GENERAL INVESTORS TRUST,
Boston, Mass., April 16, 1940.

Mr. RICHARD TALIAFERO,
c/o WILLIAM W. MACKALL, JR.,
Woodward Building, Washington, D. C.

DEAR MR. TALIAFERO: The Trustees of General Investors Trust have read with a great deal of interest a copy of the statement which, we understand, you are to make at the hearings before the Senate Banking and Finance Committee, now being held in Washington, relative to proposed investment trust legislation.

We wish to take this opportunity to assure you that we are thoroughly in accord with the principles, which you outline in your statement, in which you refer to the workings of the Ohio regulations relative to investment trusts known as Q–3. We are qualified in Ohio under these regulations.

We feel that your suggestion is constructive. The present Senate bill, S. 3580, would, in our opinion, work tremendous and unnecessary hardship on our stockholders and would greatly impede the proper and sound management of our fund.

Very truly yours,

JOHN H. SHERBURNE,
For the Trustees.

HILL, BARLOW, GOODALE & WISWALL,
Boston, Mass., April 16, 1940.

Mr. RICHARD N. TALIAFERRO,
c/o Mr. WILLIAM W. MACKALL, Jr.
Woodward Building, Washington, D. C.

DEAR MR. TALIAFERRO: As counsel for New England fund and as one of its trustees, I have read a copy of the statement which you propose to make before the congressional committee which is considering legislation to regulate investment companies.

There has been no opportunity since reading your proposed statement for me to submit a copy to any meeting of our trustees for formal action, but I am convinced from informal conversation with some of my cotrustees, that they are in entire agreement with your recommendations.

To be more specific I understand these recommendations to be in substance—

First. That separate regulatory provisions should be applied to the five types of investment companies mentioned by you; the regulations applicable to each type to be appropriate to investment companies of that specific type.

Second. That in the regulation of investment companies of the open-end management type, of which New England fund is an example, the experience of State regulatory bodies which have had long experience in actual regulation, should be drawn on by the committee. I consider the Ohio regulations, known as Q–3 to be a valuable model for the regulation of open-end investment companies in a manner which, while stringent, is nevertheless consistent with practical operation of a sound and honestly managed investment company.

I may add, for purposes of identification, that New England fund is a Massachusetts common law trust organized in 1931 as Mutual American Securities Trust. It has, in round figures, $3,300,000 in assets with no outstanding bonds or other liabilities other than routine, current operating expenses of negligible amount, accrued during the current month. It has outstanding 257,763 shares held by some 1,700 or more widely scattered holders.

Let me add further that the trustees of New England fund do not object but, rather, welcome the regulation of investment companies, including reasonable limitations of size. They ask only that regulations be intelligently and carefully framed in such a manner as to accomplish the elimination of abuses without imposing on sound and well-managed companies needless and expensive requirements which would handicap legitimate operations and which, by their complexity and expense would perhaps eliminate all but the larger companies.

Very truly yours,

FRANCIS G. GOODALE.

Senator WAGNER (chairman of the subcommittee). Secretary Adams, please.

STATEMENT OF HON. CHARLES F. ADAMS, BOSTON, MASS.

Senator WAGNER. Mr. Secretary, we are glad that you are here.

Mr. ADAMS. Senator Wagner, and members of the committee: I appear here as a citizen whose life work has largely been devoted to the management of other people's property, in a fiduciary capacity. In addition to acting as trustee under a good many investment trusts, I served for 30 years as treasurer of Harvard College. In that capacity, I was the chief financial officer of the college and a member of the governing board of seven. Subject to the directions of that board, I had charge of the funds of the university. Since 1894, I have been one of the trustees of Boston Personal Property Trust, probably the oldest investment trust in this country. It is a closed trust, and its affairs are conducted by a board of five trustees who are not elected by the shareholders, vacancies being filled by the remaining trustees. I am also a director or trustee of several other investment trusts and corporations, both open-end and closed, and a member of the advisory board of Massachusetts Investors Trust, which is, I think, the largest and oldest of the open-end companies. During this period, I have served on the boards of directors of a good many other companies, such as the American Telephone & Telegraph Co., the Boston Edison Co., Eastern Gas & Fuel Associates, and the General Electric Co., and I am chairman of the board of directors of the State Street Trust Co. of Boston. During these years it has frequently and inevitably come about that funds, for the management of which I was jointly responsible with others, have been invested in the securities of companies of which I am a director and from time to time, for one reason or another, such securities have been sold.

Such being my experience and such being the activities in which I am interested, I am naturally concerned with any proposed legislation which may affect the best way of handling the problems before us, in the public interest. I have not read this bill through. It is long and complicated. I think I have a pretty good general idea of what it seeks to accomplish and how it seeks to accomplish it. I have experience which may be of value to you and opinions which I should be glad to express in response to any particular questions which might be asked me by members of your committee; but I do not propose, nor am I prepared, to offer specific comments on most of the details of the bill as written.

There is, however, one section of the bill which has been brought to my particular attention, and that is section 10, which undertakes to do away with conflicts of interest on the part of persons connected in various capacities with the management of investment companies. Forty-six years of experience have proved to me that such conflicts are rare and unimportant and that the injury to the best conduct of industry by this section 10 is very important. The particular part of that section of which I want to speak is subsection (e) found on page 25 of the bill, which would make it unlawful for any director or officer of an investment company to serve or act as director or officer of another company, any security of which is owned by the investment company if, first, the investment company owns less than 5 percent of the voting securities of the issuing company, or, second, the director

or officer in question is an investment banker or broker or affiliated with an investment banker or broker.

I am not an investment banker or broker and never have been, so I do not propose to go into that particular phase of it. I am, however, a director of a number of companies, some of them very large companies, securities of which are owned by the investment companies, or other funds of which I am a trustee or director, and I have found myself in that position in a great many instances over a considerable number of years. I am distinctly one of the culprits against whom this particular provision of the bill is directed. So I submit myself to your questioning because you and I want to know whether or not it is better for this practice to continue.

It is easy to state a hypothetical case in which one placed in the position which I have described might be embarrassed or given an opportunity for improper action, and it may be that actual cases can be cited in which it would have been better for all concerned if the so-called conflict of interest had not existed. All I can say is that in my many years of experience, I have never found the position embarrassing or improper and I do not think that any trust or corporation with which I have been connected has ever suffered from the fact that I was in that position. I am confident that the relation has on the whole been in the public interest. I therefore feel very strongly that the possibility of any harm arising out of this situation is so remote that it does not in any way justify the laying down of such a rule as this, which I believe would tend to injure the best interests of investors to an extent far greater than any good which it could possibly do.

Please remember that I should not be in any of these positions unless my reputation gave confidence to stockholders, unless they wanted me to serve them. Moreover, the experience which I have accumulated, both on boards of industrial and other companies and on boards whose principal duty is the investment of money, has doubtless made me more useful on other boards. Perhaps I should apologize for speaking so much in the first person, but I present myself merely as an exhibit. There are plenty of other men in the same situation, whose value to the funds which they help to manage and to the companies on whose boards they serve is doubtless greater than mine. I feel that the provision of the proposed bill which I have been discussing would disrupt a great many valuable existing relationships and prevent a great many valuable new relationships, to the detriment of the investment public. May I give an example of this injury?

The difficulty, and essential importance to industry and our country, of securing directors of experience, character, and intelligence is great. The importance is obvious and essential.

Where can you find them? You generally have to look among stockholders. Many do not want to serve. The responsibility is great, the risk is considerable, the pay is small.

It is not desirable to use the office boy or his equivalent, for obvious reasons.

It is not desirable to hire at considerable salaries directors who have no interest. They tend to justify their salaries by bossing a good executive until initiative is gone and each director is a focus for the discontented. You would not think well of a President of the United States bossed by a Cabinet who controlled him.

Without more detail, the most important single job of a director is to watch for signs of failure, mentally or morally, of the chief executive and to bring about a change when necessary.

Then wisdom and experience and position are necessary, backed by holdings of stock. Do not rob industry of such essential men, to avoid a rare and fancied risk which can readily be cured by barring interlocking control.

I also understand that section 9 of the bill requires every person who acts as an officer or director of a management investment company to be registered with the S. E. C. Apparently, the purpose of this is to permit the S. E. C. to weed out those who have criminal records or have been enjoined from carrying on certain types of financial business. That may be all right, and I have no particular objection to being registered; but when I read that my application

> shall contain such information and documents, in such form and such detail, as to such person and affiliated persons of such person, as the Commission may by rules and regulations prescribe as necessary or appropriate to effect the purposes of this title

(p. 21), I cannot help wondering just how far the Commission is going to think it necessary or appropriate to go in requiring information and documents not only as to my own personal affairs but as to the affairs of my partners, if I had any, and other companies in which I may have a 5-percent interest or in which I may be a director. Perhaps the information required may be comparatively simple and easy to furnish, but certainly the power granted to the Commission is so broad that if it were to be employed unreasonably it might be a very serious deterrent to persons of the utmost integrity and ability from accepting positions as trustees or directors of investment companies. I see no good reason for the delegation of such authority as this to the S. E. C. if the only purpose is to enable them to eliminate those whose public records brand them as grossly unfit.

Then, again, it has been pointed out to me that section 30 (e), on page 69, requires all directors and officers of an investment company to report quarterly to the board of directors their own transactions in securities in which the company had any transactions during the quarter. I am told that the purpose of this is to prevent officers and directors from taking unfair advantage of their beneficiaries by acting on information which may come to them in advance of such action being taken by the trust which they are supposed to be serving. Well, I suppose that there are or may be men serving as officers or directors of trusts who would act in this way, although I have never had the misfortune to serve on investment-company boards with men of that type. The point, to my mind, is whether it is wise to make a rule which assumes that men would so act unless deterred by the necessity of disclosing their actions to their associates. I think it would be very distasteful to many men of the highest type to be required to make such disclosures. It would tend to turn a directors' meeting into a discussion of one another's private affairs. Moreover, as the bill reads, it is not clear that it does not require the disclosure of transactions carried on by directors in a fiduciary capacity. I certainly do not feel that I should be asked to recite to the directors or trustees of one investment company the transactions that I may have participated in for another company or for a testamentary trust of which I may be a trustee. I do not think it would be proper for

me to make such disclosures. This seems to be one of those features, of which I fear there are many in this bill, by which—in order to head off improbable abuses—burdensome and distasteful regulations are imposed upon men who are trying to give of their best to those whom they are appointed to serve. I think such regulations tend to deter the best men from accepting those fiduciary positions and I do not believe that the good which such regulations might possibly do in some instances is sufficient to outweigh the harm which this sort of regulation is going to do to the character of investment-trust management.

Senator WAGNER (chairman of the subcommittee). Thank you very much, Mr. Secretary.

Mr. ADAMS. Are there any questions you would like me to answer?

Senator WAGNER. Well, I think you have stated your views.

Mr. ADAMS. Thank you.

Senator WAGNER (chairman of the subcommittee). Dr. Sprague, please.

STATEMENT OF OLIVER M. W. SPRAGUE, BOSTON, MASS.

Senator WAGNER. Dr. Sprague, we are delighted to hear from you regarding the pending legislation.

Mr. SPRAGUE. Thank you, Senator.

My name is Oliver M. W. Sprague. I am a member of the advisory board of the Massachusetts Investors Trust; and I shall take but a few moments of your time. I merely wish to amplify and qualify certain evidence which I gave in 1936 that had to do with the size of investment trusts. In my evidence I was rather exploring the subject of investing trusts and indicating some of the complexities of handling trusts. At that time I was rather impressed by the rather rapid growth of the Massachusetts Investors Trust, and various other trusts; for I think that in 1935 and 1936 the growth was more rapid that at any time except in the period just before the collapse in 1929.

I was impressed a little at that time with the possible difficulties that might present themselves in connection with the rapid inflow of funds. That is the sort of difficulty that presents itself in the case of any business when it experiences an unexpected, rapid growth in its business. I think that some of the machine tool companies are in that position at the present time.

I had no idea that the suggestion would be made the basis for legislation. It was simply a business problem.

Well, Senator, in reflecting upon our experience since that time, I am unable to think of any period during which our judgment in the matter of investing seems to have been appreciably and undesirably affected by the rather rapid inflow of funds at that time. Since 1937 there has been no such growth.

It does not, then, seem to me that the contingency of rapid growth of a trust requires legislation; and the passage of this bill would not provide legislation affecting rapid growth. However, I think that the observations which I made about rapid growth are in part responsible for the provision limiting size.

Now, Senator, I was inclined some years ago to think that size might be a disadvantage in making the best possible investments.

I do not think so now, after 4 years of further experience. The reason I was inclined to think so then, I rather think, was this: that I was attaching more importance to trading profits, to moving out into different securities, than I would do now. After 4 years of further experience it is my opinion that income considerations are of overshadowing importance in the proper conduct of an investment trust, particularly one of any considerable size; and I rather think that a large investment trust is pretty certainly more influenced by pure income considerations than a smaller trust need be.

We change our securities from time to time; but my impression is that we change them because we come to think that the prospects of a particular industry are not so good as they seemed formerly or because we are dissatisfied with the management of a particular company or possibly because we think that the price of a given security has reached pretty dizzy heights.

However, with a company having assets of over a hundred million dollars, I think we are likely to feel that there is not much in it for us—the mere play of the market, meeting various mild fluctuations in the stock list.

So, Mr. Chairman, if you want highly conservative management of investment trusts, I think you make a mistake if you attempt to provide for a multitude of trusts of small size, with a very large number of separate management groups.

That, I think, is about all that I have in mind to say, in amplification of what I said about the size of companies. It is perhaps simply repetitious to say that investment is not a simple matter, that the number of people available for the satisfactory handling of investments is not indefinitely large; and so I should concur with what Mr. Adams said a moment ago: that measures calculated to eliminate a very considerable number of competent people from the service of investment trusts would not seem to me to promise very much for the investor, even though here and there, as an incidental result, you might eliminate some instances of abuse of power and relationship.

Senator, I think that covers all that I had in mind to say.

Senator WAGNER. Thank you.

Doctor, undoubtedly you did read about some of the testimony presented here, showing some very tragic abuses and improper practices. Perhaps the question almost answers itself; but if there is some regulation that can prevent such practices and can prevent the recurrence of those abuses which resulted in large losses to small investors, and without in any way interfering with the responsible and legitimate operations of investment trusts, do you not agree that such steps certainly ought to be taken?

Mr. SPRAGUE. Oh, I entirely agree.

Senator WAGNER. Yes.

Mr. SPRAGUE. Such matters as the pyramiding or complicated security arrangements seem to me to be always inadvisable, whether they be in investment trusts or in the match business.

Senator WAGNER. Yes.

You were talking about responsible directors and managers. Of course, I concur in everything you say about that. However, I am sure you remember that in some of these instances of manipulations of trusts or purchase of trusts—even without any funds—there were substitutions of directors arranged whereby mere dummies were put

on the board of directors, under circumstances where these dummy directors would do what the other directors wanted to be done. This gave rise to a situation where large losses resulted, as of course you know. All that happened because there was no regulation at all to prevent it; and I understand that in one instance one of the dummy directors was just a bartender, who was put in there as a director because he would do what the other directors wanted done. Very large losses resulted from such situations, as you know.

Mr. SPRAGUE. Yes, quite.

Senator WAGNER. Certainly it is our duty to do what we can to prevent the recurrence of a situation of that kind or to make it as difficult as possible for such a state of affairs again to exist.

Mr. SPRAGUE. I quite agree; but I should think—and I am not a lawyer—that the measure included, in order to accomplish this, in its present form threatens to eliminate a large number of serviceable people.

Senator WAGNER. Of course, we do not want to do that; and, as I say, we want to find a means of preventing those abuses without interfering with the legitimate operations.

Mr. SPRAGUE. We now have more publicity than in the case of a great many of those instances to which you refer.

Senator WAGNER. Yes.

Mr. SPRAGUE. But I am not implying that there should be no regulation. I am rather concentrating on the mere question of size.

Senator WAGNER. Yes, I understand that.

Mr. SPRAGUE. And then I happened to drift into this matter of management.

Senator WAGNER. Yes.

Mr. SPRAGUE. It is suggested to me that I criticized small trusts, in what I said a moment ago. I did not wish to criticize them. I merely wished to say that if the interest of the investor is one of making trading profits or if he expects trading profits to be made, then I think he would better invest in a smaller-sized trust, because I do not think the large kind is suitable for that particular sort of profit; and, as one of the witnesses already said here, this morning, there are different objectives of different groups of investors. I might personally be interested in a highly conservative investment trust but also might be quite willing to put a few dollars into one that I knew was seeking to make trading profits.

I do not say that the small trust will be speculative; I am simply saying that I think the large ones almost inevitably must be conservative because they have necessarily large blocks of securities which make it altogether impracticable to make profits from playing the market.

Senator WAGNER. There is one other question I was going to ask you, that I had forgotten.

Mr. SPRAGUE. Yes.

Senator WAGNER. As a general proposition, I am asking this only because I know you are a scholar on all these subjects and a recognized authority: You agree with me that investment trusts have a real and very important place in our economic life? Don't you think so?

I mean that I should think more and more people are coming to this idea of investing in diversified securities—particularly the small investor who is not in a position to inform himself as to what particu-

lar investment would be wise, or has not enough money to spread it around by the purchase of different securities?

Mr. SPRAGUE. Yes.

Senator WAGNER. It seems to me that an investment trust would be a very attractive form of investment, for that particular individual—and there are very many of them?

Mr. SPRAGUE. Yes. That is especially true as regards those who are seeking safety.

However, Senator, there is another avenue for the investment trust, almost equally important and perhaps just now more important: We do need sources of supplies of funds available for undertakings involving a considerable measure of risk.

Senator WAGNER. Yes.

Mr. SPRAGUE. It is not desirable that we should all invest in purely gilt-edged securities; and I look for a development of some investment trusts directed toward furnishing equity capital to growing undertakings, and not necessarily those of the very largest size; and I should be inclined to think, Senator, that the operations of this bill would rather work against that growth, which has not been as great as I think it should be, of enterprising investment trusts.

Senator WAGNER. I do not disagree with you in that regard, except that it seems to me that ought to be a different type of investment trust. In other words, it seems to me that when I am putting my money into that type of investment trust, I ought to know that I am supplying risk money or venture money.

Mr. SPRAGUE. Quite so.

Senator WAGNER. The important point there is that I ought to know, by the representations made, what type of trust I am investing in.

Mr. SPRAGUE. Yes.

Senator WAGNER. I agree with you that we need a good deal of this risk money or venture money and that there is not enough of it coming out now. We all understand that.

However, I think you and I do not differ upon the proposition that that is a somewhat different kind of investment from the diversified investment, where it deals primarily in safe securities with pretty sure returns—as sure as we can make them—rather than dealing in a venture.

Mr. SPRAGUE. Well, what would you think of this one, Senator: That half a dozen investment trusts would pool, say, 5 or 10 percent of their total funds for a cooperative venture, of an investment type—and, of course, the public's being fully informed, and their prospectus stating it, and so on?

That has sometimes seemed to me to be a possibility.

Senator WAGNER. Yes.

Mr. SPRAGUE. Because it requires far more research than many of, at least, the smaller trusts require, to undertake intelligently to supervise such investments; and I am fairly certain that in such a development it would probably be desirable that the cooperative trust fund, that I speak of, have representatives on the boards of the companies that they assist.

That is simply one possibility; and, of course, it would not be possible under this bill, with this elimination of any relationship on any considerable scale between portfolio and directors.

Senator WAGNER. Yes. Well, Dr. Sprague, I think we need both types, don't you?

Mr. SPRAGUE. I do.

Senator WAGNER. But I think the important thing is that the individual—and I have said this so often that I shall not say it any more—should know what type of investment he is making.

Mr. SPRAGUE. Yes.

Senator WAGNER. I think the individual investor should know whether he is taking a mere chance—perhaps with large profits in prospect, and perhaps a total loss—or whether he is putting his money in the other type of investment, which is the same, safe type of investment that we have been hearing about today.

Thank you very much, Doctor.

Mr. SPRAGUE. Thank you, Senator.

Senator WAGNER. We shall recess at this point until 2:30 p. m.

(Thereupon, at 12:15 p. m., a recess was taken until 2:30 p. m. of the same day.)

AFTER RECESS

The subcommittee resumed at 2:30 p. m., on the expiration of the recess.

Senator HUGHES (presiding). The subcommittee will resume its hearing. I believe the next witness is Mr. Eberstadt.

The chairman of the subcommittee regrets that he is unavoidably detained on other business and must be absent the balance of the day. Of course, I may not be very successful as presiding officer, and certainly cannot proceed as well as he could, or Senator Downey could, but I wondered if I might make a suggestion about the hearings: I have not consulted with the other members of the subcommittee about this, but I have attended a great many of these hearings, and, of course, all of you gentlemen must realize that the time of the members of the subcommittee is limited, because we have to act on a good many committees of the Senate. We want everybody to have an opportunity to be heard, but might I ask if you, in presenting your evidence, would be as concrete as possible?

Mr. EBERSTADT. Gladly so.

Senator HUGHES. We take it for granted that you are opposed to the bill, or at least parts of the bill.

Mr. EBERSTADT. I do not know that you are right in taking that position.

Senator HUGHES. I mean, you are opposed to parts of the bill.

Mr. EBERSTADT. Yes, to parts of the bill.

Senator HUGHES. If you would as best you can state your objections to the parts of the bill to which you do object, it would be appreciated. I have been inclined to feel that some of the witnesses have rambled all over the field of investment securities, and often have taken a lot of time and space in the record that did not seem really necessary. I want you in your evidence to cover so far as you see fit to do so what you wish to cover, but I am making that suggestion, and of course you can do as you like.

Mr. EBERSTADT. Senator Hughes, I want to comply with your suggestion. I am a guest of the subcommittee, and if you feel that in any way I am rambling over the field, you will please stop me. That is the last thing I want to do.