somewhat more than two-fifths for contractual planholders.

The emphasis on contractual plans as a means to encourage savings is clearly evident in the replies. Virtually every plan purchaser recalled discussing the question. Eighty-seven percent of contractual plan buyers said the sales representative did mention the point; in addition, about three-fifths of regular account purchasers indicated the same point was made. The advancement of contractual plans as a source of discipline in saving is in line with what one would expect. But recalling that three-quarters of the regular accounts included in the survey were outright purchases rather than voluntary accumulation programs, the relatively high frequency of regular investors mentioning this feature should be noted.

The opportunity to obtain professional investment management was apparently a highlight of a vast majority of sales presentations. More than 90 percent of regular account holders and nearly the same percentage of contractual plan buyers reported that this was said to be an advantage of owning fund shares. The stress on diversification of assets through ownership of mutual funds is also evident.

About three-fifths of regular account and contractual plan investors reported that sales representatives said the shares of their funds were *registered* with the Securities and Exchange Commission. In addition, about one-half of regular account holders and two-fifths of contractual plan investors *also* said that mutual funds' management and investment policies were presented to them as being *supervised* or *controlled* by the Securities and Exchange Commission or other agency of the Federal Government. It should be noted that the Statement of Policy also forbids any reference to registration or regulation of a mutual fund without explaining that this does not involve supervision of management of investment practices or policies.

Because the above statement, if made as alleged, would involve clear misrepresentation, the characteristics of investors reporting that the statement was made were studied in detail. Attention focused on their education, their overall knowledge of mutual funds, their relationships to sales representatives, and the classes of dealers through whom the shares were acquired. The conclusion emerged that, in general, there was little to distinguish this group of buyers from mutual fund investors as a whole.

A sizable proportion of investors did not recall whether the sales representative said that mutual funds afforded tax benefits; but among those who did about one-quarter of regular account buyers and one-fifth of contractual plan buyers reported that this feature was mentioned. A few other minor benefits were apparently indicated, among which the availability of insurance under contractual plans was the only one worth noting.

B. Influence of the sales presentation on investment decisions

Some evaluation of the impact of sales representatives' statements on investors' decisions to buy mutual funds can be made—but not with much precision. In general, according to respondents' replies, the effect was greater among contractual plan purchasers than among those who acquired regular accounts.

Investors were asked to identify up to 5 of the 13 statements shown in table VII-1 which may have influenced them. Among those who assigned weight to some of the statements, a few respondents did not identify any particular statement while others selected up to five. Among respondents who met with sales representatives, about 69 percent of regular purchasers said some of the statements affected their decisions, and approximately 74 percent of contractual plan buyers reported in the same vein.

Selections can be summarized to show what proportion of respondents attached some significance to each, but it is difficult to infer in what degree these statements were influential in shaping investment decisions. If the mean of the percentage of respondents selecting each statement is taken as a reference point, the relative significance of a particular statement on investors' decisions may then be determined rather broadly by noting whether the frequency is above or below the average for the set as a whole. This rough procedure clearly does not permit any inferences about the actual impact of a particular statement. Instead, it might be viewed simply as a device for reporting the appraisals made by respondents themselves.

The responses are summarized in table VII-2. This table shows, for regular account and contractual plan investors, the percentage of respondents who said (1) that sales representatives made the statements indicated, and (2) that particular statements at least partly influenced their decisions to purchase mutual funds. It will be noted that in a few cases, the percentage of investors reporting (2) is larger than the percentage reporting (1). This suggests that some investors misinterpreted the question. Their answers may have reflected the influence of the description of mutual fund shares implied in the statements of table VII-2, but derived from sources other than the sales representatives.

There seems to be no systematic link between salesmen's reported focus on a particular feature of fund shares and the influence of such statements on investors' decisions. For example, nearly all regular account purchasers said sales representatives mentioned that fund shares provide professional management and diversification; references to professional management and the encouragement to save were reported by almost 90 percent of contractual plan investors. But, it seems that these statements evidently influenced a substantially smaller proportion of investors in each group. About two-fifths of both regular and contractual plan buyers attributed some influence to the availability of professional management and diversification of assets. (See table VII-2.)

APPENDIX XI-A: TABLE VII-2.—*Statements by sales representatives which influenced respondents' purchase decisions*

[Percentage distribution]

Statement by sales representative	Regular accounts		Contractual plans	
	Statement was made	Statement influenced decision	Statement was made	Statement influenced decision
1. That fund shares could decrease in value	76	3	72	3
2. That the investment was safe	85	37	74	30
3. That fund shares were like insurance	26	29	35	36
4. That fund shares were like savings accounts	51	48	60	54
5. That fund shares could be cashed in easily	84	22	77	31
6. That fund shares provide a hedge against inflation	45	33	35	45
7. That fund shares encouraged you to save regularly	59	16	87	52
8. That fund shares provide professional management	94	39	87	39
9. That fund shares provide diversification	94	37	75	38
10. That shares of the fund were registered with the Securities and Exchange Commission	59	15	60	10
11. That the management of the fund, or its investment policies or practices, wer supervised or controlled by the Securities and Exchange Commission or other agency of the Federal Government	50	13	41	14
12. That fund shares offered tax benefits	26	15	18	13
13. That there were other advantages	25	25	10	33
Average of responses	60	26	56	31

The suggestion that fund shares are like savings accounts, if respondents' replies are accepted as a guide, apparently was the statement with the most influence on their decisions. Approximately one-half of them assigned some importance to it. Contractual plan buyers apparently were also impressed with the argument that this type of plan encouraged saving; more than one-half of them said it influenced them to make the purchase. A much smaller percentage of regular account investors implied they were guided by similar considerations. The differences in proportions, of course, are partly traceable to the differential emphasis on compulsory saving in the two types of investment media. On the other hand, both groups attributed some significance to the statement that fund shares provide a hedge against inflation, but the frequency was somewhat higher among contractual plan investors. While one-third of regular account purchasers cited this claimed advantage as a factor shaping their decision, 45 percent of contractual plan investors cited it. Finally, while a sizable proportion of all investors may well think mutual funds' management and investment policies are supervised or controlled by the Securities and Exchange Commission, few explicitly mentioned this as a factor in their investment decisions. (Only 13 percent of regular buyers and 14 percent of contractual plan investors cited this.)

Still another attempt was made to highlight the possible influence of statements attributed to sales representatives on purchase decisions. Respondents were classified according to the reasons given for buying fund shares and the frequencies were compared with the influential statements reportedly made by salesmen. The results are shown in tables VII-3 and VII-4, for regular account and contractual plan purchasers, respectively. The figures are the percentages of investors, with given motivations, who said that the statements listed influenced their purchase decisions.

APPENDIX XI-A: TABLE VII-3.—*Reason for choice of mutual funds against statements by salesmen that influenced purchaser's decision, regular accounts*

[Percentage distribution]

Statement by sales representative	Reasons for choice of mutual funds					
	Benefit from rise in stock prices	Hedge against inflation	Economic growth	Benefit from professional management	Benefit from diversification	Discipline in saving
1. Fund shares could decrease in value?	----------	----------	1	2	1	----------
2. Investment was safe?	15	8	16	16	13	24
3. Shares like insurance?	7	2	3	2	3	12
4. Like savings accounts?	15	8	14	9	10	35
5. Could be cashed in easily?	12	4	13	8	8	15
6. Hedge against inflation?	10	16	11	13	14	12
7. Encouraged you to save regularly?	2	2	11	6	4	21
8. Provided professional management?	20	22	30	33	29	12
9. Provided diversification?	12	18	25	30	30	18
10. Registered with SEC?	2	4	4	3	4	9
11. Supervised or controlled by SEC or other Federal agency?	7	6	4	5	6	----------
12. Offered tax benefits?	2	4	4	2	5	----------
13. Other advantages?	5	4	5	3	2	----------
Average responses	8	7	11	10	10	12

APPENDIX XI-A: TABLE VII-4.—*Reason for choice of mutual funds against statements by salesmen that influenced shareholder's decision, contractual plans*

[Percentage distribution]

Statement by sales representative	Reasons for choice of mutual funds					
	Benefit from rise in stock prices	Hedge against inflation	Economic growth	Benefit from professional management	Benefit from diversification	Discipline in saving
1. Fund shares could decrease in value?	7	----------	3	2	2	1
2. Investment was safe?	31	7	22	22	23	27
3. Shares like insurance?	17	11	17	12	11	15
4. Like savings accounts?	31	11	33	30	27	40
5. Could be cashed in easily?	31	30	25	28	18	29
6. Hedge against inflation?	14	67	30	22	21	13
7. Encouraged you to save regularly?	45	52	47	49	46	51
8. Provided professional management?	24	44	30	45	39	30
9. Provide diversification?	28	44	33	32	50	21
10. Registered with SEC?	10	7	10	4	4	9
11. Supervised or controlled by SEC or other Federal agency?	7	4	5	6	----------	9
12. Offered tax benefits?	----------	7	3	2	4	1
13. Other advantages?	3	11	3	4	4	2
Average responses	19	23	20	20	19	19

The central issue posed is this: Is there an apparent link between investors' motivations and the salesman's description of fund shares? Again, while any inference based on these figures must be drawn with special caution, the responses seems to suggest that salesmen's activities had somewhat less effect on decisions of regular account purchasers than on the decisions of contractual plan investors. Only a few of the salesmen's statements and motivations of regular account buyers appear as though they may be related in a meaningful way: These are (1) "shares are like savings accounts" versus "discipline in saving," (2) "shares provide professional management" versus "benefit from professional management," (3) "shares provide diversification" versus "benefit from diversification."

In contrast, contractual plan buyers seem as though they may have been somewhat more under the sway of sales representatives. The suggestion of an association appears to be strongest in those cases where a relationship may be supposed to exist. Note, for example, the following reported salesmen's statements versus investors' motivations: (1) "shares provide a hedge against inflation" versus "hedge against inflation," (2) "shares encourage you to save regularly" versus "discipline in savings," (3) "shares provide diversification" versus "benefit from diversification," (4) "shares provide professional management" versus "benefit from professional management." Thus, the overall pattern of response sketched in table VII–4 seems to support the conclusion that, if statements attributed to sales representatives had any impact at all on investors' decisions, they were probably of more significance for contractual plan than for regular account buyers.

Of course, it must be emphasized again that the broad statistical summaries of investor's responses presented here do not really chart the influence of sales representatives on decisions to purchase mutual funds. At most, one may infer from the evidence that a sizable proportion of all fund purchasers, and an even larger proportion of those who acquired contractual plans, may have been induced to buy shares because of the salesman's description of mutual fund advantages. Perhaps another sizable proportion was influenced by the salesman, although the latter may not have ultimately tipped the scales in favor of the decision to purchase. On the other hand, numerous investors, especially some of those who were most optimistic about the future market value of their shares, probably were attracted to funds by the generally buoyant atmosphere which has prevailed in the securities market for the last decade. This issue is examined more closely in section XI.

VIII. DESCRIPTION OF FUND OPERATIONS

To shed light on the role of sales representatives as sources of information concerning certain technical aspects of mutual funds, investors who met with salesmen were asked about the latter's explanations of several basic features of mutual fund operations. The questions posed to purchasers and the pattern of responses are shown in table VIII–1 and VIII–2 for regular account and contractual plan respondents, respectively.

A. Investment objectives and management expenses

The vast majority in both groups said that sales representatives explained the investment objectives of their particular funds, although there apparently was a little more uncertainty among contractual plan than among regular account buyers.

Over three-quarters of contractual plan respondents and one-half of regular plan investors indicated that salesmen explained to them the expenses incurred by the fund for investment management and administration. It may be noted, however, that the relatively smaller frequency of positive answers by regular account purchasers may reflect, in part, their frequent uncertainty rather than a definite recollection that the salesman did not discuss this question. One might be tempted to account for the higher proportion of contractual plan buyers who received an explanation of fund expenses by recalling that, on the average, they had more meetings with sales representatives and the sessions lasted longer. Yet, as shown in section X, and commented on below, their apparent knowledge of fund operations does not support the supposition that the extra time was used effectively.

APPENDIX XI-A: TABLE VIII-1.—*Description of mutual fund operations, regular accounts*

[Percentage distribution]

	Yes	No	Don't remember
Did the sales representative explain:			
Investment objectives of fund	85	4	11
Expenses of the fund for investment management and administration	50	29	21
Sales charge paid as percent of amount invested	79	5	16
Applicability of sales charges to reinvested dividends	43	26	31
Applicability of sales charges to reinvested capital gains	36	27	37

APPENDIX XI-A: TABLE VIII-2.—*Description of mutual fund operations, contractual plans*

[Percentage distribution]

	Yes	No	Don't remember	No answer
Did the sales representative explain:				
Investment objectives of fund	88	5	6	1
Expenses of the fund for investment management and administration	77	12	10	1
Sales charge paid as percent of amount invested:				
During the 1st year	82	6	11	1
During the 1st 2 years	65	12	21	2
During the life of the contract	67	12	19	2
Whether purchase money would be refunded if dissatisfied with the investment:				
All respondents	46	41	12	1
Time limit mentioned:				
Within 30 days	68			
Over 30 days	14			
No answer	18			
Member firms versus nonmember firms of Association of Mutual Fund Plan Sponsors:				
Member firms	46	44	10	0
Time limit mentioned:				
Within 30 days	66			
Over 30 days	16			
No answer	18			
Nonmember firms	41	39	17	3
Time limit mentioned:				
Within 30 days	74			
Over 30 days	5			
No answer	21			

B. Description of sales charges

Almost 90 percent of investors in both groups remembered that sales representatives discussed sales charges during their presentations. Investors reported considerable variation, however, in the extent to which salesmen treated this issue. The questions on sales charges covered somewhat different ground for the two kinds of investors. Regular account investors were asked simply whether the salesman described the amount of sales charges which would be deducted from the amount paid for the fund shares. About four-fifths said that he had explained this fact; approximately one-sixth did not remember.

Periodic contractual plan buyers were asked about the salesman's description of the sales charges which would apply during the first year, during the first 2 years, and over the life of the plan. Well over 80 percent of planholders said they had been told what proportions of their payments would constitute sales charges during the first year of the plan. Approximately two-thirds also reported receiving an explanation of the proportion of payments which would be absorbed as sales charges during the first 2 years and over the life of the contract. The reports of salesmen's references to sales charges during the first year and over the periods of the plans do not appear to be unreasonable. However, the high proportion reporting an explanation of sales charges during the first 2 years must be viewed with considerable reservation. A description of the sales charges in contractual plans in terms of the proportion of the payments which would be absorbed in 2 years is not commonly explicit, and normally must be inferred from tabular information given in prospectuses. The fact that the response to the question of sales charges over 2 years is not different from that relating to such charges over the life of the contract suggests caution in interpreting these accounts of the salesman's activities. On the other hand, it should be noted that the high sales charge in the early years of contractual plans is so strategic that it inevitably would receive major attention.

Regular account buyers were asked if the sales representative explained whether sales charges would apply to reinvestment of dividends and capital gains. Approximately two-fifths replied affirmatively, about one-quarter said "no," and the rest did not remember. As a matter of fact, the question was not equally applicable to all respondents; this would depend on the particular fund in which they acquired shares. Among mutual funds in the industry which impose sales charges, about half apply them also to reinvested dividends and a far smaller proportion to capital gains. The firms in the sample were classified on the basis of their own practices with regard to dividends,[13] and the responses of investors in each fund were again tabulated. On balance, respondents who bought shares in funds which do not deduct sales charges on reinvested dividends reported "no" to the question at a somewhat greater frequency than respondents who were in the group where the deduction is made. However, the differences between the percentages recorded in each of the two groups proved to be of no statistical significance.

C. Refund option in contractual plans

Investors in contractual plans were asked whether salesmen indicated that the amount paid would be returned if the purchasers were dissatisfied and changed their minds in a short period of time; and, if so, what time limits were mentioned. Just under one-half of respondents reported that they had been told of this option. Two-thirds said the time limit was 30 days, and one-seventh said it was over 30 days. An attempt was made to determine whether the frequency of positive replies was appreciably higher for investors who purchased shares through member firms of the Association of Mutual Fund Plan Sponsors (AMFPS). This organization recommends that its members provide a refund option and allow at least a 30-day turnaround period. The data in table VIII-2 show that there was no substantial difference between the responses by customers of AMFPS-member and nonmember firms. Purchasers through AMFPS members were a little less uncertain of the explanation of this option than those who purchased through nonmembers, and they gave a slightly higher percentage of affirmative replies. However, the observed differences were not statistically significant. Moreover, the reports of time limits mentioned diverged only slightly.

D. Description of fund operations and investor knowledge

A brief effort was made to determine whether one could observe a link between sales representatives' description of fund operations and the level of investors' understanding of these operations. The overall results are mixed, and the findings must be interpreted with caution.

With respect to general knowledge of the sales charge, expenses of funds, and sources of fund incomes (as appraised by methods explained in section X), those buying funds through dealers and who met with salesmen did not exhibit higher levels of understanding of these matters than those who did not have such meetings. For regular account buyers, the degree of information demonstrated seemed to improve somewhat with the number of meetings held, but this was not true of contractual plan investors. But for both groups there was no apparent relationship between aggregate time spent with salesmen and the level of knowledge.

Regular account investors reporting that the salesman had explained the sales charge exhibited somewhat more understanding in this area than those answering in the negative (whose knowledge was indistinguishable from that of respondents who answered that they did not remember whether the salesman had made this explanation). There was a smaller difference in favor of those reporting that the salesman had described the fund's expenses for investment management and administration.

The relationship disclosed between what salesmen were reported as saying and investor knowledge in the area was similar for contractual buyers—with one exception. As noted above, respondents reported salesmen described sales

[13] Only one fund in the sample deducts the sales charge from reinvested capital gains.

charges for contractual plans over a period of 2 years with the same frequency as over the whole period of the plans. But their apparent knowledge of these two rates was significantly lower for the 2-year rate than for that for the life of the plan. This finding reinforces the reservation expressed above about the validity of the reported description of the charges over 2 years.

On the whole, however, even the groups who reported they received an explanation of fund operations exhibited modest levels of understanding in these areas. Again, it must be emphasized that the finding of some relationship between reported statements by salesmen and knowledge must be interpreted with caution. A positive finding may well indicate that sales presentations were informative; but to some degree they may also reflect an inherent bias in the way respondents typically reply to questionnaires of the sort used in the survey; namely, respondents who are not familiar with the information requested or terms used may be inclined to suggest that the salesmen had not discussed the relevant points.

IX. REPRESENTATIONS ABOUT CHANGES IN MARKET VALUES

A. Representations of probabilities of changes in share prices

Among those mutual fund investors who had direct contact with their mutual fund salesmen, about 90 percent indicated that salesmen commented upon possible changes in market values of shares.[14] Respondents were asked about salesmen's emphases on various probabilities of changes in the market value of shares in a year or less as well as for periods longer than a year. The reported year-or-less estimates of mutual fund salesmen are given in table IX-1. As indicated, between 50 and 60 percent of respondents reported that salesmen emphasized that share prices were equally likely to rise or fall in a year or less, and from 30 to 40 percent indicated that share prices were more likely to rise than to fall in this same period. About 10 percent of regular respondents and a somewhat higher percentage of contractual plan buyers reported that even in the short period of a year or less salesmen had emphasized either a strong chance of a rise with almost no chance of fall, or the prospect of an almost certain rise in prices.

Forecasts of share price changes emphasized by salesmen for periods longer than a year are reported in table IX-2. Here about three-quarters or more of the responses indicated relatively restrained comments. Thus about 30 percent indicated an equal likelihood of rise or fall, and 40 to 50 percent, the somewhat greater likelhihood of a rise than a fall. A fourth of the respondents reported that salesmen indicated either that there was a strong chance of a rise with almost no chance of a fall, or that a rise in price was certain. Moreover, among this last group, 10 percent or more of respondents meeting with salesmen reported that salesmen emphasized that in the long run the rise in value was certain.

APPENDIX XI-A: TABLE IX-1.—*Reported emphases of salesmen about changes in the market values of shares in a year or less*

[Percentage distribution of investors meeting with salesmen]

Statement closest to salesman's emphasis	Regular accounts	Contractual plans
Equally likely to rise or fall	51	60
Somewhat more likely to rise than fall	39	28
Strong chance of rise with almost no chance of fall	7	7
Rise in value is certain	3	5
Total	100	100

[14] Data for sec. IX were derived exclusively from the regular account and contractual plan interview samples.

APPENDIX XI–A: TABLE IX–2.—*Reported emphases of salesmen about changes in the market values of shares for periods longer than a year*

[Percentage distribution of investors meeting with salesmen]

Statement closest to salesman's emphasis	Regular accounts	Contractual plans
Equally likely to rise or fall	29	30
Somewhat more likely to rise than fall	47	43
Strong chance of rise with almost no chance of fall	11	16
Rise in value is certain	13	11
Total	100	100

B. Representations of specific rates of growth of market values of shares

In addition to questions of the probabilities of general rises and falls in share prices, an attempt was made to elicit information regarding any specific rates of change suggested as likely by mutual fund salesmen. About 20 percent of all respondents who met with salesmen reported stress on some specific amount or rate of growth.

Among respondents who reported stress on specific amounts or rates of growth in share values by salesmen, a majority reported 10 to 14 years as the period emphasized in connection with the forecast of growth. This period was reported by 70 percent of contractual buyers in this subgroup, with the remaining 30 percent equally divided among periods with limits 0 to 5 years, 5 to 8 years, and 15 to 20 years.

The Commission's Statement of Policy on selling literature for mutual funds requires that charts and tables used in such material cover the life of the company or the preceding 10 years or longer periods in multiples of 5 years. The concentration of reported emphasis of growth by salesmen over a period of 10 to 14 years suggests an association of future prospects with the historical record as described in the prospectus and associated material. In addition comments by contractual plan investors also suggest an attempt to link prospective performance with the periods of the plans, which largely had a similar duration.

For regular accounts buyers, about one-quarter of the group under discussion did not mention any amount or rate of growth. But about half of this group, or almost 10 percent of those meeting with sales representatives, reported that salesmen had emphasized rates of growth of market values of shares of double or triple or more. In addition a number suggested other substantial prospective increases, such as 20 percent in a year, 40 percent in a year, up to a tenfold increase in 15 to 20 years. A small percentage also specifically mentioned "the rate of growth indicated in the prospectus."

Among those buying contractual plans, again about one-quarter of those reporting some sales emphasis on a specific rate of growth could report no particular quantities. But over one-half suggested that a doubling or more of fund asset values might reasonably be anticipated. Among the remainder there was considerable variation, ranging from the suggestion that growth in asset values might be expected to exceed the performance of time deposits in a bank to the prediction of a gain of 22 percent per annum.

The overall impression conveyed by the responses summarized in the preceding discussion (and in tables IX–1 and IX–2) is that a majority of mutual fund salesmen exercised restraint in discussing prospective changes in the market values of mutual funds shares with buyers. But this record also discloses much less restraint by a substantial minority of fund salesmen. This group apparently put heavy emphasis on the growth in market values of mutual fund shares during the stock market boom of the 1950's, and conveyed to buyers a strong impression that a similar performance was a reasonable likelihood for the future.

PART III. INVESTOR KNOWLEDGE AND EXPECTATIONS

X. INVESTOR KNOWLEDGE

This section appraises investors' knowledge of several basic elements of funds' operations. These relate to sales charges of their own and other funds, expenses of funds for investment management and administration, and the important source of funds' earnings. In addition, attention is given to a few special characteristics of contractual plans. Finally, relationships between investors' knowledge of mutual funds and various characteristics of investors, the funds, and sales intermediaries are also explored.[15]

In appraising the extent to which mutual fund investors are informed about their underlying investment, it is well to bear in mind that guidelines do not exist which would make it possible to compare mutual fund investors with other classes of participants in financial markets. Thus one cannot conclude that mutual fund investors are either better or more poorly informed than purchasers of listed or over-the-counter stocks, or holders of savings accounts in general, or purchasers of insurance, among others.

Moreover, it is well to bear in mind that a survey of investor knowledge of mutual funds does not necessarily imply that mutual fund organizations or salesmen are primarily responsible for whatever state of knowledge is found to exist, or are responsible in greater degree than are the sellers of any other commodity or service. Nevertheless, despite the lack of comparative data for buyers of other financial claims, information on the state of knowledge of buyers of mutual funds is important in revealing the nature of the market in which the funds are sold, the kind of sales strategies likely to be operative, and the nature and extent of competitive pressures which are likely to bear on those selling funds. For this purpose what is relevant is not only investors' knowledge of the securities they actually bought, but also their comparative knowledge of sales charges, expenses, and performance of other funds, and other available alternatives.

From the evidence derived from the survey it seems clear that mutual fund buyers had only a modest understanding of their investment. While they made some use of the prospectus, they appeared to place heavy reliance on information from and the recommendations of sales representatives, friends, and relatives, and to use relatively few outside sources of financial information.

A. Sources of information

1. *The prospectus.*—Among investors reporting receipt of the prospectus, the median time devoted to reading it by those able to make such an estimate was a little over an hour for regular purchasers, and a little less than 1½ hours for those who bought contractual plans. About 15 percent of both classes devoted less than one-half hour to the prospectus, and 10 percent of regular and 20 percent of contractual buyers devoted over 3 hours to it. The statistical summary above includes about 65 percent of buyers on regular account in the interview sample and about 85 percent of purchasers of contractual plans. Excluded are those reporting they had received no prospectus (this group is described in section V), those who did not remember whether they had received it, and those who could make no estimate.

2. *Other sources of information.*—Purchasers apparently made little use of information other than that provided by sales representatives or the funds. About 40 percent mentioned other sources of information, but these were confined largely to references to friends, relatives, and other purchasers. About 11 percent of purchasers mentioned financial sections of newspapers, and only about 15 percent of regular and 5 percent of contractual mentioned other financial publications of any kind.

B. Sales charges

Purchasers' knowledge of sales charges, while better than that relating to other elements of their investment security, was nevertheless weak. Regular account buyers were asked: "When you bought shares in your fund, did you pay a sales charge?" The results, broken down for funds with and without sales charges, are presented in table X-1. Among those buying funds with sales charges, 13 percent apparently thought they had not paid a sales charge, and 15 percent did not know whether they had or not. On the other hand, over 90 percent of those buying no-load funds appeared to know that they had paid no such charge.

[15] Data for this section were derived exclusively from the regular account and contractual plan interview samples. This was desirable, in part, because of the fact that in mail responses there was no control over the extent to which the respondents relied on reports or prospectuses or assistance from others. Moreover, it was important in this area, as in others, to avoid inherent biases stemming from voluntary returns of a mail questionnaire. As noted above, interviewers were instructed to exclude members of the securities industry from the sample. Nonetheless, a small number of mutual fund salesmen amounting to 4 percent of regular accounts were interviewed. Responses of this group, included in the summary appendix, are excluded here.

APPENDIX XI-A: TABLE X-1.—*Percentages of regular account buyers of load and no-load funds aware of whether they had paid a sales charge*

	Funds with sales charges (percent in each class)	Funds without sales charges (percent in each class)
Yes	72	6
No	13	91
Don't know	15	3
Total	100	100

Those aware of a sales load were asked to estimate its amount. For those buying funds with typical sales charges, the results are given in table X-2.

APPENDIX XI-A: TABLE X-2.—*Estimates of the sales charge by those buying funds with typical sales charges*

Size of the sales charge (percent):	*Percent of responses*
0 up to 1	1
1 up to 3	1
3 up to 7	5
7 up to 9.5	37
9.5 and over	1
Don't know	27
No answer	28
Total	100

Thus in addition to the 28 percent who believed that they did not pay a sales charge or did not know whether they did or not, an additional 27 percent answered, "don't know" to the question asking an estimate of its amount. Another 7 percent thought it was lower than it actually was, and about 1 percent thought it was higher. Overall, about 37 percent provided a reasonable estimate of the sales charge they had paid.

In contractual plans, as noted in section I, the nominal sales charge as a percentage of payments over the life of the plan is typically between 8 and 9 percent. But a substantial part of the sales load is deducted from early periodic payments (the "front end load"). For most monthly payment plans (and all but 1 in this survey), the sales load for the first 12 payments was about 50 percent, to which was added custodian fees and other administrative charges.[16] The distribution of these charges over time is of critical importance for purchasers of contractual plans because if the plans are not carried to conclusion, the overall sales charge would be higher than that applicable over the life of the plan; and if the plan is terminated in early years, the load can result in substantial absolute losses unless the stock market experiences sharp gains. For example, assuming stock prices constant, if the plan were terminated within the first year, the net asset values returned to the plan-holder would be less than 50 percent of his payments; if it were terminated toward the end of the second year, his receipts would be on the order of 70 percent. These implications of the front-end load are stated in the prospectuses of the plans.

To appraise their understanding of the level and structure of contractual sales charges, planholders were asked to estimate these charges for the first year, during the first 2 years, and over the life of the contract. The results are indicated in table X-3.

[16] As noted in section I, the effect of prepaying a substantial part of the total sales charge is to make the effective rate of sales charge over the life of the plan greater than the nominal or stated rate. In this section, however, attention is given only to investors' understanding of the more simple concept of the nominal rate.

APPENDIX XI-A: TABLE X-3.—*Contractual plan investors' estimates of sales charges*

Estimate (percent):	Percent in class
During the 1st year:	
0 up to 20	9
20 up to 40	6
40 up to 60	42
60 and over	2
Don't know	40
No answer	1
Total	100
During the 1st 2 years:	
0 up to 5	6
5 up to 10	7
10 up to 25	1
25 up to 35	5
35 and over	3
Don't know	76
No answer	2
Total	100
Over the life of the contract:	
0 up to 5	8
5 up to 10	16
10 up to 15	7
15 and over	1
Don't know	67
No answer	1
Total	100

Table X-3 shows that 40 percent of contractual plan purchasers did not know what the first year sales load was, and another 15 percent believed that it was substantially lower than it was. Another 2 percent thought that it was higher. Taking 40 to 60 percent as an acceptable response, only about two-fifths of these investors placed the first year charge within this range.

Their knowledge of the sales charge over the life of the contract was considerably weaker. About two-thirds could make no estimate of what it might be. Another 8 percent believed it was much lower than it was in fact. If we take the broad limits of 5 to 15 percent as an acceptable response, somewhat fewer than one-fourth of contractual purchasers answered correctly. As regards the effective sales charge which would be applicable if the funds were redeemed within 2 years, estimates were weakest of all. Over 75 percent attempted no estimate, and of the 25 percent who did, most were much too low. Only 5 percent of contractual respondents placed their estimate within the reasonable range of 25 to 35 percent.

Respondents were asked whether they were aware of mutual funds with sales charges different from those they actually paid. The questions were intended to assess investor information about alternatives available to them within their chosen sector of the financial market. The answers reflect the sources of information used by investors, the comprehensiveness of their investigation, and the information possessed and provided by sales representatives. Responses to these questions are given in table X-4 below.

APPENDIX XI-A: TABLE X-4.—*Knowledge of sales charges of mutual funds*

[Percentage distribution]

Knowledge of whether there are mutual funds in which the sales charge is—	Investors buying funds with normal loads			Investors buying no-load funds			Investors buying contractual plans		
	Yes	No	No answer	Yes	No	No answer	Yes	No	No answer
Higher than that of fund bought	23	74	3	76	24	9	13	85	2
Lower than that of fund bought	26	72	2	30	67	3	19	78	2
Zero (no sales charge)	24	74	2	55	46	0	12	85	3

Table X-4 indicates that about three-quarters of regular purchasers had no knowledge of funds with sales charges which were higher or lower; about the same proportion was unaware of the existence of no-load funds. Among investors in contractual plans a somewhat higher percentage was unaware of funds that could be purchased with sales charges different from that of the fund they bought. A similarly high proportion was not aware of the availability of no-load funds.

Responses by buyers of no-load funds are difficult to interpret. Over 90 percent apparently knew that they had paid no sales charge (see table X-1, above), and about three-fourths had indicated that they knew there were funds with sales charges higher than the fund they had bought. But 30 percent also apparently believed there were funds with lower sales charges. Finally, 46 percent indicated they did not know whether there were funds with zero sales charges, even though they had themselves bought such a fund. A survey of comments made in association with this question suggests that a high proportion of these respondents may have interpreted the question to refer to funds without a sales load other than their own, and of these they had no information. But the comments do not explain the views of the 30 percent who believed there were funds with lower sales charges.

C. Fund expenses

Respondents' knowledge of annual expenses incurred by their funds for investment management and administration was approached in two ways. They were asked to estimate these expenses as a percentage of assets and as a percentage of funds' annual incomes. Estimates on the asset base (which is the form most prominently stated in the prospectus) are presented in table X-5.

APPENDIX XI-A: TABLE X-5.—*Respondents' estimates of annual expenses for investment management and administration as percentages of fund assets*

[Percentage distribution]

Percent of assets (1)	Regular accounts (2)	Contractual plans (3)	Expected (4)
0 up to ⅛	4	1	0
⅛ up to ⅜	3	2	6
⅜ up to ⅝	8	3	23
⅝ up to 1	3	3	1
1 up to 3	6	4	0
3 up to 7	5	3	
7 up to 9.5	2	1	0
9.5 and over	2	8	0
Don't know	68	74	70
No answer	0	1	
Total	100	100	100

Columns (2) and (3) show actual estimates of regular account and contractual buyers. It appears that about 70 percent of all purchasers could make no estimate. Of those that could, estimates tended to be too high. Among the 40-odd funds included in the regular and contractual samples, the bulk of funds had ratios of these expenses to assets close to 0.5 percent. At the low end, six were in the range of one-eight to three-eighths percent, and at the high end two were in the range of five-eighths to 1 percent. None were above 1 percent or below one-eighth percent. Taking account of the number of respondents appearing in the sample from each fund, we can set up the distribution of estimates which would have occurred if those who made estimates had done so correctly. These results are presented in column (4) of table X-5. If for comparison we assume that 70 percent of respondents could make no estimate, and if the remaining 30 percent were correct, the results would be distributed as shown. It seems apparent in comparing columns (2) and (3) with (4) that even those attempting estimates may have had little knowledge of the underlying facts.

Shareholder estimates of these same annual expenses as percentages of fund incomes are presented in the first three columns of table X-6.

APPENDIX XI–A: TABLE X–6.—*Respondents' estimates of annual expenses for investment management and administration as percentages of fund incomes*

[Percentage distribution]

Percent of incomes (1)	Regular accounts (2)	Contractual plans (3)	Expected (4)
0 to 5	16	8	0
6 to 10	7	6	4
11 to 20	0	2	14
21 to 30	2	2	2
Over 30	0	2	0
Don't know	75	81	80
No answer	0	0	0
Total	100	100	100

Overall, almost four-fifths of purchasers were unable to make any estimate; and the remaining one-quarter to one-fifth who did, generally made estimates which were far too low.

The median ratio of these expenses to incomes of the 40-odd funds in the sample was 15 percent, and most funds exhibited ratios in the range 11 to 20 percent. Six funds had ratios below 11 percent, and four in the range 21 to 30 percent. None appeared in the two extreme classes.

If the roughly 20 percent who made estimates had made them correctly (assuming that the percentages of respondents making estimates were about equal for all funds), the distribution of estimates would have been as indicated in column (4). Again a comparison of actual with "expected" estimates provides little reason to believe that many of the estimates actually made were based on firm underlying knowledge of fund expenses.

To determine whether investors in funds with low expense ratios were aware of differences in the expense ratios of their funds as compared to funds as a whole, estimates of purchasers of six funds at the low end of the expense ratio scale were segregated. These are presented in tables X–7 and X–8 along with those of regular investors as a whole. There appears to be no significant difference between the estimates of shareholders in funds with low expense ratios and shareholders as a whole. The lack of knowledge of fund expenses generally, and the apparent inability by buyers to discriminate among them would suggest that comparative expenses of funds would have little competitive effect on sales.

APPENDIX XI–A: TABLE X–7.—*Estimates of expense-asset ratios by all purchasers and by purchasers of 6 funds with low ratios*

[Percentage distribution]

Response	All purchasers	Purchasers of low-ratio funds
0 up to ⅛	4	1
⅛ up to ⅜	3	3
⅜ up to ⅝	9	8
⅝ up to 1	3	3
1 and over	15	12
Don't know	66	73
No answer	0	0
Total	100	100

APPENDIX XI-A: TABLE X-8.—*Estimates of expense-income ratios by all purchasers and by purchasers of 6 funds with low ratios*

[Percentage distribution]

Response	All purchasers	Purchasers of low-ratio funds
0 to 5	16	16
6 to 10	8	11
11 to 20	1	1
21 to 30	2	1
Over 30	1	0
Don't know	72	71
No answer	1	0
Total	100	100

D. Sources of earnings

Investors' knowledge of the sources of earnings of their funds, which is a rough indication of their understanding of how mutual funds operate, was somewhat greater than their information on quantitative aspects of expenses. But there was evidence that a considerable number had either a vague impression or a clear misconception of the functions performed by their funds. Overall, almost 20 percent did not know whether funds derived earnings or profits from buying and selling securities in the stock market, and another small percentage indicated that they derived no such earnings. More than 30 percent of purchasers did not know whether sales charges paid by new investors contributed to earnings of their funds, and a significant percentage (22 percent for regular purchasers and 36 percent for contractual buyers) thought that they did. Forty-five percent of regular buyers and about one-third of contractual buyers stated correctly that these elements did not enter into earnings of their funds. About 80 percent of mutual fund buyers overall knew that dividends and interest on stocks and bonds held by the fund were an important element in fund earnings. But somewhat more than one-sixth did not know whether these elements entered into fund earnings, and another small percentage thought that they did not. Somewhat more than 10 percent of mutual fund buyers thought that their funds gained earnings or profits from rents or fees from the ownership or management of real estate and other property. About one-half were uncertain as to whether they did or not, and about 40 percent indicated correctly that they did not. Finally, almost 30 percent of contractual respondents and about 18 percent of regular respondents believed that brokerage fees and commissions contributed to their funds' earnings. In addition, about 35 to 40 percent did not know, and a similar proportion indicated that they did not.

E. Further aspects of contractual plans

The front-end load and periodic payments associated with contractual plans suggested two questions bearing on purchasers' understanding of these features. On the issue of whether, having begun the contractual periodic investment plan, there was any financial disadvantage if the plan were not carried out, 61 percent indicated that there was a disadvantage, but, significantly, 31 percent said that there was not, and an additional 8 percent did not know. A majority of those indicating that there was a disadvantage identified it in general terms as related to losses that might occur because of the nature of the sales charge. A somewhat lesser percentage identified this potential loss somewhat more precisely.

In an attempt to assess the extent to which contractual plan buyers view the periodic payment feature of such plans as a binding commitment on them to make payments over the life of the plan, they were asked, "In your opinion, does your plan impose on you any legally binding obligations?" About 3 percent of plan holders thought that a legally binding obligation existed, but about 91 percent did not, and about 5 percent did not know.

F. The relationship between knowledge of mutual funds and other factors

To facilitate comparisons of knowledge and other characteristics or variables the responses to the questions covered in this section were summarized in an overall knowledge score for each investor. Each investor's responses, matched against the characteristics of his own fund, were weighted to give a summary score on a scale running from one to nine. A score of one indicates virtually no reasonable answers, while a score of nine indicates all answers in an acceptable range. The questions included and weights applied differ somewhat for regular and contractual respondents, reflecting differences in the questions posed, and for this reason overall scores are not necessarily comparable between groups. The scores were intended for intragroup comparisons as indicated below.

For purchasers on regular account the questions entering into the combined score and their weights are as follows:

Question	*Weight*
Whether a sales charge was paid	1
The amount of the sales charge	3
The expense-asset ratio	2
The expense-income ratio	1
Sources of fund earnings	2
Total	9

For contractual purchasers the weights given knowledge of sales charges and expense-asset ratios were reduced to make room for other topics. The content and weights of the summary score for this group are as follows:

Question	*Weight*
Amount of the 1st-year sales charge	1.5
Amount of the sales charge over the life of the plan	1.5
The expense-asset ratio	1.0
The expense-income ratio	1.0
Whether there is any financial disadvantage if plans are terminated before maturity	1.0
Whether the plan embodies a legally binding obligation	1.0
Sources of fund earnings	2.0
Total	9.0

The overall distribution of summary scores of buyers through regular accounts and contractual plans is given in table X-9 below.

APPENDIX XI-A: TABLE X-9.—*Distribution of summary knowledge scores of regular and contractual buyers*

[Percentage distribution]

Summary knowledge score	Regular investors	Contractual plan investors
1	22	17
2	19	24
3	8	15
4	6	15
5	19	12
6	12	11
7	7	4
8	6	1
9	1	1
Total	100	100

Both distributions are concentrated at the lower end of the scale, with the contractual distribution somewhat more so. The arithmetic means of these distributions are 3.8 for regular investors and 3.4 for buyers of contractual plans. As indicated above, because of differences in the tests, these measures in themselves do not necessarily imply that contractual plan buyers are less informed; but an examination of responses of the two groups to common questions, as noted in the discussion of individual topics above, does suggest that this is in fact the case.

These two groups of buyers were classified in a number of ways, and within each classification the distribution of scores was derived. As a summarizing device, we present in table X-10 a number of such classifications together with percentage distributions of buyers and arithmetic means of the applicable knowledge score distributions of each class.

APPENDIX XI-A: TABLE X-10.—*Average summary knowledge scores of various classes of mutual fund investors*

	Regular		Contractual	
	Percent	Average	Percent	Average
Total or average	100	3.8	100	3.4
1. Sex:				
Men	59	4.3	77	3.6
Women	41	3.0	23	2.8
2. Age:				
Under 30	5	3.8	22	3.3
30 to 39	17	4.8	29	3.5
40 to 49	24	4.3	28	3.6
50 to 59	21	3.8	17	3.4
60 to 64	10	3.0	1	----------
65 and over	20	2.7	3	----------
No answer	3	----------	0	----------
3. Marital status:				
Married	67	4.1	73	3.5
Widows	17	2.8	7	2.3
Single	15	3.6	20	3.3
No answer	1	----------	0	----------
4. Education—Those whose education terminated in—				
Grade school	10	2.5	15	2.3
High school	35	3.5	46	3.2
College	38	4.2	29	3.8
Postgraduate education	15	4.3	9	4.5
No answer	2	----------	0	----------
5. Income:				
0 up to $5,000	19	2.5	20	2.4
$5,000 up to $10,000	30	3.6	48	3.3
$10,000 up to $15,000	18	4.2	18	3.8
$15,000 up to $25,000	18	5.0	9	4.3
$25,000 up to $50,000	6	3.9	2	----------
Over $50,000	1	----------	1	----------
No answer	8	----------	2	----------
6. Geographic area:				
New England	10	3.3	13	2.7
Middle Atlantic	31	4.5	52	3.6
Midwest	30	3.3	21	3.1
South	3	----------	4	2.7
West	27	3.7	9	3.9
7. Initiator of purchase:				
Respondent	50	4.5	38	3.6
Sales representative	30	2.8	48	3.3
Friend or relative	14	2.9	13	2.8
Other	1	----------	1	----------
No answer	5	----------	0	----------
8. Type of dealer:				
Member of New York Stock Exchange	32	3.1	----------	----------
Member only of other exchanges	5	3.8	----------	----------
General broker-dealer unaffiliated with exchanges	6	3.4	----------	----------
Mutual fund specialists	23	3.8	----------	----------
Mail	14	5.9	----------	----------
Not classified	20	----------	----------	----------
9. Most important influence on selection of the particular fund:				
Sales representative	35	3.0	32	3.1
Advertising and sales literature	5	4.2	4	3.0
Respondent's independent appraisal	29	4.8	17	4.7
Friend or relative	22	3.4	45	3.2
Business adviser	3	----------	2	----------
Others	5	----------	1	----------
10. Portfolio policy of fund:				
Balanced	25	2.9	16	3.3
Common stock	63	4.1	83	3.4
Specialty	12	3.8	2	----------
11. Investment objectives of funds:				
Income	14	3.4	4	1.4
Growth	39	4.7	58	3.4
Mixed	47	3.0	37	3.4
12. Method of distribution:				
Controlled selling organization	11	3.3	21	3.2
Through independent broker-dealers	74	3.4	31	3.1
Combination of above	----------	----------	48	3.6
Mail	15	5.9	0	----------

(Continued)

APPENDIX XI-A: TABLE X-10.—*Average summary knowledge scores of various classes of mutual fund investors*—Continued

	Regular		Contractual	
	Percent	Average	Percent	Average
13. Time spent reading the prospectus (hours):				
None	4	4.3	7	2.8
0 up to ½	8	4.0	8	3.7
½ up to 1	17	3.8	16	3.2
1 up to 1½	14	4.1	16	2.9
1½ up to 2	2		2	
2 up to 2½	8	4.3	16	4.0
2½ up to 3	1		2	
3 and over	10	4.3	19	3.7
Don't know	9	2.9	1	
No answer (didn't receive or doubtful of receiving prospectus)	27	3.4	13	2.8

It was not feasible to carry out generally more than a two-way classification of the data. The result is that the variations in knowledge recorded as associated with one variable may reflect substantially the influence of closely associated variables. For example, the variations in knowledge associated with income may reflect also variations in knowledge associated in part with education and in part wtih sex—both of which are also related systematically to income. In some cases where further subclassifications were made, the results are indicated in the comments which follow.

It may also be noted that because of the greater concentration of contractual plan investor scores at the lower end of the scale, average scores of this group are less sensitive to changes in classification, and are thus somewhat less revealing of factors associated with differences in knowledge. This is indicated by the lesser variation in average scores as one moves up or down the average knowledge score column for contractual plan investors.

Comments on these classifications below are numbered to correspond to the numbers of the classifications in table X-10.

1. Table X-10 indicates that women typically are considerably less knowledgeable about mutual funds than men, but their disadvantage is somewhat less in contractuals. In part the lower level of knowledge of women may be associated with a somewhat lower level of education, but it also appears that women's knowledge scores are lower than men's for groups with comparable education.

2. Knowledge of mutual funds also varies with age. In regular accounts, those in the age group 30 to 50 appear best informed, with the level of knowledge dropping off rapidly at higher ages. Higher age groups are less important for contractuals, but in any case age seems to have little influence on the performance of this group.

3. Married respondents seemingly indicate levels of knowledge at or somewhat above their group averages, and single respondents, while maintaining the group average among contractual buyers, do less well in the regular group. Widows, accounting for about one-sixth of regular respondents, reveal minimal levels of information in both groups.

4. As might be expected, lowest levels of knowledge were exhibited by those whose formal education did not progress beyond grade school, and levels of knowledge increased consistently with higher levels of schooling.

5. Table X-10 indicates lowest levels of knowledge for low incomes, rising with rising incomes to $25,000, with some indication of decline for incomes beyond $25,000. The low level of knowledge indicated by low income groups may be accounted for in part by associated low levels of education and in part by the concentration of women investors in the lowest income class.

6. Knowledge appears to vary in a geographic pattern. Scores were below average in the South (where our sample was small), New England, and the Midwest, and above average in the Middle Atlantic States. In the West, contractual scores were above average, and regular scores were about average.

Moving away from personal characteristics, geographic area, and education, table X-10 also suggests relationships between knowledge of mutual funds and various aspects of the mutual fund security or transaction.

7. For regular accounts, those respondents who had indicated they had initiated the purchases also demonstrated above average knowledge scores. Regular account purchases reported as being initiated by sales representatives or friends or relatives were associated with below average scores by their buyers. For contractuals, the scores were somewhat above average when the purchases were initiated by respondents, but about average when initiated by sales representatives, and below average when initiated by friends or relatives.

8. Classification by types of dealers, as noted above in the section on selling organizations, was carried through only for those buying on regular account. The knowledge scores appear to indicate that customers of member firms of the New York Stock Exchange, the most numerous class in our sample, were least well informed, suggesting perhaps that they were relying primarily on the reputations of the selling firms. Customers of member firms of other exchanges (but not the New York Stock Exchange) and firms specializing in mutual funds appeared average, and those of general broker-dealers unaffiliated with exchanges appeared somewhat below average. Those purchasing by mail achieved scores well above average.

9. Those respondents who reported that they themselves were the major influence in selecting the particular fund also demonstrated above average knowledge of their investment instrument. Those depending on sales representatives or friends and relatives for this decision demonstrated significantly lower levels of knowledge. While these results do not suggest new insights—ability to select a particular fund is clearly itself a measure of knowledge—these relationships provide some check on the plausibility of the knowledge scores themselves.

10. When classified by portfolio policies of the funds they purchased, no important distinction appears between contractual buyers of plans involving balanced or common stock funds. But among regular buyers, those buying common stock funds, making up about two-thirds of the group, score somewhat above average on the knowledge scale; those buying specialty funds achieve results equal to the average; and the 25 percent of regular investors in balanced funds score considerably lower. This result may well reflect the heavy proportion among balanced fund investors of widows and older individuals, who, as seen above, also exhibit low scores.

11. When buyers are classified by the investment objectives of their funds, buyers of contractual plans involving funds with growth or mixed objectives, and accounting for 95 percent of contractual buyers, exhibit average scores. Buyers of plans involving income funds show evidence of less knowledge, but they compose a very small sample. Among regular buyers, those purchasing funds with growth objectives appear to score above average on our knowledge scale, those purchasing funds with income objectives score somewhat below average, and those buying funds with mixed objectives appear to score even lower. The low level of knowledge disclosed by buyers of funds with income and mixed objectives again may reflect in part the relatively large influence of widows and other older individuals among such investors.

12. When buyers of funds are classified by the general channels of distribution through which funds were sold, those buying through selling organizations controlled by fund managements or through independent broker-dealers indicate levels of knowledge somewhat below average. Buyers of contractual plans distributed by organizations using a combination of these methods score somewhat above average for their group. As noted in other classifications, buyers negotiating their transactions by mail appear significantly better informed.

13. There appears no clear relationship between time spent reading the prospectus and knowledge of the mutual fund instrument. We have already noted that those who indicated that they did not receive the prospectus or were doubtful of receiving it score below average. For those who had received the prospectus but reported not reading it (a relatively small group in each case), regular buyers scored above average, and contractual buyers below average. For contractual buyers, those who spent additional time beyond some minimal amount did not demonstrate greater knowledge, and for regular buyers knowledge was essentially unrelated to time. These results raise a question about the effectiveness of existing prospectuses as devices to promote investor understanding.

XI. INVESTOR EXPECTATIONS

A. Overall expectations of mutual fund performances

One of the findings of the present study was the high investor expectations regarding the prospective performance of both the stock market in general and of mutual funds relative to the market. Regular account buyers had high expectations, and those purchasing contractual plans were even more optimistic.

These expectations were derived from (1) investors' estimates of the funds' future performance compared with their estimates of past performance, (2) investors' estimates of the funds' future performance compared with the stock market as a whole, and (3) investors' estimates of the prospective performance of the funds compared with Government bonds. The first and third comparisons provide some indication of stock price movements expected by mutual fund investors at the time of their purchase. The second is suggestive of the benefits which they expect to derive from the professional management of their funds.

To chart expectations, investors were asked (1) whether they were familiar with the investment performance of their funds during the last 10 years or so, (2) whether they had any views as to how their funds might perform in comparison with the stock market generally during the next 10 years or so, and (3) whether they had views as to how their funds would perform in comparison with Government bonds during the same period. Those answering "yes" to any of these questions were asked whether they expected their funds to perform over the next 10 years about the same as, better than, or poorer than, the performance benchmark used for comparison in each case. The responses are indicated in table XI-1 below.

APPENDIX XI-A: TABLE XI-1.—*Investors' views as to the expected performance of their funds in the next 10 years or so*

	Percent of responses	
	Regular accounts	Contractual plans
In comparison with the performance of the fund in the last 10 years:		
About the same	34	32
Better	24	37
Poorer	14	11
No views	28	20
Total	100	100
In comparison with the stock market generally:		
About the same	35	31
Better	26	33
Poorer	1	2
No views	38	34
Total	100	100
In comparison with Government bonds:		
About the same	3	2
Better	59	54
Poorer	0	0
No views	38	44
Total	100	100

Despite the sharp rise in stock prices over the preceding 10 years, one-third of regular investors and almost one-half of contractual plan buyers who indicated a familiarity with the past performance of their funds, expected them to do even better in the next 10 years. More than 80 percent of both groups expected them to perform as well or better, and fewer than 20 percent expected them to do less well than during the preceding decade.

Those who were able to compare their funds with other corporate stocks almost unanimously expected their funds to do as well as or better than the stock market generally in the 10 years ahead. Fully half of the contractual buyers expressing an opinion expected their funds to do better than the market, and about 45 percent of comparable regular account buyers expressed the same opinion.

In comparing the performance of their funds with Government bonds, those expressing an opinion almost unanimously expected their funds to do better. It is interesting to note the relatively high percentage of contractual plan buyers who would not venture a comparison between their funds and bonds in the future, even though a large proportion of them indicated that they expected their funds in the next 10 years to do as well as or better than in the past.

B. Expectations of various classes of mutual fund investors

In order to ascertain differences in optimism among mutual fund investors, the views of various subclasses were examined. The results are recorded in table XI–2. In this table, a "O" opposite any classification indicates that the views of the reported group were not significantly different from those of all regular or contractual mutual fund shareholders on the average. Wherever a group reported significantly higher expectations than the average, a "+" was entered in the appropriate row; whenever the views reported indicated a pattern of expectations significantly below the average a "–" was entered in each column.

APPENDIX XI–A: TABLE XI–2.—*Expectations of classes of mutual fund investors compared with expectations of mutual fund investors in general*

Class of investor	On performance of the fund in the future as compared with the past		On performance of the fund in the future as compared with stocks in general	
	Regular accounts (1)	Contractual plans (2)	Regular accounts (3)	Contractual plans (4)
1. Sex:				
Men	–	0	0	0
Women	+	0	0	+
2. Marital status:				
Married	0	0	0	0
Widowed	+	+	–	[1]
Single	0	–	0	–
3. Education: Those whose formal education terminated in—				
Grade school	+	0	+	0
High school	0	0	–	0
College	0	–	0	0
Graduate school	0	0	+	0
4. Income:				
0 up to $5,000	+	0	–	0
$5,000 up to $10,000	0	0	0	0
$10,000 up to $15,000	0	–	0	0
$15,000 up to $25,000	–	–	0	0
$25,000 up to $50,000	[1]	[1]	+	[1]
Over $50,000	[1]	[1]	[1]	[1]
5. Ownership of corporate stock other than mutual funds:				
Owners of stock before mutual fund purchase	–	0	0	0
Nonowners of stock before mutual fund purchase	+	0	0	0
6. Previous or initial purchasers of mutual funds:				
Previous	0	0	0	–
Initial	+	0	–	+
7. Class of fund:				
Balanced, mixed	+	0	–	+
Common stock, income	0	[1]	0	[1]
Common stock, growth	–	0	0	0
Common stock, mixed	–	+	0	0
Specialty	0	[1]	0	[1]
8. Period of purchase:				
March	0	0	0	0
June	0	–	0	0

[1] Small sample.

Two aspects of this table deserve emphasis. First, each column records the comparative expectations of the particular class with contractual or regular account investors as a whole. As we have seen, both groups generally exhibited high levels of expectations. Thus, a minus entry on performance of the fund in the future as compared with the past, does not mean that the class of investors expects the fund to perform less well in the future than in the past, but only that a smaller than average proportion of the group expects it to perform better. Similarly, a zero entry does not imply that the corresponding group of investors expects the fund to perform the same in the future as in the past, but only that it expects performance comparable to the average expectation of the regular account group or contractual plan group as a whole. Second, the departures indicated by pluses or minuses are departures from the average structure of responses sufficiently large to be significant.

We turn first to views of regular account respondents on the prospective performance of their funds as compared to the past (col. (1)). Among those whose optimism was above average were women, widows, those with low levels of formal education, those with low incomes, those whose entry into equities was exclusively via mutual funds, those who were purchasing mutual funds for the first time, and purchasers of balanced funds with mixed investment objectives. Below average in expected performance were men, upper income groups, previous owners of other corporate stock, and purchasers of common stock funds with mixed and growth objectives.

Among contractual plan investors (col. (2)) the only class above average which was also above average among regular account holders was widows. They are joined here by purchasers of plans based on common stock funds with mixed objectives.

Among regular account holders comparing the prospective performance of their funds with the stock market as a whole (col. (3)), those with low levels of formal education again appear above average, but they are joined by those with graduate school training and upper income groups. Those whose education ended in high school, low income groups, initial purchasers of mutual funds, and balanced fund buyers express less optimistic views. Among contractual plan buyers comparing their funds with the market as a whole, women were more optimistic about the performance of their fund managers than men or plan holders on the average. They were joined by initial purchasers of mutual funds and buyers of balanced funds with mixed objectives. Less optimistic than average about the future performance of their funds were single individuals, and those who held mutual funds before the purchases covered in this survey.

It is interesting that few differences appear between the attitudes of the investors purchasing in March (before the sharp market decline of May) and the group in June. The only significant difference is that those buying contractual plans in June were less optimistic than average in comparing the future performance of their funds with the past.

C. Fund salesmen and expectations of mutual fund buyers

It was noted in section IX that an important minority of mutual fund salesmen apparently put heavy emphasis on substantial prospective rates of growth of share prices in their sales representations. It was also noted in the discussion above that mutual fund investors were highly optimistic about the future of share prices and about the ability of their funds to outperform the market. The question may be raised about the possible relationship between reported sales representations about prospective share prices and the level and variations in expectations held by mutual fund shareholders.

To examine this issue regular account and contractual plan investors were grouped in accordance with (1) reported salesmen's stress on share price changes (*a*) with a year and (*b*) over longer periods, and (2) by the direction and likelihood of changes emphasized. These included representations that share prices: (*a*) were equally likely to rise or to fall, (*b*) were somewhat more likely to rise than fall, (*c*) had a strong chance of rising with almost no chance of falling, and (*d*) were certain to rise. The expectations of all these groups concerning the prospective performance of their funds compared with the past and with the stock market in general were not significantly different from each other and from the entire samples of regular or contractual plan investors in the survey.

In addition, an examination was made of the expectations of those who reported that sales representatives had stressed a particular prospective rate of growth in share values; this group composed about 20 percent of mutual fund purchasers studied. The expectations of regular account buyers in this class were not significantly different from those of other mutual fund buyers on regular account. Contractual plan buyers of this class, however, provided some variation. In comparing the expected performance of their funds with their performance in the past, this group's views did not differ significantly from those of other mutual fund investors. But they were considerably more optimistic about the expected performance of their funds compared with the stock market as a whole. About half of contractual plan buyers who had views on the subject expected their funds to do about the same as common stocks generally in the future, and about half thought their funds would do better than common stocks generally. However, of those reporting salemen's specific emphasis on some prospective rate of growth of share values, about one-third expected their funds to do about as well as the stock market generally, and about two-thirds to do better.

The limited evidence available is consistent with the view that the buoyant expectations of mutual fund shareholders may be related primarily to such factors as the generally high level of postwar prosperity and general investor optimism, with undoubtedly a large role assigned to the boom psychology developed in a rising stock market. There is some suggestion also that for some contractual plan buyers the representations of salesmen may have promoted—or perhaps exaggerated—these investors' views about the ability of mutual fund managements to outperform the market in the years ahead.

D. Attitudes relating to additional purchases of mutual funds

The question whether to purchase additional mutual fund shares involves not only the investor's expectations but also his motives and objectives, and his knowledge of this form of investment as well as others. When the survey was conducted in October 1962 the level of stock prices was lower than it was at the time of purchase for those investing in March, but it was about the same as it was at the time of purchase for the June group. Willingness to purchase additional shares in October could reflect the impact of the intervening price experience on investors' attitudes; it could also reflect an increase in information about and understanding of mutual fund and other financial instruments.

1. *Overall attitudes.*—In the survey, regular account investors were asked whether, if they had the money to invest, they would have bought an additional amount of mutual funds. Contractual plan investors were asked two questions: whether, having the money, they would have invested more in contractual plans, or, under the same conditions, they would have invested more in mutual funds generally (other than through periodic contractual plans). Overall responses are summarized in table XI–3.

APPENDIX XI–A: TABLE XI–3.—*Attitudes toward purchase of additional amounts of mutual funds*

[Percentage distribution]

Type of investor	Yes	No	Don't know
Regular account	53	37	10
Contractual plan:			
Purchase of additional contractual plans	65	27	8
Purchase of other mutual funds	44	44	11

A majority of investors of both classes clearly favored further investment in the type of mutual fund security they then held. Among those who could report a decision, the ratio of positive to negative responses was 3 to 2 for regular account holders and 7 to 3 for purchasers of contractual plans.

As indicated in table XI–3, contractual plan investors who would have bought more mutual fund shares through regular accounts were far fewer than those who would have bought additional plans. This pattern may reflect simply a preference for the periodic contractual form of investment. But other considerations tend to weaken this conclusion. A reading of the questionnaires suggests that some respondents did not give weight to the conditional clause: "If you had additional money to invest now." Their answers apparently reflected the belief that other forms of purchases were out of their reach. In addition the generally modest level of familiarity of contractual plan investors with the mutual fund industry as indicated in section X suggests that many were not familiar with voluntary accumulation plans or other means of purchasing mutual fund shares.

2. *Attitudes of various subgroups.*—Decisions to purchase additional mutual funds by regular account holders or to expand holdings of contractual plans by planholders were classified (1) by expectations of investors, (2) by those who were previous owners of mutual funds versus those who were first purchasers, (3) by those who owned other corporate stock before their mutual fund purchase versus those whose entry into equities was via mutual funds, and (4) by time of purchase. The responses appear in table XI–4.

APPENDIX XI–A: TABLE XI–4.—*Decisions to purchase additional shares, classified by expectations, stock ownership, and time of purchase*

[Those who would purchase as percentage of those coming to a decision]

Classification	Regular accounts	Contractual plans
1. Expected performance of the funds as compared with fund performance in the last 10 years:		
Same	58	70
Higher	61	78
Lower	66	71
2. Expected performance of the funds as compared with the stock market:		
Same	55	65
Higher	69	71
Lower	(1)	(1)
3. Previous or first purchasers of mutual funds:		
Previous purchasers	63	71
First purchasers	58	71
4. Corporate stock ownership:		
Owners of stock before mutual fund purchase	54	58
Nonowners of stock before mutual fund purchase	65	75
5. Time of purchase:		
March 1962	55	69
June 1962	63	73
Total	59	71

[1] Small sample.

The table suggests that the relationship between expected performance of funds and willingness to purchase additional mutual funds is somewhat mixed. Regular account holders who expected their funds to do better in the future than in the past were not significantly more willing to purchase additional funds than those who expected their funds to perform the same in the future as in the past. There is some indication that among those who were less optimistic about their funds' future performance compared with the past (who may be considered as dubious about a simple projection of the preceding stock market boom) were a greater proportion who were willing to purchase additional funds than among those expressing a more optimistic view of the market.

Among contractual plan buyers who expected their funds to do better in the future than in the past, the proportion willing to extend their investment was greater than for those who expected their funds to perform as well as in the past. But among those who expected their funds to perform less well in the future than in the past, as great a percentage was willing to purchase additional plans as among those who expected them to perform as well.

The relationship between attitudes toward purchase of additional shares and expected comparative performance of funds with the stock market is much simpler. Those who expected funds to outperform the market were also more willing to purchase additional shares in October. The relationship was more significant for those purchasing on regular account than for those holding contractual plans. When decisions to purchase additional shares are classified by whether respondents were previous holders of mutual funds or first purchasers, no significant difference appears.

When prospective purchasers of additional shares are classified by whether they were previous owners of corporate stock other than mutual funds before they purchased mutual funds originally, those who apparently gained entry into the stock market via the medium of mutual funds were considerably more eager than average to add to their holdings, while previous holders of corporate stock were about average (possibly slightly less than average for regular account purchasers).

When respondents are classified by time of purchase, those purchasing after the sharp decline of May 1962 show some indication of greater willingness to purchase additional shares than those purchasing in March, but the differences are not statistically significant.

3. *Reasons for and against additional purchases.*—A number of motives were given by regular account holders for their favorable attitudes toward purchase of additional mutual funds. About one-seventh of those who would buy more shares gave lower prices as a reason for additional investment. This group apparently interpreted the downtrend in prices earlier in 1962 as a temporary interruption of a generally upward price movement. Other reasons given gen-

erally mirror investors' motives in buying mutual funds originally. On this list the desire for diversification, professional management, and higher income or dividends stand high, each being indicated by about a fifth of those who would buy additional shares. A higher rate of capital growth was mentioned by one-seventh of regular account investors, and others mentioned a number of miscellaneous investment objectives.

For the almost 40 percent of regular account buyers who would not have purchased additional shares, the reasons given reflect a number of sources of dissatisfaction. The most important was the fall in market prices, mentioned explicitly by almost 40 percent of the negative responses. Much lower in importance, but together accounting for about another third of reasons given for not purchasing additional shares, were mention of a preference for better investments, and "pessimistic views" or "negative talk." Inasmuch as some part of these responses also probably reflects the fall in stock prices, market movements could well have accounted for a majority of negative attitudes. Other reasons given for unwillingness to invest further in mutual funds were high sales costs, high management costs, a preference for cash or savings accounts, and lack of knowledge of mutual funds.

Among contractual plan buyers who would not purchase additional contractual plan shares, it is difficult to appraise the influence of stock market developments on their decisions. Less than a tenth of those with negative attitudes specifically mentioned the previous fall in market prices, but another 20 percent reported a generally pessimistic outlook—which may also partly reflect market developments. While sales or other costs of mutual funds were given only negligible attention, a fourth of those who would not invest further gave as a reason the availability of other investments which they considered superior to fund shares.

Among contractual purchasers who explained why they would not buy regular accounts, one-seventh mentioned the availability of better investments, a tenth mentioned a preference for monthly investment plans, a tenth, a lack of knowledge of mutual funds, and a tenth, the existence of pessimism.

PART IV. REDEMPTION OF MUTUAL FUNDS

XII. CHARACTERISTICS OF INVESTORS WHO REDEEMED MUTUAL FUND SHARES

A. Investor characteristics

With few exceptions investors who redeemed mutual fund shares were essentially similar to those who purchased shares covered in the survey. The few observed differences were typically associated with those who redeemed contractual plans. The characteristics of those who redeemed shares are compared with the characteristics of purchasers in table XII–1.

Professional and executive people were a somewhat larger percentage of the redemption group than they were of the group which purchased shares in mid-March and mid-June 1962. When the redemption group is compared with the purchase group in terms of education, those with college training appear in a somewhat higher proportion among redeemers than among purchasers. The difference is due entirely to those who redeemed contractual plans. The similarity in the percentages of college-educated investors and those with professional status among contractual plan redeemers reflects the considerable overlap between the two categories.

Regular account investors in nonprofessional occupations represented a much smaller proportion of those who redeemed than of those who purchased this type of mutual funds. In contrast, contractual plan investors employed in nonprofessional occupations constituted about the same percentage of the redeemers as they did of the 1962 purchase group. Heads of households were somewhat more heavily represented among those who liquidated contractual plans in 1962 than among those who purchased contractual plans in the same year. But heads of households who closed out regular accounts were a substantially smaller percentage of the redemption group than they were of the 1962 purchase group.

APPENDIX XI-A: TABLE XII-1.—*Comparative characteristics of investors who redeemed or purchased mutual fund shares, by type of account*

[Percentage distribution]

Investor characteristics	Redemptions		Purchases	
	Regular	Contractual	Regular	Contractual
Sex:				
Male	64	80	59	77
Female	35	20	41	23
No answer	1	0	0	0
Marital status:				
Married	73	80	67	73
Widowed	18	7	17	7
Single	8	13	15	20
No answer	1	0	1	0
Age:				
Under 30	5	19	5	22
30 to 39	11	30	19	29
40 to 49	30	34	24	28
50 to 59	20	10	21	17
60 to 64	11	3	10	1
65 and over	19	2	20	3
No answer	4	2	1	0
Education:				
Elementary school	5	2	10	16
High school	34	49	35	46
College	38	41	38	28
Postgraduate	19	8	15	10
No answer	4	0	0	0
Occupation:				
Professional and executive	37	42	32	29
Self-employed	11	10	11	15
Nonprofessional	22	37	30	39
Retired	13	5	12	1
Other	14	4	14	16
No answer	3	2	1	0
Family status:				
Head	59	80	71	73
Other	34	17	28	26
No answer	7	3	1	1
Family size:				
1	12	9	15	8
2	26	24	34	17
3	16	19	19	20
4	16	32	17	27
5	12	10	9	17
6 or more	11	5	5	11
No answer	7	1	1	0
Family income:				
Under $5,000	19	17	19	20
$5,000 to $9,999	32	47	31	48
$10,000 to $14,999	20	24	18	18
$15,000 to $24,999	9	7	18	9
$25,000 to $49,999	15	0	6	2
$50,000 and over	0	0	1	0
No answer	5	5	7	3
Covered by life insurance:				
Yes	78	93	86	93
No	17	5	14	7
No answer	5	2	0	0
Face amount:				
Less than $5,000	16	14	21	19
$5,000 to $9,999	10	14	13	22
$10,000 to $14,999	9	22	11	22
$15,000 to $24,999	15	12	10	12
$25,000 to $49,999	17	22	11	13
$50,000 and over	11	8	15	4
None or no answer	22	8	19	8
Home owned by respondents:				
Yes	67	46	68	56
No	28	52	32	44
No answer	5	2	0	0
Home mortgaged:				
Yes	31	32	32	45
No	34	12	36	11
No answer or not homebuyer	35	56	32	44

(Continued)

APPENDIX XI–A: TABLE XII–1.—*Comparative characteristics of investors who redeemed or purchased mutual fund shares, by type of account*—Continued

[Percentage distribution]

Investor characteristics	Redemptions		Purchases	
	Regular	Contractual	Regular	Contractual
Financial and other assets:				
Owned at time of acquisition:				
Other mutual funds	40	14	36	18
Other corporate stock	46	27	57	24
Government bonds	40	32	51	45
Other bonds	9	5	15	10
Savings accounts	60	56	92	89
Real estate	33	22	28	17
Owned at time of redemption:				
Other mutual funds	49	14		
Other corporate stock	51	31		
Government bonds	30	31		
Other bonds	10	3		
Savings accounts	66	47		
Real estate	36	24		

In general, sellers of mutual fund shares seemed to have had fewer assets than purchasers covered in the survey. This was particularly true of assets in liquid forms—i.e., Government bonds and savings accounts. The types of assets considered are shown in table XII–1. The relative paucity of financial resources was especially marked for those who sold contractual plans. About half of the latter group had no savings accounts at the time they closed out their plans. One-third of regular account redeemers were in the same position. Moreover, approximately one-third of those who sold contractual plans, but less than 10 percent of those who redeemed regular accounts, reported they had no financial assets or real property of any kind—except the mutual fund shares they redeemed.

Table XII–1 also shows the proportion of respondents in the redemption group who owned specified types of assets at the time they acquired the mutual fund shares covered in the survey and the time they redeemed them in 1962.

It should be noted that the proportion of regular account investors who held each type of asset increased slightly, except in the case of Government bonds where the proportion of investors who reported such securities dropped appreciably. Among redeemers of contractual plans, there was generally no increase in the proportion which reported ownership of the indicated types of assets between the acquisition of fund shares and their redemption in 1962. In fact, the only striking change was in their holdings of savings accounts where the percentage with such accounts declined substantially.

The differences are put into sharper focus by comparing the pattern of asset ownership at the time persons in the redemption group acquired shares some years ago with the pattern of asset ownership reported by persons who purchased shares in 1962. (To facilitate the comparison, those in the redemption group will be designated as pre-1962 purchasers.) A much higher proportion of 1962 than of pre-1962 purchasers reported holding a variety of financial assets. The percentage of 1962 buyers with savings accounts was from one-half to two-fifths higher than that for pre-1962 purchasers. The proportion of the 1962 group who held Government and other bonds was also higher. The above differences apply to both regular account and contractual plan investors. However, the proportion of 1962 and pre-1962 purchasers with mutual funds and other corporate stock showed a mixed pattern. A slightly smaller percentage of 1962 regular account buyers (but a slightly larger percentage of 1962 contractual plan buyers) already owned mutual funds compared with pre-1962 purchasers who acquired the same types of mutual funds. The reverse was true with respect to the ownership of other corporate stock.

No quantitative estimates could be made of the sizes of the asset holdings of the 1962 purchasers and those who redeemed shares in that year. However, the vulnerability of the reserve positions of the redeemers is evident. This fact assumes special significance in light of the personal characteristics of the investors without financial reserves. A substantial proportion of the contractual plan redeemers had incomes below $5,000, while the incomes of regular account redeemers were concentrated in the lower end of the $5,000 to $10,000 bracket.

Among contractual plan redeemers, there was a high representation of married men, in the 40 to 50 age range, who were heads of families, and who had three or four dependents. In the light of these circumstances, one might question whether these investors should have purchased mutual funds in the first place.

B. Investor objectives and motives for selecting mutual funds

When investors acquired the shares they redeemed at the time of the survey, they were seeking objectives quite similar to those projected by 1962 purchasers. This was true of both regular and contractual plan buyers. In fact, the only noticeable variation was in the relatively small weight given by pre-1962 purchasers to the provision for retirement or the financing of children's college education. (See table XII–2.)

Investors who redeemed shares reported somewhat different investment motives at the time of acquisition compared with 1962 purchasers studied in the survey. In general, those shifting out of mutual funds appeared to be initially attracted to these assets because of a somewhat greater interest in capital appreciation than that shown by investors who purchased shares in 1962. For example, the desire to benefit from a rise in stock prices and to hedge against inflation were reported 50 percent more frequently by sellers than by purchasers. On the other hand, more purchasers than sellers had hoped to achieve a higher return on investment.

In addition, a higher proportion of regular account redeemers than purchasers initially acquired shares because they expected to benefit from professional investment management. The hope of benefiting from diversification was reported by a considerably higher proportion of the redeemers of regular accounts than by 1962 investors who purchased the same type of shares.

APPENDIX XI–A: TABLE XII–2.—*Investor objectives and choice of mutual funds, redemptions compared with purchases*

[Percentage distribution]

Investor objectives and choice of mutual funds	Redemptions		Purchases	
	Regular	Contractual	Regular	Contractual
Investor objectives:				
Provide a means of general saving	40	64	41	58
Provide for retirement	31	27	46	42
Provide for children's college education	10	27	17	38
Provide for purchase of business or home	4	5	0	7
Accumulate an estate	29	19	28	20
Provide for current income	14	3	16	0
Some other objective	5	2	7	6
Factors influencing choice of mutual funds:				
Benefit from a rise in stock prices	35	25	16	16
Hedge against inflation	31	22	19	15
Benefit from professional investment management	58	54	48	52
Benefit from diversification	50	32	41	31
Protect capital	14	5	14	8
Acquire discipline in saving	10	46	13	49
Benefit from economic growth	34	42	36	33
Higher return on investment	1	2	11	15
Some other reason	2	5	9	11

XIII. MOTIVES FOR REDEMPTION

A. Size of redemptions

The vast majority of regular account investors had purchased the shares they redeemed, but a small proportion received them as gifts or legacies. All contractual plan holders had bought the shares they liquidated. (See table XIII–1.) In a few of the regular account cases involving inheritances, the shares may have been redeemed in the process of settling an estate. Some of the shares received as gifts were apparently redeemed because the beneficiary preferred to use the funds for some other purpose. These are included in the following analysis, but in the main the reasons given for redeeming shares relate to those who bought and sold their shares.

As indicated in table XIII–1, about two-thirds of regular account, but about four-fifths of contractual plan sellers, liquidated all of their shares in the mutual funds covered in the survey. Among those making partial redemptions the percentage of holdings cashed in was about the same in each group. No substantial differences were observed with respect to size distribution of total and partial redemptions by regular account holders. But among contractual plan investors who liquidated their holdings, there was a marked tendency for those with large accounts to close them out completely.

In terms of relative size, redemptions of shares by regular and contractual plan investors reflect the differential size of initial purchases which is typical of the two groups—as explained in section III. The median value of shares redeemed through regular accounts was between $1,000 and $2,000; for contractual plan holders the figure was between $300 and $500. (See table XIII-2.) (It may be recalled from section III that the median value of purchases was between $500 and $1,000 for regular accounts, and the median initial payment in contractual plans was $80.) Well over one-quarter of regular account redemptions exceeded $2,000, and 10 percent exceeded $5,000. Only 10 percent of contractual plans redeemed provided more than $2,000 in cash, and very few were larger than $5,000.

APPENDIX XI-A: TABLE XIII-1.—*Method of share acquisition and type of redemption, by type of account*

[Percentage distribution]

Method of acquisition and type of redemption	Regular account	Contractual plans	Method of acquisition and type of redemption	Regular account	Contractual plans
Method of acquisition:			Partial redemptions (percent of holdings redeemed):		
Purchase	88	100	0 to 24	8	5
Gift	4	0	25 to 49	7	5
Inheritance	8	0	50 to 74	8	3
Type of redemption:			75 to 99	5	7
Total	67	78	No answer	4	2
Partial	32	22			
No answer	1	0			

APPENDIX XI-A: TABLE XIII-2.—*Size and type of redemptions, by type of account*

[Percentage distribution]

Size range	Regular accounts			Contractual plans		
	All redemptions	Total	Partial	All redemptions	Total	Partial
0 to $50	1	1	0	5	6	0
$50 to $99	1	0	2	10	9	15
$100 to $199	4	6	0	15	17	8
$200 to $299	8	11	2	15	14	23
$300 to $499	14	15	15	13	9	23
$500 to $999	18	17	20	15	15	15
$1,000 to $1,999	25	23	29	13	15	8
$2,000 to $4,999	18	15	20	10	11	8
$5,000 and over	11	12	12	4	4	0
Total	100	100	100	100	100	100

This behavior seems to be another facet of the tendency already noted for some investors with high income or large holdings of assets to shift from mutual funds into other types of assets. It may be recalled that the percentage of contractual planholders in professional and executive positions (with relatively high incomes) who liquidated shares was somewhat above their representation in the sample as a whole. They also owned a substantial proportion of the larger accounts redeemed. For both regular and contractual plan investors, a significant percentage of the larger accounts was closed out after the sharp decline in stock market prices in the late spring of 1962. The proceeds from many of these liquidations were shifted into other types of financial assets, especially by those holding regular accounts. This pattern of behavior is examined further below.

B. Intervals between purchase and redemption

The intervals between purchase and redemption for respondents to the redemption questionnaire are shown in table XIII-3. The table indicates that those redeeming regular purchases had held them longer than those redeeming contractual plans. The median interval between purchase and redemption was almost 6 years for those in the former group, but less than 3 years for those in the latter.

As a check on possible bias from returns of a mail questionnaire, purchase-redemption intervals were also determined for plan redeemers on the total redemption lists of plan sponsors from which the respondents were drawn. These intervals are shown in table XIII-4. As indicated, the median purchase-redemption interval for those redeeming in total was somewhat less than 3 years; the median interval for those accomplishing partial redemption was between 3 and 4 years (reflecting the fact that to be worth redeeming in part, a somewhat greater accumulation must exist). An examination of the underlying data indicated no differences in intervals held between those redeeming in March as opposed to June.

APPENDIX XI-A: TABLE XIII-3.—*Intervals between initial purchase and redemption of regular accounts and contractual plans of questionnaire respondents*

[Percentage distribution]

Interval between purchase and redemption	Type of account	
	Regular	Contractual plan
Within 30 days	0	0
30 days up to 6 months	1	3
6 monthsup to 1 year	2	5
1 year up to 2 years	9	26
2 years up to 3 years	10	20
3 years up to 6 years	20	29
6 years up to 10 years	24	14
10 years up to 15 years	9	3
15 years and over	1	0
No answer	24	0

APPENDIX XI-A: TABLE XIII-4.—*Intervals between initial purchase and redemption of periodic contractual plans, from plan sponsor sample data*

[Percentage distribution]

Interval between purchase and redemption	Type of redemption	
	Total	Partial
Within 30 days	1	0
30 days up to 6 months	2	2
6 months up to 1 year	5	5
1 year up to 2 years	20	12
2 years up to 3 years	24	18
3 years up to 4 years	15	23
4 years up to 5 years	11	14
5 years up to 6 years	10	9
6 years up to 10 years	9	11
10 years up to 15 years	2	5
15 years and over	1	1

Actually the time between purchase and redemption indicated in tables XIII-3 and XIII-4 would overstate the actual period of contractual plan investment if periodic payments were terminated significantly before redemption. The intervals between the dates of last periodic payments and redemption are shown in table XIII-5. The majority of contractual plan investors had ended periodic payments within 6 months of the redemption date. But the important proportion who ended them more than 6 months before liquidation reduced the average period of actual investment significantly below the 2- to 3-year period of investment already noted.

C. Reasons for the redemption of mutual fund shares

As already mentioned, a sharp dichotomy is evident in the factors inducing regular account holders and those with contractual plans to redeem their shares. (See table XIII-6.) Uses of money derived from the liquidation of contractual plans were dominated by expenditures on household or personal items. Household and personal consumption expenditures were also important for those redeeming regular accounts, but they account for only about half of the indicated uses. For this group, asset transfers take on almost equal importance.

APPENDIX XI-A: TABLE XIII-5.—*Interval between last periodic payment and redemption of contractual plans*

Interval	*Percent*
Within 30 days	27
30 days up to 6 months	17
6 months up to 1 year	14
1 year up to 18 months	10
18 months up to 2 years	0
2 years up to 3 years	5
3 years up to 6 years	3
No answer	24

APPENDIX XI-A: TABLE XIII-6.—*Reasons for the redemption of shares*

[Percentage of respondents indicating each reason] [1]

Reason	Regular account	Contractual plans
Consumption expenditures:		
Purchase of durable consumer goods	10	9
Payment of medical or hospital bills	5	9
Payment of other debts	12	34
Educational expenditures	5	7
Other household or personal expenditures	12	21
Purchase of a home	9	9
Investment in a business	3	5
Acquisition of other financial assets:		
Purchase of common stock other than fund shares	16	3
Purchase of shares in another mutual fund	9	5
Purchase of other types of securities	5	0
Open or increase savings accounts	9	7
Other purposes	4	3
No answer	21	14

[1] Because some investors indicated more than 1 reason for the redemption of shares, percentages add to more than 100.

The purposes for which funds were redeemed can be ranked roughly from the most- to least-pressing need to obtain cash. Payment of medical or hospital bills, payment of other types of debts, or household or personal expenditures would appear to be the most urgent purposes. Lower on the scale would be the purchase of a home or investment in a business. These would be followed by shifts into other financial assets—including other mutual funds, corporate and other securities, and savings accounts.

In terms of this ranking, the use by contractual planholders of mutual fund shares as a source of "rainy day" savings is clearly evident. Three-fifths of those redeeming contractual plans reported they used the proceeds for household or personal expenditure purposes. Repayment of debts other than medical bills was reported by one-third of contractual plan respondents. Medical bills and personal household outlays were reported by another one-fourth. These uses of proceeds from redemptions for emergency or immediate needs were listed by only one-quarter of regular account holders. Relative uses of proceeds for expenditures on durable consumer goods and education were similar for both groups.

Almost 40 percent of regular account sellers shifted from mutual funds into other financial assets. About 10 percent liquidated shares of one mutual fund and acquired shares in another mutual fund. About 16 percent used the money from redemptions to purchase corporate stock and a much smaller percentage to purchase other types of securities. In contrast, the proportions of contractual plan sellers who switched from one mutual fund to another or from mutual funds into other corporate securities were negligible. Overall a relatively small proportion of investors redeemed mutual funds to purchase homes or invest in businesses. Finally, almost 10 percent of investors redeemed mutual funds and left the proceeds in savings accounts.

A fairly large proportion of the asset switches described above were probably induced by the sharp decline in stock market prices in May 1962. The effects of the break in prices are especially evident among those who liquidated regular accounts.

D. *Expectations and decisions to redeem mutual fund shares*

Expectations about future share prices played different roles in the decisions to liquidate shares by these two groups of investors. The relevant data, classified by type of respondent and period of redemption, are shown in table XIII-7. Overall, at the time of redeeming shares about a third of former holders expected prices to change significantly within a year. Moreover, of this group with established expectations, the overwhelming majority expected prices to fall. Expectations of changes apparently influenced redemption decisions of about 20 percent of former holders of contractual plans and about one-third of regular account holders (virtually all who reported expectations of price changes).

Stock market movements between March and June 1962 had no discernible impact on expectations and decisions of those redeeming contractual plans in this period. The market decline did not affect the proportion of these investors holding definite expectations, the nature of the expectations, or the contribution of expectations to redemption decisions. It may be concluded, therefore, that for those liquidating contractual plans, expectations and associated investment motives played a minor role. This conclusion supports the finding drawn from reports of investors' motives for redemption that redemptions were dominated by household and personal expenditure considerations.

APPENDIX XI-A: TABLE XIII-7.—*Expectations and the decision to redeem shares, by type of respondent and period of redemption*

[Percentage distribution]

	Regular accounts			Contractual plans		
	March	June	Total	March	June	Total
Expectation that price of shares would change significantly in next year:						
Yes	24	48	33	29	29	29
No	71	50	61	71	71	71
No answer	5	2	6	0	0	0
Expectation that price of shares would—						
Rise	4	6	5	9	8	8
Fall	20	40	29	26	21	24
No answer	76	54	66	65	71	68
Did expectation of future price movement influence decision to redeem shares?						
Yes	23	46	32	20	21	20
No	41	27	35	31	29	31
No answer	36	27	33	49	50	49

The role of expectations was particularly significant in regular account liquidations. The market decline of May 1962 doubled the number of account holders who reported opinions of future market prices, adding them predominantly to those who expected future prices to fall, and doubled the number who attributed to pessimistic expectations an influence on their redemption decisions.

XIV. INVESTOR EXPERIENCE WITH MUTUAL FUNDS

As indicated in table XIV-1, a substantial majority of investors liquidating contractual plans reported losses on their investments. This was as true in March as in June. Since the bulk of contractual plan installments had been made before the stock market peak of December 1961, and prices in March had fallen only slightly from the December level, the losses reported by those redeeming contractual plans in March would seem to reflect the structure of sales charges rather than market changes.

The majority of regular account liquidators reported gains rather than losses, but the margin of those gaining to those losing diminished from March to June.

The preponderance of regular account sellers liquidating at a profit reflects their longer average interval between purchase and redemption, the general rise in stock prices during the period, and the lower effective ratio of sales charges to amounts invested.

APPENDIX XI-A: TABLE XIV-1.—*Reported gains and losses, by type of account and time of redemption*

[Percentage distribution]

Estimate of gain or loss	Regular accounts			Contractual plans		
	March	June	Total	March	June	Total
Net gain	60	42	52	25	30	27
Loss	19	40	28	64	52	59
Don't remember	5	4	5	11	13	12
No answer	16	14	15	0	4	2

When contractual plan and regular account sellers were asked to compare the actual investment performance of their shares with that expected at time of purchase, both groups reported similar evaluations of fund performance. About 45 percent of those responding indicated that their funds had performed the same as expected; about 10 percent reported they had performed better; and about 45 percent evaluated their performance as worse. These appraisals of performance are consistent with the gain-loss experience of regular investors as noted above. But there is some incongruity in the reports by some 55 percent of contractual investors that the performance of their funds was the same or better than expected, while at the same time almost 60 percent reported having realized losses. This suggests that a number of contractual plan investors distinguished between their own experience and that of their funds—that is, they recognized the incidence of sales costs. The extent of knowledge in this area is suggested by other data below.

Among contractual plan redeemers, a dominant majority, reflecting the fact that their investment programs were not completed, indicated that they had not accomplished their general investment objectives. A slight majority of those who liquidated regular accounts thought they had. However, when one includes consideration of the benefits expected from the mutual fund instrument,[17] a majority of those liquidating shares thought their shares had provided some of the saving objectives or investment benefits indicated. Over a third thought they had not.

Those liquidating contractual plans explained benefits received by emphasizing the encouragement of discipline in saving; regular account liquidators stressed the increase in market values, followed by mention of good management and benefits of diversification.

Regular account sellers who were disappointed with their purchase stressed elements of performance: that better performance could be obtained by direct investment in the stock market, that stock prices had fallen, and that fund shares had not performed as expected. But dissatisfied sellers of contractual plans emphasized a theme related to sales charges: they had not held their shares long enough, and the sales load was high. Price performance received minor attention.

Investors who redeemed shares were asked whether they had acquired any knowledge after their purchase which would have affected their decision to invest. About a third of contractual plan sellers and about a fifth of those liquidating regular accounts suggested that they had acquired information which would have had significance for their purchase. Again the themes were different. Topics mentioned by regular account holders included: a growing awareness through reading various publications that better performance might be available in other funds, and a concern for "high management costs." On the other hand, former contractual planholders mainly stressed topics relating to sales charges: they reported learning of front-end loads after the sale (10 per-

[17] Contractual plan sellers had expected to benefit primarily from professional investment management, the acquisition of discipline in saving, economic growth, and diversification. Regular investors had stressed expected benefits from professional investment management, diversification, and price appreciation.

cent of contractual redemptions), misrepresentation of sales charges by the sales representative (5 percent), and learning of methods of acquiring mutual funds without a front-end load (5 percent).

The lack of awareness by contractual plan buyers of the nature and implications of the structure of sales charges was pointed up in another fashion. The relatively short intervals already noted between purchase of such plans and redemption (and even shorter between purchase and discontinuance of payments) suggests heavy redemptions by those with incomplete plans. Over 90 percent of contractual plan sellers reported that their plans had not been completed. About half of these investors were aware at the time of redemption that the effective sales charges they had paid were greater percentages of their investments than if the plans had been completed. Almost an equal number indicated either that the charges were not greater, or that they didn't know. Of those who did recognize the effects of front-end loads on effective sales charges at redemption, over a fourth reported that they did not anticipate this effect at the time of purchase in the event their plan had to be redeemed before completion.

When those who redeemed contractual plans were asked how they regarded the " 'front-end-load,' or a large proportion of the sales charge deducted in the first year of the plan," about 60 percent reported it was a disadvantage, about 30 percent reported that it was an advantage, and 10 percent that it was neither an advantage or disadvantage.

Altogether this evidence derived from those who redeemed funds of lack of information and confusion about contractual plan sales charges would seem to reenforce the findings about investor knowledge drawn from purchasers in section X.

Part V. Summary and Conclusions

XV. SUMMARY AND CONCLUSIONS

I. Introduction

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

The Survey, conducted in October 1962, was based on a nationwide sample of investors who purchased or redeemed mutual fund shares in mid-March and mid-June 1962. The basic lists of purchasers included all those who opened new accounts with a particular fund or contractual plan sponsor on given days in March and June, and the lists of those who redeemed shares included all those who liquidated shares, totally or partially, from the same organizations on the same days. The selection of individual funds and plan sponsors was designed to provide a representative cross-section of the industry by type, size, and location of these organizations. A stratified random sample of 450 purchasers was interviewed by the field staff of a national market research organization. In addition mail questionaires were sent to random samples of 500 investors who purchased and 500 investors who redeemed shares. (Almost half of the mail questionnaires were returned in usable form.) The investors were divided into two basic groups; namely, those who acquired or redeemed "regular" accounts, and those who acquired or redeemed "contractual plans." Sixty percent of each sample was drawn from lists of regular accounts, and 40 percent from contractual plans. The allocation of 40 percent of each sample to contractual plans overstates the relative quantitative importance of these plans in the mutual funds industry, but the relatively large weight given to contractual plans was necessary to permit collecting a number of responses large enough to allow for significant subclassification.[18]

The regular account is simply an outright purchase, with or without a sales charge, in which the investor receives his stock certificates shortly after the transaction is completed. In addition to outright sales, many mutual funds also sell shares through "voluntary accumulation plans." These provide for the accumulation of shares by a sequence of purchases over time as determined by the investor, and involve sales charges comparable to those on regular accounts for the same organization. In the present study outright purchases as well as shares acquired under voluntary accumulation plans are included in "regular accounts."

[18] The characteristics of the samples are discussed more fully in app. I.

Investment programs administered by contractual plan sponsors embrace essentially two types of plans; namely, periodic and single payment. The typical characteristics of periodic plans are: (1) the purchase of shares by regular periodic payments which are expected to be kept up over the period of the plan; (2) a large proportion of first-year installments allocated to sales charges (normally 50 percent); (3) retail distribution by salesmen who call in person on their customers; (4) automatic reinvestment of dividends and capital gains without a sales charge; and (5) optional completion insurance. Single-payment plans, being essentially similar to outright regular purchases, were excluded from the Survey. Thus, in the present study the term "contractual plan" refers exclusively to periodic payment plans issued by contractual plan sponsors.

II. Characteristics of mutual fund investors

The typical mutual fund purchaser covered in the Survey was a man in his mid-to-late forties, married, with three dependents. His formal education ended with the completion of his high school work. His employment, involving specialized skills, provided an annual income between $5,000 and $10,000. He was covered by life insurance of between $10,000 and $15,000.

Although the majority of purchasers were buying mutual funds for the first time, the proportion which held other financial assets was greater than for the public at large. Almost one-third already held mutual fund shares, and more than two-fifths owned corporate stock other than mutual funds. Half of those reporting owned Government bonds, and a few also owned other types of bonds. Eighty percent or more of those who replied had savings accounts.

Behind this overall view of typical mutual fund purchasers, several significant differences are evident between regular account and contractual plan investors considered as groups. One of the most striking is the proportion of shares of each type purchased by investors in different occupational groups. The preference for regular accounts appeared to be strongest among those professional and executive people—accountants, bankers, lawyers, and securities' brokers and dealers—whom one might assume to be more familiar with financial matters. In contrast, a substantial majority of the investors in the semiskilled and service worker group bought contractual plans. These choices highlight a general tendency for the proportion of contractual plan purchasers to rise as levels of education, income, and occupational skills decline.

Another sharp contrast was observable in the characteristics of regular and contractual plan investors with incomes below $5,000. About the same proportion of buyers in each group was in this income category, but the people involved were quite dissimilar. A fairly large percentage of regular account investors with relatively low incomes were retired men or elderly widows, while another sizable percentage were young, single individuals. In contrast, many of the contractual plan purchasers with low incomes were heads of families employed in low-paying jobs. Finally, although the proportion of married respondents did not differ much between groups, the proportion of wives contributing to family income was much higher for contractual plan holders.

The proportion of regular account purchasers who already owned a variety of financial assets was considerably higher than for contractual plan buyers. The incidence of prior ownership of mutual funds by regular account buyers was twice that for contractual plan buyers. Three-fifths of regular account buyers, but only one-quarter of contractual plan holders covered by the Survey owned other corporate stock.

The characteristics of mutual fund shareholders—especially the large number of new investors from unskilled occupations and with little experience in financial matters, the high percentage of retired men and older women (including many widows)—should be kept in mind when appraising the investors' objectives, their knowledge of mutual funds, and their expectations about the future performance of their investments. These characteristics explain why many of these investors rely heavily on others (particularly on friends and relatives and sales intermediaries) for advice and guidance in managing their affairs.

III. Size and financing of mutual fund purchases

Data from the Survey confirm the description of mutual funds as primarily a vehicle for mobilizing the savings flows of small-to-medium-sized investors. More than half of regular account investors made purchases involving less than $1,000. More than half the contractual plan buyers invested initially less than $100.

Most contractual plans purchased involved long-term commitments—10 to 12 years being typical. No plan involved a commitment for less than 5 years. The average initial payment under contractual plans was approximately $80, or more than three times the average periodic payment of $25. Although plans occasionally are sold involving quarterly or annual payments, all of the plans covered in the Survey called for monthly payments. In the typical transaction, two monthly payments were made in advance as required by most of the plans. But in a substantial proportion the initial outlays represented a larger number of periodic payments.

For investors as a whole, the mutual fund purchases described above represented a relatively modest commitment in terms of buyers' annual incomes. Among all regular accounts, the median ratio of purchase to annual income was between 5 and 9 percent. However, this relationship was somewhat erratic, reflecting the investment of cash received as gifts or inheritances, as well as other asset transfers which are essentially unrelated to income.

For contractual plan investors, the median ratio of monthly payments to monthly income was between 3 and 4 percent. However, the ratio was particularly high for those having incomes of less than $5,000. For more than a half in this class it was above 10 percent, and for more than a third it was above 12 percent. By conventional standards these undertakings represent substantial financial commitments. If periodic payments of other kinds were added (e.g., repayment of consumer installment credit), the prospect of discontinuance or delinquency increases. Because of the structure of sales charges already noted, the considerable financial commitment represented by the periodic payments in contractual plans carries the danger of a financial sacrifice if the plans cannot be maintained.

A substantial majority of investors paid for their mutual fund shares out of current income or by withdrawals from savings accounts. Some, however, switched from other financial assets into fund shares, and still others put essentially windfall receipts into mutual funds. Regular account buyers used resources other than current income or savings accounts somewhat more frequently than purchasers of contractual plans. The latter group relied almost wholly on current income and savings accounts for the initial payment. Moreover, virtually all plan holders expected to make future payments out of current income.

The Survey provides no marked support for the thesis that mutual funds encourage significantly higher rates of saving out of income. No regular account investors reported that they paid for fund shares by reducing spending on durable goods or other personal household items. About 3 percent of contractual plan respondents indicated they obtained money for the initial payments in this way, and 6 percent said they intended to reduce current expenditures in order to make future payments. But in view of redemptions and lapses in purchases, such intentions may not always be carried out. Life insurance benefits, gifts, and legacies provided the funds for about 13 percent of regular account buyers, but for virtually none of those who acquired contractual plans. Moreover, a scattering both of regular account and contractual plan investors indicated that they borrowed against life insurance policies or converted such policies into cash in order to purchase mutual funds.

About a fifth of regular account buyers financed the acquisition of mutual funds by the sale of other assets. The majority in this group switched from corporate stock into fund shares, while a relatively small percentage liquidated Government bonds. A very small percentage (2 percent) of regular account buyers switched, some at salesmen's suggestions, from one mutual fund into the fund covered in the Survey.

IV. Investors' objectives and the choice of mutual funds

Investors were asked to report the general savings objectives they had in mind and the motives which induced them to purchase mutual funds. In both cases a number of options were provided, to which investors could add others. The majority of investors indicated they purchased mutual funds without specific savings objectives in mind. The least specific objective, general saving, was reported by nearly half the respondents. Among the specific targets, the provision for retirement was about twice as important as the next most frequently mentioned objectives, which were the accumulation of an estate and the financing of children's college education. Apparently few investors acquired mutual funds with the hope of enjoying larger current income. A small number bought shares to save with the ultimate desire of purchasing a business or home. For the most part, there was little difference in specific objectives between regular account and contractual plan purchasers. The outstanding observed difference was in the greater proportion of contractual plan buyers planning to finance children's college education.

The most frequently encountered reason given by both regular and contractual plan investors for acquiring mutual funds (mentioned by about 60 percent) was the desire for professional investment management. Portfolio diversification was also deemed of considerable importance. Almost one-half of contractual plan buyers cited discipline in saving as a chief reason for acquiring this type of investment.

The desire for capital gains was an investment incentive reported by a sizable proportion of regular and contractual plan investors. Somewhat less than 20 percent of respondents in each group indicated that they became owners of mutual funds to benefit from a rise in stock prices, but two other motives which are essentially variants of capital appreciation accounted for higher percentages of responses. Thus, the expectation of gains from economic growth was mentioned by more than one-third of all respondents. The belief that mutual funds provide a hedge against inflation was a consideration for one-quarter of each class of respondents.

The investors most interested in capital appreciation included proportionately more men than women, young people, those with higher education, professionals and executives, the middle and upper income groups, and investors who had purchased mutual funds or other corporate stocks previously. In contrast, it is interesting to note that women, older people, lower income groups, and new investors in equities of any kind emphasized professional management, diversification, and discipline in saving as reasons for purchasing fund shares.

Over 10 percent of regular account investors switched from other corporate stocks into mutual funds. (But at the same time, as noted below, some 16 percent of those redeeming regular account mutual fund holdings used the proceeds to acquire other corporate stocks.) Many of the investors who switched after the break in stock prices in May 1962 apparently became pessimistic about the outlook for individual corporate stocks and decided to shift into fund shares. Their comments and other responses suggest that they expected professional management in mutual funds to yield benefits superior to those they could have enjoyed by retaining the corporate stocks they sold.

V. Investor contact with sales representatives

The distribution of mutual fund shares takes several basic forms. The primary technique of distributing regular accounts is through principal underwriters who sell to independent broker-dealers, and this was the method employed by the majority of the funds included in the Survey. A small number distribute directly through fund-controlled selling organizations; the rest sell by mail; virtually all of which are no-load funds. One-quarter of the firms in the survey which sponsor contractual plans offer them primarily through their own affiliated organizations. Somewhat over one-third rely mainly on independent broker-dealers, and more than two-fifths use a combination of controlled selling arrangements and independent broker-dealers. Furthermore, a substantial proportion of the independent broker-dealers handling contractual plans specialize in the distribution of mutual funds rather than in issues traded generally in the securities market.

For four-fifths of regular accounts in the survey, the identity of the dealers who distributed the shares was known. Member firms of the New York Stock Exchange handled one-third of the transactions. Members of other exchanges accounted for 5 percent, and nonexchange members of the National Association of Securities Dealers (NASD) who do not specialize in mutual funds were responsible for 6 percent. Member firms of NASD specializing in mutual fund shares handled 23 percent, and 13 percent of the regular purchases were by mail.[19]

Sales representatives could influence the decision to buy mutual funds at two stages: (1) the initiation of the transaction and (2) the choice of a particular fund. It should be noted that the concept of "initiation" in the present context lacks precision, and therefore permits differences of interpretation by re-

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

spondents. In addition some investors may have a tendency to enhance their role in the transaction. On balance salesmen appear to have been more important in the investment decisions of contractual plan buyers than in the decisions of regular account purchasers. Sales representatives reportedly initiated half of the contractual plan transactions, and in one-third of the cases they were identified as the most important influence in the choice of the particular fund. One-third of regular account investors assigned the strategic role to salesmen in each phase of the investment decision. Half of regular account buyers indicated that they took the initiative, and one-third said they selected their own fund. Two-fifths of contractual plan investors took the first step, and less than one-fifth chose their own funds. Furthermore, well over two-fifths of contractual plan buyers (compared with one-seventh of regular purchasers) reported the advice of friends and relatives as the most important influence on the choice of the particular fund.

Close personal relationships between buyers and sellers have considerable bearing on the conditions under which mutual funds are sold. About a fifth of regular account, and about a third of contractual plan, transactions appeared to be handled by a sales representative who was also a friend or relative of the purchaser. Comments made in the personal interviews suggest that the personal relationships between buyers and sellers also have significance for the character of responses at many points in the Survey. A considerable number appeared reluctant to provide interviewers with information which might reflect adversely on the sales representative, and some seemed to attribute certain statements to the sales representatives on the assumption that such statements were required by securities regulations.

About 25 percent of regular purchasers reported no meetings with the sales representative, but virtually all contractual plan buyers reported that such meetings did occur. This different pattern of contact with the sales representatives suggests that regular account buyers more frequently relied on the broker-dealer firms with which they traditionally did business. Greater contact between contractual plan buyers and sales representatives is probably a reflection of the basic method of retailing such plans—personal calls on prospective clients in their homes or places of business. While a large majority of the meetings with contractual plan purchasers occurred in this setting, the proportion was much smaller for regular accounts. The more striking difference, however, is indicated in the fact that, in relative terms, five times as many regular account respondents as contractual plan buyers reported that the meetings took place in the offices of traditional broker-dealer firms.

Investors who met directly with sales representatives had an average of three meetings. The average time spent in all meetings by regular purchasers was between 1 and 2 hours, while purchasers of contractual plans spent approximately twice as much time with the salesmen. Sales representatives working through firms specializing in mutual funds seemed to make the greatest selling effort. They typically had direct contact with a larger percentage of their clients than did representatives of firms engaged in a general securities business, and they spent considerably more time with them. Finally, mutual fund specialists saw relatively twice as many clients at home as representatives of NYSE member firms or other member firms of NASD.

Surprisingly, 20 percent of regular account and 10 percent of contractual plan purchasers reported that they did not receive the fund's prospectus. In addition, a small number of regular purchasers did not remember. It should be noted that a failure to deliver a prospectus in connection with the purchase of mutual fund shares is a violation of law. Investors who did not receive the prospectus knew less about mutual funds than buyers as a whole. Whether they were poorly informed because they did not receive a prospectus, or whether their reported failure to receive a prospectus is simply evidence that they did not know what a prospectus was, clearly cannot be determined. In any case, regular account investors in the no-prospectus group who met with salesmen spent less time in the meetings than the average investor in the Survey, and contractual buyers spent substantially less. A majority of regular buyers in the no-prospectus group were customers of member firms of the New York Stock Exchange, and the same sales representative had previously sold to many of them both mutual funds and other securities.

VI. Investment counseling

As indicated above, salesmen were reported to have initiated from a third to a half of all purchases of mutual funds, and in addition were the most important.

influence in selecting the particular funds acquired by one-third of all purchasers. Thus the salesman played a major role in determining both the entry of mutual funds into the portfolios of investors and the particular funds selected. A number of questions in the Survey were directed toward the problem of investment counseling or provision of investment advice by sales representatives of mutual funds. While it is clear that the answers to these questions cannot reveal in detail the quality of advice received, they do provide a broad impression of the extent of this activity.

Apparently, sales representatives made inquiries about the incomes, financial assets, and financial obligations of about one-third of regular respondents with whom they had contact, and a somewhat higher proportion of contractual planholders. These responses seem to indicate that in about 60 percent or more of the cases the sales representative made no inquiry into these matters. It may be noted that the Rules of Fair Practice of the National Association of Securities Dealers requires that in recommending to a customer the purchase of any security, a broker-dealer must have reasonable grounds for believing that the security is suitable for the customer on the basis of the facts, if any, disclosed by the customer as to his financial position and needs, and the NASD has taken the position that the failure of a purchaser to volunteer information does not relieve the salesman of his duty to inquire. While in many cases prior information which the salesman may have gained through continuing customer-client relationships or close personal ties may satisfy his obligation, the proportion of transactions in which the salesman seemingly made no inquiry into investors' financial position would appear inevitably to involve some violations of the rule.

The failure to inquire into investors' financial positions would seem of particular importance in the case of periodic contractual plans. The concentration of sales charges in early periods of such plans makes them appropriate investment media only if there is a high probability that they can be carried through to completion, but they are questionable choices for contingency or "rainy-day" savings which the purchaser may need to fall back on to meet various emergencies.

Between 80 and 90 percent of all purchasers who had contact with salesmen reported that salesmen had initiated one or more of such topics as: tax treatment of payments from the funds, general income tax problems, quality of investments, taxes on investors' estates in the event of death, and problems relating to wills and trusts. Fewer than 20 percent of respondents said that the salesmen advised them to consult an attorney or financial adviser. Whether the training of mutual fund sales representatives equipped them to handle this array of complicated legal and financial topics is an open question.

In comparing funds, it was reported that salesmen had commented broadly on the suitability of a particular fund to the investor's needs, had referred to investment objectives of different funds, or had made general statements indicating that a particular fund was best. But on such topics as comparative sales charges, comparative expenses, or comparative performance, the responses indicated only negligible attention.

Some information was collected in the survey regarding the portfolios of mutual fund share purchasers. These data were limited to qualitative indications of the presence or absence of certain asset holdings at the time of purchase of mutual funds. They do not, therefore, reveal much detail on the total portfolios of mutual fund buyers. Nevertheless, they disclose some qualitative information relating to the assets of mutual fund buyers that may also have some significance in appraising the appropriateness of the investment decisions of these purchasers.

Of particular interest are those buyers who apparently held no assets other than mutual fund shares. These investors whose sole investments consisted of mutual funds constituted only about 3 percent of buyers on regular account, but included about 10 percent of all contractual plan buyers in the study. These contractual plan buyers had incomes averaging about $5,000. Typically, they were heads of families, of early middle age, with three or four dependents. Their coverage by life insurance was at the low end of the $5,000–$10,000 range.

It should be noted that about two-thirds of the purchases of this group were reported as initiated by mutual fund salesmen, as compared with a little less than half for contractual plan buyers in the sample as a whole. Given the deficiencies of the contractual form of mutual fund buying as a means for establishing contingency reserves, a question is raised as to the propriety of the sale of contractual plans to this group.

VII. Description of fund shares

To obtain an impression of the general description of mutual fund shares by sales representatives, investors were asked a series of questions concerning statements made during the discussion of the transaction covered in the survey. The overall image which emerges about investors' conception of mutual funds as derived from sales representations seems to be as follows: mutual fund shares are safe, relatively liquid assets which simultaneously provide the benefits of professional management and diversification. A large majority of respondents indicated they were told fund shares could decrease in value. A sizable number also reported that sales representatives said that shares were like savings accounts. It should be noted that the Securities and Exchange Commission's Statement of Policy on mutual fund selling material forbids any representation or implication that shares of an investment company are similiar to savings accounts. A fair proportion of regular account and a somewhat larger proportion of contractual plan investors said the sales representative discussed mutual funds as a possible hedge against inflation. The vast majority of contractual plan buyers said that the sales representative mentioned such plans as a means to encourage savings.

About 60 percent of investors reported that sales representatives said the shares of their funds were registered with the Securities and Exchange Commission. In addition, some 40 to 50 percent also said that mutual funds' management and investment policies were presented to them as being supervised or controlled by the Securities and Exchange Commission or other agency of the Federal Government. It should be noted that the Statement of Policy also forbids any reference to registration or regulation of a mutual fund without explaining that this does not involve supervision of management or investment practices or policies.

Some evaluation of the impact of sales representatives' statements on investors' decisions to buy mutual funds can be made—but not with much precision. In general, according to respondents' replies, the effect was greater among contractual plan purchasers than among those who acquired regular accounts. The suggestion that fund shares are like savings accounts apparently was the statement with the most influence on investor decisions. Moreover, a large proportion of contractual plan buyers were impressed with the argument that this type of plan encouraged saving. Both groups attributed some significance to the statement that fund shares provide a hedge against inflation, but the frequency was somewhat higher among contractual plan investors. Finally, while a sizable proportion of all investors may well think that mutual funds' management and investment policies are supervised or controlled by the Securities and Exchange Commission, few explicitly mentioned this as a factor in their investment decision.

VIII. Description of fund operations

To shed light on the role of sales representatives as sources of information concerning certain technical aspects of mutual funds, investors who met with salesmen were asked about the latter's explanations of several basic features of mutual fund operations. The vast majority in both groups said that sales representatives explained the investment objectives of their particular funds. A substantial proportion of contractual plan respondents, but fewer regular plan investors, indicated that salesmen explained the expenses incurred by the fund for investment management and administration.

A substantial majority of regular account investors reported that the salesmen described the amount of sales charges which would be deducted from the amount paid for the fund shares. Eighty-two percent of contractual plan purchasers said that they had been told what proportions of their payments would constitute sales charges during the first year of the plan; 6 percent answered in the negative, and the rest did not remember. About two-thirds of the contractual plan buyers also reported receiving an explanation of the sales charges over the life of the contract.

An attempt was made to determine whether a link between sales representatives' description of fund operations and the level of investors' understanding of these operations could be found. The overall results were mixed. For regular account buyers who met with salesmen knowledge of sales charges, expenses of funds, and sources of fund incomes seemed to improve somewhat with the number of meetings held, but this was not true of contractual plan investors. For both groups there was no apparent relationship between aggregate time spent with salesmen and the level of knowledge.

Regular account and contractual plan investors who reported that the salesman had explained sales charges showed greater understanding in this area than those who answered in the negative. Investors who reported that the salesman had described the fund's expenses for investment management and administration also knew more about these matters than those who said they did not receive such an explanation. Nonetheless, as noted below, even the groups who reported being informed of fund operations exhibited modest levels of understanding in these areas.

It must be emphasized that the finding of some relationship between reported statements by salesmen and knowledge must be interpreted with caution. A positive finding may well indicate that sales presentations were informative; but to some degree they may also reflect an inherent bias in the way respondents typically reply to questionnaires of the sort used in the survey—namely, respondents who are not familiar with the information requested or terms used may be inclined to suggest that the salesmen had not discussed the relevant points. Alternatively, investors may have assumed that the issues were covered because the questions were asked.

IX. Representations about changes in market values

Among those mutual fund investors who had direct contact with their mutual fund salesmen, about 90 percent indicated that salesmen commented upon possible changes in the market value of fund shares. Between 50 and 60 percent of respondents reported that salesmen emphasized that share prices were equally likely to rise or fall in a year or less, and from 30 to 40 percent indicated that share prices were more likely to rise than to fall in this same period. About 10 percent of regular respondents and a somewhat higher percentage of contractual plan buyers reported that even for the short period of a year or less salesmen had emphasized either a strong chance of a rise with almost no chance of fall, or the prospect of an almost certain rise in prices. With respect to forecasts of share price changes emphasized by salesmen for periods longer than a year, about three-quarters or more of the responses indicated relatively restrained comments. Thus about 30 percent indicated an equal likelihood of rise or fall, and about 45 percent, the somewhat greater likelihood of a rise than a fall. A quarter reported that salesmen indicated either that there was a strong chance of a rise with almost no chance of a fall, or that a rise in price was certain. Moreover, among this last group, 10 percent or more of respondents meeting with salesmen reported that salesmen emphasized that in the long run the rise in value was certain.

In addition to questions of the probabilities of general rises and falls in share prices, an attempt was made to elicit information regarding any specific rates of change suggested as likely by mutual fund salesmen. About 20 percent of all respondents who met with salesmen reported stress on some specific amount or rate of growth. Among respondents who reported stress on specific amounts or rates of growth in share values by salesmen, a majority indicated that a period of 10 to 14 years was emphasized in connection with the forecast of growth.

The Commission's Statement of Policy on selling literature for mutual funds requires that charts and tables used in such material cover the life of the company or the preceding 10 years or longer periods in multiples of 5 years. The concentration of reported emphasis of growth by salesmen over a period of 10 to 14 years suggests an association of future prospects with the historical record as described in the prospectus and associated material. In addition comments by contractual plan investors also suggest an attempt to link prospective performance with the periods of the plans, which largely had a similar duration.

For regular account buyers, almost 10 percent of those meeting with sales representitives, or about half of the group reporting salesmen's emphasis on specific rates of growth, reported that salesmen had emphasized rates of growth of market values of shares of double or triple or more. Among those buying contractual plans over one-half of those reporting salesmen's emphasis on specific rates suggested that a doubling or more of fund asset values might reasonably be anticipated.

The overall impression conveyed by the responses summarized in the preceding discussion is that a majority of mutual fund salesmen for both regular accounts and contractual plans exercised restraint in discussing prospective changes in the market values of mutual fund shares with buyers. But this record also discloses much less restraint by some fund salesmen. This latter group apparently put heavy emphasis on the growth in market values of mutual fund shares during the stock market boom of the 1950's, and conveyed to buyers a strong impression that a similar performance was a reasonable likelihood for the future.

X. Investor knowledge

The study included a survey of investors' knowledge of sales charges of their own and other funds, expenses of funds for investment management and administration, and the important sources of funds' earnings. In addition, attention was given to a few special characteristics of contractual plans. Finally, relationships between investors' knowledge of mutual funds and various characteristics of investors, the funds, and sales intermediaries were also explored.

In appraising the extent to which mutual fund investors are informed about their underlying investment, it is well to bear in mind that guidelines do not exist which would make it possible to compare mutual fund investors with other classes of participants in financial markets. Thus one cannot conclude that mutual fund investors are either better or more poorly informed than purchasers of listed or over-the-counter stocks, or holders of savings accounts in general, or purchasers of insurance, among others.

Moreover, it is well to bear in mind that a survey of investor knowledge of mutual funds does not necessarily imply that mutual fund organizations or salesmen are primarily responsible for whatever state of knowledge is found to exist, or are responsible in greater degree than are the sellers of any other commodity or service. Nevertheless, despite the lack of comparative data for buyers of other financial claims, information on the state of knowledge of buyers of mutual funds is important in revealing the nature of the market in which the funds are sold, the kind of sales strategies likely to be operative, and the nature and extent of competitive pressures which are likely to bear on those selling funds. For this purpose what is relevant is not only investors' knowledge of the securities they actually bought, but also their comparative knowledge of sales charges, expenses, and performance of other funds, and other available alternatives.

From the evidence derived from the Survey it seems clear that mutual fund buyers had only a modest understanding of their investment. While they made some use of the prospectus, they appeared to place heavy reliance on information from and the recommendations of sales representatives, friends, and relatives, and to use relatively few outside sources of financial information.

Sources of information.—The average time devoted to reading the prospectus was a little over an hour for regular purchasers, and a little less than 1½ hours for those who bought contractual plans. Few purchasers apparently made use of information other than that provided by sales representatives of the funds. About 40 percent mentioned other sources of information, but these were mainly friends, relatives, and other purchases. About 10 percent of purchasers mentioned financial sections of newspapers or other financial publications.

Sales charges.—While more purchasers were informed on sales charges than on other elements of their investment security, for most their knowledge was incomplete and often inadequate. Among those who bought funds with sales charges on regular account, about one-eighth apparently thought they paid no sales charge, and an equal proportion did not know whether they did or not. In addition to those who believed that they did not pay a sales charge or did not know whether they did or not, over one-quarter could make no estimate of its amount. Overall, less than 40 percent provided a reasonable estimate (taken here as 7 to 9.5 percent) of the sales charge they had paid. On the other hand, over 90 percent of those who purchased no-load funds stated that they had paid no such charge.

In contractual plans, a substantial part of the sales load is deducted from periodic payments made in the first year (the "front-end load"). For most plans (and all but one in this survey), the sales load during the first year was about 50 percent, to which was added custodian fees and other administrative charges. As noted at various points above, the distribution of these charges over the number of installments is important for purchasers of contractual plans because if the plans are not carried to conclusion, the overall sales charge would be higher than that applicable over the life of the plan; and if the plan is terminated in early years, the loan can result in substantial absolute losses unless the stock market exhibits substantial gains.

To determine their understanding of the level and structure of contractual sales charges, planholders were asked to estimate these charges for the first year, during the first 2 years, and over the life of the contract. Forty percent of contractual plan purchasers could make no estimate of the first-year sales charge, and only about two-fifths of purchasers of these plans placed the first-year charge within a reasonable range (taken here as 40 to 60 percent of the payments in the first year).

Considerably fewer contractual plan buyers knew the level of the sales charge over the life of the contract. About two-thirds could make no estimate of what it might be, and somewhat fewer than one-fourth of contractual purchasers provided a reasonable estimate (here taken as 5 to 15 percent). As regards the effective sales charge which would be applicable if the funds were redeemed within 2 years, over 75 percent attempted no estimate, and only 5 percent of contractual respondents made a reasonable approximation of the charge.

Generally, mutual fund buyers had little knowledge of alternatives. About three-quarters of regular purchasers who paid normal sales charges did not know whether there were funds with sales charges which were higher or lower; about the same proportion was unaware of the existence of no-load funds. Among investors in contractual plans, a somewhat higher percentage was unaware that fund shares could be purchased with sales charges different from that of the fund they bought. A similar proportion was not aware of the availability of no-load funds.

Fund expenses.—Investors' knowledge of annual expenses incurred by their funds for investment management and administration was approached in two ways. They were asked to estimate these expenses as a percentage of assets and as a percentage of funds' annual incomes. About 70 to 80 percent of all purchasers could make no estimates of these expenses. Of those that could, estimates on the asset base tended to be too high, and those made on the income base tended to be too low.

To determine whether investors in funds with low expense ratios were aware of differences in the expense ratios of their funds as compared to funds as a whole, estimates of purchasers of six funds at the low end of the expense ratio scale were compared with those of regular investors as a whole. There appeared to be no significant difference between the estimates of shareholders in funds with low expense ratios and shareholders as a whole. Buyers' lack of knowledge of fund expenses and their apparent inability to compare such expenses suggest that funds' expense ratios will have little competitive effect on sales.

Sources of earnings.—Investors' knowledge of the sources of earnings of their funds, which is a rough indication of their understanding of the performance and risk implications of mutual fund investment, was somewhat greater than their knowledge of expenses. But there was evidence that a considerable number had either a vague impression or a clear misconception of the functions performed by their funds. For example, almost 20 percent did not know whether funds derived earnings or profits from buying and selling securities in the stock market, about 25 percent thought that sales charges paid by new investors contributed to earnings of their funds, and an additional 30 percent were uncertain on this point.

The front-end load and periodic payments associated with contractual plans suggested two questions bearing on purchasers' understanding of these features. On the isue of whether there was any financial disadvantage if a contractual plan were not carried out, 60 percent indicated that there was a disadvantage, but almost a third said that there was not. This evidence of lack of knowledge of the implications of the front-end load is reinforced by reports from those redeeming plans, as discussed below.

XI. Investor expectations

One of the findings of the present study was high investor expectations regarding the prospective performance of both the stock market in general and of mutual funds relative to the market. Despite the sharp rise in stock prices over the preceding 10 years, one-third of regular investors and almost one-half of contractual plan buyers who indicated a familiarity with the past performance of their funds expected them to do even better in the next 10 years. More than 80 percent of both groups expected them to perform as well or better, and fewer than 20 percent expected them to do less well than during the preceding decade.

Those who were able to compare their funds with other corporate stocks almost unanimously expected their funds to do as well as or better than the stock market generally in the 10 years ahead. Half of the contractual plan buyers expressing an opinion and almost as high a proportion of comparable regular account buyers expected their funds to do better than the market. In comparing the perform-