Mr. Traylor and others have asked me to say that they also stand by their testimony, and likewise wish to file statements.

Senator HUGHES. I made the statement that you would be permitted to do so.

Mr. BUNKER. I appreciate that, Senator. I wondered if there was any chance of extending the period. There has been such a mass of matters presented in the last three days that, frankly, with just Saturday and Sunday in which to prepare it——

Senator HUGHES. We will give you ample time. We will give you until Friday.

Mr. BUNKER. That would be very much appreciated indeed. Any time during Friday?

Senator HUGHES. Yes.

Mr. BUNKER. That will be very much appreciated.

Senator HUGHES. It will take us that long at least to read the testimony.

Mr. BUNKER. You will not catch up to us, I think.

A considerable number of the gentlemen who have appeared before you—in both the open-end and closed-end sections of the investment company industry—have done me the honor of asking me to present to this committee a statement of their joint views.

At the outset of these hearings, speaking on behalf of a committee of investment companies, I declared ourselves to be in favor of reasonable Federal regulation of our industry. During the course of these long hearings, various leading members of both sections of this business have outlined to this committee their views as to the proper scope of regulation of investment companies, as well as their objections to certain portions of the bill before you. Most of us have presented to you sets of broad principles upon which, in our opinion, regulatory legislation should be based.

Senator Wagner has indicated upon several occasions that it would be helpful to the Committee if these general suggestions could be translated into specific recommendations applying directly to the bill in hand.

We are very anxious indeed as these hearings close to put the stamp of sincerity upon our initially expressed desire for regulation. Therefore, representatives of a substantial proportion of our industry—both open-end and closed-end—have held a number of conferences in the past few days, and have correlated and combined our various individual suggestions into a specific set of practical proposals, within the framework of the bill before you. We are submitting to you today this outline, which is as precise and complete as time has permitted us to make. I am sure you will appreciate that there has been no chance to devise detailed language but only to state general provisions, which, however, we believe are definite enough to leave no doubt as to their meaning.

While there has been insufficient time to consult all members of our industry, our proposals, as I have said, embody the considered and agreed views of a large and, we think, representative portion of it.

The proposals which we are making to you will, in our opinion, take care of most of the abuses which have been discussed at these hearings. In fact, I think I can say that they will take care of all of the abuses insofar as any reasonable legislation can do so.

Specifically, these provisions cover the subjects of independent directors; overnight changes in management; dumping of securities

by interested parties, and self-dealing; changes of fundamental policies which are to be prohibited without stockholders' approval; abuses in the distribution of investment company securities, including dilution of the equity of existing stockholders; full publicity and disclosure to stockholders in periodic reports; proper advices as to source of dividends; proxy control; the establishment of accounting standards; and provisions for complete audits.

All of these will be accomplished in a simple manner with administrative discretion reduced to that minimum required for flexibility. Certainty takes the place of uncertainty in the bill now before you. Our proposals do not attempt the impossible. They are not so drastic and so complex that they can be made workable only by vast delegations of power. They do not attempt to cure all possible defects of State corporate laws—defects which, if they exist, apply equally to all corporations and not merely to investment companies.

We do not guarantee that these proposals are a complete cure-all, or that when tested by experience it may not develop that some amendments may be desirable. But we do say that they constitute a basis for workable legislation, that they accomplish the main objectives of the bill now before you, and that legislation embodying them would receive our support. Under such regulations we are certain that the industry could live and better serve the interests of its stockholders and of the public.

We hope that our suggestions may permit the realization in workable form of the objective of this committee, namely, to bring about at the earliest practicable moment adequate and livable regulations. Should, as we hope, our suggestions agree with your opinions in this matter, those elements of the industry for which I am now speaking are prepared to cooperate with your committee in any way which you may indicate, not only in drafting such amendments to the present bill as may be appropriate, but also in endeavoring to bring into agreement those members of our industry who would be affected by the legislation, and to whom we have not yet communicated these suggestions.

The framework of the proposed investment company bill, Title I, is as follows:

1. With reference to Findings and Declaration of Policy, Sections 1 and 2 of the present bill: These should be revised to accord with the revision of the bill. We earnestly hope that the report of your committee will call attention to the tax problem and to the desirability of providing special tax treatment not merely for certain classes of open-end investment companies as under the present tax law, but for closed-end investment companies as well.

2. Definition of Investment Companies, now Section 3 of the present bill: These definitions are in the main satisfactory, but careful consideration should be given by the draftsman to make certain that there are eliminated those companies whose inclusion under the present bill was neither intended nor desired. As in the present bill, power should be lodged in the Commission upon application to determine that a company is not an investment company, where such is the case, even if it falls within the scope of the technical definition.

3. Classification of investment companies, now section 4 of the present bill: The classifications in the present bill are satisfactory. Later the question will be raised of treating face amount certificate

companies, unit investment trusts, and periodic payment plan companies under a separate title.

4. Subclassification of management investment companies, now section 5 of the present bill: The division of management investment companies into "open-end" and "closed-end" companies is satisfactory. The further subclassifications of this section are neither logical nor sound, and should be revised to provide for only two types of companies perhaps known as diversified investment companies and securities finance or holding companies.

(*a*) A diversified investment company should be defined as a company which as to at least 75 percent of its total assets holds no security of any one company in an amount greater than 5 percent of its total assets and not more than 10 percent of the voting securities of any one company.

(*b*) A securities finance or holding company should constitute any management investment company not falling within the requirements of a diversified investment company.

5. Exemptions, section 6 of the present bill: We believe the present provisions of the bill to be satisfactory substantially in their present form, including the powers delegated to the Commission.

6. Transactions by unregistered investment companies, section 7 of the present bill: The provisions of the bill constituting a ban on transactions of unregistered companies are satisfactory in substance as a means of enforcement of the provisions of the bill. We question, however, the desirability of precluding the registration of foreign investment companies.

Senator HUGHES. You would include foreign investment companies?

Mr. BUNKER. We question the desirability of precluding the registration of foreign investment companies.

Senator HUGHES. Then you think they should be included?

Mr. BUNKER. That is right.

7. Registration of investment companies, section 8 of the present bill: Our suggestion would be that the provision for registration conform with similar provisions of the Securities and Exchange Act of 1934 including equivalent powers to the Commission.

In addition the registration statement should contain a declaration of the fundamental policy of the investment company in respect of the following items:

(*a*) Classification in which the company proposes to operate;

(*b*) Policy as to borrowing;

(*c*) Policy as to issuance of senior securities;

(*d*) Policy as to underwriting;

(*e*) Policy as to concentration of investment in any particular industry or group of industries.

8. Prohibition on certain persons acting as officers or directors, section 9 of the present bill: In lieu of the provision for the registration of officers and directors, provide for a flat prohibition of any person acting as such who has within the past 10 years been convicted of a felony or misdemeanor involving the purchase or sale of any security or is under injunction by court from acting in certain capacities as specified in the present bill. However, power should be given to the Commission in its discretion to grant exemptions from this prohibition.

9. Affiliations of directors, section 10 of the present bill: In lieu of the elaborate and complicated provisions of section 10 of the bill, provide that the board of directors of any investment company shall include a minimum percentage (40 percent) of directors who are independent of principal underwriters, regular brokers, managers or investment advisers.

This requirement for independent representation, plus the prohibition on self-dealing later referred to, should remove possibilities of abuse without stripping investment companies of competent and experienced directors.

10. Certain prohibitions, section 12 of the present bill: Margin purchases and joint trading accounts should be prohibited and also short selling in contravention of rules and regulations of the Commission. Underwriting commitments of diversified investment companies should be limited to a maximum of 25 percent of total assets and should, of course, be permitted only to such companies who have in their registration statement declared that they proposed to underwrite. In respect of underwriting, provision should also be made for carrying on underwriting and related activities through subsidiaries or companies to be owned by more than one investment company.

In the future no investment company should be permitted to exceed the 5 percent and 10 percent rule advocated for diversified companies in acquiring the stock of another investment company. This will put an end to pyramiding. Proper exception, however, should be made in connection with transactions designed to simplify existing investment company systems and in connection with reorganizations, mergers, and so forth.

11. Changes in investment policy, section 13 of the present bill: With classification and investment policy provided for, there should be a prohibition against any change in classification or in fundamental investment policy as announced in the registration statement without stockholders' consent.

12. Compensation of management, management and underwriting contracts, section 15 of the present bill: This provision should contain substantially the same requirements for approval by stockholders and prohibition on transfer of management contracts without consent of shareholders. It should not, however, dictate the basis of management compensation, provided that the method of payment is clearly and adequately set forth to shareholders. Underwriting contracts should also be covered substantially as in the present bill. It would seem advisable that existing rights under outstanding contracts be left undisturbed.

13. Changes in board of directors, section 16 of the present bill: The provisions of section 16 are satisfactory except in respect to a special situation which now exists.

The bill should not interfere in this respect with the operation of existing strict trusts except to provide for the right of removal of trustees by the holders of two-thirds of outstanding certificates. The concept of a trusteeship is different from the corporate idea. It seems reasonable to permit their continued existence.

14. Transactions of certain affiliated persons and underwriters, section 17 of the present bill: The prohibition on self-dealing is approved and there should be prohibited any sales to or purchases from

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insiders whether of portfolio securities or other property and also any loans to insiders. Agency fees and similar payments should be exempt and it seems reasonable to give to the Commission power to grant by general rules and regulations exemptions under certain circumstances to these flat prohibitions.

This section also deals with custodianship of the securities of investment companies. It is suggested that provision be made that all such securities be placed with (1) a bank or trust company subject to Federal or State supervision; (2) a private banking organization if subject to State or Federal supervision; or (3) institutions subject to control and discipline of a national securities exchange under the Securities and Exchange Act of 1934.

The obscure and indefinable provision in section 17 regarding gross misconduct and gross abuse of trust should be eliminated. Also, the provision requiring change of charters, bylaws, trust indentures, etc., should be deleted as unnecessary.

15. Capital structure, section 18 of the present bill: In lieu of the prohibition on the future issue of senior securities, provision should be made for the limitation on the future issue of senior securities of closed-end companies in some such manner as the following: In the case of debentures, there should be a minimum coverage of assets at the time of issuance of 300 percent, and in the case of preferred stock, a minimum coverage of 200 percent, including any obligations senior to the preferred stock. Dividend restrictions to correspond should be provided as to future issues of preferred stock. All stock, whether preferred or common, should have voting privileges. The exception with respect to existing strict trusts heretofore discussed in paragraph 13 would apply to this situation.

Refunding of existing senior securities should, of course, be permitted.

The subsection dealing with redistribution of existing voting rights should be eliminated.

16. Dividends, section 19 of the present bill: Provision should be made for full disclosure to shareholders as to the source of any dividend. Requirements as to dividends in relation to senior securities hereafter issued have been discussed in No. 15.

The provisions of the proposed bill which interfere drastically with existing contract rights are indefensible.

17. Proxies: Voting trusts: Circular ownership, section 20 of the present bill: The proxy requirements of the Securities and Exchange Act of 1934 which now apply to such investment companies as are listed on any national security exchange should be made to apply to all investment companies.

The prohibition of voting trusts is approved except that voting trusts presently existing under State laws should be permitted to be continued.

The complicated provisions in respect to circular ownership are replaced by the limitation on investment of one investment company in the stock of another provided for in No. 10.

18. Loans, section 21 of the present bill: Borrowings should be prohibited only to the extent of the limitation on indebtedness provided in No. 15 dealing with future capital structure, and provision should also be made permitting the refunding of any existing indebt-

edness and permitting borrowings for temporary purposes. Needless to say, loans to insiders are prohibited as self-dealing in paragraph No. 14.

19. Distribution, redemption, and repurchase of redeemable securities, section 22 of the present bill: These sections have to do primarily with problems of dilution and excessive sales loads. As these are problems affecting distributions and transactions with dealers, all of whom are members of a securities association organized and regulated under the Maloney Act, this section should provide that the rules of such securities association may deal with this subject matter. This section should also provide that no securities issued by an investment company shall be sold to insiders or to anyone other than an underwriter or dealer except on the same terms as are offered to other investors. Appropriate provision may be made for mergers.

This section should also provide that the redemption privileges of any redeemable security shall not be suspended except (*a*) for a period of not more than 7 days, or (*b*) in case of an emergency, including a period during which the New York Stock Exchange is closed, or (*c*) under such other circumstances as the Commission may by rules and regulations or by orders permit.

20. Repurchase of securities: Closed-end management companies, section 23 of the present bill: The purchase by closed-end investment companies of outstanding securities should be permitted only on the open market or pursuant to tenders or under such other circumstances as the Commission may prescribe by rules and regulations or orders.

21. Periodic reports, accounts and accountants, sections 30, 31, and 32 of the present bill: Investment companies should be required to send to their shareholders periodic reports. Bearing in mind the expense in relation to smaller companies, the requirement should probably not be for more than semiannual reports. These reports should be certified to at least annually by independent public accountants. Each report should include:

(*a*) Balance sheet showing the market or appraised value of securities and a list of securities held.

(*b*) When certified by public accountant, the certificate should include a verification of securities held or confirmation thereof from the custodian.

(*c*) The income account should show the source of all substantial items of income.

(*d*) Expenses should be broken down in detail at least as to those items constituting 10 percent or more of the total expenses.

(*e*) The report should include a supplemental statement of amounts paid to any director or interested person in the way of stock-exchange commissions, legal fees, or agency or similar payments.

The Commission should be directed to consult with representatives of the industry and public accountants, with a view to encouraging a reasonable degree of uniformity in accounting standards. We approve the theory of a periodic verification of security holdings and transactions outlined by Mr. Bailie and referred to at these hearings. But this is quite different from giving the S. E. C. a roving commission with inquisitorial powers, as provided for in the present bill.

22. Destruction and falsification of reports and records, section 34 of the present bill: This section dealing with destruction and falsifi-

cation of reports and records should be confined to corporate documents and corporate accounts.

23. Unlawful representations and names, section 35 of the present bill: The prohibition in the present bill in respect to unlawful representations is satisfactory and the adoption of misleading names should be prohibited. There is no necessity for any discretion to the Commission.

24. Rules, regulations, and orders—General powers of Commission, section 36 of the present bill: The general authority contained in subparagraph (a) of section 36 of the present bill should be made to apply only to specific sections of the bill which may require rules and regulations and should also be more limited in the scope of the power granted to the Commission.

25. Hearings by Commission, section 37 of the present bill: A policy should be expressed for consultation by the Commission with representatives of the industry, and for public hearings in the discretion of the Commission whenever it appears that there is a substantial demand for such hearings. Neither should be mandatory.

Provision should be made for hearings in respect of any formal proceeding before the Commission in relation to any proposed order.

26. Court review of orders—Jurisdiction of offenses and suits, sections 39 and 40 of the present bill: The provisions of sections 39 and 40 in the present bill are satisfactory.

27. Information filed with the Commission, section 41 of the present bill: This section is satisfactory as applied to the bill herein proposed. The effect of these provisions, however, if applied to the bill as introduced are much too far-reaching.

28. Annual reports of Commission, etc., section 42 of the present bill: This is satisfactory.

29. Penalties, section 43 of the present bill: There can be no question that penalties must be provided for violation of the act. The extent of the penalties is a matter in respect of which we would prefer to make no suggestions to the committee.

30. Effect of existing law, section 44 of the present bill: This section as it now stands is satisfactory.

31. General definitions, section 45 of the present bill: Many of these definitions need revision, but this is a matter for detailed drafting.

32. Separability of provisions, section 46 of the present bill: This is satisfactory.

Unit investment trusts, periodic payment plans, face amount certificate companies, sections 26, 27, 28, and 29 of the present bill: As the characteristics of these companies are essentially different from those of the ordinary investment company, it seems desirable that these subjects be dealt with under a separate title of the bill.

Sections which have been eliminated: There have been eliminated from this framework sections 11, 14, 24, 25, 33, and 38. These have to do with the recurrent promotion of investment companies, limitation on size, additional requirements in respect to prospectuses and sales literature, absolute jurisdiction to the Commission over voluntary reorganizations and recapitalizations, settlement of civil actions, and broad powers of investigation to the Commission. All of these subjects have been dealt with in the hearings before you. I might

just add the following brief comments as to a few of the sections eliminated.

Section 24 dealt with registration and sales literature in connection with the selling of securities. It is believed by us that this is properly taken care of by the Securities Act of 1933. If any additional provisions are needed, it should be by amendment to that act.

As has already been pointed out, Section 25 dealing with reorganizations and recapitalizations is one of the most drastic provisions of the bill. So far as insolvent companies are affected, this is covered by the Bankruptcy Act. Proxy regulations give the Commission power to require full disclosure to stockholders. This would seem to be adequate and there seems to be no reason why investment companies should be treated differently from any other type of company in respect to this matter.

Similarly in respect to section 33 dealing with the settlement of civil actions, there is no reason why investment companies should be treated in any manner different from other companies. The implications of these provisions are much too far reaching to be accepted without a most thorough study of the subject matter.

That, gentlemen, completes our comments.

I also, as Judge Healy has done, would like to thank this committee very earnestly for their sincere attention to and interest in the material which we had to present on the part of the industry.

Senator HUGHES (presiding). Thank you, Mr. Bunker. I am sure that your statement will be very valuable to the committee.

Mr. BUNKER. I also want to thank Judge Healy for his consideration in all these matters and for his courtesy and kindness to the members of the industry.

Senator HUGHES (presiding). The hearings are closed. If there is a further meeting the chairman will call it.

(Whereupon, at 4:15 p. m., the hearings were closed.)

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