

Senator TAFT (interposing). No; it says he shall not do it unless he registers with the Federal Government. If he has been convicted of a crime, all right, make it illegal for him to be a manager, although I think that is going pretty far. I don't even see why that should be held up to the public. A man may have been convicted early in his life and have been an honorable man for 20 years, and then he would be fired. Even that is going pretty far, but the important point is this new idea of requiring that a man be registered before he can get a job.

Mr. HEALY. I suppose you could have an express provision for a man convicted within 10 years that would prevent him from becoming an officer or director. If you had such a provision I think the very circumstance that you are speaking of would be legal. It seems to me that there may be cases, just as you indicated, where a man has been convicted within 10 years, where there are extenuating circumstances, where, nevertheless, it might be proper to let him act as an officer or director.

I think you will agree that, on the average, the presumption should be against such a man being put in charge of these large pools of liquid capital. That is all we are trying to accomplish there. Maybe the method is not the best that could be devised.

Senator TAFT. Well, it seems to me that if you had a complete inspection and publicity and required the companies to publish the names of their directors and managers, just as in the case of a bank, they are not going to employ anybody who has been in jail. There is no danger of it. If you have enough publicity about it, that seems to be the cure for it, not registration with the Federal Government.

Mr. HEALY. Of course, we have had instances where people have been in control of the investment trust despite the fact that they had unsavory criminal records.

Senator TAFT. You had a complete lack of publicity about investment trusts. You had an industry where there was no regulation and where undoubtedly a tremendous number of abuses arose, but I wonder if it would not be cured by inspection and regulation, rather than by registering everybody in the business and giving them complete control over all the details.

Mr. HEALY. You may be right. I would like to make this observation, however: that some of the worst things that have happened in this particular industry, due to the fact that men with unsavory records and few scruples got control of them, have happened since the Securities Act of 1933 was passed and the disclosure features were not sufficient to prevent their doing it.

Senator TAFT. Companies which had registered and had obtained a license?

Mr. HEALY. I can't say that they had actually registered, but I will point this out: That a company might at the time of this registration not have among its board or officers men with unsavory records, and those men might get control of it at a period subsequent to the registration.

In the case of the Kenyon Co. and the Continental Securities Co., as a matter of fact, I think some of those men came into those situations quite a time after their organization.

This seemed a flexible device to make provision so that that kind of man could not get into this kind of position, and yet make provision

for the companies where, despite that record, perhaps it would be all right to allow him to do it. At least, we have tried to explain the philosophy and the approach of this section of the bill.

Senator WAGNER. Of course, we have to consider that Senator Taft did not have the advantage of hearing all of these revelations before the committee. I have sat on many investigations, including the investigation of stock exchanges and banks, and I never heard of such outrageous exploitations of other people's money and the absolute looting of these investment trusts. I am speaking only of some of them. I know many men in the industry are men of high character and conduct their affairs in an honorable way. But this testimony shows that a large part of \$3,000,000,000 lost—not their money, not the manipulators' money, but the people's money—has been taken from the people by looting. Although I am willing to hear suggestions from everybody, the industry and the legislators, I personally am convinced that this bill is a mild approach to protect the public's investments. I am not afraid of regimentation. I do not think this is. I think it is a very mild form of supervision to protect the American public. The testimony today, which I wish Senator Taft had listened to, of the methods used to secure the funds of truckmen, school teachers, domestics, and these absolutely outrageous misrepresentations made to them, which induced them to give up and lose their last pennies, has shown us a state of affairs which we cannot ignore. We have got to devise some means of protecting the people.

I am ready to receive suggestions and I am anxious to hear both from men as scholarly and as able as Senator Taft and other Senators here and also the industry. But I certainly won't sit still, as a representative of the people, and ignore these outrageous practices which, fortunately, have been exposed by the work of the S. E. C.

The other day Mr. Cook appeared here, and he represented Mr. Ballantine. We know him as one of our very distinguished lawyers in New York and a former Assistant Secretary. He is trustee and Mr. Cook is the attorney for the trustee in connection with the Continental Securities Co. They conceded that they could not have secured the evidence which is now being gathered to prosecute them. They said that without the aid and the investigation of the S. E. C. they could never have found this evidence. I think Mr. Fulton told us the same thing. They exposed these cases, and I feel that something has got to be done. I do not say that this is the perfect way to do it, but I do not think it is an effort at regimentation. It is an effort to protect the investing public.

Senator TAFT. I think it is the most radical possible approach to the question——

Senator WAGNER (interposing). That may be so, but——

Senator TAFT (interposing). Senator, you made a speech. Let me make a speech.

Senator WAGNER. Pardon me.

Senator TAFT. My suggestion is that the approach to the regulation of investment trusts should be the same as the approach to the regulation of banks, which incidentally, have far more money to handle for stockholders and depositors than investment trusts. I suggest that periodical published statements and examinations of the investment trusts' books by a corps of bank examiners whenever they chose to walk in would be simpler than the plan proposed here. This would

be sounder, I think, than the plan proposed here, handing over to the S. E. C. the regulation of the companies and their directors and officers. I do not question the need of regulation, not that these revelations show the most outrageous treatment of other people's money, nor that it has been revealed by the excellent work of the S. E. C.; I do not mean to question any of that at all.

Senator WAGNER. By the democratic process, that is the way we finally get to the solution of a problem.

Mr. SCHENKER. Section 9 (c), line 9, on page 21 provides:

Except as hereinafter provided, such registration shall become effective thirty days after receipt of such application by the Commission, or within such shorter period of time as the Commission may determine.

Now, the mechanics we set up is this: a simple registration statement, under which we have registered 6,000 brokers and dealers, which became the backbone of the national association of brokers and dealers in this country.

Unless the Commission takes steps to revoke the registration—and the only ones are the grounds which the judge elaborated upon, and that the application itself contains untrue statements or does not state all the facts—that registration statement becomes effective. In addition, as the judge has indicated, even though he has been convicted within 10 years, if there were extenuating circumstances in connection with that, the Commission still does not have to revoke his registration statement.

Now, we felt that this approach would serve both those salutary purposes, and in all my discussion with the industry, Senator Taft, I do not think we heard any objection to this registration provision—

Senator TAFT (interposing). I think you will hear of it, because I have had two or three violent letters particularly about this provision that the application of every company—

shall contain such information and documents in such form and such detail, as to such person and affiliated persons of such person as the Commission may by rules and regulations prescribe as necessary or appropriate to effectuate the purposes of this title.

That certainly gives the Commission power to ask anybody any kind of personal question about anything that he has ever done in his life, any property that he has, any money that he owes, and any securities that he owns. It requires a complete financial statement. It gives the Commission power absolutely to put anybody on the grill to any extent if he happens to be a director of any investment company.

Mr. HEALY. Of course, the provision to which I think the Senator refers limits the Commission's power to such methods as are necessary and appropriate to effect the purpose of the title. It seems to me that if we asked some of the questions you just mentioned we would be going far beyond the powers given us.

Senator TAFT. No; I do not admit that. I think this provision gives you enough power to make him give you a statement of everything he owns, everything he has ever owned, everything he owes, and everything he has ever owed.

Mr. HEALY. If it means as much as that, I would admit it is too broad. I do not think it means as much as that. If some additional language is necessary to indicate that, I am sure that there would be no objection to it.

Senator TAFT. Is "affiliated persons" defined? It does not include wives and relatives, I suppose?

Mr. HEALY. That is not included in the definition.

Senator TAFT. Is it defined somewhere?

Mr. HEALY. Yes.

May I also say that somewhat similar language is found in section 15 (b) of the Securities and Exchange Act, which requires application by brokers and dealers, and the forms that we have used for those applications do not go to the extent that the Senator has mentioned.

We have never construed similar language to give us any such power. The administrative practice has been to restrict it to the precise duty that is imposed on the Commission by the statute. In other words, the administrative interpretation of a very similar provision has been much more restricted than the Senator has indicated.

Senator WAGNER. That type of inquiry is in line with the trend of legislation. I know in my time as State legislator we passed an act because of abuses in the real-estate brokerage fees or insurance broker fees. Men of disrepute got into that industry or that occupation and it was upon the suggestion of the industry itself, the brokers, that we passed this kind of legislation to protect them from these undesirable characters. As I remember, our language was broader than this; but I think the Senator has raised a question that if there was any chance of their having powers that were too broad, they ought to be narrowed to what was intended.

Mr. HEALY. Of course, you have the background of administrative interpretation of similar provisions, which I believe would be given some consideration if this were up for construction.

Senator TAFT. That is section 15 of the Securities and Exchange Act?

Mr. HEALY. 15 (b) of the Securities and Exchange Act.

Senator TAFT. That extends only, of course, to brokers and dealers themselves, and not to directors of companies?

Mr. HEALY. That is true. Of course, if you had a direct legislative prohibition against a person with this kind of record serving any one of these positions, you would still have left the task of discovering what persons had those records, which would involve inquiry on the part of someone.

Senator TAFT. Do you think you would discover another Musica if he desired not to be discovered?

Mr. HEALY. Senator, as to that case nothing seems impossible. A great novelist could not have imagined that.

Senator WAGNER. Well, I might say that about several of the cases you presented here. They sounded incredible, except that they were the truth.

All right, Mr. Schenker.

Mr. SCHENKER. Mr. Lawrence Meredith Clemson Smith is going to discuss section 10, which deals with affiliations involving conflicts of interest.

STATEMENT OF L. M. C. SMITH, ASSOCIATE COUNSEL, INVESTMENT TRUST STUDY

Senator WAGNER. Give your full name and position for the record.

Mr. SMITH. L. M. C. Smith. I am associate counsel, or have been

associate counsel, in the investment trust study over a period of several years.

I want to discuss section 10, which deals generally with the affiliation of persons with the companies and insofar as those persons have a pecuniary interest in the transactions of those companies. In section 10 we attempt to cover the people who would stand to gain or lose by what the investment trust does. Sometimes they stand to gain at the same time with the investment trust and sometimes they stand to gain in different ways.

Our record shows, at least as far as I am concerned, that some of the serious losses have come from people who have tried to carry water on both shoulders, whose integrity I do not attack, but who have tried to act in a dual capacity and serve their own interest at the same time that they have served the investment trust.

Mr. Fulton spoke the other day about the amateurs, whom you can always catch, but the thing that bothers me more is the person who says, "I can serve the investment trust and at the same time serve myself." That has been characteristic of a great many companies, particularly those organized by investment bankers and brokers, who have put in clauses which say they can deal with the investment trust without any responsibility except for gross negligence or fraud. It relieves them of any responsibility for their own errors except for gross negligence.

In some of these cases I do not attack the integrity of the people involved, but I do want to question the fairness of the transactions. Those situations become particularly acute when the investment company gets into large holdings of industrial companies or portfolio companies.

At that time, when you have the investment banker on the board and the investment banker is influenced in getting underwriting business or banking business, there becomes a very definite active conflict, as I see it, and we have case after case of that.

Now, the situation in regard to these people, such as the managers and brokers and people like that, becomes more acute in the case of the investment banker and also in the case of the commercial banker, and I would like to tell you the case of the commercial banker that I know of. That was a commercial bank up in New York State. At the time when it was merged with another investment company in 1929, it had about a million and a half dollars of loans outstanding, of which the major portion were loans to the commercial bank which had sponsored this investment company. In other words, the bank had bought out an affiliate security company, which was an investment company, and in 1929 it put a million and a half of loans out to officers and directors of that bank----

Senator TAFT (interposing). You mean the securities company loaned it to the directors of the bank?

Mr. SMITH. To the directors, president, and officers of the bank. I think those loans by 1931 amounted to \$5,000,000 out of total assets of \$9,000,000----

Senator TAFT (interposing). The investment company was not confined to dealing in those securities?

Mr. SMITH. They were engaged in all kinds of activities. These loans were used for trading in margin accounts, in the investment company stocks and in other stocks, by the officers and directors of that bank—I think there were 86 of them—and by 1935 those loans

still amounted to \$3,400,000, and the collateral behind them was a few hundred thousand dollars. It is significant that little collateral was put up, the loans were not collateralized at all or had a different collateral standing from that of the bank loans.

In 1931, when the market had changed and it looked as if it was going up, the president of the bank and eight other directors started trading in the bank stock and they started an account called the Blakely account. Each one assumed liability for \$200,000, making a total liability of \$1,800,000. They started trading. The price of the bank stock went down and down, and by the time they stopped, I think it was the following February or March, the whole account was away under margin and they had not put up a cent of money—in other words, they were gambling with the investment company's money—and the president of that bank was not able to put up his \$200,000 and neither was another director, and that company went through liquidation in 1934.

As an example, I had the president down here and he defended all the practices, and when I say I am afraid of the people who think they are acting in good faith, there is an example. He said these trading accounts were perfectly good investments, that the individuals were responsible individuals, that they did not need any collateral, and he admitted he had a different practice in the investment company than in the bank.

Senator TAFT. Who owned the stock in the investment company? The stockholders of the bank?

Mr. SMITH. The stockholders of the bank.

As I say, he defended these transactions and insisted that it was perfectly all right, although he admitted that in the bank whenever they took a loan they took collateral and had different standards. Also, the banking law provided that the particular persons could not borrow from the bank, but the investment company borrowed large sums from the bank and then the investment company loaned to these officers, so it was an indirect way of doing what they could not do directly.

These loans are still being liquidated. That man is still president of the bank. The directors are all in charge of the bank up there. A large amount of the indebtedness is still unpaid. They have put it into a separate bundle, so to speak, and the same people who are trying to collect the indebtedness are the ones who owe the money.

Senator WAGNER. Where did the \$9,000,000 come from?

Mr. SMITH. The \$9,000,000 came from investors all around that upper part of New York State.

Senator TAFT. I thought you said it was the bank stock.

Senator WAGNER. The common stock.

Mr. SMITH. Yes; the stockholders and the people who were depositors in the bank.

Senator TAFT. I thought you said it was a parallel distribution of the bank's stock.

Mr. SMITH. It was a parallel distribution of the bank's stock, also to the depositors of the bank. It was broader than that, because I know a case of another company who had a similar record up there. There were a great number of Polish-American citizens involved, and they were threatening the lives of the officers.

Senator WAGNER. What did they get for their security? Common stock or other types of security?