Should Mutual Funds Be Corporations?

A Legal & Econometric Analysis*

A. Joseph Warburton**

There has been significant policy debate in recent years about whether mutual fund boards of directors, and the corporate paradigm imposed upon mutual funds in the United States, serve the interests of mutual fund investors. It is imperative that the effectiveness of the mutual fund corporate form be evaluated, as mutual funds are increasingly competing with alternative investment vehicles, such as hedge funds, with greater organizational freedom. If mutual funds in the United States are organized in corporate form simply to satisfy legal requirements, those requirements represent a deadweight cost to mutual fund investors. If mutual funds are organized in corporate form as a market solution to the agency problems that characterize mutual funds, corporate mutual funds should, in total, benefit funds and their investors. This Article finds empirical evidence in favor of the mutual fund corporate form. In the United Kingdom, where corporate and non-corporate mutual funds exist side-by-side, mutual funds organized as corporations charge significantly lower front-end loads and annual management fees than mutual funds not organized as corporations, after controlling for other factors. This difference in expenses is not reflected in significantly different fund performance on a gross (pre-expense) basis. In all, the corporate form’s downward impact on fund expenses, and its insignificant impact on gross performance, provide empirical support in favor of corporate funds.

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** Ph.D. Candidate, Department of Finance, Ross School of Business, University of Michigan. E-mail: Warburto@bus.umich.edu.
I. INTRODUCTION

Since the inception of the Investment Company Act of 1940 (the “Investment Company Act”), the U.S. Securities and Exchange Commission (SEC) has sought to enhance the independence and effectiveness of mutual fund boards of directors and to improve their ability to protect the interests of the funds and fund shareholders they serve. Most recently, in 2004, after discovering that a number of mutual fund complexes had been engaging in late trading, inappropriate market timing activities, and misuse of nonpublic information about fund portfolios, the SEC proposed numerous changes pertaining to fund governance, including requirements that independent directors comprise at least 75% of each mutual fund’s board, and that an independent director chair each fund’s board. These changes followed the SEC’s adoption, in 2001, of rules that required independent directors to comprise at least a majority of each mutual fund’s board (the previous requirement had been 40%), and that required independent directors...
to be selected and nominated only by other independent directors. In fact, the SEC has been reviewing, revising, and adopting rules and regulations pertaining to fund governance throughout the more than six decade existence of the Investment Company Act.

This continuing need to revisit fund governance issues raises the possibility that the SEC is not asking the correct questions. Instead of asking how to enhance the effectiveness of mutual fund boards, perhaps the SEC should consider whether mutual funds should have boards at all. Similar consideration might also be given to the requirement that mutual fund investors be shareholders in the fund with full voting rights. That is, perhaps the SEC should question, more broadly, the assumption that mutual funds must be organized in accordance with a corporate model. This reevaluation is particularly important as mutual funds increasingly compete with collective investment arrangements, such as hedge funds, that have freedom in their choice of organizational form. If mutual funds in the United States are organized in corporate form simply to satisfy legal requirements, those requirements represent a deadweight cost to mutual funds and their investors. This Article analyzes whether mutual fund investors in the United States could be better served by mutual funds organized according to an alternative, non-corporate governance structure.

Part II of this Article explores the corporate model required in the U.S. mutual fund industry. Part III examines the contractual model that characterizes many mutual fund industries outside the United States. Part IV assesses empirically the impact, if any, of requiring mutual funds to take a corporate form. Specifically, this Article analyzes data on British mutual funds, which can be organized in either corporate or non-corporate form. This Article tests whether the corporate mutual funds charge significantly different


3. For instance, in the 1990s, the SEC’s Division of Investment Management recommended raising the minimum percentage of independent directors of a fund’s board from 40% to a majority, and modifying the list of issues that should require shareholder vote to better comport with market realities. The Division’s objective was to “increase the effectiveness of boards of directors in monitoring conflicts of interest [and] provide shareholders with more meaningful voting opportunities[.]” Div. of Inv. Mgmt., SEC, Protecting Investors: A Half-Century of Investment Company Regulation 253 (1992) [hereinafter 1992 SEC REPORT]. Before that, the SEC commenced a four-year legislative program in 1966 to address what it perceived as excessive sales loads and management fees stemming from an apparent lack of price competition and economies of scale in the industry. The SEC’s efforts resulted in the 1970 amendments to the Investment Company Act, which strengthened independent director requirements and imposed a fiduciary duty with respect to management compensation.

4. When the SEC requested comments on its recent proposal to require at least 75% of the board of directors be independent, it asked the following:

Is any change from the current requirement necessary? Should the requirement be higher? Should it be lower? Should it be phrased in terms other than a fraction or percentage, e.g., that all directors, or all directors but one, must be independent?

See Release No. 26,520, supra note 1. But it did not ask the more fundamental and antecedent question of whether mutual funds should have boards of directors at all.
expenses than the non-corporate mutual funds, and/or generate significantly different returns. This Article finds evidence in favor of corporate mutual funds. In the United Kingdom, mutual funds organized as corporations charge significantly lower front-end loads than mutual funds not organized as corporations, after controlling for other factors. Similarly, mutual funds organized as corporations charge significantly lower annual management fees than mutual funds not organized as corporations, after controlling for other factors. However, this difference in expenses is not reflected in significantly different fund performance on a gross (pre-expense) basis. In all, the corporate form’s downward impact on fund expenses, and its insignificant impact on gross performance, provide empirical support in favor of the corporate form. Part V concludes.

II. MUTUAL FUNDS IN THE UNITED STATES

This Part details the corporate paradigm that governs mutual fund regulation in the United States, and a critique of that paradigm.

A. Organization of Mutual Funds

Mutual funds in the United States, or “investment companies” as they are referred to in the statutes, are organized pursuant to a corporate model. In the United States, the mutual fund is an independent legal entity, owned by shareholders, with a board of directors. It has full corporate powers, including the capacity to enter into contracts, to sue, and to be sued. The mutual fund raises money by issuing shares and invests the pooled proceeds in securities. The shares entitle their owners to a pro rata interest in the pooled assets. Investors in mutual funds are shareholders in the fund, with voting rights.

Virtually all mutual funds are externally managed. That is, they do not have their own employees, other than a few officers. Instead, each fund contracts with an entity, the investment adviser, which manages the fund’s investments for a fee, which is typically a percentage of assets under management. The investment adviser, from a legal perspective, is an entity that is separate and distinct from the mutual fund. The investment adviser, or its affiliate, is usually the entity that created the fund and promoted its sale to investors. Acting through its board, the mutual fund enters into contracts with not only an investment adviser, but various other service providers as well, including an administrator, a distributor (or principal underwriter), a custodian, and a transfer agent. Each mutual fund, and its relationships with these outside service providers, is overseen by a board of directors (or trustees) elected by the fund’s shareholders.

While the law does not expressly require that mutual funds be organized as corporations, it does impose requirements that assume a typical corporate form: a board of directors (whose function is to oversee the operations of the mutual fund and review contracts with service providers, such as those with the investment adviser) and shareholder voting (to elect directors, accept or reject fee arrangement, and approve fundamental changes). These requirements equally apply to investment companies that

5. Often, the investment adviser, or an affiliate, organizes a variety of funds and distributes their shares through a common, wholly owned distributor. The group of such funds is often referred to as a mutual fund family or complex. The best known examples of fund families or complexes are Fidelity, Vanguard, and T. Rowe Price.
are not corporations but are organized in some other form, such as business trusts or limited partnerships. That is, the Investment Company Act, which regulates mutual funds in the United States, imposes the corporate paraphernalia of boards of directors and shareholder voting on all mutual funds, whether they are organized as corporations, trusts, limited partnerships, or simply pools of investment funds.6

The reason the Investment Company Act takes this approach is straightforward when one considers the state of the industry in 1940. At the end of 1940, mutual fund industry assets totaled $2.1 billion.7 Of that amount, only $450 million were in open-end mutual funds (which were then commonly organized as trusts).8 The remaining $1.65 billion were in closed-end investment companies.9 Closed-end investment companies were (and are) organized in traditional corporate form. Given the dominance of investment companies organized on a corporate basis, it is understandable that, in 1940, Congress and the SEC would apply to investment companies the corporate mechanisms of boards of directors and shareholder voting. And it is equally understandable why the industry accepted this form. In short, the Investment Company Act was crafted to regulate an industry that was dominated by closed-end funds organized along corporate lines.10 Moreover, given that shares of closed-end mutual funds trade in secondary markets which, in 1940, were thin and not very liquid, investors were deemed vulnerable to expropriation by fund managers and in need of safeguards that boards of directors and voting rights were to provide.11 Today, however, the investment company industry is dominated by open-end funds, not closed-end ones. In 2004, open-end funds managed $8.1 trillion, or 95% of total investment company assets.12 In contrast, closed-end funds held only $254 billion.13 Furthermore, closed-end mutual fund shares today are highly liquid. Notwithstanding the shift from closed-end funds to open-end funds, and the increased liquidity of the markets, the corporate paradigm continues.

B. Pros and Cons of the Corporate Model

This subsection examines the arguments for and against the corporate paradigm, namely, the requirements that mutual funds have boards of directors and that mutual

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6. Notably, the corporate paraphernalia that is required of mutual funds is not required of other collective investment arrangements, such as bank common trust funds, commodity pools, separately managed accounts, and hedge funds.
8. Id.
9. Investors buy and sell shares of closed-end funds in the public markets, in the same manner they buy and sell shares of public companies. Investors invest in open-end funds by going directly to the fund to buy or redeem shares. See 15 U.S.C. § 80a-5(a) (2000). It is estimated that closed-end funds were formed in greater number before 1940 because more money was made distributing their shares than managing their portfolios. PETER J. WALLISON & ROBERT E. LITAN, COMPETITIVE EQUITY: A BETTER WAY TO ORGANIZE MUTUAL FUNDS 25 (2007).
11. Id.
13. Id.
funds grant shareholder voting rights to investors.

1. Mutual Fund Boards: Watchdogs or Sleeping Dogs

Mutual funds must have a board of directors, according to advocates, to police potential conflicts of interest inherent in mutual fund creation and operation. A typical mutual fund is organized by its investment adviser, which provides the fund with its management services. Because the adviser is a legally distinct entity from the fund and must seek higher profits for its owners, it has objectives that differ from those of mutual fund investors, who seek the highest possible return on their investment, after fees and expenses. The investment adviser thus serves two masters. The investment adviser’s interest “in maximizing its own profits for the benefit of its owners may conflict with its paramount duty to act solely in the best interests of the fund and its shareholders.”

While fund investors have the legal authority to remove the investment adviser, it is not realistic to expect fund investors to sever that special relationship between the fund and its adviser. Consequently, a conflict arises. In response, the Investment Company Act requires that a board of directors oversee fund operations. The board of directors is intended to be a monitor, protecting the interests of mutual fund investors in situations where the investment adviser could exploit them. Under the Investment Company Act, the board is responsible for selecting the fund’s investment adviser and other service providers, evaluating fees for services provided to the fund, policing operational conflicts, permitting certain transactions in the absence of SEC review, and establishing the fund’s investment objective and policy. Moreover, the Investment Company Act requires that a percentage of the fund’s directors be independent of the fund’s investment adviser. The independent directors, in particular, are expected to look after the interests of investors, and the Investment Company Act assigns additional responsibilities to these independent directors. Because of the independence requirement and the mandated responsibilities, some claim that independent directors are “watchdogs” of shareholder interests. The SEC has sought (and continues to seek) to enhance the bargaining power of mutual fund boards by strengthening the influence of the independent directors.
The corporate paradigm has its critics. Critics observe that a board of directors imposes costs on mutual funds. Direct costs include compensation of directors, reimbursement of travel expenses for board meetings, costs of counsel for the independent directors, and expenses of keeping directors informed.21 There are indirect costs as well. Fund management must reallocate considerable time and resources away from portfolio management to preparing for board meetings and tending to director requests.

Critics also argue that boards do not fulfill their intended function. These critics argue that, despite their “watchdog” role, mutual fund boards are ineffective in policing conflicts between the adviser and investors.22 Directors do not have much more information than investors, critics point out. Directors are typically generalists with only limited resources. Boards lack a full-time professional staff, and directors are dependent upon the investment adviser to keep them informed. Moreover, boards meet only quarterly or bimonthly, not daily. Further, fund directors typically lack the subject-matter expertise in portfolio management that the adviser possesses. While corporate boards outside the mutual fund context perform two functions, monitoring of management and providing strategic expertise, mutual fund boards typically perform only the monitoring function. If directors do not possess full information or expertise, critics argue that it is not realistic to expect them to strike the best deal for investors. This lack of information and expertise is compounded by the compensation scheme for directors. Directors are typically paid an annual retainer fee and a separate fee for each meeting attended. Payment is not tied to fund performance. The compensation scheme thus does not align director interests with shareholder interests.

Other critics argue that the independent director requirement that underpins mutual fund corporate governance rests on a faulty definition of independence.23 The Investment Company Act views independence in a relational context. Under the Act, a director is deemed independent if he or she does not have a close relational nexus with the investment adviser, underwriter, or administrator.24 The Investment Company Act assumes that every director who meets the relational distance test from the fund adviser will look out for the best interests of fund shareholders. However, critics argue that this assumption is flawed for three reasons.25 The first reason is that, over time, the distance


22. See, e.g., WALLISON & LITAN, supra note 9.


24. The Investment Company Act disqualifies “persons who are investment advisers of, affiliated persons of an investment adviser of, or officers or employees of” a registered investment company. Investment Company Act of 1940, ch. 686, § 10(a), 54 Stat. 789, 806 (1940) (current version at 15 U.S.C. § 80a-10 (2000)). Congress expanded the scope of the relational nexus in 1970 to include the term “interested persons,” the effect of which was to widen the relational nexus and permit fewer individuals to qualify as independent. Investment Company Amendments Act of 1970, Pub. L. No. 91-547, 84 Stat. 1413, 1416 (1970). Simply put, interested persons are defined to include a long list of persons who have some business or professional relationship with the investment company or are affiliated with the adviser, underwriter, or broker for the investment company.

25. See, e.g., Haas & Howard, supra note 23, at 186–90.
between the independent directors and the fund adviser narrows considerably. Independent directors may become “house directors,” serving on the boards of many funds within a fund family, and receive considerable compensation as a result of maintaining friendly relations with a particular investment adviser. Yet, under the Investment Company Act, this compensation is irrelevant, due to the relational standard. The second reason is directorial incompetence. Directors may stand the requisite distance away from the fund adviser to qualify as independent, but if they lack the necessary knowledge and skill, then they cannot be an effective watchdog. Third, funds are typically formed by an investment adviser, who is the fund’s initial shareholder. Given this special relationship between an adviser and its fund, it is unrealistic to expect an independent director to sever that relationship, particularly since most directors are initially selected by the adviser. And, indeed, instances of a board choosing to replace the fund’s adviser are rare.

Besides the fact that the statutory regime does not capture a meaningful notion of independence, critics find other shortcomings with the reliance upon independent directors. Critics often cite the process by which mutual funds select independent directors as creating an inherent conflict of interest. Often independent directors are selected as a reward for being a friend or colleague of the person or entity that started the mutual fund. This results in boards composed of independent directors who are anything but independent. Other critics point out that the statutory regime does not allow shareholders to pursue private enforcement of a break-down in the arm’s length relationship between directors and advisers. Finally, critics have observed that, until

26. One Maryland case, Strougo v. Scudder, Stevens & Clark, Inc., 964 F. Supp. 783 (S.D.N.Y. 1997), may be read “as implying that the court [involved in that case] would be sympathetic to the argument that clustered boards whose members receive ‘substantial remuneration’ [would] violate section 10(a) of the Investment Company Act.” David J. Carter, Mutual Fund Boards and Shareholder Action, 3 VILL. J. L. & INV. MGMT. 6, 33 (2001). Section 10(a) mandates that a certain percentage of a fund’s board be independent. However, in no subsequent case has a court taken this approach, and both Maryland and Massachusetts have since adopted statutes effectively overruling the holding. See id. at 34.


28. Shareholders do have an express cause of action with respect to compensation, pursuant to section 36(b) of the Investment Company Act, which imposes a fiduciary duty on the adviser. 15 U.S.C. § 80a-35(b) (2000). However, section 36(b) is limited to fee-related conflicts of interest only. Id. Further limitations include the following: (1) plaintiffs are not entitled to a jury trial, (2) only shareholders or the SEC have standing (not the fund, as with a derivative suit), (3) the burden of proof is on the plaintiffs, (4) damages are not recoverable for any period prior to one year before the start of the suit, (5) damages are limited to actual damages resulting
recently, errors and omissions insurance did not cover litigation between independent directors and fund advisers. A director would have had to know to ask for it, and would have had to be willing to ask the fund to pay the cost.29

The system of mutual fund directors has faced mounting criticisms over the years, leading to claims that they are not “watchdogs” but rather “sleeping dogs.” As tangible evidence, critics typically point to directors’ failure to keep management fees low, to terminate management contracts with poorly performing investment advisers, and to effectively challenge practices of investment advisers. For instance, consider board performance in terms of fees and expenses. Critics who argue that boards have not been effective in negotiating fees and expenses cite escalating fund expense ratios. The SEC estimates that mutual fund expense ratios have risen from an average of 1.14% in 1979 to 1.36% in 1999.30 One study calculates that average expense ratios for U.S. funds increased from 0.96% in 1971 to 1.44% in 1990.31 Another study claims that expense ratios have, on average, doubled over four decades.32 Critics note that this escalation in expense ratios has occurred simultaneously with the growth of the fund industry, which should permit large economies of scale and hence declining expense ratios for investors.33 Critics thus argue that these increasing fees and expenses reveal that boards have not been effective in negotiating on behalf of investors. In fact, boards rarely re-negotiate management fees over time and advisers are rarely fired; one study shows that, on average over the 1993-2002 period, only about 10% of all U.S. mutual funds renegotiated their management fees or changed their subadvisers.34 Certain critics go further, arguing that escalating fees are not just a reflection of ineffective boards. Rather, these critics assert that escalating fees are caused by the corporate paradigm that requires mutual funds to have boards and empowers them to review and approve fund

from breach of fiduciary duty and may not exceed the amount of payments received from the investment company or its shareholders, and (6) federal courts have exclusive jurisdiction. Id. Section 36(b) was interpreted by the Second Circuit in Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923 (2d Cir. 1982), which held that for a management fee to violate section 36(b) it must be so disproportionately large that it bears no reasonable relationship to the services rendered, and could not have been the product of arms-length bargaining. Id. at 928. Moreover, the court rejected comparisons with the fees and expenses of advisers to other funds. Id. at 929. No plaintiff has met the standards set forth in Gartenberg. Note that one case, Stroovo v. Scudder, Stevens & Clark, Inc., may have opened the door to derivative litigation whereby shareholders on behalf of the fund could challenge the independence of putatively independent directors. Stroovo v. Scudder, Stevens & Clark, Inc., 964 F. Supp 783 (S.D.N.Y. 1997); see also Carter, supra note 26, at 33.

29. See Haas & Howard, supra note 23, at 189.
33. Economics of scale result from the fact that the expenses associated with mutual fund management increase more slowly than the size of assets under management, and the fact that most funds are offered as part of a larger fund family (as the net asset values of families grow larger, they can spread fixed costs, such as research costs, or expenses for bank lines of credit, over a larger base). Sources of economies of scale also include savings from larger securities trades and from more efficient utilization of investment analysis; computers; shareholder servicing, accounting, record-keeping and reporting systems; and legal services.
fees. For instance, Wallison and Litan analogize the way adviser fees and expenses are approved by fund boards to the way rates are established by public utility commissions.\footnote{WALLISON & LITAN, supra note 9, at 77–78.}

Observing that mutual fund boards often set fund fees on the basis of reported costs plus a reasonable profit, they believe the corporate paradigm eliminates the incentive of investment advisers to cut costs and compete on the basis of price. Wallison and Litan state the following:

\begin{quote}
[I]n the mutual fund world where virtually all advisers must receive approval of their fees and expenses from a board of directors, there is, as noted, no incentive for them to discover all the innovations and efficiencies that would reduce their costs. If they did, the board, adding a ‘reasonable’ profit to the lower cost figures presented to them, would simply reduce the adviser’s fee accordingly.\footnote{Id. at 6.}
\end{quote}

Recently, a number of counter arguments have arisen in response to the critics. One counter argument notes that mutual fund shares, which are redeemable upon demand in open-end funds, put competitive checks on advisers. That is, while boards may not often fire advisers, investors can effectively fire an investment adviser on their own by redeeming their shares and investing elsewhere.\footnote{There can be, however, disincentives to redemption, including loads, redemption fees, and adverse tax consequences.\footnote{See John C. Coates & R. Glenn Hubbard, Competition and Shareholder Fees in the Mutual Fund Industry: Evidence and Implications for Policy, 33 J. CORP. L. 151, 167–70 (2007).}} If advisers charge excessive fees, in the long run they will lose out as investors shift to lower fee funds. A related counter argument points to the number of funds competing in the market, and the lack of substantial barriers to entry and expansion in the mutual fund market.\footnote{Studies by the U.S. General Accounting Office find that average expense ratios were 0.74% in 1990, 0.65% in 1998, and 0.70% in 2001. U.S. GEN. ACCOUNTING OFFICE, MUTUAL FUNDS: INFORMATION ON TRENDS IN FEES AND THEIR RELATED DISCLOSURE 6 (2003), available at http://www.gao.gov/new.items/d03551t.pdf; U.S. GEN. ACCOUNTING OFFICE, MUTUAL FUND FEES: ADDITIONAL DISCLOSURE COULD ENCOURAGE PRICE COMPETITION (2000), available at http://www.gao.gov/archive/2000/gg00126.pdf. The Investment Company Institute estimates that average equity mutual fund fees and expenses in 2005 were at their lowest level in 25 years. See 2005 ICI FACT BOOK, supra note 12.} Such factors make it hard to argue that the mutual fund market suffers from lack of price competition. Since investors can move in and out of funds with little cost or frictions, and funds can enter, exit and expand with few obstacles, competition in the market place should be an effective regulator. Hence, boards are not needed.

Some recent studies find that mutual fund expenses have been declining over time, contradicting studies cited by critics.\footnote{Although it found that the average expense ratio had risen from 1979 to 1999, the SEC Division of Investment Management cautioned that the overall cost of owning fund shares may not have risen if changes in sales loads are taken into consideration. T HE FEE REPORT, supra note 30. (Sales loads are not taken into consideration when calculating expense ratios and have generally decreased during the period. Id.) According to the Division,} Studies of trends in mutual fund expenses produce contradictory results depending upon the time period analyzed, how expense ratios are computed,\footnote{Studies by the U.S. General Accounting Office find that average expense ratios were 0.74% in 1990, 0.65% in 1998, and 0.70% in 2001. U.S. GEN. ACCOUNTING OFFICE, MUTUAL FUNDS: INFORMATION ON TRENDS IN FEES AND THEIR RELATED DISCLOSURE 6 (2003), available at http://www.gao.gov/new.items/d03551t.pdf; U.S. GEN. ACCOUNTING OFFICE, MUTUAL FUND FEES: ADDITIONAL DISCLOSURE COULD ENCOURAGE PRICE COMPETITION (2000), available at http://www.gao.gov/archive/2000/gg00126.pdf. The Investment Company Institute estimates that average equity mutual fund fees and expenses in 2005 were at their lowest level in 25 years. See 2005 ICI FACT BOOK, supra note 12.} and the sample of funds analyzed.\footnote{Studies by the U.S. General Accounting Office find that average expense ratios were 0.74% in 1990, 0.65% in 1998, and 0.70% in 2001. U.S. GEN. ACCOUNTING OFFICE, MUTUAL FUNDS: INFORMATION ON TRENDS IN FEES AND THEIR RELATED DISCLOSURE 6 (2003), available at http://www.gao.gov/new.items/d03551t.pdf; U.S. GEN. ACCOUNTING OFFICE, MUTUAL FUND FEES: ADDITIONAL DISCLOSURE COULD ENCOURAGE PRICE COMPETITION (2000), available at http://www.gao.gov/archive/2000/gg00126.pdf. The Investment Company Institute estimates that average equity mutual fund fees and expenses in 2005 were at their lowest level in 25 years. See 2005 ICI FACT BOOK, supra note 12.} A further complicating factor is that,
while funds may not often change their stated fees, they do frequently offer to waive some of those fees. One study finds that almost half of money market fund expenses were being waived, and that 37% of equity funds were offering fee waivers. Moreover, the study found that these fee waivers changed frequently throughout the year. Thus, it might be that price competition gets reflected in fee waivers instead of in fees themselves.

With compelling arguments made by proponents and critics of fund boards, the question remains: Do the advantages of boards of directors in mutual funds outweigh their disadvantages? Before answering that question, however, we must first examine the other element of the corporate paradigm: shareholder voting.

2. Shareholder Voting

In the United States, a mutual fund, as a corporation organized under state law, must grant voting rights to its shareholders in accordance with state corporate law. Moreover, the Investment Company Act reinforces and extends these shareholder voting rights. Section 18(i) of the Investment Company Act requires, with a few exceptions, that every share of stock issued by an investment company “shall be a voting stock and have equal voting rights with every other outstanding voting stock.” Further, the Investment Company Act grants additional voting rights to shareholders, beyond those given by state corporate law. Such shareholder voting rights include the right to elect directors, to approve changes to fundamental policies with respect to key investment activities, to approve changes to fundamental policies with respect to key investment activities, to

the increase in mutual fund expense ratios since the 1970s can be attributed primarily to changes in the manner that distribution and marketing charges are paid by mutual funds and their shareholders. Many funds have decreased or replaced front-end loads, which are not included in a fund’s expense ratio, with ongoing Rule 12b-1 fees, which are included in a fund’s expense ratio. This change complicates the comparison of current expense ratios with expense ratios from earlier periods.


41. See Coates & Hubbard, supra note 38, at 175–77 (discussing varying study results across several samples of funds).


43. Id.

44. The Investment Company Act also mandates these rights for funds of non-corporate form, such as trusts.

45. 15 U.S.C. § 80a-18(i) (2000). There is an exception for investment companies organized as series, where each series represents interests in a single portfolio of securities. Id. § 80a-18(i)(2).

46. Id. § 80a-16(a).

47. Id. § 80a-13(a). Activities that must be governed by fundamental investment policies are capital structure, permissible investments and investment strategies that significantly affect the investment characteristics, and risk-reward profile of the shares issued by the mutual fund. See 1992 SEC REPORT, supra
approve Rule 12b-1 plans, and to approve the initial management contract, subsequent changes to the management contract, assignments of the management contract, and any new management contract. Over the years, these shareholder voting rights have been emphasized and expanded by the SEC. For instance, in administrative proceedings, the SEC staff has often taken broad positions on classifying investment policies as fundamental investment policies that cannot be changed without shareholder approval. Also, the SEC staff has interpreted the notion of “assignment” of management contracts broadly to require shareholder approval following minor changes in ownership or control of the investment adviser. Advocates argue that shareholder voting is necessary to ensure the accountability of fund management to investors. Shareholder voting is also necessary to elect directors to the funds’ boards, and to preserve the independence of the independent directors. Advocates also cite the informational advantages that accompany the proxy process.

Notwithstanding the foregoing, critics argue that voting rights have been of limited value in governing the relationship between the fund and its investment advisers, underwriters, and others. These critics argue that, in the more than six decade history of the Investment Company Act, there have been few instances where shareholders appear to have had a significant impact on the management of the fund. There have been almost no reported instances of successful shareholder opposition to any management proposal for advisory contracts, change in investment policies, or selection of accountants, which are issues that expressly require shareholder approval. There have been three instances in recent years where shareholders have been involved in a proxy fight between the investment adviser and independent directors. The three instances involve the Navalier funds in 1997, the Yacktman funds in 1998, and the Japan Fund in 2002. In those cases, the independent directors refused to approve management contracts and the issue subsequently fell to shareholders. In the first two cases, the shareholders actually defeated the independent directors and voted to retain the investment adviser. Only in the last case did the shareholders support the independent directors. Nevertheless, in cases such as these, most shareholders choose to sell their shares rather than vote. Consequently, critics conclude that shareholder voting is generally not a viable mechanism for ensuring accountability or even for meaningful expression of opposition to management.

Critics also argue that shareholder voting is ineffective in preserving the independence of directors. Independent directors are initially selected by the fund sponsor or adviser, in most cases. Thereafter, vacancies are typically filled by nominating committees composed of the independent directors. While shareholders in theory have the power to reject candidates nominated by the nominating committee, it is rarely

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49. 15 U.S.C. § 80a-15(a); id. § 80a-15(f). Either the shareholders or the board must approve multi-year contracts. Id. § 80a-15(a)(2).
50. Phillips, supra note 7, at 907 (describing how the Commission has expanded voting requirements).
51. Id.
52. See David A. Sturms, Enhancing the Effectiveness of Independent Directors: Is the System Broken, Creaking or Working?, 1 VILL. J.L & INV. MGMT. 103, 111 (1999) (“Approximately 69% of the mutual funds shares had ‘voted with their feet’ by redeeming their investments in the fund.”).
exercised. Shareholders overwhelmingly approve the proposed slate of directors. Critics conclude that shareholder voting tends to be a “ritualistic ratification” of nominees already selected pursuant to this process. In the history of the Investment Company Act, critics observe that there have been virtually no shareholder attempts to elect nominees to the board in opposition to management nominees, or to ouster an incumbent director through a proxy fight. Furthermore, critics argue that proxy materials do not serve a useful communication function for shareholders. Fund investors already receive, in addition to the proxy materials, annual statutory prospectuses and periodic shareholder reports. Proxy materials are likely the least read and least understood of all communications investors receive.

Critics offer several reasons for the ineffectiveness of shareholder voting. First, mutual fund shares are typically dispersed widely. There are no large blocks of shares in the hands of individual investors or management and, hence, collective action problems prevail. Second is the nature of an investment in a mutual fund. The instant diversification provided by a mutual fund obviates the incentive to follow fund management decisions closely or to expend the energy necessary to participate in the voting process. Mutual fund investors “hire” the fund’s investment adviser precisely because they wish to avoid such involvement. Third, the liquidity offered by mutual funds means investors can redeem their shares (“vote with their feet”) rather than bother to vote. As a result, mutual fund shareholders participate in the voting process even less often than shareholders of traditional corporations.

Nevertheless, providing for shareholder voting is costly for mutual funds. Critics note that voting has direct costs. These costs include the expenses of proxy solicitations, including legal and accounting fees in connection with the preparation and distribution of proxy materials, as well as the costs of holding annual or special meetings of shareholders. Attendance of investors at shareholder meetings and the number of proxies actually returned is sparse, making it difficult to achieve a quorum. Two and three adjournments of shareholder meetings for lack of response to proxy solicitations are not uncommon, causing delay and increased costs for re-solicitations. The expenses associated with shareholder voting are typically paid by the fund (and thus the investors), and not by the investment adviser. Although there are no published figures that isolate these costs from other funds expenses, they likely are not negligible. There are more indirect costs as well. In order to comply with shareholder voting requirements, fund management must reallocate considerable time and resources away from portfolio management to shareholder solicitations. Moreover, collective decision making by shareholders can result in decisions that are different from those that would have been

53. See Carter, supra note 26, at 25 (stating that shareholders typically approve the proposed slate without objection).
54. Phillips, supra note 7, at 909-10.
55. There are nevertheless disincentives to redemption, including loads, redemption fees, and adverse tax consequences.
56. See Carter, supra note 26, at 26 (comparing mutual fund shareholders to shareholders of traditional corporations); WHARTON SCH. OF FIN. & COMMERCE, A STUDY OF MUTUAL FUNDS, H.R. REP. 87-2274, at 68 (1962) [hereinafter WHARTON REPORT].
57. WHARTON REPORT, supra note 56.
58. Phillips, supra note 7, at 908 (discussing responses to proxy solicitation).
reached if shareholders each contracted individually. In other words, the collective decision making of shareholder voting may be inefficient in that it does not maximize shareholder welfare. Consequently, critics have often called for the SEC to permit funds to issue non-voting securities and to convert outstanding voting securities to non-voting securities.

We are left with the question: Do the advantages of shareholder voting in mutual funds outweigh the disadvantages? Similarly, do the advantages of boards outweigh their disadvantages? More generally, do corporate mutual funds represent an optimal market solution to the agency problems that characterize mutual funds? If so, the corporate model should, in total, benefit funds and their investors. But if mutual funds in the United States are organized along corporate lines solely to satisfy legal requirements, those requirements represent a deadweight cost to mutual funds and their investors. This Article answers this general question by exploring the alternatives to the corporate model in Part III and by testing it empirically in Part IV.

III. MUTUAL FUNDS OUTSIDE THE UNITED STATES (THE CONTRACTUAL MODEL)

With respect to fund structure and governance, two dominant types of mutual funds have arisen in the world: the “corporate fund” (the U.S. model) and the “contractual fund” (the German, Japanese, and British models). In the United States, mutual funds have been required to take the corporate form. However, in much of Europe, in Japan, and in many other countries, funds have arisen under contract or trust law, as opposed to corporate law. Investors in these funds contribute money to a pool of funds, in which contribution is governed by a contract between the investors and the manager of the pool. The manager then manages the portfolio. Unlike funds organized pursuant to the corporate model, funds organized pursuant to this contractual model do not empower a monitor (such as a board of directors) with discretion to oversee the fund and provide little, if any, shareholder voting. The fact that mutual funds have arisen in many countries pursuant to a contractual model raises the possibility that the corporate model is not a market solution to the organizational design problem.

A. Differences Between the Corporate Model and the Contractual Model

The two models differ in how they allocate decision-making power and control among the three primary actors (the investment adviser, the monitor, and the investors).

1. Fund Versus Adviser as the Focal Point

The corporate model places the mutual fund at the center of the model. In the corporate model, the fund is an independent legal entity with the capacity, for instance, to enter into contracts and to sue and be sued. The laws and regulations governing mutual funds focus on the operation and structure of the fund. The fund offers shares in itself to the investors. It is the proceeds from the issuance of its shares that form the investment pool of the fund. The investment pool may not be commingled with the assets of the

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61. See Phillips, supra note 7, at 910 (stating one critic’s view on non-voting securities).
investment adviser or any other entity, or paid out to any other entity except pursuant to contracts approved by the fund’s board. The fund has a board of directors, with ultimate responsibility for coordinating and managing the fund. With board approval, the fund contracts with legally independent third party service providers, such as the investment adviser, the distributor, and the administrator.

In contrast, the contractual model places the investment adviser (or its equivalent, the “investment manager”) at the center, instead of the fund. The fund in the contractual model is a contractual entity which is not independent of its investment manager or sponsor. Rather, the design and operation of the fund, and its success or failure, are the responsibility of the manager. In this sense, the contractual fund is “more like a proprietary financial product.”62 For instance, the Financial Services Regulation of the United Kingdom states the following:

It is the duty of the manager to manage the property of the [fund], and it is his right and duty to make decisions as to the constituents of that property from time to time in accordance with . . . the trust deed, [laws and regulations] and the most recently published [prospectus].63

Consequently, in the contractual model, the investment manager is not subject to the control of a board or any other organizational superior. The investment manager is responsible for all services necessary for the operation of the fund (except for custodial services)64 and all costs involved in operating the fund and distributing its shares (though the manager may recoup all or some of such costs through pre-set fees).

2. Rules Versus Discretion

In the corporate model, the fund’s board of directors is granted considerable discretionary authority and is responsible for making business judgments. For instance, the board must approve the contracts with the fund’s adviser, distributor, and administrator, and review them annually. The board is provided with no guidance or decision rules; rather, these are decisions for the board in its sole discretion.65


64. Because fund assets are mostly held in liquid form, the potential for insider misconduct is high. It is therefore important that fund assets are held by custodians. The custodian typically safeguards fund assets, makes payments for purchases of securities in a fund’s portfolio, and receives payments from sales of portfolio securities. In the United Kingdom, the manager must be independent from the custodian (whose function is performed by the trustee). The trustee (1) carries out the instructions of the manager (subject to laws and regulations), (2) takes reasonable care to ensure that the manager accurately calculates issue and redemption prices, and (3) takes custody of assets and holds them in trust for investors. The trustee may delegate its custodial function to a separate custodian. If it does so, the trustee must make reasonable inquiry to ensure that the custodian is fit and proper and that arrangements have been made to protect the trustee’s priority over other creditors of the custodian. Financial Services (Authorised Unit Trust Schemes) Regulation, 1988, S.I. 1988/284, § 4.05 (U.K.), reprinted in VAUGHAN, supra note 63, at 38.

In contrast, funds following the contractual model rely more on rules than discretion. In the contractual model, the typical fund contract is composed of “standard terms or rules, with allowances for variations (i.e., discretion) in only exceptional cases.” 66 To ensure that contract terms are fulfilled, a passive monitor (typically a custodian or trustee) is employed to “ensure that the [fund] is administered by the managers in accordance with the [management contract, regulations and prospectus].” 67 Thus, instead of imposing a board of directors, the contractual model relies on a passive monitor to oversee the manager’s compliance with pre-established rules and, in carrying out the function, the monitor is given little discretion. In the United Kingdom, for example, if a trustee of a unit trust desires to remove a fund manager, the trustee can only do so in one of six events that are specified in the regulations. Such events include the liquidation of the manager or the appointment of a receiver for any part of the manager’s activities. In another example, instead of requiring the trustee to be a watchdog over potential conflicts, as boards are required in corporate funds, the laws and regulations of contractual fund jurisdictions explicitly set forth which transactions are permitted and prohibited for managers.

3. Shareholder Voting

Voting occurs when decisions are not already decided by contract. Thus, not surprisingly, corporate funds typically provide for greater shareholder voting than contractual funds. In the United States, a mutual fund, as a corporation organized under state law, must grant voting rights to its shareholders in accordance with state corporate law. 68 Moreover, the Investment Company Act grants additional voting rights to shareholders, beyond those given by state corporate law. Such shareholder voting rights include election of directors, changes to fundamental policies with respect to key investment activities, approval of the initial management contract, subsequent changes to the management contract, assignments of the management contract, and any new management contract. 69

In contrast, contractual funds provide few voting rights to investors. In the United Kingdom, for example, unit trust investors may vote on only four issues: (1) amendment of the trust deed, if the trustee and manager consent, (2) approval of a manager to depart from a policy set forth in the prospectus, (3) removal of the manager, and (4) merger of the fund with another fund or other body. 70 In many other countries following the contractual model, such as Germany and Japan, investors have no voting rights at all. 71

35 (2000)). Yet no guidance was provided as to what the term “fiduciary duty” would allow.
68. The Investment Company Act also mandates these rights for funds of non-corporate form, such as trusts.
69. See discussion supra Part II.B.2.
70. See Vaughan, supra note 63, at 76 (discussing voting rights in the United Kingdom).
B. Purported Advantages of the Contractual Model

As noted above, the contractual model places the investment adviser (or its equivalent, the investment manager) at the center. That is, the investment manager provides and coordinates all fund operations. It is not solely one of several outside service providers. While the corporate model assigns legally separate roles to the sponsor, the investment adviser, the distributor, and the administrator, in the contractual model, these functions are all performed by the investment manager.

Advocates of the contractual model cite efficiency as a justification for combining these functions. Running a mutual fund involves coordinated execution of multiple tasks. Since the functions are complimentary activities, advocates argue that they can be performed more efficiently by a single entity.

It is not only more efficient, but also easier to assess performance if those tasks are accomplished by a single entity. Combining functions makes it easier to evaluate performance and provide incentives. In a contractual fund, the investment manager can set a single, fixed fee in exchange for all services necessary for a fund’s operation. All fund expenses are paid out of that single fee or from the investment manager’s own resources. This unitary, or bundled, fee structure greatly simplifies the investors’ ability to evaluate bottom-line fund expenses as well as net mutual fund performance. In contrast, corporate funds have much more complex fee structures. Corporate funds, acting through their boards of directors, enter into multiple service contracts with separate service providers, each with its own fee and expense provisions. But this approach produces, in the aggregate, a complex fee structure. The problem is compounded by the fact that, in corporate funds, the allocation of costs among service providers is somewhat arbitrary.72

Combining functions may benefit investors in other ways, according to advocates. As the provider of all services, the investment manager becomes fully responsible for the design and operation, and success and failure, of the fund. The fund is not independent of the investment manager, but rather part of it, just as any financial product the investment manager offers. A contractual mutual fund is, in a sense, a proprietary product whose success or failure directly impacts the reputation of the investment manager.

Another advantage of the contractual model is that it likely reflects investor perceptions of their relationship to their fund, even in the United States. Typical investors in U.S. mutual funds do not think of themselves as owners of the fund, though legally they are. More likely they view themselves as customers of the investment adviser. For instance, investors in the Fidelity Magellan Fund most likely view it as Fidelity’s fund, not a fund that they own as shareholders, and they likely view themselves as contracting with Fidelity to be provided with Fidelity’s service, investment management.73

C. SEC Consideration of Contractual Fund Proposals

The SEC’s Division of Investment Management considered permitting mutual funds

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72. See WALLISON & LITAN, supra note 9, at 82-83 (discussing problems in allocating costs).
to organize pursuant to an alternative governance structure in the early 1990s, and rejected the idea.\(^{74}\) Two alternatives to a corporate model were considered: the Unitary Investment Fund and the Unified Fee Investment Company.

In concept, the Unitary Investment Fund (UIF) follows the contractual model closely. Specifically, the UIF would be a mutual fund organized in trust form and would be operated under the management of a sponsor, without the provision for a board of trustees elected by shareholders.\(^{75}\) Instead, the sponsor/manager would act as the fund’s trustee. A trust indenture would spell out fundamental investment policies and the management fee. Investors would hold non-voting interests in the trust. In return for the elimination of shareholder voting and fund boards, the UIF would be required to operate in accordance with its trust indenture, and the UIF’s manager would limit itself to a single management fee to cover all operating expenses (except extraordinary expenses and shareholder account services). The fee would be set forth in the trust indenture and be subject to a statutory maximum, which the SEC could adjust. The trust indenture could not be amended for a certain period (perhaps five years) without an SEC exemptive order. Thereafter, it could be amended upon adequate prior notice to investors, who could respond by redeeming.

The advantage of the UIF is its simplified governance structure, with neither voting shareholders nor a board of directors, and a simple fee arrangement. However, the UIF was criticized by the Division along several lines.\(^{76}\) The Division first pointed out that boards in the corporate model do more than police fees. They also police potential transactions that would transfer value from investors to the adviser or its affiliates. The Division, consequently, called for an independent monitor to accompany the UIF proposal, which role might be performed by either an independent trustee or the SEC through oversight and examination. However, in the end, the Division felt that the added cost of an independent monitor would undermine the initial rationale for the contractual model.\(^{77}\) Second, the Division took the position that shareholder voting rights “serve an important communicative and deterrent function, particularly in circumstances where there are impediments to redemption.”\(^{78}\) Thus, although the Division acknowledged that “the current voting structure is a ‘ritualistic anachronism,’” it chose to retain the traditional corporate model and eliminate certain shareholder voting requirements that did not have any bearing on investor protection concerns.\(^{79}\) Consequently, the Division “concluded that a contractual or UIF structure is fundamentally incompatible with the regulatory philosophy of the Act, which relies on boards of directors to monitor investment company operations and resolve conflicts of interest.”\(^{80}\) The Division stated that “implementation of the UIF concept would require a wholesale restructuring of


\(^{75}\) 1992 SEC REPORT, supra note 3, at 282-88.

\(^{76}\) Id.

\(^{77}\) See id. at 285 (explaining that without demonstrable savings there is no reason to replace the current model).

\(^{78}\) Id. at 276.

\(^{79}\) Id.

\(^{80}\) 1992 SEC REPORT, supra note 3, at 254.
existing regulatory arrangements, with . . . no apparent benefit for investors."81

Having rejected the UIF proposal, the Division considered a compromise: the Unified Fee Investment Company (UFIC), which retained the board of directors feature of the corporate model, retained some shareholder voting rights and eliminated others, and added the single fee aspect of the contractual model.82 Under the UFIC proposal, two-thirds of the board would be independent. The board, including the independent directors voting separately, would review and approve all material contracts, including the management contract, and would have the right to terminate any contract at any time. However, the board would have no role with respect to fund fees. Instead, the UFIC would have a single, unified fee which would cover all operating expenses (except extraordinary expenses and shareholder account services). The fee would be displayed prominently in the prospectus, sales materials, and advertisements, and would be set by competitive pressures in the marketplace. Shareholders would no longer have the right to vote with respect to the fund’s advisory contract. Instead, they would receive 90 days notice of any management or advisory fee changes, and would be expected to redeem their shares if they disagreed with the changes (there would be no sales charges or redemption fees). Shareholders would retain all other voting rights that they had.83

However, the Division downplayed the importance of the UFIC proposal, placing a discussion of it in Chapter 8 of its report (“The Sale of Open-End Investment Company Shares”) instead of in Chapter 7 (“Investment Company Governance”), with a discussion of the UIF. The Division appeared to consider the UFIC to be merely a modified version of the corporate model, rather than an alternative to it.84

An important factor in the Division’s rejection of these proposals was an estimate of the cost of corporate governance structures. The Division rejected the idea that the corporate governance structure is more costly than a contractual structure. The Division determined that the elimination of the corporate structure “would result in only minimal cost savings.”85 However, in reaching this conclusion, the Division did not make a fully informed decision. First, it did not conduct its own study or rely upon an independent study. Instead, it based its decision on estimates provided by three mutual fund complexes.86 The authors of these submissions would have had a vested interest in continuing the current system.87 Moreover, one can question whether three estimates are sufficient. Further, the three estimates had very narrow scopes, looking at direct costs only, such as fees and expenses of independent directors, the cost of proxy solicitations, the cost of counsel for the independent directors, and the cost to prepare materials and reports to directors. These estimates did not address the potentially greater costs of a corporate governance structure that diverts resources away from fund management in order to comply with corporate governance requirements and that empowers boards of

81. Id. at 254–55. Note that another criticism of the UIF was that it would have a “relatively inflexible and static trust structure that quickly could become anachronistic and unresponsive to investor needs.” Phillips, supra note 7, at 904.
82. 1992 SEC REPORT, supra note 3, at 332–45.
83. Id., at 337–45.
85. 1992 SEC REPORT, supra note 3, at 286.
86. See Cost Letters, supra note 21.
87. One of the three estimates was submitted by the independent directors of a fund complex.
directors whose interests are not aligned with shareholders. In contrast to these direct
cost, industry-sponsored studies considered by the SEC, Part IV of this Article takes a
more comprehensive approach, using regression analysis, to empirically assess the impact
of the corporate model.

IV. EVIDENCE FROM THE UNITED KINGDOM

This Part examines mutual funds in the United Kingdom where, since 1997, mutual
funds have been organized in both corporate and non-corporate form. Prior to 1997,
British open-end mutual funds were organized exclusively as trusts, not corporations.
These British mutual funds are called “unit trusts.” Unit trusts are created under British
trust law and have been in existence for over a century. Unlike U.S. mutual funds, British
unit trusts have no separate legal existence, do not have boards of directors, and do not
issue voting securities to investors. Instead, investors invest in a unit trust by entering into
a contract with the fund manager, who manages the assets. The contract between the
manager and the investors requires the manager to appoint a trustee pursuant to a trust
deed. The trust deed between the manager and the trustee states that the trust deed is
binding upon and enforceable by the investors as if they are a party to the trust deed. The
relationship between the investors and the manager is thus governed by both contract and
trust law. The trustee of the unit trust has custody and control over the assets, and holds it
in trust for investors. The trustee is also responsible for protecting investors’ interests and
ensuring that the manager complies with all applicable laws. The manager and the trustee
must be independent of each other.

Open-end mutual funds in the United Kingdom evolved as unit trusts under trust
law, as opposed to corporations under English company law, in order to avoid certain
restrictions of English company law, which does not apply to trusts. English company
law prevents corporations from repurchasing their own shares. Thus, under English
company law, investors could not liquidate their investments by demanding that the
issuer repurchase their shares; they could only liquidate by selling the shares in a
secondary market. However, since trusts are not subject to company law, nothing
prohibits unit trusts from repurchasing investors’ interests. This flexibility accounts for
the development of open-end mutual funds in the United Kingdom as unit trusts rather
than as corporations. In the United States, mutual funds faced no restrictions on
repurchases of their own shares, and the use of trusts was unnecessary.

A major change to the open-end British mutual fund market occurred in 1997. In
1997, British regulators permitted a new kind of open-end mutual fund, the Open-Ended
Investment Company (OEIC). OEICs are corporations organized under The Open-Ended
Investment Companies (Investment Companies with Variable Capital) Regulations of
1996, which came into effect on January 6, 1997. Although they are corporations, the
Regulations authorize them to repurchase their shares. As corporations, OEICs have a
separate legal existence, a board of directors, and voting shareholders. Note, however,

88. A crucial feature on an open-end mutual fund is the ability of an investor to exit a fund by demanding
that the fund redeem the shares at a price determined by reference to the fund’s net asset value. In contrast,
investors exit a closed-end fund by selling the shares in a secondary market, at a price determined by supply and
demand for those shares.
that the changes did not displace unit trusts. Rather, investment managers are now allowed to organize and market two forms of open-end mutual funds in the United Kingdom: the OEIC and the unit trust (along with the closed-end fund, the investment trust).90

While functionally similar to unit trusts, OEICs are distinct organizationally. OEICs are incorporated bodies, governed by an instrument of incorporation, and have a separate legal existence. In contrast, unit trusts are governed by a trust deed, and have no separate legal existence. Further, OEICs have a board of directors, unlike unit trusts.91 Acting through its board of directors, the OEIC contracts with a separate legal entity to act as its manager. Thus, to replace the manager, the board need only terminate the contract with the manager. The manager of the OEIC, however, is entitled to a seat on the fund’s board, and is referred to as the “Authorized Corporate Director.”92 In contrast, the manager of a unit trust is appointed by being a party to the trust deed that constitutes the trust, and can only be replaced in certain exceptional circumstances which are set forth in the regulations.93 Moreover, while investors in unit trusts own units, investors in OEICs own shares. In addition, OEICs are required to hold an annual general meeting, and OEIC shareholders have wide powers to call general meetings.94 The annual meetings ensure that OEIC shareholders have a regular opportunity to be brought up to date with the affairs of the fund, and to air any grievances they may have.

There are several reasons for the United Kingdom’s adoption of the OEIC:

90. The mutual fund industry in the United Kingdom is today governed by the Financial Services and Markets Act 2000 (FMSA), 2000, c. 8 (Eng.). The FMSA delegates regulatory authority over unit trusts to the Financial Services Authority (section 247(1)) and regulatory authority over OEICs to the Treasury (section 262(1)). Id. Common rules and guidance related to the operation of funds and the activities of fund managers are contained in the Financial Service Authority’s “Sourcebooks.” See INV. MGMT. ASS’N, REVIEW OF THE GOVERNANCE ARRANGEMENTS OF UNITED KINGDOM AUTHORIZED COLLECTIVE INVESTMENT SCHEMES 17-18 (2005) [hereinafter REVIEW OF U.K. GOVERNANCE ARRANGEMENTS] (describing the uses and categorization of the “sourcebooks”).

91. However, OEIC directors are not required to be independent. Instead, U.K. authorities have looked to an independent depository for protection of shareholder interests. REVIEW OF U.K. GOVERNANCE ARRANGEMENTS, supra note 90, at 21-22. The “depository” performs a custodial role similar to that of the trustee of a unit trust. Id.; FINANCIAL TIMES, UNIT TRUST & OEICS YEARBOOK 1997, at A14 (1999) [hereinafter the 1997 YEARBOOK]; FINANCIAL TIMES, UNIT TRUST & OEICS YEARBOOK 1998, at A38 (2000) [hereinafter the 1998 YEARBOOK]. The depository is responsible for custody of the OEIC’s assets, overseeing the activities of the fund and protecting investor interests. To fulfill these oversight and protection functions, the depository is permitted to convene and attend shareholder meetings, to receive board materials, and to attend relevant board meetings. REVIEW OF U.K. GOVERNANCE ARRANGEMENTS, supra note 90, at 21-22. The depository is required to be independent of the fund manager and the OEIC. The Open-Ended Investment Company Regulations, 2001, S.I. 2001/1228, art. 15, ¶ 8(f) (U.K.), available at http://www.opsi.gov.uk/Si/si2001/20011228.htm.


93. In an OEIC, both the manager and the depository are appointed pursuant to a contract with the OEIC (acting through the board of directors). Thus, to replace the manager or the depository, the board need only terminate the contract with the respective party. In contrast, with a unit trust, the trustee and the manager are appointed by being parties to the trust deed constituting the trust. The unit trust manager is not legally entitled to replace the trustee (though the trustee can replace the manager in the exceptional circumstances that are set forth in the regulations). REVIEW OF U.K. GOVERNANCE ARRANGEMENTS, supra note 90, at 18 (providing a general overview of the regulatory framework for OEICs).

simplification, internationalization, and flexibility. First, OEICs have a more simplified pricing structure than the unit trusts. OEICs have a single price for both purchases and sales of shares. Unit trusts have traditionally had separate prices at which investors buy and sell units, known as the bid-offer spread. The bid-offer spread is effectively an upfront fee, intended to cover transaction costs in effecting the sale or purchase. The single price structure of the OEIC was seen as a way to simplify pricing and promote mutual fund investment.

Second, OEICs were perceived to be more marketable in the European Union than unit trusts. In the 1980s, the European Union set forth a framework for promoting cross-border flow of mutual funds among its members. Known as the UCITS Directive, this framework imposed minimum standards regulating open-end investment funds within the European Union. The UCITS Directive sets forth minimum standards with respect to diversification, authorization, company structure, permissible activities, and disclosure, allowing mutual funds organized under the laws of one member nation to comply with only the marketing, advertising, and tax laws of another nation in which they do business. In other words, the Directive allowed mutual funds to operate under a “passport” system, where they could be offered for sale throughout Europe once they were authorized in one member state, and so long as they met the minimum standards set forth in the Directive. Unlike unit trusts, which initially did not meet the requirements of the Directive in terms of company structure, OEICs could be sold throughout Europe. Moreover, the law of trusts, which governs unit trusts, grew out of English common law and is peculiar to that heritage. While trusts are common to those parts of the world with a strong British heritage, they are a foreign concept in European continental countries, where the Napoleonic and Roman legal heritage dominates. Thus, European investors were not likely to be familiar with the technical legal structure of unit trusts. OEICs, therefore, were anticipated to be more marketable outside the United Kingdom.

The third reason for the adoption of OEICs is flexibility. OEICs can issue a wider range of shares than unit trusts. Unlike unit trusts, OEICs can issue multiple share classes. That is, a single OEIC can offer different share classes, each with a different pricing structure, to different types of investors (for instance, retail versus institutional investors). Thus, by issuing multiple share classes, the same OEIC can be marketed to both retail and institutional investors. The same cannot be done with unit trusts; either the same unit trust must be marketed to both retail and institutional investors, or two unit trusts must be established, one for retail investors and one for institutional investors.

Moreover, unlike unit trusts, an OEIC can function like a corporate umbrella for a

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98. Note, however, that it does not follow that all continental European funds are corporate entities. France, Luxembourg, Belgium, and Spain offer both corporate and non-corporate funds, while Germany and Switzerland permit only non-corporate funds, and the Netherlands allows only corporate funds. Therefore, one may question the assumption that continental European investors would prefer corporate funds. See 1998 YEARBOOK, supra note 91, at A9-A10.
number of sub-funds. That is, a single OEIC can be established with multiple sub-funds, each pursuing different investment objectives. For instance, an OEIC can have one sub-fund investing in value stocks and another investing in growth stocks. Different series of shares are issued by the OEIC, depending on which particular sub-fund the investor selects, and each series gives the right to a share in a separate pool of assets. Unit trusts cannot do this.

Despite the asserted advantages, OEICs were initially slow to catch on. At the end of 2000, there were approximately 50 OEIC providers, managing only about 25% of open-end mutual funds in the United Kingdom.99 Hesitation may have been caused by the desire to wait for other fund managers to work out the glitches in the new structure, or by the legal and technological costs of switching. Hesitation may also have been caused by initial restrictions on the types of funds that could constitute OEICs. The 1996 Regulations that authorized OEICs only permitted that vehicle for funds investing in “transferable securities,” a term used in the UCITS Directive. This term was interpreted to include only exchange-listed bonds and equities, preventing money market funds, property funds, and funds of funds from organizing as OEICs. It is estimated that approximately 200 such funds were excluded from organizing as OEICs due to the restriction.100 The 1996 Regulations were amended in 2001 to permit funds to organize as OEICs even if they do not invest in transferable securities.101 The 2001 amendment appears to have had an effect, as OEICs accounted for over half of the open-end mutual fund market in the United Kingdom by 2004.102

A. The Literature

Part II of this Article detailed the debate in the United States about whether mutual fund boards are effective in protecting the interests of fund shareholders. This debate has spawned much empirical research on mutual fund boards. For instance, many studies have examined how board structure and composition impact fund fees and expenses.103 Other studies have examined how board structure and composition impact the likelihood that a board will act in the interests of mutual fund investors.104 Other studies have

100. Id. ¶ 11.
101. Id.
103. See, e.g., Peter Tufano & Matthew Sevick, Board Structure and Fee-Setting in the U.S. Mutual Fund Industry, 46 J. FIN. ECON. 321 (1997) (finding that expenses are lower in funds governed by smaller boards and by boards containing a greater percentage of independent directors); Diane Del Guercio et al., Governance and Boards of Directors in Closed-End Investment Companies, 69 J. FIN. ECON. 111 (2003) (finding that expenses are lower in funds with more independent directors and in funds with more independent directors serving since fund inception); Sophie X. Kong & Dragon Y. Tang, Mutual Fund Governance: What Works and What Doesn’t? (March 1, 2006) (unpublished manuscript, on file with author) (finding that fees are not lower in funds with more independent boards; instead, low fees are associated with unitary boards, i.e., boards where the same directors comprise boards of all funds in the fund complex).
104. Del Guercio et al., supra note 103, at 148, find that fund boards are more likely to act in investors’ interests the greater the proportion of independent directors on the board. They also find that fund boards are
analyzed the factors that determine board structures. Despite this volume of work analyzing mutual fund boards, no studies examine the more antecedent question of whether mutual funds should be organized as corporations at all, with boards of directors and voting rights for investors.

This gap in the literature may be due to the fact that almost all empirical work on fund structure and governance has focused on the U.S. mutual fund industry, where funds must follow the corporate paradigm. However, Part III described how, in the United Kingdom and many other countries around the world, mutual funds are not required to organize as corporations and lack boards of directors and investor voting rights. But no studies have focused on such differences in mutual funds around the world. The few comparative studies that exist explore differences in mutual funds at the industry or national levels only, and none highlight differences in mutual fund organizational structures.

There have been many empirical studies of the British mutual fund market since 1997. However, despite the fact that two forms of mutual funds (the OEIC and the unit trust) have co-existed in the United Kingdom since 1997, the empirical literature on the British market has largely ignored the differences between these funds. The few studies that do acknowledge that two forms of mutual funds exist in the United Kingdom proceed to treat each form as the same. For instance, Keswani and Stolin, in examining whether the “smart money effect” exists in the British mutual fund market, acknowledge that OEICs entered the market in the 1990s, but they assume that “differences between unit trusts and OEICs are unimportant and [they] refer to both types of funds as mutual funds.” Similarly, Wallison and Litan, who make references to the British mutual fund market in their study advocating regulatory reform in the United States, dismiss the differences between OEICs and unit trusts. In their discussion of the British mutual funds, the authors state that “[a]lthough the corporation, unlike the trust, does have an independent legal existence, this does not appear to have any practical legal effect . . . .” In contrast to existing studies that either neglect or dismiss the distinction between corporate and non-corporate mutual funds, this Article concentrates on that issue. To my knowledge, this study is the first premised on the fact that mutual funds are more likely to act in investors’ interests when all directors are elected annually. Id. at 149. In a similar manner, Ajay Khorana et al., Board Structure, Mergers and Shareholder Wealth: A Study of the Mutual Fund Industry, 85 J. FIN. ECON. 571 (2007), examine how board structure and composition impact the likelihood of acting in the interests of investors in the specific context of mutual fund mergers. They find that boards of underperforming funds are more likely to approve mergers the greater the proportion of independent directors on the board and the lower the compensation of directors. Id. at 597. Kong & Tang, supra note 103, at 14, find that unitary boards are more likely to act in investors’ interests.

For instance, Kong & Tang, supra note 103, at 14, analyze the factors (fund size, age, investment objective, etc.) that determine the choice of board structure (i.e., independent chair, supermajority independent board, unitary board).


WALLISON & LITAN, supra note 9, at 104.
organized and governed differently around the world, and the first to attempt to assess the impact. Specifically, the remainder of this Article explores whether the corporate funds in the United Kingdom (the OEICs) charge significantly different fees than the non-corporate funds (the unit trusts), and/or generate significantly different returns, after controlling for other effects.

B. Data

This Article employs a cross-sectional data set consisting of all British unit trusts and OEICs contained in Morningstar’s Advisor Workstation as of September 30, 2006. Morningstar’s Advisor Workstation contains such data as management fees, front-end loads, fund size, date of inception, fund style, and whether the fund is an OEIC or unit trust. This data is supplemented with returns data obtained from Datastream and manually linked to funds in the data set.

C. Methodology & Results

1. Expenses

In order to compare the two organizational structures, we need tools to measure organizational effectiveness. A common measure is mutual fund expenses. Since it is generally argued that lower expenses reflect better governance, lower expenses should also reflect a superior organizational structure. Thus, this subsection examines the relationship between fund expenses and organizational structure in the United Kingdom. This subsection analyzes two types of fund expenses, front-end loads and annual management fees.

Summary statistics for front-end loads appear in Panel A of Table 1. The average front-end load for unit trusts in the data set is 4.65%, while the average front-end load for corporate funds (the OEICs) in the data set is 4.41%. This difference is significant at the 1% level. Thus, the corporate form (the OEIC) appears to be associated with lower front-end loads. Summary statistics for annual management fees appear in Panel B of Table 1. The average management fee for unit trusts in the data set is 1.28%, while the average management fee for corporate funds (the OEICs) in the data set is 1.23%. This difference is significant at the 1% level. Thus, the corporate form appears to be associated with lower management fees, in addition to lower front-end loads.

To understand if and how organizational form is responsible for this difference in expenses, front-end loads and management fees, in turn, are regressed on an organizational form dummy variable, with control variables. The dummy variable takes a value of zero if a mutual fund is organized as a unit trust and one if a mutual fund is organized as a corporation. This Article’s hypothesis is that a fund’s choice of organizational form will have a statistically significant impact on front-end loads and/or

109. See, e.g., Del Guercio et al., supra note 103 and accompanying text.

110. A “front-end load” is a sales charge paid by investors upon the purchase of shares in a mutual fund. A “management fee” is a fee paid by the fund on an annual basis to the fund’s manager for fund operation and management.

111. The reported results were obtained by equal-weighting. Similar results were obtained by value-weighting.
management fees, after controlling for other factors. To test the impact of the corporate form on fund expenses, I estimate the following model:

\[ y_i = \alpha + \beta_1 I_i + \beta_2 X_i + \epsilon_i \]

Here, \( i \) indexes fund, \( \alpha \) is a constant term, \( I_i \) is the variable of interest and takes a value of one if a fund is a corporation (an OEIC) and zero if it is a unit trust, \( X_i \) represents a set of control variables and \( \epsilon_i \) is the error term. The dependent variable, \( y_i \), is fund expenses, represented by front-end loads (in percent) in the first set of regressions, and annual management fees (in percent) in the second. Control variables include those factors that tend to affect fund expenses: fund size (in log form), fund age (in log form), investment style,\(^{112}\) a dummy variable indicating whether the fund is an index fund, and prior fund performance (as measured by one-year returns, lagged by one year).\(^{114}\)

Results with respect to front-end loads appear in column (1) of Table 2. According to column (1), the corporate dummy is significant at the 1% level. The coefficient on the corporate dummy takes a negative value, indicating that the corporate form has a negative impact on front-end loads. The magnitude of the reduction in loads is also fairly large: about 29 basis points (or 0.29%). Note that none of the other variables (size, age, the index fund dummy, or one-year lagged returns) has a statistically significant coefficient.\(^{114}\) Thus, according to this empirical evidence, the corporate form has a negative impact on loads.

The finding that the corporate form has a negative impact on loads is particularly surprising given the OEICs’ pricing structure. Shares in OEICs (the corporate funds) are bought and sold at a single price. In contrast, units in unit trusts are bought and sold at two different prices, due to the bid-offer spread, which functions as an effective load.\(^{115}\) One would expect OEICs to have higher loads than unit trusts to compensate for the loss of the bid-offer spread. In fact, the opposite is the case. This result indicates that corporate funds are likely selling and distributing shares through different channels than unit trusts. With lower front-end loads, the typical corporate fund is likely relying relatively more on direct sales and other no-load channels, while the typical unit trust is relying relatively more on brokers and other intermediaries. With less need to compensate their sales force, the corporate funds do without the bid-ask spread while simultaneously lowering front-end loads. Recent research shows that such differences in distribution channels have ramifications for investors as well as the fund and their

112. In the United Kingdom, each fund is assigned to an investment style category as defined by the Investment Management Association, the industry association for the U.K. investment management industry. Presently, the Investment Management Association’s classification system categorizes funds into 30 investment style categories. The effect of investment style is captured by including 29 style dummy variables in the regression. Controlling for the effect of investment style is critical, as higher fees tend to predominate in international funds, specialty funds, and small cap funds.

113. See Tufano & Sevick, supra note 103 (listing the factors that affect fund fee levels).

114. Note that the only returns variable to be included as an explanatory variable is one-year returns. While three-year returns and five-year returns, when included in the regression, are significant at the 10% level (results are available from the author), their inclusion does not impact the significance of the other variables, and it reduces the number of observations substantially. Hence, only one-year returns have been included in the results shown.

115. See supra note 95 and related discussion.
managers.116 Results with respect to management fees appear in column (2) of Table 2. According to column (2), the corporate dummy is significant at the 1% level. The coefficient on the corporate dummy takes a negative value, indicating that the corporate form has a negative impact on annual management fees. The magnitude of the reduction in fees is about six basis points (or 0.06%) per annum. Although it appears that the corporate form has a larger impact (in magnitude) on front-end loads than on management fees (29 basis points versus 6 basis points), one must consider that loads are one-time charges whereas management fees are on-going annual charges. Over a five-year holding period, the corporate form would have a 30 basis point impact on management fees, on average. Note that the other statistically significant variable in column (2) of Table 2 is the index fund dummy. It is significant at the 1% level and its coefficient takes a negative value, reducing management fees by 49 basis points (or nearly half a percent). The other variables (size, age, and one-year lagged returns) are not statistically significant.117

The finding that the corporate form has a negative impact on annual management fees is surprising in light of how the two organizational forms allocate decision making power and control. The corporate model grants greater discretionary authority to fund management (and the board of directors) than the contractual model, which relies more on rules than discretion. With greater discretionary authority should come greater agency costs and, presumably, greater fund expenses. Hence, due to the greater scope for agency conflict, one would expect the corporate funds to have greater expenses. In fact, we observe the opposite.

In summary, the corporate form has a negative impact on front-end loads. The coefficient is statistically significant (at the 1% level) and the impact is fairly large (29 basis points). Similarly, the corporate form has a negative impact on annual management fees. The coefficient is statistically significant (at the 1% level) and shows that the corporate form reduces management fees by about six basis points per year. Together, these results provide evidence that the corporate model, which imposes boards of directors and investor voting rights on mutual funds, benefits investors. Notwithstanding the flaws cited by its critics, the corporate model appears to do a better job of keeping expenses low. It may be that boards fulfill their “watchdog” role, preventing overreaching by fund management and actively negotiating expenses on behalf of investors.118 Or, the


117. Note that the only returns variable to be included as an explanatory variable is one-year returns. Three-year returns and five-year returns, when included in the regression, are not significant (results are available from the author), and reduce the number of observations substantially. Hence, only one-year returns have been included in the results shown.

118. Active negotiation by a board is unlikely in the case of OEICs, however, since they are not required to have independent directors on their board. This fact makes the empirical results all the more surprising. If
effect may be more subtle. Mere knowledge that fund managers must justify their actions before a board of directors or at a shareholder meeting might deter managers from proposing unreasonable fees to begin with. Thus, “sleeping dogs” may be better than “no dogs” if fund managers know they could wake up at any time.

One caution is that this Article assumes organizational form is exogenous or, in other words, that organizational form causes the difference in expenses. This approach is consistent with the corporate governance literature, which suggests that changing corporate governance mechanisms can better align managers’ interests with shareholders’ interests, resulting in superior firm performance and higher firm value. However, other studies suggest that governance mechanisms are endogenously determined. That is, causation may run in the opposite direction, with expenses impacting choice of organizational form. Or, perhaps some third unobserved variable is influencing both expenses and choice of organizational form, making it mistakenly appear as if there is a direct causal connection between expenses and organizational form. If so, attributing lower expenses to the corporate form might be premature.

2. Returns

The cost of investing in a fund is not the only consideration for investors. Investors ultimately care about fund performance. Since we have already analyzed fund expenses, we want to determine whether performance before expenses is correlated with organizational form. Thus, this subsection examines the relationship between gross returns and organizational form. Summary statistics appear in Panels C and D of Table 1.

corporate funds that are not required to have independent directors charge lower expenses than unit trusts, one would think corporate funds that are required to have independent directors would charge even lower expenses. However, this is not necessarily the case. Boards with independent directors may impose costs on corporate funds that are not imposed by boards without independent directors. For instance, independent directors must be kept informed and will make special requests to fund management.


121. There are, however, valid reasons to give less attention to fund performance than to fund expenses. Fund expenses have been the primary focus of regulatory scrutiny and investor lawsuits. Moreover, fund expenses are less noisy than returns and have been shown to predict returns. For evidence on the inverse relationship between fund returns and expenses, see Marcin Kacperczyk et al., Unobserved Actions of Mutual Funds, REV. OF FIN. STUD. (advance access published online Oct. 25, 2006), available at http://rfs.oxfordjournals.org (search “Search This Journal” for “Unobserved Actions of Mutual Funds”); John M.R. Chalmers et al., An Analysis of Mutual Fund Trading Costs (Nov. 23, 1999) (unpublished manuscript), available at http://ssrn.com/abstract=195849; Mark M. Carhart, On Persistence in Mutual Fund Performance, 52 J. FIN. 57 (1997); Michael C. Jensen, Problems in Selection of Security Portfolios: The Performance of Mutual Funds in the Period 1945-1964, 23 J. FIN. 389 (1968).
The average one-year raw return for unit trusts is 10.47%, while the average one-year raw return for corporations (the OEICs) is 9.73%. This difference is significant at the 10% level. Thus, the corporate form appears to be associated with lower raw returns.\(^{122}\) Performance is also measured on a style-adjusted basis by subtracting from a fund’s one-year raw return the median one-year return for all funds with the same style classification. The average one-year style-adjusted return for unit trusts is 0.09%, while the average one-year style-adjusted return for corporations (the OEICs) is 0.00%. Thus, the corporate form appears to be associated with lower style-adjusted returns.\(^{123}\) However, this difference is not statistically significant, and corporations have a higher average return on a value-weighted basis than unit trusts (1.27% and 0.51%, respectively).

To understand if and how organizational form is responsible for this difference in performance, returns are regressed on an organizational form dummy variable, with control variables. Results appear in column (3) of Table 2 for raw returns and column (4) of Table 2 for style-adjusted returns. The corporate dummy is not significant in either regression. In other words, the results indicate that organizational form does not impact gross returns significantly, whether measured in terms of raw or style-adjusted returns. Fund size is significant at the 1% level, with larger funds associated with higher returns. Fund age, the index fund dummy, and lagged returns are not statistically significant.

Thus, it appears that organizational form does not have a statistically significant impact on gross fund returns. Although unit trusts are associated with higher expenses, unit trusts do not offer their investors superior fund performance, on a gross basis, to compensate for charging those higher expenses. This result implies that, on average, unit trusts are generating inferior returns, on a net basis, relative to corporate funds. Investors in unit trusts are paying higher expenses for that choice of organizational form and, since organizational form does not impact gross returns, investors are receiving lower net returns on average. The corporate fund, therefore, is the superior organizational form from the investor’s perspective.

V. CONCLUSION

There has been significant debate in the United States in recent years about whether mutual fund boards protect the interests of the funds and fund shareholders they serve, particularly with respect to fund expenses. Concerns about the ineffectiveness of mutual fund boards led the SEC in 2001 to require that independent directors comprise at least a majority of a fund’s board and, since 2004, to pursue a requirement that independent directors comprise at least 75% of a fund’s board. Is the corporate form, with boards of directors and voting shareholders, the best model for investors, or is the contractual arrangement, common outside the United States, a superior model? Using a cross-section data set of British mutual funds, this Article finds evidence in favor of the corporate form. In the United Kingdom, mutual funds organized as corporations (the OEICs) charge significantly lower front-end loads than mutual funds not organized as corporations (the unit trusts), after controlling for other factors. Similarly, mutual funds

\(^{122}\) The reported results were obtained by equal-weighting. Similar results were obtained by value-weighting.

\(^{123}\) The reported results were obtained by equal-weighting.
organized as corporations (the OEICs) charge significantly lower annual management fees than mutual funds not organized as corporations (the unit trusts), after controlling for other factors. This difference in expenses is not reflected in significantly different fund performance on a gross basis. In all, the lower expenses associated with the corporate form provide empirical support in favor of corporate funds. Based on the empirical evidence from the United Kingdom, the corporate form promotes the interests of mutual fund investors.
Below are summary statistics for mutual funds included in the data set. I have grouped mutual funds according to organizational form (corporation versus unit trust). Panel A presents summary statistics on front-end loads (as a percent). Panel B presents summary statistics on annual management fees (as a percent). Panel C presents summary statistics for one-year raw returns (as a percent) computed on a gross basis (before expenses). Panel D presents summary statistics for one-year style-adjusted returns (as a percent) computed on a gross basis (before expenses).

### Panel A: Front-End Loads

<table>
<thead>
<tr>
<th></th>
<th>Number</th>
<th>Mean</th>
<th>Median</th>
<th>Std. Dev.</th>
<th>Min.</th>
<th>Max.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporations (OEICs)</td>
<td>1313</td>
<td>4.41</td>
<td>5.00</td>
<td>0.99</td>
<td>0.50</td>
<td>7.50</td>
</tr>
<tr>
<td>Unit Trusts</td>
<td>657</td>
<td>4.65</td>
<td>5.00</td>
<td>0.93</td>
<td>0.50</td>
<td>7.00</td>
</tr>
<tr>
<td>Difference (Corporation-Unit Trust):</td>
<td>-0.24***</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Panel B: Annual Management Fees

<table>
<thead>
<tr>
<th></th>
<th>Number</th>
<th>Mean</th>
<th>Median</th>
<th>Std. Dev.</th>
<th>Min.</th>
<th>Max.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporations (OEICs)</td>
<td>1688</td>
<td>1.23</td>
<td>1.25</td>
<td>0.37</td>
<td>0.00</td>
<td>2.98</td>
</tr>
<tr>
<td>Unit Trusts</td>
<td>786</td>
<td>1.28</td>
<td>1.50</td>
<td>0.37</td>
<td>0.20</td>
<td>3.50</td>
</tr>
<tr>
<td>Difference (Corporation-Unit Trust):</td>
<td>-0.05***</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Panel C: Raw Returns

<table>
<thead>
<tr>
<th></th>
<th>Number</th>
<th>Mean</th>
<th>Median</th>
<th>Std. Dev.</th>
<th>Min.</th>
<th>Max.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporations (OEICs)</td>
<td>1589</td>
<td>9.73</td>
<td>9.85</td>
<td>8.60</td>
<td>-98.82</td>
<td>34.19</td>
</tr>
<tr>
<td>Unit Trusts</td>
<td>739</td>
<td>10.47</td>
<td>10.54</td>
<td>8.55</td>
<td>-10.67</td>
<td>147.22</td>
</tr>
<tr>
<td>Difference (Corporation-Unit Trust):</td>
<td>-0.74*</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Panel D: Style-Adjusted Returns

<table>
<thead>
<tr>
<th></th>
<th>Number</th>
<th>Mean</th>
<th>Median</th>
<th>Std. Dev.</th>
<th>Min.</th>
<th>Max.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporations (OEICs)</td>
<td>1467</td>
<td>-0.00</td>
<td>0.00</td>
<td>6.24</td>
<td>-117.41</td>
<td>19.00</td>
</tr>
<tr>
<td>Unit Trusts</td>
<td>683</td>
<td>0.09</td>
<td>-0.03</td>
<td>7.03</td>
<td>-27.94</td>
<td>136.58</td>
</tr>
<tr>
<td>Difference (Corporation-Unit Trust):</td>
<td>-0.09</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*** 1% significance; ** 5% significance; * 10% significance
### Table 2

**Regression Results**

This table shows ordinary least squares regressions of (1) front-end loads, (2) annual management fees, (3) raw returns, and (4) style-adjusted returns on an organizational form dummy (equal to 1 for a corporation and 0 for a unit trust), with control variables as shown. Front-end loads, annual management fees, raw returns, style-adjusted returns, and lagged returns are expressed as a percent. Regressions include style dummy variables (equal to 1 if a fund is a member of that style as classified by the U.K. Investment Management Association and 0 otherwise); results for the style dummies are not shown in the table. I have excluded the specialty style dummy from the regression. Robust standard errors are in parentheses.

<table>
<thead>
<tr>
<th>Dependant Variable</th>
<th>Front-End Loads (1)</th>
<th>Annual Management Fees (2)</th>
<th>Raw Returns (3)</th>
<th>Style-Adjusted Returns (4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organizational Form Dummy</td>
<td>-0.285 (0.048)***</td>
<td>-0.062 (0.015)***</td>
<td>-0.229 (0.328)</td>
<td>-0.120 (0.335)</td>
</tr>
<tr>
<td>Size (log)</td>
<td>-0.008 (0.017)</td>
<td>-0.003 (0.005)</td>
<td>0.295 (0.110)***</td>
<td>0.358 (0.114)***</td>
</tr>
<tr>
<td>Age (log)</td>
<td>0.027 (0.033)</td>
<td>-0.015 (0.010)</td>
<td>-0.248 (0.286)</td>
<td>-0.293 (0.293)</td>
</tr>
<tr>
<td>Index Fund Dummy (Dummy)</td>
<td>-0.692 (0.437)</td>
<td>-0.491 (0.047)***</td>
<td>-0.376 (0.552)</td>
<td>-0.486 (0.570)</td>
</tr>
<tr>
<td>One-Year Returns (lagged)</td>
<td>-0.021 (0.037)</td>
<td>0.009 (0.014)</td>
<td>0.033 (0.026)</td>
<td>0.031 (0.025)</td>
</tr>
<tr>
<td>Constant</td>
<td>4.965 (0.356)***</td>
<td>1.349 (0.110)***</td>
<td>6.974 (2.801)**</td>
<td>-7.686 (3.380)**</td>
</tr>
<tr>
<td>Style Dummies</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Observations</td>
<td>1585</td>
<td>2004</td>
<td>2031</td>
<td>1938</td>
</tr>
<tr>
<td>R²</td>
<td>0.12</td>
<td>0.29</td>
<td>0.44</td>
<td>0.04</td>
</tr>
</tbody>
</table>

*** 1% significance; ** 5% significance; * 10% significance