[CHAPTER 686]

AN ACT

To provide for the registration and regulation of investment companies and investment advisers, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE I – INVESTMENT COMPANIES

FINDINGS AND DECLARATION OF POLICY

SEC. 1. (a) Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 30 of the Public Utility Holding Company Act of 1935, and facts otherwise disclosed and ascertained, it is hereby found that investment companies are affected with a national public interest in that, among other things—

(1) the securities issued by such companies, which constitute a substantial part of all securities publicly offered, are distributed, purchased, paid for, exchanged, transferred, redeemed, and repurchased by use of the mails and means of instrumentalities of interstate commerce, and in the case of the numerous companies which issue redeemable securities this process of distribution and redemption is continuous;

(2) the principal activities of such companies—investing, reinvesting, and trading in securities—are conducted by use of the mails and means and instrumentalities of interstate commerce, including the facilities of national securities exchanges, and constitute a substantial part of all transactions effected in the securities markets of the Nation;

(3) such companies customarily invest and trade in securities issued by, and may dominate and control or otherwise affect the policies and management of, companies engaged in business in interstate commerce;

(4) such companies are media for the investment in the national economy of a substantial part of the national savings and may have a vital effect upon the flow of such savings into the capital markets; and

(5) the activities of such companies, extending over many States, their use of the instrumentalities of interstate commerce and the wide geographic distribution of their security holders, make difficult, if not impossible, effective State regulation of such companies in the interest of investors.

(b) Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 30 of the Public Utility Holding Company Act of 1935, and facts otherwise disclosed and ascertained, it is hereby declared that the national public interest and the interest of investors are adversely affected—

(1) when investors purchase, pay for, exchange, receive dividends upon, vote, refrain from voting, sell, or surrender securities issued by investment companies without adequate, accurate and explicit information, fairly presented, concerning the character of such securities and the circumstances, policies, and financial responsibility of such companies and their management;

(2) when investment companies are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers, depositors, or other affiliated persons thereof, in the interest of underwriters, brokers, or dealers, in the interest of special classes of their security holders, or in the interest of other investment companies or persons engaged in other lines of business, rather than in the interest of all classes of such companies' security holders;

(3) when investment companies issue securities containing inequitable or discriminatory provisions, or fail to protect the preferences and privileges of the holders of their outstanding securities;

(4) when the control of investment companies is unduly concentrated through pyramiding or inequitable methods of control, or is inequitably distributed, or when investment companies are managed by irresponsible persons;

(5) when investment companies, in keeping their accounts, in maintaining reserves, and in computing their earnings and the asset value of their outstanding securities, employ unsound or misleading methods, or are not subjected to adequate independent scrutiny;

(6) when investment companies are reorganized, become inactive, or change the character of their business, or when the control or management thereof is transferred, without the consent of their security holders;

(7) when investment companies by excessive borrowing and the issuance of excessive amounts of senior securities increase unduly the speculative character of their junior securities; or

(8) when investment companies operate without adequate assets or reserves.

It is hereby declared that the policy and purposes of this title, in accordance with which the provisions of this title shall be interpreted, are to mitigate and, so far as is feasible, to eliminate the conditions enumerated in this section which adversely affect the national public interest and the interest of investors.

GENERAL DEFINITIONS

SEC. 2. (a) When used in this title, unless the context otherwise requires—

(1) "Advisory board" means a board, whether elected or appointed, which is distinct from the board of directors or board of trustees, of an investment company, and which is composed solely

of persons who do not serve such company in any other capacity, whether or not the functions of such board are such as to render its members "directors" within the definition of that term, which board has advisory functions as to investments but has no power to determine that any security or other investment shall be purchased or sold by such company.

(2) "Affiliated company" means a company which is an affiliated person.

(3) "Affiliated person" of another person means (A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person; (B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person; (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof; and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof.

(4) "Assignment" includes any direct or indirect transfer or hypothecation of a contract or chose in action by the assignor, or of a controlling block of the assignor's outstanding voting securities by a security holder of the assignor; but does not include an assignment of partnership interests incidental to the death or withdrawal of a minority of the members of the partnership having only a minority interest in the partnership business or to the admission to the partnership of one or more members who, after such admission, shall be only a minority of the members and shall have only a minority interest in the business.

(5) "Bank" means (A) a banking institution organized under the laws of the United States, (B) a member bank of the Federal Reserve System, (C) any other banking institution or trust company, whether incorporated or not, doing business under the laws of any State or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under section 11 (k) of the Federal Reserve Act, as amended, and which is supervised and examined by State or Federal authority having supervision over banks, and which is not operated for the purpose of evading the provisions of this title, and (D) a receiver, conservator, or other liquidating agent of any institution or firm included in clauses (A), (B), or (C) of this paragraph.

(6) "Broker" means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank or any person solely by reason of the fact that such person is an underwriter for one or more investment companies.

(7) "Commission" means the Securities and Exchange Commission.

(8) "Company" means a corporation, a partnership, an association, a joint-stock company, a trust, a fund, or any organized groups of persons whether incorporated or not; or any receiver, trustee in bankruptcy or similar official or any liquidating agent for any of the foregoing, in his capacity as such.

(9) "Control" means the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company.

Any person who owns beneficially, either directly or through one or more controlled companies, more than 25 per centum of the voting securities of a company shall be presumed to control such com-

pany. Any person who does not so own more than 25 per centum of the voting securities of any company shall be presumed not to control such company. A natural person shall be presumed not to be a controlled person within the meaning of this title. Any such presumption may be rebutted by evidence, but except as hereinafter provided, shall continue until a determination to the contrary made by the Commission by order either on its own motion or on application by an interested person. If an application filed hereunder is not granted or denied by the Commission within sixty days after filing thereof, the determination sought by the application shall be deemed to have been temporarily granted pending final determination of the Commission thereon. The Commission, upon its own motion or upon application, may be order revoke or modify any order issued under this paragraph whenever it shall find that the determination embraced in such original order is no longer consistent with the facts.

(10) "Convicted" includes a verdict, judgment, or plea of guilty, or a finding of guilt on a plea of nolo contendere, if such verdict, judgment, plea, or finding has not been reversed, set aside, or withdrawn, whether or not sentence has been imposed.

(11) "Dealer" means any person regularly engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, insurance company, or investment company, or any person insofar as he is engaged in investing, reinvesting, or trading in securities, or in owning or holding securities, for his own account, either individually or in some fiduciary capacity, but not as a part of a regular business.

(12) "Director" means any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated, including any natural person who is a member of a board of trustees of a management company created as a common-law trust.

(13) "Employees' securities company" means any investment company or similar issuer all of the outstanding securities of which (other than short-term paper) are beneficially owned (A) by the employees or persons on retainer of a single employer or of two or more employers each of which is an affiliated company of the other, (B) by former employees of such employer or employers, (C) by members of the immediate family of such employees, persons on retainer, or former employees, (D) by any two or more of the foregoing classes of persons, or (E) by such employer or employers together with any one or more of the foregoing classes of persons.

(14) "Exchange" means any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and the market facilities maintained by such exchange.

(15) "Face-amount certificate" means any certificate, investment contract, or other security which represents an obligation on the part of its issuer to pay a stated or determinable sum or sums at a fixed or determinable date or dates more than twenty-four months after the date of issuance, in consideration of the payment of periodic installments of a stated or determinable amount (which security shall be known as a face-amount certificate of the "installment type"); or any security which represents a similar obligation on the part of a face-amount certificate company, the consideration for which is the

payment of a single lump sum (which security shall be known as a "fully paid" face-amount certificate).

(16) "Government security" means any security issued or guaranteed as to principal or interest by the United States, or by a person controlled or supervised by and acting as an instrumentality of the Government of the United States pursuant to authority granted by the Congress of the United States; or any certificate of deposit for any of the foregoing.

(17) "Insurance company" means a company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies, and which is subject to supervision by the insurance commissioner or a similar official or agency of a State; or any receiver or similar official or any liquidating agent for such a company, in his capacity as such.

(18) "Interstate commerce" means trade, commerce, transportation, or communication among the several States, or between any foreign country and any State, or between any State and any place or ship outside thereof.

(19) "Investment adviser" of an investment company means (A) any person (other than a bona fide officer, director, trustee, member of an advisory board, or employee of such company, as such) who pursuant to contract with such company regularly furnishes advice to such company with respect to the desirability of investing in, purchasing or selling securities or other property, or is empowered to determine what securities or other property shall be purchased or sold by such company, and (B) any other person who pursuant to contract with a person described in clause (A) regularly performs substantially all of the duties undertaken by such person described in clause (A); but does not include (i) a person whose advice is furnished solely through uniform publications distributed to subscribers thereto, (ii) a person who furnishes only statistical and other factual information, advice regarding economic factors and trends, or advice as to occasional transactions in specific securities, but without generally furnishing advice or making recommendations regarding the purchase or sale of securities, (iii) a company furnishing such services at cost to one or more investment companies, insurance companies, or other financial institutions, (iv) any person the character and amount of whose compensation for such services must be approved by a court, or (v) such other persons as the Commission may by rules and regulations or order determine not to be within the intent of this definition.

(20) "Investment banker" means any person engaged in the business of underwriting securities issued by other persons, but does not include an investment company, any person who acts as an underwriter in isolated transactions but not as a part of a regular business, or any person solely by reason of the fact that such person is an underwriter for one or more investment companies.

(21) "Issuer" means every person who issues or proposes to issue any security, or has outstanding any security which it has issued.

(22) "Lend" includes a purchase coupled with an agreement by the vendor to repurchase; "borrow" includes a sale coupled with a similar agreement.

(23) "Majority-owned subsidiary" of a person means a company 50 per centum or more of the outstanding voting securities of which are owned by such person, or by a company which, within the meaning of this paragraph, is a majority-owned subsidiary of such person.

(24) "Means or instrumentality of interstate commerce" includes any facility of a national securities exchange.

(25) "National securities exchange" means an exchange registered under section 6 of the Securities Exchange Act of 1934.

(26) "Periodic payment plan certificate" means (A) any certificate, investment contract, or other security providing for a series of periodic payments by the holder, and representing an undivided interest in certain specified securities or in a unit or fund of securities purchased wholly or partly with the proceeds of such payments, and (B) any security the issuer of which is also issuing securities of the character described in clause (A) and the holder of which has substantially the same rights and privileges as those which holders of securities of the character described in clause (A) have upon completing the periodic payments for which such securities provide.

(27) "Person" means a natural person or a company.

(28) "Principal underwriter" of or for any investment company other than a closed-end company, or of any security issued by such a company, means any underwriter who as principal purchases from such company, or pursuant to contract has the right (whether absolute or conditional) from time to time to purchase from such company, any such security for distribution, or who as agent for such company sells or has the right to sell any such security to a dealer or to the public or both, but does not include a dealer who purchases from such company through a principal underwriter acting as agent for such company. "Principal underwriter" of or for a closed-end company or any issuer which is not an investment company, or of any security issued by such a company or issuer, means any underwriter who, in connection with a primary distribution of securities, (A) is in privity of contract with the issuer or an affiliated person of the issuer; (B) acting alone or in concert with one or more other persons, initiates or directs the formation of an underwriting syndicate; or (C) is allowed a rate of gross commission, spread, or other profit greater than the rate allowed another underwriter participating in the distribution.

(29) "Promoter" of a company or a proposed company means a person who, acting alone or in concert with other persons, is initiating or directing, or has within one year initiated or directed, the organization of such company.

(30) "Prospectus", as used in section 22, means a written prospectus intended to meet the requirements of section 5 (b) of the Securities Act of 1933 and currently in use. As used elsewhere, "prospectus" means a prospectus as defined in the Securities Act of 1933.

(31) "Redeemable security" means any security, other than short-term paper, under the terms of which the holder, upon its presentation to the issuer or to a person designated by the issuer, is entitled (whether absolutely or only out of surplus) to receive approximately his proportionate share of the issuer's current net assets, or the cash equivalent thereof.

(32) "Reorganization" means (A) a reorganization under the supervision of a court of competent jurisdiction; (B) a merger or consolidation; (C) a sale of 75 per centum or more in value of the assets of a company; (D) a restatement of the capital of a company, or an exchange of securities issued by a company for any of its own outstanding securities; (E) a voluntary dissolution or liquidation of a company; (F) a recapitalization or other procedure or transaction which has for its purpose the alteration, modification, or elimination of any of the rights, preferences, or privileges of any class of securities issued by a company, as provided in its charter or other instrument creating or defining such rights, preferences, and privileges; (G) an exchange of securities issued by a company for

outstanding securities issued by another company or companies, preliminary to and for the purpose of effecting or consummating any of the foregoing; or (H) any exchange of securities by a company which is not an investment company for securities issued by a registered investment company.

(33) "Sale", "sell", "offer to sell", or "offer for sale" includes every contract of sale or disposition of, attempt to offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value. Any security given or delivered with, or as a bonus on account of, any purchase of securities or any other thing, shall be conclusively presumed to constitute a part of the subject or such purchase and to have been sold for value.

(34) "Sales load" means the difference between the price of a security to the public and that portion of the proceeds from its sale which is received and invested or held for investment by the issuer (or in the case of a unit investment trust, by the depositor or trustee), less any portion of such difference deducted for trustee's or custodian's fees, insurance premiums, issue taxes, or administrative expenses or fees which are not properly chargeable to sales or promotional activities. In the case of a periodic payment plan certificate, "sales load" includes the sales load on any investment company securities in which the payments made on such certificate are invested, as well as the sales load on the certificate itself.

(35) "Security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

(36) "Short-term paper" means any note, draft, bill of exchange, or banker's acceptance payable on demand or having a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof payable on demand or having a maturity likewise limited; and such other classes of securities of a commercial rather than an investment character, as the Commission may designate by rules and regulations.

(37) "State" means any State of the United States, the District of Columbia, Alaska, Hawaii, Puerto Rico, the Philippine Islands, the Canal Zone, the Virgin Islands, or any other possession of the United States.

(38) "Underwriter" means any person who has purchased from an issuer with a view to, or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributor's or seller's commission. As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer. When the distribution of the securities in respect of which any person is an underwriter is completed such person shall cease to be an underwriter in respect of such securities or the issuer thereof.

(39) "Value", with respect to assets of registered investment companies, except as provided in subsection (b) of section 28 of this title, means—

(A) as used in sections 3, 5, and 12 of this title, (i) with respect to securities owned at the end of the last preceding fiscal quarter for which market quotations are readily available, the market value at the end of such quarter; (ii) with respect to other securities and assets owned at the end of the last preceding fiscal quarter, fair value at the end of such quarter, as determined in good faith by the board of directors; and (iii) with respect to securities and other assets acquired after the end of the last preceding fiscal quarter, the cost thereof; and

(B) as used elsewhere in this title, (i) with respect to securities for which market quotations are readily available, the market value of such securities; and (ii) with respect to other securities and assets, fair value as determined in good faith by the board of directors;

in each case as of such time or times as determined pursuant to this title, and the rules and regulations issued by the Commission hereunder. Notwithstanding the fact that market quotations for securities issued by controlled companies are available, the board of directors may in good faith determine the value of such securities: *Provided,* That the value so determined is not in excess of the higher of market value or asset value of such securities in the case of majority-owned subsidiaries, and is not in excess of market value in the case of other controlled companies.

For purposes of the valuation of those assets of a registered diversified company which are not subject to the limitations provided for in section 5 (b) (1), the Commission may, by rules and regulations or orders, permit any security to be carried at cost, if it shall determine that such procedure is consistent with the general intent and purposes of this title. For purposes of sections 5 and 12, in lieu of values determined as provided in clause (A) above, the Commission shall by rules and regulations permit valuation of securities at cost or other basis in cases where it may be more convenient for such company to make its computations on such basis by reason of the necessity or desirability of complying with the provisions of any United States revenue laws or rules and regulations issued thereunder, or the laws or the rules and regulations issued thereunder of any State in which the securities of such company may be qualified for sale.

The foregoing definition shall not derogate from the authority of the Commission with respect to the reports, information, and documents to be filed with the Commission by any registered company, or with respect to the accounting policies and principles to be followed by any such company, as provided in sections 8, 30, and 31.

(40) "Voting security" means any security presently entitling the owner or holder thereof to vote for the election of directors of a company. A specified percentage of the outstanding voting securities of a company means such amount of its outstanding voting securities as entitles the holder or holders thereof to cast said specified percentage of the aggregate votes which the holders of all the outstanding voting securities of such company are entitled to cast. The vote of a majority of the outstanding voting securities of a company means the vote, at the annual or a special meeting of the security holders of such company duly called, (A) of 67 per centum or more of the voting securities present at such meeting, if the holders of more than 50 per centum of the outstanding voting securities of such company are present or represented by proxy; or (B) of more than 50 per centum of the outstanding voting securities of such company, whichever is the less.

(41) "Wholly-owned subsidiary" of a person means a company 95 per centum or more of the outstanding voting securities of which are owned by such person, or by a company which, within the meaning of this paragraph, is a wholly-owned subsidiary of such person.

(42) "Securities Act of 1933", "Securities Exchange Act of 1934", "Public Utility Holding Company Act of 1935", and "Trust Indenture Act of 1939" mean those Acts, respectively, as heretofore or hereafter amended.

(b) No provision in this title shall apply to, or be deemed to include, the United States, a State, or any political subdivision of a State, or any agency, authority, or instrumentality of any one or more of the foregoing, or any corporation which is wholly, owned directly or indirectly by any one or more of the foregoing, or any officer, agent, or employee of any of the foregoing acting as such in the course of his official duty, unless such provision makes specific reference thereto.

DEFINITION OF INVESTMENT COMPANY

SEC. 3. (a) When used in this title, "investment company" means any issuer which—

(1) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investment, reinvesting, or trading in securities.

(2) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or

(3) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis.

As used in this section, "investment securities" includes all securities except (A) Government securities, (B) securities issued by employees' securities companies, and (C) securities issued by majority-owned subsidiaries of the owner which are not investment companies.

(b) Notwithstanding paragraph (3) of subsection (a), none of the following persons is an investment company within the meaning of this title:

(1) Any issuer primarily engaged, directly or through a wholly-owned subsidiary or subsidiaries, in a business or businesses other than that of investing, reinvesting, owning, holding, or trading in securities.

(2) Any issuer which the Commission, upon application by such issuer, finds and by order declares to be primarily engaged in a business or businesses other than that of investing, reinvesting, owning, holding, or trading in securities either directly or (A) through majority-owned subsidiaries or (B) through controlled companies conducting similar types of businesses. The filing of an application under this paragraph by an issuer other than a registered investment company shall exempt the applicant for a period of sixty days from all provisions of this title applicable to investment companies as such. For cause shown, the Commission by order may extend such period of exemption for an additional period or periods. Whenever the Commission, upon its own motion or upon application, finds that the circumstances which gave rise to the issuance of an order granting an application under this paragraph no longer exist, the Commission shall by order revoke such order.

(3) Any issuer all the outstanding securities of which (other than short-term paper and directors' qualifying shares) are directly or indirectly owned by a company excepted from the definition of investment company by paragraph (1) or (2) of this subsection.

(c) Notwithstanding subsections (a) and (b), none of the following persons is an investment company within the meaning of this title:

(1) Any issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than one hundred persons and which is not making and does not presently propose to make a public offering of its securities. For the purposes of this paragraph, beneficial ownership by a company shall be deemed to be beneficial ownership by one person; except that, if such company owns 10 per centum or more of the outstanding voting securities of the issuer, the beneficial ownership shall be deemed to be that of the holders of such company's outstanding securities (other than short-term paper).

(2) Any person primarily engaged in the business of underwriting and distributing securities issued by other persons, selling securities to customers, and acting as broker, or any one or more of such activities, whose gross income normally is derived principally from such business and related activities.

(3) Any bank or insurance company; any savings and loan association, building and loan association, cooperative bank, homestead association, or similar institution, or any receiver, conservator, liquidator, liquidating agent, or similar official or person thereof or therefor; any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian; or any common trust fund or similar fund, established before the effective date of the Revenue Act of 1936 by a corporation which is supervised or examined by State or Federal authority having supervision over banks, if a majority of the units of beneficial interest in such fund, other than units owned by charitable or educational institutions, are held under instruments providing for payment of income to one or more persons and of principal to another or others.

(4) Any holding company affiliate, as defined in the Banking Act of 1933, which is under the supervision of the Board of Governors of the Federal Reserve System by reason of the fact that such holding company affiliate holds a general voting permit issued to it by such Board prior to January 1, 1940; and any holding company affiliate which is under such supervision by reason of the fact that it holds a general voting permit thereafter issued to it by the Board of Governors and which is determined by such Board to be primarily engaged, directly or indirectly, in the business of holding the stock of, and managing or controlling, banks, banking associations, savings banks, or trust companies. The Commission shall be given appropriate notice prior to any such determination and shall be entitled to be heard. The definition of the term "control" in section 2 (a) shall not apply to this paragraph.

(5) Any person substantially all of whose business is confined to making small loans, industrial banking, or similar businesses.

(6) Any person who is not engaged in the business of issuing face-amount certificates of the installment type or periodic payment plan certificates, and who is primarily engaged in one or more of the following businesses: (A) Purchasing or otherwise acquiring notes, drafts, acceptances, open accounts receivable, and other obligations

representing part or all of the sales price of merchandise, insurance, and services; (B) making loans to manufacturers, wholesalers, and retailers of, and to prospective purchasers of, specified merchandise, insurance, and services; and (C) purchasing or otherwise acquiring mortgages and other liens on and interest in real estate.

(7) Any company primarily engaged, directly or through majority-owned subsidiaries, in one or more of the businesses described in paragraphs (3), (5), and (6), or in one or more of such businesses (from which not less than 25 per centum of such company's gross income during its last fiscal year was derived) together with an additional business or businesses other than investing, reinvesting, owning, holding, or trading in securities.

(8) Any company 90 per centum or more of the value of whose investment securities are represented by securities of a single issuer included within a class of persons enumerated in paragraph (5), (6), or (7).

(9) Any company subject to regulation under the Interstate Commerce Act, or any company whose entire outstanding capital stock is owned or controlled by such a company: *Provided,* That the assets of the controlled company consist substantially of securities issued by companies which are subject to regulation under the Interstate Commerce Act.

(10) Any company with a registration in effect as a holding company under the Public Utility Holding Company Act of 1935.

(11) Any person substantially all of whose business consists of owning or holding oil, gas, or other mineral royalties or leases, or fractional interests therein, or certificates of interest or participation in or investment contract relative to such royalties, leases, or fractional interests.

(12) Any company organized and operated exclusively for religious, educational, benevolent, fraternal, charitable, or reformatory purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(13) Any employees' stock bonus, pension, or profit-sharing trust which meets the conditions of section 165 of the Internal Revenue Code.

(14) Any voting trust the assets of which consist exclusively of securities of a single issuer which is not an investment company.

(15) Any security holders' protective committee or similar issuer having outstanding and issuing no securities other than certificates of deposit and short-term paper.

CLASSIFICATION OF INVESTMENT COMPANIES

SEC. 4. For the purposes of this title, investment companies are divided into three principal classes, defined as follows:

(1)"Face-amount certificate company" means an investment company which is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or which has been engaged in such business and has any such certificate outstanding.

(2) "Unit investment trust" means an investment company which (A) is organized under a trust indenture, contract of custodianship or agency, or similar instrument, (B) does not have a board of directors, and (C) issues only redeemable securities, each of which represents an undivided interest in a unit of specified securities; but does not include a voting trust.

(3) "Management company" means any investment company other than a face-amount certificate company or a unit investment trust.

SUBCLASSIFICATION OF MANAGEMENT COMPANIES

SEC. 5. (a) For the purposes of this title, management companies are divided into open-end and closed-end companies, defined as follows:

(1) "Open-end company" means a management company which is offering for sale or has outstanding any redeemable security of which it is the issuer.

(2) "Closed-end company" means any management company other than an open-end company.

(b) Management companies are further divided into diversified companies and non-diversified companies, defined as follows:

(1) "Diversified company" means a management company which meets the following requirements: At least 75 per centum of the value of its total assets is represented by cash and cash items (including receivables), Government securities, securities of other investment companies, and other securities for the purposes of this calculation limited in respect of any one issuer to an amount not greater in value than 5 per centum of the value of the total assets of such management company and to not more than 10 per centum of the outstanding voting securities of such issuer.

(2) "Non-diversified company" means any management company other than a diversified company.

(c) A registered diversified company which at the time of its qualification as such meets the requirements of paragraph (1) of subsection (b) shall not lose its status as a diversified company because of any subsequent discrepancy between the value of its various investments and the requirements of said paragraph, so long as any such discrepancy existing immediately after its acquisition of any security or other property is neither wholly nor partly the result of such acquisition.

EXEMPTIONS

SEC. 6. (a) The following investment companies are exempt from the provisions of this title:

(1) Any company organized or otherwise created under the laws of and having its principal office and place of business in Alaska, Hawaii, Puerto Rico, the Philippine Islands, the Canal Zone, the Virgin Islands, or any other possession of the United States; but such exemption shall terminate if any security of which such company is the issuer is offered for sale or sold after the effective date of this title, by such company or an underwriter therefor, to a resident of any State other than the State in which such company is organized.

(2) Any company for which, in a proceeding in any court of the United States or of a State, a receiver, trustee in bankruptcy, or similar officer had been appointed or elected prior to the effective date of this title, and every such officer so appointed or elected prior to the effective date of this title; but such exemption shall continue only so long as (A) the conduct of such company's business remains subject to the supervision of such court or officer thereof, and (B) such company does not sell exclusively for cash any security of which it is the issuer, except short-term paper and ordinary receiver's or trustee's certificates.

(3) Any company which since the effective date of this title or within five years prior to such date has been reorganized under the supervision of a court of competent jurisdiction, if (A) such company was not an investment company at the commencement of such

reorganization proceedings, (B) at the conclusion of such proceedings all outstanding securities of such company were owned by creditors of such company or by persons to whom such securities were issued on account of creditors' claims, and (C) more than 50 per centum of the voting securities of such company, and securities representing more than 50 per centum of the net asset value of such company, are currently owned beneficially by not more than twenty-five persons; but such exemption shall terminate if any security of which such company is the issuer is offered for sale or sold to the public after the conclusion of such proceedings by the issuer or by or through any underwriter. For the purposes of this paragraph, any new company organized as part of the reorganization shall be deemed the same company as its predecessor; and beneficial ownership shall be determined in the manner provided in section 3 (c) (1).

(4) Any issuer as to which there is outstanding a writing filed with the Commission by the Federal Savings and Loan Insurance Corporation stating that exemption of such issuer from the provisions of this title is consistent with the public interest and the protection of investors and is necessary or appropriate by reason of the fact that such issuer holds or proposes to acquire any assets or any product of any assets which have been segregated (A) from assets of any company which at the filing of such writing is an insured institution within the meaning of section 401 (a) of the National Housing Act, as heretofore or hereafter amended, or (B) as part of or in connection with any plan for or condition to the insurance of accounts of any company by said corporation or the conversion of any company into a Federal savings and loan association. Any such writing shall expire when canceled by a writing similarly filed or at the expiration of two years after the date of its filing, whichever first occurs; but said corporation may, nevertheless, before, at, or after the expiration of any such writing file another writing or writings with respect to such issuer.

(5) Any company which prior to March 15, 1940, was and now is a wholly-owned subsidiary of a registered face-amount certificate company and was prior to said date and now is organized and operating under the insurance laws of any State and subject to supervision and examination by the insurance commissioner thereof, and which prior to March 15, 1940, was and now is engaged, subject to such laws, in business substantially all of which consists of issuing and selling only to residents of such State and investing the proceeds from, securities providing for or representing participations or interests in intangible assets consisting of mortgages or other liens on real estate or notes or bonds secured thereby or in a fund or deposit of mortgages or other liens on real estate or notes or bonds secured thereby or having outstanding such securities so issued and sold.

(b) Upon application by any employees' security company, the Commission shall by order exempt such company from the provisions of this title and of the rules and regulations hereunder, if and to the extent that such exemption is consistent with the protection of investors. In determining the provisions to which such an order of exemption shall apply, the Commission shall give due weight, among other things, to the form of organization and the capital structure of such company, the persons by whom its voting securities, evidences of indebtedness, and other securities are owned and controlled, the prices at which securities issued by such company are sold and the sales load thereon, the disposition of the proceeds of such sales, the character of the securities in which such proceeds are invested, and any relationship between such company and the issuer of any such security.

193470*—41—PT. I——51

(c) The Commission, by rules and regulations upon its own motion, or by order upon application, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this title or of any rule or regulation thereunder, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this title.

(d) The Commission, by rules and regulations or order, shall exempt a closed-end investment company from any or all provisions of this title, but subject to such terms and conditions as may be necessary or appropriate in the public interest or for the protection of investors, if—

(1) the aggregate sums received by such company from the sale of all its outstanding securities, plus the aggregate offering price of all securities of which such company is the issuer and which it proposes to offer for sale, do not exceed $100,000;

(2) no security of which such company is the issuer has been or is proposed to be sold by such company or any underwriter therefor, in connection with a public offering, to any person who is not a resident of the State under the laws of which such company is organized or otherwise created; and

(3) such exemption is not contrary to the public interest or inconsistent with the protection of investors.

(e) If, in connection with any rule, regulation, or order under this section exempting any investment company from any provision of section 7, the Commission deems it necessary or appropriate in the public interest or for the protection of investors that certain specified provisions of this title pertaining to registered investment companies shall be applicable in respect of such company, the provisions so specified shall apply to such company, and to other persons in their transactions and relations with such company, as though such company were a registered investment company.

TRANSACTIONS BY UNREGISTERED INVESTMENT COMPANIES

SEC. 7. (a) No investment company organized or otherwise created under the laws of the United States or of a State and having a board of directors, unless registered under section 8, shall directly or indirectly—

(1) offer for sale, sell, or deliver after sale, by the use of the mails or any means or instrumentality of interstate commerce, any security or any interest in a security, whether the issuer of such security is such investment company or another person; or offer for sale, sell, or deliver after sale any such security or interest, having reason to believe that such security or interest will be made the subject of a public offering by use of the mails or any means or instrumentality of interstate commerce;

(2) purchase, redeem, retire, or otherwise acquire or attempt to acquire, by use of the mails or any means or instrumentality of interstate commerce, any security or any interest in a security, whether the issuer or such security is such investment company or another person;

(3) control any investment company which does any of the acts enumerated in paragraphs (1) and (2);

(4) engage in any business in interstate commerce; or

(5) control any company which is engaged in any business in interstate commerce.

The provisions of this subsection (a) shall not apply to transactions of an investment company which are merely incidental to its dissolution.

(b) No depositor or trustee of or underwriter for any investment company, organized or otherwise created under the laws of the United States or of a State and not having a board of directors, unless such company is registered under section 8 or exempt under section 6, shall directly or indirectly—

(1) offer for sale, sell, or deliver after sale, by use of the mails or any means or instrumentality of interstate commerce, and security or any interest in a security of which such company is the issuer; or offer for sale, sell, or deliver after sale any such security or interest, having reason to believe that such security or interest will be made the subject of a public offering by use of the mails or any means or instrumentality of interstate commerce;

(2) purchase, redeem, or otherwise acquire or attempt to acquire, by use of the mails or any means or instrumentality of interstate commerce, any security or any interest in a security of which such company is the issuer; or

(3) sell or purchase for the account of such company, by use of the mails or any means or instrumentality of interstate commerce, any security or interest in a security, by whomever issued.

The provisions of this subsection (b) shall not apply to transactions which are merely incidental to the dissolution of an investment company.

(c) No promoter of a proposed investment company, and no underwriter for such a promoter, shall make use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to offer for sale, sell, or deliver after sale, in connection with a public offering, any preorganization certificate or subscription for such a company.

(d) No investment company, unless organized or otherwise created under the laws of the United States or of a State, and no depositor or trustee of or underwriter for such a company not so organized or created, shall make use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to offer for sale, sell, or deliver after sale, in connection with a public offering, any security of which such company is the issuer. Notwithstanding the provisions of this subsection and of section 8 (a), the Commission is authorized, upon application by an investment company organized or otherwise created under the laws of a foreign country, to issue a conditional or unconditional order permitting such company to register under this title and to make a public offering of its securities by use of the mails and means or instrumentalities of interstate commerce, if the Commission finds that, by reason of special circumstances or arrangements, it is both legally and practically feasible effectively to enforce the provisions of this title against such company and that the issuance of such order is otherwise consistent with the public interest and the protection of investors.

REGISTRATION OF INVESTMENT COMPANIES

SEC. 8. (a) Any investment company organized or otherwise created under the laws of the United States or of a State may register for the purposes of this title by filing with the Commission a notification of registration, in such form as the Commission shall by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors. An investment company shall be deemed to be registered upon receipt by the Commission of such notification of registration.

(b) Every registered investment company shall file with the Commission, within such reasonable time after registration as the Commission shall fix by rules and regulations, an original and such copies of a registration statement, in such form and containing such of the following information and documents as the Commission shall by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors:

(1) a recital of the policy of the registrant in respect of each of the following types of activities, such recital consisting in each case of a statement whether the registrant reserves freedom of action to engage in activities of such type, and if such freedom of action is reserved, a statement briefly indicating, insofar as is practicable, the extent to which the registrant intends to engage therein: (A) the classification and subclassifications, as defined in sections 4 and 5, within which the registrant proposes to operate; (B) borrowing money; (C) the issuance of senior securities; (D) engaging in the business of underwriting securities issued by other persons; (E) concentrating investments in a particular industry or group of industries; (F) the purchase and sale of real estate and commodities, or either of them; (G) making loans to other persons; and (H) portfolio turn-over (including a statement showing the aggregate dollar amount of purchases and sales of portfolio securities, other than Government securities, in each of the last three full fiscal years preceding the filing of such registration statement);

(2) a recital of the policy of the registrant in respect of matters, not enumerated in paragraph (1), which the registrant deems matters of fundamental policy and elects to treat as such;

(3) the name and address of each affiliated person of the registrant; the name and principal address of every company, other than the registrant, of which each such person is an officer, director, or partner; a brief statement of the business experience for the preceding five years of each officer and director of the registrant; and

(4) the information and document which would be required to be filed in order to register under the Securities Act of 1933 and the Securities Exchange Act of 1934 all securities (other than short-term paper) which the registrant has outstanding or proposes to issue.

(c) The Commission shall make provision, by permissive rules and regulations or order, for the filing of the following, or so much of the following as the Commission may designate, in lieu of the information and documents required pursuant to subsection (b):

(1) copies of the most recent registration statement filed by the registrant under the Securities Act of 1933 and currently effective under such Act, or if the registrant has not filed such a statement, copies of a registration statement filed by the registrant under the Securities Exchange Act of 1934 and currently effective under such Act;

(2) copies of any reports filed by the registrant pursuant to section 13 or 15 (d) of the Securities Exchange Act of 1934; and

(3) a report containing reasonably current information regarding the matters included in copies filed pursuant to paragraphs (1) and (2), and such further information regarding matters not included in such copies as the Commission is authorized to require under subsection (b).

(d) If the registrant is a unit investment trust substantially all of the assets of which are securities issued by another registered investment company, the Commission is authorized to prescribe for the

registrant, by rules and regulations or order, a registration statement which eliminates inappropriate duplication of information contained in the registration statement filed under this section by such other investment company.

(e) If it appears to the Commission that a registered investment company has failed to file the registration statement required by this section or a report required pursuant to section 30 (a) or (b), or has filed such a registration statement or report but omitted therefrom material facts required to be stated therein, or has filed such a registration statement or report in violation of section 34 (b), the Commission shall notify such company by registered mail of the failure to file such registration statement or report, or of the respects in which such registration statement or report appears to be materially incomplete or misleading, as the case may be, and shall fix a date (in no event earlier than thirty days after the mailing of such notice) prior to which such company may file such registration statement or report or correct the same. If such registration statement or report is not filed or corrected within the time so fixed by the Commission or any extension thereof, the Commission, after appropriate notice and opportunity for hearing, and upon such conditions and with such exemptions as it deems appropriate for the protection of investors, may by order suspend the registration of such company until such statement or report is filed or corrected, or may by order revoke such registration, if the evidence establishes—

(1) that such company has failed to file a registration statement required by this section or a report required pursuant to section 30 (a) or (b), or has filed such a registration statement or report but omitted therefrom material facts required to be stated therein, or has filed such a registration statement or report in violation of section 34 (b) ; and

(2) that such suspension or revocation is in the public interest.

(f) Whenever the Commission, on its own motion or upon application, finds that a registered investment company has ceased to be an investment company, it shall so declare by order and upon the taking effect of such order the registration of such company shall cease to be in effect. If necessary for the protection of investors, an order under this subsection may be made upon appropriate conditions. The Commission's denial of any application under this subsection shall be by order.

INELIGIBILITY OF CERTAIN AFFILIATED PERSONS AND UNDERWRITERS

SEC. 9. (a) It shall be unlawful for any of the following persons to serve or act in the capacity of officer, director, member of an advisory board, investment adviser, or depositor of any registered investment company, or principal underwriter for any registered open-end company, registered unit investment trust, or registered face-amount certificate company:

(1) any person who within ten years has been convicted of any felony or misdemeanor involving the purchase or sale of any security or arising out of such person's conduct as an underwriter, broker, dealer, or investment adviser, or as an affiliated person, salesman, or employee of any investment company, bank, or insurance company;

(2) any person who, by reason of any misconduct, is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as a underwriter, broker, dealer, or investment adviser, or as an affiliated person, salesman, or employee of any investment company, bank,

or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity or in connection with the purchase or sale of any security; or

(3) a company any affiliated person of which is ineligible, by reason of paragraph (1) or (2), to serve or act in the foregoing capacities.

For the purposes of paragraphs (1), (2), and (3) of this subsection, the term "investment adviser" shall include an investment adviser as defined in title II of this Act.

(b) Any person who is ineligible, by reason of subsection (a), to serve or act in the capacities enumerated in that subsection, may file with the Commission an application for an exemption from the provisions of that subsection. The Commission shall by order grant such application, either unconditionally or on an appropriate temporary or other conditional basis, if it is established that the prohibitions of subsection (a), as applied to such person, are unduly or disproportionately severe or that the conduct of such person has been such as not to make it against the public interest or protection of investors to grant such application.

AFFILIATIONS OF DIRECTORS

SEC. 10. (a) After one year from the effective date of this title, no registered investment company shall have a board of directors more than 60 per centum of the members of which are persons who are investment advisers of, affiliated persons of an investment adviser of, or officers or employees of, such registered company.

(b) After one year from the effective date of this title, no registered investment company shall—

(1) employ as regular broker any director, officer, or employee of such registered company, or any person of which any such director, officer, or employee is an affiliated person, unless a majority of the board of director of such registered company shall be persons who are not such brokers or affiliated persons of any of such brokers;

(2) use as a principal underwriter of securities issued by it any director, officer, or employee of such registered company or any person of which any such director, officer, or employee is an affiliated person, unless a majority of the board of directors of such registered company shall be persons who are not such principal underwriters of affiliated persons of any of such principal underwriters; or

(3) have as director, officer, or employee any investment banker, or any affiliated person of an investment banker, unless a majority of the board of directors of such registered company shall be persons who are not investment bankers or affiliated persons of any investment banker. For the purposes of this paragraph, a person shall not be deemed an affiliated person of an investment banker solely by reason of the fact that he is an affiliated person of a company of the character described in section 12 (d) (3) (A) and (B).

(c) After the effective date of this title, no registered investment company shall have a majority of its board of directors constricting of persons who are officers or directors of any one bank: *Provided,* That, if on March 15, 1940, any registered investment company shall have had a majority of its directors consisting of persons who are directors, officers, or employees of any one bank, such registered company may continue to have the same percentage of its board of directors consisting of persons who are directors, officers, or employees of such bank.

(d) Notwithstanding subsection (a) and subsection (b) (2), a registered investment company may have a board of directors all the members of which, except one, are affiliated persons of the investment adviser of such company, or are officers or employees of such company, if—

(1) such investment company is an open-end company;

(2) such investment adviser is registered under title II of this Act and such investment adviser is engaged principally in the business of rendering investment supervisory services as defined in title II;

(3) no sales load is charged on securities issued by such investment company;

(4) any premium over net asset value charged by such company upon the issuance of any such security, plus any discount from net asset value charged on redemption thereof, shall not in the aggregate exceed 2 per centum;

(5) no sales or promotion expenses are incurred by such registered company; but expenses incurred in complying with laws regulating the issue or sale of securities shall not be deemed sales or promotion expenses;

(6) such investment adviser is the only investment adviser to such investment company, and such investment adviser does not receive a management fee exceeding 1 per centum per annum of the value of such company's net assets averaged over the year or taken as of a definite date or dates within the year;

(7) all executive salaries and executive expenses and office rent of such investment company are paid by such investment adviser; and

(8) such investment company has only one class of stock outstanding, each share of which has equal voting rights with every other share.

(e) If by reason of the death, disqualification, or bona fide resignation of any director or directors, the requirements of the foregoing provisions of this section in respect of directors shall not be met by a registered investment company, the operation of such provisions shall be suspended as to such registered company for a period of thirty days if the vacancy or vacancies may be filled by action of the board of directors, and for a period of sixty days if a vote of stockholders is required to fill the vacancy or vacancies, or for such longer period as the Commission may prescribe, by rules and regulations upon its own motion or by order upon application, as not inconsistent with the protection of investors.

(f) No registered investment company shall knowingly purchase or otherwise acquire, during the existence of any underwriting or selling syndicate, any security (except a security of which such company is the issuer) a principal underwriter of which is an officer, director, member of an advisory board, investment adviser, or employee of such registered company, or is a person (other than a company of the character described in section 12 (d) (3) (A) and (B)) of which any officer, director, member of an advisory board, investment adviser, or employee is an affiliated person, unless in acquiring such security such registered company is itself acting as a principal underwriter for the issuer. The Commission, by rules and regulations upon its own motion or by order upon application, may conditionally or unconditionally exempt any transaction or classes of transactions from any of the provisions of this subsection, if and to the extent that such exemption is consistent with the protection of investors.

(g) In the case of a registered investment company which has an advisory board, such board, as a distinct entity, shall be subject to

the same restrictions as to its membership as are imposed upon a board of directors by this section.

(h) In the case of a registered management company which is an unincorporated company not having a board of directors, the provisions of this section shall apply as follows:

(1) the provisions of subsection (a), as modified by subsection (e), shall apply to the board of directors of the depositor of such company;

(2) the provisions of subsections (b) and (c), as modified by subsection (e), shall apply to the board of directors of the depositor and of every investment adviser of such company; and

(3) the provisions of subsection (f) shall apply to purchases and other acquisitions for the account of such company of securities a principal underwriter of which is the depositor or an investment adviser of such company, or an affiliated person of such depositor or investment adviser.

OFFERS OF EXCHANGE

SEC. 11. (a) It shall be unlawful for any registered open-end company or any principal underwriter for such a company to make or cause to be made an offer to the holder of a security of such company or of any other open-end investment company to exchange his security for a security in the same or another such company on any basis other than the relative net asset values of the respective securities to be exchanged, unless the terms of the offer have first been submitted to and approved by the Commission or are in accordance with such rules and regulations as the Commission may have prescribed in respect of such offers which are in effect at the time such offer is made. For the purposes of this section, (A) an offer by a principal underwriter means an offer communicated to holders of securities of a class or series but does not include an offer made by such principal underwriter to an individual investor in the course of a retail business conducted by such principal underwriter, and (B) the net asset value means the net asset value which is in effect for the purpose of determining the price at which the securities, or class or series of securities involved, are offered for sale to the public either (1) at the time of the receipt by the offeror of the acceptance of the offer or (2) at such later times as is specified in the officer.

(b) The provisions of this section shall not apply to any offer made pursuant to (1) any plan of reorganization, which is submitted to and requires the approval of the holders of at least a majority of the outstanding shares of the class or series to which the security owned by the offeree belongs; or (2) the right of conversion, at the option of the holder, from one class or series into another class or series of securities issued by the same company upon such terms as are specified in the charter, certificate of incorporation, articles of association, by-laws, or trust indenture subject to which the securities to be converted were issued or are to be issued.

(c) The provisions of subsection (a) shall be applicable, irrespective of the basis of exchange, (1) to any offer of exchange of any security of a registered open-end company for a security of a registered unit investment trust or registered face-amount certificate company; and (2) to any type of offer of exchange of the securities of registered unit investment trusts or registered face-amount certificate companies for the securities of any other investment company.

FUNCTIONS AND ACTIVITIES OF INVESTMENT COMPANIES

SEC. 12. (a) It shall be unlawful for any registered investment company, in contravention of such rules and regulations or orders as

the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors—

(1) to purchase any security on margin, except such short-term credits as are necessary for the clearance of transactions;

(2) to participate on a joint or a joint and several basis in any trading account in securities, except in connection with an underwriting in which such registered company is a participant; or

(3) to effect a short sale of any security, except in connection with an underwriting in which such registered company is a participant.

(b) It shall be unlawful for any registered open-end company (other than a company complying with the provisions of section 10 (d)) to act as a distributor of securities of which it is the issuer, except through an underwriter, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(c) It shall be unlawful for any registered diversified company to make any commitment as underwriter, if immediately thereafter the amount of its outstanding underwriting commitments, plus the value of its investments in securities of issuers (other than investment companies) of which it owns more than 10 per centum of the outstanding voting securities, exceeds 25 per centum of the value of its total assets.

(d) It shall be unlawful for any registered investment company and any company or companies controlled by such registered investment company to purchase or otherwise acquire after the enactment of this title any security issued by or any other interest in the business of—

(1) any other investment company of which such registered investment company and any company or companies controlled by such registered company shall not at the time of such purchase or acquisition own in the aggregate at least 25 per centum of the total outstanding voting stock, if such registered investment company and any company or companies controlled by it own in the aggregate or as a result of such purchase or acquisition will own in the aggregate more than 5 per centum of the total outstanding voting stock of such other investment company if the policy of such other investment company is the concentration of investments in a particular industry or group of industries, or more than 3 per centum of the total outstanding voting stock of such other investment company if the policy of such other investment company if the policy of such other investment company is not the concentration of investments in a particular industry of group of industries, except (A) a security received as a dividend or as a result of a plan of reorganization of any company (other than a plan devised for the purpose of evading the foregoing provisions), or (B) a security purchased with the proceeds of payments on periodic payment plan certificates, pursuant to the terms of the trust indenture under which such certificates are issued; or

(2) any insurance company of which such registered investment company and any company or companies controlled by such registered company shall not at the time of such purchase or acquisition own in the aggregate at least 25 per centum of the total outstanding voting stock, if such registered company and any company or companies controlled by it own in the aggregate or as a result of such purchase or acquisition will own in the aggregate more than 10 per centum of the total outstanding voting stock of such insurance company, except a security received as a dividend or as a result of a plan of reorganization of any company (other than a plan devised for the purpose of evading the foregoing provisions); or

(3) any person who is a broker, a dealer, is engaged in the business of underwriting, or is either an investment adviser of an investment company or an investment adviser registered under title II of this Act, unless (A) such person is a corporation all the outstanding securities of which (other than short-term paper, securities representing bank loans and directors' qualifying shares) are, or after such acquisition will be, owned by one or more registered investment companies; and (B) such person is primarily engaged in the business of underwriting and distributing securities issued by other persons, selling securities to customers, or any one or more of such or related activities, and the gross income of such person normally is derived principally from such business or related activities.

(e) Notwithstanding any provisions of this title, any registered investment company may hereafter purchase or otherwise acquire any security issued by any one corporation engaged or proposing to engage in the business of underwriting, furnishing capital to industry, financing promotional enterprises, purchasing securities of issuers for which no ready market is in existence, and reorganizing companies or similar activities; provided—

(1) That the securities issued by such corporation (other than short-term paper and securities representing bank loans) shall consist solely of one class of common stock and shall have been originally issued or sold for investment to registered investment companies only;

(2) That the aggregate cost of the securities of such corporation purchased by such registered investment company does not exceed 5 per centum of the value of the total assets of such registered company at the time of any purchase or acquisition of such securities; and

(3) That the aggregate paid-in capital and surplus of such corporation does not exceed $100,000,000.

For the purpose of paragraph (1) of section 5 (b) any investment in any such corporation shall be deemed to be an investment in an investment company.

(f) Notwithstanding any provisions of this Act, any registered face-amount certificate company may organize not more than two face-amount certificate companies and acquire and own all or any part of the capital stock only thereof if such stock is acquired and held for investment; *Provided*, That the aggregate cost to such registered company of all such stock so acquired shall not exceed six times the amount of the minimum capital stock requirement provided in subdivision (1) of subsection (a) of section 28 for a face-amount company organized on or after March 15, 1940: *And provided further,* That the aggregate cost to such registered company of all such capital stock issued by face-amount certificate companies organized or otherwise created under laws other than the laws of the United States or any State thereof shall not exceed twice the amount of the minimum capital stock requirement provided in subdivision (1) of subsection (a) of section 28 for a company organized on or after March 15, 1940. Nothing contained in this subsection shall be deemed to prevent the sale of any such stock to any other person if the original purchase was made by such registered face-amount certificate company in good faith for investment and not for resale.

(g) Notwithstanding the provisions of this section any registered investment company and any company or companies controlled by such registered company may purchase or otherwise acquire from another investment company or any company or companies controlled by such registered company more than 10 per centum of the

total outstanding voting stock of any insurance company owned by any such company or companies, or may acquire the securities of any insurance company if the Commission by order determines that such acquisition is in the public interest because the financial condition of such insurance company will be improved as a result of such acquisition or any plan contemplated as a result thereof. This section shall not be deemed to prohibit the promotion of a new insurance company or the acquisition of the securities of any newly created insurance company by a registered investment company, alone or with other persons. Nothing contained in this section shall in any way affect or derogate from the powers of any insurance commissioner or similar official or agency of the United States or any State, or to affect the right under State law of any insurance company to acquire securities of any other insurance company or insurance companies.

CHANGES IN INVESTMENT POLICY

SEC. 13. (a) No registered investment company shall, unless authorized by the vote of a majority of its outstanding voting securities—

(1) change its subclassification as defined in section 5 (a) (1) and (2) of this title or its subclassification from a diversified to a non-diversified company;

(2) borrow money, issue senior securities, underwrite securities issued by other persons, purchase or sell real estate or commodities or make loans to other persons, except in each case in accordance with the recitals of policy contained in its registration statement in respect thereto;

(3) deviate from its policy in respect of concentration of investments in any particular industry or group of industries as recited in its registration statement, or deviate from any fundamental policy recited in its registration statement pursuant to section 8 (b) (2); or

(4) change the nature of its business so as to cease to be an investment company.

(b) In the case of a common-law trust of the character described in subsection (b) of section 16, either written approval by holders of a majority of the outstanding shares of beneficial interest or the vote of a majority of such outstanding shares cast in person or by proxy at a meeting called for the purpose shall for the purposes of subsection (a) be deemed the equivalent of the vote of a majority of the outstanding voting securities, and the provisions of paragraph (40) of section 2 (a) as to a majority shall be applicable to the vote cast at such a meeting.

SIZE OF INVESTMENT COMPANIES

SEC. 14. (a) No registered investment company organized after the date of enactment of this title, and no principal underwriter for such a company, shall make a public offering of securities of which such company is the issuer, unless—

(1) such company has a net worth of at least $100,000;

(2) such company has previously made a public offering of its securities, and at the time of such offering had a net worth of at least $100,000; or

(3) provision is made in connection with and as a condition of the registration of such securities under the Securities Act of 1933 which in the opinion of the Commission adequately insures (A) that after the effective date of such registration statement such company will not issue any security or receive any proceeds of any subscription for any security until firm agree-

ments have been made with such company by not more than twenty-five responsible persons to purchase from it securities to be issued by it for an aggregate net amount which plus the then net worth of the company, if any, will equal at least $100,000; (B) that said aggregate net amount will be paid in to such company before any subscriptions for such securities will be accepted from any persons in excess of twenty-five; (C) that arrangements will be made whereby any proceeds so paid in, as well as any sales load, will be refunded to any subscriber on demand without any deduction, in the event that the net proceeds so received by the company do not result in the company having a net worth of at least $100,000 within ninety days after such registration statement becomes effective.

At any time after the occurrence of the event specified in clause (C) of paragraph (3) of this subsection the Commission may issue a stop order suspending the effectiveness of the registration statement of such securities under the Securities Act of 1933 and may suspend or revoke the registration of such company under this title.

(b) The Commission is authorized, at such times as it deems that any substantial further increase in size of investment companies creates any problem involving the protection of investors of the public interest, to make a study and investigation of the effects of size on the investment policy of investment companies and on security markets, on concentration of control of wealth and industry, and on companies in which investment companies are interested, and from time to time to report the results of its studies and investigations and its recommendations to the Congress.

INVESTMENT ADVISORY AND UNDERWRITING CONTRACTS

SEC. 15. (a) After one year from the effective date of this title it shall be unlawful for any person to serve or act as investment adviser of a registered investment company, except pursuant to a written contract, which contract, whether with such registered company or with an investment adviser of such registered company, unless in effect prior to March 15, 1940, has been approved by the vote of a majority of the outstanding voting securities of such registered company and—

(1) precisely describes all compensation to be paid thereunder;

(2) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company;

(3) provides, in substance, that it may be terminated at any time, without the payment of any penalty, by the board of directors of such registered company or by vote of a majority of the outstanding voting securities of such company on not more than sixty days' written notice to the investment adviser; and

(4) provides, in substance, for its automatic termination in the event of its assignment by the investment adviser.

(b) After one year from the effective date of this title, it shall be unlawful for any principal underwriter for a registered open-end company to offer for sale, sell, or deliver after sale any security of which such company is the issuer, except pursuant to a written contract with such company, which contract, unless in effect prior to March 15, 1940—

(1) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance

is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company; and

(2) provides, in substance, for its automatic termination in the event of its assignment by such underwriter.

(c) In addition to the requirements of subsections (a) and (b) it shall be unlawful for any registered investment company having a board of directors to enter into, renew, or perform any contract or agreement, written or oral, except a written agreement which was in effect prior to March 15, 1940, whereby a person undertakes regularly to serve or act as investment adviser of or principal underwriter for such company, unless the terms of such contract or agreement and any renewal thereof have been approved (1) by a majority of the directors who are not parties to such contract or agreement or affiliated persons of any such party, or (2) by the vote of a majority of the outstanding voting securities of such company.

(d) It shall be unlawful for any person—

(1) to serve or act as investment adviser of a registered investment company, pursuant to a written contract which was in effect prior to March 15, 1940, after March 15, 1945, or the date of termination provided in such contract, whichever is the prior date, or after assignment thereof subsequent to March 15, 1940, by the person acting as investment adviser thereunder; or

(2) as principal underwriter for a registered open-end investment company to offer for sale, sell, or deliver after sale any security of which such company is the issuer, pursuant to a written contract which was in effect prior to March 15, 1940, after March 15, 1945, or the date of termination provided for in such contract, whichever is the prior date, or after assignment thereof subsequent to March 15, 1940, by the person acting as principal underwriter thereunder:

Provided, however, That the limitation to March 15, 1945, shall not apply in either case if prior to that date such contract is renewed in such form that it complies with the requirements of subsection (a) or (b) of this section, as the case may be, and is approved in the manner required by this section in respect of a contract of the same character made after March 15, 1940.

(e) In the case of a common-law trust of the character described in subsection (b) of section 16, either written approval by holders of a majority of the outstanding shares of beneficial interest or the vote of a majority of such outstanding shares cast in person or by proxy at a meeting called for the purpose shall for the purposes of this section be deemed the equivalent of the vote of a majority of the outstanding voting securities, and the provisions of paragraph (40) of section 2 (a) as to a majority shall be applicable to the vote cast at such a meeting.

(f) Nothing contained in this section shall be deemed to require or contemplate any action by an advisory board of any registered company or by any of the members of such a board.

CHANGES IN BOARD OF DIRECTORS; PROVISIONS RELATIVE TO STRICT TRUSTS

SEC. 16. (a) No person shall serve as a director of a registered investment company unless elected to that office by the holders of the outstanding voting securities of such company, at an annual or a special meeting duly called for that purpose; except that vacancies occurring between such meetings may be filled in any otherwise legal manner if immediately after filling any such vacancy at least two-thirds of the directors then holding office shall have been elected to such office by the holders of the outstanding voting securities of the

company at such an annual or special meeting. In the event that at any time less than a majority of the directors of such company holding office at that time were so elected by the holders of the outstanding voting securities, the board of directors or proper officer of such company shall forthwith cause to be held as promptly as possible and in any event within sixty days a meeting of such holders for the purpose of electing directors to fill any existing vacancies in the board of directors unless the Commission shall by order extend such period. The foregoing provisions of this subsection shall not apply to members of an advisory board.

Nothing herein shall, however, preclude a registered investment company from dividing its directors into classes if its charter, certificate of incorporation, articles of association, by-laws, trust indenture, or other instrument or the law under which it is organized, so provides and prescribes the tenure of office of the several classes: *Provided,* That no class shall be elected for a shorter period than one year or for a longer period than five years and the term of office of at least one class shall expire each year.

(b) The provisions of subsection (a) of this section shall not apply to a common-law trust existing on the date of enactment of this title under an indenture of trust which does not provide for the election of trustees by the shareholders. No natural person shall serve as trustee of such a trust, which is registered as an investment company, after the holders of record of not less than two-thirds of the outstanding shares of beneficial interest in such trust have declared that he be removed from that office either by declaration in writing filed with the custodian of the securities of the trust or by votes cast in person or by proxy at a meeting called for the purpose. Solicitation of such a declaration shall be deemed a solicitation of a proxy within the meaning of section 20 (a).

The trustees of such a trust shall promptly call a meeting of shareholders for the purpose of voting upon the question of removal of any such trustee or trustees when requested in writing so to do by the record holders of not less than 10 per centum of the outstanding shares.

Whenever ten or more shareholders of record who have been such for at least six months preceding the date of application, and who hold in the aggregate either shares having a net asset value of at least $25,000 or at least 1 per centum of the outstanding shares, whichever is less, shall apply to the trustees in writing, stating that they wish to communicate with other shareholders with a view to obtaining signatures to a request for a meeting pursuant to this subsection (b) and accompanied by a form of communication and request which they wish to transmit, the trustees shall within five business days after receipt of such application either—

(1) afford to such applicants access to a list of the names and addresses of all shareholders as recorded on the books of the trust; or

(2) inform such applicants as to the approximate number of shareholders of record, and the approximate cost of mailing to them the proposed communication and form of request.

If the trustees elect to follow the course specified in paragraph (2) of this subsection (b) the trustees, upon the written request of such applicants, accompanied by a tender of the material to be mailed and of the reasonable expenses of mailing, shall, with reasonable promptness, mail such material to all shareholders of record at their addresses as recorded on the books, unless within five business days after such tender the trustees shall mail to such applicants and file with the Commission, together with a copy of the material to be

mailed, a written statement signed by at least a majority of the trustees to the effect that in their opinion either such material contains untrue statements of fact or omits to state facts necessary to make the statements contained therein not misleading, or would be in violation of applicable law, and specifying the basis of such opinion.

After opportunity for hearing upon the objections specified in the written statement so filed, the Commission may, and if demanded by the trustees or by such applicants shall, enter an order either sustaining one or more of such objections or refusing to sustain any of them. If the Commission shall enter an order refusing to sustain any of such objections, or if, after the entry of an order sustaining one or more of such objections, the Commission shall find, after notice and opportunity for hearing, that all objections so sustained have been met, and shall enter an order so declaring, the trustees shall mail copies of such material to all shareholders with reasonable promptness after the entry of such order and the renewal of such tender.

TRANSACTIONS OF CERTAIN AFFILIATED PERSONS AND UNDERWRITERS

SEC. 17. (a) It shall be unlawful for any affiliated person or promoter of or principal underwriter for a registered investment company (other than a company of the character described in section 12 (d) (3) (A) and (B)), or any affiliated person of such a person, promoter, or principal underwriter, acting as principal—

(1) knowingly to sell any security or other property to such registered company or to any company controlled by such registered company, unless such sale involves solely (A) securities of which the buyer is the issuer, (B) securities of which the seller is the issuer and which are part of a general offering to the holders of a class of its securities, or (C) securities deposited with the trustee of a unit investment trust or periodic payment plan by the depositor thereof;

(2) knowingly to purchase from such registered company, or from any company controlled by such registered company, any security or other property (except securities of which the seller is the issuer); or

(3) to borrow money or other property from such registered company or from any company controlled by such registered company (unless the borrower is controlled by the lender) except as permitted in section 21 (b).

(b) Notwithstanding subsection (a), any person may file with the Commission an application for an order exempting a proposed transaction of the applicant from one or more provisions of that subsection. The Commission shall grant such application and issue such order of exemption if evidence establishes that—

(1) the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned;

(2) the proposed transaction is consistent with the policy of each registered investment company concerned, as recited in its registration statement and reports filed under this title; and

(3) the proposed transaction is consistent with the general purpose of this title.

(c) Notwithstanding subsection (a), a person may, in the ordinary course of business, sell to or purchase from any company merchandise or may enter into a lessor-lessee relationship with any person and furnish the services incident thereto.

(d) It shall be unlawful for any affiliated person of or principal underwriter for a registered investment company (other than a company of the character described in section 12 (d) (3) (A) and (B)), or any affiliated person of such a person or principal underwriter, acting as principal to effect any transaction in which such registered company, or a company controlled by such registered company, is a join or a joint and several participant with such person, principal underwriter, or affiliated person, in contravention of such rules and regulations as the Commission may prescribe for the purpose of limiting or preventing participation by such registered or controlled company on a basis different from or less advantageous than that of such other participant. Nothing contained in this subsection shall be deemed to preclude any affiliated person from acting as manager of any underwriting syndicate or other group in which such registered or controlled company is a participant and receiving compensation therefor.

(e) It shall be unlawful for any affiliated person of a registered investment company, or any affiliated person of such person—

(1) acting as agent, to accept from any source any compensation (other than a regular salary or wages from such registered company) for the purchase or sale of any property to or for such registered company or any controlled company thereof, except in the course of such person's business as an underwriter or broker; or

(2) acting as broker, in connection with the sale of securities to or by such registered company or any controlled company thereof, to receive from any source a commission, fee, or other remuneration for effecting such transaction which exceeds (A) the usual and customary broker's commission if the sale is effected on a securities exchange, or (B) 2 per centum of the sales price if the sale is effected in connection with a secondary distribution of such securities, or (C) 1 per centum of the purchase or sale price of such securities if the sale is otherwise effected unless the Commission shall, by rules and regulations or order in the public interest and consistent with the protection of investors, permit a larger commission.

(f) Every registered management company shall place and maintain its securities and similar investments in the custody of (1) a bank having the qualifications prescribed in paragraph (1) of section 26 (a) for the trustees of unit investment trusts; or (2) a company which is a member of a national securities exchange as defined in the Securities Exchange Act of 1934, subject to such rules and regulations as the Commission may from time to time prescribe for the protection of investors; or (3) such registered company, but only in accordance with such rules and regulations or orders as the Commission may from time to time prescribe for the protection of investors. Rules, regulations, and orders of the Commission under this subsection, among other things, may make appropriate provision with respect to such matters as the earmarking, segregation, and hypothecation of such securities and investments, and may provide for or require periodic or other inspections by any or all of the following: Independent public accountants, employees and agents of the Commission, and such other persons as the Commission may designate. No such member which trades in securities for its own account may act as custodian except in accordance with rules and regulations prescribed by the Commission for the protection of investors.

(g) The Commission is authorized to require by rules and regulations or orders for the protection of investors that any officer and

employee of a registered management investment company who may singly, or jointly with others, have access to securities or funds of any registered company, either directly or through authority to draw upon such funds or to direct generally the disposition of such securities, be bonded by a reputable fidelity insurance company against larceny and embezzlement in such reasonable minimum amounts as the Commission may prescribe.

(h) After one year from the effective date of this title, neither the charter, certificate of incorporation, articles of association, indenture of trust, nor the by-laws of any registered investment company, nor any other instrument pursuant to which such a company is organized or administered, shall contain any provision which protects or purports to protect any director or officer of such company against any liability to the company or to its security holders to which he would otherwise be subject by reason of willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his office.

In the event that any such instrument does not at the effective date of this Act comply with the requirements of this subsection (h) and is not amended to comply therewith prior to the expiration of said one year, such company may nevertheless continue to be a registered investment company and shall not be deemed to violate this subsection if prior to said expiration date each such director or officer shall have filed with the Commission a waiver in writing of any protective provision of the instrument to the extent that it does not comply with this subsection, and each such person subsequently elected or appointed shall before assuming office file a similar waiver.

(i) After one year from the effective date of this title no contract or agreement under which any person undertakes to act as investment adviser of, or principal underwriter for, a registered investment company shall contain any provision which protects or purports to protect such person against any liability to such company or its security holders to which he would otherwise be subject by reason of willful misfeasance, bad faith, or gross negligence, in the performance of his duties, or by reason of his reckless disregard of his obligations and duties under such contract or agreement.

In the event that any such contract or agreement does not at the effective date of this Act comply with the requirements of this subsection (i) and is not amended to comply therewith prior to the expiration of said one year, this subsection shall not be deemed to have been violated if prior to said expiration date each such investment adviser or principal underwriter shall have filed with the Commission a waiver in writing of any protective provision of the contract or agreement to the extent that it does not comply with this subsection.

CAPITAL STRUCTURE

SEC 18. (a) It shall be unlawful for any registered closed-end company to issue any class of senior security, or to sell any such security of which it is the issuer, unless—

(1) if such class of senior security represents an indebtedness—

(A) immediately after such issuance or sale, it will have an asset coverage of at least 300 per centum;

(B) provision is made to prohibit the declaration of any dividend (except a dividend payable in stock of the issuer), or the declaration of any other distribution, upon any class of the capital stock of such investment company, or the purchase of any such capital stock, unless, in every such

193470*—41—PT. I——52

case, such class of senior securities has at the time of the declaration of any such dividend or distribution or at the time of any such purchase an asset coverage of at least 300 per centum after deducting the amount of such dividend, distribution, or purchase price, as the case may be, except that dividends may be declared upon any preferred stock if such senior security representing indebtedness has an asset coverage of at least 200 per centum at the time of declaration thereof after deducting the amount of such dividend; and

(C) provision is made either—

(i) that, if on the last business day of each of twelve consecutive calendar months such class of senior securities shall have an asset coverage of less than 100 per centum, the holders of such securities voting as a class shall be entitled to elect at least a majority of the members of the board of directors of such registered company, such voting right to continue until such class of senior security shall have an asset coverage of 110 per centum or more on the last business day of each of three consecutive calendar months, or

(ii) that, if on the last business day of each of twenty-four consecutive calendar months such class of senior securities shall have an asset coverage of less than 100 per centum, an event of default shall be deemed to have occurred;

(2) if such class of senior security is a stock—

(A) immediately after such issuance or sale it will have an asset coverage of at least 200 per centum;

(B) provision is made to prohibit the declaration of any dividend (except a dividend payable in common stock of the issuer), or the declaration of any other distribution, upon the common stock of such investment company, or the purchase of any such common stock, unless in every such case such class of senior security has at the time of the declaration of any such dividend or distribution or at the time of any such purchase an asset coverage of at least 200 per centum after deducting the amount of such dividend, distribution or purchase price, as the case may be;

(C) provision is made to entitle the holders of such senior securities, voting as a class, to elect at least two directors at all times, and, subject to the prior rights, if any, of the holders of any other class of senior securities outstanding, to elect a majority of the directors if at any time dividends on such class of securities shall be unpaid in an amount equal to two full years' dividends on such securities, and to continue to be so represented until all dividends in arrears shall have been paid or otherwise provided for;

(D) provision is made requiring approval by the vote of a majority of such securities, voting as a class, of any plan of reorganization adversely affecting such securities or of any action requiring a vote of security holders as in section 13 (a) provided; and

(E) such class of stock shall have complete priority over any other class as to distribution of assets and payment of dividends, which dividends shall be cumulative.

(b) The asset coverage in respect of a senior security provided for in subsection (a) may be determined on the basis of values calculated as of a time within forty-eight hours (not including Sundays

or holidays) next preceding the time of such determination. The time of issue or sale shall, in the case of an offering of such securities to existing stockholders of the issuer, be deemed to be the first date on which such offering is made, and in all other cases shall be deemed to be the time as of which a firm commitment to issue or sell and to take or purchase such securities shall be made.

(c) Notwithstanding the provisions of subsection (a) it shall be unlawful for any registered closed-end investment company to issue or sell any senior security representing indebtedness if immediately thereafter such company will have outstanding more than one class of senior security representing indebtedness, or to issue or sell any senior security which is a stock if immediately thereafter such company will have outstanding more than one class of senior security which is a stock, except that (1) any such class of indebtedness or stock may be issued in one or more series: *Provided*, That no such series shall have a preference or priority over any other series upon the distribution of the assets of such registered closed-end company or in respect of the payment of interest or dividends, and (2) promissory notes or other evidences of indebtedness issued in consideration of any loan, extension, or renewal thereof, made by a bank or other person and privately arranged, and not intended to be publicly distributed, shall not be deemed to be a separate class of senior securities representing indebtedness with the meaning of this subsection (c).

(d) It shall be unlawful for any registered management company to issue any warrant or right to subscribe to or purchase a security of which such company is the issuer, except in the form of warrants or rights to subscribe expiring not later than one hundred and twenty days after their issuance and issued exclusively and ratably to a class or classes of such company's security holders; except that any warrant may be issued in exchange for outstanding warrants in connection with a plan of reorganization.

(e) The provisions of this section 18 shall not apply to any senior securities issued or sold by any registered closed-end company—

(1) pursuant to any firm contract to purchase or sell entered into prior to March 15, 1940;

(2) for the purpose of refunding through payment, purchase, redemption, retirement, or exchange, any senior security of such registered investment company except that no senior security representing indebtedness shall be so issued or sold for the purpose of refunding any senior security which is a stock; or

(3) pursuant to any plan of reorganization (other than for refunding as referred to in subsection (e) (2)), provided—

(A) that such senior securities are issued or sold for the purpose of substituting or exchanging such senior securities for outstanding senior securities, and if such senior securities represent indebtedness they are issued or sold for the purpose of substituting or exchanging such senior securities for outstanding senior securities representing indebtedness, of any registered investment company which is a party to such plan of reorganization; or

(B) that the total amount of such senior securities so issued or sold pursuant to such plan does not exceed the total amount of senior securities of all the companies which are parties to such plan, and the total amount of senior securities representing indebtedness so issued or sold pursuant to such plan does not exceed the total amount of senior securities representing indebtedness of all such companies, or, alternatively, the total amount of such senior securities so issued or sold pursuant to such plan does not have the

effect of increasing the ratio of senior securities representing indebtedness to the securities representing stock or the ratio of senior securities representing stock to securities junior thereto when compared with such ratios as they existed before such reorganization.

(f) (1) It shall be unlawful for any registered open-end company to issue any class of senior security or to sell any senior security of which it is the issuer, except that any such registered company shall be permitted to borrow from any bank: *Provided*, That immediately after any such borrowing there is an asset coverage of at least 300 per centum for all borrowings of such registered company: *And provided further,* That in the event that such asset coverage shall at any time fall below 300 per centum such registered company shall, within three days thereafter (not including Sundays and holidays) or such longer period as the Commission may prescribe by rules and regulations, reduce the amount of its borrowings to an extent that the asset coverage of such borrowings shall be at least 300 per centum.

(2) "Senior security" shall not, in the case of a registered open-end company include a class or classes or a number of series of preferred or special stock each of which is preferred over all other classes or series in respect of assets specifically allocated to that class or series: *Provided,* (A) That such company has outstanding no class or series of stock which is not so preferred over all other classes or series; or (B) that the only other outstanding class of the issuer's stock consists of a common stock upon which no dividend (other than a liquidating dividend) is permitted to be paid and which in the aggregate represents not more than one-half of 1 per centum of the issuer's outstanding voting securities.

(g) Unless otherwise provided: "Senior security" means any bond, debenture, note, or similar obligation or instrument constituting a security and evidencing indebtedness, and any stock of a class having priority over any other class as to distribution of assets or payment of dividends; and "senior security representing indebtedness" means any senior security other than stock.

The term "senior security", when used in subparagraphs (B) and (C) of paragraph (1) of subsection (a), shall not include any promissory note or other evidence of indebtedness issued in consideration of any loan, extension, or renewal thereof, made by a bank or other person and privately arranged, and not intended to be publicly distributed; nor shall such term, when used in this section 18, include any such promissory note or other evidence of indebtedness in any case where such a loan is for temporary purposes only and in an amount not exceeding 5 per centum of the value of the total assets of the issuer at the time when the loan is made. A loan shall be presumed to be for temporary purposes if it is repaid within sixty days and is not extended or renewed; otherwise it shall be presumed not to be for temporary purposes. Any such presumption may be rebutted by evidence.

(h) "Asset coverage" of a class of senior security representing an indebtedness of an issuer means the ratio which the value of the total assets of such issuer, less all liabilities and indebtedness not represented by senior securities, bears to the aggregate amount of senior securities representing indebtedness of such issuer. "Asset coverage" of a class of senior security of an issuer which is a stock means the ratio which the value of the total assets of such issuer, less all liabilities and indebtedness not represented by senior securities, bears to the aggregate amount of senior securities representing indebtedness of such issuer plus the aggregate of the involuntary liquidation preference of

such class of senior security which is a stock. The involuntary liquidation preference of a class of senior security which is a stock shall be deemed to mean the amount to which such class of senior security would be entitled on involuntary liquidation of the issuer in preference to a security junior to it.

(i) Except as provided in subsection (a) of this section, or as otherwise required by law, every share of stock hereafter issued by a registered management company (except a common-law trust of the character described in section 16 (b)) shall be a voting stock and have equal voting rights with every other outstanding voting stock: *Provided*, That this subsection shall not apply to shares issued pursuant to the terms of any warrant or subscription right outstanding on March 15, 1940, or any firm contract entered into before March 15, 1940, to purchase such securities from such company nor to shares issued in accordance with any rules, regulations, or orders which the Commission may make permitting such issue.

(j) Notwithstanding any provision of this title, it shall be unlawful, after the date of enactment of this title, for any registered face-amount certificate company—

(1) to issue, except in accordance with such rules, regulations, or orders as the Commission may prescribe in the public interest or as necessary or appropriate for the protection of investors, any security other than (A) a face-amount certificate; (B) a common stock having a par value and being without preference as to dividends or distributions and having at least equal voting rights with any outstanding security of such company; or (C) short-term payment or promissory notes or other indebtedness issued in consideration of any loan, extension, or renewal thereof, made by a bank or other person and privately arranged and not intended to be publicly offered;

(2) if such company has outstanding any security, other than such face-amount certificates, common stock, promissory notes, or other evidence of indebtedness, to make any distribution or declare or pay any dividend on any capital security in contravention of such rules and regulations or orders as the Commission may prescribe in the public interest or as necessary or appropriate for the protection of investors or to insure the financial integrity of such company, to prevent the impairment of the company's ability to meet its obligations upon its face-amount certificates; or

(3) to issue any of its securities except for cash or securities including securities of which such company is the issuer.

DIVIDENDS

SEC. 19. It shall be unlawful for any registered investment company to pay any dividend, or to make any distribution in the nature of a dividend payment, wholly or partly from any source other than—

(1) such company's accumulated undistributed net income, determined in accordance with good accounting practice and not including profits or losses realized upon the sale of securities or other properties; or

(2) such co company's net income so determined for the current or preceding fiscal year;

unless such payment is accompanied by a written statement which adequately discloses the source or sources of such payment. The Commission may prescribe the form of such statement by rules and regulations in the public interest and for the protection of investors.

PROXIES; VOTING TRUSTS; CIRCULAR OWNERSHIP

SEC. 20. (a) It shall be unlawful for any person, by use of the mails or any means or instrumentality of interstate commerce or otherwise, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security of which a registered investment company is the issuer in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) It shall be unlawful for any registered investment company or affiliated person thereof, any issuer of a voting-trust certificate relating to any security of a registered investment company, or any underwriter of such a certificate, by use of the mails or any means or instrumentality of interstate commerce, or otherwise, to offer for sale, sell, or deliver after sale, in connection with a public offering, any such voting-trust certificate. The prohibitions of this subsection shall not apply to a class of voting-trust certificates, if any certificate of such class was made the subject of a public offering by the issuer or by or through an underwriter prior to March 15, 1940.

(c) No registered investment company shall purchase any voting security if, to the knowledge of such registered company, cross-ownership or circular ownership exists, or after such acquisition will exist, between such registered company and the issuer of such security. Cross-ownership shall be deemed to exist between two companies when each of such companies beneficially owns more than 3 per centum of the outstanding voting securities of the other company. Circular ownership shall be deemed to exist between two companies if such companies are included within a group of three or more companies, each of which —

(1) beneficially owns more than 3 per centum of the outstanding voting securities of one or more other companies of the group; and

(2) has more than 3 per centum of its own outstanding voting securities beneficially owned by another company, or by each of two or more other companies, of the group.

(d) If on the effective date of this title cross-ownership of circular ownership exists between a registered investment company and any other company or companies, it shall be the duty of such registered company, within five years after such effective date, to eliminate such cross-ownership or circular ownership. If at any time after the effective date of this title cross-ownership or circular ownership between a registered investment company and any other company or companies comes into existence upon the purchase by a registered investment company of the securities of another company, it shall be the duty of such registered company, within one year after it first knows of the existence of such cross-ownership or circular ownership, to eliminate the same.

LOANS

SEC. 21. It shall be unlawful for any registered management company to lend money or property to any person, directly or indirectly, if—

(a) the investment policies of such registered company, as recited in its registration statement and reports filed under this title, do not permit such a loan; or

(b) such person controls or is under common control with such registered company; except that the provisions of this paragraph shall not apply to the extension or renewal of any such loan made prior to March 15, 1940, or to any loan from a reg-

istered company to a company which owns all of the outstanding securities of such registered company, except directors' qualifying shares.

DISTRIBUTION, REDEMPTION, AND REPURCHASE OF REDEEMABLE SECURITIES

SEC. 22. (a) A securities association registered under section 15A of the Securities Exchange Act of 1934 may prescribe, by rules adopted and in effect in accordance with said section and subject to all provisions of said section applicable to the rules of such an association—

(1) a method or methods for computing the minimum price at which a member thereof may purchase from any investment company, any redeemable security issued by such company and the maximum price at which a member may sell to such company any redeemable security issued by it or which he may receive for such security upon redemption, so that the price in each case will bear such relation to the current net asset value of such security computed as of such time as the rules may prescribe; and

(2) a minimum period of time which must elapse after the sale or issue of such security before any resale to such company by a member or its redemption upon surrender by a member;

in each case for the purpose of eliminating or reducing so far as reasonably practicable any dilution of the value of other outstanding securities of such company or any other result of such purchase, redemption, or sale which is unfair to holders of such other outstanding securities; and said rules may prohibit the members of the association from purchasing, selling, or surrendering for redemption any such redeemable securities in contravention of said rules.

(b) Such a securities association may also, by rules adopted and in effect in accordance with said section 15A, and subject to all provisions of said section applicable to the rules of such an association, prohibit its members from purchasing, in connection with a primary distribution of redeemable securities of which any registered investment company is the issuer, any such security from the issuer or from any principal underwriter except at a price equal to the price at which such security is then offered to the public less a commission, discount, or spread which is computed in conformity with a method or methods, and within such limitations as to the relation thereof to said public offering price as such rules may prescribe, in order that the price at which such security is offered or sold to the public shall not include an unconscionable or grossly excessive sales load.

(c) After one year from the effective date of this Act, the Commission may make rules and regulations applicable to principal underwriters of, and dealers in, the redeemable securities of any registered investment company, whether or not members of any registered securities association, to the same extent, covering the same subject matter and for the accomplishment of the same ends as are prescribed in subsection (a) and (b) of this section in respect of the rules which may be made by a registered securities association governing its members; and any rules and regulations so made by the Commission, to the extent that they may be inconsistent with the rules of any such association, shall so long as they remain in force supersede the rules of the association and be binding upon its members as well as all other underwriters and dealers to whom they may be applicable.

(d) No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter or the issuer, except at a current public offering price described in the prospectus: *Provided, however,* That nothing in this subsection shall prevent a sale made (i) pursuant to an offer of exchange permitted by section 11 hereof including any offer made pursuant to clause (1) or (2) of section 11 (b); (ii) pursuant to an offer made solely to all registered holders of the securities, or of a particular class or series of securities issued by the company proportionate to their holdings or proportionate to any cash distribution made to them by the company (subject to appropriate qualifications designed solely to avoid issuance of fractional securities); or (iii) in accordance with rules and regulations of the Commission made pursuant to subsection (b) of section 12.

(e) No registered investment company shall suspend the right of redemption or postpone the date of payment or satisfaction upon redemption of any redeemable security in accordance with its terms for more than seven days after the tender of such security to the company or its agent designated for that purpose for redemption except—

(1) for any period (A) during the New York Stock Exchange is closed other than customary week-end and holiday closings or (B) during which trading on the New York Stock Exchange is restricted;

(2) for any period during which an emergency exists as a result of which (A) disposal by the company of securities owned by it is not reasonably practicable or (B) it is not reasonably practicable for such company fairly to determine the value of its net assets; or

(3) for such other periods as the Commission may by order permit for the protection of security holders of the company.

The Commission shall by rules and regulations determine the conditions under which (i) trading shall be deemed to be restricted and (ii) an emergency shall be deemed to exist within the meaning of this subsection. Any company which, as of March 15, 1940, was required by provision of its charter, certificate of incorporation, articles of association, or trust indenture, or of a bylaw or regulation duly adopted thereunder, to postpone the date of payment or satisfaction upon redemption of redeemable securities issued by it, shall be exempt from the requirements of this subsection; but such exemption shall terminate upon the expiration of one year from the effective date of this title, or upon the repeal or amendment of such provision or upon the sale by such company after March 15, 1940, of any security (other than short-term paper) of which it is the issuer, whichever first occurs.

(f) No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company.

(g) No registered open-end company shall issue any of its securities (1) for services; or (2) for property other than cash or securities (including securities of which such registered company is the issuer),

except as a dividend or distribution to its security holders or in connection with a reorganization.

DISTRIBUTION AND REPURCHASE OF SECURITIES: CLOSED-END COMPANIES

SEC. 23. (a) No registered closed-end company shall issue any of its securities (1) for services; or (2) for property other than cash or securities (including securities of which such registered company is the issuer), except as a dividend or distribution to its security holders or in connection with a reorganization.

(b) No registered closed-end company shall sell any common stock of which it is the issuer at a price below the current net asset value of such stock, exclusive of any distributing commission or discount (which net asset value shall be determined as of the time within forty-eight hours, excluding Sundays and holidays, next preceding the time of such determination), except (1) in connection with an offering to the holders of one or more classes of its capital stock; (2) with the consent of a majority of its common stockholders; (3) upon conversion of a convertible security in accordance with its terms; (4) upon the exercise of any warrant outstanding on the date of enactment of this Act or issued in accordance with the provisions of section 18 (d); or (5) under such other circumstances as the Commission may permit by rules and regulations or orders for the protection of investors.

(c) No registered closed-end company shall purchase any securities of any class of which it is the issuer except—

(1) on a securities exchange or such other open market as the Commission may designate by rules and regulations or orders: *Provided*, That if such securities are stock, such registered company shall, within the preceding six months, have informed stockholders of its intention to purchase stock of such class by letter or report addressed to stockholders of such class; or

(2) pursuant to tenders, after reasonable opportunity to submit tenders given to all holders of securities of the class to be purchased; or

(3) under such other circumstances as the Commission may permit by rules and regulations or orders for the protection of investors in order to insure that such purchases are made in a manner or on a basis which does not unfairly discriminate against any holders of the class or classes of securities to be purchased.

REGISTRATION OF SECURITIES UNDER SECURITIES ACT OF 1933

SEC. 24. (a) In registering under the Securities Act of 1933 any security of which it is the issuer, a registered investment company, in lieu of furnishing a registration statement containing the information and documents specified in schedule A of said Act, may file a registration statement containing the following information and documents:

(1) such copies of the registration statement filed by such company under this title, and of such reports filed by such company pursuant to section 30 or such copies of portions of such registration statement and reports, as the Commission shall designate by rules and relegations; and

(2) such additional information and documents (including a prospectus) as the Commission shall prescribe by rules and regulations as necessary or appropriate in the public interest or for the protection of investors.

(b) It shall be unlawful for any of the following companies, or for any underwriter for such a company, in connection with a public offering of any security of which such company is the issuer, to make use of the mails or any means or instrumentalities of interstate commerce, to transmit any advertisement, pamphlet, circular, form letter, or other sales literature addressed to or intended for distribution to prospective investors unless three copies of the full text thereof have been filed with the Commission or are filed with the Commission within ten days thereafter:

(1) any registered open-end company;

(2) any registered unit investment trust; or

(3) any registered face-amount certificate company.

(c) In addition to the powers relative to prospectuses granted the Commission by section 10 of the Securities Act of 1933, the Commission is authorized to require, by rules and regulations or order, that the information contained in any prospectus relating to any periodic payment plan certificate or face-amount certificate registered under the Securities Act of 1933 on or after the effective date of this title be presented in such form and order of items, and such prospectus contain such summaries of any portion of such information, as are necessary or appropriate in the public interest or for the protection of investors.

(d) The exemption provided by paragraph (8) of section 3 (a) of the Securities Act of 1933 shall not apply to any security of which an investment company is the issuer. The exemption provided by paragraph (11) of said section 3 (a) shall not apply to any security of which a registered investment company is the issuer, except a security sold or disposed of by the issuer or bona fide offered to the public prior to the effective date of this title, and with respect to a security so sold, disposed of, or offered, shall not apply to any new offering thereof on or after the effective date of this title.

PLANS OF REORGANIZATION

SEC. 25. (a) Any person who, by use of the mails or any means or instrumentality of interstate commerce or otherwise, solicits or permits the use of his name to solicit any proxy, consent, authorization, power of attorney, ratification, deposit, or dissent in respect of any plan of reorganization of any registered investment company shall file with, or mail to, the Commission for its information, within twenty-four hours after the commencement of any such solicitation, a copy of such plan and any deposit agreement relating thereto and of any proxy, consent, authorization, power of attorney, ratification, instrument of deposit, or instrument of dissent in respect thereto, if or to the extent that such documents shall not already have been filed with the Commission.

(b) The Commission is authorized, if so requested, prior to any solicitation of security holders with respect to any plan of reorganization, by any registered investment company which is, or any of the securities of which are, the subject of or is a participant in any such plan, or if so requested by the holders of 25 per centum of any class of its outstanding securities, to render an advisory report in respect of the fairness of any such plan and its effect upon any investment company, in respect of which the Commission shall have rendered any such advisory report, shall mail promptly a copy of such advisory report to all its security holders affected by any such plan: *Provided,* That such advisory report shall have been received by it at least forty-eight hours (not including Sunday and holi-

days) before final action is taken in relation to such plan at any meeting of security holders called to act in relation thereto, or any adjournment of any such meeting, or if no meeting be called, then prior to the final date of acceptance of such plan by security holders. In respect of securities not registered as to ownership, in lieu of mailing a copy of such advisory report, such registered company shall publish promptly a statement of the existence of such advisory report in a newspaper of general circulation in its principal place of business and shall make available copies of such advisory report upon request. Notwithstanding the provision of this section the Commission shall not render such advisory report although so requested by any such investment company or such security holders if the fairness or feasibility of said plan is in issue in any proceeding pending in any court of competent jurisdiction unless such plan is submitted to the Commission for that purpose by such court.

(c) Any district court of the United States in the State of incorporation of a registered investment company or any such court for the district in which such company maintains its principal place of business is authorized to enjoin the consummation of any plan of reorganization of such registered investment company upon proceedings instituted by the Commission (which is authorized so to proceed upon behalf of security holders of such registered company, or any class thereof), if such court shall determine any such plan to be grossly unfair or to constitute gross misconduct or gross abuse of trust on the part of the officers, directors, or investment advisers of such registered company or other sponsors of such plan.

(d) Nothing contained in this section shall in any way affect or derogate from the powers of the courts of the United States and the Commission with reference to reorganizations contained in the Bankruptcy Act of 1898, as amended.

UNIT INVESTMENT TRUSTS

SEC. 26. (a) No principal underwriter for or depositor of a registered unit investment trust shall sell, except by surrender to the trustee for redemption, any security of which such trust is the issuer (other than short-term paper), unless the trust indenture, agreement of custodianship, or other instrument pursuant to which such security is issued—

(1) designates one or more trustees or custodians, each of which is a bank, and provides that each such trustee or custodian shall have at all times an aggregate capital, surplus, and undivided profits of a specified minimum amount, which shall not be less than $500,000 (but may also provide, if such trustee or custodian publishes reports of condition at least annually, pursuant to law or to the requirements of its supervising or examining authority, that for the purposes of this paragraph the aggregate capital, surplus, and undivided profits of such trustee or custodian shall be deemed to be its aggregate capital, surplus, and undivided profit as set forth in its most recent report of condition so published);

(2) provides, in substance, (A) that during the life of the trust the trustee or custodian, if not otherwise remunerated, may charge against and collect from the income of the trust, and from the corpus thereof if no income is available, such fees for its services and such reimbursement for its expenses as are provided for in such instrument; (B) that no such charge or collection shall be made except for services theretofore performed or expenses theretofore incurred; (C) that no payment to the

depositor of or a principal underwriter for such trust, or to any affiliated person or agent of such depositor or underwriter, shall be allowed the trustee or custodian as an expense (except that provision may be made for the payment to any such person of a fee, not exceeding such reasonable amount as the Commission may prescribe as compensation for performing bookkeeping and other administrative services, of a character normally performed by the trustee or custodian itself); and (D) that the trustee or custodian shall have possession of all securities and other property in which the funds of the trust are invested, all funds held for such investment, all equalization, redemption, and other special funds of the trust, and all income upon, accretions to, and proceeds of such property and funds, and shall segregate and hold the same in trust (subject only to the charges and collections allowed under clauses (A), (B), and (C) until distribution thereof to the security holders of the trust;

(3) provides, in substance, that the trustee or custodian shall not resign until either (A) the trust has been completely liquidated and the proceeds of the liquidation distributed to the security holders of the trust, or (B) a successor trustee or custodian, having the qualifications prescribed in paragraph (1), has been designated and has accepted such trusteeship or custodianship; and

(4) provides, in substance, (A) that a record will be kept by the depositor or an agent of the depositor of the name and address of, and the shares issued by the trust and held by, every holder of any security issued pursuant to such instrument, insofar as such information is known to the depositor or agent; and (B) that whenever a security is deposited with the trustee in substitution for any security in which such security holder has an undivided interest, the depositor or the agent of the depositor will, within five days after such substitution, either deliver or mail to such security holder a notice of substitution, including an identification of the securities eliminated and the securities substituted, and a specification of the shares of such security holder affected by the substitution.

(b) In the event that a trust indenture, agreement of custodianship, or other instrument pursuant to which securities of a registered unit investment trust are issued does not at the effective date of this title comply with the requirements of subsection (a), such instrument will be deemed to meet such requirements if a written contract or agreement binding on the parties and embodying such requirements has been executed by the depositor on the one part and the trustee or custodian on the other part, and three copies of such contract or agreement have been filed with the Commission.

(c) Whenever the Commission has reason to believe that a unit investment trust is inactive and that its liquidation is in the interest of the security holders of such trust, the Commission may file a complaint seeking the liquidation of such trust in the district court of the United States in any district wherein any trustee of such trust resides or has its principal place of business. A copy of such complaint shall be served on every trustee of such trust, and notice of the proceeding shall be given such other interested persons in such manner and at such times as the court may direct. If the court determines that such liquidation is in the interest of the security holders of such trust, the court shall order such liquidation and, after payment of necessary expenses, the distribution of the proceeds to the security holders of the trust in such manner and on such terms as may to the court appear equitable.

PERIODIC PAYMENT PLANS

SEC. 27. (a) It shall be unlawful for any registered investment company issuing periodic payment plan certificates, or for any depositor of or underwriter for such company, to sell any such certificate, if—

(1) the sales load on such certificate exceeds 9 per centum of the total payments to be made thereon;

(2) more than one-half of any of the first twelve monthly payments thereon, or their equivalent, is deducted for sales load;

(3) the amount of sales load deducted from any one of such first payments exceeds proportionately the amount deducted from any other such payment, or the amount deducted from any subsequent payment exceeds proportionately the amount deducted from any other subsequent payment;

(4) The first payment on such certificate is less than $20, or any subsequent payment is less than $10;

(5) if such registered company is a management company, the proceeds of such certificate or the securities in which such proceeds are invested are subject to management fees (other than fees for administrative services of the character described in clause (C), paragraph (2), of section 26 (a)) exceeding such reasonable amount as the Commission may prescribe, whether such fees are payable to such company or to investment advisers thereof; or

(6) if such registered company is a unit investment trust the assets of which are securities issued by a management company, the depositor of or principal underwriter for such trust, or any affiliated person of such depositor or underwriter, is to receive from such management company or any affiliated person thereof any fee or payment on account of payments on such certificate exceeding such reasonable amount as the Commission may prescribe.

(b) If it appears to the Commission, upon application or otherwise, that smaller companies are subjected to relatively higher operating costs and that in order to make due allowance therefor it is necessary or appropriate in the public interest and consistent with the protection of investors that a provision or provisions of paragraph (1), (2), or (3) of subsection (a) relative to sales load be relaxed in the case of certain registered investment companies issuing periodic payment plan certificates, or certain specified classes of such companies, the Commission is authorized by rules and regulations or order to grant any such company or class of companies appropriate qualified exemptions from the provisions of said paragraphs.

(c) It shall be unlawful for any registered investment company issuing periodic payment plan certificates, or for any depositor of or underwriter for such company, to sell any such certificate, unless—

(1) such certificate is a redeemable security; and

(2) the proceeds of all payments on such certificate (except such amounts s are deducted for sales load) are deposited with a trustee or custodian having the qualifications prescribed in paragraph (1) of section 26 (a) for the trustees of unit investment trusts, and are held by such trustee or custodian under an indenture or agreement containing, in substance, the provisions required by paragraphs (2) and (3) of section 26 (a) for the trust indentures of unit investment trusts.

FACE-AMOUNT CERTIFICATE COMPANIES

SEC. 28. (a) It shall be unlawful for any registered face-amount certificate company to issue or sell any face-amount certificate, or to

collect or accept any payment on any such certificate issued by such company on or after the effective date of this title, unless—

(1) such company, if organized before March 15, 1940, was actively and continuously engaged in selling face-amount certificates on and before that date, and has outstanding capital stock worth upon a fair valuation of assets not less than $50,000; or if organized on or after March 15, 1940, has capital stock in an amount not less than $250,000 which has been bona fide subscribed and paid for in cash; and

(2) such company maintains at all times minimum certificate reserves on all its outstanding face-amount certificates in an aggregate amount calculated and adjusted as follows:

(A) the reserves for each certificate of the installment type shall be based on assumed annual, semi-annual, quarterly, or monthly reserve payments according to the manner in which gross payments for any certificate year are made by the holder, which reserve payments shall be sufficient in amount, as and when accumulated at a rate not to exceed 3½ per centum per annum compounded annually, to provide the minimum maturity or face amount of the certificate when due. Such reserve payments may be graduated according to certificate years so that the reserve payment or payments for the first certificate year shall amount to at least 50 per centum of the required gross annual payment for such year and the reserve payment or payments for each of the second to fifth certificate years inclusive shall amount to at least 93 per centum of each such year's required gross annual payment and for the sixth and each subsequent certificate year the reserve payment or payments shall amount to at least 96 per centum of each such year's required gross annual payment: *Provided,* That such aggregate reserve payments shall amount to at least 93 per centum of the aggregate gross annual payments required to be made by the holder to obtain the maturity of the certificate. The company may at its option take as loading from the gross payment or payments for a certificate year, as and when made by the certificate holder, an amount or amounts equal in the aggregate for such year to not more than the excess, if any, of the gross payment or payments required to be made by the holder for such year, over and above the percentage of the gross annual payment required herein for such year for reserve purposes. Such loading may be taken by the company prior to or after the setting up of the reserve payment or payments for such year and the reserve payment or payments for such year may be graduated and adjusted to correspond with the amount of the gross payment or payments made by the certificate holder for such year less the loading so taken;

(B) if the foregoing minimum percentages of the gross annual payments required under the provisions of such certificate should produce reserve payments larger than are necessary at 3½ per centum per annum compounded annually to provide the minimum maturity or face amount of the certificate when due, the reserve shall be based upon reserve payments accumulated as provided under preceding subparagraph (A) of this subsection except that in lieu of the 3½ per centum rate specified therein, such rate shall be lowered to the minimum rate, expressed in multiples of one-eighth of 1 per centum, which will accumulate such reserve payments to the maturity value when due;

(C) if the actual annual gross payment to be made by the certificate holder on any certificate issued prior to or after the effective date of this Act is less than the amount of any assumed reserve payment or payments for a certificate year, such company shall maintain as a part of such minimum certificate reserves a deficiency reserve equal to the total present value of future deficiencies in the gross payments, calculated at a rate not to exceed 3½ per centum per annum compounded annually;

(D) for each certificate of the installment type the amount of the reserve shall at any time be at least equal to (1) the then amount of the reserve payments set up under section 28 (a) (2) (A) or (B); (2) the accumulations on such reserve payments as computed under subparagraphs (A) or (B) of this paragraph (2); (3) the amount of any deficiency reserve required under subparagraph (C) hereof; and (4) such amount as shall have been credited to the account of each certificate holder in the form of any credit, or any dividend, or any interest in addition to the minimum maturity amount specified in such certificate, plus any accumulations on any amount or amounts so credited, at a rate not exceeding 3½ per centum per annum compounded annually;

(E) for each certificate which is fully paid, including any fully paid obligations resulting from or effected upon the maturity of the previously issued certificate, and for each paid-up certificate issued as provided in subsection (f) of this section prior to maturity, the amount of the reserve shall at any time be at least equal to (1) such amount as and when accumulated at a rate not to exceed 3½ per centum per annum compounded annually, will provide the amount or amounts payable when due and (2) such amount as shall have been credited to the account of each such certificate holder in the form of any credit, or any dividend, or any interest in addition to the minimum maturity amount specified in the certificate, plus any accumulations on any amount or amounts so credited, at a rate not exceeding 3½ per centum per annum compounded annually;

(F) for each certificate of the installment type under which gross payments have been made by or credited to the holder thereof covering a payment period or periods or any part thereof beyond the then current payment period as defined by the terms of such certificate, and for which period or periods no reserve has been set up under subparagraph (A) or (B) hereof, an advance payment reserve shall be set up and maintained in the amount of the present value of any such unapplied advance gross payments, computed at a rate not to exceed 3½ per centum per annum compounded annually;

(G) such appropriate contingency reserves for death and disability benefits and for reinstatement rights on any such certificate providing for such benefits or rights as the Commission shall prescribe by rule, regulation, or order based upon the experience of face-amount companies in relation to such contingencies.

At no time shall the aggregate certificate reserves herein required by subparagraphs (A) to (F), inclusive, be less than the aggregate surrender values and other amounts to which all certificate holders may be then entitled.

For the purpose of this subsection (a), no certificate of the installment type shall be deemed to be outstanding if before a surrender value has been attained the holder thereof has been in continuous default in making his payments thereon for a period of one year.

(b) It shall be unlawful for any registered face-amount certificate company to issue or sell any face-amount certificate, or to collect or accept any payment on any such certificate issued by such company on or after the effective date of this title, unless such company has, in cash or qualified investments, assets having a value not less than the aggregate amount of the capital stock requirement and certificate reserves as computed under the provisions of subsection (a) hereof. As used in this subsection, "qualified investments" means investments of a kind which life-insurance companies are permitted to invest in or hold under the provisions of the Code of the District of Columbia as heretofore or hereafter amended, and such other investments as the Commission shall by rule, regulation, or order authorize as qualified investments. Such investments shall be valued in accordance with the provisions of said Code where such provisions are applicable. Investments to which such provisions do not apply shall be valued in accordance with such rules, regulations, or orders as the Commission shall prescribe for the protection of investors.

(c) The Commission shall by rule, regulation, or order, in the public interest or for the protection of investors, require a registered face-amount certificate company to deposit and maintain, upon such terms and conditions as the Commission shall prescribe and as are appropriate for the protection of investors, with one or more institutions having the qualifications required by paragraph (1) of section 26 (a) for a trustee of a unit investment trust, all or any part of the investments maintained by such company as certificate reserve requirements under the provisions of subsection (b) hereof: *Provided, however*, That where qualified investments are maintained on deposit by such company in respect of its liabilities under certificates issued to or held by residents of any State as required by the statute of such State or by any order, regulation, or requirement of such State or any official or agency thereof, the amount so on deposit, but not to exceed the amount of reserves required by subsection (a) hereof for the certificates so issued or held, shall be deducted from the amount of qualified investments that may be required to be deposited hereunder.

Assets which are qualified investments under subsection (b) and which are deposited under or as permitted by this subsection (c), may be used and shall be considered as a part of the assets required to be maintained under the provisions of said subsection (b).

(d) It shall be unlawful for any registered face-amount certificate company to issue or sell any face-amount certificate, or to collect or accept any payment on any such certificate issued by such company on or after the effective date of this title, unless such certificate contains a provision or provisions to the effect—

(1) that, in respect of any certificate of the installment type, during the first certificate year the holder of the certificate, upon surrender thereof, shall be entitled to a value payable in cash not less than the reserve payments as specified in subparagraph (A) or (B) of paragraph (2) of subsection (a) and at the end of such certificate year, a value payable in cash at least equal to 50 per centum of the amount of the gross annual payment required thereby for such year;

(2) that, in respect of any certificate of the installment type, at any time after the expiration of the first certificate year and

prior to maturity, the holder of the certificate, upon surrender thereof, shall be entitled to a value payable in cash not less than the then amount of the reserve for such certificate required by numbered items (1) and (2) of subparagraph (D) of paragraph (2) subsection (a) hereof, less a surrender charge that shall not exceed 2 per centum of the face or maturity amount of the certificate, or 15 per centum of the amount of such reserve, whichever is the lesser, but in no event shall such value be less than 50 per centum of the amount of such reserve. The amount of the surrender value for the end of each certificate year shall be set out in the certificate;

(3) that, in respect of any certificate of the installment type, the holder of the certificate, upon surrender thereof for cash or upon receipt of a paid-up certificate as provided in subsection (f) hereof, shall be entitled to a value payable in cash equal to the then amount of any advance payment reserve under such certificate required by subparagraph (F) of paragraph (2) of subsection (a) hereof in addition to any other amounts due the holder hereunder;

(4) that at any time prior to maturity, in respect of any certificate which is fully paid, the holder of the certificate, upon surrender thereof, shall be entitled to a value payable in cash not less than the then amount of the reserve for such certificate required by item (1) of subparagraph (E) of paragraph (2) of subsection (a) hereof, less a surrender charge that shall not exceed 2 per centum of the face or maturity amount of the certificate, or 15 per centum of the amount of such reserve, whichever is the lesser: *Provided, however,* That such surrender charge shall not apply as to any obligations of a fully paid type resulting from the maturity of a previously issued certificate. The amount of the surrender value for the end of each certificate year shall be set out in the certificate;

(5) that in respect of any certificate, the holder of the certificate, upon maturity, upon surrender thereof for cash or upon receipt of a paid-up certificate as provided in subsection (f) hereof, shall be entitled to a value payable in cash equal to the then amount of the reserve, if any, for such certificate required by item (4) of subparagraph (D) of paragraph (2) of subsection (a) hereof or item (2) of subparagraph (E) of paragraph (2) of subsection (a) hereof in addition to any other amounts due the holder hereunder.

The term "certificate year" as used in this section in respect of any certificate of the installment type means a period or periods for which one year's payment or payments as provided by the certificate have been made thereon by the holder and the certificate maintained in force by such payments for the time for which the same have been made, and in respect of any certificate which is fully paid or paid-up means any year ending on the anniversary of the date of issuance of the certificate.

Any certificate may provide for loans or advances by the company to the certificate holder on the security of such certificate upon terms prescribed therein but at an interest rate not exceeding 6 per centum per annum. The amount of the required reserves, deposits, and the surrender values thereof available to the holder may be adjusted to take into account any unpaid balance on such loans or advances and interest thereon, for the purposes of this subsection and subsections (b) and (c) hereof.

Any certificate may provide that the company at its option may, prior to the maturity thereof, defer any payment or payments to the

1934701—41—PT. I——53

certificate holder to which he may be entitled under this subsection (d), for a period of not more than thirty days: *Provided,* That in the event such option is exercised by the company, interest shall accrue on any payment or payments due to the holder, for the period of such deferment at a rate equal to that used in accumulating the reserves for such certificate: *And provided further,* That the Commission may, by rules and regulations or orders in the public interest or for the protection of investors, make provision for any other deferment upon such terms and conditions as it shall prescribe.

(e) It shall be unlawful for any registered face-amount certificate company to issue or sell any face-amount certificate, or to collect or accept any payment on any such certificate issued by such company on or after the effective date of this title, which certificate makes the holder liable to any legal action or proceeding for any unpaid amount on such certificate.

(f) It shall be unlawful for any registered face-amount certificate company to issue or sell any face-amount certificate, or to collect or accept any payment on any such certificate issued by such company on or after the effective date of this title, (1) unless such face-amount certificate contains a provision or provisions to the effect that the holder shall have an optional right to receive a paid-up certificate in lieu of the then attained cash surrender value provided therein and in the amount of such value plus accumulations thereon at a rate to be specified in the paid-up certificate equal to that used in computing the reserve on the original certificate under subparagraph (A) or (B) of paragraph (2) of subsection (a) of this section, such paid-up certificate to become due and payable at the end of a period equal to the balance of the term of such original certificate before maturity; and during the period prior to maturity such paid-up certificate shall have a cash value upon surrender thereof equal to the then amount of the reserve therefor; and (2) unless such face-amount certificate contains a further provision or provisions to the effect that if the holder be in continuous default in his payments on such certificate for a period of six months without having exercised his option to receive a paid-up certificate, as herein provided, the company at the expiration of such six months shall pay the surrender value in cash if such value is less than $100 or if such value is $100 or more shall issue such paid-up certificate to such holder and such payment or issuance, plus the payment of all other amounts to which he may be then entitled under the original certificate, shall operate to cancel his original certificate: *Provided,* That in lieu of the issuance of a new paid-up certificate the original certificate may be converted into a paid-up certificate with the same effect; and (3) unless, where such certificate provides, in the event of default, for the deferment of payments thereon by the holder or of the due dates of such payments or of the maturity date of the certificate, it shall also provide in effect for the right of reinstatement by the holder of the certificate after default and for an option in the holder, at the time of reinstatement, to make up the payment or payments for the default period next preceding such reinstatement with interest thereon not exceeding 6 per centum per annum, with the same effect as if no such default in making such payments had occurred.

The term "default" as used in this subsection (f) shall, without restricting its usual meaning, include a failure to make a payment or payments as and when provided by the certificate.

(g) The foregoing provisions of this section shall not apply to a face-amount certificate company which on or before the effective date of this Act has discontinued the offering of face-amount certificates

to the public and issues face-amount certificates only to the holders of certificates previously issued pursuant to an obligation expressed or implied in such certificates.

(h) It shall be unlawful for any registered face-amount certificate company which does not maintain the minimum certificate reserve on all its outstanding face-amount certificates issued prior to the effective date of this Act, in an aggregate amount calculated and adjusted as provided in section 28, to declare or pay any dividends on the shares of such company for or during any calendar year which shall exceed one-third of the net earnings for the next preceding calendar year or which shall exceed 10 per centum of the aggregate net earnings for the next preceding five calendar years, whichever is the lesser amount, or any divided which shall have been forbidden by the Commission pursuant to the provision of the next sentence of this paragraph. At least thirty days before such company shall declare, pay, or distribute any dividend, it shall give the Commission written notice of its intention to declare, pay, or distribute the same; and if at any time it shall appear to the Commission that the declaration, payment or distribution of any dividend for or during any calendar year might impair the financial integrity of such company or its ability to meet its liabilities under its outstanding face-amount certificates, it may by order forbid the declaration, distribution, or payment of any such dividend.

BANKRUPTCY OF FACE-AMOUNT CERTIFICATE COMPANIES

SEC. 29. (a) Section 67 of an Act entitled "An Act to establish a uniform system of bankruptcy throughout the United States", approved July 1, 1898, as amended, is amended by adding at the end thereof the following:

"f. (1) For the purposes of, and exclusively applicable to, this subdivision f (a) 'debtor' shall mean a face-amount certificate company as defined in section 4 of the Investment Company Act of 1940; (b) 'face-amount certificate' shall mean a face-amount certificate as defined in section 2 of the Investment Company Act of 1940; (c) 'depositary' is a person or State agency with whom securities or other property of a debtor is deposited or to whom property of a debtor is transferred, in trust or otherwise, pursuant to the requirements of a State law or an agreement by the debtor providing for the distribution of such property or its proceeds to creditors or security holders of the debtor in the event of the insolvency of the debtor or under other specified circumstances; (d) 'deposit creditor' is a creditor who, under the provisions of a State law or agreement providing for a deposit with or transfer to a depositary, has rights as to the securities or property so deposited or transferred which exceed the rights of a general creditor; and (e) 'State agency' is an official or agency of a State designated to act as depositary or to distribute property, or the proceeds of property held by a depositary.

"(2) Every deposit or transfer of securities or other property made by or on behalf of a debtor with or to any depositary for the benefit or protection of or to secure the holder of any security sold by or on behalf of the debtor on or after January 1, 1941, shall be voidable as against the trustee of such debtor if the property of the estate is insufficient for the full payment and discharge of all claims on account of all face-amount certificates sold by or on behalf of the debtor and such deposit or transfer and every lien created thereby shall thereupon be avoided by the trustee subject to the provisions of paragraph 3 of this subdivision f.

"(3) In the event any deposit or transfer described in paragraph 2 of this subdivision f shall be avoided the trustee shall segregate

the property received by the trustee from the depositary and charge the same with the costs and expenses of maintenance and liquidation and distribute the net proceeds thereof to the creditors who would have been entitled thereto under the provisions of the law or agreement providing for the deposit or transfer of the property, and each such creditor shall thereafter be entitled to dividends from the estate only after all creditors of the same rank shall have received the same percentage.

"(4) The court shall have summary jurisdiction of any proceedings to hear and determine the rights of any parties under this subdivision f and to hear and determine the sufficiency of the property of the estate for the full payment and discharge of all claims on account of all face-amount certificates sold by or on behalf of the debtor. Due notice of any hearing in such proceedings shall be given to every depositary and State agency which is a party in interest.

"(5) Where the provisions of subsection (c) of section 28 are not applicable, the provisions of this section will not apply."

(b) Section 44 of said Act of July 1, 1898, as amended, is amended by adding at the end of subdivision (a) thereof the following sentence:

"If the bankrupt is a face-amount certificate company, as defined in section 4 of the Investment Company Act of 1940, the court alone shall make the appointment; but the court shall not make such appointment without first notifying the Securities and Exchange Commission and giving it an opportunity to be heard."

PERIODIC AND OTHER REPORTS; REPORTS OF AFFILIATED PERSONS

SEC. 30. (a) Every registered investment company shall file annually with the Commission such information, documents, and reports as investment companies having securities registered on a national securities exchange are required to file annually pursuant to section 13 (a) of the Securities Exchange Act of 1934 and the rules and regulations issued thereunder.

(b) Every registered investment company shall file with the Commission—

(1) such information and documents (other than financial statements) as the Commission may require, on a semi-annual or quarterly basis, to keep reasonably current the information and documents contained in the registration statement of such company filed under this title; and

(2) copies of every periodic or interim report or similar communication containing financial statements and transmitted to any class of such company's security holders, such copies to be filed not later than ten days after such transmission.

Any information or documents contained in a report or other communication to security holders filed pursuant to paragraph (2) may be incorporated by reference in any report subsequently or concurrently filed pursuant to paragraph (1).

(c) The Commission shall issue rules and regulations permitting the filing with the Commission, and with any national securities exchange concerned, of copies of periodic reports, or of extracts therefrom, filed by any registered investment company pursuant to subsections (a) and (b), in lieu of any reports and documents required of such company under section 13 or 15 (d) of the Securities Exchange Act of 1934.

(d) Every registered investment company shall transmit to its stockholders, at least semi-annually, reports containing such of the

following information and financial statements or their equivalent as of a reasonably current date, as the Commission may prescribe by rules and regulations for the protection of investors, which reports shall not be misleading in any material respect in the light of the reports required to be filed pursuant to subsections (a) and (b):

(1) a balance sheet accompanied by a statement of the aggregate value of investments on the date of such balance sheet;

(2) a list showing the amounts and values of securities owned on the date of such balance sheet;

(3) a statement of income, for the period covered by the report, which shall be itemized at least with respect to each category of income and expense representing more than 5 per centum of total income or expense;

(4) a statement of surplus, which shall be itemized at least with respect to each charge or credit to the surplus account which represents more than 5 per centum of the total charges or credits during the period covered by the report;

(5) a statement of the aggregate remuneration paid by the company during the period covered by the report (A) to all directors and to all members of any advisory board for regular compensation; (B) to each director and to each member of an advisory board for special compensation; (C) to all officers; and (D) to each person of whom any officer or director of the company is an affiliated person; and

(6) a statement of the aggregate dollar amounts of purchases and sales of investment securities, other than Government securities, made during the period covered by the report:

Provided, That if in the judgment of the Commission any item required under this subsection is inapplicable or inappropriate to any specified type or types of investment company, the Commission may by rules and regulations permit in lieu thereof the inclusion of such item of a comparable character as it may deem applicable or appropriate to such type or types of investment company.

(e) Financial statements contained in annual reports required pursuant to subsections (a) and (d), if required by the rules and regulations of the Commission, shall be accompanied by a certificate of independent public accountants. The certificate of such independent public accountants shall be based upon an audit not less in scope or procedures followed than that which independent public accountants would ordinarily make for the purpose of presenting comprehensive and dependable financial statements, and shall contain such information as the Commission may prescribe, by rules and regulations in the public interest or for the protection of investors, as to the nature and scope of the audit and the findings and opinion of the accountants. Each such report shall state that such independent public accountants have verified securities owned, either by actual examination, or by receipt of a certificate from the custodian, as the Commission may prescribe by rules and regulations.

(f) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of outstanding securities (other than short-term paper) of which a registered closed-end company is the issuer or who is an officer, director, member of an advisory board, investment adviser, or affiliated person of an investment adviser of such a company shall in respect of his transactions in any securities of such company (other than short-term paper) be subject to the same duties and liabilities as those imposed by section 16 of the Securities Exchange Act of 1934 upon certain beneficial owners, directors, and officers in respect of their transactions in certain equity securities.

ACCOUNTS AND RECORDS

SEC. 31. (a) Every registered investment company, and every underwriter, broker, dealer, or investment adviser which is a majority-owned subsidiary of such a company, shall maintain and preserve for such period or periods as the Commission may prescribe by rules and regulations, such accounts, books, and other documents as constitute the record forming the basis for financial statements required to be filed pursuant to section 30 of this title, and of the auditor's certificates relating thereto. Every investment adviser not a majority-owned subsidiary of, and every depositor of any registered investment company, and every principal underwriter for any registered investment company other than a closed-end company, shall maintain and preserve for such period or periods as the Commission shall prescribe by rules and regulations, such accounts, books, and other documents as are necessary or appropriate to record such person's transactions with such registered company.

(b) All accounts, books, and other records, required to be maintained and preserved by any person pursuant to subsection (a), shall be subject at any time and from time to time to such reasonable periodic, special, and other examinations by the Commission, or any member or representative thereof, as the Commission may prescribe. Any such person shall furnish to the Commission, within such reasonable time as the Commission may prescribe, copies of or extracts from such records which may be prepared without undue effort, expense, or delay, as the Commission may by order require.

(c) The Commission may, in the public interest or for the protection of investors, issue rules and regulations providing for a reasonable degree of uniformity in the accounting policies and principles to be followed by registered investment companies in maintaining their accounting records and in preparing financial statements required pursuant to this title.

(d) The Commission, upon application made by any registered investment company, may by order exempt a specific transaction or transactions from the provisions of any rule or regulation made pursuant to subsection (c), if the Commission finds that such rule or regulation should not reasonably be applied to such transaction.

ACCOUNTANTS AND AUDITORS

SEC. 32. (a) After one year from the effective date of this title, it shall be unlawful for any registered management company or registered face-amount certificate company to file with the Commission any financial statement signed or certified by an independent public accountant, unless—

(1) such accountant shall have been selected at a meeting held within thirty days before or after the beginning of the fiscal year or before the annual meeting of stockholders in that year by a majority of those members of the board of directors who are not investment advisers of, or affiliated persons of an investment adviser or, or officers or employees of, such registered company;

(2) such selection shall have been submitted for ratification or rejection at the next succeeding annual meeting of stockholders if such meeting be held, except that any vacancy occurring between annual meetings, due to the death or resignation of the accountant, may be filled by the board of directors;

(3) the employment of such accountant shall have been conditioned upon the right of the company by vote of a majority of the outstanding voting securities at any meeting called for the purpose to terminate such employment forthwith without any penalty; and

(4) such certificate or report of such accountant shall be addressed both to the board of directors of such registered company and to the security holders thereof;

Provided, That if the selection of an accountant has been rejected pursuant to paragraph (2) or his employment terminated pursuant to paragraph (3) the vacancy so occurring may be filled by a vote of a majority of the outstanding voting securities, either at the meeting at which the rejection or termination occurred or if not so filled then at a subsequent meeting which shall be called for the purpose. In the case of a common-law trust of the character described in section 16 (b) no ratification of the employment of such accountant shall be required but such employment may be terminated and such accountant removed by action of the holders of record of a majority of the outstanding shares of beneficial interest in such trust in the same manner as is provided in said section 16 (b) in respect of the removal of a trustee, and all the provisions therein contained as to the calling of a meeting shall be applicable. In the event of such termination and removal the vacancy so occurring may be filled by action of the holders of record of a majority of the shares of beneficial interest either at the meeting, if any, at which such termination and removal occurs, or by instruments in writing filed with the custodian, or if not so filled within a reasonable time then at subsequent meeting which shall be called by the trustees for the purpose. The provisions of paragraph (40) of section 2 (a) as to a majority shall be applicable to the vote cast at any meeting of the shareholders of such a trust held pursuant to this subsection.

(b) No registered management company or registered face-amount certificate company shall file with the Commission any financial statement in the preparation of which the controller or other principal accounting officer or employee of such company participated, unless such controller, officer or employee was selected, either by vote of the holders of such company's voting securities at the last annual meeting of such security holders, or by the board of directors of such company.

(c) The Commission is authorized, by rules and regulations or order in the public interest or for the protection of investors, to require accountants and auditors to keep reports, work sheets, and other documents and papers relating to registered investment companies for such period or periods as the Commission may prescribe, and to make the same available for inspection by the Commission or any member or representative thereof.

SETTLEMENT OF CIVIL ACTIONS

SEC. 33. (a) Every registered investment company which is a party and every affiliated person of such company who is a party defendant to any action or claim by a registered investment company or a security holder thereof in a derivative capacity against an officer, director, investment adviser, trustee, or depositor of such company for an alleged breach of official duty, which such action or claim is commenced or asserted after the effective date of this title, shall transmit, unless already transmitted to the Commission, the documents specified in subsection (b) hereof if—

(1) such action has been compromised or settled and such settlement or compromise has had the approval of a court having jurisdiction to approve such settlement or compromise; or

(2) a verdict has been rendered or final judgment entered on the merits in such action.

(b) Within thirty days after such settlement or compromise, verdict or final judgment, copies of all pleadings and any written record made in such action, together with a statement of the terms

of settlement or compromise, if such terms be not included in the record, shall be transmitted to the Commission; and any information contained in any such documents may be used by the Commission in connection with any report or study which may be made by the Commission of lawsuits whether of investment companies or companies generally: *Provided,* That the name of persons involved shall not be disclosed.

DESTRUCTION AND FALSIFICATION OF REPORTS AND RECORDS

SEC. 34. (a) It shall be unlawful for any person, except as permitted by rule, regulation, or order of the Commission, willfully to destroy, mutilate, or alter any account, book, or other document the preservation of which has been required pursuant to section 31 (a) or 32 (c).

(b) It shall be unlawful for any person to make any untrue statement of a material fact in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to this title or the keeping of which is required pursuant to section 31 (a). It shall be unlawful for any person so filing, transmitting, or keeping any such document to omit to state therein any fact necessary in order to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading. For the purposes of this subsection, any part of any such document which is signed or certified by an accountant or auditor in his capacity as such shall be deemed to be made, filed, transmitted, or kept by such accountant or auditor, as well as by the person filing, transmitting, or keeping the complete document.

UNLAWFUL REPRESENTATIONS AND NAMES

SEC. 35. (a) It shall be unlawful for any person, in issuing or selling any security of which a registered investment company is the issuer, to represent or imply in any manner whatsoever that such security or company has been guaranteed, sponsored, recommended, or approved by the United States or any agency or officer thereof.

(b) It shall be unlawful for any person registered under any section of this title to represent or imply in any manner whatsoever that such person has been sponsored, recommended, or approved, or that his abilities or qualifications have in any respect been passed upon by the United States or any agency or officer thereof.

(c) No provision of subsection (a) or (b) shall be construed to prohibit a statement that a person or security is registered under this Act, the Securities Act of 1933, or the Securities Exchange Act of 1934, if such statement is true in fact and if the effect of such registration is not misrepresented.

(d) It shall be unlawful for any registered investment company hereafter to adopt as a part of the name or title of such company, or of any security of which it is the issuer, any word or words which the Commission finds and by order declares to be deceptive or misleading. The Commission is authorized to bring an action in the proper district court of the United States or United State court of any Territory or other place subject to the jurisdiction of the United States alleging that the name or title of any registered investment company, or of any security which it has issued, is materially deceptive or misleading. If the court finds that the Commission's allegations in this respect, taking into consideration the history of the investment company and the length of time which it may have used any such name or title, are established, the court shall enjoin such investment company from continuing to use any such name or title.

INJUNCTIONS AGAINST GROSS ABUSE

SEC. 36. The Commission is authorized to bring an action in the proper district court of the United States or United States court of any Territory or other place subject to the jurisdiction of the United States, alleging that a person serving or acting in one or more of the following capacities has been guilty, after the enactment of this title and within five years of the commencement of the action, of gross misconduct or gross abuse of trust in respect of any registered investment company for which such person so serves or acts:

(1) as officer, director, member of an advisory board, investment adviser, or depositor; or

(2) as principal underwriter, if such registered company is an open-end company, unit investment trust, or face-amount certificate company.

If the Commission's allegations of such gross misconduct or gross abuse of trust are established, the court shall enjoin such person from acting in such capacity or capacities either permanently or for such period of time as it in its discretion shall deem appropriate.

LARCENY AND EMBEZZLEMENT

SEC. 37. Whoever steals, unlawfully abstract, unlawfully and willfully converts to his own use or to the use of another, or embezzles any of the moneys, funds, securities, credits, property, or assets of any registered investment company shall be deemed guilty of a crime, and upon conviction thereof shall be subject to the penalties provided in section 49. A judgment of conviction or acquittal on the merits under the laws of any State shall be a bar to any prosecution under this section for the same act or acts.

RULES, REGULATIONS, AND ORDERS; GENERAL POWERS OF COMMISSION

SEC. 38. (a) The Commission shall have authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as are necessary or appropriate to the exercise of the powers conferred upon the Commission elsewhere in this title, including rules and regulations defining accounting, technical, and trade terms used in this title, and prescribing the form or forms in which information required in registration statements, applications, and reports to the Commission shall be set forth. For the purposes of its rules or regulations the Commission may classify persons, securities, and other matters within its jurisdiction and prescribe different requirements for different classes of persons, securities, or matters.

(b) The Commission, by such rules and regulations or order as it deems necessary or appropriate in the public interest or for the protection of investors, may authorize the filing of any information or documents required to be filed with the Commission under this title, title II of this Act, the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, or the Trust Indenture Act of 1939, by incorporating by reference any information or documents theretofore or concurrently filed with the Commission under this title or any of such Acts.

(c) No provision of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or order of the Commission, notwithstanding that such rule, regulation, or order may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason.

RULES AND REGULATIONS; PROCEDURE FOR ISSUANCE

SEC. 39. Subject to the provisions of the Federal Register Act and regulations prescribed under the authority thereof, the rules and regulations of the Commission under this title, and amendments thereof, shall be effective upon publication in the manner which the Commission shall prescribe, or upon such later date as may be provided in such rules and regulations.

ORDERS; PROCEDURE FOR ISSUANCE

SEC. 40. (a) Orders of the Commission under this title shall be issued only after appropriate notice and opportunity for hearing. Notice to the parties to a proceeding before the Commission shall be given by personal service upon each party or by registered mail or confirmed telegraphic notice to the party's last known business address. Notice to interested persons, if any, other than parties may be given in the same manner or by publication in the Federal Register.

(b) The Commission may provide, by appropriate rules or regulations, that an application verified under oath may be admissible in evidence in a proceeding before the Commission and that the record in such a proceeding may consist, in whole or in part, of such application.

(c) In any proceeding before the Commission, the Commission, in accordance with such rules and regulations as it may prescribe, shall admit as a party any representative of interested security holders, or any other person whose participation in the proceeding may be in the public interest or for the protection of investors.

HEARINGS BY COMMISSION

SEC. 41. Hearings may be public and may be held before the Commission, any member or members thereof, or any officer or officers of the Commission designed by it, and appropriate records thereof shall be kept.

ENFORCEMENT OF TITLE

SEC. 42. (a) The Commission may make such investigations as it deems necessary to determine whether any person has violated or is about to violate any provision of this title or of any rule, regulation, or order hereunder, or to determine whether any action in any court or any proceeding before the Commission shall be instituted under this title against a particular person or persons, or with respect to a particular transaction or transactions. The Commission shall permit any person to file with it a statement in writing, under oath or otherwise as the Commission shall determine, as to all the facts and circumstances concerning the matter to be investigated.

(b) For the purpose of any investigation or any other proceeding under this title, any member of the Commission, or any officer thereof designated by it, is empowered to administer oaths and affirmations, subpena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, contracts, agreements, or other records which are relevant or material to the inquiry. Such attendance of witnesses and the production of any such records may be required from any place in any State or in any Territory or other place subject to the jurisdiction of the United States at any designated place of hearing.

(c) In case of contumacy by, or refusal to obey a subpena issued to, any person, the Commission may invoke the aid of any court of the

United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, contracts, agreements, and other records. And such court may issue an order requiring such person to appear before the Commission or member or officer designated by the Commission, there to produce records, if so ordered, or to give testimony touching the matter under investigation or in question; any failure to obey such order of the court may be punished by such court as a contempt thereof. All process in any such case may be served in the judicial district whereof such person is an inhabitant or wherever he may be found. Any person who without just cause shall fail or refuse to attend and testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, contracts, agreements, or other records, if in his or its power so to do, in obedience to the subpena of the Commission, shall be guilty of a misdemeanor, and upon conviction shall be subject to a fine of not more than $1,000 or to imprisonment for a term of not more than one year, or both.

(d) No person shall be excused from attending and testifying or from producing books, papers, correspondence, memoranda, contracts, agreements, or other records and documents before the Commission, or in obedience to the subpena of the Commission or any member thereof or any officer designated by it, or in any cause or proceeding instituted by the Commission, on the ground that the testimony or evidence, documentary or otherwise, required of him may tend to incriminate him or subject him to a penalty or forfeiture; but no individual shall be prosecuted or subject to any penalty or forfeiture for or on account of any transaction, matter, or thing concerning which he is compelled to testify or produce evidence, documentary or otherwise, after having claimed his privilege against self-incrimination, except that such individual so testifying shall not be exempt from prosecution and punishment for perjury committed in so testifying.

(e) Whenever it shall appear to the Commission that any person has engaged or is about to engage in any act of practice constituting a violation of any provision of this title, or of any rule, regulation, or order hereunder, it may in its discretion bring an action in the proper district court of the United States, or the proper United States court of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices and to enforce compliance with this title or any rule, regulation, or order hereunder. Upon a showing that such person has engaged or is about to engage in any such act or practice, a permanent or temporary injunction or decree or restraining order shall be granted without bond. In any proceeding under this subsection to enforce compliance with section 7, the court as a court of equity may, to the extent it deems necessary or appropriate, take exclusive jurisdiction and possession of the investment company or companies involved and the books, records, and assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, who with the approval of the court shall have power to dispose of any or all of such assets, subject to such terms and conditions as the court may prescribe. The Commission may transmit such evidence as may be available concerning any violation of the provisions of this title, or of any rule, regulation, or order thereunder, to the Attorney General, who, in his discretion, may institute the appropriate criminal proceedings under this title.

COURT REVIEW OR ORDERS

SEC. 43. (a) Any person or party aggrieved by an order issued by the Commission under this title may obtain a review of such order in the circuit court of appeals of the United States within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall be forthwith served upon any member of the Commission, or upon any officer thereof designated by the Commission for that purpose, and thereupon the Commission shall certify and file in a court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order, in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission or unless there were reasonable grounds for failure so to do. The findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If application is made to the court for leave to adduce additional evidence, and it is shown to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceeding before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court affirming, modifying, or setting aside, in whole or in part, any such order of the Commission shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended.

(b) The commencement of proceedings under subsection (a) to review an order of the Commission issued under section 8 (e) shall operate as a stay of the Commission's order unless the court otherwise orders. The commencement of proceedings under subsection (a) to review an order of the Commission issued under any provision of this title other than section 8 (e) shall not operate as a stay of the Commission's order unless the court specifically so orders.

JURISDICTION OF OFFENSES AND SUITS

SEC. 44. The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this title or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this title or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. A criminal proceeding based upon a violation of section 34, or upon a failure to file a report or other document required to be filed under this title, may be brought in the district wherein the

defendant is an inhabitant or maintains his principal office or place of business. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this title or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 128 and 240 of the Judicial Code, as amended, and section 7, as amended, of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 8, 1893. No costs shall be assessed for or against the Commission in any proceeding under this title brought by or against the Commission in any court.

INFORMATION FILED WITH COMMISSION

SEC. 45. (a) The information contained in any registration statement, application, report, or other document filed with the Commission pursuant to any provision of this title or of any rule or regulation thereunder (as distinguished from any information or document transmitted to the Commission) shall be made available to the public, unless and except insofar as the Commission, by rules and regulations upon its own motion, or by order upon application, finds that public disclosure is neither necessary nor appropriate in the public interest or for the protection of investors. It shall be unlawful for any member, officer, or employee of the Commission to use for personal benefit, or to disclose to any person other than an official or employee of the United States or of a State, for official use, or for any such official or employee to use for personal benefit, any information contained in any document so filed or transmitted, if such information is not available to the public.

(b) Photostatic or other copies of information contained in documents filed with the Commission under this title and made available to the public shall be furnished any person at such reasonable charge and under such reasonable limitations as the Commission shall prescribe.

ANNUAL REPORTS OF COMMISSION; EMPLOYEES OF THE COMMISSION

SEC. 46. (a) The Commission shall submit annually a report to the Congress covering the work of the Commission for the preceding year and including such information, data, and recommendations for further legislation in connection with the matters covered by this title as it may find advisable.

(b) For the purposes of this title, the Commission may select, employ, and fix the compensation of such attorneys, examiners, and other experts as shall be necessary for the transaction of the business of the Commission in respect of this title without regard to the provisions of other laws applicable to the employment and compensation of officers or employees of the United States; and the Commission may, subject to the civil-service laws, appoint such other officers and employees as are necessary in the execution of the functions of the Commission and fix their salaries in accordance with the Classification Act of 1923, as amended.

VALIDITY OF CONTRACTS

SEC. 47. (a) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or with any rule, regulation, or order thereunder shall be void.

(b) Every contract made in violation of any provision of this title or of any rule, regulation, or order thereunder, and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this title, or any rule, regulation, or order thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, regulation, or order, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, regulation, or order.

LIABILITY OF CONTROLLING PERSONS; PREVENTING COMPLIANCE WITH TITLE

SEC. 48. (a) It shall be unlawful for any person, directly or indirectly, to cause to be done any act or thing through or by means of any other person which it would be unlawful for such person to do under the provisions of this title or any rule, regulation, or order thereunder.

(b) It shall be unlawful for any person without just cause to hinder, delay, or obstruct the making, filing, or keeping of any information, document, report, record, or account required to be made, filed, or kept under any provision of this title or any rule, regulation, or order thereunder.

PENALTIES

SEC. 49. Any person who willfully violates any provision of this title or of any rule, regulation, or order hereunder, or any person who willfully in any registration statement, application, report, account, record, or other document filed or transmitted pursuant to this title or the keeping of which is required pursuant to section 31 (a) makes any untrue statement of a material fact or omits to state any material fact necessary in order to prevent the statements made therein from being materially misleading in the light of the circumstances under which they were made, shall upon conviction be fined not more than $10,000 or imprisoned not more than two years, or both; but no person shall be convicted under this section for the violation of any rule, regulation, or order if he proves that head no actual knowledge of such rule, regulation, or order.

EFFECT ON EXISTING LAW

SEC. 50. Except where specific provision is made to the contrary, nothing in this title shall affect (1) the jurisdiction of the Commission under the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, or title II of this Act, over any person, security, or transaction, or (2) the rights, obligations, duties, or liabilities of any person under such Acts; nor shall anything in this title affect the jurisdiction of any other commission, board, agency, or officer of the United States or of any State or political subdivision of any State, over any person, security, or transaction, insofar as such jurisdiction does not conflict with any provision of this title or of any rule, regulation, or order hereunder.

SEPARABILITY OF PROVISIONS

SEC. 51. If any provision of this title or any provision incorporated in this title by reference, or the application of any such provision to

any person or circumstances, shall be held invalid, the remainder of this title and the application of any such provision to person or circumstances other than those as to which it is held invalid shall not be affected thereby.

SHORT TITLE

SEC. 52. This title may be cited as the "Investment Company Act of 1940".

EFFECTIVE DATE

SEC 53. The effective date of the provisions of this title, so far as the same relate to face-amount certificates or to face-amount certificate companies, is January 1, 1941: *Provided, however*, That any such face-amount certificate company may register prior to said date, as provided by section 8 of this title, and such registration shall not operate to change or affect said effective date as to any such company or any face-amount certificates issued by it. The effective date of provisions hereof, insofar as the same do not apply to face-amount certificates or face-amount certificate companies is November 1, 1940. Except as herein otherwise provided, every provision of this title shall take effect of November 1, 1940.

TITLE II—INVESTMENT ADVISERS

FINDINGS

SEC. 201. Upon the basis of facts disclosed by the record and report of the Securities and Exchange Commission made pursuant to section 30 of the Public Utility Holding Company Act of 1935, and facts otherwise disclosed and ascertained, it is hereby found that investment advisers are of national concern, in that, among other things—

(1) their advice, counsel, publications, writings, analyses, and reports are furnished and distributed, and their contracts, subscription agreements, and other arrangements with clients are negotiated and performed, by the use of the mails and means and instrumentalities of interstate commerce;

(2) their advice, counsel, publications, writings, analyses, and reports customarily relate to the purchase and sale of securities traded on national securities exchanges and in interstate over-the-counter markets, securities issued by companies engaged in business in interstate commerce, and securities issued by national banks and member banks of the Federal Reserve System; and

(3) the foregoing transactions occur in such volume as substantially to affect interstate commerce, national securities exchanges, and other securities markets, the national banking system and the national economy.

DEFINITIONS

SEC. 202. (a) When used in this title, unless the context otherwise requires—

(1) "Assignment" includes any direct or indirect transfer or hypothecation of any investment advisory contract by the assignor or of a controlling block of the assignor's outstanding voting securities by a security holder of the assignor; but if the investment adviser is a partnership, no assignment of an investment advisory contract shall be deemed to result from the death or withdrawal of a minority of the members of the investment adviser having only a minority interest in the business of the investment adviser, or from the admission to the investment adviser of one or more mem-

Calendar No. 1866

76TH CONGRESS | SENATE | REPORT
3d Session | No. 1775

INVESTMENT COMPANY ACT OF 1940 AND INVESTMENT ADVISERS ACT OF 1940

JUNE 6 (legislative day, MAY 28), 1940.—Ordered to be printed

Mr. WAGNER from the Committee on Banking and Currency, submitted the following

R E P O R T

[To accompany S. 4108]

The Committee on Banking and Currency, to which was referred a bill (S. 4108) to provide for the registration and regulation of investment companies and investment advisers and for other purposes, having considered the same, reports favorably thereon, and recommends that the bill do pass.

This bill is a substitute for S. 3580, introduced March 14, 1940. The original bill was the outgrowth of an extensive study and investigation of investment trusts and investment companies conducted by the Securities and Exchange Commission pursuant to the direction of the Congress. A subcommittee held hearings on the original bill extending over a period of approximately four weeks. At these hearings, while the immediate need for national legislation regulating investment companies was conceded by virtually every witness who testified, representatives of the companies affected expressed considerable opposition to some features of the bill. Many of these joined in submitting to the subcommittee, at the close of the hearings, concrete proposals to regulate investment trusts and investment companies.

Almost immediately after the conclusion of the hearings, representatives of the investment companies and of the Securities and Exchange Commission advised the chairman of the subcommittee that they believed it might be possible for them to reach a common ground and to submit a joint recommendation as to the scope and provisions of the bill. The chairman encouraged them in this endeavor, and as a result of their cooperative efforts, the substitute bill (S. 4108) was drafted.

The substitute bill represents the result of intensive effort for a period of some five weeks by representatives of the industry and of the Commission. Not merely the principles of this bill, but also its

provisions as drafted, are strongly endorsed both by the Securities and Exchange Commission and by almost every company which appeared in opposition to the bill as originally drafted. In addition, the substitute bill is endorsed by a number of companies which did not appear either in opposition to or in support of the original bill. Thus the substitute bill, as introduced and reported, has the distinction of having the virtually unanimous support of the persons for whose regulation it provides, as well as of the regulatory agency by which it is to be administered. Representatives of the industry urged upon the committee that the present international situation should not only not be a deterrent to the enactment of this legislation but should rather serve as a vital reason for its immediate passage. As was stated by the representative of a substantial portion of the investment company industry at the close of the hearing:

* * * we feel that this bill is not only a workable bill, but is a bill which is a good thing for the industry. We would like very much to see it passed, and we hope very much that it can be passed at this session. The industry would like to feel that it has regulation behind it; that is, that we may know what the regulation is to be and that we will no longer live in uncertainty as to what the future holds for us. this is the type of regulation under which the industry feels it can work and which it feels will be very beneficial to the industry. We are hopeful that if this legislation passes it will constitute a stimulus to the investment company industry's contributing to venture capital.

* * * the critical period that we are going through now, rather than being a reason for postponing legislation, is, in our opinion, an added reason for passing this legislation. We feel that it would be helpful not only to the industry to have this legislation passed now, * * * but also * * * we feel that it is a very healthy sign that Government and industry can come together and do a constructive job of this kind.

TITLE I. INVESTMENT TRUSTS AND INVESTMENT COMPANIES

GENERAL STATEMENT

Nature and types of investment trusts and investment companies.— Investment trusts and investment companies are essentially institutions which provide a medium for public investment in common stocks and other securities. They may be divided into four broad classifications: (1) Management investment companies; (2) unit investment trusts, including the so-called "fixed trusts"; (3) periodic or installment payment plans; and (4) companies issuing face-amount certificates.

The distinctive feature of the management investment companies is that no restrictions, or only limited restrictions, are imposed with respect to the nature, type and amounts of investment which their managements may make. These companies fall into two broad classes—the open-end and the closed-end types. The peculiarity of open-end companies is that they issue so-called redeemable securities—that is, a security which provides that the holder may tender it to the company at any time and receive a sum of money approximating the current market value of his proportionate interest in the company's assets. Because of the exercise of this redemption feature, the assets of most open-end companies would constantly be shrinking if they did not continuously sell new securities to investors. It is because of this constant redemption and sales activity that these companies are called open-end companies. Closed-end companies are management investment companies which do not have

this redemption feature. They do not distribute their securities continuously but only from time to time as they need new capital. Up to 1929 nearly all investment companies were of the closed-end type. However, the open-end companies, though a relatively recent development, have expanded rapidly.

In the fixed or unit investment trusts, management discretion is completely or almost completely eliminated. The investor is sold an undivided interest in a specified package or unit of securities, which are deposited with a trustee. The underlying securities cannot be changed, or can be eliminated only upon the happening of certain specified contingencies, such as the passing of a dividend on any security in the package for a prescribed period of time, or the reduction in the investment rating of the security by a prescribed statistical service.

The so-called installment investment or periodic payment plan is in essence a device to sell investment trust or investment company shares to the public on the installment plan. These plans have been designed to tap the savings of individuals in the lowest economic and income strata of the population, for investment in common stocks. Some plans have provided for installments as low as $5 a month, but the usual payment is $10 a month and the period of payment is generally 10 years.

The so-called face-amount certificates are in essence contracts between the corporation which issues them and the purchaser, whereby in consideration of the payment of certain specified installments the corporation agrees to pay to the purchaser at maturity a definite sum, the "face amount" of the certificate; or to pay prior to maturity a specified surrender value of the certificate.

Public participation in investment trusts and companies.— Investment companies have emerged as important financial institutions only within the last 20 years. The growth of the industry has been phenomenal, particularly since 1926. During the 1920's the type of investment company which was almost exclusively organized was the closed-end management investment company. So rapid was their organization during this period, that by 1929 they were being created at the rate of almost one a day.

After the market crash of 1929, the substantial losses suffered by closed-end management investment companies acted as an impediment to the further distribution of their securities, and the rise of other types of companies was accelerated. The open-end management companies, which offered the investor the opportunity to redeem his stock or security at approximately its actual value if dissatisfied with the management of the company, and the unit investment trusts, which dispensed with management entirely, rapidly increased the sales of their securities after 1930. Although face-amount certificate companies have been in existence since 1894, the greater portion of their certificates have been sold since 1929. Finally, since 1930, periodic payment plans have attracted the savings of a large number of individuals in the lower income strata of the country's population.

The American public has invested altogether almost $7,000,000,000 in investment companies of all types. This sum may be compared with the $14,000,000,000 roughly estimated as the investment in the electric light industry. The present assets of all investment companies have a value of approximately $4,000,000,000. Investors have suffered tremendous losses on their investment in such companies.

At present, the securities of such companies are owned by approximately 2,000,000 investors throughout this country. The number of security holders of investment trusts and investment companies probably exceeds that of all other industries except utility holding company systems. It is estimated that 1 out of every 10 holders of securities of all types in this country is a holder of investment trust and investment company shares or certificates. Widely promoted as institutions for the small investor, the securities of investment companies evidently appealed mostly to that type of individual. The reports of the Securities and Exchange Commission indicate that approximately one-fourth of the common-stock holders in the large management investment companies hold 10 shares or less and well over half of all such common-stock holders hold 50 shares or less. Similarly, approximately half of the preferred stockholders in such companies hold 10 shares or less, and about 95 percent hold 100 shares or less. Stated in terms of the market values of holdings of common-stock holders, approximately one-half of common-stock holders in management investment companies hold common shares with a market value of $500 or less. The certificates and shares of unit investment trusts, periodic payment plans and face-amount certificate companies are also held predominantly by small investors.

Relationship of investment companies to the national economy.—Investment trusts and investment companies are vitally associated with the national economy. They conduct their business by the use of the mails and the channels of interstate and foreign commerce. In numerous cases they conduct a substantial portion of their business in States other than those in which they are incorporated or otherwise created. Their security holders are situation in every State and in several foreign countries. A large proportion of all corporate securities sold in this country are those of investment trusts and investment companies. For example, from 1927 to 1936 inclusive, the reports of the Securities and Exchange Commission indicate that these organizations sold approximately $6,500,000,000 of their securities to the public. These sales represented approximately 22 percent of all nonrefunding sales of corporate securities during the period. Furthermore, approximately one-half of all common stock issues registered with the Securities and Exchange Commission under the Securities Act of 1933 are those of investment companies. From the effective date of the Securities Act up to the end of 1939 approximately $2,200,000,000 of common stocks of investment trusts and companies, as compared with a total of $4,000,000,000 of common stock offerings of all types of companies, have been registered with the Commission. Investment companies are also substantial purchasers of securities listed on national securities exchanges, and their trading may have an important effect on the price movements of securities.

The Securities and Exchange Commission's studies indicate that management investment companies individually held directly or indirectly 1 percent or more of the voting stocks of 200 noninvestment companies having total assets and resources of perhaps $30,000,000,000. The enterprises subject to the control and influence of investment companies include banks, insurance and mortgage financing companies, aviation and steamship companies, oil producing and refining companies, chemical companies, motion-picture producing and exhibiting companies, steel and rubber companies, food and food products

companies, manufacturing companies of all types, department stores and other merchandising companies engaged in sales of their wares by mail order and the channels of interstate commerce.

Finally, a most significant function of investment companies in relation to the immediate needs of the national economy is their potential usefulness in the supply of new capital to industry, particularly to small and promotional ventures. Although in the past investment companies have furnished but comparatively little capital to industry, it is the hope of the committee, as well as of the investment company industry and of the Securities and Exchange Commission, that regulation of investment companies, as provided for in this bill, may stimulate venture capital and the financing of industry.

Study of investment companies by the Securities and Exchange Commission.—The study of the investment trusts and investment companies by the Securities and Exchange Commission, to which reference has previously been made, furnishes much of the background and data for this bill. The study was conducted pursuant to the authorization and direction of the Congress contained in section 30 of the Public Utility Holding Company Act of 1935.

Most of the basic data of the study was obtained from answers to questionnaires, prepared by the Commission after consultations with committees of the industry. By the end of 1937, the Commission had received replies from about 700 trusts and companies of all types and from about 400 investment advisers. In addition, field studies were made of many companies. After the examinations in the field and study of the questionnaires, the Commission prepared a detailed preliminary report on each company. Each report was submitted to the company concerned for criticism and comment.

Public examinations were held on 250 companies—practically every company which had $10,000,000 or more of assets. In these public hearings the companies examined were entitled to be represented by counsel, to cross-examine witnesses produced by the Commission, and to present evidence through witnesses of their own choosing. The record of these public examinations consists of 33,000 pages of testimony and 4,800 exhibits.

Based on the data thus obtained, the Commission's reports were prepared and from time to time, as they were completed, were transmitted to the Congress. The scope and subject matter of these reports are as follows:

Part 1 of the Commission's over-all report, entitled "The Nature, Classification, and Origins of Investment Trusts and Investment Companies" (H. Doc. No. 707, 75th Cong.), deals with the scope, magnitude, and conduct of the Commission's study; the nature and classification of investment companies and the origins of the investment company movement in this country.

Part 2 of the report, entitled "Statistical Survey of Investment Trusts and Investment Companies" (H. Doc. No. 70, 76th Cong.), is a detailed statistical study of the growth of the total assets of investment companies; sales and repurchases of the securities of such companies; trading in their securities; the ownership and control of such companies; the performance of large management investment companies; the investor's experience in such companies and the portfolio investments made by such companies.

Part 3 of the Commission's report, entitled "Abuses and Deficiencies in the Organization and Operation of Investment Trusts and

Investment Companies" (H. Doc. No. 279, 76th Cong.), deals with the background of the industry in relation to abuses and contains detailed histories of various investment trusts and investment companies. In addition this part of the report deals with problems in connection with: (1) The sales and repurchases of the securities of investment companies; (2) shifts in control, mergers and consolidations of investment companies; (3) capital structures of investment companies; (4) accounting practices and reports to stockholders of investment companies; and (5) the management of the assets of such companies.

In addition to its over-all report, the Commission has submitted to the Congress six supplemental reports dealing, respectively, with Fixed and Semifixed Trusts (H. Doc. No. 567, 76th Cong.), Companies Sponsoring Installment Investment Plans (H. Doc. No. 482, 76th Cong.), Commingled or Common Trust Funds Administered by Banks and Trust Companies (H. Doc. No. 380, 76th Cong.), Investment Counsel, Investment Management, Investment Supervisory, Investment Advisory Services (H. Doc. No. 477, 76th Cong.), Investment Trusts in Great Britain (H. Doc. No. 380, 76th Cong.), and Companies Issuing Face-Amount Certificates (H. Doc. No. 659, 76th Cong.).

Problems in connection with the investment company industry.—The record of the study of the Securities and Exchange Commission and the testimony taken before the subcommittee show there are various problems with respect to the organization and operation of investment companies which should be remedied by legislation. That this is so is recognized by representatives of the industry. The more important of these problems will be briefly summarized.

Basically the problems flow from the very nature of the assets of investment companies. The assets of such companies invariably consist of cash and securities, assets which are completely liquid, mobile and readily negotiable. Because of these characteristics, control of such funds offers manifold opportunities for exploitation by the unscrupulous managements of some companies. These assets can and have been easily misappropriated and diverted by such types of managements, and have been employed to foster their personal interests rather than the interests of public security holders. It is obvious that in the absence of regulatory legislation, individuals who lack integrity will continue to be attracted by the opportunities for personal profit available in the control of the liquid assets of investment companies and that deficiencies which have occurred in the past will continue to occur in the future.

The wide appeal to the public which has been made by investment companies in the past has been indicated in the testimony before the committee. It is evident that companies honestly and efficiently managed can serve a most useful purpose in extending to the public an opportunity to participate financially in the economic enterprise of the country. The committee believes that this bill will provide safeguards without undue restriction, so that those who desire to put their savings to work in this manner may do so with greater confidence.

Since no specified amount of capital is required to organize investment trusts and companies, they can be and have been created and their securities have been sold to the public in many instances by irresponsible individuals. Persons convicted or enjoined by courts

because of perpetration of securities frauds are able, nevertheless, to organize and operate investment companies. Brokers, security dealers, investment banker, and commercial banks are in a position to dominate the board of directors and control the management of investment companies; and thus, when they are unscrupulous, to advance their own pecuniary interests at the expense of the investment companies and their security holders.

MANAGEMENT INVESTMENT COMPANIES

The capital structures of management investment companies have often been inordinately complex, and the rights, preferences, and dividend claims of senior securities have in many instances been inadequately safeguarded. By various devices of control, such as special voting stocks issued to distributors and managements, voting trusts, long term management contracts, control of the proxy machinery, and pyramiding of companies, public investors are effectively denied, in many instances, any real participation in the management of their companies.

The distribution and repurchase of the securities issued by investment companies have on occasion resulted in discrimination in favor of the management or other "insiders" who have been able to acquire the securities and to have the companies repurchase them on a basis more favorable than that accorded public stockholders. In the open-end companies the method of pricing their securities, which they are continuously selling and redeeming, may lead at times to substantial dilution of the investors' equity in the companies, and in some instances has even been used by persons closely connected with the companies to realize riskless trading profits.

A major problem in the case of management companies is created by the absence of any legal requirement for adherence to any announced investment policies or purposes. Such policies have often been radically changed without the knowledge or prior consent of stockholders. Similarly, after investors have invested in companies on their faith in the reputation and standing of the existing managements, control of the public's funds has frequently been transferred without the prior knowledge or consent of stockholders to other persons who were subsequently guilty of gross mismanagement of the companies.

The representatives of the investment trust industry were of the unanimous opinion that "self-dealing"—that is, transactions between officers, directors, and similar persons and the investment companies with which they are associated—presented opportunities for gross abuse by unscrupulous persons, through unloading of securities upon the companies, unfair purchases from the companies, the obtaining of unsecured or inadequately secured loans from the companies, etc. The industry recognized that, even for the most conscientious managements, transactions between these affiliated persons and the investment companies present many difficulties. Many investment companies have voluntarily barred this type of transaction.

The small investors in certain investment companies, particularly in unit investment trusts and open-end management companies, have been subjected to switching operations from one investment company to another to their pecuniary damage. Similarly, investors have been

often powerless to protect themselves against plans of reorganization which have been grossly unfair or have constituted gross abuses of trust on the part of their sponsors.

Finally, particularly with respect to those companies which have not registered their securities under the Securities Act of 1933 or the Securities Exchange Act of 1934, and only a small number has so registered its securities, the investor has been unable to obtain adequate information as to their operations. The accounting practices and financial reports to stockholders of management investment companies frequently are deficient and inadequate in many respects and ofttimes are misleading. In many cases, dividends have been declared and paid without informing the stockholders that such dividends represented not earnings but a return of capital to stockholders.

UNIT INVESTMENT TRUSTS

Certain abuses and deficiencies characterized particularly the unit investment or fixed trusts. These abuses are traceable to the fact that the most important emolument to the promoters of such trusts were the profits to be derived by the methods of pricing an selling the certificates of such trusts to the public. Inequitable pricing of shares, excessive sales loads, hidden loads, and charges have not been infrequent.

Furthermore, riskless trading profits and improper dilution of the investors' equity have not been unusual. The fixed trusts shareholder was particularly subject to switching operations. Each of these switches invariably included additional loading charges exacted from the investor. Usually the trustee of the underlying assets of trusts would also cease its active connection with the trust, frequently because the rate of compensation was insufficient to sustain its interest in the trust. The result is that no responsible party is connected with the trust with whom the investor can deal. Certificate holders are thus left without any method of realizing on their certificates and the trusts become "orphans."

PERIODIC PAYMENT PLANS

Early in 1930 a somewhat novel variety of investment scheme, called variously "installment-investment plan," "periodic payment plan," "thrift plan," "foundation plan," etc., was conceived. These periodic payment plans are in essence devices for selling investment trust or investment company securities on a periodic or installment plan basis. These periodic payment plans should be distinguished from programs sponsored by savings banks, building and loan associations, insurance companies, etc. The holder of a periodic payment plan certificate is not entitled to be repaid a fixed sum of money or a fixed amount of income, but is entitled to receive only the asset value of his certificate. This asset value is in essence based upon the market value of the securities in the portfolio of the investment company or investment trust underlying the installment investment certificate. The amount of which the certificate holder is entitled may be less than, equal to, or more than the amount paid by the certificate holder, depending upon market prices of these portfolio securities which almost invariably consisted of common stocks. The

purchaser of a periodic payment plan certificate is, therefore, speculating or investing in the stock market.

The structure of the periodic payment plan in most instances, but not in every instance, was that of a "trust on a trust" whereby two sets of sales loads were imposed upon the investors, usually without their knowledge.

The plans which were most widely sold to the public had sales loads ranging from 17 percent to 20 percent. The Securities and Exchange Commission, in its report to the Congress on periodic payment plans, stated that the total loading charges, including trustees' fees and secondary loading charges, were more than 30 percent of the net amount invested by certificate holders during the period studied. A serious problem is presented by the fact that these substantial sales loads have been usually deducted entirely from the payments made in the early months of the periodic payment plan contract. As a consequence only a very small part of the purchaser's early payments were invested for his account. An investor withdrawing in the first year of the plan almost inevitably received substantially less than the amount he had paid on his certificate. During the first 6 months of most plans a withdrawing certificate holder sustained practically a total loss. At the end of the year, this loss was well over 50 percent in many plans. Lapses of certificates in the early period of the contract have been frequent. In fact, the Securities and Exchange Commission reported to the Congress that well over 85 percent of the payments made by certificate holders of periodic payment plans was lost to them because of lapses during the first year. Approximately 40 percent of the total amount payable on periodic payment plan certificates sold in the period 1930-35 was lapsed at the end of 1935. The holders of periodic payment plan certificates were subject to a variety of switching operations resulting in profits to the sponsor and a loss to the investor by the exaction of another "secondary" sales load on the switches.

These periodic payment plan certificates, which were sold for as low as $5 a month, were specifically designed to make their strongest appeal to wage-earning men and women who were not in a financial position to invest or speculate in common stocks. As a result, these certificates were sold to housewives, domestic workers, laborers, nurses, stenographers, clerks, and others who had little financial experience. Inasmuch as the refinement and technique of the operation of periodic payment plans are intricate, they were far beyond the comprehension of the class of persons to whom these certificates were sold.

In addition to the fact that persons unqualified to understand the intricacies of the plan were employed as salesmen, the committee was impressed by the evidence that salesmen often flagrantly misrepresented these plans. Fees were minimized or not disclosed. Undue emphasis was placed on the "trustee" and "trusteeships." The "trustee," whose functions were usually confined to holding title and custody of the underlying securities for the benefit of the certificate holder, was usually a large financial institution. Salesmen would show the balance sheets of these banks to prospects who would be advised that the trustee was back f and sponsored the plan. Thus, subscribers to these plans were apparently under the misapprehension that these large financial institutions actually guaranteed the so-called maturity value. Actually the trustee is in no way responsible for the operation

of the plan. Further supposed similarities between the plans and savings accounts and insurance and endowment policies were indicated. A "maturity value" or "termination value" which did not represent an obligation was placed on the installment plan certificate. Withdrawal and borrowing privileges were enlarged upon as salesmen analogized the periodic payment plans to savings bonds. Glowing predictions of wealth and financial independence were made. Emphasis was placed upon the "great" corporations, the common stock of which underpaid the installment plan. Not only were there a tendency to confuse the soundness of the "great" corporations with the soundness of the periodic payment plan, but many certificate holders were misled into believing that their money was directly invested in these securities rather than in interposed investment trust shares. Emphasis on the "savings" in the periodic payment plan literature was made in an effort to meet the sales resistance of a prospective purchaser to a speculative incursion into the investment field.

COMPANIES ISSUING FACE-AMOUNT INSTALLMENT CERTIFICATES

Face-amount installment certificate are, in essence, unsecured obligations to pay a specified amount to the holder at a specified future date provided the purchaser makes all the payments required by these contract. The contracts after a certain number of prescribed payments have a cash surrender value—the holder of the contract is entitled to receive prior to maturity a specified amount if he surrenders his certificate to the issuing company.

The face amounts of these certificates are usually $2,500 or less with payments in installments over a period of 10 or 15 years, varying according to series. A typical certificate issued by these companies has a face amount of $2,500 and requires payments in installments over a period of 15 years of $1,800 or $120 per year. The strength of the appeal of these certificates to investors is indicated by the fact that at the end of 1936 such investors has contracted to invest some $700,000,000 in these companies and had already paid in about $100,000,000 on this obligation.

Many instances have been disclosed where this type of security has been sold on the basis of the comparison with savings bank deposits and insurance policies. Although savings banks and insurance companies are subject to strict regulation as to assets and reserves, the face-amount certificate companies have operated without any such uniform type of regulation with the result that, in some cases, assets have been carried at highly fictitious values and, in other cases, inadequate reserves have been maintained for the fixed obligations.

The Commission's study has indicated that in certain cases obligations of face-amount companies with high improvement rates have been met despite changed conditions with lower prevailing interest returns on investments, through a combination of several factors. The lapse experience of investors was high, particularly during the first and second years when the investor had no surrender value or a surrender value substantially less than the total of the amount he had paid (although the certificates issued by some of the face-amount companies provided for reinstatement with credit for the amount paid in). The so-called "stretch-out" practice of depriving the investor pursuant to contract of any interest return on his entire investment

during any period in which he has been in default, lowered the improvement rate so far as the company was concerned.

Furthermore, surrender values only accrued as of anniversary dates of the certificates which was yearly. Monthly payments less than a year and interest on the last attained surrender value would not increase the surrender value above the preceding anniversary date. Payments made and interest on the entire investment between anniversary dates, therefore, might be sacrificed under the terms of the contract in the event of any surrender between such dates.

As a result of the various types of regulatory provisions in the many States in which face-amount companies operate, there is presently no uniform actuarial reserve system required by law.

Another serious aspect of this type of investment company relates to the problems of the investors in these certificates in the event of the bankruptcy of such a company. Not all of these companies are at present required to deposit qualified assets with any custodian for the benefit of all their certificate holders. Some State authorities do require such deposits for the protection of certificate holders residing in the particular States and even such requirements are not on a uniform basis. In the event of bankruptcy a situation might be created where inequality of treatment might exist for certificate holders of the various States. Furthermore the problems arising out of bankruptcy would be accentuated by the fact that the assets of these companies are located in almost every State in this country.

NECESSITY FOR LEGISLATION

The committee has been greatly impressed with the sincerity and public-spirited attitude evinced by the representatives of the industry in participating in the formulation of this legislation. The committee, in recommending this regulatory legislation, does not mean to imply that most investment trusts and investment companies were mismanaged. Nor does it mean to indicate that in the last decade progress has not been made by the members of the industry voluntarily to eliminate some of the major abuses and deficiencies, and to improve generally standards of practice in the light of experience. However, the record does indicate that some of the grossest abuses were perpetrated in most recent years, in fact during the very course of the Commission's study. The conclusion is clear that the perpetrations of these misfeasances and the recurrence of these abuses cannot be completely abated nor the deficiencies eliminated without the enactment of adequate Federal legislation regulating these institutions. Virtually every representative of investment companies who appeared before the subcommittee conceded the necessity for, and in fact urged the immediate passage of, effective legislation to regulate investment companies. Practically no dissenting voice has been raised against any of the provisions of the substitute bill. In fact, this bill has received the affirmative and unequivocal approval of the industry as a whole.

The Securities Act of 1933 and the Securities Exchange Act of 1934 have been ineffective to correct abuses and deficiencies in investment companies: first, because the record before the committee is clear that

publicity alone, which in general is the remedy provided by these acts, is insufficient to eliminate the abuses and deficiencies which exist in investment companies, and second, because a large number of such companies have never come under the purview of these acts. The representatives of the industry recognized that the protection of investors against unscrupulous management and the necessity for the prevention of the recurrence of the abuses disclosed by the Commission's study and committee hearings made indispensable the immediate enactment of adequate legislation regulating investment companies. This is also the opinion of the committee, and the Securities and Exchange Commission concurs. Representatives of the industry have stated for the committee's record that they definitely feel that this bill (S. 4108) will materially abate, if not virtually eliminate, the malpractices and deficiencies in these organizations. They have urged that this legislation will serve the most salutary purpose of protecting small investors from breaches of trust; will afford investors a regulated and supervised institution in which to invest their savings; will act as an incentive for venture and risk capital; and will supply an intelligent and articulate group of stockholders in industrial and other public corporations. The industry asserted, and the Commission and the committee believe, that this legislation will tend to prevent those abuses which have been a stigma upon and impaired the usefulness of the investment trust industry as a whole.

Representatives of the Securities and Exchange Commission and of the industry who appeared at the hearings called the attention of the committee to the serious tax problem affecting investment companies. It appears that the nature of these companies in many respects, constituting a conduit for distribution of income to the smaller investor, is such that they should not be subjected to the same type of taxation as the ordinary business corporation. This has already been recognized in respect of certain classes of open-end companies which receive special tax treatment under existing Federal tax laws. The record before the committee indicates that the tax problem is acute with respect to closed-end companies of the type classified in this bill as "diversified". If this bill is passed, the committee believes that the tax problem of these companies should receive prompt consideration.

ANALYSIS OF PROVISIONS OF TITLE I

Findings and declaration of policy.—Section 1 of the bill contains the findings of the Congress with respect to investment companies and the declaration of policy of the bill.

Definitions and exemptions of investment companies.—Investment companies within the purview of this bill are in general defined as companies which are engaged primarily in the business of investing, reinvesting, and trading in securities; and issuers which invest in or hold securities (other than securities of non-investment company subsidiaries) having a value exceeding 40 percent of the value of their total assets. A third group of investment companies covered by the bill are companies which engage in the business of issuing so-called face-amount installment certificates. Provision is made generally to exclude from the bill companies primarily engaged, directly or through subsidiaries in the operation of a business other than that of an investment company. In addition the bill specifically excludes

brokers, underwriters, banks, insurance companies, common or commingled trust funds administered by a bank, bank holding company affiliates subject to the supervision of the Board of Governors of the Federal Reserve System, companies subject to the Interstate Commerce Act, and those of their wholly owned subsidiaries substantially all of whose assets consist of securities of companies which themselves are subject to the Interstate Commerce Act, small loan companies, factoring companies, companies dealing in mortgages or discount paper, holding companies subject to the Public Utility Holding Company Act of 1935, and certain other special types of companies (sec. 3). The bill makes provision for the exempting of employees' investment companies, and certain other persons who are not within the interest of the proposed legislation (sec. 6).

Classification and subclassification of investment companies.—Investment companies are broadly classified into three categories: management companies, unit investment trusts, and face-amount certificate companies. Management companies are divided into two types: open-end companies—companies in which the stockholder or certificate holder has a right to compel the company to redeem his shares at their asset value: and closed-end companies—companies in which the shareholders do not have such a right. Management companies, both of the open-end and closed-end type, are further subclassified upon the basis of the extent of the diversification of their investments, into diversified companies which, speaking generally, must have at least 75 percent of their assets in diversified securities and non-diversified companies which are not required so to diversity their investments (secs. 4 and 5).

Transactions by unregistered investment companies.—Investment companies, unless registered as provided in the bill, are forbidden to conduct their activities through use of the mails or instrumentalities of interstate commerce. Foreign investment companies may not register as investment companies or publicly offer securities of which they are the issuer in the United States unless the Commission finds that these foreign investment companies can be effectively subjected to the same type of regulation as domestic investment companies (sec. 7).

Registration of, disclosure of investment policy, and size of investment companies.—Provision is made for the registration of investment companies with the Commission. In the main, the Commission may require the information required to register securities under the Securities Act of 1933 and the Securities Exchange Act of 1934. In addition, the registration statement must state the policy of the company as to items specifically enumerated in the bill and supply information with respect to the business affiliation and experience of the officers and directors of the company. Provision is made for the simplification of the registration procedure by permitting the filing of copies of registration statements already filed under the acts now administered by the Commission. No shift in the company's fundamental policies as stated in the registration statement may be made without the approval of the majority of the company's outstanding voting securities (secs. 8 and 13).

To put a brake on the irresponsible formation of investment companies, no investment company organized hereafter may make a public offering of its securities unless it has or is assured of having at

least $100,000 through private subscription. The bill does not contain any limitation with respect to maximum size of investment companies, but authorizes the Commission to study and report from time to time the effect of size of investment companies both on the national economy and on the trusts themselves (sec. 14).

Ineligibility of certain affiliated persons and underwriters.—Any person, who within 10 years has been convicted of a crime or is enjoined by a court in connection with a security or financial fraud is prohibited by the bill from acting as an officer, or director, of any investment company or in certain other capacities. The bill recognizes, however, that even such a person may rehabilitate himself and so the Commission is authorized to exempt persons from this prohibition where it is shown that the penalty as applied to any such person would be unduly or disproportionately severe or that the conduct of such person has been such as not to make it against the public interest or protection of investors that such exception be granted (sec. 9).

Provisions relating to directors, officers, and certain affiliated persons.—In the future, no person shall serve as a director of an investment company unless elected by the holders of its outstanding voting securities, except that, in effect, vacancies not exceeding one-third of the board occurring between meetings of stockholders may be filled in any otherwise legal manner. However, with respect to existing strict trusts, where no provision is made for election of trustees, the bill does not require an affirmative election of trustees but provides a procedure for their removal by certificate holders (sec. 16).

The bill provides that at least 40 percent of the board of directors of an investment company shall be "independent"; that is, no more than 60 percent may consist of investment advisers to the company or affiliated persons of such an adviser or officers or employees of the company. Moreover, a majority of the board of directors of an investment company must be composed of persons who are not regular brokers for the company or principal underwriters of its securities, or investment bankers, or in each case persons affiliated with them. An exception is made to take care of certain types of investment companies which are closely affiliated with investment advisers and which are designed primarily to make available this medium of diversification of investment to the smaller customers of these advisers. This exception is carefully safeguarded by specific conditions. Hereafter the majority of the board of directors of an investment company may not consist of persons who are officers or directors of any one bank, except that any investment company which, on March 15, 1940, shall have had a majority of its directors consisting of such persons may continue to do so (sec. 10).

In the future persons who are officers, directors, investment advisers, etc., or persons affiliated with such persons may not, as principal, knowingly sell to or purchase from any investment company any securities or other property or borrow from any such investment company. Provision is made for certain exceptions with respect to transactions involving the company's own security issues and for transactions exempted by the Commission (sec. 17).

In general, agency transactions are not affected by the bill, but brokerage commissions are limited in the main to standard rates

with provisions for special exemptions. Provision is made that those officers and employees who have access to securities or funds of investment companies may be required to be bonded. Securities of investment companies must be placed in the custody either of banks, or with stock exchange firms subject to supervision by the Commission as to methods of safekeeping (sec. 17).

Investment companies may not purchase securities underwritten by persons affiliated with the investment company, unless the investment company itself is a principal underwriter of such securities, until after the termination of the underwriting syndicate (sec. 10). Officers and directors of investment companies and certain other persons are not allowed to exculpate themselves from liability for any willful misfeasance, bad faith, gross negligence, or reckless disregard of their duties (sec. 17). The provisions of section 16 of the Securities Exchange Act of 1934 relating to transactions of officers, directors, and controlling persons which now apply to equity securities of investment companies whose securities are listed on a national securities exchange are made applicable to all securities of all registered closed-end companies (sec. 30). Gross misconduct or gross abuse of trust by directors, officers, investment advisers, principal underwriters, etc., is made a basis for injunctive proceedings in a Federal court to be instituted by the Commission (sec. 36). Larceny or embezzlement of property of investment companies is made a Federal crime (sec. 37).

Provisions with respect to certain activities of investment companies.—Investment companies, generally speaking, may not trade on margin, participate in joint trading accounts, or effect short sales in portfolio securities in contravention of rules and regulations which may be prescribed. Investment companies may engage in underwriting activities if consistent with their declared investment policies (sec. 12). Upstream loans to investment companies, except by wholly owned subsidiaries, are prohibited (sec. 21).

Hereafter, an investment company or group of controlled companies may not purchase securities issued by another investment company if as a result of such acquisition such group will have more than 3 percent of the outstanding voting securities of such other investment company, or 5 percent of a specialized investment company. Investment companies, however, may increase their holdings in other investment companies of which they already hold 25 percent of the voting stock, since such holdings constitute presumptive control. A similar provision limits the acquisition by investment companies of an insurance company's stock, to 10 percent, with additional exceptions relating to the organization of new insurance companies and the purchase of stock of insurance companies from other investment companies or where it is found that such acquisition is in the public interest because the financial condition of such insurance company will be improved as a result of such acquisition or any plan contemplated as a result thereof (sec. 12).

Cross and circular ownership as defined are prohibited in the future and existing cross and circular ownership must be eliminated within 5 years (sec. 20).

Although investment companies are in general prohibited from acquiring securities of persons engaged in the brokerage business or in the business of underwriting and dealing in securities, provision is made to permit investment companies, either alone or jointly with other investment companies, to purchase stock of a company engaged

primarily in the business of underwriting and distributing securities and to acquire stock of a company formed to engage in the business of furnishing new capital to industry, financing promotional enterprises and similar activities (sec. 12). It is hoped that investment companies will soon jointly form such a company. It is believed it should make a material contribution to national recovery.

Distribution, repurchases, and redemptions of investment company securities.—No open-end company and no closed-end company may issue any of its securities except for cash or for securities (secs. 22 and 23).

Publicly offered securities of all investment companies must be registered under the Securities Act of 1933, but provision is made to eliminate duplication in the material filed under that act and the present bill. Circular literature intended for distribution to prospective purchasers of the securities of open-end companies, unit investment trusts, and face-amount certificate companies must be filed with the Commission (sec. 24).

Closed-end companies may not issue their common stock at a price below the current net asset value, except in connection with an offering to their security holders, conversion of a convertible security, exercise of any warrant outstanding on the date of enactment of this bill, or with consent of a majority of their stockholders. No closed-end company may repurchase any of its outstanding securities except on a securities exchange or open market upon prescribed notice to its stockholders or pursuant to tenders or under other circumstances to be prescribed to insure fair treatment of all security holders (sec. 23).

With respect to the distribution and redemption of securities issued by open-end companies, an association of securities dealers registered under section 15A of the Securities Exchange Act of 1934 is, subject to the provisions of that section, empowered to make rules to protect investors, so far as is reasonably practicable, against any dilution of their equity due to the methods of pricing, distribution, and redemption of redeemable securities and to prevent grossly excessive sales loads on such securities. The Commission after 1 year is empowered to make rules and regulations to deal with these subjects. In other words, the industry is given a year in which to solve this problem for itself. In addition, provision is made to prohibit the sale of redeemable securities to any person other than a dealer or principal underwriter at a price less than that at which the security is sold to the public. The bill prohibits the suspension of redemption of a redeemable security for a period more than 7 days except during certain specified emergency periods or other period fixed by the Commission. The negotiability of open-end securities may not be restricted in contravention of provisions which may be formulated (sec. 22).

Capital structure.—Except for refunding of outstanding securities and securities issued in connection with reorganizations, closed-end companies in the future may not issue more than three classes of securities—one class of security representing indebtedness (including loans not publicly distributed), on class of preferred stock and one class of common stock. Securities representing indebtedness must have at the time of issue an asset coverage of at least 300 percent and preferred stock an asset coverage of at least 200 percent. Similarly no dividends or distributions may be declared or made upon the common stock unless the securities representing indebtedness and preferred

stock issued in the future have an asset coverage of 300 percent and 200 percent respectively, and dividends may not be paid on such preferred stock unless such indebtedness has an asset coverage of at least 200 percent. Voting rights are also provided for preferred stock and in certain contingencies for senior securities representing indebtedness other than loans. Temporary borrowings up to 5 percent are exempted from this provision (sec. 18).

Open-end investment companies are not permitted to issue any senior securities, except that such companies are permitted bank borrowings provided that an asset coverage of 300 percent is maintained at all times for such borrowings (sec. 18).

Dividends.—In respect of dividends on existing securities, as well as securities issued in the future, investment companies are required to disclose by written statement accompanying any dividend the source of such payment when made other than from the current or accumulated net income as defined (sec. 19).

Proxies and voting trusts.—Solicitations of proxies, consents, and authorizations relating to securities of investment companies registered under this bill are to be subject to the regulations to which solicitations relating to securities listed on national securities exchanges are already subject by reason of the Commission's regulations adopted under section 14 (a) of the Securities Exchange Act of 1934. To assure uniformity of interpretation and administration as between that act and the present bill, section 20 (a) of the bill has been so drafted as to follow verbatim section 14 (a) of the Securities Exchange Act, with only such slight modifications of language as are necessary because of the special classes of companies to which section 20 (a) applies.

Hereafter, no public offering may be made of voting trust certificates of investment companies. Existing voting trusts may continue until their expiration (sec. 20).

Investment advisory contracts and contracts for distribution of open-end company securities.—After 1 year from the effective date of the act all investment advisory or management contracts must be in writing, must prescribe in detail the compensation to be paid, and must be non-assignable and terminable upon 60-days notice. In effect, the contract has to be approved by a majority of the voting stock, may be for an initial period of 2 years, and renewable annually thereafter by the board of directors or stockholders. Analogous provisions are incorporated with respect to contracts for the distribution of open-end company securities. Existing arrangements are permitted to continue for a period no exceeding 5 years (section 15).

Reorganizations of investment companies.—With respect to investment company reorganizations as defined, the bill provides that the Commission, at the request of 25 percent of any class of the security holders to be affected by such reorganization, or on the request of a company which is a party to such a plan, may give an advisory opinion. The company is required to send a copy of such advisory opinion to its security holders. The Commission may institute injunction proceedings in a Federal Court to restrain the consummation of grossly unfair plans of reorganization or plans which constitute gross misconduct or gross abuse of trust (sec. 25). The functions and duties of the Securities and Exchange Commission under the Bankruptcy Act remain unchanged.

Reports and accounting.—Investment companies are required to file with the Commission annual reports, including financial statements, similar to the annual reports now filed with the Commission under the Securities Exchange Act of 1934 by companies having securities listed on national securities exchanges, and less comprehensive reports on a semiannual or quarterly basis. In addition, investment companies must file with the Commission copies of reports sent to their security holders and may be required to transmit semi-annually to their stockholders reports containing certain specified financial and other information. The reports to stockholders may not be misleading in any material respect in the light of the reports filed with the Commission. Under other acts administered by the Commission, lacking such a provision as this, misleading financial statements, inconsistent with those filed with the Commission, have been sent security holders in an appreciable number of instances. Annual reports to the Commission and to stockholders may be required to be certified by independent public accountants, whose certificate must be based on a reasonably comprehensive audit (sec. 30).

The Commission is authorized to require investment companies and certain of their majority-owned subsidiaries to preserve accounts, records, and documents upon which the financial statements filed with the Commission are predicated. Investment advisers, depositors, and principal underwriters of certain investment companies may likewise be required to preserve records showing their transactions with the investment companies with which they are associated. These accounts, records and documents are subject at all times to examination by the Commission or its representatives. The Commission is authorized to provide for a reasonable degree of uniformity in the accounting policies and principles to be followed by investment companies in maintaining their accounts and records and preparing the financial statements required in their reports to the Commission and stockholders (sec. 31).

Subject to certain exceptions, the selection of independent public accountants of investment companies must be submitted for ratification or rejection to stockholders who, in addition, at any time by a majority vote may terminate their employment. The auditor's certificate must be addressed to security holders as well as the directors. The controller or other principal accounting officer of every company is to be chosen either by the board of directors of the company or by its security holders, and not merely be appointed by its executive officers. The Commission is also empowered to require accountants and auditors to keep reports and work sheets and other documents relating to investment companies (sec. 32).

Unit investment trusts.—The trust indentures of unit investment trusts must designate as trustee or custodian a bank of a specified minimum size; must require that all property and funds of the trust will be held by the trustee; and that the trustee (which may not resign unless a successor trustee has been designated or the trust liquidated) be entitled to reimburse itself out of the trust property for its expenses actually incurred and fees actually earned. Except under special circumstances, the depositor or underwriter must be prohibited from deriving any fees from the trust other than the original sales load for distributing the shares. Provision must also be made to advise shareholders of portfolio changes. Finally, proceedings in court may be

instituted by the Commission to liquidate so-called orphan trusts (sec. 26).

Periodic payment plans.—The bill contains additional provisions which relate specifically to companies issuing periodic payment plan certificates. These provisions fall roughly into three classes: provisions relative to sales load; provisions regulating the incidents and denominations of the certificates, and provisions regarding custodianship. The sales load is limited to 9 percent. Recognizing the heavier initial expense, due primarily to sales commission, the bill permits half of the sales load to be taken out during the first year of the plan; the balance is to be spread equally over the subsequent years. To prevent evasion of these restrictions on sales load by the imposition of so-called management fees, the Commission is authorized to prescribe maximum management fees. The provision relating to sales load may be modified by the Commission to meet the problems of small companies. Periodic payment plan certificates must be redeemable securities; and the initial payment under any plan must be at least $20, with each subsequent payment at least $10 (sec. 27).

Face-amount certificate companies.—Companies which sell face-amount certificates are generally subject to the provisions of the bill but must comply with certain provisions which are specifically applicable to that type of company. The bill contains provisions with respect to minimum capitalization of face-amount certificate companies. All companies which in the future sell these certificates must at all times maintain reserves, which, accumulated at a rate not to exceed 3½ percent compounded annually, must provide an amount sufficient to meet at all times all the liabilities and obligations of the company to all its certificate holders. The companies must have cash or qualified investments (investments which are qualified under the Code for the District of Columbia for life insurance companies) of a value not less than the aggregate of their capital and reserve requirements. The bill makes provision to require deposit with certain qualified banks all or any part of the investments maintained by such company as certificate reserve requirements except that the company may be credited with deposits made pursuant to law or regulation with State authorities in respect to liabilities of the certificates sold to the residents of such States. The bill makes provision for the distribution of the loading charge (the maximum amount of which charge is fixed by the bill) over the life of the certificate. In essence, no more than 50 percent of the load may be taken out the first year, no more than 7 percent in each of the following 4 years, and not more than 4 percent the remaining years. The surrender value of the certificate for the first year must be equal to at least 50 percent of the gross annual payment made on the certificate and for any subsequent time must be the amount of reserve of such certificate less a prescribed surrender charge. A certificate may not contain a provision making the holder liable for any unpaid balance on the certificate and must provide for the issuance to the certificate holder upon the happening of certain contingencies of a so-called paid-up certificate.

The obligations of the company to a certificate holder, who has defaulted, are specifically enumerated in the bill (sec. 28). If a face-amount company does not maintain the minimum certificate

reserve on all its outstanding face-amount certificates issued prior to the effective date of the bill then the company cannot make any distribution or pay any dividend on any senior capital security which exceeds a prescribed percentage of its earnings or which the Commission determines might impair the financial integrity of the company or its ability to meet its liabilities on the outstanding certificates. In the future, face-amount certificate companies cannot issue senior capital securities in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate for the protection of investors, or if such company has such senior capital securities outstanding to make any distribution or pay any dividend in contravention of such rules and regulations as the Commission may prescribe to insure the financial integrity of the company and to prevent the impairment of the company's abilities to meet its obligations on its face-amount certificates (sec. 18). A face-amount company can acquire the securities of another face-amount company only upon certain prescribed conditions (sec. 12). The bill makes provision to obtain equality of treatment of certificate holders who are residents of various States in the event of bankruptcy of a face-amount company. The bill preserves the rights of residents in those States which require specific deposits with their State officials but makes provision for equalization of treatment of all certificate holders, by providing that residents of other States must receive an amount equal to that received by the residents of States with deposits, before the latter can share in the general assets of the bankrupt company (sec. 29).

Unlawful representations.—The bill contains the usual provisions prohibiting misrepresentations and half-truths in registration statements, reports and other documents filed with the Commission, and prohibiting the misrepresentation of the effect of registration with the Commission. In addition, the use of misleading names by registered investment companies is specifically prohibited. The latter provisions may be enforced by order of the Commission when the name is adopted after the effective date of the bill, and by a court at the suit of the Commission as to names theretofore adopted (secs. 34 (b), 35).

Administrative and enforcement machinery.—The bill contains ample provisions, but appropriately circumscribed, for the enforcement of its provisions; for the carrying out of the powers and duties vested in the Commission, and for court review of the Commission's action (secs. 38 to 46, 49).

Formal provisions.—The bill contains the usual provisions regarding validity of contract, liability of controlling persons, the effect of the bill on existing law, and separability of provisions. The effective date of title I is November 1, 1940, as to all companies except face-amount certificate companies, as to which the bill does not become effective until January 1, 1941. The short title of the bill is the "Investment Company Act of 1940" (secs. 47, 48, 50 to 53).

TITLE II. INVESTMENT ADVISERS

Title II, which deals with investment advisory services, is an outgrowth of the Commission's survey of these organizations in connection with its study of investment trusts and investment companies.

76TH CONGRESS
3d Session

HOUSE OF REPRESENTATIVES

REPORT
No. 2639

INVESTMENT COMPANY ACT OF 1940 AND INVESTMENT ADVISERS ACT OF 1940

JUNE 18, 1940.—Committed to the Committee of the Whole House on the state of the Union and ordered to be printed

---

Mr. COLE of Maryland, from the Committee on Interstate and Foreign Commerce, submitted the following

R E P O R T

[To accompany H.R. 10065]

The Committee on Interstate and Foreign Commerce to whom was referred the bill (H. R. 10065) to provide for the registration and regulation of investment companies and investment advisers, and for other purposes, having considered the same, report favorably thereon with amendments and recommend that the bill, as amended, do pass.

The amendments are as follows:

Page 12, line 9, strike out "prescribed" and insert in lieu thereof "described".

Page 19, line 2, after the word "securities", insert "or the issuer thereof".

Page 20, line 3, strike out all the line and insert in lieu thereof:

so determined is not in excess of market value of asset value of such securities in the case of majority-owned subsidiaries, and is not in excess of market value in the case of other controlled companies.

Page 31, after line 23, insert a new paragraph as follows:

(2) Any company which since the effective date of this title or within five years prior to such date has been reorganized under the supervision of a court of competent jurisdiction, if (A) such company was not an investment company at the commencement of such reorganization proceedings, (B) at the conclusion of such proceedings all outstanding securities of such company were owned by creditors of such company or by persons to whom such securities were issued on account of such company or by persons to whom such securities were issued on account of creditors' claims, and (C) more than 50 per centum of the voting securities of such company, and securities representing more than 50 per centum of the net asset value of such company, are currently owned beneficially by not more than 25 persons; but such exemption shall terminate if any security of which such company is the issuer is offered for sale or sold to the public after the conclusion of such proceedings by the issuer or by or through any underwriter. For the purposes of this paragraph, any new company organized as part of the reorganization shall be deemed the same company as its predecessor; and beneficial ownership shall be determined in the manner provided in section 3 (c) (1).

Page 31, line 24, change "(3)" to "(4)".

Page 33, after line 16, insert a new paragraph as follows:

(d) The Commission, by rules and regulations or order, shall exempt a closed-end investment company from any or all provisions of this title, but subject to such terms and conditions as may be necessary or appropriate in the public interest or for the protection of investors, if—

(1) the aggregate sums received by such company from the sale of all its outstanding securities, plus the aggregate offering price of all securities of which such company is the issuer and which it proposes to offer for sale, does not exceed $100,000;

(2) no security of which such company is the issuer has been or is proposed to be sold by such company or any underwriter therefor, in connection with a public offering, to any person who is not a resident of the State under the laws of which such company is organized or otherwise created; and

(3) such exemption is not contrary to the public interest or inconsistent with the protection of investors.

Page 33, line 17, change "(d)" to "(e)".

Page 46, after line 7, strike out all of lines 8, 9, 10, and 11 and in lieu thereof insert the following:

(2) such investment adviser is registered under title II of this Act and such investment adviser is engaged principally in no business other than that of rendering investment supervisory services as defined in title II;

Page 56, line 2, after "of", strike out "only".

Page 56, line 2, after "stock", insert "only".

Page 56, line 22, after "company", insert "and any company or companies controlled by such registered company"

Page 57, strike out all of line 14 and in lieu thereof insert the following:

or any State, or to affect the right under State law of any insurance company to acquire securities of any other insurance company or insurance companies.

Page 71, line 20, after "place", insert "and maintain".

Page 72, strike out all of lines 1 to 14, inclusive, and in lieu thereof insert the following:

subject to such rules and regulations as the Commission may from time to time prescribe for the protection of investors; or (3) such registered company, but only in accordance with such rules and regulations or orders as the Commission may from time to time prescribe for the protection of investors. Rules, regulations, and orders of the Commission under this subsection, among other things, may make appropriate provision with respect to such matters as the earmarking, segregation, and hypothecation of such securities and investments, and may provide for or require periodic or other inspections by any or all of the following: Independent public accountants, employees and agents of the Commission, and such other persons as the Commission may designate. No such member which trades in securities for its own account may act as custodian except in accordance with rules and regulations prescribed by the Commission for the protection of investors.

Page 93, line 3, after the period at the end of the line, insert a new sentence as follows: Any company which, as of March 15, 1940, was required by provision of its charter, certificate of incorporation, articles of association, or trust indenture, or of a bylaw or regulation duly adopted thereunder, to postpone the date of payment or satisfaction upon redemption of redeemable securities issued by it, shall be exempt from the requirements of this subsection; but such exemption shall terminate upon the expiration of one year from the effective date of this title, or upon the repeal or amendment of such provision, or upon the sale by such company after March 15, 1940, of any security (other than short-term paper) of which it is the issuer, whichever first occurs.

Page 93, strike out all of lines 12, 13, and 14 and in lieu thereof insert the following:

(g) No registered open-end company shall issue any of its securities (1) for services; or (2) for property other than cash or securities (including securities of which such registered company is the issuer), except as a dividend or distribution to its security holders or in connection with a reorganization.

Page 93, strike out all of lines 17, 18, and 19 and in lieu thereof insert the following:

SEC. 23. (a) No registered closed-end company shall issue any of its securities (1) for services; or (2) for property other than cash or securities (including securities of which such registered company is the issuer), except as a dividend or destruction to its security holders or in connection with a reorganization.

Page 93, line 23, after "which", strike out "price" and insert in lieu thereof "net asset value".

Page 93, line 24, after "determined", strike out "on the basis of values calculated".

Page 94, line 4, after "its", strike out "common-stock holders" and insert "common stockholders".

Page 96, line 1, after "commerce," strike out "or" and insert "to".

Page 98, strike out the word "opinion" and insert in lieu thereof the word "report" in lines 2, 6, 7, 9, 17, 19, 21, and 23.

Page 103, line 21, after "investment", strike out "company, or" and insert in lieu thereof "company issuing periodic payment plan certificates, or".

Page 103, line 22, after "any", strike out "periodic payment plan" and insert "such".

Page 105, line 19, strike out "company, or" and in lieu thereof insert "company issuing periodic payment plan certificate, or".

Page 105, line 20, after "any", strike out "periodic payment plan" and insert "such".

Page 108, line 5, after "the", strike out "specified".

Page 108, line 17, after "minimum rate", insert a comma.

Page 108, line 18, after "of", strike out the comma and "the nearest".

Page 109, line 16, after "holder", strike out "under the terms of his certificate".

Page 110, lines 9 and 10, strike out "under the terms of his certificate".

Page 110, line 10, after "of", strike out "a" and insert "any".

Page 120, line 19, after "Sec. 29.", insert "(a)".

Page 121, line 2, strike out the figures "45" and insert the figure "2".

Page 121, line 23, strike out "October 1, 1940" and insert in lieu thereof "January 1, 1941".

Page 124, line 20, after "section", insert "13 or".

Page 130, line 1, strike out "such holders" and in lieu thereof insert "stockholders".

Page 130, line 13, change the period at the end of the line to a colon.

Page 130, after line 13, insert the following:

Provided, That if the selection of an accountant has been rejected pursuant to paragraph (2) or his employment terminated pursuant to paragraph (3) the vacancy so occurring may be filled by a vote of a majority of the outstanding voting securities, either at the meeting at which the rejection or termination occurred or if not so filled then at a subsequent meeting which shall be called for the purpose.

Page 130, line 22, after the end of the line, insert the following:

In the event of such termination and removal the vacancy so occurring may be filled by action of the holders of record of a majority of the shares of beneficial

interest either at the meeting, if any, at which such termination and removal occurs, or by instruments in writing filed with the custodian, or if not so filled within a reasonable time then at a subsequent meeting which shall be called by the trustees for the purpose. The provisions of paragraph (40) of section 2 (a) as to a majority shall be applicable to the vote cast at any meeting of the shareholders of such a trust held pursuant to this subsection.

Page 149, line 4, after "misleading", strike out the comma and insert "in the light of the circumstances under which they were made".

Page 155, line 8, after "broker", insert "or dealer".

Page 155, line 10, strike out "brokerage" and after the word "business" insert "as a broker or dealer".

Page 155, line 25, at the end of the line strike out "and" and insert " 'control' and".

Page 156, strike out all of lines 3, 4, and 5.

Page 156, line 6, strike out "(14)" and insert "(13)".

Page 156, lines 8 to 12, inclusive, strike out the following:

For the purposes of this paragraph the term "continuous advice" shall mean at least a quarterly review by the investment adviser of the investments of the client entrusted to his supervision.

Pages 156 and 157, renumber paragraphs (15), (16), (17), (18), (19), (20), and (21), respectively, to paragraphs (14), (15), (16), (17), (18), (19), and (20).

Page 162, strike out all of lines 5 and 6 and in lieu thereof insert the following:

(2) A statement as to whether such investment adviser is engaged or is to engage primarily in the business of rendering investment supervisory services.

Page 165, strike out all after line 17 and in lieu thereof insert the following:

(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph (3) shall not apply to any transaction with a customer or a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction.

Page 166, strike out all after line 19 and in lieu thereof insert the following:

(c) It shall be unlawful for any person registered under section 203 of this title to represent that he is an investment counsel or to use the name investment counsel as descriptive of his business unless such person is primarily engaged in the business of rendering investment supervisory services or unless his registration application as amended or as supplemented by the most recent report on file with the Commission states that such person is engaged or is about to engage primarily in the business of rendering investment supervisory services.

This bill is substitute for H. R. 8935, introduced March 14, 1940, and as originally introduced was identical with S. 4108, reported favorably to the Senate on June 6, 1940, by its Committee on Banking and Currency. The Senate bill itself was a substitute for S. 3580, introduced March 14, 1940, as a companion bill to H. R. 8935.

These bills are the outgrowth of a comprehensive study and investigation of investment trusts and investment companies made by the Securities and Exchange Commission pursuant to the direction of the Congress. A subcommittee of the Senate Banking and Currency Committee held hearings on S. 3580 for a period of approximately 4 weeks

and carefully and exhaustively scrutinized and explored all of its provisions. In its consideration of this bill, your committee had before it the complete testimony on the original Senate bill and the reports of the Securities and Exchange Commission.

At the hearings before the Senate Committee on Banking and Currency the immediate need for national legislation regulating investment companies was admitted by virtually every witness who testified, but objection was made to several features of the bill. At the conclusion of these hearings the investment companies who had appeared submitted to the Senate committee specific principles for the regulation of investment trusts and investment companies. Following the submission of these counterproposals for regulation by the investment companies themselves, representatives of the Securities and Exchange Commission and of the investment companies informed the Senate Committee on Banking and Currency that it might be possible for them to reconcile their differences and to recommend a bill which would be acceptable both to the Securities and Exchange Commission and to the investment-company industry.

As a result of this cooperative effort upon the part of the Securities and Exchange Commission and the representatives of the investment-company industry, this bill, H. R. 10065, and its companion bill in the Senate, S. 4108, were recommended. They represent the result of intensive effort for a period of 5 weeks by representatives of the industry and of the Commission.

The bill as drafted has the unqualified support and endorsement of practically the entire investment-company industry and of the Securities and Exchange Commission, the body by whom the provisions of the bill are to be administered. No opposition to the bill was expressed by any witness who appeared before the subcommittee of this committee which held hearings on the bill. Every witness representing the industry who appeared, unqualifiedly endorsed the bill.

Thus this bill is a highly salutary indication that Government and business can come together in a cooperative spirit to do a constructive job. Representatives of investment companies urge that the present international situation should not only not constitute an impediment to the passage of this bill but rather should serve as a vital reason for its immediate enactment.

These representatives of the investment-company industry stressed the fact that proper and reasonable regulation of investment companies may substantially stimulate investment companies to supply new capital for the expansion of industry, particularly industries vital to the national defense, to a far greater extent than has been done in the past. To accelerate this activity upon the part of investment companies the bill expressly authorizes investment companies to contribute a portion of their capital to companies organized by themselves to underwrite the securities of, and to furnish capital to, industry.

TITLE I. INVESTMENT TRUSTS AND INVESTMENT COMPANIES

A detailed discussion of the background of this bill and the evils it is intended to remedy appears in the report to the Senate Banking and Currency Committee to the Senate, Report No. 1775, and the reports of the Securities and Exchange Commission to the Congress made pursuant to section 30 of the Public Utility Holding Company Act

of 1935. Only a brief recital of the background of the bill and the more important abuses in investment companies will be described in this report.

Investment trusts and investment companies are in essence institutions for the investment of the savings of small investors in securities, particularly the common stocks of industrial and other companies. Four types of investment enterprises exist:

(1) Management investment companies in which management has complete discretion as to the investments to be made. These companies are subdivided into open-end companies—those in which the security holders can at their option compel the company to redeem or repurchase their securities at the actual asset value of such securities; and closed-end companies—those which do not accord this privilege to stockholders;

(2) Unit investment trusts in which no management exists and the investor is sold an undivided interest in a specific package or unit of securities, the composition of which is relatively unchangeable;

(3) Periodic payment plans which in essence are merely devices to sell the securities of management investment companies or unit investment trusts on the installment plan to small investors; and

(4) Face-amount-certificate companies which sell to the public face-amount certificates whereby in consideration of the payment of certain specified installments the corporation agrees to pay to the purchaser at maturity a definite sum, the face amount of the certificate; or to pay, prior to maturity, a specified surrender value of the certificate.

Robert E. Healy, Commissioner of the Securities and Exchange Commission, who had general supervision of the investment-trust study, generally described these organizations as follows:[1]

> Let me try my hand at a general description of investment trusts and investment companies. Essentially these organizations are large liquid pools of the public's savings entrusted to managements to be invested. The sales and promotional literature of investment trusts and investment companies has created the impression that they are not unlike savings banks and insurance companies, except that they are not limited to so-called legal investments. The sales emphasis by promoters of investment companies has been upon the necessity for providing security for old age and for emergencies, and upon the claim that by expert management and diversification of risk, this security can be furnished by these organizations.
>
> For example, Charles A. Kettering, vice president and research director of General Motors Corporation (and I pause to say, one of our most useful and finest citizens), testified at the public examination that in 1930 he purchased 40,000 shares of an investment company for $260,000 in the belief that it gave him a participation in a wide range of securities and was "akin or about the same participation you would get in, say, one of these single payment life-insurance companies." He said that he did not know that investment companies were not subject to supervision as were life-insurance companies or banks. Ultimately Mr. Kettering realized only $20,000 on his investment—that is, he lost approximately a quarter of a million dollars. And, incidentally, I may add that he served as a director of that company; said he had been unable to attend meetings, and said he did not understand investments; adding, what interested me greatly, that he saw life through the laboratory window.

Commenting on the losses of the American public in these institutions, Mr. Healy stated:

> The interest of the public in investment trusts and investment companies has been and still is very large. In the last 15 years approximately 1,300 such companies have been created. Speaking generally these organizations have made

[1] Hearings before a subcommittee of the Committee on Banking and Currency, U.S. Senate (76th Cong., 3d sess.), on S. 3580, a bill to provide for the registration and regulation of investment companies and investment advisers, pp. 33 et seq.

comparatively little original contribution of capital to industry, the investments for the most part being in securities already issued and outstanding. The reason for that I think will appear before the hearings are over. It is due, in part, to the necessity of some companies keeping themselves in a strictly liquid position. The American public has contributed over $7,000,000,000 to these organizations. That is on the basis of investment. You can compare that with $14,000,000,000 roughly estimated as the investment in the electric light industry. The value of their assets at present is approximately $4,000,000,000. At present only some 650 or approximately one-half of investment companies formed in this country, are still in existence. The other companies have disappeared through bankruptcy, receivership, dissolution, mergers, and consolidations. With respect to 22 of the bankrupt companies upon which the Commission has reasonably accurate figures, the security holders sustained a capital loss to December 31, 1935, of approximately $510,000,000 out of a total net capital contribution of almost $560,000,000, or a loss of about 90 percent. Altogether investors have sustained a capital shrinkage of approximately $3,000,000,000 in all types of investment trusts and investment companies.

Discussing the national public interest in investment trusts and investment companies, Mr. Healy stated:

Many individual investment companies have total assets equal to those of the larger savings banks. Their securities are owned by approximately 2,000,000 investors throughout this country, with the majority of the individual investments in such securities having a value under $500. The number of security holders of investment trusts and companies probably exceeds that of all other industries except utility holding company systems. It is estimated that one out of every 10 holders of securities of all types in this country is a holder of investment trust and investment company shares or certificates.

In addition, investment companies at present control or are in a position to control or importantly influence various industrial, banking, utility, and other enterprises having total assets which, as of the end of 1935, amounted to some $30,000,000,000. Furthermore, these investment trusts and investment companies, because of their very substantial trading in securities on stock exchanges, are a most substantial factor in our securities markets.

Because of the large public interest in these organizations, and because these investment trusts and investment companies represent unsupervised pools of savings, these institutions have been a matter of concern to representatives of the investment company industry, stock exchanges, financial writers, and governmental bodies from the early period of their existence in this country. The potential dangers of these organizations have been indicated, and with the passing years criticism has increased.

This tremendous loss must be principally attributed, of course, to the sharp decline in security values since 1929. However, in a substantial number of instances, losses suffered by investors were caused in good part by selfish, and in some cases unscrupulous, mismanagement of investment trusts and investment companies. The record of the study and the reports to the Congress of the Securities and Exchange Commission and the testimony taken before the Senate Committee on Banking and Currency contains many examples of abuses in the organization and operation of investment trusts and investment companies. These abuses have been persistent and have occurred and recurred constantly during the last 10 years.[2]

The investors in investment trusts and investment companies are subject to substantial losses at the hands of unscrupulous persons is obvious from the very nature of the assets of such companies. Their assets consist almost invariably of cash and marketable securities. They are liquid, mobile, and easily negotiable. These assets can be easily misappropriated, "looted," or otherwise misused for the selfish

[2]See Report of the Securities and Exchange Commission on Investment Trusts and Investment Companies, pt. III, H. Doc. 279 (76th Cong.); also testimony of David Schenker, counsel to Investment Trust Study, hearings before Senate Banking and Currency Committee on S. 3580, pp. 970, et seq.

purposes of those in control of these enterprises. In the absence of regulating legislation, individuals who lack integrity will continue to be attracted by the opportunity available for personal profit in the control of the liquid assets of investment trusts and investment companies.

Little capital is needed to form and market the securities of investment trusts and investment companies, and there is nothing to prevent irresponsible individuals and even individuals actually convicted of, or enjoined by the courts for, financial frauds from forming and controlling investment companies by a variety of devices such as special voting stocks, long-term management, and underwriting contracts, voting trusts, and the pyramiding of investment companies which do not require them to make any pecuniary investment in the enterprise. In addition, brokers, security dealers, and investment bankers are in a position to use controlled investment companies solely as financial adjuncts to enhance their own banking and brokerage businesses.

The distribution and repurchase of the securities issued by investment companies have on occasion resulted in discrimination in favor of the management or other "insiders" who have been able to acquire the securities and to have the companies repurchase them on a basis more favorable than that accorded to public stockholders. In the open-end companies the method of pricing their securities which they are continuously selling and redeeming may tend at times to substantial dilution of the investors' equity in the companies and in some instances have been used by persons closely connected with the companies to realize riskless trading profits.

Furthermore, the capital structures of investment companies have often been extremely complex, and the rights, preferences, and dividend or interest claims of the senior securities of such companies sold to the public; that is, their bonds and preferred stocks have in many cases been inadequately safeguarded. In the case of unit investment trusts and open-end management investment companies, investors have been sold securities in one of such enterprises and then repeatedly "switched" into other investment trusts and companies organized by the promoters of the original company or trust solely for the purpose of exacting additional selling charges and profits from the investor.

Some of the most unfair selling practices have occurred in the case of the companies which sell investment-company securities on the installment plans—so-called periodic-payment plans. These companies sell to investors in the lowest income brackets who are not in a financial position to invest their surplus funds in common stocks and who almost invariably have great difficulty in making the required installment payments. They have sold securities carrying selling charges which sometimes approached 25 percent of the price paid by the investor. With the knowledge that the class of individuals who invest in these installment plans, because of their financial status, will rarely be able to complete even the first year's payments, the entire first year's payments have been used to pay selling charges. As a result, thousands of small investors have lost their entire savings in these plans.

Similar practices exist in the case of companies selling face-amount certificates on the installment plan. The lapse experience of investors in these certificates has been high and in some cases the assets

of the companies have been carried at highly fictitious values and in some cases inadequate reserves have been maintained to meet the obligation of the companies of their outstanding certificates. No uniform actuarial reserve system is required by law for these companies.

With respect to the management of the assets of investment companies many abuses have existed. First the promoters and managers of investment companies determine the direction and scope of the business activities of the company and have the power to change, without the prior approval of the security holders, investment policies originally undertaken. The security holder has, therefore, no assurance of the stability of any announced investment policies of his company and no voice in the determination of any desire of the management to change such policies. Similarly, after investors have invested in investment companies on their faith in the reputation and standing of the existing managements, control of the public's funds has frequently been transferred without the prior knowledge or consent of stockholders to other persons who have looted the assets of such companies or to other investment companies which have subjected the stockholders to grossly unfair plans of merger, consolidation, or other corporate readjustments.

Second, unscrupulous individuals in control of investment companies have not hesitated to engage in self-dealing; that is, transactions between officers, directors, and similar persons and the investment companies with which they are associated. These individuals have sold worthless securities at extravagant prices to their controlled companies, have purchased securities and other property from such companies at unfairly low prices, and have borrowed extensively and without repayment from such companies. The industry recognized that even for the most conscientious managements, transactions between these affiliated persons and the investment companies present many difficulties. Many investment companies have voluntarily barred this type of transaction.

Finally the investor has been unable to obtain adequate financial information as to the operations of investment companies. The accounting practices and financial reports to stockholders of management investment companies frequently are deficient and inadequate in many respects. Often they are misleading. In many cases dividends have been paid without notifying stockholders that such dividends did not constitute earnings but were a return of the capital invested by the stockholder.

NECESSITY FOR LEGISLATION

It is not to be implied or inferred that most investment trusts and investment companies at present operating in this country were guilty of unfair practice or were mismanaged. In the last decade some progress has been made by the members of the industry voluntarily to eliminate some of the major malpractices, and to improve generally standards of practice in the light of experience. However, it is clear that malpractices cannot be eliminated without the enactment of a Federal law to regulate these institutions. This conclusion was concede by virtually every witness who appeared before the subcommittee and is the virtually unanimous opinion of the entire industry itself.

The Securities Act of 1933 and the Securities Exchange Act of 1934 have not acted as deterrents to the continuous occurrence of abuses in the organization and operation of investment companies. Generally these acts provide only for publicity. The record is clear that publicity alone is insufficient to eliminate malpractices in investment companies. Further, the great majority of investment companies have never come within the purview of these acts.

In the opinion of the committee, the Securities and exchange Commission, and the industry itself, this legislation is needed to protect small investors from breaches of trust upon the part of unscrupulous managements and to provide such investors with a regulated institution for the investment of their savings. This legislation will also prevent those abuses which have damaged the reputation of the industry as a whole.

Representatives of the Securities and Exchange Commission in connection with the bill and members of the industry who appeared at the hearings called the attention of the subcommittee to the serious tax problem affecting investment companies. This problem has already been recognized by the Congress in the case of certain open-end management investment companies which receive special tax treatment under existing Federal revenue acts. The record before the committee indicates that the tax problem is very pressing with respect to closed-end management investment companies of the type classified in this bill as "diversified." If the bill is passed the committee believes that the tax problem of these companies should receive prompt consideration by the Congress.

ANALYSIS, BY SECTIONS

Section 1: Findings and declaration of policy.
Section 2: General definitions.
Section 3: Definition of investment company.
Section 4: Classification of investment company.
Section 5: Subclassification of management companies.
Section 6: Exemptions.
Section 7: Transactions by unregistered investment companies.
Section 8: Registration of investment companies.
Section 9: Ineligibility of certain affiliated persons and underwriters.
Section 10: Affiliation of directors.
Section 11: Office of exchange.
Section 12: Functions and activities of investment companies.
Section 13: Changes in investment policy.
Section 14: Size of investment companies.
Section 15: Changes in boards of directors; provisions relative to strict trusts.
Section 17: Transactions of certain affiliated persons and underwriters.
Section 18: Capital structure.
Section 19: Dividends.
Section 20: Proxies, voting trusts, circular ownership.
Section 21: Loans.
Section 22: Distribution, redemption, and repurchase of redeemable securities.

Section 1. Findings and general policy

This section sets forth the findings of the Congress with respect to investment companies and the declaration of policy of the bill.

Section 2. General definitions

This section sets forth the general definitions of terms used in the bill.

Section 3. Definition of investment company

Subsection (a) specifies that the following companies are within the purview of the bill: Companies which are engaged primarily in the business of investing, reinvesting, and trading in securities; and issuers which invest in or hold securities (other than securities of noninvestment company subsidiaries) having a value exceeding 40 percent of the value of their total assets. A third group of companies covered by the bill are companies which engage in the business of issuing so-called face-amount installment certificates.

Subsection (b) excludes from the bill companies primarily engaged, directly or through subsidiaries, in the operation of a business other than that of an investment company.

Subsection (c) specifically excludes brokers, underwriters, banks, insurance companies, common or commingled trust funds administered by a bank, bank-holding-company affiliates subject to the supervision of the Board of Governors of the Federal Reserve System, companies subject to the Interstate Commerce Act, and those of their wholly owned subsidiaries substantially all of whose assets consist of securities of companies which themselves are subject to the Interstate Commerce Act, small-loan companies, factoring companies, companies dealing in mortgages or discount papers, holding companies subject to the Public Utility Holding Company Act of 1935, and certain other special types of companies.

Section 4. Classification of investment companies

Section 4 classifies investment companies into three categories: Management companies, unit-investment trusts, and face-amount-certificate companies.

Section 5. Subclassification of management companies

Subsection (a) divides management companies into two types: Open-end companies—companies in which the stockholder or certificate holder has a right to compel the company to redeem his shares at their asset value; and closed-end companies—companies in which the shareholders do not have such a right.

Subsection (b) further subclassifies management companies, both of the open-end and closed-end types, upon the basis of the extent of the diversification of their investments, into diversified companies and nondiversified companies. Diversified companies must have at least 75 percent of their assets in diversified securities, and with respect to this 75 percent of the assets, no more than 5 percent can be invested in more than 10 percent of the outstanding voting securities of any one company. Nondiversified companies are not required so to diversify their investments.

Subsection (c) is a technical paragraph and provides that if the company has invested only 5 percent of its assets in one company and if the market value of that investment goes up so that its value is more than 5 percent of the investment company's assets, it does not lose its status of a diversified company.

Section 6. Exemptions

Subsection (a) (a) exempts from the provision of this bill investment companies organized or created under the laws of Alaska, Hawaii, Puerto Rico, the Philippine Islands, the Canal Zone, and the Virgin Islands, provided they do not sell any securities to residents of any State other than the State in which they were organized.

Paragraph (2) exempts companies which, on the effective date of this act, were in receivership or bankruptcy, and such exemption shall continue as long as the company's business is under court jurisdiction.

Paragraph (3) exempts companies which have gone through reorganization and are temporarily investing their cash in securities.

Paragraph (4) exempts face-amount-certificate companies which were organized under the insurance laws of a particular State and are subject to the supervision of an insurance commissioner, and all of the stock of which has been sold in that State.

Subsection (b) empowers the Commission to exempt by order employees' investment companies.

Subsection (c) empowers the Commission to exempt other companies if such exemption is consistent with the protection of investors.

Subsection (d) authorizes the exemption of certain small closed-end investment companies doing an intrastate business.

Subsection (e) provides that a company is not required to be registered in order to subject it to specific provisions of the bill; and conversely, the Commission is empowered to relieve the company from all provisions, including registration, and just subject it to those which it may fine are particularly applicable to that company.

Section 7. Transactions by unregistered investment companies

Subsection (a) provides that an investment company, unless it is exempt, or unless it is registered as provided in the bill, is forbidden to conduct its activities through use of the mails or instrumentalities of interstate commerce.

Subsection (b) makes the same provision with respect to fixed and semifixed investment companies.

Subsection (c) provides that no promoter of a proposed investment trust shall use the mails or any means of interstate commerce to sell preorganization certificates.

Subsection (d) provides that foreign investment companies may not register as investment companies or publicly offer securities of which they are the issuer in the United States unless the Commission finds that these foreign investment companies can be effectively subjected to the same type of regulation as domestic investment companies.

Section 3. Registration of investment companies

Subsection (a) provides that the registration of any investment company may become effective upon the filing with the Commission of a notification of registration.

Subsection (b) provides that the formal registration statement may be filed by a company after effective registration at some time to be fixed by the Commission. In the main, the Commission may require the information required to register securities under the Securities Act of 1933 and the Securities Exchange Act of 1934. In addition, the registration statement must state the policy of the company as to items specifically enumerated in the bill and supply information with respect to the business affiliation and experience of the officers and directors of the company.

Subsection (c) makes provision for the simplification of the registration procedure by permitting the filing of copies of registration statements already filed under the acts now administered by the Commission.

Subsection (d) empowers the Commission to exempt unit investment trusts from supplying information in its registration statement

which may duplicate information supplied by a registered investment company all of whose securities are substantially owned by the unit investment trusts.

Subsection (e) sets forth the mechanics for correcting and for revealing omission of material facts.

Subsection (f) empowers the Commission to cancel the registration statement of an investment company if the Commission find [sic] that a company has ceased to be an investment company.

Section 9. Ineligibility of certain affiliated persons and underwriters

Subsection (a) provides that any person who within 10 years has been convicted of a crime, or is enjoined by a court in connection with a security or financial fraud, is prohibited by the bill from acting as an officer, director, member of an advisory board, investment advisor, or depositor of any investment company, or principal underwriter for any registered open-end company, registered unit investment trust, or registered face-amount company.

Subsection (b) authorizes the Commission to exempt persons from the prohibition set forth under subsection (a) where it is shown that the penalty as applied to any such person would be unduly or disproportionately severe or that the conduct of such person has been such as not to make it against the public interest or protection of investors that such exception be granted.

Section 10. Affiliations of directors

Subsection (a) provides that at least 40 percent of the board of directors of an investment company shall be "independent"; that is, no more than 60 percent may consist of investment advisers to the company or affiliated persons of such an adviser or officers or employees of the company.

Subsection (b) provides that a majority of the board of directors of an investment company must be composed of persons who are not regular brokers for the company or principal underwriters of its securities, or investment bankers, or in each case persons affiliated with them.

Subsection (c) provides that after the effective date of this title, the majority of the board of directors of an investment company may not consist of persons who are officers or directors of any one bank, except that any investment company which, on March 15, 1940, shall have had a majority of its directors consisting of such persons may continue to do so.

Subsection (d) exempts from the provisions of subsections (a) and (b) of this section (10) directors of certain types of investment companies which are closely affiliated with investment advisers and which are designated primarily to make available the medium of diversification to the smaller customers of these advisers. This exception is carefully safeguarded by specific condition.

Subsection (e) provides that any change in the board of directors resulting from the death, resignation, or disqualification of a director resulting in a violation of subsections (a), (b), or (c) must be filled within 30 days, if only the action of the board of directors is required, or within 60 days if a stockholders' vote is required to fill the vacancy,

as the Commission may designate by rules and regulations or order.

Subsection (f) prohibits investment companies from purchasing securities underwritten by persons affiliated with the investment company, unless the investment company itself is a principal underwriter of such securities, until after the termination of the underwriting syndicate.

Subsection (g) subjects the members of an advisory board to the restriction of subsections (a), (b) and (c), (e) and (f).

Subsection (h) makes the provisions of subsection (a) as modified by subsection (e) applicable to the boards of directors of the depositor of an unincorporated management company; makes the provisions of subsections (b) and (c) as modified by (e) applicable to the board of directors of the depositor and of every investment adviser of such company; and makes the provisions of subsection (f) applicable to acquisitions of securities when the depositor or investment adviser, or persons affiliated with them, is the underwriter of such securities.

Section 11. Offers of exchange

Subsection (a) provides that exchange offers of open-end companies made on any other basis than respective asset values of the securities involved must be submitted for the approval of the Commission.

Subsection (b) exempts from the provision of subsection (a) those exchange offers which are made in connection with reorganizations.

Subsection (c) subjects the exchange offers of the securities of open-end companies for the securities of unit-investment trusts or face-amount-certificate companies, and the exchange offers of securities of unit-investment trusts or face-amount-certificate companies for the securities of any other investment company, to the restriction set forth in subsection (a), irrespective of the basis of exchange.

Section 12. Functions and activities of investment companies

Subsection (a) makes it unlawful for investment companies to trade on margin, participate in joint-trading accounts, or effect short sales in portfolio securities in contravention of rules and regulations which may be prescribed.

Subsection (b) provides that an open-end company cannot be its own distributor except in accordance with the Commission's rules and regulations.

Subsection (c) permits a diversified company to engage in underwritings provided these commitments do not exceed 25 percent of its total assets.

Paragraph (1) of subsection (d) provides that an investment company or group of controlled companies may not purchase securities issued by another investment company if as a result of such acquisition such group will have more than 3 percent of the outstanding voting securities of such other investment company, or 5 percent of a specialized investment company. Investment companies, however, may increase their holdings in other investment companies of which they already hold 25 percent of the voting stock, since such holdings constitute presumptive control.

Paragraph (2) of subsection (d) limits the acquisition by investment companies of an insurance company's stock to 10 percent of such

company's outstanding stock. However, investment companies may increase their holdings in insurance companies of which they already hold 25 percent of the voting stock.

Paragraph (3) of this subsection prohibits investment companies from acquiring securities of persons engaged in the brokerage business or in the business or underwriting and dealing in securities unless the investment company will, after such acquisition, own all outstanding securities of such person and the principal business of such company is that of underwriting securities.

Subsection (e) permits investment companies, either alone or jointly with other investment companies, to purchase stock of a company engaged primarily in the business of underwriting and distributing securities and to acquire stock of a company formed to engage in the business of furnishing new capital to industry, financial promotional enterprises, and similar activities.

Subsection (f) provides that a face-amount-certificate company can acquire the securities of not more than two other face-amount-certificate companies only upon certain prescribed conditions.

Subsection (g) permits an investment company to acquire more than 10 percent of the outstanding voting securities of an insurance company where it is found that such acquisition is in the public interest because the financial condition of such insurance company will be improved as a result of such acquisition or any plan contemplated as a result thereof. This subsection also permits investment companies to participate in the organization of new insurance companies and to purchase the stock of newly created insurance companies from other investment companies. The powers of any insurance commissioner or similar official or agency of the United States or any State are in no way to be affected by any of the provisions of this section.

Section 13. Changes in investment policy

Subsection (a) provides that no shift in an investment company's fundamental policies as stated in its registration statement may be made without the approval of a majority of the company's outstanding voting securities.

Subsection (b) defines what shall constitute a vote of the majority of the outstanding shares in the case of a common-law trust.

Section 14. Size of investment companies

Subsection (a) provides that no investment company organized after the effective date of this bill may make a public offering of its securities unless it has or is assured of having at least $100,000 through private subscriptions.

Subsection (b) authorizes the Commission to study and report from time to time the effect of size of investment companies, both on the national economy and on the trusts themselves.

Section 15. Investment advisory and underwriting contracts

Subsection (a) provides that after 1 year from the effective date of this title all investment advisory or management contracts must be in writing, must prescribe in detail the compensation to be paid,

and must be nonassignable and terminable upon 60 days' notice. Such contract have to be approved by a majority of the voting stock, may be for an initial period of 2 years, and renewable annually thereafter by the board of directors or stockholders.

Subsection (b) makes the provisions of subsection (a) except stockholders' approval applicable to contracts for the distribution of open-end company securities.

Subsection (c) provides that investment advisory or management contracts and underwriting contracts for the distribution of the securities of open-end investment companies can be entered into or renewed only upon the approval of a majority of the directors independent of those persons who may either be parties to the contract or persons who may be affiliated with such parties.

Subsection (d) provides that contracts in existence as at March 15, 1940, are permitted to continue for a period not exceeding 5 years, unless such contracts have been renewed in accordance with the provision of subsection (a) or (b) prior to March 15, 1945.

Subsection (e) defines what shall constitute the vote of a majority of the outstanding voting securities in the case of a common-law trust.

Subsection (f) provides that none of the restrictions set forth in the foregoing subsections of this section are to apply to the members of an advisory board.

Section 16. Changes in board of directors; provisions relative to strict trusts

Subsection (a) provides that in the future no person shall serve as a director of an investment company unless elected by the holders of its outstanding voting securities, except that, in effect, vacancies not exceeding one-third of the board occurring between meetings of stockholders may be filled in any otherwise legal manner.

Subsection (b) provides a procedure for the removal of trustees of existing strict trusts by certificate holders where no provision is made for their election.

Section 17. Transactions of certain affiliated persons and underwriters

Subsection (a) of this section makes it unlawful for persons who are officers, directors, promoters, investment advisers, etc., or persons affiliated with such persons acting as principal, knowingly to sell to or purchase from their investment company any securities or property or borrow from such investment company.

Subsection (b) provides that the Commission may grant exemptions from subsection (a) if the transaction is fair and is consistent with the investment policies of the company and with the purposes of this bill.

Subsection (c) provides that notwithstanding subsection (a) a person may sell to or purchase from any investment company merchandise, or may enter into lessor-lessee relationship with an investment company.

Subsection (d) prohibits joint participation and transactions between investment companies and their officers, directors, investment advisers, principal underwriters, etc., in contravention of rules and regulations of the Commission promulgated for the purpose of limiting or preventing participation by the investment company on a basis dif-

ferent from or less advantageous than that of such other participants.

Subsection (e) provides that brokerage commissions from investment companies obtained by affiliated persons are to be limited to standard rates, with provision for special exemptions.

Subsection (f) provides that the portfolio securities of investment companies must be placed in the custody either of banks or with certain types of stock-exchange firms or with the investment company subject to supervision by the Commission as to methods of safekeeping, etc.

Subsection (h) provides that directors and officers, and subsection (i) provides that principal underwriters and investment advisers of registered investment companies are not to be permitted to exculpate themselves from liability for willful misfeasance, bad faith, gross negligence, or reckless disregard of their duties.

Section 18. Capital structure

Subsection (a) makes it unlawful for closed-end companies to issue securities representing indebtedness or preferred stocks unless such securities have an asset coverage of at least 300 percent and 200 percent, respectively. Dividends may not be paid on the common stock unless the securities representing indebtedness have an asset coverage of 300 percent and the preferred stock an asset coverage of 200 percent. Dividends cannot be paid on the preferred stock unless such indebtedness has an asset coverage of 200 percent. Unless these coverages are maintained repurchases of securities junior to senior securities are forbidden. Voting rights are also provided for preferred stocks and in certain contingencies for senior securities representing indebtedness other than loans.

Temporary borrowings up to 5 percent are exempt from the foregoing provisions.

Subsection (b) provides for the time at which asset coverages must be calculated for the purposes of the preceding section.

Subsection (c) provides that investment companies may not issue more than three classes of securities—one class of security representing indebtedness (including loans not publicly distributed), one class of preferred stock, and one class of common stock.

Subsection (d) provides that hereafter investment companies may not issue warrants to purchase their securities except warrants or rights offered to their security holders which expire in 120 days. In the case of reorganization, however, warrants may be issued for existing warrants.

Subsection (e) exempts from other provisions of the section senior securities issued by investment companies to refund senior securities and senior securities issued in connection with reorganization provided, speaking generally, that as a result of the reorganization the ratio of senior securities to various stocks is not increased over such ratio as it existed prior to the reorganization.

Subsection (f) prohibits open-end companies from issuing senior securities except that such companies are permitted to borrow from banks provided that an asset coverage of 300 percent is maintained at all times for such borrowings.

Subsections (g) and (h) define “senior securities” and “asset coverage,” respectively.

Subsection (i) provides that hereafter every share of stock issued by a registered management investment company (except a common-law trust of the character described in sec. 16) shall be a voting stock and have equal voting rights with every other outstanding stock. The right to elect a majority of the directors must be accorded to preferred-stock holders in the event of default in 2 years' dividends on their stock.

Subsection (j) provides that in the future face-amount certificate companies cannot issue senior capital securities or, if such company has such securities outstanding, to make any distribution or pay any dividend in contravention of rules and regulations of the Commission prescribed to insure the financial integrity of the company and to prevent the impairment of the company's ability to meet its obligations on its face-amount certificates. If a face-amount certificate company does not maintain the minimum certificate reserves on all its face-amount certificates issued prior to the effective date of the bill, then the company cannot make any distribution or pay any dividend on any senior capital security which exceeds a prescribed percentage of its earnings or which the Commission determines might impair the financial integrity of the company or its ability to meet its liabilities on its outstanding face-amount certificates. Finally, face-amount certificate companies may issue their securities only for cash or securities including their own outstanding securities.

Section 19. Dividends

This section provides, in respect of dividends on existing securities issued by investment companies as well as securities issued by such companies in the future, that the investment companies must disclose by written statement accompanying such dividends the source of such payment when made other than from current or accumulated net income as defined.

Section 20. Proxies; voting trusts; circular ownership

Subsection (a) provides that solicitation of proxies, consents, and authorizations relating to securities of investment companies registered under this bill are to be subject to the regulations to which solicitations relating to securities listed on national securities exchanges are already subject by reason of the Commission's regulations adopted under section 14 (a) of the Securities Exchange Act of 1934. To assure uniformity of interpretation and administration as between that act and the present bill, section 20 (a) of the bill has been so drafted as to follow verbatim section 14 (a) of the Securities Exchange Act, with only slight modifications of language as are necessary because of the special classes of companies to which section 20 (a) of this bill applies.

Subsection (b) provides that hereafter no public offering by the use of the mails or means or instrumentalities of interstate commerce shall be made of voting-trust certificates of investment companies. However, existing voting trusts for investment companies may continue until their expiration.

Subsection (c) provides that no investment company shall purchase any voting security if to the knowledge of such company cross or circular ownership of securities exists or will exist between the invest-

ment company and the company whose securities it purchases. Cross ownership is defined to exist between two companies when each company owns more than 3 percent of the voting securities of the other company. Circular ownership is defined to exist among companies included in a group of three or more companies if two or more of such companies own 3 percent or more of the voting securities of each other.

Subsection (d) provides that cross or circular ownership between investment or other companies now in evidence must be eliminated within 5 years. If cross or circular ownership comes into effect between an investment company and other companies after the effective date of this bill upon the purchase by a registered investment company, such company is required to eliminate such cross or circular ownership within 1 year after knowledge of its existence.

Section 21. Loans

This section makes it unlawful for investment companies to lend money or property to any person if (1) such loan is not authorized by the investment policies of the company as recited in its registration statement and reports filed with the Commission, or (2) the loan is made to a person which controls or is under common control with the investment company. Exception is made for the renewal of loans outstanding prior to March 15, 1940, and for loans by a registered company to a person owning all of its outstanding securities.

Section 22. Distribution, redemption, and repurchase of redeemable securities

Subsections (a) and (b) empower an association of securities dealers registered under section 15A of the Securities Exchange Act of 1934, subject to the provisions of that section, to make rules to protect investors so far as is reasonably practicable, against any dilution of their equity due to the methods or pricing, distribution, and redemption of redeemable securities issued by investment companies and to prevent grossly excessive sales loads upon such securities.

Subsection (c) empowers the Commission, after 1 year, to make rules and regulations to deal with the subjects mentioned in subsections (a) and (b). In other words, the industry is given a year to solve these problems for itself.

Subsection (d) prohibits investment companies from selling their redeemable securities to any person other than a dealer or principal underwriter at a price less than that at which the security is sold to the public.

Subsection (e) prohibits the suspension of redemption of redeemable securities issued by investment companies for a period more than 7 days except during certain specified emergency periods or other periods fixed by the Commission.

Subsection (f) provides that the negotiability or transferability of redeemable securities of open-end companies may not be restricted in contravention of rules and regulations which the Commission may prescribe.

Subsection (g) provides that open-end investment companies may issue their securities only for cash or securities. However, such

securities may be issued as stock dividends or for property pursuant to a plan of reorganization of such company.

Section 23. Distribution and repurchase of securities: Closed-end companies

Subsection (a) provides that no closed-end investment company may issue its securities except for cash or securities. However, such company may issue securities as stock dividends or for property in connection with a plan of reorganization of such company.

Subsection (b) provides that closed-end companies may not issue their common stock below asset value except in connection with an offering to their own security holders, conversion of a convertible security exercise of any warrant outstanding at the date of enactment of the bill, or with the consent of a majority of their common-stock holders.

Subsection (c) provides that no closed-end company may repurchase any of its outstanding securities except on a securities exchange or open market upon prescribed notice to its stockholders or pursuant to tenders or under other circumstances to be prescribed to insure fair treatment to all security holders.

Section 24. Registration of securities under Securities Act of 1933

In order to eliminate duplication in the material filed under the Securities Act and this bill, subsection (a) of this section provides that investment companies may register under the Securities Act of 1933 by filing copies of their registration statements under this title and such other information as the Commission may prescribe.

Subsection (b) provides that sales literature intended for distribution to prospective purchasers of the securities of open-end companies, unit investment trust, and face-amount certificate companies must be filed with the Commission within 10 days after the distribution of such literature by the use of the mails or means or instrumentalities of interstate commerce.

Subsection (c) empowers the Commission to prescribe the form in which information shall be presented or summarized in the prospectuses used by face-amount certificate companies and periodic payment plans.

Subsection (d) provides that the provisions of section 3 (a) (8) of the Securities Act shall be inapplicable to securities issued by investment companies. The provisions of section 3 (a) (11) of the same act are made inapplicable to securities of registered investment companies.

Section 25. Plans of reorganization

Subsection (a) requires that information relating to plans of reorganization of investment companies be filed with the Commission.

Subsection (b) provides that the Commission, at the request of 25 percent of any class of the security holders to be affected by such reorganization, or at the request of a company which is a party to such a plan, may render an advisory report as to the fairness of the plan. The company is required to send a copy of any such report to its security holders.

Subsection (c) authorizes the Commission to institute injunction proceedings in a Federal court to restrain the consummation of any grossly unfair plan of reorganization or any plan which constitutes gross misconduct or gross abuse of trust.

Subsection (d) makes it clear that the functions and duties of the Securities and Exchange Commission under the Bankruptcy Act remain unchanged.

Section 26. Unit investment trusts

Under subsection (a), the trust indentures of unit investment trusts must designate as trustee or custodian a bank of a specified minimum size; must require that all property and funds of the trust will be held by the trustee; and must provide, among other things, that the trustee (which may not resign unless a successor trustee has been designated or the trust liquidated) be entitled to reimburse itself out of the trust property for its expenses actually incurred and fees actually earned. Except under special circumstances, the depositor or underwriter must be prohibited from deriving any fees from the trust other than the original sales load for distributing the shares. Provision must also be made to advise shareholders of portfolio changes.

In view of the fact that amendment of existing trust indentures to comply with subsection (a) may in certain cases involve appreciable effort and expense, subsection (b) permits the same result to be accomplished by a written contract between the depositor and trustee.

Subsection (c) authorizes the institution of proceedings in court by the Commission to liquidate so-called “orphan” trusts.

Section 27. Periodic payment plans

Subsection (a) contains provisions which limit the sales load on period-payment-plan certificates to 9 percent; permit half of the sales load to be taken out during the first year of the plan but require the balance to be spread equally over the subsequent year; require the initial payment under any plan to be at least $20, and each subsequent payment at least $10; and to prevent evasion of the restrictions on sales load by the imposition of so-called management fees; authorize the Commission to prescribe maximum fees.

Under subsection (b), the Commission may modify the provisions of subsection (a0 relative to sales load in order to meet the problems of smaller companies.

Subsection (c) requires that periodic-payment-plan certificates be redeemable securities and that the proceeds of payment thereon be deposited with a trustee or custodian having the qualifications required for unit-investment trusts, under an indenture or agreement meeting certain of the conditions required of the trust indentures of unit-investment trusts.

Section 28. Face-amount-certificate companies

Paragraph (1) of subsection (a) provides that companies which sell face-amount certificates are generally subject to the provisions of the bill but must comply with certain provisions which are specifically applicable to that type of company. The bill contains provisions

with respect to minimum capitalization of face-amount-certificate companies.

Paragraph (2) of subsection (a) provides that all companies which in the future sell these certificates must at all times maintain reserves, which, accumulated at a rate not to exceed 3½ percent compounded annually must provide an amount sufficient to meet at all times all the liabilities and obligations of the company to all its certificate holders.

Subsection (b) provides that companies must have cash or qualified investments (investments which are qualified under the Code for the District of Columbia for life insurance companies) of a value not less than the aggregate of their capital and reserve requirements.

Subsection (c) requires face-amount-certificate companies to deposit with certain qualified banks all or any part of the investments maintained by such company as certificate reserve requirements, except that the company may be credited with deposits made pursuant to law or regulation with State authorities in respect to liabilities of the certificates sold to the residents of such States.

Subsection (d) requires that the loading charge (the maximum amount of which charge is fixed by the bill) for the distribution of the certificate be spread over the life of the certificate. In essence, no more than 50 percent of the load may be taken out the first year, no more than 7 percent in each of the following 4 years, and not more than 4 percent in each of the remaining years. The surrender value of the certificate for the first year must be equal to at least 50 percent of the gross annual payment made on the certificate, less a prescribed surrender charge.

Subsection (e) provides that a certificate may not contain a provision making the holder liable for any unpaid balance on the certificate.

Subsection (f) requires that the certificate must provide for the issuance of a so-called paid-up certificate to the certificate holder upon the happening of certain contingencies.

Subsection (g) provides that the foregoing provisions are not applicable to certificates issued to holders of certificates issued before the effective date of the act.

Subsection (h) provides that if a face-amount company does not maintain the minimum certificate reserve on all its outstanding face-amount certificates issued prior to the effective date of the bill, then the company cannot make any distribution or pay any dividend on any senior capital security which exceeds a prescribed percentage of its earnings or which the Commission determines might impair the financial integrity of the company or its ability to meet its liabilities on the outstanding certificates.

Section 29. Bankruptcy of face-amount-certificate companies

Subsection (a), while preserving the rights, even in the event of bankruptcy, of residents in those States which require specific deposits with their State officials, promotes more equal treatment of all certificate holders by providing that residents of other States must receive an amount equal to that received by the residents of States with deposits, before the latter can share in the general assets of the bankrupt company.

Subsection (b) provides that the trustee in bankruptcy of a face-amount-certificate company shall be appointed by the court instead of being elected by certificate holders and other creditors scattered throughout the Nation. The Securities and Exchange Commission is entitled to be heard by the court before the appointment is made.

Section 30. Periodic and other reports; reports of affiliated persons

Subsection (a) requires investment companies to file with the Commission annual reports, including financial statements, similar to the annual reports now filed with the Commission under the Securities Exchange Act of 1934 by companies having securities listed on national securities exchanges.

Subsection (b) authorizes the Commission to require less comprehensive reports on a semiannual or quarterly basis. It also provides that investment companies must file with the Commission copies of reports sent to their security holders.

Subsection (c) provides that copies of reports filed hereunder may be filed in substitution for reports which the company would otherwise be required to file pursuant to the Securities Exchange Act of 1934.

Subsection (d) authorizes the Commission to require investment companies to transmit semiannually to their stockholders reports containing certain specified financial and other information. The reports to stockholders may not be misleading in any material respect in the light of the reports filed with the Commission.

Under subsection (e), annual reports to the Commission and to stockholders may be required to be certified by independent public accountants, whose certificate must be based on a reasonably comprehensive audit.

Under subsection (f), the provisions of section 16 of the Securities Exchange Act of 1934 relating to transactions of officers, directors, and controlling persons, which now apply to equity securities of investment companies whose securities are listed on a national securities exchange, are made applicable to all securities of all registered closed-end companies.

Section 31. Accounts and records

Subsection (a) authorizes the Commission to require investment companies and certain of their majority-owned subsidiaries to preserve accounts, records, and documents upon which their financial statements filed with the Commission are predicated. Investment advisers, depositors, and principal underwriters of certain investment companies may likewise be required to preserve records showing their transactions with the investment companies with which they are associated.

Under subsection (b), the accounts, records, and documents kept pursuant to subsection (a) are subject at all times to examination by the Commission or its representatives.

Subsection (c) authorizes the Commission to provide for a reasonable degree of uniformity in the accounting policies and principles to be followed by investment companies in maintaining their accounts and records and preparing the financial statements required in their reports to the Commission and stockholders.

Subsection (d) authorizes the Commission in special cases to grant exemptions from its accounting rules under subsection (c).

Section 32. Accountants and auditors

Under subsection (a), the selection of independent public accountants of investment companies, subject to certain exceptions, must be submitted for ratification or rejection to stockholders who, in addition, at any time by a majority vote may terminate their employment. The auditor's certificate must be addressed to security holders as well as the directors.

Subsection (b) requires that the controller or other principal accounting officer of an investment company be chosen either by the board of directors of the company or by its security holders, and not merely by appointed by its executive officers.

Under subsection (c), the Commission is empowered to require accountants and auditors to keep reports and work sheets and other documents relating to investment companies.

Section 33. Settlement of civil actions

Subsection (a) requires that the documents specified in subsection (b) be transmitted to the Commission if an action or claim for an alleged breach of official duty on the part of an officer, director, investment adviser, trustee, or depositor of an investment company has been compromised with court approval, or if a verdict has been rendered or final judgment entered thereon.

Subsection (b) enumerates the pleadings, written record, and other papers relating to the proceedings which are to be filed. The Commission is authorized to use any information derived from such documents, except the names of the persons concerned, in connection with any report or study which it may make of lawsuits.

Section 34. Destruction and falsification of reports and records.

Subsection (a) prohibits the willful destruction, mutilation, or alteration of accounts and papers required to be preserved pursuant to section 31 (a) or 32 (c).

Subsection (b) contains the usual provisions prohibiting misrepresentations and half-truths in registration statements, applications, reports, accounts, and other documents provided for in the bill. It also imposes a similar responsibility upon accountants and auditors insofar as financial statements and reports signed or certified by them are concerned.

Section 35. Unlawful misrepresentations and names

Subsections (a) and (b) contain the usual provisions prohibiting the misrepresentation of the effect of registration with the Commission.

Subsection (c) makes it clear that subsections (a) and (b) do not prohibit a statement that a person or security is registered, if the effect of such registration is not misrepresented.

The use of misleading names by registered investment companies is specifically prohibited by subsection (d). This prohibition may be enforced by order of the Commission when the name is adopted

after the effective date of the bill, and by a court at the suit of the Commission as to names theretofore adopted.

Section 36. Injunctions against gross abuse

This section authorizes the Commission to bring an action in a proper court of the United States to enjoin certain affiliated persons and underwriters of investment companies from acting in those capacities, alleging that the defendant or defendants have been guilty of gross misconduct or gross abuse of trust in respect of the investment company with which he or they are associated. If the allegations are established by evidence before the court, the court is required to enjoin the defendant or defendants for such period of time as appears appropriate to the court. A 5-year statute of limitations is provided. As in the case of noncriminal proceedings which the Commission is authorized to bring pursuant to other sections of the bill, actions under this section are to be brought in the Commission's own name and by its own attorneys.

Section 37. Larceny and embezzlement

Larceny and embezzlement from investment companies registered under this title is made a Federal crime. This provision is in line with similar provisions relating to national banks, interstate carriers, and other institutions subject to comprehensive Federal supervision.

PROCEDURAL, ADMINISTRATIVE, ENFORCEMENT, AND FORMAL PROVISIONS

The remaining provisions of title I, with certain minor exceptions hereinafter noted, closely follow similar provisions in statutes now administered by the Securities and Exchange Commission. All these provisions, as well as the substantive provisions of the bill, have been carefully scrutinized by the members of the industry and their counsel.

Section 38: Contains the usual provisions authorizing the Commission to promulgate rules, regulations, and orders in order to carry out its functions under the bill. Subsection (a) of the corresponding section of the original bill has been modified to make it clear that this section does not grant the Commission substantive powers but merely implements powers elsewhere conferred.

Section 39: Provides for publication of the rules and regulations of the Commission.

Section 40: Sets forth, in somewhat more detail than in the statutes now administered by the Commission, the procedures to be followed in the issuance of orders.

Section 41: Provides for hearings by the Commission.

Section 42: Contains appropriate provisions for investigations, injunctive proceedings, criminal references, and other enforcement procedures.

Section 43: Contains the usual provisions for review by the court of order of the Commission.

Section 44: Contains the usual provisions regarding jurisdiction and venue of offenses and suits. To avoid the necessity of bringing

certain types of criminal proceedings in the District of Columbia, the third sentence of the section contains a special provision making it clear that such proceedings may be brought in the district wherein the defendant is an inhabitant or maintains his principal office or place of business.

Section 45: Provides for confidential treatment of information filed with the Commission, and for the sale by the Commission of copies of information which is available to the public.

Sections 46, 47, and 48: Contain the usual provisions relating to annual reports, validity of contract, liability of controlling persons, and preventing compliance.

Section 49: Contains the penalties for willful violations of the bill.

Section 50: Saving clause for existing laws.

Section 51: Separability clause.

Section 52: Short title.

Section 53: Effective date.

TITLE II. INVESTMENT ADVISERS

Title II of the bill which deals with investment advisers is based on a survey of these organizations by the Securities and Exchange Commission made in connection with its study of investment trusts and investment companies. As in the case of title, I, many of the original provisions of title II were opposed by many investment advisers who appeared at the hearings before the Senate Committee on Banking and Currency. However, at the conclusion of these hearings, the representatives of the Securities and Exchange Commission and those investment advisers who opposed the provisions of the original title II met and as a result of their cooperative endeavors the present title II was drafted. As now drafted, the title has the approval and endorsement of the investment advisers who appeared at the hearings before the committee. In addition, the title is unqualifiedly endorsed by the Investment Counsel Association of America and by a large number of investment advisory organizations which did not testify before the congressional committee.

GENERAL STATEMENT

Investment advisers are persons who for compensation engage in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing or selling securities or who for compensation and as part of a regular business, promulgate analyses or reports concerning securities. The provision or occupation of investment adviser came into being after the World War and since 1929 the number of individuals and firms engaged in this vocation has increased rapidly. Although it is difficult to determine with precision the amount of public funds administered by investment advisers, some idea of the size of such funds may be deduced from the fact that only 51 firms for which information was available to the Securities and Exchange Commission, managed, supervised, and give investment advice with respect to funds aggregating approximately $4,000,000,000, a sum roughly equivalent to the entire assets of all investment trusts and investment companies now operating.