shall receive such compensation as may be fixed by the commission with the approval of the governor and council. During the absence or disability of said director, his duties may be performed by the commission. The commission may likewise appoint and provide such employees as may, from time to time, be necessary to the proper administration of this chapter. Any interested person aggrieved at any official act of the director of the securities division shall be entitled to a hearing as provided in section seven hereof.

Senator WAGNER. We will next hear from Mr. Richard Wagner.

STATEMENT OF RICHARD WAGNER, PRESIDENT, THE CHICAGO CORPORATION, CHICAGO, ILL.

Mr. WAGNER. Mr. Chairman and Senators, I am president of The Chicago Corporation, a closed-end management type company conforming to the characteristics which the Commission has termed a "securities finance company." The net assets of The Chicago Corporation at this time are approximately $32,000,000. I have never been connected with an investment banking concern. I have had no part in the actual forming of the corporation or of those two companies which were later merged with it. My training was in commercial banking, from 1910 until late 1930, when I became an officer of the corporation, about a year and a half after its formation. In 1938 I was elected president. I would like to tell you a little about our activities because I think they have a bearing on the bill under consideration here.

At the time of the formation of the company the following description of its business appeared in the offering prospectus, a photostatic copy of which I would like to hand you, which contains some rather interesting phraseology [reading]:

> The Chicago Corporation has been organized under the laws of Delaware to buy, sell, and trade in stocks and securities of any kind, to participate in underwritings and syndicates, and to engage in such other investment activity as its board of directors may determine. The Chicago Corporation is not a so-called "investment trust", but is a financial corporation designed to supplement the existing facilities of the Middle West.

That is rather a broad statement. [Continuing reading:]

> There are no restrictions on the investment authority of the directorate within the broad provisions of the certificates of incorporation.

You will observe the specific statement that the company is not an investment trust. You will note likewise that no one could possibly confuse the securities offered with a plan for savings. Frankly, we feel that the emphasis in these hearings, that these investment companies partake of the nature of savings banks, is particularly unfortunate as that emphasis might apply to closed and management companies. To what extent the offering prospectuses of other management companies contained similar statements, I cannot say definitely, but such as I recall were not greatly different.

As to whether people who bought these securities fully understood the purposes of these companies, I have only to recall to you the hectic conditions which prevailed at that time; that is, in the late twenties.

I have a very vivid recollection, and I am sure that you have, of the speculative fever which existed in the late twenties. Every issue was "snapped up" as soon as it was offered. To save money? Certainly not. It was the desire to make a quick profit. Few persons

escaped the contagion. Large pools of capital were hastily thrown together, and it was under these conditions that many management companies were born. But to maintain that they were generally represented as plans for savings is not in accordance with the facts.

As an illustration, one of these companies which was later merged with our company, started out with $60,000,000. Within a day after the announcement of its formation there was over a billion dollars of subscriptions entered for the stock by people who wanted to buy it.

It may be inappropriate to compare the experience of those who purchased securities of investment companies in the late twenties with the experience of savings depositors, though some of the latter lost money, too. But to supplement what Mr. Bunker has told you happened to the value of securities of management investment companies issued in 1929 compared with other securities issued and listed at that time on the New York Stock Exchange, which were issued during that period, it would, I think, be fair also to compare the experience of the public stockholders in investment companies with the results they would have had through purchasing bank stocks in that same period.

It is an interesting fact that the persons who bought the original public offering of the securities of the company I represent and retained them have fared better by a good deal than they would had they purchased any of the publicly traded bank stocks at the same time. This, according to Mr. Bunker's study, I believe would be true of most of the management companies which have survived.

To illustrate this point, the public offering of the original Chicago Corporation was of units consisting of one share of preferred and one share of common stock at a price of $66 per unit. The original offering of Continental Chicago Corporation which was later merged with the Chicago Corporation was an offering of units of one preferred and one common share at $68.50 per unit, and the third company which was merged with the Chicago Corporation, known as Chicago Investors, was of a preferred stock only at a price of $50 per share. Apart from these public offerings additional funds were provided through common-stock subscriptions by persons or institutions closely identified with the directors and management. For instance, the Continental Chicago Corporation was organized by the securities affiliate of the Continental Illinois Bank of Chicago. That company purchased $15,000,000 of common stock in the Continental Chicago Corporation which was later distributed to the stockholders of the bank when securities affiliates of banks were liquidated under the 1933 Bank Act.

Total asset coverage for preferred stock of The Chicago Corporation at the outset in 1929 amounted to approximately $79 per share for each preferred share issued. Of course this asset value dropped greatly in the early thirties but by the end of 1936 there was again coverage for each preferred share of approximately $79.25.

These preferred stocks were entitled to $3 cumulative dividends and by the end of 1936 approximately $22 per share had been paid in dividends. During that year we find that one share of preferred in 1936 and one share of common combined sold for as high as $60.50, which was a close approximation of the original offering price. Today the market equivalence of the original units sold in 1929 is approximately $38.50 per unit, which is approximately 60 percent of the original offering price. So, taking the original offering price of the

units, it will be observed that the market today represents approximately 60 percent in the case of The Chicago Corporation of the original offering price, approximately 56 percent in the case of the Continental Chicago Corporation, and approximately 74 percent in the case of Chicago Investors Preferred.

Comparing this with what happened to stocks of leading Chicago banks we find that the present market price is from 19 to 26 percent of the prices attained in September 1929, and if we look at some of the New York banks we find that the percentage is somewhat less.

This statement is in nowise intended as a reflection upon these banks. This, I think, is indicated by the fact that we have very substantial holdings of bank stocks at this time.

It is interesting also to note that had the same money been invested in real estate mortgage bonds in the late 1920's, the investor would have fared even worse than had he purchased bank stocks, and in real estate mortgage bonds he thought he was not speculating. He thought he was buying a sound investment for an interest return only. A compilation which I have here shows that a large number of publicly quoted real estate mortgage securities issued in 1928 and 1929, and even in 1930, are today selling at from 5 percent to 25 percent of their original cost to the investor. Considering these facts I think it is only fair to recognize that purchases of stocks at offering prices in investment companies of the general management type have not caused investors losses comparable with those suffered in securities presumed to be of much less speculative nature, in all instances, certainly; and please bear in mind, gentlemen, that the market quotations for most management type company stocks are at a considerable discount from their true asset values today.

May I now refer again to the description of the business of the company which I read to you. In the hearings on April 9 Mr. Schenker referred to our company in the following terms [reading]:

> Recently the Chicago corporation has started to change the fundamental nature of its business and is attempting to serve a very useful function—

Thank you, Mr. Schenker—

> in making capital available to small industries. But in those circumstances, because the securities they get are not liquid and have no market, they necessarily have to take a controlling position to protect their investment.

Then, Mr. Chairman, you stated [reading]:

> I do not see any objection to that method of changing their activities; but should not the stockholders know about that, who originally put their money in under certain definite assurances?

The point I wish to make is that we have not changed our fundamental policy. I again refer you to the original offering prospectus.

We told them in the beginning what we were going to do, what we were trying to do, and what we had actually accomplished. I want to make the point clear that we did not change our fundamental policy by that proceeding. I think Mr. Schenker will agree with that.

We have endeavored to find employment for a portion of our funds in what we call "intermediate financing," for want of a better term. By this I mean such activities as the seasoning of securities prior to public offering, extension of working capital to companies unable to obtain it from regular banking channels, supplying senior capital for new enterprises and for reorganizations, participating in under-

writings, and in occasional instances arranging orderly liquidations.

I think you will agree with me that such activities perform a useful economic function, but there seems to be a general impression that they constitute an extremely hazardous business. Our experience does not justify that assumption.

At this time approximately 30 percent of our total funds is employed in investments of this character.

When I use 30 percent—because Mr. Schenker might question that a little later—I want to include there some of those investments that have since become market securities. Of course we undertake them for profit, but we believe they do contribute to the general economic good.

For example, at the depth of the depression when there was over $1,000,000,000 in real-estate bonds in default in the city of Chicago alone and no vehicle to finance reorganizations, we participated in the formation of a real-estate mortgage company, known as the Fort Dearborn Mortgage Co., to make reorganization loans and discount the paper with the R. F. C. We acquired full control of that company in 1933.

In his statement to the House Committee on Banking and Currency in asking for extention of the R. F. C. powers in 1935 Mr. Justice Reed, who was then counsel for the R. F. C. stated [reading]:

> I think that the Fort Dearborn Mortgage Co. has done a great deal of good. I know of no reason why I should not say, so far as I know, the Fort Dearborn Mortgage Co. has done a more useful piece of work than almost any other mortgage company I know of and, so far as I know, they have handled it in a very economic and satisfactory manner.

The total amount of loans made through the Fort Dearborn Mortgage Co. was $9,779,000 against total original bonds issued for the properties involved of over $100,000,000. The activities of the Fort Dearborn Mortgage Co. encouraged the return of institutional lenders to the Chicago real-estate mortgage field, and by late 1935 it again became possible to obtain real-estate loans at reasonable rates from them. The R. F. C. was fully repaid and the company then turned to the real-estate field itself, purchasing and liquidating 300 small homes pledged under a bond issue and also to some extent engaging in the building and sale of residences.

In another instance Chicago Corporation supplied the capital necessary for the reorganization of a food company which was in receivership. Obviously we did so for the purpose of making a profit, but as a consequence of our action over 1,000 jobs were kept secure.

In another instance we supplied capital to a new company which constructed two plants for the extraction of distillate from natural gas which I am told provided over 400,000 man-hours of employment, and has resulted in a new technique in the production of a natural resource.

We underwrote a common stock offering to the stockholders of a moderate size steel company which could not sell its securities publicly. In another instance we supplied the major part of the capital to build and operate a sugar refinery. I could go on with a number of illustrations, but these should suffice to give you the nature of these activities. Our experience in them has been, on the average, highly satisfactory.

Obviously, we must use care in the selection of risks just as a bank does. The risks are in varying degrees greater than the extension of ordinary bank credit, but we do have a cushion which banks do not have. A bank makes an intermediate loan for interest return only. We require a participation in the equity of the business as additional compensation and we may require the right to control until a substantial portion of our advances have been repaid. Control for no other purpose than to protect our investment. We do not wish to manage anything we do not need to. Our original premise is that we will make no investment unless we are satisfied that sound management is present or is available to the enterprise under consideration. But of course we can be wrong about management and we want the right to change it if the enterprise we have invested in is not being operated properly. Our purpose is to dispose ultimately of successful undertakings. We feel that these activities make us merchants in capital and we are interested in the turn-over of our merchandise.

I have gone into some detail concerning our activities because I believe, as I have stated before, that they offer an opportunity for profit while performing an economic service and I would personally deplore any action here which would discourage the participation in that field by other investment companies. I think you will agree that in recent years concentration of capital in the hands of private individuals available for risk purposes has diminished, whether through the working of the tax laws or through the creation of trust accounts limited to fiduciary investments. While it may be true that not many investment companies have engaged in activities of the kind I have described, the fact is that more of them are becoming interested. We have occasionally invited other investment companies to join us in these undertakings and I am glad to say that they have in several instances.

As a matter of fact, a number of them have done quite a few of the same type of things that we have done.

I feel strongly that nothing should be done to handicap and restrict the flow of capital for these purposes. During the past several years we, ourselves, have expanded very slowly in this direction, partially because we did not have any clear idea about what kind of legislation the Securities Commission would propose to regulate investment companies.

There are instances in the bill before you which would, I think, restrict us and we are disturbed about the broad regulatory powers proposed for the Commission. We would like to know what the rules are going to be, because the type of investments we wish to undertake include those which require up to 5 years' time to mature.

For this reason, we believe that any Federal legislation should be simple and specific, and the broad discretion now proposed limited to reasonably necessary administrative discretion. I am mindful of Judge Healy's statement, and I have a very high respect for Judge Healy, that the broad powers proposed are desired in the interest of the investment companies themselves, but I am also mindful that the language employed leaves the character of the regulations and the effect of the act wholly uncertain at the outset—being wholly in the hands of the Securities and Exchange Commission.

I do not plan to discuss the various sections of the bill because that has been ably done by a number of witnesses who appeared before you. In general, I concur with Mr. Bunker and Mr. Quinn regarding specific sections, but I do wish to comment upon the departures in this bill from generally accepted ideas as to the sphere of Government regulation.

For example, is it not a new approach and does it not savor of ultimate Government control of business generally, when we begin prohibiting the borrowing of money by a business, when we seek to limit capital structures in the future to common stock, when we set minimum and maximum sizes which business may attain, and when we prohibit loans to natural persons who are in no wise connected with investment companies? Provisions denying redress to the courts without the permission of a bureau, to the denial of the right to purchase securities issued except by permission, to the registration requirements for individuals and to the already much-talked-of provisions of section 10 (e) applying to directors.

I just want to say this, that if this bill becomes law I would lose every director I have on our board, unless they were willing to give up substantial positions as directors in other companies or unless we were willing to sell a very substantial part of our general investments with respect to which we are best informed.

In our company, as a matter of policy, we have believed it unwise to borrow money, but we do not believe that it is a matter for law. We think that it is a matter of management policy and judgment, with respect to which stockholders should, of course, be informed.

On the question of borrowing money, I discussed this with Mr. Schenker and he told me very frankly that it was not intended to make that application to subsidiaries. On the other hand, I look at section 36, and from its language I wonder, because in the case of the Fort Dearborn Mortgage Co., we take into consideration doing a job with respect to unpaid taxes on properties in Chicago, and we have arranged a loan of $4,000,000. We have an investment in the company. If that does not apply to subsidiaries, we still have a prohibition against borrowing. Don't you see the loophole there? I do not believe it should be in the law.

Senator DOWNEY. May I interrupt you just a moment?

Mr. WAGNER. Yes, sir.

Senator DOWNEY. Does it strike you, or does it not, that investment and borrowing are rather inconsistent?

Mr. WAGNER. That depends upon the circumstances, Senator. We make an investment in the Fort Dearborn Mortgage Co., which has a specific business, that company being a real-estate mortgage company. I might say that at no time has our capital been in jeopardy. It operates against specific documents or instruments for a specific purpose, such as liberating, if you please, great amounts of bond issues that were present at that time. The collateral is specific. We do not borrow directly from The Chicago Corporation, but we may borrow through subsidiaries. It may be a sugar refinery.

In another instance, in the case of the little distillate company that I mentioned, we put up a certain amount of intermediate capital, and those companies can borrow from suppliers for the purpose of completing construction.

We may believe that ultimately the soundest structure of capital may be common stock for our particular business, but again we feel that this is not a matter for law but a matter for the stockholders.

In the course of the activities which I have outlined to you we may prefer to make a secured advance to a natural person to obtain an additional margin of safety, which you, Mr. Chairman, pointed out yourself in the testimony of a few days ago.

Concerning size, it is easy to agree that the maximum size proposed in the bill seems ample; but who knows? What would our economy be today if we had years ago set limits on the size business might attain? We are, furthermore, witnessing wide fluctuations in the values of world currencies. What will a specific dollar limitation mean a few years hence? I do not know, and I do not think anyone else does.

As to a provision for examinations by the S. E. C., that is, regular examinations such as the banks undergo, I see no need for it if regular audits by independent public accountants are required. The very nature of these companies require staffs that are relatively small in the interest of keeping expenses down to reasonable proportions. With regular auditors and revenue agents and the necessity of submitting voluminous data to the S. E. C. already required, we do need some time for the conduct of our regular business.

In conclusion, let me urge that the bill under consideration be modified so that it is specific, insofar as possible. The provisions outlined to you by Mr. Bunker seem to me to establish a good framework. If changes appear warranted after reasonable trial and experience, let such changes come through amendments carefully considered by this committee.

I sincerely hope that if, and when, a law is enacted, we can proceed with our plans for participating in constructive enterprises without undue restriction and without spending most of our time worrying about what the rules will be tomorrow.

We have at all times cooperated with the S. E. C. in its study and will be pleased to do so in any way possible in connection with this legislation.

That concludes what I have to say, Senator.

Senator WAGNER. Thank you very much, Mr. Wagner. Are there any questions?

Senator HERRING. No: I have none.

Senator WAGNER. Before we take a recess until 2:30 I would like to read, on this question of load, testimony by Mr. Schenker who referred to the loads charged. He referred to one company that received as high as a 20-percent load, and I asked him a question with reference to it, and he said [reading]:

> In other words, suppose the price of the certificate is $100 and they put a 20 percent load on it: That is $120 that you pay, but only $100 of your money is invested. Under those circumstances the management has got to make $20 on $100 before you are even.

That appears on page 290 of the printed testimony.

STATEMENT OF T. COLEMAN ANDREWS, MEMBER OF COMMITTEE OF THE AMERICAN INSTITUTE OF ACCOUNTANTS, RICHMOND, VA.

Mr. ANDREWS. Mr. Chairman and gentlemen of the committee, I am a member of the executive committee of the American Institute of Accountants. My home is Richmond, Va.

We have made a very careful study of at least one section of this bill, and we want to speak to you with respect to that one section; and in that connection I think it might be well to indicate to you in a sentence what we are not here for. We are not here to offer any objections to the bill as a bill. There is only one section that affects a matter upon which we feel we are qualified to speak, and that is the section to which I shall address myself.

In order to save the time of the committee we have prepared a brief statement, and I will present that rather than to go into it in any extended manner.

This statement, which deals only with section 32 (c) (1) of Senate bill 3580, has been prepared by a special committee of the American Institute of Accountants. The chairman of this special committee is the president of the institute, and its members include a vice president, two members of the executive committee, the chairman of the special committee on cooperation with Securities and Exchange Commission, and a member of the committee on auditing procedure.

The American Institute of Accountants is the national professional organization of certified public accountants in the United States, with a membership of 5,316, including the great majority of those who act as auditors for companies registered with the S. E. C. The institute's activities are similar to those of other professional organizations, including the maintenance and enforcement of rules of professional conduct, preparation of professional examinations, publication of technical and professional material, maintenance of an accounting library and a research department, and so forth. The institute has cooperated in various ways with many governmental and private bodies, including the Securities and Exchange Commission, which consulted the institute in the development of accounting rules and regulations under the Securities Act and the Securities Exchange Act. These matters are mentioned in order to inform the committee who we are, and to indicate that we are generally familiar with the type of problems with which Senate bill 3580 deals.

A good many sections of the bill relate to accounting and auditing. While we are, naturally, keenly interested in the bill as a whole, we believe it proper to restrict our recommendations to one provision of the bill, directly affecting professional certified public accountants as such, which we consider important enough to justify this appearance before your committee.

We earnestly recommend that section 32 (c) (1) of Senate bill 3580 be deleted. This section provides that [reading]—

> The Commission is authorized, by rules and regulations or order in the public interest or for the protection of investors—
>
> (1) to prescribe the minimum scope of and procedures to be followed in any audit of a registered investment company—

We object to this provision on the ground that it would permit assumption by a governmental administrative agency of a responsi-

bility which should be assumed by professional practitioners; i. e., determination of how extensive an investigation an independent auditor should make, and the manner in which he should make it, before signing his name to his own professional opinion regarding the financial position and the results of operations of the company under audit.

It is submitted that—

(1) Such a responsibility could not be successfully assumed by a governmental administrative agency;

(2) An attempt to fix minimum standards would tend to lower rather than to raise the standards of auditing practice;

(3) It would be a new departure in Federal legislation to provide for supervision by Government agents of the details of the work of professional practitioners;

(4) It would be an unwarranted and unnecessary invasion of a field of professional practice.

Senator MALONEY. Do you feel that way about the reference you made in your statement to the development of accounting rules and regulations under the Securities Act and the Securities Exchange Act?

Mr. ANDREWS. I do not believe I understand your question, Senator.

Senator MALONEY. Do you feel that there has been any abuse under those acts which you referred to earlier?

Mr. ANDREWS. Abuses against the profession of accounting?

Senator MALONEY. Yes.

Mr. ANDREWS. No, sir. Our relations with the Commission up to this time have been, I should say, highly satisfactory. We have undertaken to work with them in a cooperative spirit; and that is one of the reasons why we think this particular provision is totally unnecessary, because we know that we can accomplish by cooperation far more than we can accomplish by legislation.

Senator MALONEY. You refer to section 32 (c) (1) and say that you object to this provision on the ground that it would permit assumption by a governmental administrative agency of a responsibility which should be assumed by professional practitioners. Where is the guarantee there?

Mr. ANDREWS. The guaranty on the part of the accountant?

Senator MALONEY. Yes.

Mr. ANDREWS. The exercise of professional judgment and the assumption of the responsibilities that go with it, Senator, are things that are inherent in the practices of any profession.

Senator MALONEY. How about McKesson & Robbins?

Mr. ANDREWS. In the case of McKesson & Robbins or in any other cases you might mention, perhaps, there might have been some wrong doing. I believe that the determination of alleged malpractices there has not been finally disposed of; but I would like to say this, further, that the profession recognizes that in the assumption of a responsibility and in the conduct of its practice it is responsible to see that its practices follow proper rules of conduct, and that they are not negligent, and that they are skillful in the performance of their duties.

Senator MALONEY. Do you think the auditors were negligent in that case?

Mr. ANDREWS. I do not think that is a proper question to ask me, Senator.

Senator MALONEY. I will withdraw it. You prompted it, however.