

CHAPTER VIII

INVESTMENT ADVISERS OF OPEN-END INVESTMENT COMPANIES ¹

INTRODUCTION

A. SCOPE OF THE CHAPTER

The present chapter is a product of growing concern by the Securities and Exchange Commission with certain aspects of investment adviser relationships with investment companies and their shareholders, on the one hand, and with dealers in investment company shares, on the other. With respect to the former, since the unsuccessful Commission effort to halt the sale of a controlling block of shares of Insurance Securities, Inc.,² there has been a considerable increase in secondary offerings of the shares of investment advisers and underwriters by their respective control groups. The position of the Commission, and others, has been that such sales are inconsistent with the maintenance of a true fiduciary relationship between an investment adviser and the investment company shareholders; the selling shareholders are trading in a fiduciary interest, and the responsibilities of the adviser become divided between the shareholders of the investment company and the public shareholders of the adviser itself. This issue is not dealt with directly in the present chapter, but the discussion of de facto relationships between advisers and their client investment companies in section II, and the analysis of services rendered and fees charged mutual funds by their advisers in section III, have an obvious bearing on the question.

The tremendous growth in the open-end investment company business has also been accompanied by increased controversy over the level of management fee rates charged shareholders³ and the magnitude and character of efforts to sell mutual fund shares. The question of management fee rates is looked at from a number of different standpoints in sections III and IV of the present chapter: their levels in relation to the size of open-end company assets managed; the services rendered by advisers in exchange for these fees; their relationship to services provided and fee rates charged other clients by advisers who service both; and their justification in the light of a financial analysis of advisers' expenses, income, and net worth. The examination in section II of the affiliations of officers, directors, and trustees

¹ By Edward S. Herman and Douglas Vickers.

² In late 1958 the U.S. Supreme Court denied the request of the Commission to review the determination of the Court of Appeals for the Ninth Circuit that, among other things, the sale by holders of the controlling shares of Insurance Securities, Inc., an adviser and principal underwriter to an investment company, at a price substantially in excess of net book value, did not constitute gross misconduct or a gross abuse of trust with respect to the investment company within the meaning of sec. 36 of the Investment Company Act of 1940.

³ This has been reflected, in part, in the substantial number of lawsuits instituted in recent years challenging the level of management fees.

of open-end investment companies is also relevant to an understanding of the level and behavior of management fee rates.

No investigation of methods used in selling the shares of open-end companies has been carried out in the present chapter. However, a short section (V) has been devoted to an examination of the use of brokerage commissions to reward dealers for the sale of mutual fund shares and for other purposes.

The scope of the present chapter is indicated by the subheadings for the five sections which follow this introduction. These are:

- I. General characteristics of investment advisers of open-end investment companies.
- II. Control and affiliations of investment advisers.
- III. Advisory services and fee rates to open-end companies and other clients.
- IV. Income and expense account analysis.
- V. Brokerage allocations to dealers in open-end company shares and to others.

B. BACKGROUND OF THE STUDY OF INVESTMENT ADVISERS

A small volume entitled "Investment Counsel, Investment Management, Investment Supervisory, and Investment Advisory Services" was included in the Securities and Exchange Commission "Report on Investment Trusts and Investment Companies" in the late 1930's. This study was based largely on 394 replies to a questionnaire sent out to virtually all investment counseling firms in the country. Of this number 50 were submitted by advisers who had investment company clients. Thus, the earlier inquiry was directed toward investment advisers in general rather than those serving investment companies. The present chapter deals with 163 advisers who had open-end investment company clients at the end of 1960. Sixty of these one hundred and sixty-three advisers also had advisory clients other than investment companies. For this narrower range of advisers the present study builds on the valuable model of the earlier investigation, updating the material and dealing more intensively with affiliations, fees, financial, and other characteristics of investment advisers, and breaking new ground on broker-dealer relationships.

The special "Questionnaire Concerning Investment Companies and Their Investment Advisers and Principal Underwriters," on which the present chapter is largely based, was worked into final form by a cooperative effort of the Commission staff and the staff of the Securities Research Unit. Some adjustments in the final questionnaire resulted from several conferences between the Commission and its staff on the one hand, and representatives of the mutual fund industry on the other. The most significant adjustments of this character were those which reduced the amount of financial information to be made available in the financial statements of investment advisers. These are specifically referred to in section IV of this chapter.

The investment adviser questionnaire was sent out by the Commission in December 1960, with a request that replies be submitted to the Wharton School by no later than March 15, 1961. Unfortunately, numerous delays kept the number of unworkable returns too large to permit major processing until the end of July. However, by August 1, 1961, extensive correspondence by the Securities Research Unit and some followup by the Commission had elicited close to a full population response. In most cases members of the industry participated in the inquiry in a highly cooperative way. The serious

difficulties in respect to quality of return were again centered mainly in the handling of the requested financial statement of the investment adviser. In particular, in some important instances the requested breakdowns were declared to be impractical. These are again referred to in section IV of this chapter.

C. AN INTRODUCTORY NOTE ON INVESTMENT ADVISERS AND THEIR REGULATION

In its broadest sense, an investment adviser is any individual or firm who furnishes advice regarding the purchase or sale of securities. A narrower definition used in the 1939 study referred to earlier, confined advisers to—

those persons or organizations who were engaged primarily in the business of furnishing investment counsel or advice * * *.

An intermediate-type definition is used in the Investment Advisers Act of 1940, where an investment adviser is—

any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities; * * *.

As a specialty business investment advising became important only with the great expansion of public interest and participation in the security markets after the First World War. Of the 394 counseling firms included in the 1939 study of advisers, only 10 were organized prior to 1919. Surprisingly, only 36 of the 394 were formed between 1920 and 1928 inclusive—the boom in organization commenced in 1929 and reached its high points in 1932 and 1936. Of the 394 advisers in existence in 1939, only 90 had been organized by the end of 1929. In 1960 investment advisers registered under the Investment Advisers Act of 1940 numbered 1,867. This total excluded broker-dealers not separately compensated for investment advice, advisers with fewer than 15 clients and not soliciting business from the general public, advisers who confined their activities to insurance companies and investment companies, and a wide variety of other exempted individuals and firms providing investment advice.

Investment advisers were not subject to Federal regulation before 1940, although at least seven States had brought them under some sort of supervision prior to that date (mainly in the 1930's).⁴ Out of the comprehensive inquiry of the 1930's into the problems of the investment company and investment advisory businesses came two sets of laws regulating investment advisers. The Investment Advisers Act of 1940 covered the bulk of investment advisers providing investment advice for compensation; those serving exclusively as advisers to investment companies were left for regulation under the Investment Company Act of 1940.

About two-thirds of the 60 advisers of open-end companies included in this study who also provided investment advice to other clients were registered under the Investment Advisers Act of 1940. Before 1960 that act was narrowly restricted in substantive content, providing mainly for the registration (and, in effect, licensing and compulsory

⁴ See Securities and Exchange Commission, Report on Investment Trusts and Investment Companies, "Investment Counsel, Investment Management, Investment Supervisory, and Investment Advisory Services," (1939), ch. 7.

divulgence of information) of those advisers covered by its provisions. Mr. David Schenker, chief counsel for the Securities and Exchange Commission investment company study of the late 1930's, expressed the view in Senate hearings on this legislation that its fundamental purpose was to—

get something which approximated a compulsory census. * * * Aside from that fundamental approach, the only other provisions in that title are just a few broad general provisions which say that you cannot embezzle your client's funds or you cannot be guilty of fraud.⁵ One other provision relates to the transfer of the contracts which a client makes with investment counsel.⁶

In 1960 the Investment Advisers Act was amended in several important respects. Most important, advisers were not only prohibited from engaging in fraudulent, deceptive or manipulative acts or practices, the Commission was also given the power to issue rules designed to prevent such acts and practices. All these antifraud and anti-manipulative provisions are now applicable to unregistered as well as registered investment advisers.

In the Investment Company Act of 1940 the definition of investment adviser is specially tooled to the requirements of the investment company business. An adviser in that title is—

(A) any person (other than a bona fide officer, director, trustee, member of an advisory board, or employee of such company, as such) who pursuant to contract with such company regularly furnishes advice to such company with respect to the desirability of investing in, purchasing or selling securities or other property, or is empowered to determine what securities or other property shall be purchased or sold by such company, and (B) any other person who pursuant to contract with a person described in clause (A) regularly performs substantially all of the duties undertaken by such person described in clause (A); * * *

Excluded from B are: (1) those providing advice through uniform publications available to subscribers; (2) those providing information on general economic trends; (3) companies providing information at cost to clients; (4) advisers whose compensation must be approved by a court; (5) others determined by the Commission to be outside the intended coverage of this legislation.

Congress utilized four principal devices in the Investment Company Act of 1940 for regulating these companies and their advisers.⁷ First was enforced divulgence of information regarding the control group, its proposed policies, its compensation to be paid under the advisory contract, its affiliations and transactions with affiliated persons. It was declared illegal to falsify or omit information on any of these matters, or to change policies without the sanction of the owners of a majority of shares. Second, the number of directors affiliated with the adviser was limited to no more than 60 percent of the Board; and a related requirement provided that the company cannot employ as regular broker or underwriter any officer, director, employee, or person affiliated with these individuals, unless a majority of the board of directors is not affiliated with the broker or underwriter. Here the shareholder was to be protected by the existence of a substantial

⁵ "Fraud" is presumably used by Mr. Schenker to encompass section 206(3), which makes unlawful "acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for any person other than such client, without disclosing to such client in writing before the completion of such transactions the capacity in which he is acting and obtaining the consent of the client to such transactions."

⁶ Investment Trusts and Investment Companies, hearings before a subcommittee of the Committee of Banking and Currency, on S. 3580, U.S. Senate, 76th Cong., 3d sess., pt. 1 (1940), p. 48.

⁷ These are in addition to the general section 36 authorization to the Commission to bring actions against "gross misconduct or gross abuse of trust. * * *"

minority (or majority) of "independent" members of the board of directors, who would either actively protect his interests or at least serve to prevent any gross abuses.

Third, the Investment Company Act of 1940 gave investment company shareholders certain legal rights to participate in decisions pertaining to the initiation and continuance of investment management and underwriting contracts. All investment advisory contracts entered into after March 15, 1940, must be approved by the owners of a majority of shares and must exactly describe the compensation to be paid under the contract; and investment advisory and underwriting contracts may be continued beyond 2 years only if approved annually by the board of directors or the owners of a majority of shares of the company. If a vote of a majority of shares is not obtained for renewal of an investment advisory or underwriting contract, then it must be approved by a majority of the directors who are not parties to or affiliated with parties holding such contract. In addition, all written investment advisory contracts, unless in effect prior to March 15, 1940, must provide that the board or the vote of a majority of shares of an investment company may terminate such contracts on not more than 60 days written notice. All investment advisory and underwriting contracts must terminate automatically in the event of assignment. As regards agreements in effect prior to its enactment, the act of 1940 provided a period of grace extending to March 15, 1945, during which time investment advisory and underwriting contracts either had to be brought into conformity with section 15(a) and (b) or terminated.

Thus, shareholders are to be protected against the initiation of abusive advisory contract arrangements by the obligation that they approve them by majority vote. Subsequently, contracts must be approved regularly by a majority of shareholder votes or by a majority of unaffiliated members of the board of directors.

Fourth, the Investment Company Act of 1940 directly prohibits principal transactions between affiliated persons and the investment company, with certain minor exceptions, and with some provision for exceptions to be made upon application to and evaluation by the Commission. Here reliance on the protections of corporate democracy, as improved upon by previously mentioned provisions, was felt to be inadequate in the light of the experience with and possibilities of abuse. The effectiveness of these various protections is taken up at several points in the text that follows.

I. GENERAL CHARACTERISTICS OF INVESTMENT ADVISERS OF OPEN-END INVESTMENT COMPANIES

A. TYPES OF INVESTMENT ADVISERS OF OPEN-END INVESTMENT COMPANIES AND THEIR PRINCIPAL ACTIVITIES

One of the most striking features of the 163 investment advisers of open-end investment companies that are the subject of the present inquiry is their great variability in activities, size, and other characteristics. For some advisers, the advising of open-end investment companies is an exclusive function; for others it is one among a number of important activities; and for a number of advisers it is a fringe activity of minor importance. The 28 smallest advisers each had a net worth of less than \$10,000 at the end of 1960; the 30 advisers at

the upper end of the size spectrum each had a net worth in excess of \$1 million. The variation in size of these advisers reflects in part the considerable differences in the character and diversity of activities of these enterprises.

Table VIII-1 presents a classification of 163 investment advisers according to their activities carried out on behalf of the advised open-end companies. This classification is based on a broad set of functional categories, the first of which is investment advising and management.⁸ We can see in table VIII-1 that 91, or 55.8 percent, of the 163 advisers function solely as investment advisers and managers in their relations with open-end companies which they supervise. This includes 29 advisers who manage no-load companies, and who consequently may and frequently do carry out some selling activities. These are placed in this category on the dual ground that these activities are usually modest, and because no income is derived directly from them. If these advisers were shifted to category 3, the number of "pure" advisers would fall from 91 to 62 (from 55.8 to 38.0 percent).

TABLE VIII-1.—Classification of 163 investment advisers, by function performed for open-end companies, 1960

Function	Number	Percent
1. Investment advising and management (IA).....	91	55.8
2. IA, and underwriting of investment company shares (U).....	34	20.9
3. IA+U, and retailing investment company shares (R).....	21	12.9
4. IA+U+R, and serving as broker in purchases and sales of portfolio securities of the investment company (B).....	9	5.5
5. IA+B.....	4	2.5
6. IA+U+B.....	4	2.5
Total.....	163	100.0

¹ Includes 29 advisers supervising no-load companies. These receive no income directly from their distribution activities, but might plausibly be included under 3 from a functional standpoint.

Thirty-four advisers (20.9 percent) engage in and derive income from advisory and underwriting activities. Twenty-one additional advisers (12.9 percent) advise mutual funds and sell their shares (with a positive sales charge) at both wholesale and retail. Nine advisers (5.5 percent) do advising, the wholesaling and retailing of investment company shares, and brokerage work in connection with portfolio transactions. Four advisers (2.5 percent) do advising and brokerage work only, and four engage in advising, underwriting, and brokerage work for their supervised mutual funds.

It should be noted immediately that table VIII-1 refers to the activities of the included investment advisers as legal entities, thus disregarding the activities of the numerous brokers, dealers, and underwriters affiliated with these advisers. If affiliated organizations are brought into the picture—which is of course essential for a complete picture of the complex of interests of controlling management groups in the activities of open-end companies—we must make the following adjustments: In 10 cases underwriting only is done by a subsidiary of an investment adviser; in 3 instances it is done by a parent firm of the adviser; and in 14 cases it is done by an otherwise

⁸ All but 16 of the 163 advisers carry out one or more administrative, management, or "housekeeping" functions for supervised investment companies, in addition to simply providing investment advice. For brevity, in the discussion that follows, investment advisory functions will be assumed to encompass management activities. These matters will be discussed in more detail in sec. III.

closely affiliated organization.⁹ In 13 cases the underwriting and retailing of open-end company shares is done through an affiliated organization, and in a single instance they are carried out by a parent firm. In one case a subsidiary of the adviser is an important retailer of the shares of its supervised investment company; in three cases the parent of the adviser is a substantial retailer, and in three other instances retailing is carried out by closely affiliated retailers. In three cases underwriting, retailing, and brokerage are all done for the relevant investment companies by the parent of the adviser; and in six instances all three activities are carried out by an otherwise affiliated organization. In a single instance a parent firm of the adviser does only retailing and brokerage.

To summarize: in addition to direct participation by the investment adviser in the distribution of open-end company shares and brokerage, in many cases advisers and open-end company control groups participate in these activities indirectly, through parents, subsidiaries, or otherwise affiliated organizations. Specifically, in 50 instances the underwriting of investment company shares was done through 1 of these indirect agencies; in 31 cases substantial retailing of mutual fund shares was carried out by an affiliated person; and in 10 cases substantial brokerage work was done by an agency affiliated with the investment adviser.

A second classification of investment advisers is described in table VIII-2, which is based partly on function and partly on the external control relationships of the adviser. The 27 "independent" advisers are not subject to the control of any external organization or affiliated group and are engaged largely in advising. The second category, with 34 members, also includes advisers not subject to external control, but who also obtain direct remuneration for underwriting the shares of the underlying investment companies. These 2 categories of independent advisers encompass 61, or 37.5 percent, of the 163 advisers of open-end companies. The third category includes all investment advisers who are members of systems of closely affiliated advisers, which are not subject to external control or classified elsewhere by function.¹⁰ There are 12 advisers who are members of such independent multiple-adviser systems.

⁹ Usually the affiliated underwriter is either majority-owned by an individual or group who controls the adviser, or the underwriter has a common parent with the adviser.

¹⁰ A troublesome problem in this classification scheme was the location of advisers affiliated with other advisers who fit under other categories. In dealing with a company such as Loomis Sayles & Co. (Canada) Ltd., a subsidiary of the investment counseling firm Loomis Sayles & Co., the affiliate is included under 5, as a subsidiary of an investment counseling firm, although both advisers could reasonably have been put under 3. This means that category 3 excludes a number of multiple-adviser systems, not subject to external control, but included elsewhere in the classification.

TABLE VIII-2.—*Classification of types of investment advisers of open-end investment companies*

Types of advisers	Number of advisers	Percent of advisers
1. Independent investment adviser.....	27	16.6
2. Independent investment adviser-underwriter.....	34	20.9
3. Member of independent investment adviser system.....	12	7.4
4. Investment counsel.....	32	19.6
5. Subsidiary of investment counsel.....	4	2.5
6. Broker-dealer or otherwise engaged primarily in selling securities.....	16	9.8
7. Subsidiary of security dealer.....	11	6.7
8. Subsidiary of underwriter of investment company shares.....	5	3.1
9. Bank or trust company.....	4	2.5
10. Insurance company subsidiary.....	4	2.5
11. Subsidiary of diversified holding company.....	4	2.5
12. Subsidiary of company designed to hold investment adviser shares.....	3	1.8
13. Other.....	17	4.3
Total.....	163	100.0

¹ These 7 advisers include the following: (1) Subsidiary to closed-end investment company; (2) savings bank subsidiary; (3) joint subsidiary of investment counsel, investment bank, and bank and trust company; (4) subsidiary of sales finance company; (5) joint subsidiary of investment counsel and a brokerage firm; (6) subsidiary of oil exploration and production firm; (7) subsidiary of real estate and personal holding company.

It should be noted that 32 advisers fall into the category of investment counseling firms, and 4 more advisers are subsidiaries of investment counselors.¹¹ Thus counseling firms and their subsidiaries account for 22.1 percent of the total number of open-end investment company advisers. Security dealers and their subsidiaries account for another 27 advisers, or 16.5 percent of the total number of advisers. Underwriters of mutual fund shares are the parent firms of five advisers, including two of the five advisers managing open-end company assets in excess of \$600 million (Continental Research Corp. (Waddell & Reed) and Investors Management Co. (Hugh Long)).

The balance of table VIII-2 includes a miscellany of advisers, among which are four banks and trust companies, four subsidiaries of insurance companies, four subsidiaries of diversified holding companies, three subsidiaries of companies designed to hold adviser shares, and seven other diverse cases described in footnotes to the table. The group of banks and trust companies, which includes Morgan Guaranty, the (former) Hanover Bank, and State Street Bank & Trust Co., affords the most extreme instances of advisers for whom advice to open-end investment companies is a fringe activity; and for several purposes we exclude these institutions as nonhomogeneous members of the universe of investment advisers.

The variety of investment advisers of open-end companies has been increasing as a consequence of the changing pattern of entry into this business. In the 1920's and 1930's security dealers and investment counselors were of prime importance as organizers of open-end companies and their advisers. In the 1940's and 1950's the control groups of preexisting open-end company systems became of major importance in organizing new open-end companies, usually under the management of an already existing adviser, but increasingly in the 1950's and early 1960's by means of a new adviser established for the special purpose

¹¹ "Subsidiary" is used in table VIII-2 to describe instances of control by means of a very sizable shareholding interest, rather than over 50 percent stock ownership. Investors Diversified Services is included here under category 11 rather than as an "independent" investment adviser-distributor.

of supervising the affairs of the new investment company.¹² Security dealers, counseling firms, and preexisting investment company control groups are still of primary importance in the promotion of new open-end companies and advisers, but an increasing variety of groups of individuals and companies have joined them in this field. Promoters other than preexisting investment company control groups, investment counselors, and security dealers accounted for 17.5 percent of new open-end company entrants between 1946 and September 30, 1958. As shown in table VIII-3, such "other" promoters accounted for 36 percent of advisers of mutual funds established 1956 to 1960 inclusive. In addition to the 4 new advisers promoted by insurance companies and their executives¹³ 14 other advisers were organized by a varied group of individuals and companies. Of these 14, 4 were promoted by lawyers, 2 were organized by private investors, 1 was organized by a trio of scientists, 1 by 2 former bank executives, 1 by an oil exploration and production firm, and 5 by other individuals.

The diversity of function of investment advisers of open-end investment companies is also illuminated by consideration of their principal sources of income. In one of the questions in the adviser questionnaire, all respondents were requested to list "the three most important activities of the investment adviser in order of their importance measured by relative gross income from the various activities." Table VIII-4 is based on replies to this question, adjusted for inconsistencies with the income statements submitted by the advisers.

TABLE VIII-3.—*Affiliations of promoters of investment advisers, organized 1956-60*

Affiliation of promoter	Number	Percent
1. Preexisting control group	9	18
2. Investment counseling firm	12	24
3. Security dealer	11	22
4. Insurance company	4	8
5. Miscellaneous individuals and companies	14	28
Total	50	100

It may be seen in table VIII-4 that for 77 advisers, 47.2 percent of the total number, income from the advising and management of open-end companies was the largest source of gross income, and that for another 60 (36.8 percent) it was the second most important income source. Since it ranks third for another 7 advisers, the last 2 columns of the table show that it is 1 of the 3 largest sources of gross income for 144, or 88.3 percent, of the 163 advisers included in this survey. Underwriting open-end company shares is the primary source of income for 31, or 19 percent, of the 163 advisers; the second most

¹² Among the advisers included in this study were 18 who were subject to common control with at least 1 other adviser among the 163. The most elaborate of these multiple-adviser systems was the Templeton group, which included 5 different advisers each advising a single open-end company, with complex ownership and functional relationships existing among the 5 advisers and various security dealers and holding companies affiliated with this system. The E. W. Axe system included 3 separate investment advisers, and dual adviser systems were maintained by the Putnam, Scudder, Loomis Sayles, Waddell & Reed, and Keystone groups. The 2d and 3d advisers in these multiadviser systems were, with 1 exception, organized in the 1950's, and 5 of them were formed in 1959 or 1960.

The Wellington and Van Strum and Towne groups are also dual adviser systems, but for various technical reasons their secondary advisers were not included in our study. We have also excluded from the multiple-adviser category, perhaps unjustifiably, New York Capital Management Co. and Babson Management Corp., both of which were joint subsidiaries of several other firms that function as investment advisers.

¹³ At least 1 open-end investment company without an investment adviser was also promoted by an insurance company group. Variable Stock Fund was organized in 1959 by Fidelity Bankers Life Insurance Corp., which owns all of the stock of the principal underwriter and dominates the management of the investment company.

important source for 22 advisers (13.5 percent); and 1 of the 3 most important income sources for over a third of the advisers. Advising other clients is the primary source of income for 28 (17.2 percent) of the advisers of open-end companies; it is second in importance for 17 advisers (10.4 percent); and it is 1 of the 3 largest income sources for 52, or 31.9 percent, of the 163 advisers.

The only other major primary source of income to this group of 163 advisers was brokerage, which was first in importance for 11 advisers. Four advisers reported investment income as the largest source of gross income, three reported the publication of financial advice as the main source, two received their largest part of income from general underwriting, and one obtained it by retailing the shares of open-end companies. Two advisers had no income in 1960. The four remaining advisers received their largest flow of income from commercial loans (three) and trust management (one).

TABLE VIII-4.—Major sources of income to 163 investment advisers of open-end investment companies, 1960

Income sources	Primary source of income		Second most important source of income		1 of 3 most important income sources	
	Number	Percent	Number	Percent	Number	Percent
1. Advising and managing open-end investment companies.....	77	47.2	60	36.8	144	88.3
2. Underwriting the sale of shares of open-end companies.....	31	19.0	22	13.5	60	36.8
3. Retailing open-end company shares.....	1	.6	1	.6	2	1.2
4. Advising other clients.....	28	17.2	17	10.4	52	31.9
5. Brokerage activity.....	11	6.7	5	3.1	21	12.9
6. Investments owned.....	4	2.5	6	3.7	14	8.6
7. General underwriting.....	2	1.2			5	3.1
8. Publications of financial advice.....	3	1.8			4	2.5
9. Other.....	16	3.7	1	.6	15	9.2
Total.....	163	100.0	112	(2)		(3)

¹ Includes 2 cases where adviser received no income, plus 3 commercial banks and 1 trust company.
² Percentages are based on 163. Many advisers did not have 2d or 3d sources of income. Consequently percentages do not add to 100.
³ Multiple answers permit total to exceed 100.

In sum, for almost half of the 163 investment advisers the management fee from open-end companies was the single largest source of income; for almost one-fifth the principal income source was the selling of open-end company shares; for about one-sixth it was advising other clients; for almost 7 percent it was brokerage; and for the remaining 10 percent there were a number of different sources of income.

It was noted earlier that it would be somewhat misleading to analyze the functions performed by investment advisers without regard to the activities of organizations affiliated with these advisers. The same point, of course, has equal force for the analysis of the relative importance of various types of income. If brokerage income is obtained through a parent or subsidiary organization, this is just as important to the controlling management group as if the income were obtained by the adviser itself. And it is equally important to an observer attempting to ascertain the interests of a control group in the affairs of open-end companies.

It would be extremely difficult to determine all of the major sources of income of organizations affiliated with all 163 investment advisers.

However, this is not essential to our purposes. What is important here is the identification of the incomes derived by affiliated organizations from activities in which they deal with controlled open-end investment companies. An attempt has therefore been made to estimate the incomes obtained by such affiliated organizations from the distribution of open-end company shares and from brokerage arising out of portfolio transactions for these companies.

Of the 163 advisers discussed here, 59 had parent firms, subsidiaries, or otherwise closely affiliated organizations that performed selling or brokers' functions for controlled open-end companies. If we order the sources of income to controlling management groups for these 59 advisers, according to size, among management fees, incomes from distributing open-end company shares, and brokerage income from open-end company portfolio transactions, we find that the distribution is similar to that in table VIII-4. In 34 of these 59 cases the management fee was still the largest source of gross income; in 20 cases distribution of open-end company shares was the largest source of income; in 4 cases brokerage was the largest income source; and in 1 case a newly organized system had not as yet received income from any source. It is worth noting that 17 of these 20 cases in which selling shares provided the largest source of income were to be found among the systems with assets of less than \$50 million; and all four instances where brokerage provided the most important source of income were among advisers with open-end assets of less than \$50 million. On the other hand, of the 16 systems among the 59 with closely affiliated distributors or brokers which had open-end assets exceeding \$50 million, 13 derived the largest portion of their gross incomes from advisory fees and 3 from selling open-end company shares. The evidence both here and in a breakdown of table VIII-5 according to size of adviser indicates that increases in the size of investment company assets managed are associated with an increase in the relative importance of advisory fees and a diminution in the relative importance of distribution and brokerage.

TABLE VIII-5.—*An estimate of the major source of income to the control groups of 163 investment advisers of open-end investment companies, 1960*

Primary source of income	Number of advisers	Percent
1. Advising and managing open-end investment companies.....	57	35.0
2. Underwriting and retelling shares of open-end investment companies.....	48	29.4
3. Advising other clients.....	28	17.2
4. Brokerage activity.....	15	9.2
5. Investments owned.....	4	2.5
6. General underwriting.....	2	1.2
7. Publication of financial advice.....	3	1.8
8. Other.....	6	3.7
Total.....	163	100.0

How does the income of closely affiliated organizations alter the distribution of major sources of income as described in table VIII-4? Table VIII-5 shows the adjusted numbers and percentages for the primary sources of income. It should be remembered that the adjustment takes into account only the income of affiliated organizations from selling shares and doing brokerage work for the controlled