

our clients would undoubtedly consider that one of the chief advantages of investment counsel service to them had been destroyed. It is against the public interest to destroy this confidential relationship by subjecting our operations to public scrutiny through hearings and investigations.

We have shown why our profession should not be regulated. We have mentioned some of the losses and dangers which it seems to us the legislation under consideration will impose upon us by its general terms. Since we are not and do not operate or give advice to an investment trust, our concern is primarily with title II of the proposed bill. A first reading of this title by one who did not know our profession and the way it operated might leave the impression that it was mild. That is not our view; but in stating our reasons we shall not give a detailed analysis of the bill because the aspects to which we object are so broad and so implicit in all provisions of the bill that such detailed criticism would be an unnecessary duplication. In general, however, we would draw attention to the several provisions in title II or included therein by reference from title I, referring to hearings, investigations, unlawful acts and enforcement, to show that the bill gives the Commission power to do almost anything it wishes and to accomplish almost any conceivable change in our operations by means fully as effective as the threat of sentence in criminal court.

Therefore, even if we were persuaded that some legislation were necessary or desirable for our profession, which we are not, we would be forced to oppose this bill on these grounds alone.

As will be clear to the committee from our statement, we believe that the investment counsel profession is quite distinct from the investment trust business and from the business of others who give investment advice; therefore we believe that we should not be lumped with investment trusts or others when regulatory legislation for them is considered. Furthermore, we do not believe that legislation providing for the investigation, supervision, and regulation of the investment counsel profession is necessary; we believe it would be dangerous to our own business and might bring about its extinction in the long run.

We believe that the legislation is against public interest and earnestly urge that the committee drop title II from consideration. In addition, we should like to reaffirm our belief that we should be forced to take this position in the interests of our profession, even if we believed some Federal regulation was desirable, because of the broad and unqualified discretion given to the Securities and Exchange Commission to determine conditions which are vital not only to the convenience but to the very existence of our operations.

Thank you.

Senator WAGNER. Are there any questions? (No response.)

Thank you very much.

STATEMENT OF ALEXANDER STANDISH, PRESIDENT, STANDISH, RACEY & MCKAY, INC., BOSTON, MASS.

Mr. STANDISH. My name is Alexander Standish. I am president of Standish, Racey & McKay, Inc., Boston, Mass.

You have just been given a rather broad and clear picture of investment counselors and what we do. I do not want to repeat in any

way, and so I am going to discuss very briefly just one point, but a point which I believe is the heart of the whole question and is the reason that I believe that this bill will practically destroy the investment counsel profession.

The relationship of investment counsel to his client is essentially a personal one involving trust and confidence. The investment counselor's sole function is to render to his client professional advice concerning the investment of his funds in a manner appropriate to that client's needs. Recommendations often cover such a broad range of subjects as life insurance, methods of systematic savings, establishment of funds for the education and well-being of children, or the preservation and management of funds after death—and they are all private affairs.

For centuries individuals have been able to consult with their doctors or their lawyers, knowing that what they say will be treated with confidence. So important is this relationship that there have been set up legal measures to maintain the inviolability of these communications.

In New England, at least, individuals believe that information as to personal savings and family financial arrangements is to be guarded as carefully as are confidences given to medical or legal advisers. We believe that it is equally important to society that persons be able to disclose and discuss their financial affairs with trusted advisers without fear that such disclosures can or will become public property.

These are not theoretical matters. We, for instance, on occasion have had to advise the establishment of irrevocable trusts for the protection of individuals incapable of managing their own affairs; in other instances legal guardianships were set up; and in one case the confidential character of our relationship permitted information reaching us of such character that a fraud was prevented without embarrassing publicity to our client and at the same time provided the Federal Bureau of Investigation with valuable evidence.

Perhaps it will be said that that these are the few and extreme examples and are not representative. Let us look at my office as a fair sample of investment counsel firms. Our work with clients is so continuous, detailed, and inclusive that we have less than five clients for each member of the firm and staff. There is nothing comparable with this in merchandising securities. The dangers arising from the revelation of confidential details of clients' affairs affect groups of clients in various ways. For example, about two-thirds of our fees come from private trustees, mutual savings banks, and mutual insurance companies. Clients of this type do not want to it be known even that they consult us. The trustees of savings banks located in small towns have the feeling that the depositors might conclude that the trustees were not capable of investing the funds whereas actually our work is merely to assist them in carrying out their fiduciary obligations. Another group of clients is made up of business men who feel it necessary to tell us the intimate details and risks of their own business in order that we can compensate for these risks by increasing the conservatism of their own personal investments. If information given to us in this connection should become known to our clients' competitors it might result in serious damage to a client's business. Many of our clients are elderly people and the manner in which they intend to bequeath their money at death has a very important bearing on their current investments. The revela-

tion of their intentions in respect to their wills obviously could produce a great deal of trouble within families. In some instances individuals and organizations of national importance have asked us to make studies of special problems and had it become known even that such a study was being made the repercussions would have been important and definitely contrary to the client's interest.

We regard this confidential relationship as so vital that we have set up many safeguards within our own organization. Thus the records of our clients' accounts are maintained under code number so that only a few of the members of our staff know the names of the clients on whose problems they may be working. We have an absolute rule that even the mention of a client's name outside of the office means immediate dismissal. Even the physical lay-out of our office is such that every member of the firm who discusses problems with clients has a completely private office and the telephone system is so arranged that no one in our office can listen to conversations between a client and his adviser. This true professional relationship that exists between counsel and client is the very foundation of our work. There seems to be no sound reason that the public should be denied the right to go to trusted counsel and discuss their private affairs without any fear that what they say would become known to anyone.

Our principal objection to the proposed Investment Advisers Act of 1940 is that if it becomes law we can be compelled to disclose the confidential communications of our clients. We may be compelled to make this disclosure as a condition precedent to registration. We may be compelled to disclose it if the Securities and Exchange Commission decide to gather information for the purpose of future legislation or to prescribe its rules and regulations. We may be compelled to disclose it in any investigation by the Securities and Exchange Commission for a violation of law in advance of any finding of guilt, or a suspicion that we are about to violate the law.

We believe that it is not in the public interest to publish the financial affairs and private communications of our clients but rather that the public interest demands that these confidences be protected, at least so far as they now are by law.

If the Committee feels that some form of regulation of investment counsel is essential in the public interest, then we would respectfully urge that rather than adopt a law which strips the public of its right to private counsel it should provide a law that prohibits any counselor under any conditions from revealing any information concerning any of his clients.

It may be said that this is not another "pink slip" law and that it is not the intention of the Securities and Exchange Commission to make public the personal affairs of such of the public as seek the advice of investment counsel. This is not a pertinent assertion. The mere existence of such power would tend to prevent investors from revealing factors of primary importance and would destroy at once any professional relationship and would undermine the whole foundation upon which a profession such as ours is built. In fact, the publicity already given to this proposed law has led to concerned inquiries from several of our clients as to whether their private affairs would be subject to public hearings and discussion.

We can only tell them, in all honesty, that if the proposed legislation becomes law we cannot guarantee privacy as to their affairs.

If they regard such privacy as important—and they do—they must seek sanctuary by putting their financial affairs in the hands of some legal firm or other group which receives special privilege under the act.

They will have to do this even though it means accepting investment advice from those whose primary interests are elsewhere, who lack research facilities, and who are not specially trained for this work. Such a dilemma is presumably not intended by the members of the Securities and Exchange Commission who have stated that there is no intention to use this power except in instances in which fraud is suspected. Nevertheless this power is granted without qualification or limitation under the proposed statute, and the fact that such power exists is all that is necessary to destroy the confidential relationship between client and counsel. If you destroy the foundation you also destroy the profession. Perhaps the present personnel will not use this power, but obviously it is dangerous to give such great power to a future personnel appointed by unknown administrations. The history of legislation in this country indicates clearly that powers once obtained by a governmental bureau are seldom relinquished.

In order that there may be no doubt in the minds of the committee that the statute does create clearly the powers mentioned above, it is well to examine some of the specific provisions of the act [reading]:

SEC. 204 (c). Any investment adviser, or any person who presently contemplates becoming an investment adviser, may register under this section by filing with the Commission an application for registration. Such application shall contain such of the following information and documents, in such form and detail, as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors:

(1) information in respect of—

* * * * *

(c) the nature and scope of the business of, and of the advice, analyses, and reports furnished by, such investment adviser:

(3) such further information and copies of such further documents relating to such investment adviser, his or its affiliated persons and employees, as the Commission may by rules and regulations or order prescribe as necessary or appropriate in the public interest or for the protection of investors.

We wish to point out that these provisions empower the Commission to require as a part of the registration statement any information and any documents of any character requested by it. This registration statement is a public document. The broad general authority to require further and unlimited information constitutes an unfettered discretionary power which is dangerous to confer on any administrative body.

The proposed act, moreover, goes much further in giving power to the Commission, by incorporating in title II numerous sections or paragraphs of title I, among which is section 38 which provides:

SEC. 38 (a). The Commission, in its discretion, may investigate any facts, conditions, practices, or matters which it may deem necessary or appropriate to determine whether any person has violated or is about to violate any provision of this title or any rule or regulations thereunder, or to aid in the enforcement of the provisions of this title, in the prescribing of rules and regulations thereunder, or in obtaining information to serve as a basis for recommending further legislation concerning the matters to which this title relates.

Now, Senators, that seems to me as wide open as the whole world. Also in the paragraph the bill states briefly:

The Commission may require or permit any person to file with it a statement in writing, under oath or otherwise as it shall determine, as to any or all facts and

circumstances concerning a matter which may be the subject of investigation. The Commission, in its discretion, may publish information concerning any of the foregoing matters.

There can be no doubt that this wording empowers the Commission to make any investigation that it desires, irrespective of any evidence or even any suspicion of any violation of the statute.

Section 38 (b) provides:

(b) For the purpose of any investigation or any other proceeding under this title, including any examination pursuant to section 31, any member of the Commission, or any officer thereof designated by it, is empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, contracts, agreements, or other records which are relevant or material to the inquiry. Such attendance of witnesses and the production of any such records may be required from any place in the State or in any Territory or other place subject to the jurisdiction of the United States at any designated place of hearing.

There can be no doubt that under this provision we, as investment counsel, may be compelled to produce the records, correspondence, and most intimate details of our clients' accounts; and then if we decide that we are going to protect the confidences given us, we have the prospect of a \$1,000 fine or 1 year in a Federal penitentiary or both. That is the provision of paragraph (c) under the same section.

Not even the privacy inherent to a private hearing is necessarily accorded to our clients, since section 37 provides:

SEC. 37. Hearings may be public and may be held before the Commission, any member or members thereof, or any officer or officers of the Commission designated by it, and appropriate records thereof shall be kept. In any proceedings before the Commission, the Commission, in accordance with such rules and regulations as it may prescribe, shall admit as a party any interested State or State agency, and may admit as a party any representative of interested security holders, or any other person whose participation in the proceeding may be in the public interest or for the protection of investors.

The language used in the bill giving these sweeping powers is perfectly definite and clear; it is useless to argue that it does not mean what it says.

In conclusion, I should like to say that our objections to the bill are many and fundamental, but they have been or will be covered adequately by the testimony of other witnesses, and I have no desire to take the committee's time in mere repetition. I should like to state, however, with all the emphasis that I can command that, in conclusion, we believe, first, that in order to give proper investment advice we must have all the facts concerning our clients' financial problems; second, all of the facts will not be given us without complete assurance that such facts will not be revealed; third, the essential nature of completely frank discussion has been recognized in the medical and legal professions; and the law has set-up legal safeguards to maintain them inviolable. Similar safeguards should be extended to the investment counsel profession; fourth, destruction of the present confidential relationship would destroy the very foundation of the profession.

One of the finest investment counselors, and one of the earliest, who if he were now living would be at this table today, said to me several years ago, "I will tell the Government anything it wants to know about our business, but I will lock the doors and cease to practice the day that anyone can require me to reveal the affairs of my clients, told me because they trusted me not to reveal them."

Gentlemen, very many of us feel that strongly on the matter.

We most earnestly urge that title II of this bill be completely eliminated; and without in any way being impertinent, we would urge that public announcement to that effect be made as soon as possible, in order to halt the damage that is being done to the profession even by these hearings.

In our opinion, and as far as true investment counsel are concerned the bill is entirely and utterly destructive.

Thank you, Mr. Chairman and Senators, for the privilege of addressing you.

Senator WAGNER. Thank you, Mr. Standish.

Mr. Dwight C. Rose will be the next witness, I believe. Please come forward, Mr. Rose.

STATEMENT OF DWIGHT C. ROSE, PARTNER OF BRUNDAGE, STORY & ROSE, NEW YORK CITY, AND PRESIDENT, INVESTMENT COUNSEL ASSOCIATION OF AMERICA

Senator WAGNER. Will you proceed, Mr. Rose?

Mr. ROSE. Mr. Chairman and Senators, my name is Dwight C. Rose. I am a general partner of the investment counsel firm of Brundage, Story & Rose, investment counsel, at 90 Broad Street, New York. I am also president of the Investment Counsel Association of America, a voluntary, nonprofit professional association, the membership of which comprises 61 individuals who are principals or associates in 18 different investment counsel firms located in various parts of the United States—firms, the sole function of which is to “render to clients, on a personal basis, competent, unbiased, and continuous advice regarding the sound management of their investments.”

Senator WAGNER. Have you any idea how many counselors are outside of your organization?

Mr. ROSE. I will come to that point a little later in my statement, with your permission, Mr. Chairman; or I should be glad to answer that now, as you prefer.

Senator WAGNER. No; please go right on; I do not want to interrupt you.

Mr. ROSE. It is estimated that these 18 member firms have under their supervision funds of clients aggregating in excess of \$600,000,000.

I am making my statement as president of the Investment Counsel Association, and I ask your permission to read it as it has been approved by the association's executive committee.

At the outset may I assure you, without reservation, that the members of the association, and all other investment counsel with whom I have come in contact, are most desirous of keeping the profession free from all forms of abuse. Maintenance of high standards of integrity, competence, and practice is dictated by our self-interest; for in the long run we can prosper only if the investment counsel profession maintains a reputation for honesty, for ability, and for sound methods of practice. Therefore, we strongly favor whatever method may be relied upon to assure this desirable result.

It was recognition of the need for cooperative effort to bring this assurance into the field which prompted a number of investment

counsel firms a few years ago to join in an effort to maintain and improve the standards of this young profession—an effort, if you please in self-regulation. In view of this effort, now well under way, may I give you a brief history of the profession, and of the Investment Counsel Association of America, in order that you may judge the merits and the possibilities of self-regulation? Then I shall discuss the proposal for Federal legislation and regulation.

I should like first to take up the question of the origin and function of investment counsel. These matters were discussed at hearings before the Securities and Exchange Commission, at Washington, in February 1938. A stenographic transcription of these hearings has been reproduced in the 1938 Investment Counsel Annual, several copies of which I have brought along for your information; and I shall be glad to leave them with you before I go.

The rise of investment counsel in the early 1920's was occasioned partly by certain weaknesses in our investment banking system and partly by the increased complexity in the financial structure and operation of companies. A growing recognition by the investor of his difficulty in obtaining, under such conditions, competent and unbiased guidance in the management of his investments has caused a rapidly increasing demand for investment counsel services.

The two fundamental principles upon which the pioneers in this new profession undertook to meet the growing need for unbiased investment information and guidance were, first, that they would limit their efforts and activities to the study of investment problems from the investor's standpoint, not engaging in any other activity, such as security selling or brokerage, which might directly or indirectly bias their investment judgment; and, second, that their remuneration for this work would consist solely of definite, professional fees fully disclosed in advance.

The name "investment counsel," not then in use, was selected to describe both the work based on these two principles, and the persons engaged in that work.

Generally speaking, those engaged in strictly investment counsel work have conducted their activities in accordance with the highest ethical principles—partly, perhaps, because the investors with funds large enough to warrant retaining investment counsel have possessed sufficient intelligence and investment sophistication to select their investment counsel prudently. Also, it has been fortunate that the pioneers in the field were men of high ideals, willing to undergo a long period of hard sledding, and not a little ridicule within the financial community, in order to stand steadfastly by the fundamental principles upon which they had embarked.

From very small beginnings in the early 1920's, this function of rendering to clients—on a personal, professional basis—competent, unbiased, and continuous advice regarding the sound management of their investments, has had a steady growth. That growth has been reflected both in the amount and number of funds supervised and in the size and number of firms and individuals engaged in the practice. The success of the men who developed and adhered to the two fundamental principles of investment counsel resulted, before long, in the

inauguration of so-called "investment counsel" departments by investment dealers, brokers, a few banks, and by others who did not adhere to these two basic principles; but they used the name. Then, too, a few outright exploiters may have found the respectability of the investment counsel title an effective shield under which to conduct unethical and even fraudulent practices; but the young profession, until recently, has been unorganized and too weak to confine the use of its chosen name to the original meaning, or to warn the public of its misuse.

By 1934, many of the strictly investment counsel firms had come to recognize some of the common problems of the profession and began holding conferences with a view to forming an association for the formulation and advancement of standards and for the education of the public. Early in 1937, the Investment Counsel Association of America was formally organized by a number of such firms.

For your examination I shall later submit copies of three printed résumés of proceedings incident to the organization of the Investment Counsel Association in May 1937. To give you a general picture of the reasons for the organization of this association, I cannot do better than to read one or two paragraphs from these printed résumés of these proceedings.

I quote:

If an association is organized it should first be limited to those pioneers in the profession whose conduct and present methods of procedure have gradually evolved from an unqualified interest in serving the investors' welfare. Where executives of such firms have become personally known one to another and their common interest in serving the investors' welfare has led to a common ground for ethical conduct and procedure, we have the basic qualifications necessary for the original nucleus about which a sound investment counsel association may be developed.

It was agreed that the proposed Association should not be exploited for business-getting purposes, and that any publicity sponsored by the association should not advertise the names of member firms. It was further agreed that no general publicity should be given to the initial formation or to the activities of the proposed association until a suitable constitution and code of professional practice had been carefully worked out, adopted, and had stood the test of practical operation by and among the original membership.

That ends the quotation from these proceedings, of which I will give you a copy.

Since the organization of this association, our work has been confined primarily to the following:

First, the development of a code of professional practice to which all members of the association and the majority of recognized practitioners outside of the association, appeared willing to subscribe; and the development of a constitution to implement this code, to provide for the disciplinary action of members found in violation of it, and to govern the Association's organization and activities.

Copies of the constitution and code of professional practice, revised to January 22, 1940, are available for your later inspection and will be left with you. The code of professional practice is fairly short—a great deal of time and effort has been spent in developing it; and, with your permission, I should like to read it to you at this point [reading]:

INVESTMENT COUNSEL ASSOCIATION OF AMERICA

CODE OF PROFESSIONAL PRACTICE

Whereas the profession of investment counsel came into being to meet a growing need for a type of competent and unprejudiced services not otherwise rendered; and

Whereas experience in the rendering of investment counsel services has established certain basic principles of responsibility and conduct requisite to sound professional practice; and

Whereas these basic principles must be accepted and maintained if the investing public is to be assured of the standard of investment counsel services to which it is entitled;

Now, therefore, we, the subscribers to this Code of Professional Practice, do declare the following principles to guide all those who profess to render investment counsel services; do pledge ourselves and our organizations to adhere to these principles; and do agree, through proper articles of association, to enforce such adherence by all subscribing members.

The first principle is contained under the heading, "Definition and Limitation of Functions":

It is the function of the profession of investment counsel to render to clients, on a personal basis, competent, unbiased and continuous advice regarding the sound management of their investments. An investment counsel firm should devote its time exclusively to the performance of this function and services incidental thereto; it should not engage in the business of security merchandising, brokerage, banking, the publication of financial services, or acting as custodian of the securities or funds of clients; and neither the firm nor any partner, executive or employee thereof should directly or indirectly engage in any activity which may jeopardize the firm's ability to render unbiased investment advice.

The second title is, "Competence and Responsibility":

To serve its clientele effectively and continuously an investment counsel firm should preferably include at least two responsible partners or principal executives of demonstrated investment ability and unquestioned integrity; it should be supported by a competent staff of experienced assistants; and it should maintain adequate capital and reserves at all times.

On the matter of "Compensation for Services":

Compensation of an investment counsel firm should consist exclusively of direct charges to clients for services rendered, and should not be contingent upon profits, upon the number or value of transactions executed, nor upon the maintenance of any minimum income.

On the matter of "Solicitation of New Clients":

The methods employed and all written and oral statements made by an investment counsel firm in securing new clients should conform to standards consistent with the professional nature of investment counsel services.

On the matter of "Confidential Relationship":

All information concerning the security holdings and financial circumstances of clients should be held in strict confidence by the firm and its personnel.

That completes our code.

Another matter undertaken by the association is in connection with the determination of the detailed information to be required of applicants to pass upon their qualifications and suitability for membership. This subject has represented a considerable amount of serious thought and careful testing over the past 3 years. These requirements are indicated on this application for membership form, copies of which are now submitted.