

Senator WAGNER. And the trustees are usually banks?

Mr. TRAYLOR. No. They are individual trustees.

Senator WAGNER. You say they are individual trustees?

Mr. TRAYLOR. Yes, sir.

Senator WAGNER. This is a sort of right of redemption, is it?

Mr. TRAYLOR. Yes; and the liquidating value is arrived at every day.

Senator TAFT. At the market value of the stock?

Mr. TRAYLOR. Yes, sir.

Senator WAGNER. What happens if the value of the stocks in the portfolio is fixed in the morning and there is a change in price?

Mr. TRAYLOR. They fluctuate.

Senator WAGNER. Suppose they go up, do the prices go up with them?

Mr. TRAYLOR. At the end of the day a new price is determined based on the closing prices of the securities.

Senator WAGNER. In that connection I was going to ask you about some testimony we have had here, whether that is widespread or whether it is unusual.

Mr. TRAYLOR. That varies. I expect to cover that subject later on, Mr. Chairman.

Senator WAGNER. Are you going to speak about that during your appearance here?

Mr. TRAYLOR. I expect to cover that subject in more detail a little later on.

Senator WAGNER. All right. I will wait for that.

Senator HERRING. Do you know of any open-end trusts that do not have voting trusts; I mean, any company that does not have a voting trust?

Mr. TRAYLOR. Very few have voting trusts.

Senator HERRING. You say very few have voting trusts?

Mr. TRAYLOR. Yes, sir.

Senator HERRING. All right.

Senator WAGNER (chairman of the subcommittee). You may proceed with your statement.

Mr. TRAYLOR. From this fee, however, the managers have to pay important expenses of administration, such as rent and the cost of adequate research and clerical facilities. Occasionally, management compensation comprises 5 or 6 percent of the annual investment income of the fund instead of a fee based on the value of assets. Such fees based on income correspond to the charges made by trust companies for continuing service as trustees under testamentary trusts in Massachusetts where this type of investment trust was first started. When fees are 5 or 6 percent of income, as this rate is materially lower than one-half percent of assets, the fee is net, that is, the administrative expenses described above are charged to the trust in addition.

Open-end trusts sell their shares on a continuing basis, to replace shares redeemed and to increase the size of the trust, just as life-insurance companies and savings banks continually solicit new business. It is well recognized in these fields that such institutions cannot maintain themselves in healthy condition without new business efforts. Larger size not only benefits the management and selling organization, but also benefits the shareholders by making possible a reduced ratio

of operating expense and improvement and extension of research facilities.

New shares are sold from day to day at a price based on liquidating value, plus a selling commission which is added to the price, and which averages about 7½ percent. This commission is not out of line with the odd-lot brokerage commissions and taxes that the investor would otherwise have to pay to obtain a diversified list of securities. It also covers all costs of distribution, including various expenses of the distributor made necessary by the Securities Act and the qualification of the shares under the blue-sky laws of various States. It also provides compensation for the distributing organization that wholesales the shares, investment dealers throughout the country who offer them at retail, and salesmen of such dealers who sell them to individual investors.

The management and sales activities of open-end trusts are usually combined under the sponsorship of the same group of individuals.

Open-end trusts have been well conducted: In the management and operation of open-end investment trusts, honest mistakes of judgment have been made. Practical experience revealed certain weaknesses in their original setups which had to be improved. Further improvements are currently being made. In fact, the chief characteristic of investment trusts of this type is that the whole theory of their organization and operation looks first to the protection of shareholders against violation of their rights and the safeguarding of shareholders' interests as effectively as possible.

Among the more important of the protective features designed to safeguard the interests of shareholders are the following:

(a) They issue very complete and frequent reports to shareholders, usually every 3 months, containing independently audited financial statements including detailed income and expense statements, a list of securities owned and a schedule of all purchases and sales during the period under review. As a result, shareholders have the opportunity to judge for themselves how their interests are being served.

(b) The liquidating value of the shares is determined and published at least once every day, and thus a shareholder may know at any time the liquidating value of his interest in the company.

(c) With the exception of the leverage companies, which account for about 6 percent of the total assets of the industry, capitalization of an open-end company consists entirely of common stock with equal rights in all respects. There are no stock bonuses for management and no promoter interests. Accordingly, each shareholder's proportionate interest is determined solely on the basis of the number of shares owned.

(d) An open-end company does not seek to obtain control, or inject its influence into the affairs of a company in whose securities it invests except in the interests of their shareholders. Restrictions providing that no more than 5 percent of the assets of an open-end company can be invested in the securities of any one company, and that the trust may not acquire more than 10 percent of the outstanding stock of any one company, not only prevent the realization of any such aim, but they also reflect the spirit of their operation.

(e) Neither management companies, nor distributing companies, nor persons in any way affiliated with such companies, deal with

open-end companies as principals in the buying and selling of portfolio securities.

(f) The objective of most of these companies is not speculative profits but satisfactory long-term investment results with respect to both income and principal.

(g) Securities and cash comprising the assets of these companies are held in the custody of an independent agent, usually a bank or trust company.

(h) There are usually restrictions against borrowing, trading on margin, and short selling.

(i) The managements of these companies are compensated strictly on a fee basis, usually one-half of 1 percent annually of the average asset value, or sometimes a fixed percentage of investment income corresponding to the charges of trust companies for similar services.

These are important, practical safeguards developed over a period of years by responsible people in the industry whose aim has been to make open-end companies sounder and safer investment mediums. We have no objections, if it seems desirable, to requiring all open-end trusts to provide such safeguards as these.

The findings of 4 years of research and study by the S. E. C. investigating staff, as recorded in thousands of pages of testimony, statistics, and compilations, stand in support of the contention that these open-end companies, have as a group a record of clean and meritorious operation. This, it is believed, is deserving of thoughtful consideration before any legislation is enacted that might seriously endanger their continued successful operation, to the detriment of their hundreds of thousands of shareholders, whose average investment is not much over \$1,000.

Objections to the proposed bill: This bill goes far beyond anything needed to cure abuses. Although professing to attain relatively simple and sound objectives, the bill is a highly complicated piece of legislation. It involves many controversial questions and subjects the investment-trust business to objectionable censorship, red tape, and bureaucratic control, much of which is mere duplication of procedure already required under the Securities Act of 1933 and other existing laws. The bill also places on distributors of investment-company shares burdensome restrictions that are not applied to the distribution of other types of securities, and to this extent represents unfair discrimination against the investment-trust business.

Moreover, the discretionary powers and delegations of legislative authority given to the S. E. C. under the terms of the bill are dangerously broad. An analysis of the bill reveals at least 51 separate and specific delegations of discretionary authority to the Commission, plus a blanket provision that gives the S. E. C. the right to issue rules, regulations, or orders of any kind that the Commission deems necessary or appropriate. If the bill is passed in its present form, Congress will be giving the S. E. C. carte blanche to regulate the investment-trust business in virtually any way it sees fit. It is difficult to see how anyone can successfully run a business subject to personal regulation dictated by a constantly changing Commission personnel.

The bill arbitrarily limits the size of investment companies at figures far below the existing size of many other types of financial institutions. This size limitation is imposed in spite of the fact that the S. E. C.'s long investigation did not indicate that size was any

handicap to successful operation. Quite the contrary, the record shows clearly that large size brings substantial benefits to shareholders in the form of lower operating costs. Nor is there any basis for the belief that size, in the case of open-end funds, involves any undesirable concentration of economic control; because trusts of this type, qualifying as mutual companies under the Revenue Act, cannot hold more than 10 percent of the stock of any corporation, no matter how large such trusts may be.

The bill also limits the amount of funds that may be managed by any one group. This is done by preventing the same group of individuals from being the controlling directors of more than one company. This latter provision will destroy, for no good reason, many long-standing business arrangements. In this country, as well as in Great Britain, several companies have frequently been built up and are today managed by the same group. For example, Robert Fleming & Co., whose late founder was the acknowledged dean of investment trust managers in Great Britain, has under its sponsorship a large number of investment trusts with assets running into high figures. Calvin Bullock, Inc., is interested in some five or six different companies. The trustees of Massachusetts Investors Trust also manage another company.

The bill also limits the right of an individual who has participated in organizing one company to participate in the organization of another company except with the approval of the S. E. C. We regard this as a restriction of the right of any businessman to organize legitimate business ventures as often as he wishes. The bill also denies investment companies in the future the right to issue senior capital, i. e., bonds or preferred stocks.

The provisions of the bill regulating the voting rights of security holders are so sweeping as to require a complete departure from the theory of continuity of management, upon which a number of long-established investment companies, which were organized as voluntary associations or trusts, have been built up and their securities acquired by investors. These provisions go much further than the best interests of their shareholders require.

Senator TAFT. The question of stockholders, that you dealt with, presents this point about which I should like to inquire: Will you have to change all your rules to provide for voting, in the case of trusts?

Mr. TRAYLOR. Some of these trusts have been in existence for 16 years. Mr. Griswold, who is chairman of the Massachusetts Investment Trust, the largest open-end trust of that type, will cover that point thoroughly, I think, Senator.

Senator TAFT. I see.

Mr. TRAYLOR. I think part of that will be dealt with this morning.

Senator TAFT. You just mentioned your objection to the rule that there shall be only one type of securities. What is your objection to that?

Mr. TRAYLOR. I think 90 percent of the open-end industry is made up of companies with only one class of securities. There are leverage companies in the open-end field.

Senator TAFT. Do you see any particular advantage in that, so far as open-end companies are concerned?

Mr. TRAYLOR. I certainly do not think it should be prohibited.

Senator TAFT. Why not?

Mr. TRAYLOR. If an investor wants to buy a senior security in a trust of that kind, I think he should have the right to do so. If he wants a more speculative security, more so than the ordinary trust share, I think he should be permitted to buy it.

Senator TAFT. Would you limit the percentage?

Mr. TRAYLOR. Yes; I think there should be something of that sort.

Senator TAFT. Do you mean not over a third of total assets, for instance?

Mr. TRAYLOR. Yes; something like that.

The restrictions provided in the bill as to who may serve as an investment trust director are so complicated as to defy analysis and seem, moreover, highly inconsistent. An investment banker or broker, for instance, may serve as a director of one trust but not of another trust that is not in the same system. If the S. E. C. feels that such an individual, because of possible conflicts of interest, would not make a satisfactory investment company director—a theory to which we do not subscribe—why is he allowed to serve at all? Why is he satisfactory in one case and not in another?

The bill also states that no director of an investment company can serve as a director of any corporation, less than 5 percent of the stock of which is held by the trust. If the trust, however, holds more than 5 percent, he is allowed to serve in that dual capacity. In other words, if the holding is large, so that the trust might be in a position to exercise undesirable influence or control, the arrangement is allowed; but when the holding is small, and no question of control or undue influence is involved, it is not permitted. This prohibits many of the country's best qualified men from serving on trust boards.

The general effect of all the provisions of the bill on the subject of directors will be to reduce substantially the number of qualified men who can or will accept directorships in investment companies.

Senator WAGNER. Mr. Traylor, may I ask you a question, at that point?

Mr. TRAYLOR. Yes, Senator.

Senator WAGNER. Do you think there ought to be any requirement that there be some independent directors, even though they may represent only a minority of the directors?

Mr. TRAYLOR. Well, in all my experience in this business I have seen no need for it.

Senator WAGNER. You heard Mr. Bellamy's testimony yesterday?

Mr. TRAYLOR. Yes, Senator, I did.

Senator WAGNER. He seemed to think that would be very healthy and very desirable. What is your opinion?

Mr. TRAYLOR. I think that is the opinion of a number of people in the business. I think it is also the opinion of many others that, with the years of experience they have had in the business, they see no need for it, whatever.

We believe that the industry genuinely wants legislation to prevent abuses and require uniform observance of high standards of operation. Such legislation would be most helpful to honest business, as it would reduce to a practical minimum the opportunity for malpractice or abuse and thereby weed out insofar as is practically possible the fringe element of unsound or dishonest individuals who, as in any business or profession, characteristically endeavor to exploit sound

ideas to their selfish and undeserved personal advantage. At the same time, it would help rather than jeopardize the preservation of the soundest principles and highest standards that the industry has developed in its 16 years of existence.

Other members of the open-end trust business, who will follow me, will give you more detailed criticisms of the specific provisions of the bill.

Senator WAGNER. Mr. Traylor, you said that legislation is desirable. Are you prepared to submit to the committee any suggestions of your own, instead of mere criticism of its present form?

Mr. TRAYLOR. I am in thorough accord with certain suggestions that I expect will be made by Mr. Griswold.

Senator WAGNER. I see.

Mr. TRAYLOR. And I think I am in thorough accord with the suggestions that will be submitted by Mr. Paul Cabot, who will follow me.

Senator WAGNER (chairman of the subcommittee). Very well; thank you very much.

Mr. TRAYLOR. Incidentally, Senator, would you like to have in the record this list giving the classification of investment trusts?

Senator WAGNER. Yes; thank you. It will be placed in the record.

(Document entitled "Investment Trust Classification, Gross Assets at Market, December 31, 1939, of Closed Management and Open-end Management Companies" is as follows:)

Investment-trust classification—Gross assets at market Dec. 31, 1939, of closed-management and open-end management companies

[Based on Moody's Bank and Insurance Manual for 1939, adjusted as noted where Moody's classification no longer is applicable, due to changes in charter provisions. Canadian companies, and a few other companies, believed to be small, where balance sheets at market were not available, have been omitted]

OPEN-END MANAGEMENT COMPANIES

A. Without senior capital:	<i>Total assets</i>
Administered Fund Second, Inc.....	\$1,797,000
Aeronautical Securities, Inc.....	677,000
American Business Shares, Inc.....	6,613,000
American Foreign Investing Corporation ¹	794,000
American General Equities, Inc.....	167,000
American Securities Shares.....	184,000
Aviation Capital, Inc.....	517,000
Boston Fund, Inc.....	7,100,000
Broad Street Investing Corporation.....	7,445,000
Bullock Fund, Ltd.....	2,299,000
Canadian Investment Fund, Ltd.....	10,096,000
Central Investors Corporation.....	70,000
Century Shares Trust.....	12,949,000
Chain Store Investors Trust.....	119,000
Chemical Fund, Inc.....	7,390,000
Commodity Corporation.....	362,000
Commonwealth Investment Co.....	1,755,000
Delaware Fund, Inc.....	748,000
Diversified Investment Fund.....	389,000
Dividend Shares, Inc.....	46,423,000
Eaton & Howard Management Fund A-1.....	2,216,000
Eaton & Howard Management Fund B.....	713,000
Eaton & Howard Management Fund F.....	587,000
Equitable Investment Corporation of Massachusetts.....	224,000
Equity Fund, Inc.....	2,195,000
Fidelity Fund, Inc.....	4,001,000
Financial Security Fund, Inc.....	1,096,000
First Mutual Trust Fund.....	2,358,000

¹Formerly Foreign Bond Associates, Inc.

Investment-trust classification—Gross assets at market Dec. 31, 1939, of closed-management and open-end management companies—Continued

OPEN-END MANAGEMENT COMPANIES—continued

A. Without senior capital—Continued.

	<i>Total assets</i>
Fiscal Fund, Inc.:	
Bank stock series.....	\$687,000
Insurance stock series.....	1,509,000
Fundamental Investors, Inc.....	8,903,000
General Capital Corporation.....	3,743,000
General Investors Trust.....	2,007,000
George Putnam Fund.....	2,436,000
Group Securities.....	6,617,000
Income Foundation Fund, Inc.....	1,607,000
Incorporated Investors.....	48,999,000
Institutional Securities, Ltd.....	2,955,000
Investment Co. of America.....	4,413,000
Investment Trust Fund B.....	1,669,000
Investors Fund C, Inc.....	5,750,000
Keystone Custodian Funds, Certificates of Participation (various series).....	22,020,000
Loomis-Sayles Mutual Fund, Inc.....	2,333,000
Loomis-Sayles Second Fund, Inc.....	7,712,000
Manhattan Bond Fund ²	3,929,000
Manhattan Bond Fund ²	3,929,000
Maryland Fund, Inc.....	6,620,000
Massachusetts Investors Trust.....	123,111,000
Mutual Investment Fund.....	2,114,000
Nation-Wide Securities Co. (Maryland).....	4,225,000
National Investors Corporation (Maryland).....	14,937,000
New England Fund.....	3,479,000
New York Stocks, Inc. (various series).....	10,864,000
Plymouth Fund, Inc.....	63,000
Premier Shares ³	836,000
Public Investing Co.....	383,000
Scudder, Stevens & Clark Fund ⁴	11,693,000
Selected American Shares, Inc.....	9,631,000
Shareholders Corporation.....	702,000
Sovereign Investors, Inc.....	470,000
Spencer Trask Fund, Inc.....	3,405,000
State Street Investment Corporation.....	39,382,000
Supervised Shares, Inc.....	8,595,000
Third Investment Counsel Corporation.....	999,000
Trusteed Industry Shares.....	5,203,000
Wellington Fund, Inc.....	5,219,000
Wisconsin Investment Co. ³	1,569,000
World Investment Trust.....	118,000
Bay State Fund, Inc.....	
Bond Investment Trust.....	
Bond Investment Trust of America.....	
Burlingame Reserve Plan, Inc.....	
Collateral Equities Shares.....	
Fiduciary Fund, Inc.....	
Financial Shares Corporation.....	
First Management Foundation.....	
Lexington Trust Fund Shares.....	
Market Street Investment Corporation.....	
Middle States Securities Corporation.....	
Mutual Income Foundation.....	
New York-Buffalo Trading.....	
Standard Utilities, Inc.....	
U. S. Electric Light & Power Shares, Inc. (Md.).....	
Total open-end management companies (A) without senior capital.....	507,191,000

¹ Formerly Manhattan Fund, Inc.

² Reclassified.

³ Formerly First Investment Counsel Corporation

⁴ Estimated.

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Investment-trust classification—Gross assets at market Dec. 31, 1939, of closed-management and open-end management companies—Continued

OPEN-END MANAGEMENT COMPANIES—continued

	<i>Total assets</i>
B. With senior capital:	
Affiliated Fund, Inc.....	\$23,397,000
Quarterly Income Shares, Inc.....	21,795,000
Comsec Corporation.....	
Managed Estates, Inc.....	
Republic Investors Fund, Inc.....	
	} ⁵ 2,000,000
Total open-end management companies (B) with senior capital.....	<u>47,192,000</u>
Total, open-end management companies.....	<u>554,383,000</u>

CLOSED-MANAGEMENT COMPANIES

A. Without senior capital:	
Bankers National Investing Corporation ⁶	7,263,000
Boston Personal Property Trust ⁶	4,426,000
Connecticut Investment Management Corporation.....	701,000
Consolidated Investment Trust.....	14,409,000
First York Corporation.....	3,880,000
Goodall Securities Corporation.....	2,623,000
Gude Winmill Trading Corporation.....	242,000
Inland Investors, Inc.....	2,179,000
Insuranshares Certificates, Inc.....	5,157,000
Investment Corporation of Philadelphia.....	1,317,000
Lehman Corporation.....	68,618,000
Liberty Share Corporation.....	615,000
Morristown Securities Corporation.....	1,175,000
National Aviation Corporation.....	8,801,000
National Bond & Share Corporation.....	10,797,000
Oilstocks, Ltd.....	984,000
Petroleum Corporation of America.....	22,183,000
Prudential Investing Corporation.....	1,330,000
Rochester Capital Corporation.....	1,085,000
Rockwood Associates, Inc.....	631,000
Selected Securities Corporation.....	1,760,000
Shawmut Association.....	7,108,000
Tobacco & Allied Stocks, Inc.....	4,996,000
Union County Corporation.....	550,000
Western New York Securities Corporation.....	740,000
Brooklyn National Corporation.....	
Cambridge Investment Corporation.....	
Consolidated Assets Co.....	
Consolidated Equities, Inc.....	
Diversified Investment Trusts, Inc.....	
Gary First National Corporation.....	
Insuranshares Corporation of Delaware.....	
Interbanc Investors, Inc.....	
Investors & Traders, Inc.....	
Managed Investments, Inc.....	
Retail Stores Corporation.....	
Sisto Financial Corporation.....	
	} ⁵ 6,000,000
Total, closed-management companies (A) without senior securities.....	<u>179,570,000</u>

⁵Estimated.
⁶Reclassified

Investment-trust classification—Gross assets at market Dec. 31, 1939, of closed-management and open-end management companies—Continued

CLOSED-MANAGEMENT COMPANIES—continued

B. With senior capital:	<i>Total assets</i>
Adams Express Co.....	\$29,126,000
Air Investors, Inc.....	1,271,000
Aldred Investment Trust.....	4,181,000
Alliance Investment Corporation.....	1,616,000
American Capital Corporation.....	5,208,000
American European Securities Co.....	11,155,000
American General Corporation.....	23,964,000
American Insuranstocks Corporation.....	733,000
American International Corporation.....	18,733,000
Amoskeag Co.....	12,511,000
Bankers Investment Trust of America.....	884,000
Blue Ridge Corporation.....	36,256,000
Burco, Inc. (Sept. 30).....	395,000
Capital Administration Co., Ltd.....	5,658,000
Carriers & General Corporation.....	5,890,000
Central-Illinois Securities Corporation.....	3,684,000
Chartered Investors, Inc.....	5,815,000
Chicago Corporation.....	31,978,000
Commonwealth Securities, Inc.....	2,296,000
Eastern States Corporation (Md.).....	3,323,000
Federal United Corporation.....	884,000
Foresight Foundation, Inc.....	268,000
General American Investors Co., Inc.....	30,320,000
General Shareholdings Corporation ⁷	17,427,000
General Investment Corporation.....	2,723,000
General Public Service Corporation.....	4,533,000
Guardian Investors Corporation.....	1,304,000
Illuminating & Power Securities Corporation.....	8,698,000
Manhattan Financial Corporation.....	1,691,000
Niagara Share Corporation of Maryland.....	30,059,000
North American Investment Corporation.....	3,538,000
North American Utility Securities Corporation.....	5,423,000
Old Colony Investment Trust.....	4,348,000
Overseas Securities Co., Inc.....	2,097,000
Pacific Southern Investors, Inc.....	7,269,000
Penn Investment Co.....	364,000
Pennsylvania Bankshares & Securities Corporation.....	2,081,000
Pennsylvania Industries, Inc.....	5,217,000
Petroleum & Trading Corporation.....	2,027,000
Prudential Investors, Inc. (Delaware).....	9,122,000
Railway & Light Securities Co.....	9,600,000
Railway & Utility Investing Corporation.....	389,000
Reynolds Investing Co., Inc.....	3,034,000
Second Investors Corporation.....	1,049,000
Security Investment Trust, Inc.....	468,000
Selected Industries, Inc.....	33,847,000
Shawmut Bank Investment Trust.....	3,190,000
Tri-Continental Corporation.....	33,052,000
United States & Foreign Securities Corporation.....	36,312,000
United States & International Securities Corporation.....	29,955,000
Utility Equities Corporation.....	7,761,000
Utility & Industrial Corporation.....	2,337,000
Western Reserve Investing Corporation.....	1,998,000

⁷ Formerly Electric Shareholdings Corporation.