CORPORATE VERSUS CONTRACTUAL MUTUAL FUNDS:  
AN EVALUATION OF STRUCTURE AND GOVERNANCE

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Abstract

This dissertation develops an analytic framework to evaluate the comparative merits of the structure and governance of the two dominant types of mutual funds -- the Corporate Fund (the U.S. model) and the Contractual Fund (the German, Japanese and British models). The former is characterized by centralized decision-making functions, while the latter employs a more decentralized structure. The semi-hierarchical structure of the Corporate Fund leads to significant transaction costs such as influence, intervention and collective-decisionmaking costs. Specifically, the board of directors is not effective in negotiating performance-related terms (e.g., fees), and shareholder suits based on fiduciary duties do not adequately address the thorny issue of who monitors the monitor. In addition, although shareholder voting on specific issues may be desirable, the concept of voting for directors is contrary to the realities of the mutual fund business. Therefore, the Corporate Fund has placed too much reliance on the board’s discretion.

A conceptual analysis of the Contractual Fund demonstrates that its structural design and underlying rationales are fundamentally sound. Of the two Contractual Fund proposals considered by the SEC, the Unitary Investment Fund should be rejected because it provides no effective substitute for the board’s oversight. The Unified Fee Investment Company proposal is a better alternative not only because competitive forces would adequately discipline with respect to its simplified fee schedule, but also because the
investment manager would be better motivated to coordinate a mutual fund's operations. This proposal can be further improved by shifting the regulatory focus to the investment manager and by substituting the board of directors with institutional monitors such as a trustee. Accordingly, the SEC should implement the proposal to promote organizational competition with the Corporate Fund.
TABLE OF CONTENTS

I. INTRODUCTION. .......................... 1

II. THE FUNDAMENTAL STRUCTURE OF THE MUTUAL FUND. .... 9
   A. Economic Functions of the Mutual Fund .................. 9
   B. The Adviser-Investor Contractual Relationship .. 15
   C. The Investment Pool and Third Party Monitor ... 20
   D. Defining the Object of Inquiry: Mutual Fund as a
      Trilateral Arrangement. .......................... 25

III. THE CORPORATE FUND VERSUS THE CONTRACTUAL FUND ... 30
   A. The U.S. Corporate Fund .......................... 30
   B. Three Models on the Contractual Fund ................ 35
      1. The German Model .............................. 36
      2. The Japanese Model ............................ 39
      3. The British Model .............................. 41
   C. Major Structural Differences ....................... 43
      1. Pool-Centered v. Adviser-Centered Regime ........ 43
      2. Hierarchical Discretion v. Contractual Rules .... 46
      3. Investor Participation in Fund Governance .......... 49
   D. Comparative Institutional Analysis .................. 53

IV. A FRAMEWORK FOR EVALUATING MUTUAL FUND STRUCTURE. .... 57
   A. Hypothetical Contracting over Allocating Monitoring
      Functions ....................................... 57
   B. Contracting Attributes and Constraints ................ 61
V. AN EVALUATION OF THE CORPORATE FUND. 82
   A. The Effectiveness of the Semi-Hierarchy 82
      1. The Board’s Independence and Informational
         Advantage. 82
      2. The Costs of the Semi-Hierarchy. 87
   B. The Responsibilities of the Board of Directors. 93
      1. To Evaluate Fees Paid to Advisers and Their
         Affiliates. 93
      2. To Police Operational Conflicts of Interest. 102
      3. To Monitor Compliance. 108
      4. To Oversee the Fund’s Operation. 109
   C. SEC Reform Proposals. 115
      1. The Role of the Board of Directors 115
      2. The Role of Shareholder Voting 120
   D. Concluding Remarks: The Board as Coordinator-Monitor 125

VI. AN EVALUATION OF THE CONTRACTUAL FUND 129
   A. A Conceptual Analysis of the Contractual Fund 129
      1. The "Investment Manager" as Coordinator. 129
      2. Contractual Governance and Market Discipline 137