

# INVESTMENT TRUSTS AND INVESTMENT COMPANIES

---

---

## HEARINGS

BEFORE A

SUBCOMMITTEE OF THE  
COMMITTEE ON BANKING AND CURRENCY  
UNITED STATES SENATE  
SEVENTY-SIXTH CONGRESS

THIRD SESSION

ON

### S. 3580

A BILL TO PROVIDE FOR THE REGISTRATION AND  
REGULATION OF INVESTMENT COMPANIES AND  
INVESTMENT ADVISERS, AND FOR  
OTHER PURPOSES

---

#### PART 2

APRIL 12, 15, 16, 17, 18, 19, 22, 23, 24, 25 and 26, 1940

---

Printed for the use of the Committee on Banking and Currency



UNITED STATES  
GOVERNMENT PRINTING OFFICE  
WASHINGTON : 1940

## COMMITTEE ON BANKING AND CURRENCY

ROBERT F. WAGNER, New York, *Chairman*

CARTER GLASS, Virginia	JOHN G. TOWNSEND, Jr., Delaware
ALBEN W. BARKLEY, Kentucky	LYNN J. FRAZIER, North Dakota
JAMES F. BYRNES, South Carolina	CHARLES W. TOBEY, New Hampshire
JOHN H. BANKHEAD, Alabama	JOHN A. DANAHER, Connecticut
ALVA B. ADAMS, Colorado	ROBERT A. TAFT, Ohio
FRANCIS T. MALONEY, Connecticut	
GEORGE L. RADCLIFFE, Maryland	
PRENTISS M. BROWN, Michigan	
JAMES H. HUGHES, Delaware	
CLYDE L. HERRING, Iowa	
WILLIAM R. SMATHERS, New Jersey	
JOHN E. MILLER, Arkansas	
D. WORTH CLARK, Idaho	
SHERIDAN DOWNEY, California	

PHILIP LEVY, *Clerk*

## SUBCOMMITTEE ON SECURITIES AND EXCHANGE

ROBERT F. WAGNER, New York, *Chairman*

CARTER GLASS, Virginia	JOHN G. TOWNSEND, Jr., Delaware
JAMES F. BYRNES, South Carolina	LYNN J. FRAZIER, North Dakota
FRANCIS T. MALONEY, Connecticut	ROBERT A. TAFT, Ohio
JAMES H. HUGHES, Delaware	
CLYDE L. HERRING, Iowa	
JOHN E. MILLER, Arkansas	
SHERIDAN DOWNEY, California	

## CONTENTS

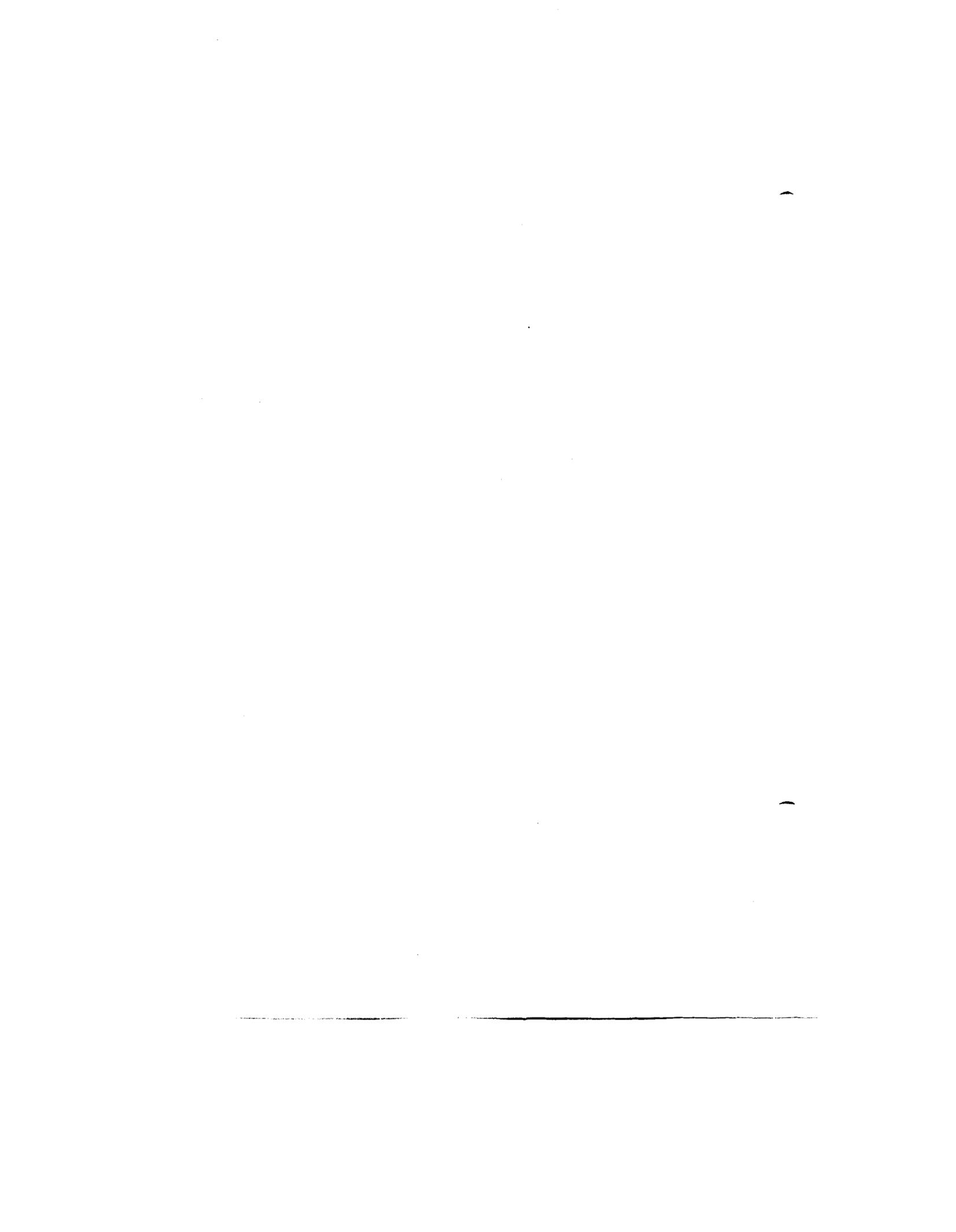
Statement of—	Page
Adams, Hon. Charles F., Boston, Mass.....	557
Adler, Robert S., president and director, Selected American Shares, Inc., Chicago, Ill.....	534, 537
Amory, Roger, Boston, Mass.....	580
Anderson, O. Kelley, president, Consolidated Investment Trust, Boston, Mass.....	642
Andrews, T. Coleman, member of committee of the American Institute of Accountants, Richmond, Va.....	689
Bane, Baldwin B., director of the Registration Division, Securities and Exchange Commission.....	835
Bellamy, F. Wilder, president, National Bond & Share Corporation, New York City.....	418
Berle, Rudolf, general counsel, Investment Counsel Association of America, New York City.....	742
Bolton-Smith, Carlile, attorney, Securities and Exchange Commission.....	893
Bullock, Hugh, vice president, Calvin Bullock Co., New York City.....	509
Bundy, Harvey H., chairman of the trustees, Boston Personal Property Trust, Boston, Mass.....	623
Bunker, Arthur H., executive vice president, The Lehman Corporation, New York City.....	325, 399, 1052
Cabot, Paul C., president, State Street Investment Corporation, Boston, Mass.....	463
Curtis, Charles P., trustee, Century Shares Trust, Boston, Mass.....	589
Curtis, Louis, partner of Brown Bros. Harriman & Co., Boston, Mass.....	546
Dewey, Bradley, president, Dewey & Almy Chemical Co., Cambridge, Mass.....	621
Dodd, Prof. E. Merrick, Harvard Law School, Cambridge, Mass.....	765
Eaton, Charles F., Jr., president, Eaton & Howard, Inc., Boston, Mass.....	595
Eberstadt, Ferdinand, president of F. Eberstadt & Co., New York City.....	567
Gardiner, William Tudor, chairman, Incorporated Investors, Boston, Mass.....	543
Goldsmith, Raymond W., assistant director, Trading and Exchange Division, Securities and Exchange Commission.....	812
Greene, Francis, assistant director, Trading and Exchange Division, Securities and Exchange Commission.....	863
Griswold, Merrill, chairman, Massachusetts Investors Trust of Boston, Mass.....	847
Healy, Robert E., Commissioner, Securities and Exchange Commission.....	930, 1047, 1050
Hollands, John H., attorney, Securities and Exchange Commission.....	1049
Johnston, Douglas T., president, Johnston & Lagerquist, Inc. and vice president, Investment Counsel Association of America, New York City.....	711
Long, Hugh W., president, New York Stocks, Inc., and Manhattan Bond Fund, Inc., New York City.....	584
Loomis, Robert H., president, Loomis, Sayles & Co., Inc., Boston, Mass.....	706, 760
Lord, Andrew J., president, Lord, Abbett & Co., Inc., and president, Affiliated Fund, Inc., New York City.....	617
McGrath, Raymond D., executive vice president, General American Investors Co., Inc., New York City.....	425
Motley, Warren, counsel, Massachusetts Investors Trust, Boston, Mass.....	651

Statement of—Continued.	Page
Myers, John Sherman, vice president of Lord, Abbett & Co., Inc., president of American Business Shares, Inc., and vice president of Affiliated Fund, Inc.....	605
O'Hearn, Charles M., vice president and director of Clarke, Sinsabaugh & Co., New York City.....	713
Orr, James H., president, Railway & Light Securities Co., Boston, Mass.....	631
Parker, William A., president, Incorporated Investors, Boston, Mass.....	545
Quinn, Cyril J. C., vice president, Tricontinental Corporation and partner of J. & W. Seligman & Co., New York City.....	370, 441
Rose, Dwight C., partner of Brundage, Story & Rose, New York City, and president, Investment Counsel Association of America.....	722
Sanders, David T., resident manager and wholesale representative in Chicago of Massachusetts Distributors, Inc.....	528
Schenker, David, Chief Counsel, Investment Trust Study, Securities and Exchange Commission.....	802, 866, 971
Smith, L. M. C., associate counsel, Investment Trust Study, Securities and Exchange Commission.....	783
Sprague, Oliver M. W., Boston, Mass.....	560
Standish, Alexander, president, Standish, Racey, & McKay, Inc., Boston, Mass.....	718
Taliaferro, Richard N., president, Fidelity Fund, Inc., Boston, Mass.....	547
Traylor, Mahlon, president, Massachusetts Distributors, Inc., of Boston, Mass.....	451, 514
Vass, Laurence C., statistician, Securities and Exchange Commission.....	821
Wagner, Richard, president, The Chicago Corporation, Chicago, Ill.....	682
Wertz, William W., chief accountant, Securities and Exchange Commission.....	906
White, James N., Scudder, Stevens & Clark, investment counsel, Boston, Mass.....	700, 755
Exhibits:	
Memoranda submitted by Arthur H. Bunker.....	350, 399, 406
Letters to stockholders of National Bond & Share Corporation submitted by F. Wilder Bellamy.....	423
Memorandum submitted by Mahlon E. Traylor, entitled "Investment Trust Classification".....	459
Memorandum submitted by Paul C. Cabot entitled, "Sixteenth Annual Report, State Street Investment Corporation, Boston, Mass.".....	464
Pamphlet submitted by Paul C. Cabot, entitled, "The Investment Trust".....	470
List of trustees and members of the advisory board of Massachusetts Investors Trust, submitted by Merrill Griswold.....	508
Memorandum submitted by Richard N. Taliaferro, entitled, "Q-3 Application for Qualification of Investment Trust Shares".....	548
Letters submitted by Richard N. Taliaferro.....	554
Memorandum submitted by Senator Downey in behalf of Henry S. McKee, president, Pacific Southern Investors, Inc., and American Capital Corporation of Los Angeles.....	565
Comparative statement of capital surplus and dividends, of the Boston Personal Property Trust, submitted by Harvey H. Bundy.....	626
Chart submitted by James H. Orr, entitled "Railway & Light Securities Co., Percent Asset Coverage per Outstanding Bond at Par for Determining Dividend payments Under Investment Company Act of 1940".....	633
Code of Fair Competition for Investment Bankers, submitted by James H. Orr.....	641
Statement of S. L. Sholley, president, Keystone Custodian Funds, Inc., Boston, Mass.....	663
Memorandum submitted by Francis I. Amory, vice president, and E. Roy Kittredge, treasurer, General Capital Corporation.....	665
Memorandum submitted by Malcolm W. Greenough, president, Boston Metal Investors, Inc.....	575
Letter addressed to Hon. Robert F. Wagner by Donald B. Litchard, president, Bay State Fund, Inc.....	675
Memorandum submitted by Donald Holbrook, Boston, Mass.....	676

CONTENTS

V

Exhibits—Continued.	Page
Memorandum submitted by John H. Sherburne, chairman, board of trustees, General Investors Trust.....	677
Chart submitted by Robert H. Loomis entitled "Loomis-Sayles Mutual Fund".....	709
Chart submitted by Robert H. Loomis entitled "Loomis-Sayles Second Fund".....	710
Code of Professional Practice of Investment Counsel Association of America submitted by Dwight C. Rose.....	726
Form of application for membership, of the Investment Counsel Association of America submitted by Dwight C. Rose.....	727
Statement submitted by R. V. Fletcher, general counsel of Association of America Railroads.....	776
Statement of Prof. E. Merrick Dodd, Jr., Harvard Law School.....	778
Table submitted by S. E. C. entitled "Table 1, Investment Companies in Receivership or Bankruptcy, 1927-35".....	784
Memorandum submitted by Securities and Exchange Commission entitled "General Management Investment Trust and Investment Companies Which Did Not File Either Questionnaires or Summary Statements and so forth".....	788
Memorandum submitted by Securities and Exchange Commission on investment company performance.....	811
Chart submitted by Securities and Exchange Commission entitled "Investors' Experience in Management Investment-Holding Companies (1927-35)".....	822
Chart submitted by Securities and Exchange Commission entitled "Investors' experience in management Investment Companies Proper" (1927-35).....	823
Letters pertaining to Massachusetts Distributors, Inc., submitted by Securities and Exchange Commission.....	849
Memorandum submitted by Securities and Exchange Commission containing analysis of banking laws of certain States.....	875
Letter addressed to Hon. Robert F. Wagner by Chester Morrill, Secretary, Federal Reserve Board, enclosing correspondence between Board and Securities and Exchange Commission.....	925
Memoranda submitted by Securities and Exchange Commission in reference to "Conferences with Representatives of Industry".....	941
Memorandum submitted by Securities and Exchange Commission on "Recurrent Promotions" (sec. 11).....	951
Chart submitted by Securities and Exchange Commission entitled "Net Sales of Investment Companies in Bullock Group".....	957
Memorandum submitted by Securities and Exchange Commission "Compilation of Statutory Provisions Respecting Dividends (1939)".....	968
Memorandum submitted by Securities and Exchange Commission entitled "Statement of Securities and Exchange Commission with reference to Section 25 of the Proposed Investment Company Bill".....	976
Memorandum submitted by the Securities and Exchange Commission entitled "Redemption Provision of Open-End Companies".....	986
Memorandum submitted by Securities and Exchange Commission entitled "State Regulation of Investment Counsel Firms".....	997
Memorandum submitted by Securities and Exchange Commission entitled "Statutory Regulation of Investment Counselors, by research department, Illinois Legislative Council".....	1005
Memorandum submitted by Securities and Exchange Commission entitled "Constitutionality of Section 18 (d) of the Investment Company Bill".....	1018
Memorandum submitted by Securities and Exchange Commission entitled "Federal Power to Regulate Investment Advisers".....	1023
Memorandum submitted by Securities and Exchange Commission entitled "Provisions of the Proposed Bill Relating to Capital Structure (secs. 18, 19b, and 21c)".....	1026
Editorial submitted by Securities and Exchange Commission from "Christian Science Monitor, dated March 20, 1940".....	1045
Editorial submitted by Securities and Exchange Commission from "Springfield (Mass.) Republican, dated April 17, 1940".....	1046



## INVESTMENT TRUSTS AND INVESTMENT COMPANIES

FRIDAY, APRIL 12, 1940

UNITED STATES SENATE,  
SUBCOMMITTEE ON SECURITIES AND EXCHANGE OF  
THE BANKING AND CURRENCY COMMITTEE,  
*Washington, D. C.*

The subcommittee met, pursuant to adjournment on Wednesday, April 10, 1940, at 10:30 a. m., in room 301, Senate Office Building, Senator Robert F. Wagner presiding.

Present: Senators Wagner (chairman of the subcommittee), Hughes, Herring, Downey, Frazier, and Taft.

Senator WAGNER. The subcommittee will come to order. Mr. Arthur Bunker, of the Lehman Corporation, New York City, is the first witness, I believe.

Mr. Bunker, would you rather make your statement without interruption and then yield to questions?

Mr. BUNKER. I will be very glad to have questions as I go along with my statement.

Senator WAGNER. All right.

Mr. BUNKER. Shall I proceed?

Senator WAGNER. Yes.

### STATEMENT OF ARTHUR H. BUNKER, EXECUTIVE VICE PRESIDENT, THE LEHMAN CORPORATION, NEW YORK CITY

Mr. BUNKER. To identify myself, my name is Arthur H. Bunker. I am executive vice president of the Lehman Corporation, one of the largest closed-end investment companies——

Senator WAGNER (interposing). Will you please keep your voice up a little?

Mr. BUNKER. Keep my voice up a little?

Senator WAGNER. Yes; so everybody round the table can hear you.

Mr. BUNKER. I am executive vice president of the Lehman Corporation, one of the largest closed-end investment companies, having assets of about \$70,000,000 at the present time.

While my company was sponsored by an investment banking house, I have never been affiliated with that banking house and I am, and always have been, therefore, an independent officer and member of the board of my company.

The views which I shall express are those of myself and those of my company, and in an informal way, I believe, represent the views also of a committee of closed-end investment companies, of which I am chairman, a group that was formed a number of years ago. This group, as I say, was formed several years ago, at the request of the S. E. C. for the purpose of conveying in a more compact manner the

general views of our section of the "industry" if it may be so termed. Its character has remained entirely informal throughout.

My experience and my direct interest are confined to the closed-end section of the industry. Frankly, I am unfamiliar with many of the practices of the other sections. The closed-end section, I believe, represents one-half or more of all the capital engaged in the business.

At the outset I want to make it perfectly clear that I am in favor of Federal legislation for the regulation of investment companies. I favor such regulation to the extent necessary, and to the extent that it is possible by legislation, to prevent the recurrence of such abuses as have existed in the past or are likely to recur without such legislation. I am not a new convert to the idea of Federal legislation. I have recognized this necessity for many years.

Over 3 years ago, at the public hearings before the Securities and Exchange Commission, when my corporation was being examined in connection with the investigation of the industry, we proposed regulations which in the light of knowledge then available appeared adequate as a cure for such abuses as were then known to exist. They embraced, in general, a requirement for the most detailed publicity and disclosure, coupled with standard accounting practice. They formed the basis, incidentally, of our reports to our stockholders from that time on. We believe these reports can well be regarded as models of accuracy and clear accountancy. We concluded those recommendations with the hope that the Commission would cooperate with the industry in "developing workable regulations."

Since then, knowledge in the matter has expanded. By virtue of the 4 years' study made by the S. E. C., employing possibly 50 statisticians, lawyers, and accountants and spending possibly well over a million dollars, a mass of data on the subject of investment trusts has been assembled. This study disclosed material which could never otherwise have been available to any private group. I am free to admit that the disclosure of the abuses which have existed in the past among some investment companies, has brought home to me the necessity for a greater measure of regulation than I had originally thought necessary or desirable.

I believe, however, that we should proceed upon the basis that legislation for investment companies should go no further than is necessary to safeguard the interests of investors and that in the very interest of investors it should not interfere with the managerial functions one bit more than is necessary; it should not confiscate valuable existing contract rights of stockholders; and it should not interfere with the freedom of choice of the investor, except to that extent which may be clearly necessary in the public interest.

While it is certainly true that it is impossible to prevent by legislation the possibility of all wrongdoing, it is quite possible by legislation completely to hamstring and shackle the operations of investment companies to such an extent that their usefulness may cease to exist.

Now, gentlemen, we have been listening for the past 2 weeks to a sorry picture. I am sure you will believe me when I tell you that it has been no pleasure for me to sit here day after day and listen to the story of abuses which have existed in an industry of which I am a member.

Needless to say, I do not feel called upon to condone such abuses as the embezzlement of funds of investment companies by criminals any

more than the president of a bank would feel called upon to condone the embezzlement of bank funds just because he happened to be a bank president. Nor would I, or anybody else, think that an honorable bank president had to apologize because some officer of another bank had been guilty of larceny.

In the light of the story which you have heard, it would not be unnatural if there had been aroused in you a burning conviction that regulation of investment companies must be undertaken by the Federal Government, something which none of us denies, and then with these misdeeds in mind you might well fail to give the proposed regulations that careful scrutiny which all legislation requires. These abuses create a powerful impression.

Even Judge Healy, whose obvious desire to be scrupulously fair in the presentation of his case has won my admiration, has nevertheless allowed himself to state to the committee, after parading the picture of these misdeeds, that he believed he had presented "a fairly comprehensive picture of the investment trust industry and its characteristics." I can hardly believe that Judge Healy meant what he said, for the fragments of the industry which you have been shown came from only one side of it—its worst side.

Now, that is all you have heard, so I think I have a right to ask you to consider these abuses in their proper perspective. I think in fairness to the respectable elements of this business—which I can assure you are in the vast majority—and in fairness to the stockholders of this business, I have a right to ask you to examine with care each provision of the bill which is set before you; that you ask yourselves the purpose of each provision and whether it accomplishes this purpose, and whether in so doing it goes beyond the necessities and needlessly interferes with sound management discretion or with existing contract rights of stockholders, or with the freedom of choice which an investor has a right to insist upon except in those cases of overriding public necessity.

I think it would be constructive to review briefly the parade of abuses that the preceding testimony has revealed, and in a calm manner to see what lessons can be learned from them.

In the first place, there have been laid before you some shocking instances of abuse with respect to the selling of securities of investment companies. My experience has been confined to the closed-end field and I am not competent to analyze that testimony. This phase of the matter I am sure will be satisfactorily dealt with at length by representatives of the open-end investment companies. But I do feel that I can adequately review and throw further light upon the character of abuses which have occurred in the closed-end field.

We have listened to a recital of the criminal acts of embezzlers in the case of Continental Securities, and of the looting by thieves in connection with Reynolds Investing and other companies. Some of these people have already been convicted and sentenced. Others, we have been told, escaped through a miscarriage of justice. Even all murderers do not go to the gallows. However, if the law is deficient and further legislation is necessary to facilitate the conviction of criminals—naively described by some witnesses as "amateurs"—let such legislation be enacted.

Now, I do not feel and I do not say that conviction of criminals is a complete answer to the lesson of the *Continental Securities case* and

---