

INVESTMENT TRUSTS AND INVESTMENT COMPANIES

TUESDAY, APRIL 23, 1940

UNITED STATES SENATE,
SUBCOMMITTEE ON SECURITIES AND EXCHANGE
OF THE BANKING AND CURRENCY COMMITTEE,
Washington, D. C.

The subcommittee met, pursuant to adjournment on yesterday, April 22, 1940, at 10:30 a. m., in room 301, Senate Office Building, Senator Robert F. Wagner presiding.

Present: Senators Wagner (chairman of the subcommittee), Hughes, and Herring.

Senator WAGNER. The subcommittee will come to order. Mr. White?

Mr. WHITE. Yes, Mr. Chairman.

Senator WAGNER. You may proceed.

ADDITIONAL STATEMENT OF JAMES N. WHITE, OF SCUDDER, STEVENS & CLARK, INVESTMENT COUNSEL, No. 10 POST OFFICE SQUARE, BOSTON, MASS.

Mr. WHITE. Mr. Chairman, as I told you before, I am a general partner in the firm of Scudder, Stevens & Clark.

I am appearing in opposition to title II, but first I want to tell you our position on Federal regulation generally. It is this: We would not oppose registration, or regulation, if there were a need for it, and if the interests of our clients were adequately protected, and if the objectives of the bill and the powers of the Securities and Exchange Commission were adequately prescribed.

The last two points—protection of the interests of our clients and definition of the objectives of the bill and of the powers of the Securities and Exchange Commission—relate to the provisions of this particular bill. The first point is whether there is any need for registration or regulation of any kind. If we thought there were any need for legislation, we should gladly agree to it.

In this connection, may I make one comment on yesterday's testimony? There may have been some misapprehension arising from what Mr. Rose said concerning the association. The association represents only a portion of the profession, not because the remainder of the profession does not observe the same standards but because many firms have doubted the advisability of an association at this stage of development. My firm, for example, is not a member of the association. There is no basis for any impression you may have gathered that nonmembership in the association implies any lower standards. I am sure that Mr. Rose did not mean to convey any such implication.

Senator WAGNER. Well, we do not understand it so either.

Mr. WHITE. Now, gentlemen, what is the case for regulation? We know the case as stated in the Securities and Exchange Commission report to Congress and in the testimony of its representatives before this committee. If there is any other case for title II, we do not know it and, though I may be wrong, I seriously doubt whether it exists.

The case for title II as stated by the Securities and Exchange Commission is based entirely on certain testimony given before the Securities and Exchange Commission by the very group of witnesses from the investment counsel profession whom you heard here yesterday. From that testimony, the Commission has apparently gathered that we believe that there is a racketeering element in the profession which needs regulation. That testimony was given at a hearing before the commission in February 1938.

I want to tell you about that hearing very briefly. A group of investment counsel firms, practically the same group which has been represented here, met by invitation with the Securities and Exchange Commission. Our attendance, while voluntary, was requested by the Commission, and we were glad to help in making ourselves and our business known to the Commission. The conference took the form of a public hearing, with Mr. Schenker, on behalf of the Commission, asking us questions.

The hearing dealt only briefly with the history of the investment counsel profession and with its methods of operation. Very early in the hearing, Mr. Schenker, indicating some general approval of the way we carried on our business, suggested that there existed in the broad field of those giving investment advice what he described as a fringe of racketeers. Specifically, he referred to a so-called financial advisory service advertising in the newspapers that they would furnish the name of a \$2 stock likely to advance in value. The suggestion was, of course, that this racketeering fringe ought to be regulated.

This question was asked—referring to this supposed tipster element:

Question. However, it is a condition and not a theory which confronts the Commission. That type of thing exists, does it not?

Answer. When I say yes, I do not know. I could not put a name to any individual.

Question. I am not being critical of Town Topics—

that was the name of the financial advisory service—

but that type of organization which gives that type of investment service exists, isn't that so?

Answer. Yes.

I mention this brief colloquy because it is typical of the testimony that we gave at this hearing before the Securities and Exchange Commission, and because it is that testimony which seems to furnish the principal basis for this attempt to regulate the investment-counsel profession.

I must say I think we were all no doubt glad to find that the Commission apparently approved of the job that we were doing, and we were quite willing to agree with the suggestions of Mr. Schenker that there was a racketeering element of tipsters which need regulation. Accordingly, it is not surprising to find that the subsequent testimony, consisting largely of long questions as to the importance of regulating this racketeering fringe, contained answers varying from outright

assent to statements to the effect that if racketeers did exist, it constituted a problem.

I think that we were quite right in agreeing with the Commission that tipster services may constitute a racketeering fringe presenting a problem. We do not know anything about them, and certainly can't say they don't exist. However, if anyone reads our testimony as agreeing that tipster services are in any way a part of our profession, we have been very badly misunderstood. You have already heard what investment counsel are and how they work. A tipster service is something else altogether.

It has been suggested that this sort of racketeer may attempt to impose upon the public by using the name investment counsel. Even if that were so, even if they did use the name, they still are easily differentiated. If additional regulation of the tipster and the racketeer is necessary or desirable, such regulation is certainly possible without subjecting investment counsel to the same treatment.

Just in passing I want to say that I doubt very much whether they do use the name investment counsel. I have never seen it used in that sort of advertising, and in the list of advertisements which appeared in the back of the Commission's report to Congress there was no mention of the words "investment counsel" or of any phrase that they would seem to hold themselves out as investment counsel.

The Securities and Exchange Commission's report to Congress contained a great many advertisements of tipster service. Not one of them, as far as we could see, used the words "investment counsel." That is why we are opposing regulation or registration of investment counsel. If we are wrong on our facts, we shall be glad to change our position.

Now as to this specific bill before the committee. I want to tell you what this bill seems to me to do. First of all, however, I would like to remind you how the Securities and Exchange Commission representatives described title II before this committee. Mr. Schenker described it in a few words. He said to this committee:

What is this registration business? What does it amount to? We simply have a piece of paper on which they put their name and address. Who are their partners? What is their background? What is their experience? What is their discretion over their customers' accounts? And we ask them if they engage in any other business. Then, if they have been convicted in connection with a securities fraud, or if they are subject to an injunction in connection with a securities fraud, we have the right * * * to say we will not register you.

Judge Healy said that the real intent of title II "is to see to it that men with this kind of a record (criminal records) cannot go into the business of being investment advisers."

That was the Securities and Exchange Commission's description of title II. It sounds reasonable enough.

Now, having in mind that the case for regulation is the racketeering fringe, and that the Commission has described title II as a simple registration to keep out of business a demonstrated felon, let us look at the actual provisions of title II.

In the first place, look at the findings which Congress is asked to make. Do they relate to a racketeering fringe? They do not. Congress is asked to find that the advice given by investment advisers relates to the volume of trading in and prices of listed securities, and of securities in the over-the-counter markets, and of securities issued by national banks, and of securities issued by member banks of the

Federal Reserve System; that their work influences the policies of large financial and banking institutions; and that their work is done in such great volume as to affect interstate commerce, securities, markets, the national banking system, and the entire national economy.

Now that is quite a statement, and, without any undue modesty, I can say that it does us too much credit. However, the point is that those findings have nothing to do with a racketeering fringe—the Securities and Exchange Commission doesn't for a moment think that the racketeers are of such great economic importance. These findings, even as applied to the investment-counsel profession, represent gross exaggeration at the best; but certainly they cannot be intended to relate to any tipster minority.

In the second place, the regulatory provisions of the bill go far beyond any simple registration or census. This point has been touched on before, but it's worth repeating. What does the registration statement contain? It must contain certain specific items and then "such further information and copies of such further documents" as the Commission shall prescribe by rule or by order. What happens to the privacy of our clients' affairs and of our sources of information with that provision in the bill? That privacy just does not exist.

Again, you have incorporated by reference in title II the broad power given by title I to make rules to carry out any of the provisions of the title. Judge Healy doubts whether this power confers any substantive regulatory power on the Commission and suggests that it is limited to the definition of certain technical terms, and so forth. I would feel better if I could be sure that he was right; taken with the proposed findings of fact and the statement of abuses alleged in the declaration of policy in title II, this seems to me a very dangerous provision.

But there is one point which seems to be more important than anything else that can be said about title II. After serious study we have come to the conclusion that what this bill really does is to give the Securities and Exchange Commission the power to make a thoroughgoing investigation of every detail of the business of the true investment counsel profession, and to follow it up with a detailed regulation of that profession.

We have come to that conclusion for several reasons. Certainly the bill gives the Securities and Exchange Commission power to make such a detailed investigation. Section 38, incorporated by reference into title II, says in so many words that the Securities and Exchange Commission has the power to investigate "any facts, conditions, practices, or matters" which it may deem appropriate for the purposes not only of enforcing the law but also of serving as a basis for recommending further legislation.

Another point is very significant. Title II has been proposed to you as a method of regulation of investment counsel by registration, but note an important omission. Nowhere in title II is there any provision for keeping registration statements up to date—no provision requiring amendments when facts change, no provision for annual or supplementary reports. In other words, under the bill as it has been introduced, an investment adviser once registered may change the entire character of its business; may change its partners, officers, and directors, or its place of business; may change its practices with respect to clients' funds and accounts; and wouldn't have to

report any of those changes to the Securities and Exchange Commission.

Now every other registration statute requires that information set forth in a registration statement be kept up to date on some reasonable basis. Why has any such provision been omitted here? It can only be because this title is not intended as a completed regulatory scheme but rather as a grant of full power to investigate and then to provide additional and detailed regulation. In fact, the absence of any provision for keeping registration statements up to date is by itself enough to make future legislation essential.

The CHAIRMAN. You favor the incorporation of such a provision.

Mr. WHITE. Well, with registration, but there is no point unless you have it. And, if you have registration, you might as well keep it up to date.

Senator WAGNER. Are you opposed to registration in any form and under any circumstances even though the language be such that your objections would be eliminated? Do I understand that you still object to registration?

Mr. WHITE. Senator Wagner, registration by itself is worthless. Registration without the power to do something about registration is of no value, is it?

Senator WAGNER. I am not so sure about that.

Mr. WHITE. But I should not ask you a question.

Senator WAGNER. That is all right, but you understand that my mind is open and that I am seeking information.

Mr. WHITE. We just feel that registration leads to investigation, and that investigation leads to regulation; and it is possible for a good deal of controversial theory on economics to creep into regulation. That is the point.

Senator WAGNER. All right. You may proceed.

Mr. WHITE. On this point of the real purposes of this bill let me mention again the proposed findings of fact. As I pointed out, they are all related, not to the existence of racketeers in the investment advisory business but to the economic importance of investing money—an ideal basis for as elaborate an exploration of the investment counsel profession as could be imagined.

Finally, there is the small but very significant phrase in the proposed declaration of policy contained in section 202 that the title is for the purpose of mitigating “as far as presently practicable” the abuses referred to in that section. Take all these factors together—the nature of the findings of fact, the broad power to investigate, the absence of any provision for keeping registration statements up to date—and we cannot doubt that this bill will be construed by the Securities and Exchange Commission as a mandate from Congress for a thorough-going investigation of the whole business of investment counsel, with further detailed regulatory legislation to follow.

We think that no case has been made which should cause Congress to authorize such an investigation or to grant such a mandate.

Senator WAGNER (chairman of the subcommittee). We thank you very much.

Mr. WHITE. And I thank you for hearing me.

(Thereupon Mr. White left the committee table.)

Senator WAGNER (chairman of the subcommittee). Mr. Loomis?

**ADDITIONAL STATEMENT OF ROBERT H. LOOMIS, PRESIDENT,
LOOMIS, SAYLES & CO., INC., BOSTON, MASS.**

Senator WAGNER. I hope your statement is not just a repetition of what you said here before.

Mr. LOOMIS. I shall try to stay away from repetition.

Senator WAGNER. All right. You may proceed.

Mr. LOOMIS. The testimony yesterday afternoon appeared to degenerate into an argument that was satisfactory to no one. We drifted into the question of constitutionality and interstate commerce—arguments that delight the lawyer and confuse the layman, but lead nowhere.

This entire question involves both the public interest and our interest but the truth of the matter is that they are one and the same thing.

We have no desire to oppose registration or any other form of legislation if it is in the public interest for the simple and selfish reason that if any group such as ours whose livelihood depends on public trust and confidence is acting against the public interest, it cannot long endure.

Now, what is registration? Registration is but a step, but where does it lead? Taken alone it cannot protect the public interest against abuses in any field. We feel that registration would hurt our business so we do not want Federal registration unless it has been demonstrated that it is necessary.

Why did many of those testifying yesterday shy off from even accepting the theory of a simple census and thus expose themselves to a very natural skepticism concerning their open-mindedness on any subject? The first step, therefore, let us say, is simple census. Let us find out that you exist and where is your place of business. This information is worthless unless having found out who is in the business it is possible to find out what kind of a business he conducts.

Therefore, the next step is taken—investigate, and what is the point of investigating without pretty broad powers so that essential information cannot be withheld.

Again, what is the point of making the investigation if the investigatory body can take no action should it discover abuses, so the following step is clearly called for—regulation, to wit, the ability to see to it that businesses are conducted according to rule and punishable when that rule is departed from.

This is why we would answer the question, "Are you against registration?" in the negative, unless the need is demonstrated fact, and would be forced to answer it in the affirmative, if the reverse were true.

Now, I am opposed to title II of this bill because, first, it would appear to me that the need and demand for this legislation has not been established; and, secondly, I believe that this proposed legislation might become harmful to the best interests of those for whose protection the bill is intended.

I believe that if investment counsel now knew adequately what the Commission was driving at, if we knew the complete objectives of the Commission—if it knew why the Commission jumped from the census idea 2 years ago to the idea of complete regulation, we would be in a much better position to cooperate intelligently with them.

On the face of it, title II appear rather mild and innocuous and it is only after careful study of it and also a study of what is implicit in its present requirements, that I have decided it is drastic enough to indicate that someone must have thought the situation pretty bad.

For example, the matter of registration of investment advisers: The uninitiated might well consider that the bill was most simple and restrained. In testimony which I gave before counsel of the Securities and Exchange Commission in Washington some time ago, when asked as to whether or not I considered registration advisable, I made the distinction between registration and a census and said that I would be willing to have a census taken. The reason for my making that distinction has been fully justified by the terms of the present bill.

The present bill is not a census and not a mere registration either, but also calls for regulation.

If at the present time there were huge and widespread scandals; if it was obvious that fraud was being perpetrated widely; in other words, if enormous abuses were prevalent right now and we were sure of them, there might be justifiability for immediate urgency of legislation to prevent widespread fraud. But in the apparent absence of this, at least so far as my observation is concerned, it would seem reasonable to make haste slowly, to legislate upon knowledge and not upon ignorance.

The discussion yesterday seemed to indicate two classes of undesirable: First, the "fringe" as typified by the tipsters; and, second, the firms which fall within any reasonable definition of investment counsel and yet have not high standards.

There is little argument on the first group, but we fear that the impression was created that those who are members of the association are on one level while those outside of it are unwilling to adopt such high standards.

The impression was thus created that the vast majority of counsel firms had standards that were to some degree questionable. Mr. Rose testified that in his opinion there was 150 to 200 firms of real investment counselors in the country while only 18 belonged to his association. This impression is very far from the truth.

We do not belong to the association because we do not now, and did not when the association was formed, believe that there existed abuses in the investment counsel profession which required the corrective influence, if any, of an association.

An association is formed generally because some group benefit can be obtained or some group benefit given. As investment counsel do not have dealings with one another, or jointly with third parties, we did not see how there was anything to be gained selfishly from banding together in an association.

Since we failed to discover the existence of abuses, we were something less than enthusiastic about getting involved in the formation of an association which we felt sure had erected a straw man without which it could not exist. Yesterday you got a glimpse of the straw man. We recognized that when and if an association were of such size and national reputation that elimination from its roster would carry such a stigma that the expelled member could not operate, it would have a corrective influence, but again we could see no point in starting in to build a corrective influence until we knew that we had

something to correct. In other words, we were not interested in forming an association just for the sake of having an association.

Our clients are paying minimum fees of from \$125 to \$250 four times a year, and of course for those having more than \$100,000 these quarterly fees may run into the thousands of dollars. It is customary to have these contracts cancelable every quarter. I believe that you will agree with me that these clients would not pay out, actually write a check for hundreds or thousands of dollars every quarter-year, and continuously through the years, unless they knew pretty well what they were paying out this money for and to whom they were paying it. Every 90 days they think this out pretty carefully.

I believe that title II is discriminatory legislation. Let me develop this point. During the past 10 to 20 years, many investment counsel have followed a long and very expensive process of acquiring and training personnel in a new profession, of building up and maintaining research departments up to 100 people costing large sums annually to provide proper facilities for clients, of training personnel in the methods of counseling for clients, and of generally molding all their endeavors into what now constitutes a fairly clearly outlined profession. They have overcome enormous difficulties, and through the greatest depression in history have built up the confidence of a large number of clients in the technique and process of a profession.

This discriminatory character of the bill is probably my strongest criticism of title II of this bill. Do you realize that every lawyer the day he passes his bar examination is automatically exempted from this bill? In other words, any lawyer, whether he knows anything at all about investments, is assumed to be fully competent to practice this profession of investment counsel.

It is a well-known fact of course, that lawyers and law firms, particularly in New England, direct the investments of hundreds of millions of dollars in this country. What is there in the training for the law that makes the lawyer automatically so fully and adequately equipped for investment counsel that he is thus put outside this proposed legislation entirely? Is it because the lawyers have made such a startling success of investment management and there is no evidence of felony in their administering of funds? The investment-trust witnesses testified that lawyers were involved in the most flagrant investment trust scandals, yet lawyers are exempt!

I cannot believe that Congress has such an objective in mind. Furthermore, I feel very strongly that the clients of investment counsel today would raise a strong protest, first against the insinuation that they do not have sense enough to choose proper investment counsel, and secondly against this attempt to discriminate against an outstanding group in America that has spent time and money solely to represent and promote the interests of the investors themselves.

Now, it is a serious matter when you take any steps to cast a cloud of suspicion over this young, vigorous, high-minded industry or profession. Prior to this time I had supposed that legislation was passed after the establishment of need for it. While I admit that I am merely a layman and do not understand the law, this is the first time to my knowledge that legislation has been enacted prior to the proof of need. Please bear with me while I attempt to review the facts in this situation as I see them.

First of all, the Securities and Exchange Commission was instructed by the Congress to investigate the investment trust field. As has been shown during the past several weeks, practices not in the public interest occurred in this industry and, in some cases, the public suffered. However, the Commission does not stop here. They decide that while they are urging the enactment of legislation to cover investment trusts, they might just as well include an entirely separate field, that is, the investment counsel or investment advisory field.

As far as I am concerned, I have not been made aware that there is either a demand for such legislation on the part of the public or that it is in the public interest. The only reasons that I have gathered from the hearings held a couple years ago, or from the testimony presented during this hearing, is that the Securities and Exchange Commission feels there are possibly two reasons why legislation covering us should be enacted: First, because perhaps there are abuses in the investment counsel profession. They do not state that there are any, in fact, Mr. Schenker, during the original hearings, repeatedly said that he was not interested in us as a group; that we were all right as far as he was concerned.

I am afraid that on yesterday the representative of the Investment Counsel Association may have given you the impression that there were abuses when he referred to the fact that all members of the association did not originally come up to the standards prescribed by the association. Here again, I wish to state as emphatically as it is possible for me to do that I, personally, am not aware of abuses practiced by the investment counsel profession which are detrimental to the public interest. The standards of practice set up by this group individually, I dare say, are as high as were ever established in the early life of any of today's professions. If there is any feeling in this committee that our organization would not need the qualification standards of the Investment Counsel Association, I would like to refer him to our code of practices, written by us to govern ourselves, and filed with the Securities and Exchange Commission.

The only other reason given me as to why the investment advisory field needs regulation is because there seems to be, in the minds of the Securities and Exchange Commission at least, an outer fringe in the industry whose practices are not up to the standards of ours. That may well be. I expect there is an outer fringe to everything. It has not yet been proven to my own satisfaction, nor has the Securities and Exchange Commission proven to the committee as far as I know that this so-called outer fringe, these so-called tipsters and what not, are important enough in our national economy to justify the enactment of legislation which in its very essence endangers our very business. I have not been told how many exist, how important they are, how many of those that do exist are good, and how many are bad. In my own mind, I have not been convinced that this legislation or any legislation will catch them anyway. They are a nimble lot and they move fast. I am not so sure but what the Federal Bureau of Investigation or other departments of the Government might still be far better equipped to deal with them than the Securities and Exchange Commission.

How can they exist? Simply because there are and always will be people who wish to take a gamble on \$2 or \$5 with the hope that they are going to get rich. But because this nebulous, undefined field appears to exist, it seems necessary in the minds of the Securities and