

MEMORANDUM

June 17, 1942

To: Chairman Purcell and Commissioner Healy

From: Harry Heller and Edward McCormick

Re: Stoppage of sales and payments received by face-amount certificates, periodic payment plan certificates and open-end companies.

Mr. McCormick, members of my staff and myself have considered the problem which you raised in your office this noon and we have reached the following conclusions:

1. In the case of Investors Syndicate and Investors Syndicate of America, Inc., we are of the opinion that sales of new certificates should be stopped, but that payments on existing certificates should be permitted to be continued.
2. With reference to open-end companies, we are of the opinion that sales of their securities should be stopped.
3. With reference to periodic payment plan certificates, we are of the opinion that sales of new certificates should be stopped, but that the continued receipt of payments on existing certificates should not be stopped.

Our reasons for these conclusions are as follows:

1. With reference to Investors Syndicate and Investors Syndicate of America, Inc.:
If payments on existing certificates were to be stopped and as a result thereof certificate holders have a right of rescission to recover the total amounts paid in, Investors Syndicate (the old company) would be unable to meet these payments and would go into the hands of receivers. The new company would just barely be able to repay all existing certificate holders in full. We

are uncertain as to what the effect of a Government prohibition on further payments would be, specifically as to whether or not it would entitle certificate holders to rescind their contracts and recover full amounts paid in to the company.

Both companies, however, are in a financial condition to meet in full the present cash surrender values of their outstanding certificates. If payments on existing certificates were to be stopped and certificates were to be converted into paid-up certificates at a face amount equivalent to the cash surrender value thereof, the new company probably could improve such securities at the contract rate. The old company, however, could not improve such paid-up certificates at the contract rates because of the fact that there would no longer be any lapses upon which the company has relied in the past as a source of revenue to improve the certificates and no income would accrue to the company through its right to omit to improve certificates during periods in which installment payments were delinquent. Furthermore, if certificate holders are restricted to obtaining only the cash surrender values of their certificates in the old company, it would result in an equity of the common stock of the old company of several million dollars. In effect, therefore, the restriction of the certificate holders to the surrender values of their certificates in the event of a Governmental order stopping payments would benefit the management very materially, while in many cases causing losses to certificate holders when certificates have not yet attained a surrender value equal to the total payments made on the certificates.

However, if the sale of certificates of the new company were stopped, the company, in our opinion, would not be adversely affected. Based on its present investments, it could continue to improve its existing certificates at the contract rate if it continued to receive payments on its existing certificates. As already indicated, if the existing certificates were converted into paid-up

certificates and no new certificates were sold, the company could continue to improve such paid-up certificates at the contract rate. In our opinion, Investors Syndicate will not be adversely affected by the stoppage of the sale of new certificates of Investors Syndicate of America, Inc. since it can compensate for its loss of revenue from this source through a sloughing off of its sales personnel and otherwise. Nor is that portion of the sales load which accrues to Investors Syndicate of America necessary to improve its contracts at the contract rate. It is our conclusion, therefore, in view of the fact that a stoppage of payments on the certificates of Investors Syndicate (the old company) might have the effect which we have already noted, that the better policy would be to stop the sale of new certificates but to permit payments on existing certificates to continue.

2. With reference to open-end companies and periodic plan companies: We see no compelling reasons of policy to permit the continued sale of open-end securities. It seems to us that to the extent that channels of investments are closed to investors, the greater the likelihood will be that investors will invest in Government bonds. The sole problem in open-end companies would be the effect that redemptions would have on the stock markets because of the fact that if a run occurs on such companies, they may be required to sell marketable securities quickly on the stock exchanges with a consequent depressing effect on the market. However, the Commission has ample power under Section 22(e) of the Act to deal with this problem. For example, it can suspend redemptions if a run occurs until all of the company's securities are liquidated and then require a pro rata distribution among the security holders. The same operations apply to the sale of periodic payment plan certificates. However, if further payments on such certificates are stopped, many investors may suffer large losses because of the fact that the load charges in the first year of the plan are approximately 50% of the payments. To the

extent that they are allowed to continue payments the load charges decrease to about 9%. In view of this fact it seems desirable in the case of periodic plans to prohibit the sale of new certificates but to continue payments on the old ones. It is also to be noted that under the Investment Company Act periodic payment plan holders can redeem their securities at any time.