STATEMENT BY RICHARD WAGNER
BEFORE SUB-COMMITTEE OF SENATE BANKING AND CURRENCY COMMITTEE
CONCERNING THE INVESTMENT COMPANY BILL

APRIL 22, 1940.

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 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 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: "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. 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 com-

panies partake of the nature of savings banks, is particularly unfortunate as that emphasis might apply to closed end 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. I have a very vivid recollection, and I am sure that you have, of the speculative fever which existed in the late '20s. 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.

It may be inappropriate to compare the experience of those who purchased securities of investment companies in 1928 and 1929 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 to other securities issued and listed at that time on the New York Stock Exchange, 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 stock in 1928 and 1929.

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 is 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 each 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 '30s 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 and one share of common combined sold for as high as $60.50. Today the market equivalence of the original units sold in 1929 is approximately $38.50 per unit, so taking the original offering price of the units it will be observed that the market today represents approximately 60% in the case of The Chicago Corporation of the original offering price, approximately 56% in the case of the Continental Chicago Corporation and approximately 74% 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% 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 no wise 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 '20s, 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% to 21% 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, 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 9th, Mr. Schenker referred to our company in the following terms: "Recently The Chicago Corporation has started to change the fundamental nature of its business and is attempting to serve a very useful function 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 "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 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 underwritings, 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% of our total funds is employed in investments of this character. 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 eatate 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 Company, 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 extension of the R.F.C. powers in 1935 Mr. Justice Reed, who was then Counsel for the R.F.C. stated, quote I think that the Fort Dearborn Mortgage Company 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 Company 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, unquote.

Mr. Schenker and others have said that very little has been accomplished by any investment company. But I wish to direct your attention to the fact that the amount of capital we use in a specific case does not tell the whole story. In the Fort Dearborn instance we contributed only $750,000 of capital, but the total amount of loans

made through the Fort Dearborn Mortgage Company was $9,779,000 and those loans liberated total original bonds issued for the properties involved of over $100,000,000. Furthermore the activities of the Fort Dearborn Mortgage Company 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 for the construction of two new 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 exten-

sion 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 which 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 turnover 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 of 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 they have in several instances. 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 five 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 today--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 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 inexplicable provisions of Section 10(e) applying to directors. If this section becomes law, we must lose our directors or sell a substantial part of our 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. 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.

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?

As to a provision for examinations by the SEC, 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 SEC 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. 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 co-operated with the SEC in its study and will be pleased to do so in any way possible in connection with this legislation.