

Mr. BOLAND. I do not have any accurate figure, Mr. Chairman, on the number of subscribers who have purchased these plans, but I should say that they go well above 100,000.

Senator WAGNER. All right.

Mr. BOLAND. And I am just advised by my associate that that was at the end of 1935, and from my own personal knowledge of the momentum which these companies gathered in 1936, 1937, and 1938, they tripled during those 3 years the sales which had been made prior to 1935, so it would be conservative, with those figures, to say that the subscribers are well above 300,000 at the present time.

Senator WAGNER. Are you going to tell us something about the experience had with those companies or that situation now?

Mr. BOLAND. I should like to, Mr. Chairman. Would you care to have me do that now?

Senator WAGNER. No; you go ahead in your own way. I am just curious about it. I really want you to go on in your own way.

Mr. BOLAND. Please interrupt me if I do not make myself clear.

It became more and more clear to us, while we were investigating these companies, and it was my pleasure to assist in the investigation, that high-pressure suggestions and misrepresentations were established. Every day salesmen were given bulletins which were designed to dynamite sales resistance.

With your permission, I should like to read excerpts from a few of them, to illustrate the manner in which the salesmen were instructed to sell these plans. This bulletin is entitled, "The Child Appeal." It reads:

An analysis of the business on our books today indicates that the most effective single appeal used in obtaining that business was the welfare of children, and since it has been clearly demonstrated that this emotional appeal actually produces contracts, it would be well to ask yourself whether or not you are making full use of it on your prospects. One argument along this line runs as follows: What your children's opportunity is to be, what your children are to be, are questions in the background of every parent's mind. You obviously cannot read the answers in the future, and while you cannot save them from many of the trials of life, you would, I am sure, like to provide them with a good opportunity.

Then, in appendix D of the investment trust study report, in the back of this report, you will find another bulletin captioned, "On Selling Women."

Reading the first paragraph:

From the cradle to the grave you have sold, and will continue to sell, women. Man, by his very nature, is continually asking of and receiving from women. Unconsciously each of us builds for himself his own especial technique in dealing with the opposite sex. It is with this thought in mind that this memorandum is prepared. I am suggesting that we can each consciously improve that technique, each in our own way, and increase our sales potential through a more intensive drive for women clients.

Skipping down to the paragraph at the bottom of the page:

Volumes have been written, and additional volumes could be written, on feminine psychology. I offer here, but a few pointers and suggestions which may be helpful. Women are definitely harder to "get to" than the average businessman. The average businessman type of client cannot always devote enough time and attention for a clear explanation of the advantages of Independence Fund for Him. Women, on the other hand, particularly women at home, are definitely harder to see, but once seen they can devote the time and attention that your presentation warrants,

and so on and so forth.

Senator WAGNER. Were there any qualifications of the salesman, as to what type he was to be physically and otherwise?

Mr. BOLAND. I suppose that entered into it. I should like to read the last paragraph of that sales bulletin, with your permission:

While you will encounter procrastination, the desire to consult the family or the friend of the family, the banker or lawyer, it is often possible to speed the closing by the use of direct, firm, quiet pressure. Leaving no question unanswered, but bringing a client again and again to the closing point will definitely accomplish your purpose. There is more truth than poetry in the saying that "A woman's no, means maybe; and a woman's maybe, means yes."

Senator WAGNER. Was what you are reading distributed among the salesmen as part of their instructions?

Mr. BOLAND. That was just a sales bulletin which the salesmen received every day from their sponsor companies, giving them ideas as to how to high pressure clients or prospects.

Going back to the service charges, it was amazing to discover in our investigation that the most commonly used misrepresentation was the statement that a subscriber could get back all of his money at any time.

This misrepresentation was generally supplemented by the further statement that the plan operated like a savings bank account, in which the deposits were 100 percent liquid at all times.

These misrepresentations were viciously misleading inasmuch as the salesman never disclosed the service charge of the top trust company or the sales loads of the bottom trust or the trustee's fees in between, and never disclosed the more important fact that the top trust service charge came out of the first 10 or 12 payments.

I have here one or two letters which indicate the surprise of the average investor upon first learning of these service charges.

With your permission, I should like to read one or two of them into the record.

This is a letter addressed to the Securities and Exchange Commission, dated June 21, 1938:

GENTLEMEN: On February 17, 1937, I purchased five units of Capital Savings, Inc., stock—

giving you an indication that the investor does not understand the transaction—

I returned the certificate to them for refund and they mailed me the enclosed two checks as the full refund due me. It is unbelievable to me that I am compelled to take a loss of this kind legitimately. I paid him an initial payment of \$150 and was promised the return of my money at any time I wanted it. I have been unable to get any satisfaction from the said company, and I, therefore, feel that I should put this matter in your hands to see that justice is done me.

He received back \$25.

Senator WAGNER. Out of the \$150?

Mr. BOLAND. That is right.

The next letter is dated September 6, 1939—

Senator WAGNER (interposing). Well, did he hold an interest after the \$25 was returned?

Mr. BOLAND. He apparently decided to withdraw from the plan after he had put in \$150.

Senator WAGNER. Yes. Continue your explanation.

Mr. BOLAND. That was one of the features of this plan which very often misled salesmen, because in the sales literature it was indicated that the subscriber could withdraw from the plan at any time. He

could withdraw, but all he could get back was the value of the underlying shares in his account, which amounted to virtually nothing during the first 7 or 8 months.

Senator WAGNER. Was the obligation of this trust discharged by the payment of the \$25? Was that the result of the transaction?

Mr. BOLAND. Yes.

Senator WAGNER. In other words, he lost \$125?

Mr. BOLAND. That is right, sir.

Senator WAGNER. I see.

Mr. BOLAND. I have here another letter, dated September 6, 1939, addressed to the Commission:

Would you have time to investigate an outfit that thrives not on gamblers' money but on the savings of ignorant yokels like me who desire to save for the rainy days? I gave these people \$150 February 26, 1938, under a plan to invest \$75 quarterly. I grew suspicious and put no more money in. A while ago I tried to cash in the certificate and was referred to the wording of the contract, according to which I would have to put in \$300 before any adjustment could be considered.

Yesterday I received the enclosed, which you will note is a form letter, indicating that others than I are being lawfully robbed of their first payments when unable to continue, as a matter of simple routine.

In this case the author of this letter received back about the same as the person who wrote the last letter I read.

Senator WAGNER. Is that what Mr. Mathews referred to as the only way you could make this sort of enterprise pay—by the lapses?

Mr. BOLAND. Well, there is a difference in the periodic payment-plan certificates, Mr. Chairman. The sponsor companies for the groups running these things really do not realize any profit by the lapse of these certificates, inasmuch as the companies are not obligated to pay anything to the subscriber. It is only in the face-amount certificates that the sponsor company profits by the lapse or default in payments.

Another very common device which the companies used in the distribution of their certificates was the use of a table which reflected hypothetical projections of their plans over various 10-year periods in the past. These tables were designed to demonstrate that if the plans had been in existence for the past 25 years, then the average \$10-per-month plan would have been worth over \$2,000 at the end of 10 years.

In spite of the inadequacy of these tables and further in spite of the unpredictability of common stocks, or the future prices of common stocks, these tables were used to demonstrate to subscribers that every \$10 monthly plan was almost guaranteed to be worth \$2,000 at the end of 10 years. In fact, most of the companies have in the past printed these hypothetical values conspicuously on the back of their certificates. They call them maturity values.

I have here a typical sales talk given by one of the companies to its salesmen, which portrays the manner in which these maturity values were used in the distribution of the certificates:

Now there are two ways to set up an account: One is by a lump sum deposit. (Write these figures out, down below the bank picture you have drawn.) From \$500 to \$500,000 or more. The other way and the most common is the monthly deposit plan from \$10 to \$10,000 or more. It works this way—you start paying, let us say \$10 a month and every month. In no event do you deposit more than \$1,200, i. e., 120 months at \$10. Now there is a definite maturity value and you cease deposits. The bank will send you a check at once. The records show that going back for 25 years or more, that it has only taken an average of 9 years and 1 month for an account to mature. For the past 15 years

approximately 8 years. Please bear in mind, Mr. Prospect, that this is your opportunity and this is your money. If you miss a deposit, there is no penalty or forfeiture. You have complete control of your trust funds at all times. The plan works this way:

\$10 per month account mature at.....	\$2,000
\$15 per month account mature at.....	3,000
\$20 per month account mature at.....	4,000
and so on.	

To illustrate the misleading effect of these maturity values, I should like to read a letter which we found in the files of one of the companies sent in by a salesman, which indicates that even the salesmen were misled by it. It is a letter dated October 1, 1937, addressed to the Pennsylvania Co. [reading]:

I am the local agent for the F. I. F., and I understand you are the trustee. Recently I sold a contract to one D. R. Benson of Sparta with a \$2,000 maturity value.

He wrote your office asking if the \$2,000 maturity value meant \$2,000 in cash, and the answer came back, "There is no guarantee as to the values of these accounts at any time, by any one."

Just what does this mean? This is a quotation from a letter written by R. M. Brandriff, September 27, 1937.

If this doesn't mean \$2,000 in cash at maturity why is the dollar sign used?

The application states that the trustee will guarantee maturity of the contract, if the founder makes regular payments. What does that clause mean?

Here is a salesman who was authorized to go out and sell these things to truck drivers and people of that caliber.

Another artifice which was commonly employed by salesmen was that of harping on the financial resources of the trustees.

The trustee generally—invariably, I might say—would be a large financial institution, and they would show a prospect the most recent balance sheet of these banks and then would tell the subscriber that the trustee was back of and sponsored the plan. In this way the subscribers got the idea that these large financial institutions actually guaranteed the successful operation of the plan and actually guaranteed the so-called maturity value, whereas, in fact, the trustee is responsible in no way for the operation of the plan, and is not responsible at all except in case of gross negligence and willful misconduct.

In passing, I might say that I hesitate to think of the headaches that these banks are going to suffer in the next few years when people start trucking in by the hundreds demanding their maturity values.

During our investigation the most vicious practice we discovered was that of reloading prospects with additional plans. A very clear illustration of this is shown by an affidavit which we took from a minister in Massachusetts. It seems that the salesman of this plan ingratiated himself into the confidence of the minister by holding himself out as a prospective convert into the minister's faith. After gaining the minister's confidence he induced him to take out a plan calling for \$85 a month, on the clear misrepresentation that the minister could get his money back at any time.

After the minister had paid in \$2,000 there was a 7½ percent service charge taken out, 7½ percent amounting to \$765 on this \$85 monthly plan. After the minister had put in the \$2,000 the salesman called on him again and told him that he would be much better off if he canceled his original contract and took out a new one calling for \$200 a month.

Senator WAGNER. Calling for \$200 a month at some later period?

Mr. BOLAND. No; starting as of that date with \$200 a month.

Senator WAGNER. He was to get that income?

Mr. BOLAND. No; he was to pay that in under his new contract. He had been paying \$85 a month and now under this new contract he would be required to pay \$200 a month.

Senator WAGNER. What was the contract? He was to pay \$200 a month and what was he to get?

Mr. BOLAND. He was to pay \$200 a month for a period of 10 years, and the consideration by the sponsor company and the other parties to the contract consisted of (a) the trustee would invest these payments in trust shares for the subscriber's account. The consideration given by the sponsor company was that at the end of 10 years if the subscriber cared to withdraw, the sponsor company would see that the subscriber got back only the value of the underlying shares. It is difficult to point out precisely what consideration is given by the other parties to the contract to the subscriber.

Senator WAGNER. What were the representations? The minister must have had something in prospect to make these payments every month. What did he look forward to?

Mr. BOLAND. Oh, he looked forward, if you please, to the so-called "maturity values."

Senator WAGNER. Were there any prognostications made as to what they might amount to?

Mr. BOLAND. Oh, invariably, the subscriber was told that if he would pay in \$10 a month he would get back \$2,000. If he put in \$100 he would get back \$20,000. If he put in \$200 a month he would get back \$400,000 at the end of 10 years.

Senator WAGNER. \$400,000?

Mr. BOLAND. Forty thousand; I beg your pardon.

Senator WAGNER. How much of a return was that? I cannot figure that out.

Mr. BOLAND. It amounts, Mr. Chairman, to about 11 or 12 percent a year return.

Well, at any rate, when he subscribed to this \$200-a-month contract he told the salesman that it would be impossible for him to make the \$200 monthly payments, and the salesman assured him that it would not be necessary to make these payments every month. So he signed, thereby subjecting himself to another service charge of \$1,800 on the new contract.

Therefore, adding the \$1,800 service charge of the new contract to the \$765, which was the service charge deducted under the old contract, we find now, after paying in \$2,000, the minister actually owed the company \$565.

Of course, he could withdraw at any time, and he was not bound to make this payment of \$565, but if he continued to make his monthly payments of \$200 under the contract, the sponsor company or trustee would deduct the \$565 from those subsequent payments.

Senator WAGNER. What happened in that case?

Mr. BOLAND. My recollection is that after the Commission instituted proceedings to enjoin this company they apparently discovered that we had obtained this affidavit from him, so they made full restitution to him.

In summary, our investigation revealed that the gospel of this industry from 1930 to 1938 was just sell, sell, sell. Salesmen were given titles and overriding commissions for getting more salesmen in, and branch offices advertised widely in newspapers for more and more salesmen. One company, just operating in Pennsylvania alone, during the 5 years of its existence hired more than 1,200 salesmen, with a turn-over of more than 100 percent. We do not know the actual number of salesmen who had been employed in this industry, but it is conservative, in my opinion, to say that they amount to tens of thousands.

It was a very favorite pastime for salesmen to split their commissions with policemen, foremen on the jobs, employers, and even ministers, for aiding them in breaking down sales resistance. With deference to the ministers, the industry referred to these people as "bird dogs," because they brushed out the prospects for the salesmen, and then the salesmen would be present at the kill.

Many of the misrepresentations which were used in the selling of these plans were due to the pseudo salesmen, principally because the part-time salesman had a complete misunderstanding of the periodic payment plan, and the same thing can be said about a number of full-time salesmen, as indicated by the letter which I read a few minutes ago.

At the completion of our investigation we presented all of these facts to the Commission. The Commission recognized at once the need for immediate action. They also recognized that the problem involved one much deeper than just ordinary sales practices, so they invited representatives of the companies investigated to Washington to attend a conference on April 15, 1938, for the purpose of discussing ways and means of correcting the abuses.

Every one at this conference agreed that the substantial and extensive charges under the plans and the indigent subscribers were the heart of the problem. They all admitted that if these charges were reduced and spread over a greater period of years there would be less incentive on the part of the salesmen to conceal them from subscribers. The conference concluded with the understanding that all of the companies represented at the conference would take immediate steps to prevent the recurrence of the abuses and would forthwith submit plans of readjustment to the Commission, reducing the sales load, spreading the service charge, and so forth.

Within the next 3 months all of these plan companies submitted readjustment programs. Not one of them went far enough; as a matter of fact, most of them merely changed the load from the top company down to the bottom company, or vice versa, and there was really no material change in the service charges except as a matter of form.

Thereupon the Commission decided to make a spot check of the sales practices in which these companies had indulged during the interim period. The investigation showed that the same old abuses, the same old misrepresentations, continued just as flagrantly as before the conference, so that the Commission was left with no alternative but to institute proceedings to enjoin all of these companies which had been investigated.

Up to January 8 of this year the Commission had enjoined eight of the larger companies in the East, and there is a proceeding against the ninth company on the west coast, against Time Trust, Inc.

At this point I would like to read the names of these companies to you, just to show that even the names had misleading effect.

Senator WAGNER. Are these the companies that had been enjoined?

Mr. BOLAND. Yes. Benjamin Franklin Foundation; Wellington Foundation; Capital Savings Plan; Lexington Foundation; United Endowment Foundation; Income Estates of America; Financial Independence Founders.

There are still over 30 periodic-payment-plan companies which are operating which are not subject to these legal restraints.

I would also like to point out that these injunctions do not put these defendant companies out of business; they merely prevent them from further violating the fraud provisions of the Securities Act.

In other words, they enjoin them from doing something which is already unlawful.

In the light of that fact, together with the additional facts of our experience during the months of April, May, and June of 1938, it would be folly to depend on these injunctions alone as the real corrective methods.

Senator WAGNER. Can you approximate the amount of money that has been received by these companies as a result of their sales of this type of securities?

Mr. BOLAND. Net profits, you mean?

Senator WAGNER. No; the amount of money that was paid into these different companies that you mentioned as a result of sales of their securities, whether they were shares, certificates, or what not.

Mr. BOLAND. By the end of 1937 all of the subscribers had paid in approximately \$55,000,000 in all of the plans. In these particular plans which have been enjoined I should say the amount of money invested would approximate \$20,000,000. They are really the larger companies operating out of the East.

So that in conclusion, Mr. Chairman, since the powers of the Commission under the statutes now being administered by it merely provide a penalty after the subscriber is defrauded, and since our experience shows that even that penalty is not sufficient to prevent the fraud that has been perpetrated in the distribution of these plans, what the industry really needs is a prophylactic such as this bill provides, to remove the practices by which that fraud in the past has been impelled.

Mr. Chairman, I am just advised by the Director of the Registration Division that a number of these companies have recently filed revised plans, which more or less incorporate the suggestions which were made at our conference with the industry in April 1938. I understand that in these revised plans they have reduced their total loads down to 10 percent, which is a substantial reduction from 25 percent, which had previously been the case.

Senator WAGNER. May I ask a question on that point? You say they filed these revised plans. Suppose they disobey them or modify them themselves, without further notice to the Commission. Suppose they make the load 14 or 15 percent. What can you do about it?

Mr. Boland. We cannot do a thing about it. They can file a revised plan with us again making it 25 percent. If they made a full disclosure we can do nothing.

Mr. HEALY. I think that is true. At the same time I think it is fair to give that branch of the industry credit for voluntarily doing what they could in the direction of changing that. I think the recital of these things happening in the past and the fact that we had to resort to injunctions, which I think has a distinct bearing on the necessity of regulation, I do not think ought to obscure the fact that in these conferences with the industry they have tried to cooperate and achieve some improvement in their practices.

Senator WAGNER. Yes. I asked the question not to intimate that any of those companies changed their plans, but to find out what the state of the law is. That is what I had in mind.

Thank you, Mr. Boland. I believe Mr. Bane is next.

Mr. SCHENKER. Do you mind taking me now instead of Mr. Bane?

Senator WAGNER. You have your choice as to the order of the appearance of witnesses.

**FURTHER STATEMENT OF DAVID SCHENKER, CHIEF COUNSEL,  
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Mr. SCHENKER. If I may say just one word on the installment plans, and we will discuss those a little more in detail when we come to that portion of the bill which relates to that type of investment company, their problem in some respects is not unlike the problem of other investment companies which have to continuously sell their securities, and one of the fundamental problems that this bill deals with is the whole problem of distribution of investment company securities.

To my mind one of the fundamental problems in the investment company industry as constituted today is just this—the closed-end company is the type of company which raised its money in one offering, say \$100,000,000, and then did not sell any more. If you wanted to get out of that company, you had to sell your security in the open market—as contra-distinguished from the open-end company, which raised its capital by continual sales—because the certificate holder could come in at any time and tender his certificate and receive not the amount of money he paid in, but the asset value of the certificate, which, in the last analysis, depends on the market value of the portfolio securities.

Now, we will elaborate upon that as we go along with the specific provisions, but the point I want to make is that one of the fundamental problems, in my opinion, which confronts this industry, is—Is the investment company going to be something that is devoted primarily and exclusively to the management of other people's money, or is it going to become a subservient or secondary function of the company and the primary emphasis be placed on the distribution of the securities? You have that conflict as you go along: Is this business going to depend upon the amount of money you can get from the distribution of the securities and is the emphasis going to be placed upon that, or is this industry going to be an industry where the small investor is going to turn his money over to it and say, "You invest it," and the people who sponsor it get the management fees? We are going to indicate the safeguards we think are needed to place the emphasis upon the investment management rather than upon distribution.

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