COMMENTS

THE PHILIPPINE INVESTMENT COMPANY ACT (R.A. 2629)

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This article discusses the Investment Company Act [1] in broad and general terms to give the reader a general picture of the law governing the existence and operation of investment companies.[2] While the law itself covers investment companies in general,[3] we shall confine our discussion of the law to its effect on mutual fund companies as a medium of investment, because it was the impact of this novel type of investment that spurred Congress to enact the law. We shall discuss the salient provisions of the law and show how they regulate specific transactions, what pertinent provisions protect the public, what mutual fund companies can and cannot do, what representations may be made by them in their sales literature, the kind of advertisement they are permitted to do, the protection of the investor against possible embezzlement, misrepresentations, bankruptcy; and such other hazards as are incident to investments of this nature. Mention will also be made of the procedure by which an investor under the Act may enforce his right or claim against a mutual fund company.[4]

Except for some new provisions obviously geared towards the implementation of the "Filipino First" policy, the Philippine Investment Company Act [5] is

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[1] R. A. 2629 approved last June 18, 1960.

[2] Sec. 4, par. (a) defines an Investment Company as: "Any issuer which is or holds itself out as being engaged primarily, or proposes to engage primarily in the business of investing, reinvesting, or trading in securities."

"The term 'investment trust' was current until the passage of the Investment Company Act. Thereafter 'trusts' were referred to as 'investment companies'. The first time the word 'mutual' ever crept into official language was in the Revenue Act of 1936, which permitted 'mutual investment companies' that distributed their taxable income to their shareholders to be themselves relieved of federal taxes on such income. But it was not until the 1940s that investment companies, divided by the SEC into 'open-end' and 'close-end', gradually began to refer to the 'open-end' variety as mutual investment companies and, in due course, as mutual funds." (*The Story of Investment Companies*, by Hugh Bullock. Copyright 1959, Columbia University Press. New York. p. 73.)

[3] Sec. 5, par. (a) classifies investment companies into "open-end" and "close-end" companies. "Open-end" Company is defined by this section as "an investment company which is offering for sale or has outstanding any redeemable security of which it is the issuer." Any investment company other than an "open end" Company is a "Close-end" company.

Mutual Fund is the popular name given to "open-end" companies. The two terms are interchangeably used. In a contest run by the *Investment Digest* in 1953, calling for "the best description of a mutual fund in 30 words or less," winner of the first prize was: "A mutual fund combines the capital of many investors to employ experienced management in purchasing securities of many companies, thus providing diversification and supervision the investors could not individually afford."

Under the U.S. Investment Company Act of 1940, as amended August 10, 1954, Investment Companies are principally divided into: a. "Face-Amount Certificate Company", b. "Unit Investment Trust", c. "open-end", "close-end", diversified" and "non-diversified" companies. (Sec. 4, par. (a) and (b); Sec. 5, par. (a) and (b).

[4] We shall refer to the Philippine Investment Company Act as the "Act" or the "law".

[5] Sec. 15 limiting the membership in the Board of Directors to *Filipino* citizens, regulating their election into the board and also their salaries, is new provision.

Sec. 22, par. (b) incorporates into the law the requirements of Art. XIII, Sec. 1 of the Constitution and Sec. 13, subparagraph 5 of the Corporation Law.

Art. XIII, Sec. 1 of the Constitution provides: "All agricultural, timber, and mineral lands of the public domain, waters, minerals, coal, petroleum, and other mineral oils, all forces of potential energy, and other natural resources of the Philippines belong to the State, and their disposition, exploitation, development, or utilization shall be limited to citizens of the Philippines, or to corporations or associations at least 60 per centum of the capital of which is owned by such citizen, subject to any existing right, grant, lease, or concession at the time of the inauguration of the Government established under this Constitution. Natural resources, with the exception of public agricultural land, shall not be alienated, and no license, concession, or lease for the exploitation, development, or utilization of any of the natural resources shall be granted for a period exceeding twenty-five years, renewable for another twenty-five years, except as to water rights for irrigation, water supply, fisheries, or industrial uses other than the development of water power, in which cases beneficial use may be the measure and the limit of the grant." By a parity amendment adopted in 1947 these rights enjoyed by citizens of the Phil-

a replica of the U.S. Investment Company Act of 1940. To understand the Philippine law in the right perspective it is important that we make a passing mention of its source. The U. S. Investment Company Act of 1940 was passed after more than sixteen years struggle for the regulation of investment companies. Section 30 of the Public Utility Holding Company Act of 1935 directed the Securities and Exchange Commission to conduct a study of investment companies. A joint study was made by the United States Senate Committee on Banking and Currency, together with the Securities and Exchange Commission and the National Association of Investment Companies of the problems then existing in the United States in connection with operation of investment companies. The result of these investigations was finally embodied in the Investment Company Act of 1940.[6]

Before the passage of the 1940 Act, especially in the years immediately following October 1929, there developed the most serious and critical decline in stock prices Wall Street had ever seen. Holding of investment trusts went down and with them, also went the stocks that they held. By 1931, a story, popular in Wall Street, tells of a financier in distress, beseeching Saint Peter to let him enter the gates of heaven. Refused, the fellow fell on his knees and whined: "But Pete, I never started an investment company".[7] And with the crash of the market came a violent and rapid distrust of trust investments.

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ippines with regards to natural resources and the operation of public utilities (Sec. 8, Art. XIV of the Constitution) could also be availed of by United States citizens and corporations and business enterprises owned directly or indirectly by U.S. citizens, "in the same manner as to and under the same conditions imposed upon citizens of the Philippines." This amendment subsists as long as the Philippine-American Executive Trade Agreement is effective and this has been entered into on July 4, 1946 and in no case will it extend beyond July 3, 1974.

Sec. 13, subparagraph 5 of the Corporation Law provides: "Every corporation has the power:

"To purchase, hold, convey, sell, lease, let, mortgage, encumber, and otherwise deal with such real and personal property as the purposes for which the corporation was formed may permit and the transaction of the lawful business of the corporation may reasonably and necessarily require, unless otherwise prescribed in this Act: Provided, That no corporation shall be authorized to conduct the business of buying and selling public lands or be permitted to hold or own real estate except such as may be reasonably necessary to enable it to carry out the purposes for which it is created, and every corporation authorized to engage in agriculture shall be restricted to the ownership and control of not to exceed one thousand and twenty-four hectares of land: and (1) it shall be unlawful for any corporation organized for the purpose of engaging in agriculture or in mining to be in anywise interested in any other corporation organized for the purpose of engaging in agriculture or in mining; (2) it shall be unlawful for any person owning stock in more than one corporation organized for the purpose of engaging in agriculture or in mining to *own more than fifteen per centum* of the capital stock then outstanding and entitled to vote of each of such corporation; (3) it shall be unlawful for any corporation to own in *excess of fifteen per centum* of the capital stock then outstanding and entitled to vote of any corporation organized for the purpose of engaging in agriculture or mining; (4) any stockholder of more than one corporation organized for the purpose of engaging in agriculture or in mining may hold his stock in such corporations solely for investment and not for the purpose of bringing about ot attempting to bring about a combination to exercise control of such corporations, or to directly or indirectly violate any of the provisions of the Public Land Law, and (5) any corporation holding stock in any corporation organized for the purpose of engaging in agriculture or in mining may hold such stock solely for investment, and not for the purpose of bringing about or attempting to bring about a combination to effect control of such corporation, or directly or indirectly violate any of the provisions of the Public Land Law. Corporations however, may loan funds upon real estate security and purchase real estate when necessary for the collection of loans but they shall dispose of real estate so obtained within five years after receiving the title."

[6] FEDERAL REGULATIONS OF INVESTMENT COMPANIES SINCE 1940. Warren, Motley and others. *Harvard Law Review*. Cambridge, 1950. Vol. 63, p. 1136-1137.

Mr. Hugh Bullock, noted American authority on mutual funds, in his book on the history of investment companies, gives this observation:

"The Public Utility Holding Company Act of 1936 contained a provision directing the SEC to make a study of investment companies and report its findings back to the Congress. The study was exhaustive. It consisted of a mountain of statistical compilations, supplemented by testimony from executives of all investment companies and so-called holding companies of any consequence. Preliminary hearings began in 1938; formal hearings followed." (For complete citation of source, see footnote no. 2.)

[7] WHAT ABOUT MUTUAL FUNDS? John A. Straley. Revised Edition 1958. Harper and Brothers. p. 75

Commenting on the status of mutual funds during this period, Mr. Straley says:

"Previous to 1940, the status and the future of the mutual fund business were both uncertain. No industry code existed, and there were trade practices which, while they in no way worked against the benefits to the investor in owning fund shares, were a sore thorn in the flesh to sponsors and wholesalers carrying on a legitimate business in the distribution of such shares. Investment Trusts were still a favorite target of scarehead columnists who, when they felt uninspired to write on other topics, could always reach into the barrel and come up with 1929." p. 76-77.

While it is true that after the United States government redeemed Liberty Bonds which it floated, the American public had so much money available for investment that it turned to the investment companies to realize its investment objectives, investment experts maintain that it was not until the passage of the Investment Company Act of 1940 that the investment companies really gained their popularity with the American public.[8]

The latest figures show that there are in the United States today over 200 mutual funds, more than double the number in 1945; assets have multiplied thirteen times, to $16 billion; shareholder accounts have increased nearly tenfold. Already more than two million investors, one sixth of all shareholders in the American industry, own shares of mutual funds, often of more than one fund. Shareholders' accounts, averaging $3,690 apiece at present, are held by investors that range from young couples building a nest egg to institutional investors such as pension funds and colleges, which also like diversifying their investments under professional management. The funds are growing so fast that by 1970 they expect to have four million shareholders, command $40 billion in assets.[9]

The Philippine Investment Company Act

In its declaration of policy,[10] the Act enumerates certain conditions which it seeks to mitigate and so far as possible eliminate, because they adversely affect the national public interest and the interest of the investors:

1. When investors buy, exchange, receive dividends, sell or surrender securities issued by investment companies without having an adequate and explicit information concerning the character of such securities; and

2. The circumstances as well as the financial responsibility of the investment company and their management;

3. When companies are organized and operated in the interest of directors, investment advisers or other affiliated persons or in the interest of its underwriters, brokers or dealers rather than in the interest of all classes of the company's shareholders;

4. When shares of stocks issued contain discriminatory provisions or fail to protect the privileges of the outstanding stockholders;

5. When investment companies are controlled through inequitable means or managed by irresponsible persons;

6. When investment companies, in keeping their accounts, reserves, and computing their earnings and asset values, employ unsound or misleading methods;

7. When investment companies are reorganized or change character of their business or change the control or management thereof, without the consent of their stockholders;

8. When investment companies engage in excessive borrowing such as the issuance of senior securities, thus increasing the speculative nature of their junior securities; or

9. When it operates without adequate assets or reserves.

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[8] SYLLABUS FOR INVESTMENT TRUST SALESMEN. Prepared by the Mutual Funds Department of Bache and Co., New York. p. 1.

[9] *Fortune* Magazine. June. 1960. p. 144. *Time*, Special Business Report, June, 1959. Said the influential *Time* Magazine in its Special Business Report, p. 46:

"In the last decade, the funds have become the fastest-growing, most competitive and most controversial phenomenon of the U.S. financial world. Ten years ago they had fewer than a million shareholders, with $1.5 billion invested. Last week they had nearly 3,900,000 with $14 billion invested in more than 200 different funds. The funds have been copied abroad in Great Britain, West Germany, Switzerland, Mexico. Ten years ago, most people had never heard of mutual funds, now the term is a household word."

[10] Sec. 2.

Truth in Securities

The first condition enumerated above has been better described among investment circles as the "truth in securities" policy, also called the "fish-bowl policy" or the "full-disclosure" policy.[11] The first law enacted to implement this objective was the Securities Act of 1933, which was passed by the United States Congress.[12] The phrase "adequate, accurate, and explicit information fairly presented" has been construed to regulate the full disclosure of the facts concerning the issue of a share of stock, such that the disclosure of facts however unimpressive, sanctions the sale of the security involved.[13] These facts are disclosed in two documents. They are disclosed first, in a registration statement that must be filed by the issuing company with the Securities and Exchange Commission, second, they are also disclosed in the prospectus of the investment company, which must be delivered to each buyer of the registered security before or at the time of the completion of the transaction.[14]

To give full effect to this principle on the "truth of securities", it is unlawful for an investment company to represent or imply in any manner that its registration or license with the Securities and Exchange Commission, is in effect tantamount to its having been sponsored or recommended by the Republic of the Philippines or its agency or officers.[15] Neither can the investment company adopt in its registration any name or title, word or words, which the Commission finds and declares deceptive or misleading.[16] However, such investment company may state that it is registered under the law, if such is true in fact and if the effect of such registration is not misrepresented.[17] The purpose of requiring the full disclosure is to limit speculation, prevent unfair practices, and discourage the use of insiders' information which is not made public. The intention is to protect the honest investor and the public against the use of fraudulent schemes and to put a stop to the sale of stocks in "fly by night" concerns.[18] Blue skies provisions of this nature have been repeatedly held constitutional and are not violative of the constitutional provision on the equal protection of the laws.

The general principle, to be observed, is that statements about a particular class of stocks made by an issuer must be frank, honest and truthful, not only literally but also in the impression it makes on the customer. A statement may be literally true, but if misleading, it is unlawful.[19] Thus the Act provides that it is not enough for an investment company to state the amount of dividend declared for a particular period, it is also required that the company must state the ratio between the dividends earned and the value per share.[20] For example: "XYZ" Company says "XYZ Mutual Funds declares ₱.10 divi-

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[11] FUNDAMENTALS OF INVESTMENT BANKING. A training course prepared for members of the Investment Bankers Association of America. Edited by Robert W. Clark, Jr., Educational Director. Published Investment Bankers Association of America. Chicago: 1946. p. 24.

[12] See Note 11

[13] Sec. 2, par. (a); see Note 11.

[14] See Note 11.

[15] Sec. 32, Pars. (a) and (b).

[16] Sec. 32, par. (d).

[17] Sec. 32, par. (c).

[18] Hall v. Geiger-Jones, 242 U.S. 539

[19] COMMENTARIES AND JURISPRUDENCE ON THE COMMERCIAL LAWS OF THE PHILIPPINES. Tolentino. Vol. II. Eighth Ed., p. 888

[20] Sec. 18 provides: "It shall likewise be unlawful to advertise such dividends in terms of centavos or pesos per share without also stating the percentage they bear to the *par value* per share." There is obviously a mistake in this provision. The purpose of this provision is to disclose to the stockholder the true earning of his shares of stocks. The *par value* has no precise relation to the true worth of the share. The more accurate term should be Net Asset Value or book value, which is the true basis for determining the actual worth of a mutual fund share of stock. For example: Filipinas Mutual Fund Shares have a *par value* of ₱1.00. But an investor buys the shares at Net Asset Value, which as of this writing is ₱6.05. If Filipinas Mutual Fund declares ₱.18 dividend and we follow the law, then the ratio of the dividend to the par of ₱1.00 is 18%!

dends!". This may be literally true, but unless the ratio it bears to the value per share is stated, it may prove to be misleading. And so is a half truth in a statement which in itself is true, but which conceals other material information. Conversely, a statement made by one which he honestly believes to be true and which he has no reasonable ground of suspecting to be false or misleading is not unlawful, even if it turns out later to be false or misleading. But even in this case the statements must not be carelessly given, they must have a reliable basis for the information.[21] Similarly, erroneous opinions or predictions as distinguished from untrue statements of facts are not unlawful, if honest, although admittedly, the distinction between an opinion and a statement of fact on a security is very shadowy.[22]

A distinction must be made between a misleading statement prohibited by this Act and the ordinary civil law principle of contractual fraud. In contractual fraud, it is necessary that the party defrauded, should have acted in reliance of the misrepresentation. Under this Act, however, it is enough that the statement was made to induce the purchase or sale of security, even if the buyer or whom the statements were made did not rely on them. Also in contractual fraud, the falsity of the statement must be known to the person making it; while with regards to fraud affecting securities, it is not necessary that he should know such falsity, if he has reasonable ground to believe that it was false or misleading.[23] In order to more effectively implement this goal of "truth in securities," the Act provides that all investment companies or any underwriter [24] for such company, in connection with a public offering of any security of which such company is the issuer, must transmit any advertisement, pamphlet, circular, form letters or other sales literature addressed to or intended for distribution to prospective investors, three copies of the full text thereof to the Securities and Exchange Commission within ten days after its issuance.[25]

The law goes about as far as any law can toward taming a financial enterprise whose main function is to deal in risk capital.[26] The law requires safeguards much stricter than the ordinary requirements in other types of securities. The regulations on advertising claims are so strict that some members of the United States mutual fund industry wonder how they manage to sell fund shares at all. Dorsey Richardson, president of the One William Street Fund and former president of the National Association of Investment Companies, makes this comment: "Supose the real estate industry had to sell houses the way we sell shares. If they were under the same requirements, house-for-sale ads might have to read: 'For Sale. A House. Nice Neighborhood, but this is not meant to indicate that the neighborhood could not change. Sound construction, but this is no guarantee that the house might not fall down at any moment. Inquiries invited'." [27]

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[21] See Note 19.

[22] MEYER, SECURITIES AND EXCHANGE ACT OF 1934, p. 76.

[23] See Note 19

[24] Sec. 3, pars. (v) and (dd) distinguished a *principal underwriter* and an *underwriter*:

"Principal Underwriter of or for any investment company other than a close-end company, means any underwriter who as principal purchaser from such company, or pursuant to contract has the right whether absolute or conditional, from time to time to purchase from such company, any such security for distribution, or who as agent for such company sells or has the right to sell any such security to a dealer or to the public or both, but does not include a dealer who purchases from such company through a principal underwriter acting as agent for such company."

"Underwriter, means any person who has purchased from an issuer with a view to, or sells for an issuer in connection with, the distribution of any security or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirert underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer, not in excess of the usual and customary distributor's or seller's commission. When the distribution of the securities in respect of which any person is an underwriter, is completed, such person shall cease to be an underwriter in respect of such securities or the issuer thereof."

[25] Sec. 24, par. (c).

[26] See Note 9.

[27] See Note 9.

The Commission may require that the information contained in any prospectus relating to any periodic payment plan certificate (also known as the Systematic Plan) be presented in such form and order of items, and such prospectus contain such summaries of any portion of such information, as are necessary in the public interest or for the protection of investors.[28]

Clearly, among those which must be stated in the prospectus relevant to the periodic payment plan is a schedule of "sales load", or amount charged by distributors or underwriters of mutual funds for issuance and distribution of shares and which is added to the Net Asset Value per share to determine the public offering price.[29] In connection with this, the Act succinctly declares it unlawful for any registered investment company to sell any such certificate, if:

a) the sales load on such certificate exceeds *eight per centum* of the total payments to be made therein;

b) more than one half of any of the first twelve monthly payments thereon, or their equivalent is deducted for sales load;

c) the amount of sales load deducted from any one of such first payment exceeds proportionately the amount deducted from any other such payment, or the amount deducted from any subsequent payment exceeds proportionately the amount deducted from any other subsequent payment;

d) the first payment on such certificate is less than ten pesos or any subsequent payment is less than ten pesos.[30]

It is worthy of note to distinguish the limitations of the above provision with a similar one from the United States Investment Company Act of 1940:

"It shall be unlawful for any registered investment company issuing periodic payment plan certificates, or for any depositor or underwriter for such company, to sell any such certificate, if:

"a) the sales load on such certificate exceeds *9 per centum* of the total payments to be made thereon;

"b) more than one-half of any of the first twelve monthly payments thereon, or their equivalent is deducted as sales load.[31]

It is obvious from the comparison, that the sales charges in the United States are higher by one per cent than the charges allowed by the 1960 Act. It is pertinent to observe at this point the comments made by some critics on the sales loads imposed by mutual funds in the Philippines prior to the passage of the Act. Some maintain that the variance of this provision with original one contained in the U.S. Act would have the effect of making it almost impossible to cover the cost of operating a mutual fund company. They contend that in 20 years of operation under the U.S. Investment Company Act of 1940, over 95% of all U.S. investment companies charge *over* 8% sales load. Cost of operation in the Philippines is higher than in the United States because the amount of investment per investor is smaller, therefore, requiring more work for a smaller investment. The effect of reducing the sales load from a maximum of 9% as authorized under the U.S. law, to a maximum of 8% under

[28] Sec. 24, par. (d).

[29] Sec. 3, par. (aa) defines "Sales Load" as:

"The difference between the price of a security to the public and that portion of the proceeds from its sales, which is received and invested or held for investment by issuer, less any portion of such difference deducted for trustee's or custodian's fees, insurance premiums, issue taxes, or administrative expenses or fees which are not properly chargeable to sales or promotional activities. In the case of a periodic payment plan certificate, 'sales load' includes load on any investment company securities in which the payments made on such certificate are invested, as well as the sales load on the certificate itself."

[30] Sec. 26.

[31] Sec. 27, par. (a), subpara. (1) and (2). U.S. Investment Company Act of 1940, as amended, August 10, 1954.

our law, would compel all established Filipino mutual fund to practically close down their operation.[32] On the other hand, some circle argue that this distinction may have been affected by the criticism levelled by some newspapermen against the mutual funds' method of deductions. Said one such columnist: "The trouble with mutuals is that they are not mutual either. The subscriber pays for 10 years of services from the time he makes his first payment. If he withdraws his shares after the second year, he forfeits the 8 years he paid for in services." [33] Explaining this sort of attitude, an influential finance magazine states that the basic defect is not in the charges imposed by the funds' distributors, but simply because people buy mutual fund shares as if they were buying just any other shares of stocks, i.e., cashing it in anytime they feel, they should. Actually, "shares in a mutual fund are more like *service contracts* than a security, and should be bought in that spirit." [34] When a person enters into a contract for the performance of a service during a given period, he does not judge the outcome until after the period is over, and to terminate the contract without completing its tenure is certainly not the right way by which one expects maximum results.

The Association of Mutual Fund Companies of the Philippines has made it clear however, that investors who have signed up for a ten-year monthly systematic plan—and who withdraw it in the first few years, contrary to the contract, will lose money because of the heavy sales charges in the first year. (In the United States the heavy deduction in the first year is called the "front-end load".) That is why every systematic plan investor should continue with their plan payments, so the mutual fund experts say.[35]

Perhaps, the most sober appraisal done by an independent group, is the study made by the Manila Jaycees' Economic Affair's Committee. Says the Committee: "Some of the charges against mutual funds are misleading. Much ado has been made over a few individuals who have lost money on withdrawing without mentioning the numerous others who withdrew at a profit. Furthermore, the losses referred to are those involved in the early withdrawal from a systematic payment plan where the investor concerned signed contracts that clearly stated withdrawal during the early years would entail a penalty because of the heavier sales charge during the first year."[36]

The Financial Responsibility of Management to the Stockholders

In the United States there are two ways by which the investment managers' legal responsibility may be established: First, there are laws like the State of New York, which specify the investments that a trust company or trustee may make. It is the so-called *Legal List*,[37] a list published by the state government enumerating the securities which are proper for trust funds. Of course, it has been pointed out that it is possible for the owner (or in the case of mutual funds, the stockholders) to instruct the trustee to buy anything he wishes but where no such instruction is given, or where the trustee is directed to buy legally authorized securities, i.e., securities listed in the Legal List, then he is limited to the legal list. Second, we have the "Prudent Man's Rule" handed down in 1830 by a Massachusetts court through Justice Putnam, settling a writ charging a trustee with negligence in investing in common stocks, the Court ruled that the test for pinning the trustee's liability is whether "he con-

[32] Memorandum of the Association of Mutual Fund Companies of the Philippines to the Honorable Jose Leido on its proposed amendments to H.B. 3210.
[33] *Over a Cup of Coffee*, column of Teodoro F. Valencia, *Manila Times*, April 6, 1959.
[34] See Note 9.
[35] *Business Drifts*, column of Emilio Jurado, *Philippines Herald*, August 8, 1960.
[36] *Manila Times*, August 5, 1960.
[37] See Note 11.

ducted himself faithfully and exercised the sound discretion" in the investment that a prudent man would. This meant that investment managers of mutual funds could prudently buy into common stocks, fear no suits from clients even if they lost every centavo. This equitable rule may perhaps be better appreciated if we consider the fact that investment is not a science but a matter of human judgment.[38]

But going further into issue, another question arises: just what is the extent of prudence? We know for a fact that prudent men are capable of error. When would such error be that of a prudent man? The United States courts have drawn the line thus: whenever a trustee buys that which is not authorized by law or by his instructions, the trustee automatically is charged for the loss.[39]

The Act prohibits changes in the investment policy, unless the same has been authorized by the vote of the majority of the outstanding voting securities. Such acts as borrowing money, issuing senior security, underwriting securities issued by other persons, purchase or sell real estate or commodities or make loans to other person if in each case, it is not in accordance with the recital of policy contained in its registration statements.[40]

It is also unlawful for the registered investment company to deviate from its policy in respect to concentration of investment in any particular industry or group of industries as recited in its registration statement, or deviate from a fundamental policy recited in its incorporation paper, *unless* the same has been done by the vote of a majority of its outstanding voting securities.[41] Neither may it change the nature of its business so as to cease to be an investment company, unless it has been voted upon by the majority of the outstanding voting share.[42]

Investment companies cannot generate funds for promoting the private business or industry of any employee, official, director, or organizer, or stockholder thereof. These persons mentioned are prohibited from buying real estate, personal property or any other property and selling the same to the company at a price higher than the procurement cost, or from selling any company property at prices below the market value thereof to any of the aforementioned persons.[43]

Similarly, buying on margin and short sales of security are unlawful, except in cases specifically permitted by law.[44] Neither may a person serve as director of an investment company unless he is a *Filipino citizen* and elected to that office by the holders of the outstanding voting securities at an annual or special meeting duly called for that purpose. This prohibition however, does not extend to any member of the Advisory Board, because their citizenship need not necessarily be Filipino and neither are they required by law to be elected by the stockholders. The reason is that the task of investment decision and policy-making is a highly technical one and realizing this fact, the law allows investment companies to get the services of even alien experts.[45] But the law is not entirely generous in this respect, as it also requires that contracts entered into between the investment company and its investment advisers cannot be changed unless the change was done with the consent of a majority of the board of directors, who are not parties to such contract or

[38] *Time*, June 1, 1959, p. 47.
[39] See Note 11.
[40] Sec. 12, par. A, subparagraph (1).
[41] Sec. 12, par. A, subparagraph (2).
[42] Sec. 12, par. A, subparagraph (3)
[43] Sec. 11, par. C.
[44] Sec. 11, par. A
[45] Sec. 15

affiliated person of such party, or by a majority vote of the voting stockholders.[46]

A rather unprecedented legal requirement, is the provision in the Act vesting upon the Securities and Exchange Commission the authority to fix the salary or emolument of a member of the board of directors or any executive official of an investment company. The Commissioner in the exercise of his power to fix salary may use the following as basis for the rate: the experience and qualifications of the official concerned; the amount and nature of securities issued by the company; the size and standing of the company in the business community; the volume of business; the number of years the company has been in business and such other pertinent conditions as the Commissioner may deem wise and proper.[47]

We find it difficult to agree with the wisdom of this particular provision. The determination of salaries and emoluments of private companies is purely a management function and to usurp such private function by sheer convenience of legislation is to say the least, most improper. This provision is definitely dangerous. If such a government agency as the Securities and Exchange Commission has the power to exercise the task of fixing salaries and emoluments of company executives, what can stop them from fixing the salary of minor employees and thus take over a vital function of personnel management? "Public interest" as a legal subterfuge is very broad, considering that there is hardly any business under the sun which in a sense is not colored with public interest. The wisdom of the provision should not justify its enactment because, it is a settled rule of law that laudable ends should not justify the employment of anomalous means. It is interesting to note that no such provision exists in the U.S. Investment Company Act of 1940, from which the bulk of the Philippine Investment Company Act of 1960 is patterned verbatim. And it is just as interesting to observe that there is no such provision in our General Banking Act and in our Insurance Law. Government interference in business to the extent of substituting its judgment for the judgment of management is very dangerous. While we favor the solicituous attitude of the government in protecting the investor and the public, we simply cannot countenance government meddling in business. As Jefferson said, the best form of government is that government which governs least.

The Act also lays down some restrictions governing specific transactions of affiliated persons. Most important of which is Section 16, paragraph E, which provides that any affiliated person of an investment company or any person affiliated with a person considered to be an affiliate of an investment company cannot accept from any source any compensation, other than a regular salary or wage from such registered investment company or any controlled company thereof, except in the course of such person's business as an underwriter or broker. Neither may such person act as broker in connection with the sale of shares of stocks to or by an investment company or any controlled person thereof, receive from any source a commission, fee or other remuneration for effecting such transaction which exceeds:

a) the usual and customary broker's commission if the sale is effected in a security exchange; or

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[46] Sec. 14, par. C
This is an important provision. In the past, there were occasions when advisory contracts would run for long periods and would be sold to a new and sometimes less desirable group of men without shareholders having any thing to say about the investment company coming under new supervision. (See footnote no. 2 for citation of source.)

[47] Sec. 15, par. 2.

b) two per centum of the sale price if the sale is effected in connection with a secondary distribution[48] of such securities; or

c) one per centum of the purchase or sale price of such securities if the sale is otherwise effected, unless the Securities and Exchange Commission shall, by rules and regulations or order, in the public interest and consistent with the protection of investors permit a larger commission.

Where are the money and assets of an investment company kept? The law answers the question thus: the investment company's securities and similar investments must be in the custody of either a local commercial bank of good repute, a company which is a member of the stock exchange, or with the registered investment company, so long as it is in accordance with the rules and regulations prescribed by the Commissioner. Such rules encompass the earmarking, segregating and hypothecation of such securities and subject to the periodic inspection by independent public accountants or agents of the Securities and Exchange Commission.[49]

Finally, the Act imposes the restriction that the expenses of an investment company for operation shall not exceed 10% of the total investment fund received from the investors. Failure to observe these provisions shall be sufficient cause for the cancellation of the company's registration and the liquidation of its assets for redistribution to investors.[50]

Capital Structure

Is the mutual fund company a speculative venture? Does it lend money like the banks? Does it borrow money? Can it issue bonds? How much capital must a corporation have before engaging in the mutual fund business?

All these questions are categorically answered by the law. The Act provides for instance, that no investment company may make a public offering of securities through their principal underwriter, unless such company has a *paid-up capital* of at least five hundred thousand pesos (₱500,000.00) as certified to by independent public accountants.[51] This is an answer to the public clamor that mutual fund companies are engaged in the so-called "high finance" business. What they really wanted to say was that, since mutual funds generate capital from the public, the capital of the company itself must be adequate enough to meet redemption requirements.

And corollary to the above mentioned requirement is the provision that no investment company shall redeem, directly or indirectly, any security of which it is the issuer unless its remaining unimpaired capital shall be at least two hundred fifty thousand pesos or 50% of its outstanding liabilities to creditors, whichever is higher. The unimpaired capital requirement is designed to meet redemption demands from its stockholders without resorting to forced sales of its assets or borrowing.

One of the conditions which the Act seeks to eliminate in its declaration of policy is "when investment companies by excessive borrowing and issuance of excessive amounts of senior securities increase unduly the speculative character of their junior securities."[52] Essentially, what this provision regulates

[48] Secondary Distribution refers to the "offering of shares outside the exchange after trading hours and non-member firms as well as member firms may participate in the sale" It generally involves larger block of shares because of the fact that both members and non-member firms participate thus enabling a wider selling effort. See Note 8.

[49] Sec. 16, par. (f)
The purpose of this provision is to assure shareholders a maximum physical safety of their property against possible purloining by an unscrupulous management.

[50] Sec. 15, par. (2).

[51] Sec. 13, par. (1).

[52] Sec. 2, par. (g).

is borrowing, because in a broad sense, borrowing is creation of a debt whether by loans obtained from the banks or through the floating of bonds or senior securities. To effectively implement this policy, the Act provides that no investment company can issue any class of senior security[53] of which it is the issuer and it may borrow money from a bank only if the following conditions are satisfied:

1) that immediately after any such borrowing there is an asset coverage of at least three hunderd percentum for all borrowing of such registered company; provided further,

2) that in case such asset coverage shall at any time fall below three hundred percentum, such registered company shall, within three days thereafter or such longer period as the Securities and Exchange Commissioner may allow, reduce the amount of its borrowings to the extent that the asset coverage pegged at three hundred percentum is maintained.[54]

What is the reason for the law's stringent requirement? This provision is predicated on a fundamental economic principle, that a corporation that incurs debt is always assuming a risk, the risk that it may either fail to pay the interest or the principal at maturity and thus force the corporation into a reorganization or even dissolution. Moreover, the corporation may also be unable to make sinking fund payments in case it is urgently needed. In both cases, the stockholdings or assets of the stockholders are used as collaterals to answer for the creditors' claims. And so long as the obligation is unpaid, the stocks of the debtor corporation acquire a speculative character. The degree of speculation tends to increase the amount borrowed increases.[55]

May an investment company lend money or property to any person? As a general rule, it can, except: when the investment policy of such registered company as recited in its registration statement does not permit such a loan, or such person controls or is under common control with such registered company.[56]

These safeguards should remove any apprehension on the part of the investing public against the much-talked-about economic phantom—"high finance".

Distribution and Redemption of Securities

Because open-end investment companies continuously sell their securities to the public, there arises a need to study the best methods by which such securities are marketed and redeemed. Distribution is a highly specialized function and mutual fund companies cannot exist unless it has an organization trained to reach investors large and small, throughout the island.

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[53] Sec. 17, par. (g) defines Senior Security as:
"any bond, debenture, note, or similar obligation or instrument constituting a security and evidencing indebtedness, and any stock of a class having priority over any other class as to distribution of assets or payment of dividends; and 'senior security representing indebtedness' means any senior security other than stock." Preferred stocks are considered as senior securities under this definition, and therefore, cannot be issued by mutual fund companies.

[54] Sec. 17, par. (f).

[55] See Note 11.

[56] Sec. 20

The various provisions of law with respect to the capital structure of an open end company were designed to plug another loophole in the operation of mutual fund companies in the past. Mr. Hugh Bullock in his observations of the history of mutual fund companies in the United States gives the following statements:

"Capital structure of investment companies in the earlier days were frequently unsound. Too many classes of securities were issued. The public too often held shares that had no voting rights. The heavily pyramided companies, with top-heavy debt and senior securities, were bound to register great losses to the common stockholder when leverage began working in reverse. Shares with no underlying asset value often controlled the company. These important provisions relating to capital structure are designed to avoid one of the most expensive pitfalls of the past." (For citation of source, refer to footnote no. 2.)

Open-end investment companies or mutual fund companies distribute their shares in three ways:

a) The majority of open-end companies distribute their shares in much the same way that a manufacturer distributes finished good—from wholesaler to retailer to the buyer. The mutual fund underwriter is responsible for the wholesale distribution to retail security dealer firms, and from these retailers sales are made to individual investors.

This method of distribution is being followed by the existing mutual fund companies in the Philippines. The reason for the popularity of this procedure lies in the fact that mutual funds shares like insurance are not bought, they have to be sold.

b) A second method of distribution is similar to that employed by life insurance companies, through regional offices operated by the underwriter and staffed with salesmen who are its own agents. This method is usually combined with the first one above. Thus most mutual fund companies have their head offices in Manila and their branches or district offices in the privinces.

c) Some open-end companies have no active sales organization and sell their shares directly to the investors. The investor learns of the company via the advertisement or from endorsements of friends. In the Philippines, only one of the present five mutual fund companies, use this method.[57]

Whatever be the method followed by an investment company, the law specifically provides that no registered investment company shall sell redeemable securities issued by it to any person except through an Underwriter.[58] The provision allows the distribution through an underwriter as well as through general agencies or dealers. Ironically, prior to the passage of the Act, this separate set-up between the underwriting firm (sometimes known as the selling company) and the investment company (sometimes referred to as the fund) has been the subject of suspicion among misinformed investors. They suspected a possible collusion between the two companies. Yet precisely, this separation is a safety devise designed to protect the investments of the public. Let us illustrate how it protects the fund:

If "X" invests say ₱100.00, ₱8.00 is deducted as sales load of the selling company. The remaining ₱92.00 is then used for the purchase of shares of stock of the fund. From this point on, the ₱92.00 is already beyond the reach of the selling company. Should anything happen to the underwriting or selling company, such as bankruptcy or dissolution, the fund will not be affected. If a particular selling company goes bankrupt, all the fund should do is rescind the contract, i.e., the contract with the underwriting company to sell the shares of the fund, and enter into another contract with another selling company. In other words, under this set-up, it is well nigh impossible for a mutual fund company to go bankrupt, unless we predicate the possibility on the assumption that all the corporation in the investment portfolio (usually numbering from forty to fifty corporations) simultaneously fold up.

Quoted hereunder is Section 22, paragraph B of the Act which limits the alien ownership of shares of stocks of mutual fund companies:

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[57] A statement made by Dorsey Richardson, Chairman, Executive Committee, National Association of Investment Companies, before the U.S. Senate Committee on Banking and Currency, March 16, 1955. p. 9

[58] Sec. 11, par. (B). Sec. 3, par. (X) defines "redeemable security" as: "any security, other than short-term paper, under the terms of which the holder, upon its presentation to the issuer or to a person designated by the issuer, is entitled to receive approximately his proportionate share of the issuer's current net assets, or the cash equivalent thereof."

> "Provided, further, That no investment company shall sell any security issued by it to any person who is not a Filipino citizen or any company or entity sixty per cent of the capital of which is not owned by Filipino citizens. When the effect of such sale would be a violation or circumvention of Section One, Article XIII of the Constitution on the limitation of the disposition, exploitation, development or utilization of the natural resources of the Philippines nor shall said company sell any such security to any person when the effect of such sale would be a violation or circumvention of Section 13, subparagraph 5 of the Corporation Law regarding the limitation of ownership by individuals or corporations to fifteen per cent of the capital of corporations engaged in mining or agriculture."

The provision is clearly influenced by the opinion given by Congressman Francisco Sumulong during a privileged speech delivered before the House of Representatives on February 18, 1960. In essence, the contention of the learned congressman was: when the mutual fund company begins operation, it issues shares of stocks and distributes them indiscriminately to the public, irrespective of the citizenship of the buyer. Since most of the stocks issued by mutual funds are common stocks and hence represent voting securities, and since most of the proceeds are invested in industrial enterprises (which may include real estate), said companies are steadily bringing into such companies or industries the money of aliens which in turn are represented by voting shares. The effect of such transaction will be: that at some future time, the shares of aliens in the *prohibited industries* (referring to industries where aliens cannot invest, e.g., real estate) will be beyond the legal 40% because the sale of mutual fund shares is continuous. Therefore, he maintained that this being the case, it is possible that the time will come when the disposition, exploitation, development, and utilization of our natural resources will be dominated by alien shareholders of mutual fund companies. He also extended the same syllogistic reasoning to cases involving mining shares which he said may also lead into a possible circumvention of the Corporation Law.

The provision above cited is so far the most significant restriction with the regards to the mode of distributing the shares of mutual fund firms.

The shares of stocks issued by a registered investment company, are redeemed by the investment company itself. Normally, shares of stocks are transacted at the Manila Stock Exchange. But with respect to shares of stocks issued by mutual fund companies, the securities are as a rule bought and sold back to the same investment company. To insure the enforcement of this rule, the Act provides that no registered investment company shall suspend the right of redemption or postpone the date of payment of satisfaction upon redemption of any redeemable shares of stocks issued in accordance with the terms appearing in the prospectus, for more than seven days after the tender of such security for redemption. The exception would be when the Manila Stock Exchange is closed, other than the customary week-ends and holidays, when trading in the stock exchange is restricted during periods of emergency or such other period as the Securities and Exchange Commission may permit for the protection of the stockholder and the company.[59]

In addition to the above requirement, the law also provides that no registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer, except in conformity with the statement contained in its registration statements nor in contravention of such rules and regulations prescribed by the Commission in the interest of the shareholders.[60]

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[59] Sec. 22, par. (B).

[60] Sec. 22, par. (C).

This provision is primarily intended to provide maximum liquidity to an investment in the fund. However, it is also aimed at preventing a repetition in the past of an instance (in the United States) where an open-end investment company, originally with a self-liquidating feature,

As previously mentioned, the distribution function is undertaken by an underwriting company which in turn depends on the salesmen or investment solicitors to do the actual selling work. Salesmen perform a specialized economic function that no investment company can perform by itself. Underwriters are able to sign up purchase agreements and provide millions of pesos for the investment companies because of the distributing power of salesmen all over the country who sell these shares of mutual funds in every province, municipality and barrios for a fixed commission Because of the important role being played by salesmen in the distribution of mutual fund securities, the law makes specific provisions on the qualification for membership of such investment solicitors. The Act provides that only those who have the Securities and Exchange Commission Certificate of Authority are allowed to undertake the selling of shares of mutual fund companies. The Certificate of Authority is either, temporary or permanent. Provided that no such certificate of authority shall be issued by the Securities and Exchange Commission unless the applicant for agent, sub-agent or investment solicitor shall have passed a written examination given for the purpose by the Commission or the said applicant possesses a college degree.[61] And no investment company shall pay any commission or other compensation to any person for services rendered, unless such person holds a certificate of authority.[62] Any person or company found violating this requirement shall upon conviction be subject to a fine of five hundred pesos and the Commission shall immediately revoke the certificate of authority issued to him, if any, and no such certificate shall thereafter be issued to such convicted person.[63] In connection with this section, it is worthy to mention the fact that most mutual fund companies in the Philippines run their Training Institutes, staffed with full time instructors on investments.

Securities and Exchange Commission Administration Under the Act

Before any investment company may be allowed to exist and operate under the Act, the first step they have to make is to file with the Commission a statement of registration containing the basic investment policy as well as all the material matters required by the Act to be contained in the said registration statement.[64] An investment company shall be deemed registered upon approval by the Commission of such registration statement and the publication thereof in the Official Gazette for two consecutive weeks and in two dailies of general circulation for two consecutive days.[65] The content of such registration statement includes: a recital of the policy of the registrant on the nature and extent of activities they intend to engage in; their classification, i.e., whether they intend to be in the open-end or in the close-end category of investment;[66] borrowing of money, issuance of senior securities, engaging in the business of underwriting securities issued by other persons, concentrating investment in a particular industry, the purchase or sale of real estate and commodities,

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which withdrew the feature and, in effect, became a close-end investment company. This amounted to a change in its investment policy and capital structure without the consent of the stockholders. (See footnote no. 2 for citation of Mr. Hugh Bullock's comments on the *Story of Investment Companies.*)

[61] Sec. 39, par. (E). Sec. 40, par. (B) defines an Investment Solicitor as: "Any person who for compensation solicits or obtains investments on behalf of any investment company or its agents or underwriter or transmits for a person other than himself an investment or application for investment in an investment company or offers or assumes to act as an agent or investment solicitor of an investment company and shall thereby become liable to all the duties, requirements, liabilities, and penalties to which such a person is subject."

[62] Sec. 40

[63] See Note 62.

[64] Sec. 7

[65] See Note 64.

making loans to other persons and portfolio turn-over (including statement showing the aggregate peso amount of purchases and sales of portfolio securities, other than government securities, in each of the full fiscal year preceding the filing of such registration statement);[67] the names and addresses of each affiliated person of the registrant; the name and principal address of every company other than the registrant, of which each such person is an officer, director or partner; a brief statement of the business experience for the preceding five years of each officer and director of the registrant and such other information and documents which would be required to be filed in order to register under the Securities Act all securities (other than short term paper) which the registrant has outstanding or proposes to issue. The Commission is given broad discretion in the exercise of judgment to limit the registration of investment companies to such number as the investment opportunities then obtaining would warrant.[68]

All these requisites are aimed at simplifying the administrative control of the Securities and Exchange Commission over the existing investment companies. Because by requiring these companies to register before operation, the Securities and Exchange Commission in effect shifts the burden of action and initiative from the regulator to the regulated with a resulting economy of effort to the former.[69] Furthermore, it has a psychological effect, which while admittedly difficult to gauge is nonetheless real.[70] The psychological effect is true both on the investing public and on the part of the investment companies. On the part of the public, because of the confidence that is usually generated whenever they know that a given organization is legitimately doing business and is subject to government regulation. On the side of the investment companies, because with these requirements they will be compelled psychologically at least, to stabilize their investment policy to pass the approval of the Commission, because its classification, character and such pertinent matters must be reflected on the registration statement which cannot afterwards be changed without submitting the changes to the approval of the investors in the company.

It is very important to note that the principal task of investment companies and of their directors, officers and investment managers is above all, the management of the investment portfolio. Therefore, so long as the prohibition and limitations are faithfully observed, management will remain unfettered by law with regards to the exercise of its investment judgment.[71]

In interpreting the provision of the Act with respect to the powers of the Commission, the following general rules should be adhered to:

a) That the Commission has wide discretion as to the form and content of the registration statement.

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[66] Sec. 5, par. (a). See Note 3.
[67] See Note 64.

"These provisions are designed to prevent certain happenings of the 1920s and their aftermath. Occasionally shareholders would discover that their companies were engaging in entirely different activities and employing quite different policies from those followed at the time shareholders had made their original investment. A company might suddenly change its classification completely. It might borrow money or issue senior securities and become more speculative. It might get involved in a large and unsuccessful underwriting. It might sell a diversified list of securities from its portfolio and concentrate heavily in a single industry. It might lend money where it never did before, perhaps even to its officers. It might buy and sell portfolio securities vigorously to create stock exchange commissions in which its sponsors had an interest." (For complete source, see citation in footnote no. 2.)

[68] See Note 64.
[69] See Note 6.
[70] See Note 6.
[71] See Note 6.

b) That the Commission cannot impose restrictions or prohibitions which are not specifically provided for in the law, or specifically delegating a general power to the Commissioner.

c) That the exemptive power of the Commission, i.e., the power to grant exemptions in the observance of certain provisions, is broad and subject only to the condition, that such grant of exemption is consistent with the public interest and the protection of the investor.[72]

The law vests on the Commissioner the general powers which he might exercise such as the making, issuance, amendment, and recession of such rules, regulations and orders as are appropriate and necessary to the exercise of his power conferred on him in the different provisions in the law, e.g., defining accounting, technical and trade terms, prescribing the form or forms in which information required in the registration statements, application and reports to the Commission shall be set forth. In the exercise of his power to issue rules and regulations he may classify persons, securities and other matters within its jurisdiction and prescribe different requirements for different classes of persons, securities or matter.[73] He can also prescribe such rules and regulations or orders as it deems necessary for the public interest or for the protection of investors, such as suspension of the operation of the stocks of companies registered in the stock exchange, the quotations for which are greatly in excess of the book value of the shares of stock. And as a means of putting weight to the rules and regulations of the Commission, the Act states that any provision imposing any liability shall not apply to any act done or omitted in good faith pursuant to any rule, regulation or order of the Commission, even if such rule, regulation or order may after such act or omission be amended or set aside by judicial or other authority as void for any reason. However, it should be borne in mind that all these orders, regulations and rules shall observe the requirements of due process, such as appropriate notice and opportunity for hearing either by personal process or registered mail or even a confirmed telegraphic notice to the party's last known address.[74] Such hearing may be public and any representative of the government agency, representative of interested security holders, or any other person whose participation in the proceeding may be in the public interest or for the protection of investors, can be a party to the administrative proceeding.[75]

In the enforcement of this Act, the Commission may make such investigation of a person who has violated or is about to violate provisions of this Act or the rules and regulations prescribed by the Commission. The Commission shall likewise have the power to administer oath, subpoena witnesses, take evidence, require the production of books and records and other documents, material to the inquiry. It may invoke the help of any Court of First Instance within the jurisdiction of such proceeding, and such Court may punish any refusal or failure to appear or produce records demanded by the Commission, with contempt.[76]

Any person who without just cause fails or refuses to attend and testify or answer lawful inquiry or to produce books, papers, agreements and other records, if in his power to do so, in obedience to the subpoena of the Commission, shall upon conviction, be subject to a fine of not more than two thousand pesos or to imprisonment for a term of not more than one year or both. Any person engaged or is about to engage in any act constituting a violation of

[72] See Note 6
[73] Sec. 35.
[74] Sec. 37.
[75] See Note 74.
[76] Sec. 39

the rules and regulations of the Commission, may upon showing that a person has engaged or is about to engage in any such act or practice, be restrained by a permanent or temporary injunction or decree or restraining order which shall be granted without bond.[77]

Any person or party aggrieved by an order issued by the Commission under this Act may obtain a review of such order in accordance with the provisions of section thirty-five of the Securities Act, as amended.[78] Any person who directly or indirectly procures the violation or obstructs the compliance under this Act shall also be held legally liable.[79]

Finally, unless otherwise specifically provided elsewhere in the provisions in this Act, *Section 48* states that "any person who violates any provision of this Act or any rule, regulation or order thereunder, or any person who in any registration statement, application, report or account, record, or other document filed or transmitted pursuant to this Act or the keeping of which is required pursuant to section twenty-eight of par. (a) of this Act makes any untrue statement of fact or omits to state any fact necessary in order to prevent the statements made therein from being materially misleading in the light of the circumstances under which they were made, shall upon conviction be fined not more than *fifty thousand pesos* or imprisoned for not more than *five years* or both."

Conclusion

The requirements of the Act are not very difficult to follow. Except for the provision fixing the salaries and emoluments of directors and executive officers of the investment company, there is little restraint upon the exercise of management discretion and judgment. Essentially, all the restrictions, prohibitions and exemptions contained in the law are aimed at maintaining a healthy atmosphere where the managerial function will be exercised in the best interest of the beneficial owners of the fund and the protection of the public interest.

The mutual fund concept of investment is relatively new in this country, and, therefore, while every means must be used to protect the public against anomalous transactions, the government must exert equal efforts to see that help must be extended to this growing business. The task of investment companies is primarily the formation of capital which is vital to the operation of our private enterprises. The effective utilization of capital has been required to produce modern standards of living as well as high standards of productivity. Furthermore, if we are to provide a large number of jobs in the future and cure the economic ill of unemployment, more capital must be forthcoming in quantities sufficient enough to provide the equipment, tools, and machineries for these additional workers. An adequate flow of new savings into investments is essential in order to attain a high level of employment.[80]

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[77] See Note 76
[78] Sec. 41.
[79] Sec. 47
[80] See Note 11. For interesting legal articles on the subject, reference may be made on the following:
"The Investment Company Act of 1940". Columbia Law Review. New York, 1941. Vol. 41, p. 269-295.
"The Investment Company Act of 1940". The Yale Law Journal. New Haven, 1941. Vol. 50, p. 440-457.
"The Investment Company Act of 1940". Washington University Law Quarterly. Alfred Jaretzki. St. Luois, 1944. Vol. 26, p. 303, 347.