

positive agency to promote high standards of integrity and responsibility, to maintain a code of professional practice as a guide to the profession, and to educate the public to demand certain minimum standards of those from whom they are willing to accept investment advice.

You asked me a moment ago something about how many investment advisers there were.

Senator WAGNER. Sixty-one in your association. Now, how many are out?

Mr. ROSE. Yes; that is what I am going to discuss, sir.

Senator WAGNER. All right.

Mr. ROSE. Besides those which may be described as exclusively investment counsel firms, a great variety of persons is engaged in investment advisory activities. Estimates as to the number vary considerably. Most banks, trust companies, investment dealers, and brokers advise on investment problems, either as an auxiliary service without charge, or for specific charges allocated to this particular function. Many lawyers advise with respect to investment problems from time to time, and in some law firms investment advice represents a substantial part of their practice. Then, of course, the number of people who are willing to, and do, offer free advice on investment matters represents a substantial portion of the country's adult population. So it is understandable that the estimates made of the number of people engaged in investment advisory work would vary widely, depending upon just what is meant by the descriptive title of "investment counsel or adviser."

The findings of the Investment Counsel Association may shed some helpful light on this point. During the 3 years since the association has been functioning, the total number of firms and individuals, exclusive of banks, which we have been able to discover operating under the "investment counsel" or a similar investment advisory title, has been approximately 540. Some of these organizations using the descriptive title of investment counsel were in reality dealers or brokers offering to give advice free in anticipation of sales and brokerage commissions on transactions executed upon such free advice. A not inconsiderable part of this 540 would probably better be described as market forecasters, trading advisers, and a few outright "tipster bureaus"; but I judge that probably 150 to 200 of these organizations or individuals could properly be described as investment counsel serving their clients on a professional basis. Probably about one-half of that 150 or 200, however, are individuals with only a handful of clients, frequently members of their own families or close personal friends, but in most cases desirous of eventually building up a general investment counsel practice.

Who's Who in Investment Counsel, a manual recently published in New York—of which I have brought a copy along with me—and currently being distributed by Bishop's Service, one of the leading credit and character-reporting agencies in the financial field, lists 156 different organizations and individuals engaged in investment advisory work, of which slightly more than one-half are listed as engaged in "investment counsel exclusively."

I shall leave this manual with you now.

The number of people presently engaged in the giving of investment advice for remuneration, exclusive of banks and lawyers, do not con-

stitute an extensive enterprise. The strictly professional section of such advisers is undertaking self-regulation with some success. The various States, as well as the Federal Government, now have laws against fraud, which cover any serious abuses which may arise. Therefore, until further development of the profession has taken place, we believe that regulation could most effectively be left to the profession and to existing laws against fraud.

Now, Mr. Chairman, there are some inherent dangers in special Federal regulation, that I should like to bring to your attention. These dangers, particularly as contemplated in view of the bill now proposed, are: First, the restrictions which may be presently imposed and the possibility of additional future restrictions on registrants, may divert into other fields some of the more capable individuals who normally would be encouraged to prepare themselves for the practice of this new profession. We know of a number of lawyers who have given up their law practices to engage solely in the practice of investment counsel. Federal regulation from which lawyers are exempt might reverse this trend. There would also be encouragement to pursue this activity under the auspices of banks or trust companies not subject to the present bill.

A second danger is this:

Many incompetents would be permitted to register and describe themselves as "registered or licensed investment counsel." This badge of registration and apparent approval by the Federal Government might, therefore, in spite of any express provision denying such approval in the act itself, give to the unsophisticated investor a mistaken and completely undeserved impression of qualification and standing. Thus, insofar as the less intelligent investors are concerned, the very act of registration under present requirements might, at least during the earlier stages, encourage exploitation by the unscrupulous and incompetent.

A third danger:

If the powers of the Commission for investigation and regulation of investment counsel should be made relatively flexible, practitioners would be confronted with an important new consideration which might severely conflict with their clients' welfare; that is, all activities and recommendations of a cautious investment counselor would first have to be subjected to the question of whether or not at some time such activities or recommendations might involve difficulties for him in connection with the statute as enacted or with such future rulings as the Commission might make.

While this aspect of the problem may seem unimportant and academic at the present time, some idea of the potentialities may be gained by a review of the limitations under which both corporate and private trustees have for years felt it necessary to operate in order to protect their own interests from liability under existing law.

The fourth danger:

Under the regulation of a Federal commission there might, under certain conditions, be times when an investment counsel would be fearful of expressing his judgment and recommendation with respect to certain aspects of Governmental fiscal policies, general business and economic conditions, or the prospect of inflationary or deflationary developments, lest such statements might in some way be interpreted by that Federal agency as being against the public interest.

Now I come to what I think may be a most important danger:

Whether investment counsel is carried on by a group of individuals operating as a firm, or by a single individual, it must be recognized that the relationship established with clients is inherently a professional one, similar to that involved in the practice of law or accountancy. Regulation of investment counsel by a Federal commission would represent the first encroachment of the Federal government into the domain of personal, professional relationships. Therefore, I think it highly important that your committee recognize that if such a step is taken, a fundamental precedent will have been established which may be used for the further expansion of Federal regulation of individuals, to include such professions as lawyers, accountants, engineers, and others whose activities appear to be fully as much interstate in character as are those of investment counsel.

This aspect of the matter is basically so important that Mr. Berle is planning to treat it in considerable detail; and I shall not, therefore, dwell on it further at this point.

Senator HUGHES. I presume it is pretty much along the same line as Mr. Andrews testified as to auditors?

Mr. ROSE. Yes, sir. I wish we had a man as able as Mr. Andrews to represent us on that point.

Senator WAGNER. You say Mr. Berle is going to talk about that. You were talking about lawyers. Of course, lawyers have to register. You cannot practice law unless you are registered; and you cannot practice in the United States Supreme Court, here, unless you are admitted to the bar of the United States Supreme Court.

Mr. ROSE. I was referring to Federal regulation.

Senator WAGNER. Well, that is regulation; because a lawyer is admitted to the bar only after examination and all that, and of course he has to register. After all, he is not regulated, except that admission to the bar qualifies him as an attorney with the right to practice; but his name is registered somewhere, so that you can always find out whether he is one who is qualified under the requirements of the statute.

I am raising these questions because I should like to get your answer: You take the case of real estate brokers—in States, of course. I think it was during the time when I was in the New York State Legislature that we enacted that law with respect to real estate brokers. Because very many unworthy persons were engaged in that business, the brokers themselves pressed for the legislation which now requires the registration of real estate brokers and also insurance brokers; and there is one other class, that escapes my mind for the moment.

Similarly there has been legislation with respect to the regulation of nurses in the practice of their profession.

Senator HUGHES. And even with respect to boiler inspectors, and all down the line.

Senator WAGNER. Yes.

Mr. ROSE. I can assure you that the association has no desire to do anything to prevent information regarding investment counsel from going to prospective clients. My only point is that if the Federal Government undertook to establish regulation at this time, it would be going into a line which I think thus far has not been entered.

Senator WAGNER. Do you think it ought to be done by the States?

Mr. ROSE. I am not sure. I think there is a trend toward more centralized Federal regulation; but I think this young profession—just about born—would not like to be used as a guinea pig to test out the idea.

Senator WAGNER. No; but I think there is a good deal of experience along the line of registration of professions which have a kinship to yours. I regard that as a very important profession, and the advice should be confidential. Nevertheless, you are certainly concerned with the question of whether or not the men in your profession are going to be men of high character; otherwise, they might very well take advantage of your clients.

Mr. ROSE. We very definitely accept that.

Senator WAGNER. And I can see that you recognize that, yourself, in your organization.

Mr. ROSE. Exactly.

Senator WAGNER. However, there are a great many whom you do not reach. What are we going to do about them? They do not come under any kind of surveillance, either by your association or by anyone else.

We are not arguing now about how much ought to be stated in that registration, because that is another question; but we are concerned with the problem of whether there should be some form of registration so that we would know who are these counselors who are engaged in this very important function. I am raising that question.

Mr. ROSE. Yes, sir.

Senator WAGNER. I have not decided it in my own mind, at all; but I am raising the question. That is why these hearings are so very helpful.

What do you say about that?

Senator HUGHES. I might suggest that there would be a considerable number who would prefer to stay outside of your association because they do not want to be brought up to these standards.

Senator WAGNER. Yes, they do not want to adhere to these high standards.

Mr. ROSE. I think we have some ideas on that; but first I should like to discuss the point you raise. It may be that you have gained the impression that the association is not desirous of having any regulation; we realize that any profession needs to have some regulation.

Senator WAGNER. Let me say that if I thought you could get all the brokers in, I—as one member of the committee—would be quite satisfied by your regulation under your own association's rules.

However, how are you going to get in the others, who may not want to live up to your high standards? Do you think mere competition will take care of that?

Mr. ROSE. I think public education will take care of that to some extent.

Senator WAGNER. It has not always done so.

Mr. ROSE. I shall discuss that later, if you do not mind, Mr. Chairman.

Senator WAGNER. Of course.

Mr. ROSE. It is a very broad subject.

Senator WAGNER. I know it is.

Mr. ROSE. And it is a subject of which the general public knows very little. Therefore, we are almost in a position of being accused before we put in our evidence.

If we have the complete picture of it, then I think we can discuss it more intelligently; and this matter I want to discuss now has a bearing on the subject you just raised—perhaps not at the present time, but I think it will have an increasing bearing as the profession develops.

That is this question of Federal versus voluntary self-regulation.

The increasing influence of competent and unbiased investment advice should tend to divert the flow of capital into the more productive channels, to discourage its utilization in unsound or decadent fields, and thus to diminish substantially the waste incident to financing operations stimulated largely by the sentiment or enthusiasm of an inexperienced investing public. Because of this important positive function which the profession of investment counsel may perform in our national economy, it seems to me that, in the public interest, every encouragement should be given to attract into this field the most capable men available. The history of detailed governmental regulation in other fields of endeavor indicates clearly that such regulation has been a serious deterrent to the better qualified and more able men who might otherwise have entered such fields.

We believe that the growth of a positive force in the financial community, as currently represented by the better known investment counsel firms, would from a practical standpoint be more effective in promoting the welfare of our national economy than new regulatory measures burdening the field of investment and finance with unnecessary restrictions.

Certainly, it is most important that no move should be made by the Federal Government which will minimize the growth and effectiveness of voluntary regulation and self-discipline which have been undertaken by the investment counsel profession itself. In the long run, we believe that definite encouragement to such voluntary, self-regulatory agencies as the Investment Counsel Association of America would prove most constructive in the public interest; and in this connection, I should like to read one or two excerpts from the report of the special committee for the study of investment counsel qualifications—to which I referred earlier. You will remember that it is the committee including, as public members, Mr. Angell, Mr. Berle, and Mr. Ordway Tead, chairman of the Board of Higher Education of New York.

I quote from their report dated July 31, 1939, and which deals with precisely the problem you are considering:

The Committee has given careful consideration to the possibility of suggesting some plan or method for improving the standards in the profession which might have a considerably broader application than is at this time within the province of the association to carry out. We have seriously considered the advisability of recommending registration or licensing, or even examinations under the auspices of the Securities & Exchange Commission at Washington, or by the Banking Departments or other suitable agencies in the various States.

In this connection we have first had to recognize that because of the youth of the profession it would be virtually impossible to appoint a public board of sufficient experience and knowledge of investment counsel to pass upon the qualifications and competence of applicants. If licenses were issued to investment counsel on any superficial or improper examination the prestige derived therefrom by many relative incompetents would serve to discourage improvement in the standards and thus bring more harm than benefit to the public. We have, therefore, reluctantly concluded that until the qualifications and practices of the profession

have become better clarified through experience it would be inadvisable to attempt any kind of intensive legislation in the field, provided that the recognized leaders in the profession itself shall choose to use more aggressive means to educate the public to a better understanding of the essential requirements. Public education, supported by the exemplary conduct of reputable firms would, we believe, be more effective in the public interest at this time than concentration upon crusades against the exploiting fringe.

On the basis of the experience of the past 2 years we believe that the Investment Counsel Association, even though at this time including as members only a relatively small proportion of the total practitioners, can now safely and most effectively in the public interest expand its membership and public usefulness.

That completes the quotation from the report of the special committee.

Now, to summarize very briefly: The association feels very strongly that investment counsel clients should be entitled to safeguards comparable to those offered the public in their dealings with the legal, medical, engineering, and accounting professions. To accomplish this, we believe the best method to employ is that method by which these other professions have achieved their present high standing. It is the tried, proved, and economical method. It is already in operation.

Ours is a new profession. It is still in the development stage. We are not yet sure what particular methods, practice, and prohibitions may be to the best interests of our various types of clients. When we feel more certain of our ground, we shall ask for at least that measure of public supervision and regulation which is now accepted by the other recognized professions. Until that time, we believe the public interest can be better served without imposition of the additional legislation and uncertain and indefinite inquisition and regulation proposed in this bill.

Senator WAGNER. Of course, Mr. Rose, "inquisition" is a rather strong word.

All right; that is your statement and not mine.

Mr. ROSE. Some of us have not felt it was too strong—those of us who have read the bill and have tried to imagine what might take place under it.

As has been indicated by what I am afraid may have been a rather tedious array of historical and factual data, the Investment Counsel Association for the past 3 years has actively and aggressively been concerned with the problem of establishing and maintaining high standards in the practice of this profession. This has not been limited to practitioners in the field, but has embraced the beginnings of a rather broad and comprehensive plan of public education to these standards.

If now, at this critical period in the development of this professional association, we are forced to abandon the constructive job upon which we have embarked, in order to protect our very existence as well as the interests of our clients, that are now threatened by the imposition of legislation which may include—again—inquisitorial powers and regulation by a governmental agency, the momentum of this positive, constructive force will have been arrested. Our energies and abilities under such conditions would have to be devoted to the preservation of our existence as a profession, rather than to the establishment and advancement of standards within that profession. We earnestly hope that the association's worthy objectives, toward which important

progress has already been made, will not have to be placed in jeopardy by a reorientation to a completely defensive position.

Mr. Chairman, I imagine you will not want to continue much longer today; but Mr. Rudolf P. Berle, general counsel to the Investment Counsel Association of America, would like to comment briefly on some of the broader implications of Federal regulation in this field.

Thank you, sir.

Senator WAGNER (chairman of the subcommittee). We are glad to have heard you, Mr. Rose.

Senator WAGNER (chairman of the subcommittee). Mr. Berle, how long do you think you will take?

Mr. BERLE. I think my statement can be concluded in 10 minutes.

Senator WAGNER. Then we should be glad to hear you now. Please proceed.

STATEMENT OF RUDOLF P. BERLE, GENERAL COUNSEL, INVESTMENT COUNSEL ASSOCIATION OF AMERICA, NEW YORK CITY

Mr. BERLE. My name is Rudolf P. Berle. I am an attorney, and am general counsel for the Investment Counsel Association of America.

I might say preliminarily that my reason for being interested in investment counsel matters has been due to the fact that, before this association concerning which Mr. Rose has testified was formed, I became peculiarly interested in the functioning of investment counsel, as such—largely by virtue of the impact of the requests for advice, that came to me as an attorney; because frequently in the course of my practice I found that clients were asking us for investment advice, and I knew perfectly well that we were not competent to give investment advice in that broad, comprehensive fashion in which investment counsel are supposed to give it; and it seemed to me that, peculiarly, it was important that there should be developed and should be crystallized as a profession which devoted itself to that type of problem which was present in the case of so many clients.

Senator HUGHES. Where do you practice, Mr. Berle?

Mr. BERLE. In New York City, sir.

Senator HUGHES. Very well.

Mr. BERLE. At the threshold of any consideration of a bill for the regulation of investment advisers by the Securities and Exchange Commission, naturally lies the broad question as to whether regulation of any character by the Federal Government is appropriate. This committee is perhaps in a better position to consider such a broad matter of policy than the members of the investment counsel profession, since necessarily they may be open to the charge that any effort to resist regulation is motivated by selfish purposes. The Investment Counsel Association of America deems it appropriate, however, to bring to the attention of the committee in its consideration of the problem the various elements involved; but let it be emphasized further that in presenting these considerations, rather more fundamental matters are dealt with than technical questions of constitutionality.

I should likewise like to point out at the beginning that the definition of investment adviser, which is contained in section 45 (a) (16) of title I of this bill, is so broad that it includes many types of activity

to which my testimony will perhaps not apply, except perhaps indirectly. The remarks which I have to make are based primarily upon my contact with investment counsel, a term which applies to those investment advisers who maintain a highly personal and professional relationship with their clients and who are as remote from the vendor of a tipster sheet as a first-class surgeon is from the seller of patent medicines. Nevertheless, the effect of this bill upon what I may call true investment counsel is of the utmost significance, because the true investment counsel stands at the heart of the entire problem.

Perhaps, likewise, it would be well to emphasize that the Investment Counsel Association is fully as acutely aware of the deficiencies in the way in which the profession is conducted at the present time as is the Securities and Exchange Commission. Mr. Rose's analysis of the purposes of the association, clearly revealed by its code of professional practice, is ample proof of the efforts made by the association to standardize some of the practices at present existing. Recognition of evils, however, does not necessarily imply a determination of the method by which those evils are to be eradicated. It has in fact been characteristic of the association that its approach has been what I believe the Securities and Exchange Commission itself would concede to be the best, namely, to have the members of the profession deal with their own problems.

At the outset, may I say that I regard it as extremely unfortunate that the proposals for the regulation of investment advisers should have been coupled with the proposals for the regulation of investment companies. Investment counsel have only services to sell. Investment companies have securities to sell. The one is capable almost exclusively of the subjective approach; for in dealing with investment counsel, fundamentally you are dealing with individuals and the capabilities of individuals, reflected in the advice which they give. In the other, an objective approach is possible, for the handling of investment trust securities can at any given time be the subject of purely objective study. We feel quite strongly that these two subjects should have been segregated, inasmuch as the material necessary to formulate conclusions with respect to the one is utterly unrelated to the facts fundamental to the other. Since, however, the two are embodied in one bill, we have no choice but to deal with the situation as we find it.

Senator HUGHES. You both manage your clients' money, don't you?

Mr. BERLE. One of us sells securities to the public, and there may be no personal contact whatsoever. In fact, in most of the investment trusts I gather there is no personal contact whatsoever; whereas in our situation that highly personal relationship is of the very essence.

Now, Mr. Chairman and Senators, I do not appear here in any sense opposed to the idea of Federal regulation, as such. I sincerely believe that the Securities and Exchange Commission has rendered a great public service in the performance of such legitimate functions as the regulation of the issuance of securities and the regulation of national security exchanges, as well as in the field of public utility companies, so ramified in their structures that they reach out over the entire country. Furthermore, I believe this in spite of many of the criticisms of administrative operation, which not only leaves room for improvement but which I believe the Commission itself is the first

to recognize as a field which needs improvement and which can be improved.

However, a real question of policy arises when it is proposed to extend the functions of the Commission into an area involving the regulation of individuals who, in essence, are rendering personal service. The dealings between one individual and another, in the matter of giving advice on the investment of funds, fall into no established pattern; nor will these dealings ever fall into an established pattern, because of the fact that no two individuals who may seek investment advice will normally present precisely the same kind of human problem to the counsel whose advice is sought.

Perhaps this can be most aptly illustrated by the provision in section 204, subdivision (c) (2), which appears on page 100 of the print, lines 4 to 6, inclusive, which requires the registering investment adviser to file copies of every form of contract or agreement regularly used by the investment adviser between himself and his clients. I am prepared to defy almost anyone to tell me when a form of contract becomes a form regularly used. Investment counsel may very well have some standard form, from which variations are made to suit the particular situation of the particular client with whom they may be dealing; but to assume that all investment counsel fall into a mold, and to assume that all investment counsel's clients fall into a mold, is to negate the great variety which exists among human beings.

Even if some standard form of contract is customarily used, it may well be that the principal vice which should be prevented would lie in the special forms of contract made in special cases. Furthermore, to determine whether any such vice does exist, it would be necessary to conduct a detailed examination into the circumstances of the relationships between the investment counsel and his client. On its face, such a contract could well be of a type which the Investment Counsel Association, for instance, would heartily condemn; and yet it might well have been entered into without the slightest taint of fraud or concealment, simply because that was the kind of an instrument with which those two people, with their eyes open, chose to define their relationship.

It is the essence of our conception of the giving of investment advice for compensation that individuals seeking advice should not be forced into a standard mold. In fact, the moment the investment counsel begins to deal with his clients on any regimented basis, I think the best investment counsellor would tell you that he had ceased properly to perform his function.

I need only sketch a variety of instances to illustrate this point. With a fund of \$100,000 to invest, the problems of the investment counsel will be utterly different for the widow having no other possible means of support, for the man with a wife and several children, for the unmarried man at the threshold of his life, for the man of substantial additional resources besides this fund, for the client who holds a responsible and reasonably secure position of employment (to the extent that such exists today) for whom the fund represents accumulated surplus, and so forth ad infinitum. Only after the immediate financial and human requirements of these individuals have been analyzed, does the investment counsel begin to deal with the problem of the purchase of different types of investments. Yet, upon the accuracy of his initial analysis of these human characteristics may very