Fourth, all literature, including form letters, issued by an investment company, or its underwriters, must be filed in advance with the S. E. C.

Fifth, investment companies, and their advisers, underwriters, and distributors will be required to make periodic reports, and special reports when requested, on any matters pertaining to their business.

Sixth, the S. E. C. is empowered to specify the form and content of the reports sent by investment companies to their own shareholders.

Seventh, directors and officers of an investment company must report to the S. E. C. each month any transactions they have effected in the shares of the company.

Eighth, all individuals affiliated with an investment company, including officers, directors, and investment advisers, must report each quarter to their own board any purchases and sales they have made in security issues that were purchsed or sold by the company in the same period.

Ninth, the S. E. C. can require the making and keeping of accounts, books, memoranda, correspondence, and other records in specified form, and can prohibit the keeping of any records other than those approved. This applies not only to investment companies, but to underwriters and investment advisers as well.

Tenth, all books, papers, memoranda, correspondence, and so forth are subject to examination by the S. E. C. at any time.

Eleventh, the S. E. C. in its discretion, can determine the amount of sales commission on trust shares if it deems existing commissions to be excessive.

Twelfth, the S. E. C. has complete authority to regulate the prices at which an investment company can buy or sell its own shares.

Thirteenth, the S. E. C. is empowered to determine not only the accounting principles to be followed by investment companies, but also the actual detailed methods to be used.

The opportunities, listed above, for bureaucratic control and censorship, already exist under the terms of the present bill and the specific delegations of authority it grants to the S. E. C.; but because the Commission is also given blanket authority to make any further rules or regulations it deems "necessary or appropriate" to administer the bill, no one can tell in advance how many more bureaucratic controls will finally be added.

That is all I have to say, Senator. I should also like to submit for the record a list of the trustees and members of the advisory board of the Massachusetts Investors Trust.

(The list of trustees and members of the advisory board of the Massachusetts Investors Trust is as follows:)

Trustees and Members of the Advisory Board of Massachusetts Investors Trust

TRUSTEES

Merrill Griswold, chairman; L. Sherman Adams, Charles F. Rowley, Dwight P. Robinson, Jr., Kenneth L. Isaacs.

ADVISORY BOARD (WITH SOME OF THEIR AFFILIATIONS)

Charles Francis Adams: Formerly Secretary of the Navy; formerly treasurer of Harvard University; State Street Trust Co., Boston, chairman of board; American Telephone & Telegraph Co., director; General Electric Co., director; John Hancock Mutual Life Insurance Co., director; New York, New Haven & Hartford R. R. Co., director; United States Smelting, Refining & Mining Co., director.

Roger Amory: Bigelow-Sanford Carpet Co., Inc., director; Boston & Maine Railroad, director; Consolidated Investment Trust, trustee; National Rockland Bank of Boston, director; Provident Institution for Savings, of Boston, trustee; State Street Trust Co., Boston, director.

James L. Richards: American Sugar Refining Co., executive committee, director: Boston Elevated Railway Co., executive committee, director; Boston Wharf Co., director; Consolidated Gas Electric Light & Power Co., Baltimore, director; Eastern Gas & Fuel Associates, executive committee; Massachusetts Bonding & Insurance Co., chairman executive and finance committee, director; Merchants National Bank of Boston, member, executive committee, director; New York, New Haven & Hartford R. R. Co., executive committee, director; United Drug Co., executive committee, director; Waltham Watch Co., executive committee, director.

Henry B. Sawyer: Chicago, Wilmington & Franklin Coal Co., director; New York, New Haven & Hartford Railroad Co., trustee; Suffolk Savings Bank for Seamen and Others, Boston, member, board of investment and trustee.

Oliver M. W. Sprague: Formerly economic adviser to the Bank of England; formerly special assistant to the Secretary of the Treasury; professor of finance at Harvard University Graduate School of Business Administration; foreign adviser, General Motors Corporation, National Shawmut Bank of Boston, director.

Mr. GRISWOLD. That is all, thank you, Senator.

Senator HUGHES (presiding). Thank you, Mr. Griswold. We are glad to have heard you.

I understand it will be satisfactory if Mr. Bullock talks during the balance of the morning session. We shall probably be here until half past 12 or a few minutes after that.

Did you want Mr. Traylor to be the next witness?

Mr. GRISWOLD. No, Senator; we were going to ask Mr. Bullock to speak next, since he has a fairly short statement to make. We shall ask him to present his statement now, if you will hear it at this time.

Senator HUGHES. Yes; we shall do that. Then this afternoon Senator Wagner will be here.

Mr. GRISWOLD. It is very important to hear these, if possible.

Senator HUGHES. Yes; but I have to go on the floor of the Senate at half past 2.

STATEMENT OF HUGH BULLOCK, VICE PRESIDENT, CALVIN BULLOCK CO., NEW YORK CITY

Senator HUGHES (presiding). Mr. Bullock, will you give your full name, for the record, please?

Mr. BULLOCK. Mr. Chairman, my name is Hugh Bullock. I am vice president of Calvin Bullock, a New York joint stock association.

First, Mr. Chairman, let me say that in desiring maximum protection for investors, the S. E. C. and ourselves have identical objectives.

It is tragic when small investors lose money as a result of financial panics or economic depressions. It is outrageous when any loss occurs as a result of unsound practices or outright dishonesty on the part of those in a position of trust. To keep our perspective, however, we must remember that, after 1929, the market value of stocks listed on the New York Stock Exchange declined from a high of $89,000,000,000 to a low of $16,000,000,000, or more than 80 percent, and that investment companies are, for the most part, organizations that deal in general market securities.

As to looting in the so-called open-end investment company field, based on what I can find on reading the comprehensive reports of the

S. E. C. study, an amount equal to only a fraction of 1 percent of the present value of the open-end companies' assets was affected.

No law can prevent losses to investors in times of depression, and I fear that no legislation can be devised always to catch the outright crook; but if any law can be passed to eliminate unsound practices in an industry which I think, when properly conducted, fills a great public need, I am for it. I am anxious to do anything I can to have all investment companies placed on the same high plane that many of them occupy. I think it would be a great public service; because I believe that a well-managed investment company is the best medium for investment of any vehicle yet devised.

We are deeply conscious of our responsibilities in managing other people's money. There are principles expressed in the present bill that we have believed in for a long time. There are some, however, that go far beyond any philosophy that we are in a position analogous to that of a trustee of other peoples' money.

To save the committee's time, some of us in the open-end industry have divided up subjects and will confine our remarks primarily to one. The subject on which I want to give you our viewpoint is that of managing more than one investment company.

The bill requires that a majority of the board of directors of an investment company be persons independent of its principal underwriter and manager; but the bill goes further and tells you that when an investment company has such a board with an independent majority, that board cannot also constitute the board of another investment company, unless one of the companies is a subsidiary of the other. It also provides that an investment officer or a manager of one trust cannot serve as such for another. In other words, it requires every company to have a separate directorate, investment officer, and manager from every other company. The same people cannot run more than one trust.

Why, in all circumstances, shouldn't the same independent group of people have the responsibility of managing more than one investment company? Section 10 says they cannot. What conceivable theoretical objection could there be?

We can only vaguely imagine two: The first is that when purchases or sales of identical securities are made for two or more trusts, the one whose orders are placed first may gain an advantage at the expense of the others. The problem can be solved, however, by the simple expedient of combining orders and making a proportionate allocation to each investment company.

Of course, if the investment companies had different portfolios and differently stated investment objectives, no one could suggest a conflict by reason of being managed by the same group.

I have heard of one other highly theoretical objection, to wit, that if the same group managed several investment companies, they might have too much influence over some company whose shares were included in all the trusts' portfolio. For example, assume that 10 trusts, managed by the same people, each owned 5 percent of a corporation's stock: This group would then control the portfolio company.

To be sure, all this is highly theoretical, because a compilation covering 51 investment companies, prepared by Barron's, showing the stocks jointly held by 18 or more investment companies as of the close of 1939, indicates that in only four cases do the combined holdings of the 51 trusts account for more than 10 percent of the stock of the corporations in question.

I am told that if the three largest open-end trusts in Boston today were operated by a single management, their combined holdings in any one corporation would represent, at the most, less than 4 percent of the outstanding stock of that corporation as far as 98 percent of the companies represented in their combined portfolios are concerned. In nearly 50 percent of all cases, such combined holdings represent less than 1 percent of the outstanding stock of the corporations involved; and the highest percentage of ownership involved is only 7.1 percent.

However, if it is still felt that the operation of several trusts under one management might lead to the danger of the control of corporations, then we submit that there are better ways to prevent any such situation than by saying the same group cannot manage more than a single fund. For instance, as Mr. Griswold suggests, a maximum might be placed on the percentage of ownership in any corporation that can be held by any group of companies under the same or affiliated management; or an individual director might be prevented from serving on all the boards of investment companies which, between them, controlled more than a specified percentage of the stock of any corporation.

What are our objections to a prohibition preventing the same group from managing several investment companies? Our first objection is the fact that several existing arrangements would have to be disturbed, through the necessity of getting a number of new directors. Competent directors are not easy to secure, particularly in view of another unfortunate provision in the proposed bill which effectually prevents, in the case of a diversified management investment company, a director of such company being a director of any company in the portfolio. We, too, want to see developed—as well as the S. E. C.—in this country a class of executives and directors who will make of this industry of investment management a profession; and we do not want hurdles put in the way.

Our second objection is that the only conflict we can possibly see would be where we take the case of a group of trusts run by different people receiving advice from the same investment adviser or investment counsel—which is perfectly allowable under the proposed bill. We assume such advice would be generally followed, otherwise such investment adviser or counsel would not be employed. Moreover, we assume his advice would be very similar, to all of his clients. Therefore, you would have the curious situation of different managements competing in the market to buy or sell the securities that such adviser suggested, and, for instance, bidding up the price of a certain security, one against the other. This scarcely seems for the best interests of stockholders.

Our third objection to any proposal that the same group could not manage several investment companies is that we do not see any conceivable conflict. Mr. Smith testified that he personally managed several personal trusts. You and I know that the same bank manages thousands of individual trust accounts. Any man who suggests that there is a conflict with respect to the trustee of a certain number of personal trusts or a bank with a large number of trust accounts, just is not realistic.

You see, my firm learned its trust lessons in England many years ago. The dean of the investment-trust company profession there, the man who attained a degree of eminence that many believe will never be equaled again in this profession in any country—and almost certainly would not be in this country, if this bill became law—was the late Robert Fleming. My father reminded me on Sunday that Mr. Fleming had told both of us in 1926 that his firm managed 23 trusts with assets of over a quarter of a billion dollars.

That does not quite check with a booklet I have here that discusses the British investment-trust groups. Tables are given showing certain groups—the number of trusts and the capital of each. The Fleming group apparently totals 15, with 25 million pounds, capital. A footnote, however, reads:

> According to Linhardt, R. Fleming & Co. is estimated to exert an influence in some form or another on companies—

which, of course, means investment companies—

> with more than £110,000,000 total assets.

That is more in line with a message dated April 13, 1940, to me from our London manager, which reads as follows:

> Replying to your inquiry as to the extent of the Fleming trusts, the most accurate estimate I have received in some time was from an independent London stock broker who specializes in trusts.
>
> He then stated that the Flemings either managed exclusively or have one or more of their people on the boards of 34 trusts, with assets estimated at £100,000,000.

Suffice it to say, we have excellent authority for the fact that British practice is for substantially the same people to manage trusts in groups, and these groups attain large size. The booklet I was quoting from is prepared for the Securities and Exchange Commission, and submitted as part of their study to Congress. It is on British investment companies. May I read another brief passage from this booklet:

> Certain advantages attach to the creation of new trusts instead of an increase in the capital of existing trusts. For instance, the capacity of the market for issues of an existing trust is in practice often limited. Securities of new associated companies have a special appeal to the investor. The regulations in the articles of association can be varied in a new trust according to new requirements. Investment policy can also be varied to suit the general lines of the trust group's policy.

Then, Mr. Chairman, somewhat higher on that same page is this statement—and I quote:

> These investment trust groups were formed by organic growth, not by the purchase of control of existing trusts. It has proved easier to use the same amount of money which would be necessary to purchase controlling interest in an investment trust, in promoting a new trust, the portfolio of which can be arranged according to the ideas of the founders. The normal way by which such a group is formed, therefore, is successive promotion by the same founders.

I want to clear the record with respect to some testimony that came up the other day regarding organization by one firm of six trusts in one year. Incidentally, the year of organization is an interesting point: They were not organized in 1929 or in 1939, but in the low year of the entire depression, to wit, 1932; and there were not six trusts, but five; one represented a consolidation.

However, Senator, it is not the number that has any significance. The essential point is the experience of investors.

May I read a letter that arrived, unsolicited, from my father to me, dated April 15th:

I understand we are accused of forming five investment trusts in 1932. We did this to take advantage of the lowest prices in years, and also to offer different classes of investors the type of securities best suited to their needs.

In the 8 years since then we have formed no trusts.

Here is the record:

This group of five neither buys on margin nor sells short.

All these companies pay dividends quarterly, have never passed a dividend, and have no debts.

Cash on hand April 8, 1940, $4,500,000.

If an investor had put $1,000, or any fixed amount, in each company at the initial offering price, and had held his shares, he could sell them today at a profit in each and every case, after receiving an average return per annum of a trifle over 7 percent on his original investment.

Directors in the 5 companies outside our office, are also directors in over 100 other companies, with which we have no connection.

The five companies have over 59,000 stockholders.

Total dividends paid, $19,396,000.

If you know of a group with a cleaner record, perhaps you can persuade them to go on our Board. We are always looking for talent.

If I remember correctly, the other day Senator Frazier expressed surprise that any one firm would organize 10 or 12 trusts over a period of time. My firm did, and is proud of it. We learned our lessons in England; and, as I have pointed out, it is the English system to organize and manage a group of trusts.

Again, let us look at the essential thing, namely, what was the experience of investors in these trusts?

I should like to read one page of my testimony given 4 years ago at the S. E. C. public hearings—and then, Mr. Chairman, I am through.

I should like to point out that the majority of our trusts show profit to the original investors today. One thousand dollars originally invested in every 1 of the 11 trusts we have formed, namely, an original total investment of $11,000, today would be worth $11,750-odd. Meanwhile, investors have received over $3,000 in dividends, or a total gain—adding income to appreciation—of about 35 percent; and today 40,000 stockholders of our company have a profit in our shares. No company under our management has ever passed a quarterly cash dividend; and even since the crash of 1929, our companies have paid out over $22,000,000 in cash dividends to shareholders.

As of today, I might say parenthetically, that is something over $35,000,000.

Again I quote:

Except in the case of one debenture issue, our trusts do not owe any money. They do not buy on margin or sell short. They do not buy or sell securities from or to each other. Except during the two offers of exchange and the brief period of the Nation-wide preferential bid, none of our trusts ever bought each other's shares. They are run as distinct from each other, except as to common management philosophy, as if they were in different offices, and it has never been our policy to deal as principals with our companies in security transactions. We do believe most earnestly that this business, as we run it, provides a genuine economic need, because we think a well managed investment company is the best medium for investment of any vehicle yet devised.

Senator HUGHES. Mr. Bullock, would you mind telling me, if you will, why you wanted more than one or why you had five? You said you had five, did you not?

Mr. BULLOCK. Yes, in 1932?

Senator HUGHES. Yes; and why you organized five?

Mr. BULLOCK. They were formed for different purposes. I think I would answer your question, Mr. Chairman, by asking why a man should not organize two trusts or five trusts instead of one trust?

Why would a man organize one trust instead of five—to put it the other way around?

I assume it would be for exactly the same reason that he would organize five.

Senator HUGHES. I did not know whether there was any other reason than that.

Mr. BULLOCK. To make an honest living in a profession which has true economic justification and is of service—if such trusts are well run (and there is the essential point to investors).

That is all, thank you, Mr. Chairman.

Senator HUGHES (presiding). I think we shall probably be able to return here at half past 2. Suppose we take a recess at this time, then, until half past 2. Then we shall hear from Mr. Traylor, this afternoon; is that the idea?

Mr. GRISWOLD. Very well, Senator—Mr. Traylor.

Senator HUGHES (presiding). All right; then we shall recess at this point until half past 2.

Mr. Bullock, we are very much obliged to you for coming here and giving us the benefit of your views. Thank you.

(Thereupon, at 12:45 p. m., a recess was taken until 2:30 p. m. of the same day.)

AFTERNOON SESSION

The committee reconvened at 2:30 p. m., upon the expiration of the recess.

Senator WAGNER. Mr. Traylor, will you proceed, please?

FURTHER STATEMENT OF MAHLON E. TRAYLOR, PRESIDENT, MASSACHUSETTS DISTRIBUTORS, INC., BOSTON, MASS.

Mr. TRAYLOR. Senator Wagner, members of the committee, before reading this I might say that this is one subject in which we have been very much interested, and in order to make the case complete, so that you will have it for the record, I should like to make this statement. It is a little technical, of necessity, and may be a little tedious in going through it, but I think it is absolutely necessary in order to cover all the points that explain the matter of dilution.

To again identify myself, my name is Mahlon E. Traylor. I am president of Massachusetts Distributors, Inc., underwriter or general distributor of shares of Massachusetts Investors Trust, Supervised Shares, Inc., and Boston Fund, Inc. These companies are open-end companies—that is, they have redeemable shares.

At this time, I would like to discuss the matter of pricing and selling shares of open-end companies. Judging by the S. E. C. testimony, this subject seems to afford the basis for the only noteworthy criticism of the open-end industry.

Senator HUGHES. May I interrupt you just a minute?

Mr. TRAYLOR. Yes, Senator.

Senator HUGHES. How many companies have you?

Mr. TRAYLOR. Beg pardon?

Senator HUGHES. How many companies have you?

Mr. TRAYLOR. We are distributor for three open-end companies.

And I should like to add, the implications of this testimony would appear on the surface to be very serious indeed. I believe, moreover, that there is a widespread misconception of what the problems really are and how the pricing system actually works. I believe it most important, therefore, that any such misconception be corrected.

Now, this subject of pricing is a rather difficult one, both to explain and to understand, and I can only ask you gentlemen to bear with me as patiently as possible. Under the present bill, full discretionary powers to govern this phase of operations by rules and regulations are granted to the S. E. C. Mr. Schenker has said, because of various problems involved, it seemed desirable early in the consideration of this matter to vest such discretionary power in the S. E. C. rather than attempt to write an inflexible provision into the law. We were generally agreeable to this at the time, because we felt that the S. E. C. would adopt a practical attitude toward the matter and that between the industry and the S. E. C. a practical solution to the problems would be found.

Since then, however, the testimony of both Mr. Bane, of the Registration Division, and of Mr. Schenker leaves no doubt in our minds that they have already decided upon a method of pricing and selling shares which we believe to be wholly impractical.

Under these circumstances, or even if the S. E. C. has not definitely decided upon a plan, because of the manner in which their testimony on the subject has been presented, I am opposed to this grant of discretionary power. I believe, moreover, that I reflect the attitude of most of the industry in voicing this opposition.

Several days ago the S. E. C. presented testimony before this committee relating to the sale and repurchase of shares of open-end investment companies. Before you were paraded examples of so-called dilution, abuses, and malpractices. I wish to take exception to many of the implications of that testimony and to discuss the entire matter in some detail from the practical viewpoint of the industry.

At the very outset, I want to bring out one vital point. I want to make a clear distinction between so-called dilution, which may result from the mechanical operation of the pricing system, and the abuses of the pricing system which a small fringe element may have practiced unethically to further their own selfish ends. The former, as I hope to prove to you, is of negligible proportions. The latter represents unethical practice, pure and simple.

While these abuses have been relatively unimportant, though nonetheless deplorable, they could be eliminated entirely by the imposition of a few simple rules which most of the industry already observes in practice. I explain his because it is easy to confuse the word "dilute" with the word "loot," and I want to make it clear that the pricing system involves no element of the latter.

Now let me take up the mechanical aspects of the so-called dilution problem. The development of the pricing, selling, and repurchasing of shares has been an evolutionary one. The aim, of course, has been to establish a basis for doing business which would be equitable to both incoming shareholders and old shareholders alike; at the same time, it readily can be appreciated that such a basis must be practical in its operation. Needless to say, since the inception of open-end companies these matters have received the most careful consideration of those in the industry.

When the sale of open-end companies began in 1924, the prices at which new shares were offered for sale were revised only once every week or two, unless a sudden change in the level of the securities markets made a prompter change seem desirable. In recent years, however, it has been customary to establish a new selling price each day on the basis of the liquidating value as established at the close of trading on the New York Stock Exchange.

To refresh your memories as to the mechanics involved, the so-called liquidating value or net asset value is determined (in our case by an independent custodian bank) by totaling the market value of all underlying securities, adding cash, deducting liabilities, and then dividing the resultant figure by the number of shares outstanding. To this per share liquidating value is added the underwriting commission, or so-called loading charge, which on the average is around 7½ percent. The selling price thus established generally remained in effect throughout the next full business day and until the opening of the stock exchange on the next succeeding day.

Shares sold on this basis, while netting the company liquidating value as last determined, obviously did not net the company the exact liquidating value at the time when purchase orders were taken.

Now, the S. E. C. testimony has set forth what, in the opinion of the Commission and its staff, constitutes dilution. You may recall the illustration of U. S. Steel advancing from 55 to 59 and that under the umbrella of that illustration was cited the example of the shares of an open-end company which on September 5 advanced in price from \$5.60 to \$6.70, and yet were sold to the public on the basis of a value of \$5.60, even though their established and known value was \$6.70, according to the S. E. C. testimony.

It is upon this illustration that the S. E. C.'s case in the matter of so-called dilution was very largely based. With all possible emphasis, I should like to say that this illustration is completely irrelevant as far as 90 percent or more of the open-end industry is concerned. It is also probably the most extravagant example the S. E. C. could have used. To employ Mr. Bunker's well-conceived analogy, this is most certainly a specimen, and an exceedingly rare one at that, rather than a run-of-the-mine sample.

You have heard that the S. E. C. figures so-called dilution as being the difference between the price at which shares are sold and the next higher price to become effective. This, however, does not accurately reflect the true situation. When an open-end company sells shares on Wednesday on the basis of the price determined at the close of the market on Tuesday, it is apparent that the selling price may not reflect the exact value of the shares at the time of sale. For example, (and for simplicity let us disregard the amount of the selling commission which plays a part in this discussion, but which I will bring up later), then assume that at the close of the market on Tuesday the value of the shares was determined to be \$20.00 and all day Wednesday these shares were sold at this price. But Wednesday the securities markets advanced so that by 11 o'clock in the morning, if we figured the value of the shares, or if we could have figured the value of the shares, we would find that they would be worth \$20.10. Yet the man who wants to buy them at 11 o'clock can do so on the basis of the \$20 price. Now, other things being equal, that might be called dilution because at the time the buyer enters his order the shares are worth 10 cents more than he has to pay.

Let us assume that 100 investors buy 100 shares each at 11 o'clock for \$20 a share when their indicated value is \$20.10. That makes