

when prudence dictates. The implications of mobility and flexibility made rigid for the mutual funds has a bearing on many of the recommendations of the Commission.

A. Size limitations

Awaiting the results of study yet to be undertaken the Commission made no recommendations respecting size limitations on mutual funds. Investment policy may continue as it has. All that is provided from the point of reality is found in the five-percent-rule already in the Act.²¹ Any company five percent or more of the outstanding stock of which is held by an investment company will be treated as an affiliated person of that investment company. In the words of the Commission "this definition is significant because most transactions between investment companies and affiliated persons require prior Commission approval. Such approval can be granted only if the Commission finds 'that the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned.'"²²

Neither portfolio rigidity nor portfolio control are prohibited by the Act. Surely, however, there is a need to do more than simply study. Isn't portfolio rigidity in view of the present industry structure itself unhealthy? Ought we not concern ourselves at the very least with controls over the dollar amount that any mutual fund complex may invest in any single issue, keeping in mind the standard not of outstanding shares but trading volume? This suggestion is not intended in any way to criticize the Commission's evaluation of give-ups, which, if accepted, might ease somewhat the pressure to trade for the sake of generating brokerage. The point is that the Commission might not have gone far enough. The danger signs clearly are present. Why wait until substantial injury results?

Should portfolio rigidity be permitted to solidify, then we must recognize that for many purposes investment companies may become locked into given issues, that is, there may not exist the opportunity to sell a "locked" issue with relative ease and without substantial loss. Are we not therefore compelled to ask how the shareholders of the mutual funds will be protected by the managers of their monies? We are assuming a not unreal situation where unfavorable factors in a portfolio company require sale, and the fund because of the size of its holdings simply is not in a position to extricate itself.²³ At this point the import of the Commission's Investment Trust Study in 1940 should be reviewed:

"Investment companies may serve the useful role of representatives of the great number of inarticulate and ineffective individual investors in industrial corporations in which investment companies are also interested. Throughout the course of the existence of such industrial corporations, various problems are presented to their stockholders which require a degree of knowledge of financial and management practices not possessed by the average stockholder. Investment companies by virtue of their research facilities and specialized personnel are not only in a position to adequately appraise these situations but also have the financial means to make their support or opposition effective. These investment companies can perform the function of sophisticated investors, disassociated from the management of their portfolio companies. They can appraise the activities of the management critically and expertly, and in that manner not only serve their own interests but the interest of the other public stockholders."²⁴

To argue that investment companies do not possess sufficient control to sway management will not suffice. Some mutual funds do hold sufficient stock to make their views felt.²⁵ But, quite aside from percentage of outstanding stock, let us not forget that portfolio management for a number of reasons, including stock options, has an interest in not seeing any substantial block of stock sold in a way that will depress the market price of that company's issue.

To answer as the Commission has that other institutional investors share the same problem as mutual funds is not to respond full or fairly.²⁶ It is the

²¹ Section 2(a)(3), Investment Company Act of 1940.

²² Report at 308.

²³ Id. at 256. Further, the Wharton Report found that the three largest fund groups had 338 separate holdings consisting of one percent or more of the voting shares of a portfolio company. Over half of these holdings exceeded two percent. Id. at 308.

²⁴ Id. at 310.

²⁵ In 1958 individual funds possessed 10 percent or more of the voting stock in 34 different issues, and five to nine percent in five others. Id. at 308, note 7.

²⁶ Id. at 310-11.