I am very much opposed to the Securities and Exchange Commission or anybody, other than the directors, determining the form in which that information is presented to the stockholders. If some agent other than the directors decides what form they shall take, it may be misleading to the stockholders; and I think that the directors themselves are responsible to give their stockholders a true picture.

Senator HUGHES. May I interrupt you a moment?

Mr. AMORY. Certainly, Senator.

Senator HUGHES. That has caused me some thought, too. I take it that you think that the directors should give a statement. Would it be sufficient, to your mind, that the bill should provide for a comprehensive statement? Would you stop there?

Mr. AMORY. I would stop there.

Senator HUGHES. Or would you say, "covering the following"?

Mr. AMORY. "Covering the following points"; yes; I think I would.

Senator HUGHES. It would be a sort of direction by statute as to the general outline of the statement?

Mr. AMORY. Yes, sir. When I come to (*b*) you will see the point that I am trying to make.

(*b*) that all investment companies shall be required to file with the Commission audited statements in such form as the Commission may prescribe and that these statements shall be made available to the public by the Commission.

A great protection to any stockholder is the statute regarding using the mails to defraud; and that is the theory that I am working on. If there is any fraud used, it would be easy to pick it up.

(*c*) that all notices, reports, and other material sent by investment companies to their stockholders shall also be sent to the Commission;

(*d*) that all prospectuses and other selling literature distributed by the underwriter to prospective stockholders shall also be sent to the Commission.

This does not mean that the Commission shall approve them. It means that we lay our cards on the table.

Such legislation, together with that which is already on the statute books, would, in my opinion, prevent (so far as any laws can prevent) abuses that have occurred in the management of investment trusts.

I would like to state here that not only have I read the proposed law in detail, but have had it read to me by a lawyer so as to have him explain what it meant. And then I have read all the evidence that has been presented to your committee, and most of the exhibits. In my opinion, those things would cover nearly all abuses that have been brought out.

I am opposed to the proposed bill (S. 3580) for the following reasons:

1. Because to an unnecessary degree it transfers the law-making powers of Congress to a commission which is in no way responsible to it.

2. Because it endeavors to insure honesty through legislation by providing supervision which, in my opinion, would be entirely inadequate for the purpose, burdensome to the management, and expensive to the investor.

3. Because it will favor the larger trusts over the smaller trusts in obtaining necessary advice.

4. Because it allows the Commission to control a business that is so varied in form and complex in nature and so dependent on personal judgment that no single group of men could understand all phases of it, no matter how experienced they were in any particular field.

5. Because it subjects the Commission to the possibility of acting through subordinates on snap judgments, on inadequate information or from dishonest motives.

6. Because it will eliminate from the management of investment trusts that type of responsible individual most helpful and best trained for such work.

7. Because it will increase the cost of administration and reduce thereby the income to the investors.

I thank you.

Senator HUGHES. Thank you, Mr. Amory.

Senator HUGHES (presiding). The next name that I have on my list is Mr. Hugh W. Long.

Mr. LONG. I am here, Senator.

Senator HUGHES. We will hear you now, sir.

Mr. LONG. Thank you.

STATEMENT OF HUGH W. LONG, PRESIDENT, NEW YORK STOCKS, INC., AND MANHATTAN BOND FUND, INC., NEW YORK, N. Y.

Mr. LONG. My name is Hugh W. Long, and I am president of New York Stocks, Inc., and of Manhattan Bond Fund, Inc. Both of these are open-end investment companies. New York Stocks, Inc., has a portfolio consisting entirely of marketable stocks; Manhattan Bond Fund, Inc., is restricted by its charter to investment only in marketable bonds. Both have the wide diversification of investment necessary to comply with the mutual investment-company provisions of the Internal Revenue Code. They are companies of moderate size; at present, one has a net asset value of about $10,000,000; the other about $5,000,000.

These companies were not sponsored by any investment banking house or brokerage firm and they are not managed by either. From their inception, their charters have contained prohibitions against self-dealing by officers or directors, short selling, margin trading, loans, borrowing, pledging of assets, and certain other practices condemned by the S. E. C. and prohibited by the proposed act. Their securities have been sold at a moderate sales load to a substantial number of investors through registered investment dealers in various parts of the country. In these respects, I believe, they are typical of the large majority of companies now operating in the open-end field.

I am also the president of Manhattan Foundation, Inc., the investment adviser for both of these companies, and of Hugh W. Long & Co., Inc., which is the wholesale distributor of the securities of both. The majority financial interest in Manhattan Foundation, Inc., is held by a number of persons not identified with either investment company or with Hugh W. Long & Co., Inc. My associates and I, however, control both of these companies. Both the advisory company and the distributor operate under separate contracts with the two investment companies.

This statement is devoted first to a consideration of those portions of section 15 of the proposed act which provide:

(a) That no person shall serve as a manager or investment adviser of a registered investment company except pursuant to a written con-

tract, approved by the vote of a majority of the outstanding voting securities of the company which—

(1) by its terms expires not later than two years from the date of its execution and is renewable thereafter only annually; and

(2) may be terminated at any time, without the payment of any penalty, by the board of directors of the company or by vote of a majority of the outstanding voting securities, on not more than sixty days' notice.

That is, the contract may be canceled on 60 days' notice.

At the outset, let me say that we approve without reservation those provisions of section 15 which require that the compensation of management be precisely defined and which provide for the cancelation of management and distributing contracts upon assignment of a contract or transfer of control of the company holding it. We quite agree that there should be no opportunity for investment companies to be "sold down the river." Although the transfer of a personal-service contract of a fiduciary nature is probably a violation of ordinary rules of law, we see no objection to a specific prohibition in this statute.

Furthermore, we are in full accord with the statement made by Judge Healy on the opening day of these hearings to the effect that "we ought to develop a group of expert investment trust managers" capable of providing "wise and careful management of the funds entrusted to them." We sincerely believe, however, that it would be impossible to develop or continue that type of management for investment companies under the limitations contained in this bill.

Here are my reasons for thinking that:

The type of organization capable of rendering efficient and valuable investment advisory or management service to investment companies is not the sort that consists of a desk, a chair, a few books, and one ex-accountant. On the contrary, to do a good job, one of these advisory organizations must have a substantial, permanent, trained staff to do extensive research, statistical and analytical work. It must be operated by persons trained in security analysis—not statisticians or customers' men or industrial plant managers, but investment analysts, possessing the background and experience necessary to make a critical evaluation of investments. It must lease space, purchase equipment, employ clerical help. Contracts must be entered into for statistical services, library facilities, and so forth. Its more important personnel must have some security of tenure, which means salary contracts. If the organization employs, as many of them do, economic experts of high caliber, it can do so only on substantial retainers and for long terms.

Research organizations of this sort can be built and maintained only upon some assurance of a steady flow of income. No really competent organization could afford to undertake to perform a short-term contract, terminable capriciously and at short notice.

If the organization which does this work is a "manager" as distinguished from an "investment adviser" (using the terminology of sec. 10 (d)), it can, under the bill, serve only one investment company (sec. 10 (d) (1)). It is prevented from obtaining the economies

and advantages of serving an aggregation of capital from several clients. In other words, it must do only one job, and be prepared to go out of business on 60 days' notice.

If this 60-day provision remains in the bill, its only effect will be to put a high premium on bad management.

The proposed measure which permits a contract to be canceled on 60 days' notice by vote of the shareholders, constitutes a direct invitation to raids upon the management of every established investment company.

Fly-by-night organizations posing as investment counsel, will, as surely as day follows night, appear upon the scene and attempt to cut the ground from under existing management by offering to reduce the management fee. Under the proxy rules, the material of these raiders must be sent to the stockholders—and the stockholders will have no adequate standard of judgment except the difference in cost. Once the pirates are in, they will be subject to the same attack by other hijackers. The field will be wide open to strike tactics and shyster practices. The net result will be to vest the management of investment companies in the very class of persons it is desired to exclude.

In the case of an open-end investment company, there is a close coordination of interest between management and distribution of securities. In these companies, shares may be redeemed by the stockholders at their option. If the funds thus withdrawn are not replaced by the concurrent sale of other shares, portfolio securities must be liquidated. In order, therefore, to keep the capital funds at an efficient operating level, there must be a constant and steady distribution of securities—just as, in the case of an insurance company, there must be a constant sale of new policies to replace those matured or lapsed. Management cannot do a good job if the amount of funds at its disposal is subject to rapid gyrations. Distributing organizations, therefore, as well as management organizations, must have a reasonable degree of stability.

Management or advisory contracts, under the bill, may be made for an initial period not exceeding 2 years, but the initial period for distributing contracts with the principal underwriters of open-end companies is limited to 1 year. Aside from the question as to whether 2 years is long enough in either case—we do not think it is—there does not appear to be any valid reason for this distinction.

An underwriter distributes through dealers, and to do a good job he must have a good many of them. Good dealers are not available at the snap of one's fingers; they must be sought out, educated to the merits of a security, and persuaded to sell. The formation of a group of dealers requires a substantial investment in time, traveling expenses, advertising, literature, quotation facilities, telegrams and postage, as well as the establishment of an efficient field and internal organization for handling the details of the business. The securities must be registered under the Securities Act of 1933 and under the "blue sky" laws of the various States—all of which requires time and the expenditure of money. No one is going to build such a structure at the risk of seeing it collapse before he has begun to recover his investment—and of having the results of his efforts handed over to someone else for nothing. Unless the distributing contract can run for an initial period sufficient to permit the underwriter to recover his original outlay,

underwriters of proper qualifications will not be available for this business.

One other factor must necessarily enter into any consideration of these contracts. That is the expense of the initial organization of the issuing company.

We have heard a lot here about $500 being run up into millions; but we know of no way of accomplishing such miracles honestly.

Senator HUGHES. Excuse me; I thought that was an illustration of how it could be done dishonestly.

Mr. LONG. I think that is true in most cases.

The organization of an open-end investment company and the operation of it until it earns its own way involves the expenditure of substantial sums of money, running into many thousands of dollars. This money must be supplied by someone. It cannot be provided by the stockholders of the fund; most of it must be spent before there are any public stockholders. Even with the proposed requirement of $100,000 initial capital, the organization and development expense must come from outside of the investment company itself, since no reputable distributor would offer securities of a company whose initial balance sheet shows a large capital deficit—due to organization expenses. Such a security could not be qualified under the "blue sky" laws of most States.

The expense of organization and development, therefore, is borne by the so-called sponsors who expect to and usually do manage the company after it has procured capital for investment. There is nothing nefarious about this; there is not the slightest indication that people who organize open-end investment companies are not qualified to manage them. On the contrary, organization—which includes the distribution of securities—can be accomplished only by those in whose management the public has ultimate confidence.

Having expended these substantial amounts of money, however, the managers of the fund must have some reasonable time in which to recoup their investment before they can be ousted from their proper employment. We believe that 1 or 2 years is not enough for this purpose. With a reasonable charge for management services and the expenditure of proper amounts for maintenance of the facilities necessary to render efficient service, the profit is not so large as to permit rapid recovery of the initial expenditure. Honest management should be allowed adequate time for this purpose. To deny it, would tend to restrict this field to organizations bent upon the rapid recovery of investment by the dishonest practices which this legislation seeks to prevent.

Finally, we must not ignore existing contracts which have been entered into in good faith for a term of years and still have substantial periods of time to run. We feel sure that the Congress would not expect deliberately and unqualifiedly to legislate these contracts out of existence. Although this is properly a matter for counsel rather than for the manager of an investment trust, one cannot help raising the question of the constitutionality of such a provision.

Yet, the proposed act provides that after 1 year from its effective date no investment company can operate under any such contract. However, the contracts are there. The investment companies cannot simply cancel them out of hand, without compensation to the other parties who have made a substantial investment on the faith of these

contracts. The necessity for complying with this provision of the proposed act is likely to cost the investment companies such very substantial amounts of money as to offset any possible benefits which may be derived from the administration of the act.

I must emphasize that the point of view I am expressing on this point is entirely realistic. In our situation the investment companies have boards of directors, the majority of whom are entirely independent of either the distributor or the investment advisory company. Neither of the latter controls either investment company; these are controlled by their thousands of stockholders. The financial interests in the advisory company and in the principal underwriting company are extremely diverse, and they have separate and independent boards. Under these circumstances, we cannot predict that the advisory company, which made the initial investment and has not yet recovered it, will, without compensation, be willing to relinquish its contracts. It could not properly be required to do so.

Our suggestions for improvement of the provisions of section 15 of the bill are, first, provide that management, advisory, or distributing contracts may be made for an initial period not exceeding 5 years, renewable thereafter annually, as now provided in section 15 (b) (2); second, provide that a company may continue to operate under existing contracts for not more than 5 years from the effective date of this provision; third, eliminate paragraph 15 (b) (3). That is the one about the 60-day cancelation clause.

I should like to turn back for a moment to those provisions of section 10 of the bill which seek to prohibit two or more investment companies from having the same manager or investment officer, or a majority of directors in common. This point has been touched on this afternoon, but it has special application in my case, which I think you would like to know about.

The two companies with which I am connected have the same board of directors—identical boards, the majority of whom are independent, disinterested businessmen of experience and judgment. These two companies have the same investment officer, who receives no direct compensation from the investment companies. I act as executive head of both companies; I have had over 20 years' experience in the investment field, during the last 10 years of which I have been connected with the administration of investment trusts. I do not draw a salary from either investment company.

If this bill is enacted into law, we must drop some of our valued directors and must attempt to find others. I must resign as president of one company or the other, which must find and pay another chief executive. Each investment company must employ a separate investment officer, pay his salary, and provide him with an office and with secretarial and other assistance. I estimate that the aggregate additional expense to each of these investment companies will be in the neighborhood of $25,000 to $30,000 a year, which must be borne by the shareholders.

Where the portfolios of the companies are of an entirely different character, as in the case of these two companies, there seems to be no good reason for the application of these provisions.

Here there can be no question of conflicting interests, divided loyalties, or concentration of economic power. We do not approve of these provisions of section 10; but whatever may be the ultimate

decision as to their application to investment companies in general, there should be a specific provision in the bill to the effect that they shall not apply under the conditions I have described, where the two companies have entirely different portfolios. One buys only stocks; one buys only bonds; there cannot be any conflict, in the administration of those two portfolios.

Senator HUGHES. Except that each has the same board of directors?

Mr. LONG. The same board of directors.

Senator HUGHES. The same manager?

Mr. LONG. That is right.

Senator HUGHES. The same president?

Mr. LONG. The same chief executive officers; that is right.

Senator HUGHES. The same president?

Mr. LONG. That is right.

In conclusion, I should like to reiterate the statement made by other members of this industry: We do not object to reasonable Federal regulation directed toward elimination of the frauds and looting described in the early days of these hearings. We believe, however, that this bill goes far beyond the necessities of the situation, and gives the S. E. C. such extensive control over the actual operation of the business as to increase materially the expenses borne by the shareholders, and to interfere seriously with free management, efficient conduct of the business, and the interests both of investors and of managers.

Thank you.

Senator HUGHES. Do you have any questions, Senator?

Senator HERRING. No; thank you.

Senator HUGHES. All right.

Mr. LONG. Thank you, Senators.

Senator HUGHES. All right; Mr. Curtis, will you come forward, please.

STATEMENT OF CHARLES P. CURTIS, JR., TRUSTEE, CENTURY SHARES TRUST, BOSTON, MASS.

Senator HUGHES. Will you proceed, please, Mr. Curtis?

Mr. CURTIS. My name is Charles P. Curtis, Jr. Senator, I come from Boston, Mass.; and I am speaking for Century Shares Trust, of which I am one of the five trustees.

Century Shares Trust is an open-end management investment company, under section 5 (a) (1), and it restricts itself to insurance stocks and bank stocks. It was organized in 1928, as a Massachusetts business trust. I do not think I need to go into their history. If you have not had it stated to you, I am sure that you will hear a description of the history and the character of the Massachusetts business trust. The oldest in the investment field is the Boston Personal Property Trust, which was drawn up in 1893 by former Secretary of State Olney, as I understand.

Century Shares Trust is younger. It was started in 1928; but it was built into that tradition. Three of our five trustees are themselves individually trustees. Charles F. Adams, whom you heard this morning; Robert H. Gardiner, who is president of the Fiduciary Trust Co.; and myself.

We are not one of the largest trusts; we have about $13,000,000 and about 4,500 shareholders. We are open-ended, and we are selling

and redeeming our shares all the time. Our shares are registered under the Securities Act of 1933.

I should like to address my few remarks chiefly and almost wholly to the provisions of the bill which require the shareholders to vote on certain subjects; and their effect, as I believe, on the nature of our trust, as a trust.

Our trust indenture requires the written consent of the holders of a majority of our shares to any form of amendment made by the trustees in the provisions regarding the distribution of income and in the provisions regarding the redemption of our shares, and also, of course, in the provisions with respect to how the trust indenture should be amended.

Otherwise, the trustees, by unanimous action, can make other amendments; but, of course, the shareholders have to be notified; and other amendments may be blocked by the holders of 10 percent of the shares filing notice of their opposition and objection. We believe that those provisions adequately protect our shareholders' interests; otherwise, except for those provisions I have referred to, our shareholders leave the entire management of the trust to our five trustees—because, as I think I shall show, otherwise we would not be a trust.

That, we believe, adequately protects our shareholders' interests. None of them has ever asked us for more control than this over their trustees. Why should they? They really are voting all the time. They know that they can redeem their shares and get back the liquidating value at any time they choose; and that includes any time they decide they do not like the way we are managing their affairs.

They have, we believe, something more than a vote. Each one, so to speak, can call his own shareholders' meeting, so far as it concerns himself, and vote by redeeming his shares. They are watching us all the time, and we know it. They are watching us especially every quarterly statement we make. That quarterly statement in a sense is our proxy statement. My point is that they are always voting, and we know we shall lose them if they are not satisfied.

This bill proposes to require the shareholders to vote on several issues. One is the election of the trustees (sec. 16); another is the approval of all management contracts (sec. 15 (b)). Another is any change in what is considered a fundamental policy of the trust (sec. 13 (b)). There is also a vote required on the selection of accountants.

I hope that the committee will consider what these voting requirements may do to a business trust. The essential character, you know, of a business trust lies in the trustees' exclusive management and control. If the trustees are subjected to the control of the shareholders they cease to be trustees and they become simply managers or agents for the shareholders. The shareholders then, if they are associated together in meetings, as this bill calls on them to be, become partners. The trust, so-called- becomes a partnership; the shareholders, being partners, become personally liable for the debts and liabilities of the business.

I hope this committee will sufficiently consider those possible consequences.

Senator HUGHES. Pardon me, Mr. Curtis, that is a new thought to me; that they become partners, and, therefore, responsible.

Mr. CURTIS. Yes; as partners, they become responsible for the debts of the business.

Senator HUGHES. Yes. Your company is an incorporation, is it not?

Mr. CURTIS. No, this is a trust; and I am talking about trusts. We are not a corporation.

Of course, some of them are.

Senator HUGHES. You may be right, but it is a new thought to me.

Mr. CURTIS. I should like, if I may, to quote and cite for you, Senator, as briefly as I can, some law on that phase of the matter.

Senator HUGHES. Very well.

Mr. CURTIS. I should like to quote from the Circuit Court of Appeals for the Eighth Circuit, in a well-considered opinion—quoting from the Texas Court of Civil Appeals. This is the case of *Otoe County National Bank* v. *Delaney* (88 Fed. (2d) 238):

> From the authorities consulted and hereafter referred to it seems that in order to create a trust which exempts the beneficial owners of the property from liability for the debts contracted by the trustee in his official capacity, the latter must have the legal title and the exclusive right of control and management of the trust property for a term, or for the accomplishment of a definite purpose. It must be made to appear that during that time the cestui que trust can exercise no power over the property except to receive the benefits and insist upon the execution of the trust agreement according to its terms.

Those are the words of the Texas Court of Civil Appeals, in *Morehead* v. *Greenville Exchange National Bank* (243 S. W. 546). They were quoted with approval by the Circuit Court of Appeals for the Eighth Circuit, in 1937.

The Massachusetts law was expounded in the case of *Williams* v. *Milton* (215 Mass. 1), where the Boston Personal Property Trust was held to be a true trust. It was later expounded in other cases.

In 1914 there was an association which called itself a trust, but it was held not to be a trust but a partnership, because the shareholders had the right to remove the trustees and appoint new ones, and had a right to amend the trust, and had a right to terminate it (*Frost* v. *Thompson*, 219 Mass. 360).

The latest case was decided by the Massachusetts court less than 2 months ago, in the case of *First National Bank of New Bedford*, v. *Chartier*, as reported in the Massachusetts advance sheets. There the Textile Loan Co. called itself a company. It was not a corporation. It regarded itself as a trust; yet all the shareholders were held liable to a creditor, because the court found that in fact it was not a trust but a partnership. The provisions which the court held gave the shareholders sufficient control to make them partners were that the officers were elected annually, that the shareholders had a right to remove an officer for cause, but only for cause; and that the bylaws could be amended by a vote of two-thirds of the stockholders. That, the court held—

> left in the shareholders the ultimate power of control of its affairs with the result that the relationship of partnership and not that of a trust was created.

Senator HUGHES. Might it not be called—and there is such a thing, I believe, in some States—an unincorporated association, like the Adams Express Co. was?

Mr. CURTIS. Yes; and in Massachusetts and under these decisions that unincorporated association would be called a partnership, and the partners would be held liable, if they have more than so much control.

Senator HUGHES. Yes.