

percentage of the total, the exact amount cannot be determined since the banks retained the collateral. Some of the other nine companies went into receivership and others were voluntarily liquidated.

To summarize, a large number of security and note holders contributed an aggregate amount of \$696,714,143.17 capital (on the 3 bases indicated in the opening paragraphs of this chapter) to 116 general management investment trusts and investment companies. Of this total capital, \$458,240,626.34 was contributed to four companies which in point of size completely overshadowed the others. These are shown on table 2 which follows:

TABLE 2.—Gross capital contributed

Name of company:	
Insull Utility Investments, Inc.....	\$249, 508, 037. 84
Corporation Securities Co. of Chicago.....	130, 909, 707. 23
Bankus Corporation.....	29, 688, 081. 27
Swedish American Investment Corporation.....	48, 134, 800. 00
Total.....	458, 240, 626. 34

By deducting the capital contributed to the 4 companies shown in table 2 from the aggregate, it is found that the remainder, amounting to \$238,473,516.83, was paid in to 112 companies, or an average of \$2,129,227.82 to each.

During the course of assembling this information, effort was made to determine how much of this aggregate contributed capital was returned to shareholders through repurchases of their shares by the company. In the cases of the 41 companies included in group 3, for which no balance sheets could be found, this figure could not be determined. However, through examination of the books of the 7 companies included in group 1 and by tracing through the outstanding capital shares, and capital and capital surplus accounts of the 68 companies included in group 2, a reasonably accurate figure was arrived at in most instances. This amounted to \$59,231,725.98, which, if deducted from the gross contributed capital of \$696,714,143.17, leaves a net amount of \$637,482,417.19. From this a further deduction of \$3,407,086.27 has been made with respect to the 7 companies included as group 3, consisting of the excess of dividends paid to stockholders plus distributing and organization expenses over interest and dividends collected. This information was available only in these 7 instances and leaves a net contributed capital to be account for the 116 companies amounting to \$634,075,330.92.

LIQUIDATION

It has already been pointed out that all 148 companies under discussion in this memorandum were either liquidated or in the process of liquidation at December 31, 1935. Herein lies an important distinction between this group and those companies which remained active. The security holders of companies still in existence, regardless of how great their present unrealized capital loss may be, or how shattered their confidence in the management of their particular company or the investment trust theory generally, are in a position with honest and competent management to recoup at least a portion of their losses as security prices and general business conditions improve. The large number of investors in these 148 companies, however, have already sustained a definite irreparable loss. Many of these, no doubt, were forced out of their investment via the bankruptcy courts just when security prices were at their lowest levels, or by panic-stricken managements that urged premature voluntary liquidation.

Because of the great amount of time and field work which would be required to determine the net worth remaining for security holders in all of these companies at dates of termination, residual values have only been obtained in a sufficient number of instances to provide a basis for computing a reasonable estimate for the group.

It has already been pointed out that of the total of 148 companies under consideration, no figures whatever were obtainable with respect to the 32 included in group 4, leaving 116 companies into which was paid the \$634,075,330.92 net aggregate capital previously discussed. Of these, the residual values of 64 companies was not determined. A total of \$513,780,377.32 net capital had been paid into the remaining 52. Upon liquidation, or at the dates of receivership, in the few cases where liquidation has not yet been completed, there remained an estimated residual value of \$68,584,705.14 in these 52 companies, indicating a capital loss of \$445,195,672.18, or 86½ percent of the net contributed capital.

Further analysis discloses that in the entire group upon which reasonably accurate information was available that there were but 8 companies voluntarily liquidating which completed such liquidation without a loss to their stockholders.

After eliminating these 8 companies from the total of 52, and also eliminating Insull Utility Investments, Inc., Corporation Securities Co. of Chicago, Swedish American Investment Co. and Bankus Corporation with its two absorbed companies, City Financial Corporation and Municipal Financial Corporation, which if included, would distort a representative picture because of their relative magnitude, it is found that 38 companies remain. To these 38 had been contributed an aggregate of \$89,878,769 net capital. It is estimated that at their termination there remained a residual value of approximately \$10,901,945.88, indicating a capital loss of \$78,976,823.12, or 90 percent of the net contributed capital.

It is believed that this 90 percent capital loss in 38 companies can be accepted as a very conservative indication of the loss sustained by the entire group of 148, and, that if more complete information was available with respect to the other 110 companies, an upward rather than a downward revision of this figure would result.

HOW TERMINATED

Every effort was made in preparing this chapter to determine how the 148 companies composing this group went out of existence. Obstacles already cited frustrated complete success in this direction, although again it is believed that a fairly elucidating cross-section picture has been produced. The cessation of the activities of 107 of the 148 companies may be summarized under the following general categories:

TABLE 3.—Number of companies

Bankruptcy.....	24
Receivership.....	19
Dissolution.....	47
Forfeiture of charter for nonpayment of taxes, etc.....	4
Enjoined from sales of capital securities.....	7
Dissolved by proclamation of the Secretary of State.....	1
Charter expired.....	1
Inactive.....	4
Total.....	107
Not known.....	41
Total.....	148

With a few brief words of explanation, the foregoing facts speak eloquently for themselves without further comment. Because of a dearth of specific information, it was impossible to determine how many of the 47 companies listed merely as having been "dissolved" were dissolved voluntarily and how many involuntarily. It is quite possible that some of these actually belong under the heading of "receivership" or "bankruptcy," but because of a lack of precision in terminology used by financial manuals or individuals supplying information, the real facts have been obscured. Likewise, there is little doubt that while the term "dissolved" or "voluntarily dissolved" describes the demise of some companies with technical accuracy, they were in fact forced into liquidation, without resorting to formal court procedure, by reason of their precarious financial condition or helpless inability to continue operations with profit.

Table 3 also shows that there were 41 companies out of the total of 148 regarding which no information at all could be found with respect to the manner in which they were terminated. In view of the circumstances under which the other 107 were liquidated, however, it is not unreasonable to assume that a substantial proportion of these companies met with similar fates.

Therefore, it becomes apparent that, with the exception of the 8 companies which liquidated without capital losses, most of the entire 148 companies were forced to liquidate. Moreover, it is definitely known that those companies whose contributed capital comprises the great bulk of the \$634,075,330.92 aggregate were placed in bankruptcy or receivership.

SPONSORS

The study conducted of the group disclosed that these companies were conceived and launched by a variety of individuals, firms, and institutions. Table 4, which immediately follows and is based upon information available, classifies these sponsors.

TABLE 4.—Classification of sponsors

	Number of companies	Percent of total
1. Companies known to have been sponsored by brokers, dealers, distributors, and/or investment bankers.....	36	25
2. Companies the sponsors of which are not definitely known but which appear to have been sponsored by brokers, dealers, distributors, and/or investment bankers since their capital securities were distributed through one of these media.....	17	12
3. Companies sponsored by other investment companies or organizations functioning as managers or fiscal agents of investment trusts.....	12	8
4. Companies sponsored by commercial banks.....	15	10
5. Companies sponsored by investment counsellors.....	3	2
6. Companies sponsored by organizations engaged in extraneous lines of business.....	2	1
7. Companies sponsored, or believed to have been sponsored, by private individuals or groups of private individuals.....	39	26
Total.....	124	84
8. Sponsorship not determined.....	24	16
Total.....	148	100

According to table 4, 85, or 58 percent numerically, of the total 148 companies were sponsored by firms engaged in one phase or another of the security business, commercial banks, or investment counsellors; the sponsorship of 24 companies was not determined; and, the remaining 39 companies, or 26 percent of the total, had for their sponsors private individuals or groups of individuals who are not specifically known to have been identified with nor to have represented interests falling within one of the other classifications. If more complete information were available with respect to the identity and business affiliations of all of these individuals it might be necessary to shift some of these 39 companies to other categories. However, the change would not be material.

Further examination of table 4 reveals that 36, or 25 percent, of the 148 companies are known to have been sponsored by broker, security dealers and distributors, and investment bankers. Sponsors of one-third of these 36 companies are identified as having been members of the following stock exchanges:

Name of stock exchange:	Number of sponsors
New York.....	9
Philadelphia.....	1
Buffalo.....	1
Portland, Oreg.....	1
Total.....	12

Still other sponsors were found to have been members of the Investment Bankers Association of America and the Security Dealers Association.

Table 4 also shows that circumstances indicate that the sponsors of 17 more companies were firms operating as brokers, dealers, distributors, or investment bankers. Assuming these circumstances to be true indications of fact, the number of sponsors coming within this classification would then be 53, or 37 percent of the total.

The foregoing table shows further that 12 of the 148 companies were sponsored by other investment trusts or firms functioning as managers or fiscal agents for investment trusts, and that 15, or 10 percent of the total had for their sponsors commercial banks.

The experience of bank-sponsored or affiliated trusts included in this section of the Commission's report appears to have been almost uniformly disastrous. Of the nine regarding which sufficient information is available to permit tabulation,

eight culminated in receivership or bankruptcy. These are shown in table 5 which follows:

TABLE 5.—*Bank-sponsored or affiliated companies which terminated in receivership or bankruptcy*

Name of trust	Sponsor or affiliated bank	How terminated
Amherst Share Corporation	Amherst National Bank, Williams-ville, N. Y.	Bankruptcy.
Bancscrip Investment Corporation...	Roosevelt State Bank, Chicago, Ill.	Forced to liquidate. ¹
Boardwalk Securities Corporation...	Boardwalk National Bank, Atlantic City, N. J.	Receivership.
Bankus Corporation	Bank of the United States, New York, N. Y.	Do.
City Shareholders, Inc.	City Trust Co., Indianapolis, Ind.	Do.
Commercial Share Corporation	Commercial Trust Co., Buffalo, N. Y.	Do.
Garard Investment Trust	Garard Trust Co., Chicago, Ill.	Bankruptcy.
Web Holding Corporation	World Exchange Bank, New York, N. Y.	Do.

¹ Forced to liquidate after president of bank was committed to penitentiary.

An outstanding exception is found in the ninth bank-sponsored trust. This was the United States Securities Investment Co. which was organized by the United States Trust Co., Newark, N. J., operated by L. F. Rothschild & Co., jointly with the bank, and liquidated with a small capital appreciation after having weathered the 1929 market decline and paid dividends consistently.

In a few instances, at least, the causes of the failures of the eight companies shown on table 5 are traceable directly to their affiliations with the banks. Two of the companies had invested heavily in the stock of the banks with which they were associated. When the banks failed, the double liability feature inherent in bank shares was too great a burden for the trust and bankruptcy resulted. In at least one other case it is definitely known that the temptation to exchange frozen assets of the bank for the liquid portfolio in the trust proved too irresistible an expedient for the directors of tottering banks. When these frozen assets failed to thaw over a period of time, the trust was left with no alternative but receivership.

In a few instances, notably the Bankus Corporation (affiliate of the Bank of United States) and the two companies it absorbed, Municipal Financial Corporation and City Financial Corporation, the certificate of interest in the investment trust was attached to or stamped upon the stock certificate of the bank. While some of the bank-sponsored investment companies took the form of an investment trust (investing a substantial portion of its capital in a diversified list of securities), the Bankus Corporation group appears to have been a combination holding company and underwriter. Its principal holding was stock of the Bank of United States. In some cases, the shares of the trust were offered publicly and in others admittedly sold to depositors of the sponsor bank.

ORGANIZATION AND LOCATION OF PRINCIPAL OFFICES

It was found that the corporate form of organization overwhelmingly predominated over any other in the choices of the organizers of these companies. Information concerning form of organization is lacking in only 6 instances. Of the remaining 142 companies, 131 were incorporated. Ten of the other 11 were common law trusts organized in the following States:

	<i>Number of com- panies</i>
Massachusetts	6
New York	1
Indiana	1
Illinois	1
California	1
Total	10

The eleventh company was created by a special act of the Legislature of the State of Connecticut and is difficult to classify.

Table 6, designed to show the number of companies which were domiciled outside of the States in which they were organized, presents an interesting study.

TABLE 6.—States in which organized and location of principal offices

	Number of companies— State of organization	Number of companies— Location of principal office
Delaware.....	66	—
New York.....	26	72
Massachusetts.....	11	12
Maryland.....	6	—
Connecticut.....	4	4
Illinois.....	5	6
New Jersey.....	3	13
Indiana.....	2	1
Washington.....	2	2
Nevada.....	2	—
Oregon.....	1	2
Iowa.....	1	3
Ohio.....	1	1
California.....	1	3
Kentucky, Kansas, Michigan.....	3	2
Missouri, District of Columbia, Pennsylvania.....	—	5
Not known.....	14	22
Total.....	148	148

Of the total of 148 companies under consideration, the States of organization could not be determined in 14 instances. The remaining 132 companies were organized in 17 different States, and, while 66, or about half, were organized in the State of Delaware, not a single one operated in that State. The table also shows that while New York was the next popular State for organizing these companies, with 26 companies organized under its laws, 72 maintained their principal offices within its borders.

Massachusetts ranked third in point of companies organized under its laws with 11 companies organized and about an equal number also maintaining their principal offices there. However, it is to be remembered that 6 of these 11 companies were Massachusetts common law trusts and were not created under the corporation laws. There were 6 companies organized in Maryland with none operating there and while only 3 companies were organized under the laws of the State of New Jersey, 13 maintained their principal offices in this State.

In summary, the statistics concerning this group of companies merely serves to confirm what is known to be true with respect to the entire industry, that the corporation laws of the States of Delaware, New York, and Maryland are best adapted to the organization of investment trusts and companies; that New York and New Jersey, because of their proximity to the world's most important financial center, and, in the case of New Jersey, because of favorable tax laws as well, are the most popular seats of operation; and that Massachusetts leads in point of number of common law trusts.

Table 7, which follows, presents a more specific tabulation of the locations of the principal offices of 126 of the 148 companies. This table examined in conjunction with table 6 discloses that of the 72 companies domiciled in New York State, 66 were located in New York City, that all of the 12 companies operating in Massachusetts were located in Boston, and that 11 of the 13 companies operating in New Jersey maintained their offices in Jersey City, a few minutes across the Hudson River from New York City. Likewise all 6 companies whose principal offices were in Illinois were located in Chicago. The offices of the remaining companies were scattered throughout 22 cities in nearly every section of the Nation.

TABLE 7.—Cities in which principal offices were located

	Number of companies
New York, N. Y.....	66
Boston, Mass.....	12
Jersey City, N. J.....	11
Chicago, Ill.....	6
Bridgeport, Conn.....	4
Des Moines, Iowa.....	3
Portland, Oreg.....	2
San Francisco, Calif.....	2
St. Louis, Mo.....	2

TABLE 7—*Cities in which principal offices were located*—Continued

	<i>Number of companies</i>
Buffalo, N. Y.....	2
Los Angeles, Calif.....	1
Newark, N. J.....	1
Salina, Kans.....	1
Rochester, N. Y.....	1
Washington, D. C.....	1
Louisville, Ky.....	1
Tacoma, Wash.....	1
Williamsville, N. Y.....	1
White Plains, N. Y.....	1
Cincinnati, Ohio.....	1
Atlantic City, N. J.....	1
Mount Vernon, N. Y.....	1
Indianapolis, Ind.....	1
Pittsburgh, Pa.....	1
Philadelphia, Pa.....	1
Seattle, Wash.....	1
Not known.....	22
Total.....	148

Senator WAGNER. I believe Senator Townsend has a question to ask you.

Senator TOWNSEND. I have not a question particularly, but I would like to call attention to the fact that these companies did not last more than from 1 to 4 years.

Mr. SMITH. Well, sir, I have a list of about 200 companies—and we were not going to put this list into your record unless you want it—but you will notice from this list of companies that were dissolved or liquidated, the great majority of them lasted only a few years, and primarily they were dissolved or liquidated in 1931, 1932, and 1933. Those are the common dates occurring through there, and those are the years of the depression.

Senator WAGNER. You may proceed.

Mr. SMITH. In addition there are about 200 companies which were merged, consolidated, or otherwise acquired by another company during the period 1927–35, mostly in the years 1930–32, which can be seen by our chapter IV. Many, if not most of these companies, can be presumed to have gone out of existence because of mismanagement based upon the known records and testimony as to a large number covered in chapter IV and the investors in these companies undoubtedly suffered large losses as a result of such mismanagement. For example, in the 20 companies (excluding Blue Ridge Corporation) acquired by the Atlas Corporation, there were large losses during the period before the Atlas Corporation acquired them which may be attributed in large measure to their mismanagement prior to being taken over by Atlas.

Similarly, large losses occurred in the companies acquired by the Equity Corporation which companies were in the United Founders Corporation group, and others.

Senator TOWNSEND. Might I make a comment there?

Mr. SMITH. Yes, sir.

Senator TOWNSEND. I have not been here very much due to the fact that I have been engaged on the work of other committees, but I presume you have put in the record a picture of how these companies contributed this capital, haven't you, or have you?

Senator WAGNER. Oh, yes; that has been shown.

Mr. SMITH. Yes, sir.

Senator TOWNSEND. Then I can read the record on that.

Mr. SMITH. May I say, and of course I am speaking now from memory, that about \$3,000,000,000 of securities were sold in 1929, which was characteristic, as Professor Dodd pointed out, that securities of these investment companies are sold in periods of high prices, because that is the period when it is easy to sell them.

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

Mr. SMITH. The contributed capital of the 200 companies which were merged and consolidated with other companies was very great. For instance, the contributed capital of 21 companies in the group taken over by Atlas was close to \$500,000,000. It has not been possible to make complete estimates for these 200 companies.

Finally, there were 390 companies that survived to 1935, but among them we find a number of companies with such heavy losses as to justify either an inference of very poor management or mismanagement. Thus out of 38 companies with a contributed capital of \$2,772,000,000, \$1,800,000,000 was lost. All these companies had losses in excess of 50 percent of their contributed capital at the end of 1935. The stories of many of these companies are covered in detail in various parts of our reports.

Included in these losses were the large losses in companies in the United Founders Corporation group aggregating at least 380 million dollars; in Eastern Utilities Investing Corporation, about 47 million dollars, now in receivership; in Petroleum Corporation over 60 million dollars; in Commonwealth Securities, Inc., about 25 million dollars; in Utility and Industrial Corporation about 33 million dollars; in Liberty Share Corporation about 7 million dollars; in Continental Securities about 5 million dollars; and in Insuranshares Corporation of Delaware, about 4 million dollars.

I have reviewed with other members of the study the various companies we know of and attempted to make an estimate of the losses which were due to looting or maladministration. Because of possible lawsuits to the companies involved and possible unfairness in mentioning their names in such a list, I am not mentioning the specific companies or the amount of losses which we attribute to these improper causes, although I have work sheets which indicate how we make out figures and I am prepared to support them.

I can show this to the subcommittee if you care to see it, but I would prefer not to put it into the record for the reason stated.

Senator TOWNSEND. What is that reason?

Mr. SMITH. I am afraid there might be lawsuits and I think it might be unfair to single out these companies in a hearing like this.

Senator TOWNSEND. I think that is proper.

Senator WAGNER (chairman of the subcommittee). All right, you may go ahead with your statement.

Mr. SMITH. Based on the cases we actually know of we estimate that at least \$1,100,000,000 of capital shrinkage in investment companies may be attributable to mismanagement, looting, or improper actions of managements in their own interests to the detriment of shareholders.

Furthermore, this figure is in many instances a conservative figure as I can show by many specific cases and it is possible that it might be as high as \$1,500,000,000.

Mr. Motley said the other day he had heard of no testimony as to banks, testimony showing abuses in connection with them. Well, in connection with commercial banks, almost every case we had showed they had suffered tremendous losses, and people who were running investment companies, in connection with banks said there should be absolute segregation, that there was no reason for them to be tied up together. The losses in this particular situation which I have included here, are about \$2,900,000, which is the amount of losses on loans made to 86 officers and directors for margin accounts, in the stock of the bank and the stock of the investment company. However, in my opinion a large part of the total loss, from \$12,000,000 to \$623,000, by 1935, was due to these margin accounts by insiders and borrowings by insiders. The Chase National Bank itself lost a million dollars because of that.

I am just trying to show you gentlemen that there are problems involved here, and how we have tried to approach the subject, that we have not gone to the extreme, or tried not to.

This estimate does not take into account how much of the market value shrinkage of the industry from its peak of \$8,000,000,000 up through the crash in 1929 to less than \$4,000,000 at the end of 1935 was due to malpractice. The figure on losses of course would be much greater than the loss included in contributed capital.

Nor do I wish it to be understood that all of the companies referred to in the above list were guilty of malpractice. Such an estimate is a difficult one to make at best and confidence must be placed in the fairness of the person attempting to make such an estimate.

So that you may realize that the problems we are talking about in these hearings are not isolated specimens but are characteristic of the industry I am going to ask your indulgence to set forth a few of the other complex problems of the industry we are dealing with.

Those chapters of part III of our report already released discuss various abuses in connection with the organization and operation of almost 100 investment companies, with an aggregate contributed capital of \$2,250,000,000. That means that in those companies we felt there were problems which we thought should be discussed in connection with the abuses in the problems of regulation of investment companies.

In other sections, about ready for release, we cover cases of about 40 or 50 companies more with similar amounts of contributed capital.

Now, there are certain other figures I would like to put into the record so that the magnitude of the problems we have had to deal with and the wide extent of possible abuses, may be indicated.

Let us take in connection with exchanges: We devoted an entire chapter, of 500 pages, to the problems of exchanges—and Professor Dodd spoke yesterday about the unfair advantages that can be taken by exchanges, and we have numerous instances of it.

Securities issued in connection with mergers and consolidations of closed-end companies (including investment holding companies) had a total value of \$873,000,000. In other words, there are \$873,000,000 of exchanges. Not all these exchanges but a large part of them, may raise very definitely the question of the fairness of the exchange, of one side getting the better of the other.

Now let us take switches: Of 56 fixed trusts studied, offers of exchange were made for 36, with securities valued at about \$92,000,000 exchanged.

Then we have the whole problem of the load, which is an indication of the cost connected with the sale of these securities, the reason why they are sold, and why it is profitable to sell them.

Based on data in chapter VII, part II, total underwriting compensation for securities of closed-end companies may be estimated at about \$301,000,000; and this "load" does not take account of profits made by "insiders" on the resale to the public of securities issued to them and on the exercise of options.

Total sales to "insiders" (private offerings and sales to bankers, sponsors, and so forth) amounted to \$343,000,000 out of aggregate offerings of \$2,869,000,000 studied (exclusive of intercompany transactions), and sales resulting from the exercise of options amounted to \$32,600,000 in this aggregate.

The "load" in open-end companies amounted to about \$37,000,000 (8 percent of the \$463,000,000 of sales) and in fixed and semifixed trusts the "load" was about \$80,000,000 (8½ percent of aggregate sales of \$943,000,000.)

In installment investment plans, the "load" amounted to about \$4,000,000 of total sales of about \$20,000,000, and in companies issuing face amount certificates the "load" aggregated \$41,000,000 in total sales of \$161,000,000.

Senator WAGNER. How much was the load there? Did you say \$41,000,000?

Mr. SMITH. Yes; \$41,000,000. Now, I am just trying to give you some over-all figures on the "load," and I do not think these figures could be related to the total sales.

Senator WAGNER. All right.

Mr. SMITH. Total sales load in all types of investment trusts and companies thus amounted to about \$460,000,000 for the period 1927-35. This indicates a possible reason, or one of the main reasons, for the origination of these companies, or the possible desire to form investment companies for the sale of securities as opposed to management companies.

Senator TOWNSEND. How do you define total load?

Mr. SMITH. Well, the load is the difference between the amount paid by the investor and the amount which the investment trust received. It is the amount which is paid to the underwriter and distributor?

Senator TAFT. How much was that?

Mr. SMITH. The total was about \$460,000,000.

Senator TAFT. What percentage is that?

Mr. SMITH. Well, the percentage varies in the different types of companies.

Senator TAFT. I have no doubt about that, but the \$460,000,000 does not mean anything unless you have the total amount of securities sold.

Mr. SMITH. I think the total sales of all types of investment company securities was something like \$7,000,000,000. I am not trying here to show that the load was excessive, but am trying to show it is a substantial amount.

Senator TOWNSEND. That would be about 6 percent, I take it?

Mr. SMITH. That is right. In some cases it is 8 percent, and in some other cases, for instance in the installment investment plan, it went up as high as 18 percent. And if you consider that in the installment investment plans that the load is paid on an average