

of the business in accordance with sound and practical principles. At the same time, such a solution would avoid the risk that the entire industry might be seriously crippled. Such a risk I believe is inherent in the delegation of discretionary power to regulate this phase of operations as granted in this bill.

Senator WAGNER. Mr. Traylor, you mentioned that your particular concern and some others have taken steps by the adoption of procedure to prevent abuses which in the light of your experience you think maybe cured. I want to ask you this. How is the price for the following day fixed? Are there some of your experts who calculate the value?

Mr. TRAYLOR. It is done by the custodian bank, Senator, every afternoon.

Senator WAGNER. I suppose it is true that if one wanted to take advantage of the situation it might be done. For instance, if he knew at the end of the day or near the end of the day that the price on the following day would be higher, say, a dollar or two, I should think it would be an abuse if, taking advantage of that, a large block of shares were bought at the end of the day.

Mr. TRAYLOR. There are two angles to that, Senator. In the first place, one of the abuses that occurred was where an insider, so called, a director or trustee, in a few instances did not have to pay the asked price.

Senator WAGNER. That is what I had in mind.

Mr. TRAYLOR. And then turned the shares back the next day. I think there were a few instances of that. Under the blue-sky law of Ohio there is one provision which makes it necessary for insiders to pay the full asked price, the members of the distributing organization and all the trustees and officers of the trust itself. In Ohio, I might add, 80 percent of the assets represented in the whole open-end industry are qualified for sale in that State. So that that particular abuse is literally cured now, at least in so far as the companies that operate in Ohio are concerned.

Senator WAGNER. That is just 1 State. We have 48 States.

Mr. TRAYLOR. Yes; but those regulations were adopted by the National Association of Security Commissioners at Skytop, Pa.; and several other States have already gone so far as to adopt those regulations. If you are observing the regulations in Ohio you are observing them all over the country, wherever you may operate. You cannot sell in Ohio under one regulation and sell in another State under another regulation.

Senator WAGNER. Why?

Mr. TRAYLOR. If we agree that we are not going to distribute our shares except on the basis that is necessary in Ohio, that means that we have agreed to that wherever we may sell them.

Senator WAGNER. That may be true of your company.

Mr. TRAYLOR. It is true of all.

Senator WAGNER. Suppose there is a company that is not going to do any buying or selling in the State of Ohio?

Mr. TRAYLOR. There may be some that are not qualified in Ohio; that is true. But 80 percent of the industry is represented at the present time and is qualified to do business in Ohio.

I might say, further, that I use Ohio as an example. But this matter of inside trading the industry wants to cure. It should not have existed; it should not be allowed to exist, and it has been cured

insofar as 80 percent of the industry is concerned, by this Ohio regulation, which is a step in the right direction.

Senator WAGNER. We had some testimony here, as you recall, where that practice was followed in some instances by insiders, which I know the industry as a general thing would condemn, and which you condemn. If it is an abuse it ought to be prohibited. So long as the legislation is carefully drafted, why should it not be prohibited?

Mr. TRAYLOR. It should be prohibited. The suggestion which I gave in my testimony should be that under the N. A. S. D. rules and regulations be devised by the industry itself, which would be adopted by all of the members of the N. A. S. D.

I might further add that all of the underwriters of open-end industrial companies are members of the N. A. S. D., and cannot sell to any other dealer who is not a member. A dealer cannot sell his shares at a discount. So in this particular case, if they did establish those rules and regulations, we would be doing business only with people who had agreed to operate under those rules and regulations.

Senator WAGNER. Is the act now working all right?

Mr. TRAYLOR. The Maloney Act?

Senator WAGNER. Yes.

Mr. TRAYLOR. So far as I know. We are all operating under it. I think this also could be covered under that act.

Senator WAGNER. The reason I asked the question was because there was considerable opposition at the time.

Mr. TRAYLOR. I can only speak insofar as our business is concerned. There has been no great hardship as the result of it.

Senator WAGNER. Are there any further questions?

Senator HUGHES. You have an organization, you say? You are already organized?

Mr. TRAYLOR. Yes, sir.

Senator HUGHES. What proportion of the industry?

Mr. TRAYLOR. What part of the industry?

Senator HUGHES. Yes; all over the country.

Mr. TRAYLOR. In its pricing system I would say that a majority have already changed their pricing system to some extent since September 5, and I think it is the attitude of the rest of them who have not made changes that the only reason they have delayed making them is because of the legislation now before us at this time.

Senator WAGNER. Is not that a good time to remove an abuse, when legislation is pending? The removal of abuses is one of its objects. Is not this a good time to do it?

Mr. TRAYLOR. Well, it is more difficult than that, Senator, because, in order to change the pricing system in many of these companies it would require stockholders' meetings to vote for those changes. They did not want to have a meeting and change the charter to cover pricing, and then have to change the charter to cover this law, for instance. That is expensive; it is very costly. I think the delay by a number of companies has been due to that.

Senator HUGHES. Would they have to change their charters to cover prices?

Mr. TRAYLOR. Yes; because it is very definitely defined what they can do and what they cannot do, in their charters.

Senator HUGHES. I did not realize that. I thought they had broad powers; I did not know they had specific regulations of that kind.

Senator WAGNER. Thank you very much, Mr. Traylor.

**STATEMENT OF DAVID T. SANDERS, RESIDENT MANAGER AND WHOLESALE REPRESENTATIVE IN CHICAGO OF MASSACHUSETTS DISTRIBUTORS, INC.**

Senator WAGNER (chairman of the subcommittee). Mr. Sanders, you represent Massachusetts Distributors, Inc.?

Mr. SANDERS. Yes, sir.

Senator WAGNER. Will you give us your official connection?

Mr. SANDERS. Mr. Chairman and Senators, to identify myself, my name is David T. Sanders. I am the resident manager and wholesale representative in Chicago of Massachusetts Distributors, Inc. During the last 8 years, all of my time has been devoted to the sale of open-end investment companies through registered investment dealers, in 17 States located in the Middle West and the Southwest. In order that no one may wonder how I can live in the Middle West and talk like a Yankee, let me explain that I was born and raised in the northern part of the State of Maine.

I would like to impress upon this committee that my job is selling. I make my living selling and it is my only means of support. I am thoroughly familiar with what goes on in the territory which I supervise and which I personally cover. In passing, let me add that approximately 75 percent of my time is spent on the road. It has been for the past 8 years. Any remarks that I have to make today will be confined to my own personal experiences and observations. Therefore, if some of my remarks, as I go along, seem to be limited to one section of the country and to one group of dealers, you will, I hope, understand my reasons for so doing.

In studying the testimony which has been presented in this hearing by the various representatives of the Securities and Exchange Commission, I have been impressed by statements which, in the light of my own personal experience, seem to me to be entirely contradictory to the true facts.

First, in reading this testimony, I was impressed with the fact that the impression must be left in the minds of anyone either reading or hearing this testimony, that the sale of open-end trusts has been accomplished through and by the use of inexperienced and high-pressure sales organizations. Furthermore, in this same connection, I am sure that anyone reading this testimony would certainly not be able to distinguish in his own mind any differences between the open-end funds, partial payment plans, and face amount certificates, which types are being sold continuously.

Senator HUGHES. You say there is no difference?

Mr. SANDERS. There is a big difference, but I do not think from the testimony that anyone would be able to determine that there was any difference.

Senator HUGHES. Oh. I see.

Mr. SANDERS. I want to make the point that there is a difference in the way they are sold.

Senator WAGNER. Do you send out literature?

Mr. SANDERS. Yes, sir.

Senator WAGNER. Have you a sample of the literature with you at this time?

Mr. SANDERS. No, sir; I have not. We have many pieces of literature, of course. I will be very glad to submit some literature. I have some at the hotel.

Senator WAGNER. May we have it tomorrow?

Mr. SANDERS. Yes, sir. I now come to my second point. Let me explain that I am objecting to three things here which I have found in reading this testimony which are contradictory of what my experience has been. The second point is that the buyers of these shares have been unsophisticated and inexperienced investors. The implication has been made here that open-end trust shares have been largely sold to parlor maids, cooks, truck drivers, waitresses, and so forth.

Thirdly, that the so-called two pricing system has been the principal sales argument used in the sale of these open-end companies.

It is these three points that I would like to discuss in the light of my own personal experience as a salesman and I will take them up in the order in which I have enumerated them.

First, the type of sales organization that has distributed these shares.

During the last 8 years, in which I have been in this business, I have come to know on a personal basis the senior officers, sales managers, and salesmen of approximately 250 investment firms, which is about the number that I am doing business with at the present time. Of course, you must realize that a man traveling a territory as large as this for so many years knows many more than 250 dealers. However, I am talking only about those that I know intimately and with whom I am doing business.

These dealers to whom I refer are, for the most part, old and established firms who enjoy the confidence of their customers and have an unquestioned reputation for integrity in the cities and in the towns in which they are doing business.

These dealers, with a very few exceptions, are the same dealers who distribute the bond and stock issues which are originated by the large underwriting houses in the East, Middle West, and the Pacific coast. In fact, a great many of these dealers are more often than not included in the banking groups on these underwritings. Furthermore, I think it might be interesting to note that they are the same dealers who in years past did the underwriting for most of the small industrial and public utility companies needing capital in the sections of the country in which they operate and live.

The distribution of the open-end funds which I represent has not been accomplished through "fly-by-night" high-pressure, inexperienced sales organizations, but through the type of dealer whom I have described, and it has been through and with the cooperation of this dealer group—and here I would like to add that every single dealer has signed our selling group agreement; we have no dealers who have not signed our selling group agreement—that more than \$75,000,000 of Massachusetts Investors Trust, Supervised Shares, Inc., and Boston Fund, Inc., has been sold to the investing public in these Middle Western and Southwestern States.

Although it is impossible for me to give you an accurate figure as to just how long these dealers, as a whole, have been in business, I am sure that I can make the statement without contradiction that at least 75 percent of them have been in business more than 10 years and a great many more than 20 years and some of them even as long as 35 or 40 years. In the limited time which I have had to prepare myself before appearing before this hearing, I was not able to make a complete and accurate analysis of all the dealers in my territory. But I was able to make a study of the dealers in the city of Chicago with whom I now do business. This dealer group,

I believe, is fairly representative of the whole territory. This study brought out the following facts. At the present time, we have 41 dealers in Chicago. This includes a few branch offices of eastern dealers. I found that 29 of these dealers are members of the Investment Bankers Association of America; that 10 of them are members of the New York Stock Exchange, and that they have been in business in the average for 22 years.

In this connection I would like to add that every one of our dealers anywhere in the United States is today and must be a member of the National Association of Security Dealers. I think that applies to 95 percent, at least, of all sponsors of the business today. I do not know that it is not a hundred percent, but I would not dare to make that statement. I am sure that practically every dealer selling investment trusts today, the open-end trusts, is a member of this association.

I hope the above facts will convince you that the sale of open-end funds has been made through reputable dealer organizations.

Now I would like to take up my second point, namely, that the buyers of these open-end funds have not been unsophisticated, inexperienced investors, but, on the average, quite the contrary.

To bring out this point in a clear-cut manner, I would like to submit the following figures taken from the 1939 annual statements of the three oldest and largest open-end funds in Boston, namely, State Street Investment Corporation, Incorporated Investors, and Massachusetts Investors Trust. I would like to call to your attention that the youngest of these three funds has been in operation more than 14 years.

The combined assets of these three funds, as of December 30, 1939, amounted to approximately \$210,000,000, and the shares of these three funds were, on that date, held by approximately 88,000 stockholders. From these two figures, we are able to determine the average holding in these three funds, which is approximately \$2,400.

I am simply trying to make the point here that these funds have not been sold to \$10 buyers, but there is an average here of \$2,400; and I think that represents a rather substantial investment, when you consider that that is only part of what most of these investors buy.

Senator WAGNER. Do you not think it would be a good thing if we could have investment trusts in which men with \$10, \$15, \$25 or \$100 could invest?

Mr. SANDERS. I think it would.

Senator WAGNER. I mean, it would be well if such opportunity existed. I really think that investment trusts play a very important part in our economic life; and I should think that those recognized investment trusts, those which are operated legitimately, would, as many of them have said, invite regulation, so that whatever confidence some of these disclosures have weakened would be restored. That is one way of restoring such confidence. I am a great believer in investment trusts, myself. I think there is a marvelous opportunity for one who wants to diversify his investments. I think they will in the future play an even greater part in our economic life, because it is difficult now for one to know just what to invest in. I should think some regulation would restore the confidence which has been weakened because of some of these exposures which have

shocked this committee, as they would shock you, I am sure, if you heard the testimony.

Senator HUGHES. Right along that same line: Have you a minimum restriction?

Mr. SANDERS. Five shares except to an old stockholder. He can buy one.

Senator WAGNER. Which is how much?

Mr. SANDERS. At the present time it would be about \$110.

I would like to answer your question, Mr. Chairman, about the \$5 or \$10 buyer. I do not know what the answer is. No one yet, that I know of, has found how to sell the \$10, \$15, or \$20 buyer at any reasonable cost. The cost is terrific, to reach that type of buyer. The salesman has to eat.

Senator WAGNER. Yes; I can see that difficulty.

Mr. SANDERS. And you can see how many \$10 sales he has got to make.

Senator WAGNER. It may be that he would not have to be solicited, though of course I do not know as much about it as you do. You may proceed.

Mr. SANDERS. Please let me explain that in offering these figures—I am referring to the figures which I previously gave—I chose these three funds not only because they were the oldest, but also because they represented, in their combined assets, approximately 40 percent of the estimated total assets of all open-end investment trusts. It is quite possible, and probably true, that the average holding for the entire open-end trust industry would not be as large as the average holding in the three trusts which I have mentioned.

In connection with this same subject in regard to the type of buyer, I would like to give you some of my personal experiences with institutions which today own substantial blocks of Massachusetts Investors Trust and other open-end funds.

Because of the nature of our business, it is impossible for us to disclose the names of stockholders. Therefore, in citing these examples, the names are omitted.

The first example concerns a large educational institution. This institution has an enviable record for satisfactory results in the investment of its endowment funds.

This institution employs two experienced financial advisers to analyze securities and make their suggestions to the board of trustees for approval. It is my understanding that nothing is ever bought or sold without the approval of this board.

In 1935, after several months of careful study, in which these two advisers carefully analyzed one of our funds—and I might say they went through it with a fine-tooth comb—they submitted their recommendation to the board of trustees, which resulted in the investment of approximately \$250,000 in this fund. During the subsequent years between 1935 and 1939, no further investments, to my knowledge, were made by this institution in open-end investment trusts. It is my firm conviction that they were watching this trust which they had purchased, in an effort to gain experience from this investment. However, this is only my assumption. I do know, however, that during the year 1939, this institution invested an additional \$1,000,000 in open-end investment trusts. I don't know what conclusions you will draw from this, and I don't know that I have any right to draw

a conclusion but I am going to make this statement, that after nearly 5 years of holding and living with a \$250,000-investment in one open-end company, these people must have been at least fairly well satisfied with their investment or they would not have put \$1,000,000 more into 9 or 10 open-end trusts and included in this investment a fund sponsored by the same people who had sponsored their original investment.

My second example I will make very brief. It has to do with the purchase of approximately \$1,500,000 of open-end trusts by one of the best known medical foundations in this country. I won't go into a long, detailed account of these purchases. I simply want to make this statement—that these investments, to the best of my knowledge, were made over a period of 6 or 7 years; that today they represent approximately \$1,600,000, and that they are spread over four different open-end funds.

I would like to cite one more example, as follows: This institution is one of the best known fire insurance companies in the Middle West, has been in business more than 70 years and for the first 66 years of its existence, I am told by the present officials of the company, had never purchased any common stocks of any kind. In 1934, they made their first investments in this field in the form of four open-end-investment trusts and one closed-investment trust. It is my understanding that from time to time they have increased their investment in this field and that, with the exception of one open-end fund, they have in every case divided their investment equally between the four remaining funds.

I could go on for hours giving you one example after another of large purchases that have been made by trust accounts, schools, colleges, hospitals, churches, fire insurance companies, fraternal organizations, cemetery foundations, and a few life insurance companies, but that would be rather tedious.

If you will allow me, however, I would like to finish up this second part of my talk with this statement—that at the present time, Massachusetts Investors Trust has among its stockholders more than 900 trust funds and more than 1,000 institutions of the character described above.

I now come to the third and final point which I would like to make. It is this—contrary to the statements which have been made in this hearing by the Securities and Exchange Commission, it is my firm conviction, and this is based on actual personal experience in the field, that the pricing system which has been so much discussed has very little, if anything, to do with the real reasons why investors buy these open-end trusts. Let me explain.

In our business, we often have dull periods lasting weeks, and sometimes months. It is during these dull periods that a great deal of educational work is done by investment dealers. This is the time when their salesmen are making new contacts and renewing old contacts. It is a time when the buying public is uncertain and, even though they have money to invest, they are in a waiting mood. This is human nature. We do not create it, neither can we change it.

These dull periods are inevitably followed by more active periods when investors as a class seem to have made up their minds what they want to do and, as a result, our market place immediately becomes active and sometimes hectic.

It is natural that during these active market periods, new bond issues, new stock issues, open-end investment-trust shares, and securities of all classes are sold in greater volume.

It is perfectly ridiculous for any one to assume that the salesmen in our business sit around for weeks waiting for an active market, and that when it arrives all they have to do is get on the telephone, call up a lot of people and sell them millions of dollars of trust shares on such a flimsy basis as a rising market or some tricky pricing system.

I can assure you, gentlemen, that investment trusts are not sold that way. If you will be patient with me, I should like actually to demonstrate in this room exactly how most of these sales are made.

Without being presumptuous, may I assume for the moment, Mr. Senator, that you are a security buyer and that I am a retail salesman, representing a reputable investment dealer, and that you are my customer. For a number of years, we have done business together. You have purchased from my security house, through me, municipal bonds, corporate bonds, preferred stocks, and common stocks. A great many times during our conversations I have mentioned to you a certain open-end company. I have supplied you with a prospectus and probably with an annual report as well as several quarterly reports, and it is more than possible that occasionally I have mailed to you other descriptive material. These discussions may have gone on for months, as they often do. In fact, I have known them to extend over a period of 2 and 3 years. You have told me that you have money to invest and that you believe part of it should be invested in a diversified list of equities; but you have hesitated to commit yourself, due to any number of uncertainties which may be worrying you.

To be more definite, let me further assume that I might have discussed with you a certain open-end company in November or December of last year and, in subsequent months, supplied you with many pieces of literature and answered the many questions that you naturally would want to ask. It is quite possible, due to political and general business uncertainties which have prevailed in the last few months, that you would have been uncertain and indecisive, and so would have desired to wait; but you have pretty well made up your mind and have given me to understand that when you felt the time was right, you would like to make an investment in this trust. Finally, something changed your mind. You are no longer doubtful, and you are ready to invest. It makes no difference why you changed your mind—it might have been the U. S. Steel \$1 dividend or a change in the war situation, or any number of things. The fact remains that you think it is time to buy, and the stock market is stronger.

You might have telephoned me, or I might either have telephoned you or called on you at your office. Naturally, I would tell you what was going on in the stock market. You would naturally ask me the price of the shares, and I would give it to you. The sale would be closed right there.

There are two points here that I want to make. One is that you, of course, were aware that we were in a strong market and that the shares which you were purchasing that day would probably be worth more the next day and, you hoped, the next month and the next year—and so did I. The second point I want to make is—and I hope you will agree with me—that the investment which you made on that

day in that particular trust was not made just because the market was rising and because you might obtain some price advantage, but rather as a result of the intimate and detailed knowledge of this security, gained by reason of the educational work which had been done by me over the previous months.

In trying to explain to you how these sales are made, please do not assume that a situation such as I have just outlined is the isolated case, because in actual experience it is the way these shares are sold. The isolated case would be for me to call you up "cold turkey" and have you buy shares in this or any other open-end fund, just because the market was advancing.

Will you be patient with me a minute longer and let me summarize? If possible, I would like to leave these thoughts in your minds, and they are as follows: That after 8 years of selling nothing but open-end trusts, I am able to come before you and make the definite statement, based on my own personal and intimate contact with the sales end of this business, that these shares have been sold only through the legitimate investment banking channels which are available to us; that these trusts have been sold to small and large investors, trust funds, and institutions, and, furthermore, that they have been sold with complete disclosure of all facts and only after considerable educational work has been done.

In closing, let me remind you that the sales which I have been talking about, and which have run into many millions of dollars, have all been made in the last 8 years, following the greatest collapse in the financial markets that this country has ever seen, and at a time when both the buying public and the investment dealer were more critical and more skeptical than ever before in the history of this country.

Thank you.

Senator WAGNER (chairman of the subcommittee). Are there any questions?

Senator HERRING. No; I believe not, thank you.

Senator HUGHES. No, thank you.

Senator WAGNER (chairman of the subcommittee). Thank you, sir.

We shall next hear from Mr. Robert S. Adler, representing Selected American Shares, Inc.

**STATEMENT OF ROBERT S. ADLER, PRESIDENT AND DIRECTOR,  
SELECTED AMERICAN SHARES, INC., CHICAGO, ILL.**

Senator WAGNER. All right, Mr. Adler; will you proceed when you are ready, please?

Mr. ADLER. My name is Robert S. Adler, of Chicago, Ill. I am an officer and director of Selected American Shares, Inc., an open-end management investment company, with assets of about \$10,000,000. It was organized during 1932. I am also an officer and director of two other companies, not publicly owned, one of which performs the function of sponsor and principal distributor of the shares, and the other of which performs the function of manager of Selected American Shares, Inc.

Although I have some views concerning various sections of this bill, and later shall make one or two brief references, I shall save you from repetitious discussion, and direct myself primarily to one section.