Senator WAGNER. That is what I want to find out from the instance given.

Mr. SCHENKER. Section 11 (a) says (reading):

> It shall be unlawful for any promoter of a registered investment company organized on or after March 1, 1940, to serve or act as director, officer, manager, investment adviser, depositor, trustee, or principal underwriter of or for such company, if within 5 years such person, or any company of which such person was then an affiliated person, has been a promoter of another investment company.

Senator TAFT. I say, he may have entirely dissociated himself and has no relation with it any longer, and for 5 years after that time he can not promote another one.

Mr. SCHENKER. The bill does not say that. If you will take a look at paragraph (d), you will find that we make provision to permit other promotions if conditions warrant such promotions. But aside from the provision for exemption—you were not here, Senator, when I gave examples where there were six investment companies promoted in 1 year by one distributor, and in conjunction with that they switched them from one investment company into the other investment company.

Senator TAFT. Those cases were cases in which they kept their hands on all of them. I can see the whole burden of that. But after he has entirely gotten out of one, why can he not start another one?

Mr. SCHENKER. Is it your suggestion, if he is in the business of promoting investment trusts, distributing their securities, and then severing his connection with the investment trust, why should he not be able to promote another?

Senator TAFT. Yes.

Mr. SCHENKER. Would you have any difficulty, Senator, if he not only was promoting one trust and currently organizes another, and sells securities of the other, and then starts another and sells the securities of that other—would you have any difficulty with that situation?

Senator TAFT. Well, if he has entirely dissociated himself, I do not see why he should not promote another one. We agree that there is some question about the whole matter of promotion.

Mr. SCHENKER. I am not unconscious, Senator, of the fact that this is a question that has two sides. We have discussed it at great length. The fact of the matter is that the situation which you describe never exists. I think I know of only one case where that was done. In all these cases, Senator, he not only promotes it; he is not only the distributor, but he is the manager, and as soon as the security loses its "sex appeal," he starts organizing another one.

Senator TAFT. Why not say "any company of which such person has been a promoter of another investment company of which he is a stockholder, director, officer, manager"——

Mr. SCHENKER (interrupting). Or distributor?

Senator TAFT. Yes; then my objection would be removed.

Mr. HEALY. May I have an opportunity to discuss that with my associates?

Senator WAGNER. Yes.

Senator MILLER. Would it be feasible to incorporate in subsection (d), page 28, terms or provisions which would determine or which should guide the Commission in answering a question propounded to it when a group or an individual came to it for a license to organize another investment company, or is the theory the same as that govern-

ing charters for national banks and other banks that are organized now? As I remember the statute relating to the creation of a bank, the mere fact that a group wants to organize a bank is not the determining factor. The needs of the community are determined, and the character of the men proposing to organize the bank. I was just wondering, in order to get away, if I can, from so much discretion now—and this is not said with any reflection upon the present Securities and Exchange Commission—just assuming that the personnel of that Commission were changed and a different philosophy entirely should be installed there, and I was just wondering if there might not be some danger in a wide open discretion and whether or not it is feasible to undertake to limit the discretion of the Securities and Exchange Commission.

Mr. HEALY. May I say a word on that?

Senator MILLER. Certainly.

Mr. HEALY. I do not think the Commission wants unlimited or unbridled discretion. Our conception is that every one of these statutes should have definite standards in them. But there are situations where those standards ought to be administered, it seems to us, by the Commission. I think that unbridled and uncontrolled discretion is unthinkable under our constitutional system. I think that every time it is said that the Commission can do a certain thing, it should be allowed to do it if a certain standard is established. Then you get a legal standard and get a thing that is reviewable in the courts and the Commission is deciding people's legal rights.

As to this subsection (d), if more definite standards can be written than the draftsmen of this bill have devised, they would be entirely acceptable.

Senator MILLER. That is not said from a critical standpoint. It is just a proposition of trying to lay down some standard there to guide not only the Commission, but the officers. In other words, I can visualize, and I know that the Commission can, a group that has made a success, that is basically sound; that is, their company is basically sound. Those men ought not to be prevented, and I do not assume that the Commission's theory is that it would prevent those men, from organizing another business and branching out.

Mr. HEALY. I have much sympathy with what you have said. May I call your attention to the fact that subsection (d) was written assuming that (a), (b), and (c) might be enacted——

Senator MILLER. That is, subsections (a), (b), and (c)?

Mr. HEALY. Yes; subsection (d) represents "rubber" in the language. That is, having adopted rigid standards in (a), (b), and (c), then you try to give the Commission authority to relieve a person of the undefinable and unpredictable case, at the same time trying to specify in the statute the circumstances to which you shall give weight in making your decision.

However, I would like to repeat that any more definite standards that can be devised, or any other means that would give a little flexibility where it is needed, I would not have the slightest objection to.

Senator MILLER. I did not think you would have any objection to a reasonable standard in there if it can be devised.

Mr. HEALY. No. I am all for it.

Mr. SCHENKER. Section 12 deals with the functions of investment companies and the formation of investment-company systems.

This bill, in my opinion, cannot even remotely be considered as an attempt to influence or participate in the management policy of investment companies. What does 12 (a) say? It says that it shall be unlawful for any registered investment company to purchase any security on margin or credit except such short-term credits, necessary for the clearance of transactions, as the Commission may designate by rules and regulations or order.

Subsection (2) is a provision which says they shall not participate in joint trading accounts.

Subsection (3) relates to the effecting of a short sale of any security in contravention of such rules and regulations as the Commission may prescribe.

The Commission has the feeling that at the present time, at least, they see no reason why an investment trust should not be able to effect a short sale. However, you cannot predict what may happen in the future. With respect to that the Commission feels that maybe at some time in the future, in the public interest, it may be necessary to formulate rules.

Senator TAFT. You mean that you are permitting short sales?

Mr. SCHENKER. Yes.

Senator TAFT. Why? What is the purpose? Is it not rather questionable whether they should engage in short selling?

Mr. SCHENKER. On that aspect, Senator, we make provision for a so-called trading corporation. If they are going to be a speculative investment trust, and they disclose that fact to their investors, and the investors want to invest in that type of investment company, who are we to say, "No; you shall not invest in that type of company"? So the statute permits it, and we feel that, if they are that type of company, why should they not sell short if that is their best investment judgment?

However, there may be some possibility of abuse. In that connection I started to say that a person came in to see me the other day and said, "I am thinking of organizing a short-selling trust." What that means, I don't know, or what its effect will be I don't know. But it is to meet that type of situation that we put this "rubber" in.

Senator TAFT. I think that if you distinguish between the two types of companies there is no harm in an investment trust making short sales. On the other hand, if the other kind of investment trust is supposed to do it, I see no reason why it should not be done.

Mr. HEALY. That is exactly the philosophy with which the Commission approaches this problem.

Senator TAFT. No; it is not. The approach is that the Commission is going to say in the future whether either kind of company shall do it or shall not do it.

Mr. HEALY. I did not speak of our approach. I said that was the Commission's philosophy. I meant to say that the point of view that I have heard expressed in the Commission is just the one which you have expressed.

Senator TAFT. We are all trying to get away from the discretion question.

Senator WAGNER. I agree with that, but as I studied this bill I thought that the discretionary powers were rather to the advantage of the company than to its disadvantage. It does provide flexibility, whereas a fixed rule would make it much more rigid.

I was going to ask you this, Mr. Schenker. There has been talk here about the promotion of investment trusts. So far as any instances that have been cited here are concerned, as I understood it, in each case those who organized a trust and distributed shares represented it not to be any trust to promote any new risk venture, but rather to provide a diversified investment for the individual, with assurances in all these cases that it is a safe investment with a very definite maturity and a sure return of the money with profit.

Mr. SCHENKER. I think you may have misunderstood Senator Taft's point, which merits consideration. Senator Taft says that if an individual promotes a company and distributes it and severs every connection with the company, why should he not be able to promote another and to sever his connection with that? Of course the answer to that, Senator, is that such a situation has not existed. But of course I think there is a great deal to that point in that type of situation.

Senator WAGNER. You misunderstood me. I do not know of a single instance where there has been any advertising that "We want this money in order to undertake a venture, some new venture," or something of that kind. Are there any such trusts formed?

Mr. SCHENKER. There have been trusts in the past, which started out originally as so-called diversified investment companies. They said they were going to buy a cross section of securities. But ultimately the fundamental nature of their business changed, and they became what we call special situation companies. They took concentrated positions in companies, reorganized them, worked them out to help them financially. The classic example of that was the Atlas Corporation, which had a $20,000,000 position in the Utilities Power & Light. The Phoenix Securities Corporation, which I told you about, has a substantial position in the United Cigar Stores, Loft, Inc.; Pepsi-Cola; New England Bus Co.; Autocar; and Southwest Corporation. Recently the Chicago Corporation has started to change the fundamental nature of its business and is attempting to serve a very useful function in making capital available to small industries. But in those circumstances, because the securities they get are not liquid and have no market, they necessarily have to take a controlling position to protect their investment.

Senator WAGNER. I do not see any objection to that method of changing their activities; but should not the stockholders who originally put their money in under certain definite assurances, know about that change of policy?

Mr. SCHENKER. That is the approach of this bill, Senator; and when we come to section 13, which deals with changes in fundamental policy, I will elaborate upon that.

Senator TAFT. Were there not always a fair number of trusts that frankly went in as trading companies? It seems to me that I remember several small ones in Cincinnati which frankly said, "We can trade on the market better than you can, and you might as well let us do it."

Mr. SCHENKER. Yes.

Senator TAFT. I remember one or two of that kind.

Mr. SCHENKER. I do not think you were here, Senator Taft, when we discussed the classifications of investment companies. This bill does not say that that type of company should not exist. It just says,

"Tell your stockholders that that is the type of company you are going into, and if they want to speculate on the New York Stock Exchange, that is all right with us."

May I go on?

Senator TAFT. Certainly.

Mr. SCHENKER. Now, we come to paragraph (4) of section 12 (a), and that substantially says that an investment trust cannot act as a dealer in or distributor of its own securities in contravention of such rules and regulations as the Commission may prescribe.

What is the significance of that? By far in the great majority of cases the distribution of the securities is not undertaken by the trust itself, but is undertaken by independent distributors who make a business of distributing securities. There are some situations in which investment trusts act as their own distributors of their own securities. There is a type like that of Scudder, Stevens & Clark, which does not have a sales load——

Senator TAFT. Scudder, Stevens & Clark are not brokers, are they?

Mr. SCHENKER. No. They are investment counsel.

Senator TAFT. They are not investment bankers?

Mr. SCHENKER. No. To my mind, Senator, that may be a model situation, because you take a bank which has trust funds, they do advertising, but they do not have salesmen who go around trying to sell participations in trust funds to the public. However, I am not unmindful of the fact that there is a differentiation between those two types of situations. We do not want to discourage that type of distribution where they do not have salesmen.

Where do Scudder, Stevens & Clark get their investors? A person comes into their office and he has $25,000. They will not take anybody who has less than $150,000 to $250,000. They say, "We can't give you a personalized investment service. Why don't you buy an interest in our investment company?"

So their expansion is through that medium rather than through the employment of salesmen.

We do not want to discourage that type of situation.

Senator TAFT. Let me ask this question. Paragraph (4) of section 12 (a) provides (reading):

to act as a dealer in or distributor of securities of which it is the issuer.

They cannot be a registered investment company. The trust shall not act as a dealer in or distributor of securities of which it is the issuer. That is, its own securities?

Mr. SCHENKER. Yes.

Senator TAFT. As for me, I think I would be willing to prohibit entirely dealing in its own securities, unless there may be some time an obligation to buy back. The common law originally provided that a company could not buy its own securities. It cannot in Ohio, and it seems to me that that was a good rule, but it has been changed in a lot of statutes.

Mr. SCHENKER. In England and Australia today a company cannot buy back its own securities, and therefore all the investment companies in England and Australia cannot. We have a specific section which deals with that.

Senator TAFT. What is the reason for allowing it at all?

Mr. SCHENKER. It is only, Senator, to cover the type of situation like that of Scudder, Stevens & Clark. I have been in pretty close

contact with pretty much all the investment counselors of repute in this country. They are all confronted with people of moderate means who want their service and cannot get it. The investment company is really an adjunct to their investment counsel business, so that they can give a type of investment advice to people of moderate means, comparatively, although not exactly the same as they can give to people in the higher brackets. I do not see why it should be discouraged.

Senator TAFT. I am saying, Why should they have a right to buy their own stocks? That always gives somebody the discretion to soak the rest of the stockholders and let one fellow out without letting the others out.

Mr. SCHENKER. The repurchase of a company's own stock is not a simple problem. We have given it a great deal of thought.

When will an investment company buy back its own stock? It will buy back its own stock when it is selling at a discount, that is, when the market value of the stock is below the asset value. So that every time they buy back their own stock they make a profit. It is true that this discount accrues to the benefit of the remaining stockholders, but you have this fundamental problem which has been disturbing the industry, and frankly, they tell me they do not know the answer.

To whom is the primary obligation of the management of an investment company? Is it to the individual who is remaining with the corporation, in which event the stock must be bought at the cheapest price? Or do we have some obligation to the fellow who turned his funds over to us to manage and who wants to get out for some reason?

So you find these companies in that dilemma. Why do they buy back their own stock? In some respects, Senator, it serves a function in that, by virtue of their purchasing power, they may be paying the stockholder who wants to leave the company a little higher price than he would be getting ordinarily. Of course it has been urged also that in case of distressed markets the buying of their own stocks has a stabilizing influence on the market price of such stocks.

As we visualize the problem, what has occurred in the past, Senator, unfortunately, is this. It is true that this bill provides that a director or officer or manager cannot sell back his holdings in the investment company. But that is a matter of each circumvention. All he does is to sell them on the New York Stock Exchange or the open market, and the investment trust will buy back his shares.

Senator TAFT. My inclination is to prohibit it altogether, and I am raising the question whether or not it should be entirely prohibited. It has always seemed to me a doubtful thing.

Mr. SCHENKER. There is much to be said for that feeling.

Senator TAFT. If they can find another purchaser, all right. If they cannot, it is a pretty good reason why the stockholders should not buy it back.

Mr. SCHENKER. Our approach has been, Senator, that if the company is going to cut down the size of its fund by acquiring its own stock, then every stockholder in the company should have a right to pro rata reduce his interest in the fund. Therefore our approach is that it be done through the form of tenders—"We are prepared to buy back our own stock." Therefore everybody, officers, managers, directors, the small investors, will have a right to sell back to the