other cases which I have just heard described. Those cases have shown that the opportunity for criminals to loot those companies was made easier because of the present lack of certain control. Those criminals were permitted by law, as it now stands, to put themselves into a position where they could accomplish their unlawful designs. They were able to obtain control of investment companies overnight without the consent of the stockholders of those companies. I favor such legislation as may be necessary to make such a thing impossible, and I am in general accord with the views expressed by Mr. Fulton on this point in his able presentation to this committee.

Next I come to the case of the Founders group which was so well presented to you by Mr. Carl Stern. This was a very complicated picture. I shall not take your time to analyze it in detail, although if the time and my personal ability permitted, much could be gained by separating the wheat from the chaff. Much could be gained if we were to find out just how much was lost and for what reasons. But I think it is sufficient for our purposes to realize that the investors in this enterprise suffered tremendous losses through malpractice of various sorts. In the first place, the promotional methods by which these companies were organized were highly improper. Much of this I am confident could not be repeated today with the controls imposed by the Securities Act of 1933, and the Securities Exchange Act of 1934. The first act would have required full disclosure to the investor, which we were told was not made, and the second act would have prevented manipulative practices in connection with the sale of these securities. If further legislation is needed to prevent a recurrence of such malpractice, I heartily favor it.

Another abuse which contributed not only to the misleading methods of selling securities but also to improper operation was the pyramiding of one company upon another and the complicated relationships and dealings between these companies. I am opposed to pyramiding. But I do not object to one investment company holding securities of another if it stops there and if there is little or no cross-ownership and no circular ownership. Transactions between companies of such systems as may be permitted to exist in future should, if not completely prohibited, be subject to rigid safeguards. Such provisions would eliminate many of the abuses described to you in the Founders picture.

Now, the prize package in the Founders group seemed to be the Buenos Aires subway. It is my understanding that the testimony showed that the loss on this investment amounted to about 50 percent over a period of time, during which I believe most securities declined substantially in value. I have a feeling that probably not much more money was lost here in this venture than might have been lost if a diversified list of securities had been bought in the open market instead. But that is not to say that I condone the subway transaction if it constituted a dumping into the investment company by persons affiliated with the investment company. I favor an absolute prohibition of such transactions. I favor a prohibition on the sale to any investment company of any securities or other property by persons affiliated with such company; and by that I mean officers, directors, managers, or other controlling persons. Conversely, of course, I favor a like prohibition of sales from an investment company to any such persons. This prohibition would take care of such
cases as the German and French electric companies and many other situations described to you as "dumping."

I am sure you will understand that I would mean this to include a prohibition on loans to officers and directors and any other similar method of effecting a bail-out. But I do not think it is necessary to write a law of 100 pages to prevent the recurrence of these abuses.

Now, I have reviewed very briefly the nature of the testimony that has come before you. I do not think it is necessary at this time to go into these questions in any greater detail, but I hope that I have said enough to convince you not only that I am opposed to the practices that have been described but also that I am prepared to support legislation which will go a long way to prevent their repetition.

For the purpose of clarity, I believe that I should formulate those principles which I have in mind, and which I believe to be as adequate as they are necessary. They are six in number, as follows:

1. Prohibitions against self-dealing with affiliated persons.
2. Prohibitions against any substantial change in management or any change in announced investment policy without prior approval of stockholders.
3. Periodic full publicity covering all activities of a company.
4. In connection with banker or broker managed companies, a requirement for a fixed percentage of independent directors on the Board.

Senator Wagner. You say there should be a certain number of independent directors. Have you in mind whether they should represent the majority or minority directors?

Mr. Bunker. Well, Senator, it depends very much on the other features of the bill. If you should take the bill as it is now written and accept every other section of the bill except that one section, I do not think you need any independent directors. But if you were to leave out a great many other sections of the bill you might need to go up 50 percent. I know that many of these things are interrelated.

Senator Wagner. You have not formulated in your mind definitely as to whether they should in all cases be a majority of the directorate, but say that that should depend on consequences? How would you describe it?

Mr. Bunker. I think I would answer it probably in another way. I would say that the purpose of that is to prevent certain things. If I have prevented every other possible thing, if, for example, I have prevented all forms of self-dealings and all forms of bailing out and all forms of other things that have been criticized, and have actually physically stopped all those things, there is not anything that can be done about it. So it depends on what you do. But I would not put layer upon layer.

Senator Wagner. But you think they should have independent directors?

Mr. Bunker. Yes; I think it is essentially desirable.

The fifth principle which I have in mind is the use of approved accounting practices coupled with reports audited by independent accountants.

The sixth is the establishment of a form of tax treatment for all investment companies which will permit them to survive.
I would rather not take the whole tax question up just now. It is well understood by the S. E. C. It is not an invention on my part, and I may say that they are quite sympathetic about it; but it seems to me to be a little out of place here.

Senator Downey. May I intervene with a question?

Senator Wagner. Certainly.

Senator Downey. I do not want to divert you by a long discussion with reference to something that you may cover later, but you have stated that there are six conditions or principles that you believe should govern the new legislation, and that you believe those are sufficient. Could you indicate to me, very briefly, because I am totally unprepared on this situation, to what extent the recommendations of the Commission in the proposed bill go beyond your six provisions? Perhaps you will cover that later on.

Mr. Bunker. As a matter of fact, Senator, I frankly do not, because it is a very complex subject. You understand, with reference to these six principles, that I might give you one answer that would incorporate all kinds of subsidiary matters. There must be registration, and other sections of the bill might be lifted out and put in here, but the present bill gives you the embodiment of these six principles. I did not happen to treat the matter at all here, because we are going to take up the bill by sections, with numerous other principles some of which I will take up later on. I do not think there is a very simple answer to it, Senator. It is a very complex question.

That, in short, is my position with respect to regulation of this industry. On the other hand, while this limits, it does not dispose of the controversy. There is a wide gap between my picture of the industry and that which has been submitted to this committee by the S. E. C. in the past 2 weeks. In judging the matter, it does not seem to me that any solution can be properly arrived at without bringing to light many more extensive and pertinent facts than those which have so far been produced at these hearings. Also it seems to me necessary at this point, in fairness to our industry, to clear up some of the misunderstandings and erroneous impressions which have inadvertently crept into the record of these hearings to date.

In the first place it is a mistake and a very serious mistake to confuse in the slightest degree the conception of investment companies with the conception of savings banks. If a man puts his savings in a savings bank he has money in the bank, money which, subject to minor restrictions, he can withdraw at any time and which he can withdraw in the same amount which he has put in, plus interest, no more and no less. That is his contract.

But if a man invests in the stock of an investment company and particularly if he invests in the common stock of an investment company, he is putting his money at the risk of the market and when he realizes on his investment he will realize the then market value of his investment, which he hopes may be more, but which may very well be less than he has paid in, by the terms of his contract.

If any salesmen of investment company securities have attempted to confuse investment companies with savings banks they have been guilty of gross fraud and they should be dealt with accordingly. If additional legislation is necessary for such purpose let such additional
legislation be passed. But do not allow yourself to be misled, because of fraudulent statements of this nature that have been repeated to you, into the idea that investment companies resemble savings banks. Any inadvertent confusion on this subject on the part of the gentlemen who have preceded me should be erased from your mind.

Again, in referring to the fact that only 650 investment companies now remain out of 1,300 which were created, Judge Healy in his opening statement said:

At present only some 650 or approximately one-half of the investment companies formed in this country are still in existence. The other companies have disappeared through bankruptcy, receivership, dissolution, mergers and consolidations.

The clear implication of this statement to me is that the fate was the same, namely, disastrous, whether the company disappeared on the one hand through bankruptcy or receivership, or on the other through merger or consolidation. Apparently I am not alone in my interpretation of what such a statement conveys. Here is how it seemed to the New York Times on April 3 in reporting this hearing:

Mr. Healy told the subcommittee that in the last 15 years approximately 1,300 investment trust companies had been formed, of whom about half had failed.

It is unfortunate that this impression was conveyed. We all know that many of these 650 companies have consolidated with the larger organizations of other active operating companies.

In the same paragraph of the Commissioner's statement two other remarks have drawn comment in the press. They are:

The American public has contributed over $7,000,000,000 to these organizations. The value of their assets at present is approximately $4,000,000,000.

And then again the statement:

Altogether investors have sustained a capital shrinkage of approximately $3,000,000,000 in all types of investment trusts and investment companies.

Now the meaning of this statement might well be that the $3,000,000,000 figure of losses is a calculated figure representing the difference between the amount of money contributed and the amount of money remaining in the industry. I may be wrong, but my understanding is that these figures are in no way related to each other. As a matter of fact, if the figures are correct with respect to the amount of contributed capital and the amount of remaining assets, that figure given to represent the losses must be completely incorrect and must represent an exaggeration of loss infinitely greater that the true loss which has occurred. The reason for this is best demonstrated by reference to House Document 70, pages 184 and 187, which is the study of the S. E. C., where the following statements appear:

It is, therefore, estimated that the grand total of sales of securities by investment companies of all types from their inception in this country up to the end of 1937 was approximately $7,200,000,000.

During the years 1927 to 1936, investment trusts and investment companies repurchased or redeemed approximately $1,200,000,000 of their own securities, valued on the basis of cost to the trusts and companies. If these repurchases be deducted from the value of sales of investment company issues which represents total moneys contributed by the public to investment companies, then the net public contribution would be approximately $5,300,000,000 during the years 1927 to 1936, and about $6,000,000,000 during the entire existence of these trusts and companies up to the end of 1937.
As the statements indicate, there is of course constantly at work an element of repurchase of securities by companies of their own stock. It is more active in the case of open-end companies, but it operates also in close-end companies. The repurchase of securities by a company is equivalent to the return of capital to stockholders and must be given credit as a deduction from the amount of capital originally contributed by stockholders. It is essential that this credit be given before any losses are calculated. It is my understanding that this has not been done. It is my further understanding that in fact no such sum as this has been lost through shrinkage.

Indeed, this statement of Judge Healy seems to have been particularly confusing. For example, Senator Wagner, in his remarks to the committee on April 8 obviously had understood it to mean that $3,000,000 had not only been lost but that a large part of it had been looted. His understanding was, of course, perfectly logical. However, since it has been necessary for me to familiarize myself with the extensive studies of the S. E. C. and the statistical facts contained therein, I know that such an interpretation does not reflect the true situation, and that any such interpretation is absolutely and completely erroneous. And I am sure that Judge Healy would be the first to agree with me.

Senator Downey. Are you leaving the subject, now, as to the amount of shrinkage which occurred in the assets of the company?

Mr. Bunker. Yes, Senator.

Senator Downey. I want to intervene to ask you this question. I have heard very little of the testimony. Was there any testimony on the part of the Commission showing how much of this remaining shrinkage of two or three billions, whatever it was, had occurred through the general shrinkage in values in the Nation over this decade?

Mr. Bunker. No, Senator; in the testimony to which I have referred there was none. It is perfectly obvious from a study of all of the data that the greater percentage was the same shrinkage in value that occurred in every walk of life over the period 1929 to 1935 or 1937.

Senator Downey. If I may make this comment at this time: As long as it is considered an important issue in this matter, I would like to have some idea in my own mind on this particular phase of the inquiry. If there was a shrinkage of $3,000,000,000, or a looting of that amount, or of a smaller amount, as Mr. Bunker suggests, I would like to have somebody apprise me as to how much of the shrinkage or loss occurred in what you might term legitimate ways; that is, through the general depression of the values of securities and property in America over the period from 1930 to 1936 or 1937. I do not want to interrupt Mr. Bunker for that purpose.

Senator Wagner. There are references in the testimony, as I recall, that part of it was due to shrinkage, or, as you say, was due to maladministration. But I think there should be a definite separation.

Mr. Bunker. Oh, yes.

Senator Wagner. I do not think you could minimize the testimony here which had to do with a large part of the assets of particular companies. I know that in your testimony you deplore the abuses which have occurred. Let us say that the money was lost through maladministration; perhaps looting is too strong a term in some instances. But a great deal of that money was lost, was it not, by particular companies whose experience has been presented here?
Mr. Bunker. Senator, it is the most extraordinarily difficult problem in the world to find out. I have been over it. If you read the case of Company A, involving 400 pages, and then read the case of Company B you will find the whole story told all over again. It may be necessary to do that, but it is difficult to distinguish how much money has been lost because of the failure of honest judgment. For example, because 100 shares of General Motors stock, which was once quoted at $100, and is now quoted at $50, were invested in and you lost 50 percent of your money, it is difficult to tell how much was because of manipulative practices and how much was because of the decline in prices of securities. I do not condone what has been stolen or lost in all these practices.

Senator Taft. I do not see how anybody can determine the figures. I suppose a study could be made showing what money invested in stocks on the New York Stock Exchange at the times at which it was invested, would have produced if let alone. That could be done. I do not see any other basis for guessing.

Senator Downey. I do not think that would quite answer the question, because if the investment was made in 1929 and was then cashed out in 1933 you could not hold the company to the value that might exist in 1937 or 1939.

I am not at all expressing my opinion and I am certainly not attempting to minimize the effect of the case of the Commission. I do not mean that. But I do want to say this, that certainly my attitude upon the question of regimentation and control that might be necessary over these trusts would be very much affected by the answer to this question. Suppose we did start with an investment of $7,000,000,000. If $3,000,000,000 of that amount was lost through improper administration and looting, that is one situation. If $2,000,000,000 or $2,500,000,000 came about through depreciation of values, or maybe there was only a loss of two or three hundred millions, through maladministration, that is a very different situation. I must admit that I would like to have a clearer idea on this. Of course there was a tremendous shrinkage in values, as we all know who were in business life at all.

Senator Wagner. It is appreciated that that is a very important factor. We have heard the instance of Founders and of Continental Securities, and a number of others whose assets were somewhat smaller where there have been definite abuses. Some of those who have been found guilty thereof have gone to jail. But large sums of money have been lost. Many of these instances, or a number of them, occurred during periods after 1929. Founders began with $500,000,000 and ended with $48,000,000. There were practices that I do not think any members of the industry would defend. They resulted in large losses in the experience of that particular company. Five hundred million dollars is a lot of money for small investors to invest and lose. We had a recitation of the practices, which certainly I condemn, and I am sure that everybody else does. Mr. Bunker has condemned it. If we can prevent that sort of thing in the future by any kind of regulation, if we can prevent a practice of that kind from recurring and causing loss to people who have invested their money, I think we ought to do it. That is the position that I am taking.

Senator Downey. I am not in any way condoning mismanagement, but I think I would approach this problem from an entirely different
viewpoint if the losses through mismanagement were only 5 or 10 percent, or they were 25 or 50 or 60 percent. I must admit that I was left somewhat with the idea that it was the contention of the Commission that there had been a loss of several billions through looting and mismanagement. I was left with that impression. If that is not correct—I know that Judge Healy undoubtedly stated only the facts, and if I have made an erroneous interpretation, that is my own fault—I would like to know the facts.

Senator Wagner. I will ask Mr. Bunker this question. Perhaps you can give us an estimate. You listened to the testimony of the experience of Continental Securities Co. How much of that loss, which was almost a complete loss, about $15,000,000, do you say was due to dishonesty or maladministration?

Mr. Bunker. In my opinion, I think that all of the money lost in the Continental chain was lost through malpractice from the date that those fellows first got into control. I think they lost seven or eight million dollars. I know the testimony said $15,000,000, but I happen to think that that is wrong.

Senator Wagner. Supposing it is $7,000,000: That is a lot of money.

Mr. Bunker. Yes. Every cent that was lost by those criminals and embezzlers was lost because of that fact. But in the Founders situation I cannot tell you; but I suppose that not 10 percent of the shrinkage in value was due to any criminal act of embezzlement. My guess would be that it was mismanagement. Five hundred million dollars, if not normally managed, over that same period of time would probably have shrunk to $100,000,000 or $150,000,000.

They have got 400 pages on Founders, and that statement appears and reappears. But it is not because they stole all of that money. They did shocking things and they stole plenty; but there is a tremendous difference between them. I would not be caught defending Founders for anything, Senator.

Senator Wagner. I know that.

Mr. Bunker. So don't misunderstand me.

Senator Wagner. But even on your own estimate it would be about $100,000,000 loss. Let us not minimize that $100,000,000.

Senator Downey. If you show an investment of $7,000,000,000, and then show looting, which occurs even in national banks, involving 1 or 2 percent, and then a general loss of $3,000,000,000 which may occur through the general collapse in the Nation, it is unfair to argue that because in one particular company or 5 or 10 particular companies you have shown losses through embezzling, no claim should be made by which you would be led to the confused belief that your over-all losses occurred through that. I think that ought to be made very clear.

Senator Wagner. I am not interested in whether it was less than $3,000,000,000 or not, as much as I am in this; that if we can, by any kind of regulation, we should prevent the recurring of looting. I think we should do so. Mr. Bunker thinks that probably $100,000,000 of loss in the case of Founders was the result of dishonesty.

Mr. Bunker. I do not know. It is a most difficult proposition.

Senator Wagner. I do not minimize that. That represents investments all over this country. If we can prevent that by regulation of some kind, I am sure that the industry is going to be for that.
Mr. Bunker has practically said so already in his testimony. We should prevent that sort of looting and dishonest practices which deprive people of their hard-earned money. It is our duty to do it.

Senator Taft. But Senator Downey raises the question——

Senator Wagner. Wait a moment. I have not finished. So in the case of the Continental. I cannot minimize these losses which have been the result of absolute looting and dishonesty. Men in that particular case have gone to jail and are there now. Of course we have got to be deliberate about this matter and not pass any kind of regulation which in any way impedes or interferes with the proper operation of the existing trusts that are decently run. I do not think it matters much whether the loss was $1,000,000,000 or $1,500,000,000 or $2,000,000,000. The question is: Can we prevent those things occurring in the future so that people will not lose their investment?

Senator Taft. But there is a logical question as to whether you are going to regulate the trusts by trying to prevent dishonesty, which you can do in a very much simpler method than by anything provided for in this bill, or whether they are really shot through with such complete false bases, resulting in inevitable losses, that we need a bill like this which regulates practically every action of every officer of every investment trust in the United States.

Senator Wagner. That is what the committee will have to decide when we get through with the testimony.

Senator Taft. So I think that Senator Downey's request for information as to whether this is something that really convicts the whole industry, or whether it is confined to isolated cases of dishonesty which can easily be dealt with directly, is a material question. I think we would like to have as much information as we can get.

Senator Wagner. Of course. That is why we are having the hearings. But I think there is a good deal in this proposed legislation of which the industry itself approves. I just cannot in my mind minimize these losses that the public has suffered as a result of this looting, which I think can be prevented by legislation. This may not be the right way. We may have to change provisions of the bill. Of course bills are always not only written but rewritten. I want to approach the subject absolutely impartially and simply to pass such legislation as everyone concedes is needed—some form of regulation—to prevent these abuses in the future. It is our duty as members of this committee to listen carefully to both sides and listen to all the facts, and then we will develop legislation which is needed to prevent these abuses in the future. That is all I am interested in. Whether the amount is two billions or one billion is not so important with me. Of course that is a lot of money.

Senator Downey. I would like, Mr. Chairman, to make myself still clearer. I am one of the very strong admirers of the Securities and Exchange Commission and of their personnel. I think they have done a great work. On the other hand, I am very anxious in this hearing as in all other hearings to see that we have a clear, fair, and equitable understanding of the issues. I cannot agree with you in this respect. If on a $7,000,000,000 investment there was a loss, say, of 5 or 10 percent, say $350,000,000 or $700,000,000, through looting and mismanagement, I cannot agree that our approach to the problem would be the same as if there were a loss of 25 or 50 percent through looting and
mismanagement. Unfortunately, we have certain weaknesses in human nature. Embezzlement occurs; mismanagement occurs; looting occurs; and whether the result of such mismanagement or looting covers 1 percent or 10 percent or 25 percent or 50 percent is, I think, very important in determining the general character of the control that we are willing to place over them. I want the very best law that can be worked out. I am sympathetic to this kind of a law, not antagonistic to it. But I do want to know the facts, whether the losses due to mismanagement and looting covered 5 percent, 10 percent, 25 percent or 50 percent of the investment.

Senator Wagner. There has been some testimony given on that point. There may be additional testimony that members of the committee will want and to which they are entitled and which they will undoubtedly get. I do not want to be misunderstood here. I will say this, that whether it is 10 percent or 5 percent, if the looting can be prevented by regulation which in no way interferes with the legitimate operation of the industry itself, it is our duty to pass such regulation.

Senator Taft. I agree a hundred percent. I think we all agree.

Senator Wagner. That is all I am saying.

Senator Downey. I think you are stating the obvious. But, Mr. Chairman, let me go further. I think it would be grossly unfair to allow information to go out from this committee under which the public would believe that there had been far greater losses than there were, through looting and mismanagement. I say that not only for the sake of fairness, but I would like to see this particular issue clarified.

Senator Wagner. I agree with you there. We are all agreed on that, too.

Senator Herring. May I suggest that we hear the witness a little while, and make our arguments later.

Senator Frazier. I would like to ask the witness if he cares to make an estimate of what percentage of this shrinkage of $3,000,000,000 was because of looting and mismanagement.

Mr. Bunker. If you will take it just as a mental guess, or as one man to another----

Senator Frazier. You are in position to know the situation. You have heard the testimony here and you know a good deal about it. I would like to have your opinion about it.

Mr. Bunker. A maximum of 10 percent. I would go further. I would say that I do not believe, in the last 7 or 8 years, that the total money lost from looting in this business has been 1 percent of the assets of the entire aggregation of capital. That is a guess. I cannot do the statistical work. I have not all the data.

I was just coming to the point of impressions. The presentation of the case against the investment trust industry by the S. E. C. must have left an impression upon you that is necessarily distorted. You have had only one side of the picture, and that has been highlighted by picked examples of outrageous abuse. In fact you are in a position very similar to that of the man to whom a mining prospector comes with interesting specimens from a mine which he says he has just discovered.

Now, as an old mining man I am accustomed to the problem of investigation of mining properties. It is a somewhat different affair from an investigation of this sort. The first rule in such work is to distinguish between specimens and samples. Specimens are those