

Mr. Bane also quoted from a letter I wrote to him on December 28, 1939, in which I advised him of the new pricing system which was to be adopted by Massachusetts Investors Trust on January 2, 1940. This is the pricing system which I have previously described whereby a new price is established in the middle of the day and again at the close of the market, only one price being known and established at a given time. Mr. Bane testified that in this letter I indicated that the steps which we and others in the industry were taking at about this time did not go far enough to solve the problem. That is incorrect. After calling Mr. Bane's attention to an enclosure which explained our new pricing system, I remarked that others in the industry were also making changes, saying, " * * * I have already heard of a number of the distributors who are taking definite steps to stop selling before the new price becomes known in the afternoon, which is a step in the right direction, but, in our judgment, does not go far enough * * *."

Mr. Bane, in introducing in the testimony our letter to dealers describing the operation of the pricing system adopted January 2, 1940, said that he "was surprised at the type of person to whom (it) is addressed in view of the claim that this (Massachusetts Investors Trust) is an investment trust." "This is headed," he read, "Important Notice to Salesmanagers and Traders." I can only assume that Mr. Bane believes that "traders" are the speculators "who trade in and out of trust shares at the expense of the trust" and that we were catering especially to such persons.

Well, in the hundreds of dealer offices with which we do business, the "trader" is the particular employee who executes salesmen's orders, and in executing orders in our trust shares he is bound by a contract between his company and ours to execute such orders at the official prices, the basis for the determination of which is set forth in the prospectuses. It is, therefore, quite essential that "traders" be fully informed concerning any change in the method of pricing shares.

As to "salesmanagers," we know of no one, apart from "traders," to whom such a notice could more appropriately be sent. Salesmanagers are in charge of the salesmen who sell the shares, and it seems to me rather important that they should be well informed concerning the pricing procedure which they are obliged by contract to observe.

Now, with respect to my "most unrealistic" testimony as to how sales of open-end companies are effected, I stand, without qualification, on every word of that testimony. But I would like to cite, as an example of the character of Mr. Bane's rebuttal testimony, the only concrete argument he advanced to discredit my statements. He said: "The story given you by witnesses from the industry of how sales are effected was most unrealistic. To compare the pricing and sale methods and the effects thereof of these trusts with the sale of Treasury bonds is illustrative of the sales ideas and arguments of these investment-trust salesmen. The statement made by Mr. T aylor respecting dilution arising from the sale of Government bonds in the light of my experience seems incredible. I have never heard of an occasion when Government bonds were being sold by the Government for a period of 19 hours at two different prices, affording the purchaser an opportunity to purchase at the lower of the two prices."

First, I made no statement "respecting dilution arising from the sale of Government bonds." I did say that Government bonds are sold on a firm price basis and that it is long-established and accepted practice for the Treasury to price a new issue in relation to its outstanding obligations so that the new issue will immediately sell at a premium. Second, it should be apparent to Mr. Bane from my previous testimony that whether or not he ever heard of it, so-called baby bonds are sold, not just for a period of 19 hours, but for 24 hours a day—day in and day out, month in and month out, and year in and year out—to the extent of around a billion dollars a year at a firm price which is considerably below the known price at which other Government bonds are selling. For example, and this was furnished me by a competent independent authority on Government bonds, while it is difficult to make a comparison between a discount obligation and a coupon obligation, United States Treasury 2½'s due September 15, 1948, recently sold at 107²⁰/₃₂ to yield 1.55 to maturity in 8 year and 7 months. A baby bond with 8½ to 9 years to run to maturity yields 2.67 percent. An 8½-year 2½-percent Treasury bond on a 2.67 percent basis would sell at 98²⁰/₃₂, a difference of 9 points.

And that's not a war-market situation but something that exists every day of the year. This independent authority also advises me that on the regular quarterly offerings of Treasury bonds, the order books are left open for 15 hours after the price of the new issue has been announced, and during a time while

other Treasury bonds of the same character may be selling at relatively higher prices in the open market. This authority adds that the Treasury endeavors to price a new issue in relation to its outstanding obligations so that the new issue will immediately sell at a premium. I wish to imply no criticism of the Treasury's methods. I am quite satisfied that they are operating in the best interests of both taxpayers and investors, and I am willing to concede that they know more about what they are doing than I do. It does seem quite obvious, however, that, as I previously said, they recognize the necessity for a firm price in selling their bonds.

And I might repeat from my earlier testimony that in the case of open-end funds there is no conscious effort to "price the shares favorably in relation to the general market." In fact, the only thing that is desired in connection with the pricing of shares of open-end companies is to establish a firm price as closely in line with the actual value as is practically possible.

I now come to my final point, and it is a most important one. Mr. Bane quoted an excerpt from Mr. Bunker's testimony to the effect that if salesmen of investment-company securities attempt to confuse investment companies with savings banks, they are guilty of gross fraud and should be dealt with accordingly. Then Mr. Bane said, "Let me read to you an extract from an illustrated booklet entitled 'Massachusetts Investors Trust, History, and General Information.'" He then read the extract which goes as follows: "Massachusetts Investors Trust is a mutual trust. It is operated on a basis similar to a mutual savings bank. Like a savings bank, it depends for its future welfare and continued success upon public confidence."

That would seem to indicate that we are being accused of gross fraud.

But, as Senator Wagner frequently remarked during the hearings, you want to hear both sides. Let me tell you a little about this booklet. It was the first descriptive booklet issued by Massachusetts Distributors, Inc., after I became president of the company. Looking back, I am rather proud of it for its complete frankness and for the detailed information which it contains. Incidentally, this booklet, published in February 1935, was replaced by a revised edition in February of the next year.

Here is what I want to tell you about the booklet. It contains 31 pages in all, and the extract quoted above appeared on page 28 in a chapter headed "Other Important Features" under one of five subheadings. The particular subheading under which the statement appears reads "Operating Costs." Now quite contrary to the misleading impression given in Mr. Bane's presentation of his testimony, there was not the slightest intent to confuse Massachusetts Investors Trust with a savings bank. After having devoted 27 pages to a detailed explanation of what Massachusetts Investors Trust is—how it operates—and the manner in which its shareholders participate in the trust, we made a perfectly fair and honest statement that with respect to operating costs, the trust is operated on a basis similar to a savings bank and that like such a bank the trust depends for its future welfare and continued success on public confidence. We went on to say, "One factor which has an important bearing on this point (public confidence) is whether or not the trust's operating expenses are out of proportion to the services performed." We then presented a table showing what the annual rate of expenses were, and we didn't use percentages. We showed in round-dollar amounts what it would cost a shareholder per year on the basis of a \$1,000 investment and on a \$5,000 investment, and on ten and fifteen and twenty and twenty-five and fifty and one hundred thousand dollar investments. Then we invited comparison of these costs with what the services performed by the trust would cost if undertaken independently, and we suggested such items as "collection and accounting of income from a diversified list of holdings, reconciling income from many sources for income tax and other purposes, statistical and research services, dependable investment advice, and time and effort necessary to proper supervision of investments."

To put this discussion of operating costs in its proper setting, I think it would be revealing if I quoted a few extracts from other parts of the booklet.

On the first page of text, the first two paragraphs read as follows:

"Massachusetts Investors Trust is not a new development. Although it embodies investment policies which have received more general recognition of late, it has been applying these policies for more than 10 years. Before the advantages of common-stock investing were very generally appreciated and before the necessity for specialized administration in this field became apparent to the rank and file of investors in this country, Massachusetts Investors Trust was functioning on a principle which gave recognition to these advantages,

and the need for specialization in obtaining them. It is, moreover, the principle which governs the trust's activities today.

"That principle is to provide investors, through honest and competent management, with a continuing investment program which meets the requirements of sound practice in common-stock investing. These requirements, fundamentally, are: (1) Diversification which introduces the law of averages in protection of principal; (2) reasonable return on invested capital; (3) opportunity for appreciation of principal; (4) high degree of marketability."

And from the third paragraph on that page—

"The trust was organized under an Agreement and Declaration of Trust * * *. Investors in this fund hold certificates of beneficial interest in a trust managed by trustees * * *. In effect, shareholders become participants in a living trust."

On page 9 there appears a chart which shows the net change in the value of the shares from the date of original offering in 1924 to the end of 1934. This chart shows that the value of the shares at the end of the period was 85 percent of their original value in 1924. It also shows that the preservation of the principal value of the shares at this reduced value was some 30 percent better than the preservation of values as represented by the general level of stock prices for the 10-year period.

On page 11 there appears a line chart picturing the fluctuations in the value of the shares over a period of 1 year. This chart shows that the value of the shares can go down as well as up.

Following that is a discussion of the record of dividend payments, which includes a chart showing the decline in the income from a hypothetical investment in 1929 when income on such investment would have amounted to \$6,500 to the income on the same investment for the depression year 1932 when the income would have amounted to \$3,230. There is also a discussion of how the trust operates, and a review of management policies which includes these statements:

"Before leaving this discussion of portfolio changes, it should be a matter of record that * * * the management of Massachusetts Investors Trust misjudged both the severity and extent of the depression.

"Instead of converting a large proportion of common-stock holdings into cash or its equivalent early in the depression, it concentrated investments in those companies and industries which seemed best able to withstand the depression * * *.

"This policy, however, failed to produce the full measure of advantage which the management felt justified in expecting * * *. It did, however, have the positive effect of conserving income, which made it possible for regular quarterly distributions to be maintained throughout the depression at a rate which compensated to some extent for the temporary shrinkage of principal."

On pages 21 and 22 there is given a detailed schedule of every change in the portfolio of the trust's investments during the year 1934. On the following page is a table showing a complete list of investments of the trust as at the end of 1934, with the dollar amount invested in each security on the basis of a \$100,000 interest in the trust. Other sections discuss in detail the investment policy, the dividend policy, and the operating procedure.

Under the subheading "Marketability" on page 30, there appears the following statement:

"Shares in Massachusetts Investors Trust represent participation in an investment program and as such do not invite consideration as a medium for trading in and out of the market. Nevertheless, the possibility is ever present that the shareholder may be obliged to sell his holdings. It is, therefore, a source of satisfaction to him that a firm market exists for the sale of his shares."

And in the following paragraph it is explained that shareholders are entitled to receive not less than 99 percent of the liquidating value of their investment upon withdrawal.

I leave it to the committee to judge whether the contents of this booklet indicate any misrepresentation, to say nothing of gross fraud.

I have shown you how misleading I believe Mr. Bane's testimony to be on this point. But even so, if Mr. Bane had read all of the supplemental literature issued by my company in the last 5 years, he would not have found a single instance in all that material of our having confused any of our companies with savings banks or any other similar institution, with the exception of the one example which I have just discussed. In all, we have issued 22 booklets and pamphlets containing some 191 pages and about 61,000 words.

In conclusion, I would like to remark that I am unschooled in the technique of presenting testimony, and I therefore desire to have it known that if my testimony appears to reflect any degree of ascerbity, it is certainly not intentional. I mention this because the testimony on the subject of pricing appears to have developed on something of a personal basis between Mr. Bane and myself. I have not, however, been talking to Mr. Bane on a personal basis; I have merely been presenting my testimony and answering his to the best of my knowledge and ability. I want the committee to know that I have a high regard for Mr. Bane personally and as a Government official. My associates and I have worked with him for a number of years and have always found him to be both understanding and cooperative.

I would like to add that Mr. Bane, as well as other Securities and Exchange Commission witnesses, have had a difficult task to perform. They have had to study and report on a forest of statistical data and written analyses without the benefit and advantages of personal experience in the investment-trust business. This, plus the existence of many large and knotty trees on the edge of that forest of data, tends to obscure the business realities, the human traits of character and honorable intentions and the background of economic conditions in which the industry has developed—all of which are fully as important to consider as words and figures.

I honestly believe that there is far less "evil," unethical practice and unduly selfish motive in the industry today than the Securities and Exchange Commission and staff seem to suspect. In connection with the subject of pricing, I believe that many of the highly controversial points have arisen simply because of a lack of thorough understanding of all the aspects of the matter, and this is said not unkindly. It is a complex matter having many ramifications.

It is, however, for this reason as supported by my testimony that I believe people in the industry possessing practical experience and knowledge (which has been broadened by the Securities and Exchange Commission study) should be given the opportunity to iron out the problems with which they are faced by self-regulation, as provided for under the Maloney Act. This is already being undertaken through a committee which has formally been appointed by the National Association of Securities Dealers, formed under this act.

MAY 2, 1940.

EXHIBIT A

The dollar volume of sales of Massachusetts Investors Trust over the last year or so has accounted for about 15 percent of the total sales of all 78 companies included in the Securities and Exchange Commission study. Thus, while the Trust is considerably larger in size than the average company in the industry, its volume of sales is also considerably larger.

I mention this to make it clear that the dilution figures on Massachusetts Investors Trust are not unduly distorted because of the size of the Trust, although I will grant that the dilution in the industry as a whole may be somewhat greater in the average than may be the case with Massachusetts Investors Trust.

Using Massachusetts Investors Trust as the basis for my estimates, I determined the dollar amount of so-called dilution on the Securities and Exchange Commission's basis of figuring¹ for all normal business days during the year 1939, and including the two abnormal days of September 11 and 19. In relation to the dollar amount of shareholders' interests, this came to fifty-six one-thousandths of 1 percent. For simplicity, I called it five one-hundredths of 1 percent (my first figure.)

Next, I added in the dilution which occurred on the other abnormal or semi-abnormal days, excluding only the unprecedented war market day on September 5. This calculation resulted in a so-called dilution figure of ninety-eight one-thousandths of 1 percent. I called it ten one-hundredths of 1 percent (my second figure.)

At this point, every business day in the year 1939, excluding only September 5, had been accounted for, and so my final figure of fifteen one-hundredths of 1

¹I have explained in detail in previous testimony why I believe the Securities and Exchange Commission's basis of figuring dilution does not accurately reflect the true situation. I stand firmly on that testimony, and believe that if all factors are taken into account such dilution as may occur is considerably less than even the minute fractional percentage amounts which I have shown.

percent (representing an increase of 50 percent over the annual basis figure, as above) was just for good measure and to allow for a reasonable margin of difference between the figures for Massachusetts Investors Trust and whatever the figures for the industry might be.

To sum up, I figured the actual dilution on the Securites and Exchange Commission's basis¹ in Massachusetts Investors Trust for the full year 1939, excluding only September 5, which it may be recalled was excluded from both the Securities and Exchange Commission illustration, as given in its original testimony, and from my illustration which elaborated on the Securities and Exchange Commission illustration and arrived at a figure of less than ten one-hundredths of 1 percent. I then increased this figure by 50 percent to allow for the possibility of greater dilution for the industry as a whole, arriving at an estimated figure of fifteen one-hundredths of 1 percent as a reasonable annual dilution figure for the industry under typical operating conditions.

GENERAL CAPITAL CORPORATION,
Boston, Mass., May 2, 1940.

Senator ROBERT WAGNER,
Chairman, Senate Banking and Currency Committee,
Washington, D. C.

DEAR SIR: We have read a report of the suggestions (index No. 730) made to your committee a few days ago for an investment company bill to take the place of S. 3580 and should like to submit the following comments for the committee's consideration. We would appreciate it if you would include this letter in the record of the committee's hearing on the bill.

ITEM 7. REGISTRATION OF INVESTMENT COMPANIES, SECTION 8 OF S. 3580

All open-end companies are already registered with the Securities and Exchange Commission under the Securities Act of 1933 and some companies, including General Capital Corporation, are also registered under the Securities and Exchange Act. The proposed additional registration would make three registrations with the Securities and Exchange Commission, each one of which would duplicate almost all of the information in each of the others but in a form sufficiently different to involve considerable unnecessary effort and expense.

We believe the bill should provide for the elimination of this duplication as far as possible.

ITEM 9. AFFILIATIONS OF DIRECTORS, SECTION 10 OF S. 3580

The proposed restriction would not add anything to, but would take away from, the present rights and powers of stockholders over their managements. We do not see how the taking away of these rights and powers could be expected to work out to the advantage of the stockholders. We do not believe that directors who are elected solely to satisfy a legal restriction such as the restriction proposed are likely to add anything but needless complications and expense to the operation of a company.

We do not believe that stockholders would exercise their right to elect fully competent unaffiliated directors if the proposed restriction were made a part of the law to any greater extent than they do at present without such a restriction. We do not believe that misconduct of affiliated directors would be less with the proposed restriction than without it.

We believe the proposed restriction would be harmful in many cases both to stockholders and to honest managements, particularly among the smaller companies.

1. We believe protection of stockholders against misconduct of directors and officers should take the form of requirements for publicity and restrictions against certain kinds of action without publicity and without stockholders' approval rather than the form of restrictions on outside affiliations and activities. We believe the proposed bill would adequately protect stockholders in its requirements for publicity and restrictions against certain kinds of action.

2. We believe restrictions on outside affiliations would, in most cases, result at best in the election of some directors who would be more or less uninformed and subservient to the others, in whom the effective control of the manage-

¹Footnote 1 is printed on page 1095.

ment would lie, or at worst in inefficiency resulting from conflicts among directors.

3. We believe affiliations of directors are, in many cases, the best means for: (a) Insuring that a trust will have the benefit of a responsible, competent, continuing investment and management organization; (b) defining and limiting responsibilities, costs to be borne by the trust, costs to be paid for from the management fee, etc.; (c) assuring a trust of background of responsibility, financial and otherwise, over and above the responsibility of unaffiliated individual directors of the trust, etc.

Many companies and firms provide trusts which they manage with services and practical guaranties of substance which the trusts standing alone could not possibly duplicate except at an unreasonable cost, if at all.

Whether the people who participate in the management compensation do so indirectly through a management company, a management contract, etc., or receive their participation directly as directors, officers, etc., is, in our opinion, immaterial where the management arrangements are made entirely clear to the stockholders. If other restrictions do not adequately protect stockholders such other restrictions, in our opinion, will not be made more effective by taking away from stockholders any of their rights to elect directors of their own choice.

Very truly yours,

FRANCIS I. AMORY,
Vice President.
E. R. KITREDGE,
Treasurer.

(Exhibit submitted by Securities and Exchange Commission:)

[From the New York Times, financial section, May 5, 1940]

GIVES LISTING RULE FOR SENIOR STOCK—EXCHANGE DECIDES ON MINIMUM VOTING RIGHTS TO ACCEPT PREFERRED SHARES

New preferred stocks which do not provide certain minimum protections for holders may not be listed on the New York Stock Exchange, according to an announcement yesterday. These minimum voting rights would allow the preferred stock, voting as a class, to elect not fewer than two directors after default of six quarterly dividends and would require the affirmative approval of at least two-thirds of the preferred for any charter or bylaw amendment changing its rights.

In announcing this new requirement for listing the committee on stock list of the stock exchange made the following statement:

"Since 1926 the New York Stock Exchange has refused to list nonvoting common stock. For several years the exchange, without formal announcement, has been extending this policy to preferred stock not possessing the right to at least one vote per share after recurrent defaults of dividends. However, it has been observed that in most instances in which preferred stock receives only one vote per share that right has been of small practical effect because of the numerically superior voting power of the common stock. Recently, in considering issues proposed for listing, the exchange has been exerting its influence to obtain voting rights sufficient to insure the preferred stockholders at least representation on the board of directors upon recurring defaults of dividends.

"PREFERRED STOCKS' RIGHTS

"The right of preferred stockholders to vote under certain circumstances is now receiving more general recognition. For example, many preferred stocks provide for representation of the class on the board after dividend defaults and the right to elect a majority of the board after a specified number of recurrent defaults.

"There is also a noticeable trend in new preferred issues to prohibit changes in protective provisions, the issuance of senior securities, and dilution, either by charter amendment, reclassification, merger, or other means, without the affirmative approval of the preferred stock as a class.

"MINIMUM RIGHTS NEEDED"

"The circumstances under which different preferred stocks are issued, and their relation to the capital of different companies present such variety that the committee on stock list does not believe it desirable at this time to establish definitive standards of the adequacy of voting rights as a uniform listing requirement applicable to all cases. However, the committee feels that, to qualify for listing under the label of a 'preferred stock,' preferred stock should at least have certain minimum rights, both for representation on the board of directors after dividend defaults and for protection against a compulsory change in its existing provisions, even if such minimum voting rights are not granted under the laws of the particular State of the company's incorporation.

"Therefore, the committee on stock list has decided that, as a matter of policy, it will not list new preferred stocks which do not provide at least the following minimum voting rights:

"1. The right of the preferred stock, voting as a class, to elect not less than two directors after default of the equivalent of six quarterly dividends.

"2. The affirmative approval of at least two-thirds of the preferred stock, voting as a class, as a prerequisite to any charter or bylaw amendment altering materially any existing provision of such preferred stock.

"While preferred stocks with the above provisions will satisfy present listing requirements, these minimum standards are not to be regarded as the opinion of the committee on stock list as to the adequacy of protective provisions under all circumstances. The committee is hopeful that issuing companies and underwriters will continue their efforts for the improvement of the voting position and protective rights of preferred stock beyond these minimum listing requirements.

"The new policy will not be applied retroactively to issues already listed, many of which do not conform to the above standards."

WELLINGTON FUND, INC.,
Camden, N. J., May 3, 1940.

HON. ROBERT WAGNER,
Chairman, Senate Banking and Currency Committee,
Washington, D. C.

DEAR SIR: I am writing this letter to correct an error in the transcript of the testimony in the matter of the investment-trust bill S. 3580. The errors occur on index 778 and 780 concerning the questions of redemption provisions in open-end companies.

The documentary evidence submitted by the Securities and Exchange Commission, presumably through Mr. David Schenker, counsel, is in error when it states that the Wellington Fund redemption rights may be changed and amended by the directors. In the Wellington Fund all investment restrictions, redemption rights, and other matters are defined in the bylaws, but the bylaws also contain a provision that the investment restrictions and liquidation rights may not be removed without approval of a majority of the stockholders.

A copy of the bylaws evidencing the foregoing provisions is attached hereto.

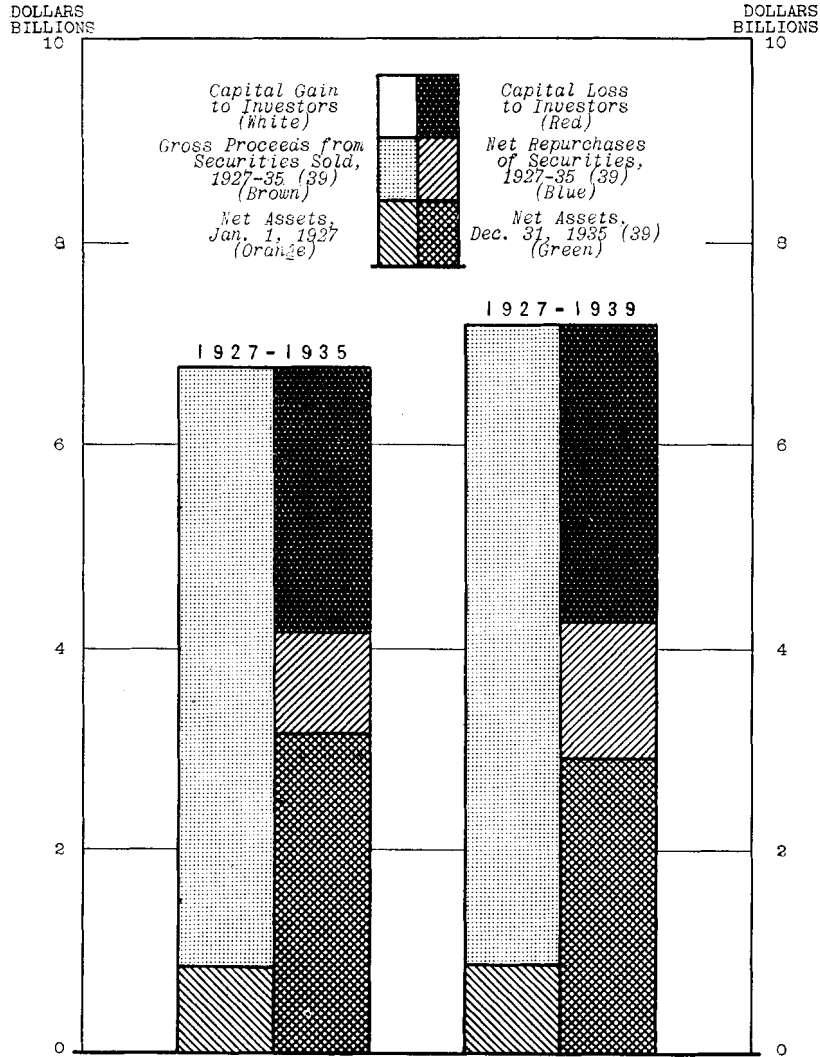
I am sending a copy of this memorandum to Mr. Schenker in order that he may correct the record for the statement erroneously made.

Yours very truly,

WALTER L. MORGAN, *President.*

(The following charts were submitted by Raymond W. Goldsmith, Trading and Exchange Division, Securities and Exchange Commission, and are referred to in pt. 2, p. 821:)

INVESTORS' EXPERIENCE IN
MANAGEMENT INVESTMENT COMPANIES

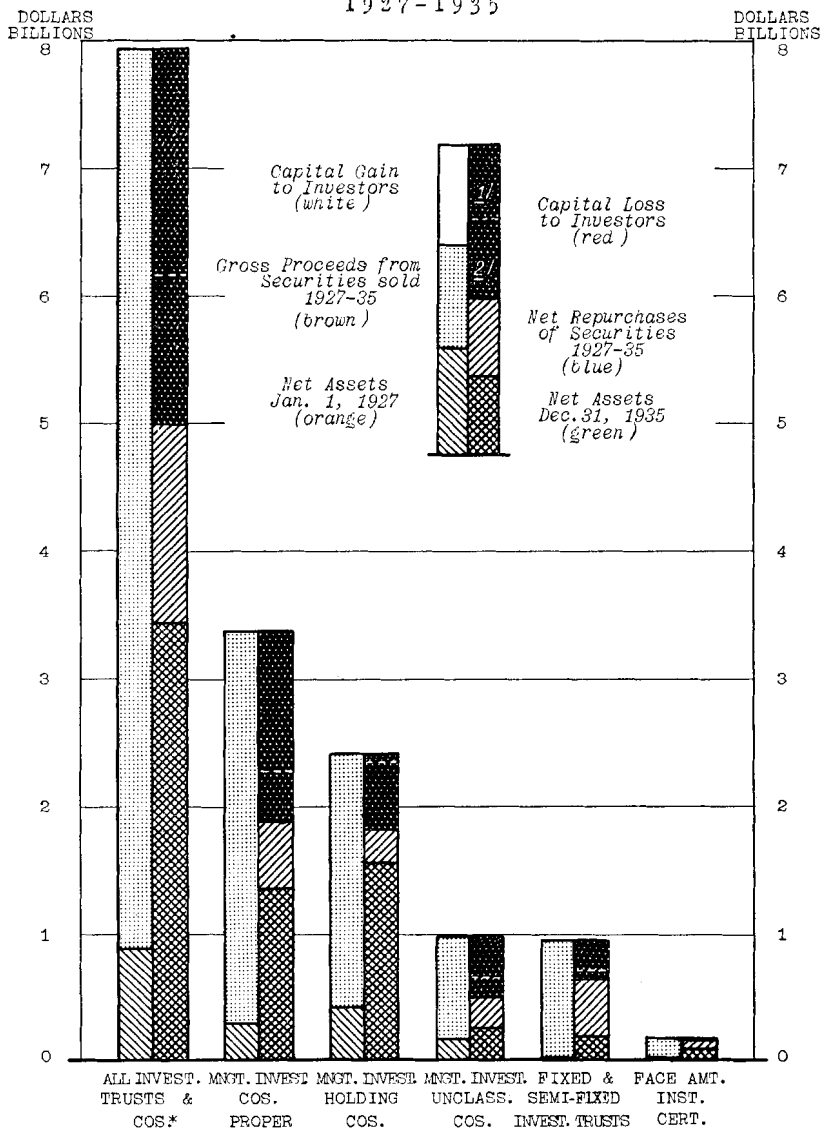


Colors in Parenthesis () appeared on original chart.

DS-1529 PREPARED BY SEC. & EXCH. COMM.

INVESTORS' EXPERIENCE IN INVESTMENT TRUSTS AND INVESTMENT COMPANIES*

1927-1935



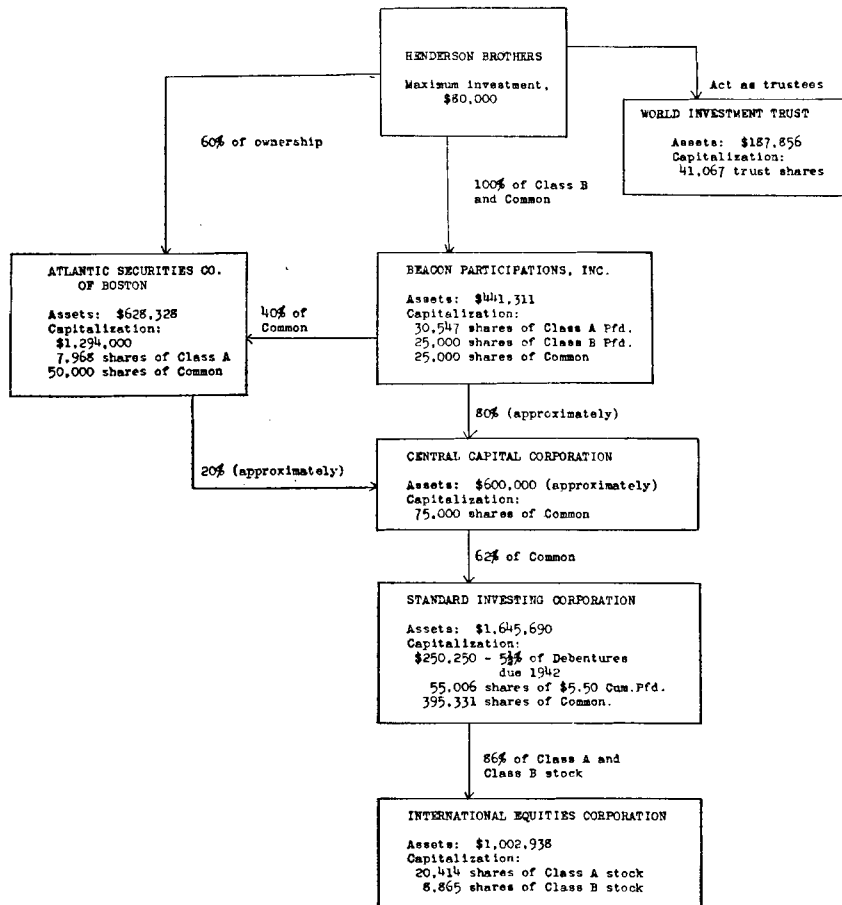
1/ Net Loss to Investors

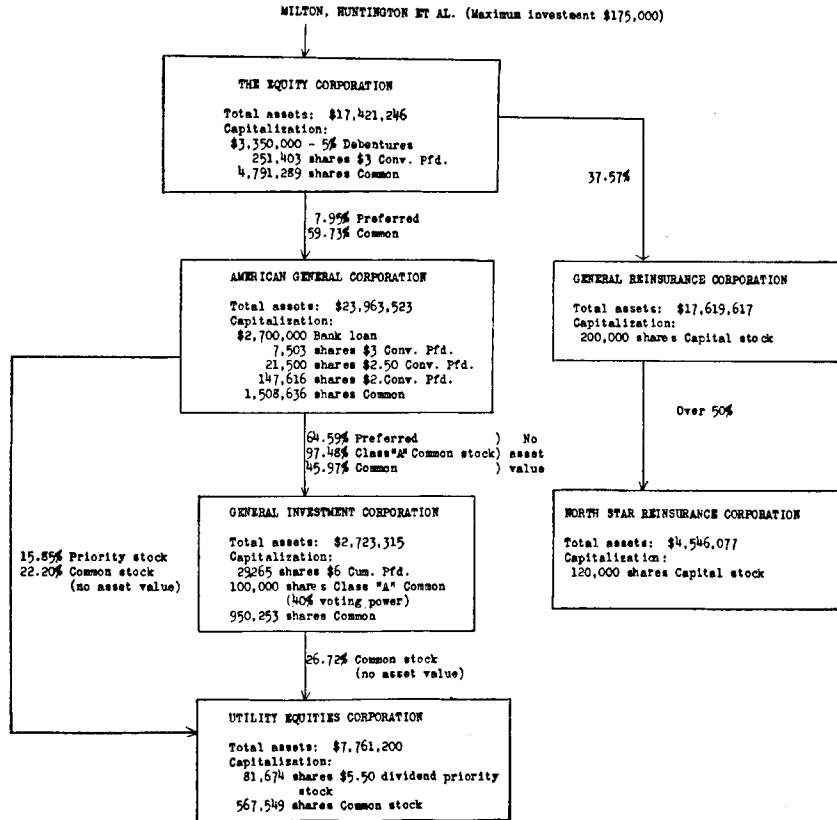
2/ Interest & Dividends Paid, 1927-35

* Excluding Common Trust Funds & Installment Investment Plans

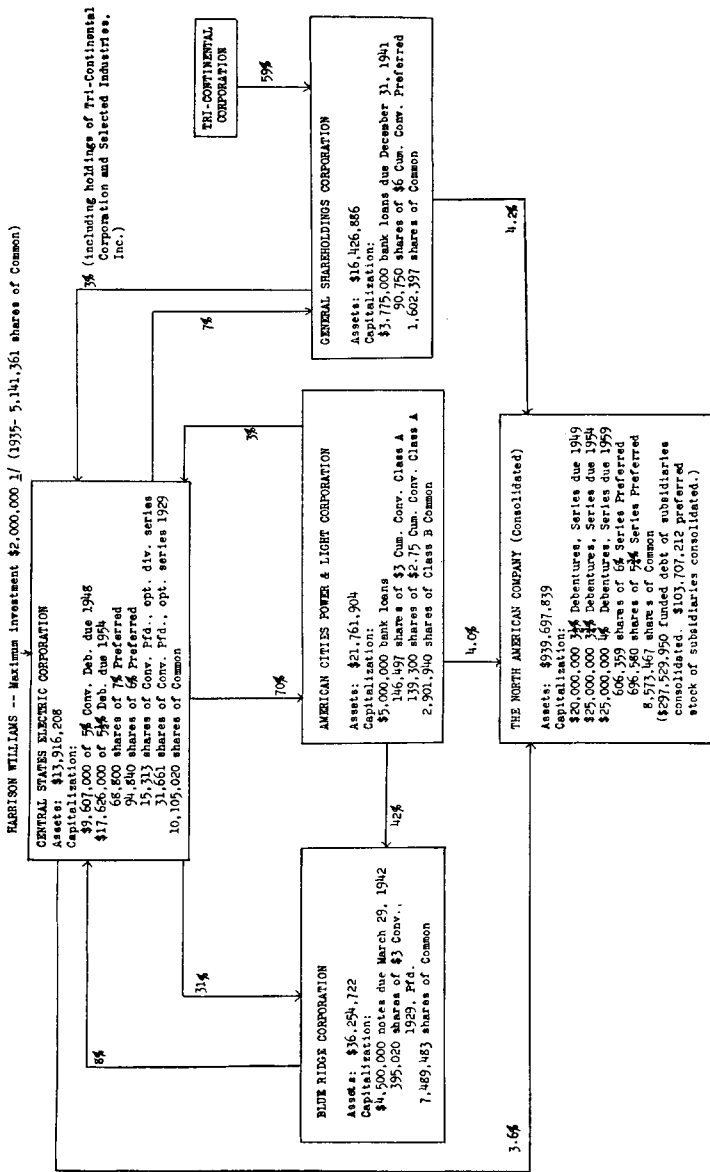
Colors in Parenthesis () appeared on original chart.

(The following charts were submitted by Mr. David Schenker, Chief Counsel, Investment Trust Study, Securities and Exchange Commission, and are referred to in pt. 2, p. 967:)



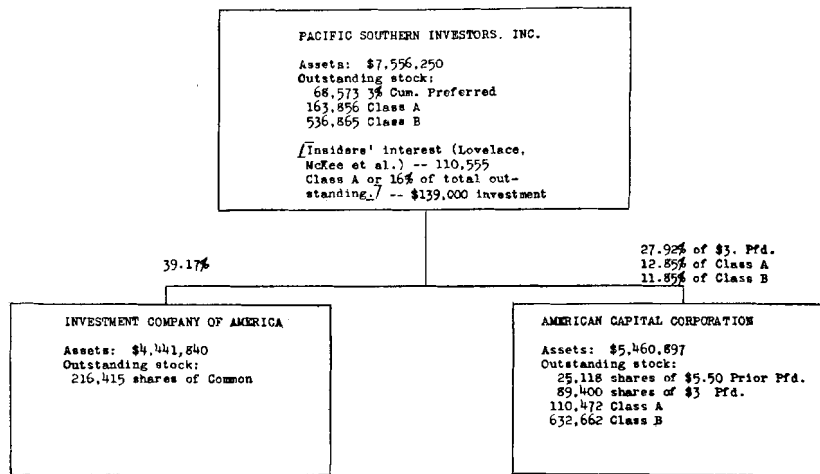


HARRISON WILLIAMS' GROUP OF INVESTMENT COMPANIES
December 31, 1939



1/ All of this investment was returned as dividends and as profit in the sale of a portion of his holdings.

PACIFIC SOUTHERN INVESTORS, INC. GROUP
December 31, 1939



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