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# INVESTMENT TRUSTS AND INVESTMENT COMPANIES

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## HEARINGS

BEFORE A

SUBCOMMITTEE OF THE  
COMMITTEE ON BANKING AND CURRENCY  
UNITED STATES SENATE  
SEVENTY-SIXTH CONGRESS

THIRD SESSION

ON

### S. 3580

A BILL TO PROVIDE FOR THE REGISTRATION AND  
REGULATION OF INVESTMENT COMPANIES AND  
INVESTMENT ADVISERS, AND FOR  
OTHER PURPOSES

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PART 3

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EXHIBITS

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Printed for the use of the Committee on Banking and Currency



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GOVERNMENT PRINTING OFFICE  
WASHINGTON : 1940

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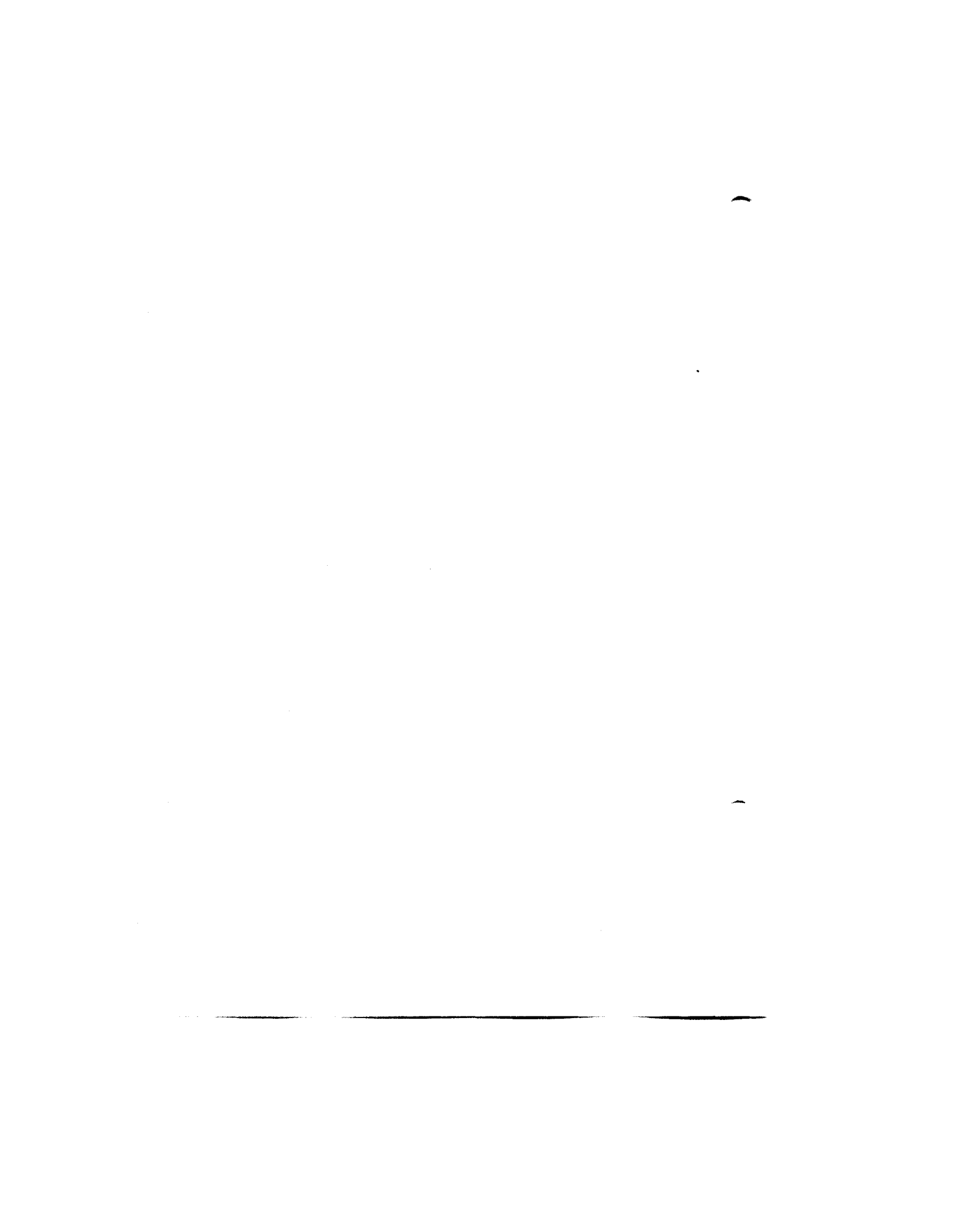
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## EXHIBITS

NATIONAL AVIATION CORPORATION,  
*New York, April 24, 1940.*

COMMITTEE ON BANKING AND CURRENCY,  
*United States Senate, Washington, D. C.*

GENTLEMEN: National Aviation Corporation is an investment company specializing in the aviation industry, including the furnishing of new capital from its own resources for new ventures in that field. Senate bill No. 3580, if enacted in anything like its present form and content, might so adversely affect the interests of our 3,400 stockholders, that we feel obliged, in their interests, to go on record in opposition to certain features of the bill.

We have not asked to testify at your hearings because the point of view of our branch ("closed-end management") of the investment industry on the wider aspects of the bill—such as the very broad control (without prescribed standards) given the Securities and Exchange Commission to regulate not only the general functioning of the industry but the business policies and detailed operations of the individual companies—have been adequately presented by others. The sphere of activities of our company, however, is so much more specialized and limited, and its field of investment so distinctive, that we feel justified in detailing these special features and in commenting upon provisions in the bill which are especially damaging in our situation. Also, we respectfully ask that this letter be incorporated into the record of the hearings.

### FACTS ABOUT NATIONAL AVIATION CORPORATION

Our company is a New York corporation, organized in 1928 by a group who desired to foster and participate in the growth of the American aviation industry through investment. The only securities ever authorized by the company have been stock, all of the same class and with identical attributes. Stock was offered to the public in 1928 and 1929, but none since. The company is not in debt; its policy is not to borrow; it has never bought or sold on margin, and since 1931 has kept its portfolio in safekeeping with Guaranty Trust Co., New York City, under a strict custody agreement. On the basis of present market values, our portfolio (consisting of securities in 22 aviation companies) and cash are worth about \$8,700,000 out of a net worth in excess of \$10,000,000. Except for a wholly owned subsidiary operating Washington Airport, a small aviation research subsidiary, and a small subsidiary owning undeveloped real estate, our company does not directly or indirectly control any of the companies whose securities it owns. These securities are almost all common stocks, and the highest percentage of stock of any company (except the subsidiaries) which we own is 6.8 percent. The highest percentage of our assets invested in the stock of any one company (except the Washington Airport subsidiary) is 8.5 percent. The stock of National Aviation Corporation is listed on the New York Stock Exchange. A stock dividend was paid in 1929 and cash dividends in 1936, 1938, and 1939. The company is managed by a board of 10 directors, all of whom have had many years of experience with the aviation industry, its financing, dealings in aviation securities, or in investment generally. As stated, we have more than 3,400 stockholders.

The aviation industry, in which our company invests and reinvests its funds, is, as the committee doubtless appreciates, still adolescent and relatively small. It is highly competitive, changes rapidly, is subject to wide fluctuations, and is speculative.

### CLASSIFICATION PROBLEM

National Aviation Corporation is a "closed-end management investment company" and a "securities finance company," within the definitions of the bill.

We submit, however, that from the functional standpoint, our company is

really the type of enterprise contemplated to be included within the definition of "diversified investment company," and entitled to such benefits as might accrue from such classification; but because of the 5-percent limitation in section 5 (b) (1) (a)—unreasonable of application to a company like ours which specializes in a comparatively small industry—we are outside that classification.

True, section 5 empowers the Securities and Exchange Commission to make "further classifications and subclassifications" of investment companies, but without prescribing or indicating standards of any sort. We feel that this is too uncertain. We, therefore, recommend that any legislation like S. 3580 contain at least one classification for companies which confine their investments to a particular field. The absence of such special classification from the present bill is especially serious in connection with taxation. Relief, on the same principle and to the same extent as extended to open-end investment companies by the Revenue Acts of 1936 and 1938 should be extended to companies like ours. The man of small means who purchases shares of our company for purposes of diversifying and getting expert judgment and management (essential in connection with an industry like aviation), now finds himself subjected directly and indirectly to a tax burden far greater (because of the relatively high corporate income-tax rate—plus the tax he pays on dividend distributions) than would concern him if he had invested directly for his own account.

Also, we point out the uncertainties confronting management arising out of the combination of sections 5 and 13 whereby a company like ours, for which it is vital to be able to act with great rapidity in shifting its investments from certain companies or groups (e. g., manufacturing as against transport) within the aviation industry, might have to take time to get advance stockholder approval of a buying and/or selling program (perhaps too late to be of avail) for fear this might be deemed by the Commission a change of fundamental investment or management policy.

#### MANAGEMENT RESTRICTION PROBLEM

To manage our company in the interests of our stockholders there must be on the board of directors and as principal executive officers, men who are able, experienced, and of standing in (a) the aviation industry, (b) the vocation of investment generally, and (c) the securities business, especially as related to aviation securities.

Four members of our board of directors hold directorates in a total of nine important aviation companies. Five of our directors are partners in brokerage firms and have been particularly helpful in the affairs of this company.

Under one or more of the provisions of sections 9 and 10 we should certainly lose 6 of our 10 directors (including the chairman), and possibly the other 4 members, too, through automatic disqualifications, resignations to retain other affiliations (in many cases their primary interests), or resignations to avoid individual registration requirements which can be made oppressive. We do not see how or whence (again emphasizing the specialized field of National Aviation Corporation) substitutes qualified under the bill, and willing to serve, can be found, who have the requisite competence, experience, and standing to manage substantial investments in aviation securities. Particularly in a specialized field will section 10 eliminate as officers and directors, men who are directors and officers of leading subjects for investment, because the investment company usually will, in the interests of conservative diversification, own less than 5 percent of their outstanding voting stock.

#### POLICY RESTRICTION PROBLEM

Any change of investment or management policy which really is fundamental, should be authorized or approved by the stockholders. But, in the case of a company like ours, investing only in specialized industry, it is important for the management to be able to decide and act quickly in time of need, especially as to buying and selling programs. Consequently, at least in the case of such investment companies, it is unwise, and may well be destructive of proper management, to require prior stockholder approval. Most alarming of all, however, is the blanket power given to the Securities and Exchange Commission to designate those investment and management policies which are fundamental. Whatever may be said about this from the standpoint of the general investment company, we submit that dependence upon the making and limitations of such designations, is inappropriate in connection with a highly specialized industry



like aviation. For example, in the absence of a designation—or a clear designation—the board of directors will have to make immediate decisions at their peril, with respect to purely investment action.

#### DIVIDEND RESTRICTION PROBLEM

Clause (B) of subparagraph (2) of section 19 (a) appears to apply to closed-end companies though we believe it was intended to relate only to "open-enders." Application of the clause to the former—especially to a company like ours, whose principal source of income from its aviation investments is necessarily not interest and dividends, but realized capital appreciation—impresses us as conducive to great difficulty and inordinate expense. We cannot visualize how the provision will operate as a practical matter, either from the standpoint of the stockholder or that of conservative capital management.

#### STOCK OWNERSHIP RESTRICTION PROBLEM

We submit that the prohibition against ownership of the stock of an investment trust by another investment trust contained in subsection (c) of section 12 of the bill should be modified, by some raising of the crucial percentage, probably to 10 percent, so as to make it practically possible for general investment companies to hold stock in an investment company specializing in a particular industry. A unit of investment of 1 percent of our stock would be much too small to serve the purposes of a large general investment company. We believe that investments by such companies in stocks of specialized companies like National Aviation Corporation should be encouraged, and that, for example, instead of attempting itself to diversify an investment between units in the aviation industry and incur the substantial expense of maintaining a specialized research department for the purpose, the general investment company may prefer, with wisdom, to have such diversification made and maintained for it, with considerable economy, through the medium of the specialized company's management who are experts in the particular field.

The point just made, we suggest, is another consideration for according special classification and treatment to the specialized investment company.

#### CONCLUSION

One complaint currently and widely made of the economy of the United States, is the "drying up of reservoirs of venture capital for new industry." National Aviation Corporation has been such a reservoir, nourishing in divers ways America's most promising young industry. The specialized investment company, particularly when capitalized only with stock of one class sold as a speculation, is particularly well adapted to fulfill that function. But it can continue to do so only under such regulation as recognizes business practicalities.

Yours very truly,

NATIONAL AVIATION CORPORATION,  
By FRANK F. RUSSELL, *President*.

POOR'S PUBLISHING CO.,  
*New York, April 22, 1940.*

Re Senate bill No. 3580, title 2.

To the COMMITTEE ON BANKING AND CURRENCY,  
*United States Senate, Washington, D. C.*

GENTLEMEN: It is not my intention or desire to appear in opposition to the underlying purposes of this bill. Some form of governmental regulation seems desirable both from the standpoint of the investing public and from that of the profession itself.

My plea is directed toward a simplification and clarification of the wording of the bill. As now written, it contains so many broad provisions and generalities that, in effect, it would not be a law but rather an open-end authority to the Securities and Exchange Commission to regulate the entire profession of investment counseling as they might deem desirable.

I wish to be recorded in opposition to the granting of such broad general powers to any governmental commission, as I believe such authority should be retained by the Congress and not be delegated to others.

Any bill which may be passed for the purpose of regulating the business or profession of investment counseling should be both clear and definite in its provisions, so that everyone concerned may know just what is to be required, and the substance of whatever regulations are to be applied.

Furthermore, any bill should be carefully studied as to its effects on both the rather recently developed profession of personal investment counseling and the business of publishing financial statistics and analyses such as has been carried on for many years by such firms as Poor's Publishing Co., Standard Statistics Co., Moody's Investor's Service, and others.

In my opinion, the framers of this bill have not clearly thought through the effects of a number of its provisions on this latter type of investment analytical and advisory organization.

Again expressing my sympathy with the underlying purposes of this bill, I respectfully request that it be studied more carefully as to its effects on all types of business which would come under its control, and that it then be redrafted in simpler and more definite form.

Presented by,

PAUL T. BABSON,  
*President, Poor's Publishing Co.*

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NORTH AMERICA INVESTMENT CORPORATION,  
*San Francisco, April 12, 1940.*

HON. ROBERT F. WAGNER,  
*Chairman, Committee on Banking and Currency,  
The United States Senate, Washington, D. C.*

DEAR SIR: We wish to take this opportunity to express to your committee our views regarding Senate bill 3580, entitled "A bill to provide for the registration and regulation of investment companies and investment advisers, and for other purposes."

We have extensively reviewed the provisions of the bill with respect to its possible effects, not only as applied to our particular companies but to the investment-company industry as a whole. While we do not wish to protest against the enactment of legislation designed primarily to regulate the industry so as to eliminate former abuses and past unsound practices of some investment companies, we do object to the enactment of the bill in its present form for the following reasons:

1. Many provisions of the bill go far beyond the scope of necessary or required regulation. The practically unrestricted authority delegated the Securities and Exchange Commission to issue rules and regulations governing almost every phase of investment-company operations gives the Commission far too broad legislative powers.

2. The bill would add substantially to the expense of investment companies' operations by requiring further costly registration statements and reports to the Securities and Exchange Commission in addition to such expenses that might be occasioned by subsequent rules and regulations prescribed by the Commission under the discretionary power delegated to it in the act. This particular feature of the bill would operate most disadvantageously to the smaller investment companies by the disproportionate increase in expenses that would result from such costs.

3. The bill makes it practically impossible for persons presently connected with any phase of investment-company operations to form or assist in the formation of new investment companies even though through experience, proven ability, and other qualifications they may be the most able to engage in such undertaking.

While we disagree with many of the specific provisions of the bill, the above objections are, in our opinion, a few of the essential difficulties that would arise in the event the bill were passed in its present form.

We regret that we are unable to request the opportunity to appear before your committee as we feel the expense of a trip from the west coast to Washington would not be warranted by the size of our companies, but trust that this letter will serve the purpose of setting forth in a very general way our views regarding this proposed legislation.

Very truly yours,

LOUIS W. JENKINS, Jr., *Secretary.*