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# INVESTMENT TRUSTS AND INVESTMENT COMPANIES

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## 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

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#### **PART 1**

APRIL 2, 3, 4, 5, 8, 9, AND 10, 1940

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# INVESTMENT TRUSTS AND INVESTMENT COMPANIES

TUESDAY, APRIL 2, 1940

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

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

Present: Senators Wagner (chairman of the subcommittee), Maloney, Hughes, Miller, Downey, Townsend, and Taft.

Senator WAGNER. The subcommittee will come to order. Senators Miller and Hughes have authorized the chairman to vote them for a quorum, and they will be here presently.

This subcommittee is called to begin hearings on S. 3580, introduced by the chairman, to provide for the registration and regulation of investment companies and investment advisers, and for other purposes. The full text of the bill will be made a part of the record at this point.

(S. 3580 is printed in full, as follows:)

[S. 3580, 76th Cong., 3d sess.]

A BILL To provide for the registration and regulation of investment companies and investment advisers, and for other purposes

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

## TITLE I—INVESTMENT COMPANIES

### FINDINGS

SECTION 1. Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 30 of the Public Utility Holding Company Act of 1935, and facts otherwise disclosed and ascertained, it is hereby found that investment companies are affected with a national public interest in that, among other things—

(1) the securities issued by such companies, which constitute a substantial part of all securities publicly offered, are distributed, exchanged, transferred, redeemed, and repurchased by use of the mails and means and instrumentalities of interstate commerce, and in the case of the numerous companies which issue redeemable securities this process of distribution and redemption is continuous and constant;

(2) the principal activities of such companies—investing, reinvesting, and trading in securities issued by other companies—are conducted by use of the mails and means and instrumentalities of interstate commerce, including the facilities of national securities exchanges, and constitute a substantial part of all transactions effected in the securities markets of the Nation;

(3) such companies customarily invest and trade in securities issued by, and may dominate and control or otherwise affect the policies and management of, companies engaged in business in interstate commerce;

(4) such companies are media for the investment in the national economy of a substantial part of the national savings and may have a vital effect upon the flow of such savings into the capital markets; and

(5) the activities of such companies, extending over many States, and the wide geographic distribution of their security holders, make difficult, if not impossible, any effective State regulation of such companies in the interest of investors.

#### DECLARATION OF POLICY

SEC. 2. Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 30 of the Public Utility Holding Company Act of 1935, and facts otherwise disclosed and ascertained, it is hereby declared that the national public interest and the interest of investors are adversely affected—

(1) when investors purchase, pay for, exchange, receive dividends upon, vote, refrain from voting, sell, or surrender securities issued by investment companies without adequate, accurate, and explicit information, fairly presented, concerning the character of such securities and the circumstances, policies, and responsibility of such companies and their management;

(2) when investment companies are organized, operated, or managed in the interest of directors, officers, managers, investment advisers, depositors, or other affiliated persons thereof, in the interest of underwriters, brokers, or dealers, in the interest of special classes of their security holders, or in the interest of other investment companies or persons engaged in other lines of business, rather than in the interest of all classes of such companies' security holders and of the public;

(3) when investment companies issue securities containing inequitable, discriminatory, or anomalous provisions, or fail to protect the preferences and privileges of their outstanding securities;

(4) when the control or management of investment companies is unduly concentrated, inequitably distributed, or irresponsibly held;

(5) when investment companies, in keeping their accounts in maintaining reserves, and in computing their earnings and the asset value of their outstanding securities, employ unsound or misleading methods, or are not subjected to adequate independent scrutiny;

(6) when investment companies are reorganized, dissolved, become inactive, or change the character of their business, or when the control or management thereof is transferred, without the consent of their security holders and without adequate public supervision;

(7) when investment companies engage in manipulative or unduly speculative transactions, have excessive investments in securities or property of a speculative or unmarketable character, or by borrowing and the issuance of senior securities increase the speculative character of their junior securities; or

(8) when investment companies operate without adequate assets or reserves, or attain such great size as to preclude efficient investment management and to have excessive influence in the national economy.

It is hereby declared that the policy and purposes of this title, in accordance with which the provisions of this title shall be interpreted, are to mitigate and, so far as is feasible, to eliminate the abuses enumerated in this section.

#### DEFINITION OF INVESTMENT COMPANY

SEC. 3. (a) When used in this title, "investment company" means any issuer which—

(1) holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities; or

(2) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis.

As used in this subsection, "investment securities" includes all securities except (A) Government securities, (B) securities issued by employees' securities companies, and (C) securities issued by majority-owned subsidiaries of the owner which are not investment companies.

(b) Notwithstanding paragraph (2) of subsection (a), none of the following issuers is an investment company within the meaning of this title:

(1) Any issuer primarily engaged, directly or through wholly-owned subsidiaries, in a business or businesses other than that of investing, reinvesting, or trading in securities.

(2) Any issuer which the Commission, upon application by such issuer, finds and by order declares to be primarily engaged, directly or through majority-owned subsidiaries, in a business or businesses other than that of investing, reinvesting, or trading in securities. The filing of an application under this paragraph by an issuer other than a registered investment company shall exempt the applicant from all provisions of this title for a period of sixty days. For cause shown the Commission by order may extend such period of exemption for an additional period or periods. Whenever the Commission, upon its own motion or upon application, finds that the circumstances which gave rise to the issuance of an order granting an application under this paragraph no longer exist, the Commission shall by order revoke such order.

(3) Any issuer all the outstanding securities of which (other than short-term paper) are directly or indirectly owned by a company excepted from the definition of investment company by paragraph (1) or (2) of this subsection.

(c) Notwithstanding subsections (a) and (b), none of the following persons is an investment company within the meaning of this title:

(1) Any issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than one hundred persons and which is not making and does not propose to make a public offering of its securities. For the purposes of this paragraph, beneficial ownership by a company shall be deemed to be beneficial ownership by one person; except that, if such company is an affiliated company of the issuer, the beneficial ownership shall be deemed to be that of the holders of such affiliated company's outstanding securities (other than short-term paper).

(2) Any person substantially all of whose gross income from securities and securities transactions is derived from acting as broker and from the distribution of securities issued by other persons.

(3) Any bank or insurance company; any common trust fund, as defined in section 169 of the Revenue Act of 1938; any savings and loan association substantially all the business of which is confined to the making of loans to members; or any person engaged exclusively in the business of making small loans and licensed under the laws of a State to engage in such business.

(4) Any company effectively registered as a holding company under the Public Utility Holding Company Act of 1935.

(5) Any company, other than a face-amount certificate company, substantially all the intangible assets of which consist of mortgages and other liens on real estate.

(6) Any person substantially all of whose business consists of owning or holding oil, gas, or other mineral royalties or leases, or fractional interests therein, or certificates of interest or participation in or investment contracts relative to such royalties, leases, or fractional interests.

(7) Any company organized and operated exclusively for religious, educational, benevolent, fraternal, charitable, or reformatory purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(8) Any voting trust the assets of which consist exclusively of securities of a single issuer which is not an investment company.

(9) Any security holders' protective committee or similar issuer having outstanding and issuing no securities other than certificates of deposit and short-term paper.

#### CLASSIFICATION OF INVESTMENT COMPANIES

Sec. 4. For the purposes of this title, investment companies are divided into three principal classes, defined as follows:

(1) "Face-amount certificate company" means an investment company which is engaged in the business of issuing face-amount certificates, or which has been engaged in such business and has any such certificate outstanding.

(2) "Unit investment trust" means an investment company which (A) is organized under a trust indenture, contract of custodianship or agency, or similar instrument, (B) does not have a board of directors, and (C) issues only redeemable securities, each of which represents an undivided interest in a unit of specified securities; but does not include a voting trust, or any trust which issues and has outstanding no securities other than short-term paper and periodic payment plan certificates.

(3) "Management investment company" means any investment company other than a face-amount certificate company, a unit investment trust, or a company

which issues and has outstanding no securities other than short-term paper and periodic payment plan certificates.

SUBCLASSIFICATION OF MANAGEMENT INVESTMENT COMPANIES

SEC. 5. (a) For the purposes of this title, management investment companies are divided, according to the securities which they issue, into open-end and closed-end management investment companies, defined as follows:

(1) "Open-end management investment company" means a management investment company which is offering for sale or has outstanding any redeemable security of which it is the issuer.

(2) "Closed-end management investment company" means any management investment company other than an open-end management investment company.

(b) Management investment companies are further divided, according to the character of their assets, their investment policy and capital structure into diversified investment companies, securities trading companies, and securities finance companies, defined as follows:

(1) "Diversified investment company" means a management investment company which meets the following requirements:

(A) the value of its investment in the securities of any one issuer (other than Government securities) does not exceed 5 per centum of the value of its total assets;

(B) at least 85 per centum of the value of its total assets is represented by cash items, by Government securities, and by marketable securities of issuers of which it does not own more than 5 per centum of any class of securities outstanding;

(C) its portfolio turn-over during its last fiscal year did not exceed 150 per centum;

(D) it has outstanding only one class of securities other than short-term paper; and

(E) it does not control or own any voting security issued by any other investment company.

(2) "Securities trading company" means any management investment company other than a diversified investment company, which meets the requirements of subparagraphs (A) and (B) of paragraph (1).

(3) "Securities finance company" means any management investment company other than a diversified investment company or securities trading company.

(c) A registered diversified investment or securities trading company which at the time of its registration meets the requirements of subparagraphs (A) and (B) of paragraph (1) of subsection (b) shall not lose its status as a diversified investment or securities trading company because of any subsequent discrepancy between the value of its various investments and the requirements of said subparagraphs, so long as any such discrepancy existing immediately after its acquisition of any security or other property is neither wholly or partly the result of such acquisition.

(d) The Commission shall have authority, by rules and regulations in the public interest or for the protection of investors, to make further classifications and subclassifications of investment companies according to organization, capital structure, nature of assets, amount of assets, investment policy, character of business done, or any one or more other characteristics which the Commission deems significant and which are consistent with the definitions contained in this section and section 4.

EXEMPTIONS

SEC. 6. (a) The following investment companies are exempt from every provision of this title except section 7 (d):

(1) Any company not organized under the laws of the United States or of a State.

(2) Any company organized under the laws of and having its principal office and place of business in Alaska, Hawaii, Puerto Rico, the Philippine Islands, the Canal Zone, the Virgin Islands, or any other possession of the United States; but such exemption shall terminate if any security of which such company is the issuer is offered for sale or sold, after the effective date of this title, by such company or an underwriter therefor, to a resident of any State other than the State in which such company is organized.

(3) Any company for which, in a proceeding in any court of the United States or of a State, a receiver, trustee in bankruptcy, or similar officer had been appointed