

stantial profits. While we do not have the corresponding figures for the remaining trusts, we believe, from the information we have as to many of them, that they would show up equally favorably. These results, it seems to me, are very favorable, considering the unsettled conditions in recent years. And these figures, incidentally, take no account of the dividends paid to the public, which have amounted to millions of dollars. Our trust alone has paid out over \$26,000,000 from investment income.

I mention these figures, not to prove that these trusts invest their money or perform their service any better than anyone else, but our stock seemed to sell much higher in 1929 than now, also sold much lower in 1933. The point I wish to emphasize is this: By and large, in the aggregate, these trusts have been a good thing for the public because the public in the aggregate have not lost money in them.

In preparing these figures, we have followed the S. E. C.'s accounting method, which is to subtract the amount of redemptions from the amount received by the trust. The result obtained in this way is misleading and incorrect as applied to open-end companies, because it includes not only the losses of the trusts, but also the losses of shareholders who elected to redeem their shares at low prices. If a fair and proper method had been used, the result, favorable as it is, would have been much more favorable to these open-end management companies.

I am sorry to have to bore you with mathematical proof of this but it is most important that the record be set straight on this matter. I am going to say this slowly for you. A company sells 200 shares at \$20 a share, receiving therefor \$4,000. In the middle of the depression, shareholders redeemed half of these shares at \$10 a share, the market having fallen, which reduces the assets of the trust by \$1,000. Later, the market goes up again and each outstanding share is again worth \$20. There are then 100 shares outstanding, which were issued at \$20 a share and which are worth \$20 a share, so that the assets of the company are worth \$2,000. To see how much money has been lost, the S. E. C. method subtracts from the \$4,000 originally received the \$1,000 paid to the shareholders who redeemed, leaving \$3,000, and in effect says that if the company is now worth only \$2,000, \$1,000 has been lost. It is true that the shareholders who sold out at \$10, instead of holding their shares until they recovered their value, lost \$1,000. It is not true that the trust lost \$1,000. The Government figures for open-end management companies, therefore, do not really show the amounts lost by the trusts at all. They are, as I have said, a combination of the amounts lost by the trusts and the amounts lost by the shareholders who elected to sell out their shares when the market was low. It is not the trusts' fault if some of their shareholders unfortunately took such action.

This method of presenting the facts, when applied to open-end management companies, is just as silly as it would be to say that if 1,000,000 shares of U. S. Steel Corporation, for which investors in 1929 paid \$250 a share, were sold on the Stock Exchange in 1932 at \$25 a share, the U. S. Steel Corporation lost \$225 a share, or \$225,000,000. The U. S. Steel Corporation really lost \$71,000,000 in 1932. It would be pretty tough to say that it lost not \$71,000,000 but \$71,000,000 plus \$225,000,000 or a total of \$296,000,000. I am not

making this criticism ill-advisedly; I have discussed this matter at length with our auditors, Lybrand, Ross Bros. & Montgomery.

Senator DOWNEY. May I intervene here, Mr. Chairman?

Senator WAGNER. Yes.

Senator DOWNEY. One difficulty in this hearing, with me, at least, is that I have not been able to be here all the time. I must admit that Mr. Griswold's statement in that respect seems to me to be sound, that to hold investment trusts liable for the loss incurred because some of the stockholders cash out at the bottom of a depression does seem to me to be an unfair criticism.

Senator WAGNER. We are not holding anybody liable for anything.

Senator DOWNEY. If the figures had been presented on that basis as showing losses to the investment trusts arising because stockholders did cash out at an unfortunate period of the general market—

Senator WAGNER. Of course nobody could be held responsible for that. There is more than that presented. I suppose the Securities and Exchange Commission will present other testimony. But we are trying to get both sides of this picture, and of course we begin by saying that many of these investment trusts were run honestly and efficiently and in the interest of the stockholders. But we are concerned with those who have looted; there is no question about that. What we are trying to ascertain is what we can do by legislation to prevent such looting, without in any way interfering with the operation of trusts which are operated in the interest of the stockholders and investors. That is what we are concerned with. So let us hear both sides, Senator, before we decide.

Senator DOWNEY. All I wanted to say was that I hope that Judge Healy will later rediscuss that point.

Senator WAGNER. On the question of losses?

Senator DOWNEY. Yes.

Senator WAGNER. There is no doubt that that will be done.

Senator DOWNEY. It is very hard to judge the soundness of any argument just by hearing one side. But I must admit that that sounds to me like a very sound argument.

Senator WAGNER. That is the reason that we are hearing these gentlemen, because we want to hear both sides. I have been enlightened a good deal by hearing both sides so far.

Mr. GRISWOLD. I want to say in that connection, Senator, with reference to our trust, that we had the figures recomputed by our auditors to see what difference it made—that is, by the two methods—and it made a difference in our trust of \$6,000,000.

I recall that Mr. Paul C. Cabot once told the Securities and Exchange Commission—and right here let me say that the official to whom he told it is not among those present, so that this is no reflection on anyone present—I recall that Mr. Paul C. Cabot once told the S. E. C. that some of their statistics, in his opinion, constituted statistical monstrosities. I now claim that this method of figuring the losses of open-end management trusts is also a statistical monstrosity, and, therefore, misleading.

I hope I have not antagonized the committee by the criticisms I have made of some of the figures used by the S. E. C. I do not wish to imply that the S. E. C. in any way intended to create a false impression. I have merely presented these facts in order that the records might be clearer on this subject.

With respect to the importance of investment companies as a medium for the public's funds, one of the S. E. C. witnesses made the statement that one large investment trust held more common stocks than the 49 leading life insurance companies combined. This is a rather startling statement if you say it fast enough and don't think about it. But when you think about it, you will realize that it is about as sensible as saying that a village cobbler makes more shoes than the General Motors Corporation.

The fact of the matter, of course, is that because of investment restrictions imposed by various States in which they do business, life-insurance companies are prevented from holding stocks except in a most limited way. The Metropolitan Life Insurance Co., for instance, with nearly \$5,000,000,000 of assets, has only 1.8 percent of its resources in either preferred or common stocks. The Prudential Life Insurance Co., with assets of \$3,700,000,000, has only 2.1 percent of its resources invested in preferred and common stocks.

Statistical comparisons of this sort are unfair. Such unsound analogies as that just described lead me to suggest that statistics should be taken not with one grain of salt, but with three or four.

We respectfully suggest that before reporting legislation, the Senate committee acquaint itself with what has already been done in a legislative way respecting this type of company in Great Britain and in the different States, in order that we may profit by the experience and research which have gone into such legislation. Others will no doubt explain about the development which has taken place regarding this type of company in the numerous States. In some of these States, such as Ohio, Iowa, Michigan, and Wisconsin, substantial progress has been made in eliminating most of the abuses to which open-end management companies are susceptible. Because nearly all open-end management trusts are distributed on a national basis, these existing State regulations affect virtually the whole industry. For instance, trusts whose assets represent 80 percent of the open-end industry are registered in the State of Ohio and subject to its regulations.

There are some States outside of those four mentioned which have very good blue-sky laws; but those particular States are quite noteworthy.

In Great Britain open-end management companies are treated entirely separately from other types of investment companies. In my opinion, they should be treated separately in this country as regards a great many matters. In Great Britain, the Companies Act, which partially corresponds to our Securities Act, is not applicable at all to open-end management companies. The reason is that in Great Britain open-end management companies have never been organized as corporations. They have all been organized as trusts. The reason for that is that in Great Britain a corporation cannot legally buy in or redeem its own shares. If organized as a trust, however, it can. Such trusts being exempt from the Companies Act, the British Government arranged for the British Board of Trade, which is a department of the Government, to appoint in 1936 a committee to inquire into so-called unit open-end trusts and to report what action, if any, was desirable in the public interest.

This report, which not only contains a complete analysis of the subject but also makes many recommendations as to legislation, is only 59 pages long and will, we believe, repay study by the members

of the committee. It was evidently prepared in an impartial and fair manner. It in all cases explains both sides of all questions. Its recommendations are specific and concrete. It covers what are known as unit trusts. As many of the problems of flexible unit trusts are parallel to the problems of open-end management companies, we hope the committee will consider the recommendations made, which were in certain respects, we believe, more sound and more carefully thought out than some of the recommendations of the S. E. C. It is interesting to note that, after considering all the criticisms in the committee's report and considering to what extent legislation was necessary, the final decision of Parliament was that all that was needed was to make a very few simple provisions.

That seems to us concrete and workable legislation. It was decided that it was not necessary to encumber the act with constant and repetitious delegations of authority and the right to make rules and regulations on every conceivable subject having anything to do with such trusts. The drafting of simple legislation such as this way be more difficult, but at least it has the advantage of letting those subject to it know where they stand. The effort of Parliament was evidently to draft an act designed to heal a financial sore without hampering the pursuit of legitimate business.

We do not claim that the specific provisions of the British law are those which are necessary to cure the particular abuses that have arisen in this country, but we do claim that so far as the open-end management business is concerned, a few simple provisions could easily be devised which would prevent the sort of abuses which have taken place here. We claim that it is unnecessary to provide for every hypothetical abuse and possibility of temptation, at the expense of hampering legitimate business. For example, section 10 as a whole, is a prime illustration of this. We claim it would be sufficient for this bill to cover such matters as follows, in order to prevent abuses in the open-end trust business:

- (1) Dealing with insiders as principals.
- (2) Custodianship arrangements.
- (3) Improper exculpatory clauses.
- (4) "Selling down the river" abuses.
- (5) Radial changes in the character of business, which provisions must, however, be more carefully drafted than in this bill.
- (6) Audits and standard accounting principles, and adequate reports to shareholders.
- (7) Proper limitations on borrowing.
- (8) Restrictions on buying on margin or short-selling.
- (9) Disclosure of source of dividends.
- (10) Proper diversification of investment holdings.
- (11) Provision for removal of improper management.
- (12) Regulation of the sale and redemption of shares, which could be handled under the Maloney Act. I shall be very glad to tell you some time later exactly how this could be done.

Senator WAGNER. You yourself have not attempted to draft anything, have you?

Mr. GRISWOLD. I am not the expert who is testifying on that subject. Mr. Traylor will. It is the general belief of the industry that already under section 15 (a), I think it is, of the Maloney Act of 1934

it can apply to this abuse. If it is not absolutely clear to the S. E. C. that that is so, we are prepared to offer language which will make it so.

Senator WAGNER. Suppose they are not, as someone has referred to it, a member of the "Maloney Association." Then how do you control it?

Mr. GRISWOLD. On that point, Senator, I am going to ask you to talk to Mr. Traylor.

Senator WAGNER. Your suggestions are very interesting and rather comprehensive.

Mr. GRISWOLD. They are satisfactory to us.

Senator WAGNER. Yes; they are rather comprehensive. They go pretty nearly as far as section 10 does.

Mr. GRISWOLD. Oh, no, sir; they do not have anything to do with section 10.

Senator WAGNER. I did not mean as to the specific things, but in the way of attempting regulation they would be rather effective, I think.

Mr. GRISWOLD. As to the Maloney Act, Mr. Traylor will be prepared to explain that to the committee. That is something that we will be glad to cooperate with you on.

Senator WAGNER. It has worked out pretty well, I am told.

Mr. GRISWOLD. I am told that it has. I am in the management end. I am not in the distribution of securities.

Senator WAGNER. There were a great many objections lodged against it, that it was going to raise havoc in the industry, etc. But I understand that it has worked out very well.

Mr. GRISWOLD. So I am told.

Senator WAGNER. I have been called away, and I am going to ask Senator Hughes to preside. I am very much interested in your constructive suggestions, and I hate to leave at this time; but I will read carefully what you have to say about it.

(Senator Wagner withdrew from the hearing room and Senator Hughes assumed the chair.)

Mr. GRISWOLD. Shall I continue, Senator?

Senator HUGHES (presiding). Yes.

Mr. GRISWOLD. If adequate study is given to the drafting of legislation on these subjects, we believe that they can be adequately covered with a minimum of delegation of authority to the S. E. C.

Before commenting on two or three specific sections of the bill, I should like to add another word. The S. E. C. witnesses have told you that, although the Commission invited the industry to discuss the bill after the text was made public, the industry failed to cooperate. Although the time available was too short, prior to these hearings, to permit effective discussion of possible changes, I decided nevertheless to accept the S. E. C.'s invitation. I asked the S. E. C. staff whether or not they would like to "clear" a few of the points, in cases where I felt sure we could satisfy them that their language did not accomplish what was intended. They said they would be glad to, and stated that if I could convince them, they would say so and that we could thus eliminate certain controversial questions. I submitted two specific recommendations for their consideration, but it was impossible to get any answer from them. I am not blaming the members of the S. E. C. staff. How could they commit the entire Commission to a change? I mention this simply to indicate that the

suggested procedure was perfectly hopeless. So I was forced to give up the attempt.

I will now come to the specific subject of size.

The bill for Federal regulation of investment companies proposes that trusts which maintain diversified portfolios shall be arbitrarily limited to a maximum size of \$150,000,000. Higher and lower limits are also set for other types of investment companies. In addition, by preventing the same group of individuals from serving as a majority of the board of directors of more than one trust, the bill limits the amount of funds under any one management.

As reasons for these provisions for limitation of size, the bill states that the public interest is adversely affected when investment companies—

1. Attain such great size as to preclude efficient investment management; or
2. Attain such great size as to have excessive influence on the national economy.

I do not know what facts, if any, the S. E. C. may have discovered in the course of its investigation that would tend to bear out either of the above contentions. My own experience and observations have convinced me that neither contention is justified, at least in the case of diversified companies.

It is my firm belief that the reasons for size limitation, as given in the bill, are not the real reasons for this provision. I say this because such reasons are too easily disproved. I believe that the real attitude of the S. E. C. is that size in itself is bad, and that this limitation has been imposed in accordance with preconceived social and economic theories.

This arbitrary size limitation is one of the most revolutionary provisions of this bill. It is utterly without precedent. No other type of business has ever been subjected to such limitation. And the limits proposed are exceedingly low as compared with the size of other types of financial and industrial institutions. Are we to suppose that this bill is to set a precedent for the limitation, at some future date, of the size of steel companies, automobile companies, banks and all other types of business?

I noted, with great interest and some amusement, that when Mr. Schenker testified as to the reasons for this size limitation, he did not advance any of the reasons ascribed in the bill itself. Instead, he gave a number of brand new reasons, none of which had been previously discussed between representatives of the industry and the staff of the Commission. The S. E. C. has given various reasons in the past for its recommendation of size limitation. And when representatives of the industry have disproved these reasons, the Commission staff has advanced new reasons. This leads me to believe that the S. E. C. decided on the provision first, and then sought to find reasons to support it, with a notable lack of success, in my opinion, to date.

In their testimony before your committee last week, the S. E. C. witnesses made no mention of the effect of size on investment performance or of the possible influence of large investment companies on the national economy. The facts which I shall give you later will indicate clearly, I believe, why they abandoned both those original lines of argument.

Instead, the theory was advanced that limitation of size was necessary to protect investors against possible "runs" on open-end trusts, whose shares are redeemable at the option of their holders at any time. To make the point clear, the analogy of a run on a bank was mentioned.

I want to make it very clear to you gentlemen that there are certain fundamental differences between a bank and an open-end investment trust that make any such fears groundless. In the first place, an open-end company is not committed to repay a given number of dollars, as a bank is. It merely repays on demand a certain specified percentage of its assets, representing the ratio between the shares tendered by any investor and the total number of shares outstanding. Its obligations are at all times limited to its assets. Therefore, no open-end investment company such as ours can ever become insolvent.

Moreover, the investments of an open-end management trust, comprising a diversified list of highly marketable common stocks, are far easier to liquidate quickly and at fair prices than are the assets of a commercial bank, savings bank, or life-insurance company. And because open-end mutual companies are limited by the tax laws to the investment of not more than 5 percent of their assets in the securities of any one corporation, their holdings of any one issue never become so large as to be illiquid.

There is nothing in the 16-year record of the open-end trusts that gives the slightest reason for the belief that "runs" on them would take place. There were no such runs in 1929 or the early 1930's during the heaviest security liquidation that ever occurred in this country. There were no such runs during the violent market decline of 1937. The reason for this is fundamental. The shares of an open-end trust are not a bank deposit. They are an investment. And a difference of opinion always exists as to the attractiveness of any investment at any given moment. That's why there are always buyers and sellers. That is what makes a market. It is conceivable that all of the depositors of a bank might decide at the same time that it was wise for them to withdraw their funds. But it is inconceivable that all the holders of an open-end trust would simultaneously decide to liquidate their investment. The very market action that would cause some holders to liquidate would cause others to hold or increase their investment.

In 1937, during the severe decline in the stock market, the S. E. C. requested all open-end trusts to report each week the volume of their redemptions, and has asked all trusts to make such reports regularly ever since. The purpose of this, apparently, was to enable the Commission to ascertain whether redemptions increased heavily during declining markets and whether any liquidation of securities resulting from the need for redeeming shares had a depressing effect upon the securities market. In his testimony last week, Mr. Schenker said that one of the reasons for limiting the size of open-end companies was to protect the general level of security prices against the effect of liquidation caused by the redemption of open-end trust shares. But he quoted no figures from the S. E. C.'s 2½-year study of this question to support his argument. The natural inference is that the facts of this continuing study failed to support his contention.

In my opinion, there is only one way in which the funds of open-end companies can become illiquid. Strangely enough, that is when they are in the form of cash in the bank. If a trust with a substantial por-

tion of its assets in cash, placed all such cash in a single bank and that bank failed, an illiquid asset might result. In Massachusetts Investors Trust, which I head, we protect our shareholders against even this remote contingency by a policy that not more than 5 percent of our assets can be represented by a deposit with any one bank. In other words, we regard a bank deposit as an investment subject to risk and diversify such deposits on the same basis required in the case of our security investments.

In discussing the provision for limitation of the size of investment companies, Mr. Schenker also said that there was a correlation between large size and heavy investment losses. In citing examples, however, he switched from the open-end field to trusts of other types, such as holding companies and pyramided trusts. I should be very interested to see any figures the Commission has that prove that large size has been any detriment to investment performance in the field of open-end trusts.

Although no abuses as a result of size have ever occurred in the open-end trust business, the size limitation provided in the bill is obviously directed at this particular section of the industry. Mr. Schenker went to some lengths to point out that growth of assets, through appreciation, to a figure in excess of the specified maximum size was not prohibited by the bill. He said that there was no objection if a \$10,000,000 company ran its assets up to \$3,000,000,000 through appreciation of values. But growth through the sale of new shares to new investors beyond the specified figure is prohibited. If trusts beyond a certain size are undesirable (a theory to which I do not subscribe), what difference is there whether that size was attained through appreciation or through the raising of new capital?

In explaining this provision to your committee, the S. E. C. has stated that the size limitations imposed by this bill will not affect any existing company. It is true that no open-end company is presently larger than the maximum provided in the bill. But the size limit nevertheless seriously affects the future operations of any companies that are now near the specified limit. In the case of Massachusetts Investors Trust, for instance, with present assets of \$121,000,000, we believe it will be very difficult to interest dealers in further distribution of our shares because of their fear that a rise in market values would place the trust in excess of the legal size, and thus limit the supply of securities they have contracted to sell. And although the sale of new shares is permitted as an offset to redemptions, dealers will be unwilling to sell on this basis because no continuous supply of shares is assured. Therefore, we feel it will be difficult, if not impossible, for us even to replace those shares redeemed in the future. And most important of all, general investor interest in our shares will be greatly lessened, merely because the imposition of an arbitrary size limitation will cause many investors to feel that the Government believes large trusts to be unwieldy and inefficient. This same fear of Government disapproval may cause many shareholders to liquidate their interest.

I should now like to explain why I believe that the two reasons for limiting size, as stated in the bill itself, are not valid. These reasons, you will recall, were (1) that large size resulted in inefficient operation, and (2) that large-sized investment companies exert excessive influence on the national economy.

Does large size injure or benefit the shareholder?

One of the earliest criticisms of the investment trust movement was that the cost of operation, from the standpoint of the shareholder, was high in relation to the amount of his investment. Reduction of the costs of the small investor has been the constant goal both of the Commission and of reputable trust managers.

It is now almost axiomatic in the trust business that operating costs decline proportionately as the size of a trust increases. The experience of shareholders of Massachusetts Investors Trust clearly proves this. With assets of \$13,000,000 in 1932, operating costs were \$11.02 per \$1,000 of net assets. By 1939, when the trust had grown to \$121,000,000, operating costs per \$1,000 of assets had been reduced to \$4.41, a decrease of 60 percent from the 1932 figure.

This advantage of size from the shareholder's standpoint is also clearly evident from a study we have made of 22 representative open-end companies with assets ranging from about \$2,000,000 to about \$50,000,000.

Senator DOWNEY. That deduction assumes, of course, that the entire increase or decrease per thousand dollars in the cost of operation came from the increased magnitude of the operations, does it not?

Mr. GRISWOLD. Substantially; yes.

Senator DOWNEY. You feel confident that that is correct; that that was the major or sole reason for the decrease of costs? Perhaps the fact that you have been in existence longer and have become more efficient in management might have accounted for a part of it.

Mr. GRISWOLD. Senator, whether a company is a one-million-dollar company, a ten-million-dollar company, or a hundred-million-dollar company, it has to maintain an office, pay rent, pay for long distance telephone calls, retain experts, clerks, stenographers, all the numerous expenses that go with it; and those expenses do not go up proportionately. We maintain what we consider to be a very good research department. We have a number of men who receive good salaries, and a large staff. If our trust were half as large, if we were to do the same kind of an investment job, we could not fire one single one of those people.

Senator DOWNEY. Thank you.

Mr. GRISWOLD. I was telling about the study which we made of 22 trusts. Their expenses per \$1,000 of assets varied in 1939 from \$6.80 to \$14.48, as compared with \$4.41 for the largest open-end company in existence.

It is our belief that further growth in the assets of Massachusetts Investors Trust would bring about still further reduction in proportionate costs of operation, with resulting benefit to all shareholders. Moreover, the economies to date have been more than relative, for Massachusetts Investors Trust, because of the growth in funds under its management, has set its trustees' fees at the same rate charged by most trust companies and private trustees in the State of Massachusetts for services as trustees under testamentary trusts. The rate of such charge is far less than the average for the investment trust industry as a whole.

Is size a handicap to investment performance?

It has frequently been contended that the small trust is better than the large trust because it theoretically has a greater agility in getting in and out of the market. This theory, however, is not borne out by