

feature of outstanding certificates would have been rendered nugatory by law until capital impairment was eliminated.<sup>19</sup>

The Maryland law, although preserving the general rule that a corporation may not purchase or redeem its stock except out of surplus, has made a specific exception for investment companies. While this would seem to make permissible repurchases out of capital, the effect of this provision is offset by the fact that the charters of all the open-end companies incorporated in Maryland stipulate that they will redeem their stock "to the extent that they have surplus available, and out of such surplus."

If a corporation is required to resort to a reduction in capital in order to create surplus out of which shares may be repurchased, then complications of various kinds are met. Approval of stockholders is necessary, in some cases (such as Maryland) by a two-thirds vote. Moreover, the statutes of some States place restrictions on purchases of shares from "reduction" surplus or from any surplus except earned surplus.<sup>20</sup>

#### CONCLUSION

It seems doubtful, in the light of what has been said above, whether the provisions of section 22 (d) (1) giving the Commission power to prohibit suspension of the redemption privileges of redeemable securities is broad enough to protect the investor adequately. Obviously, the Commission could not prohibit the suspension of the redemption feature of a redeemable security if the corporation's capital is impaired and the State of incorporation prohibits repurchases under such circumstances. In order for the Commission to ensure that a redeemable security actually is such, it should have the power to supervise the wording of trust indentures and certificates of incorporation in respect to the redemption provision. Under the Barkley bill, it received such powers for trust indentures generally. There would seem no valid reason to omit them in the present bill.

#### REDEMPTION PROVISIONS OF OPEN-END CORPORATIONS

1. Incorporated Investors (Massachusetts corporation, 1925): Will repurchase on third day after tender.
2. State Street Investment Corporation (Massachusetts corporation, 1924): Nothing in charter or bylaws, but by vote of stockholders, January 31, 1933, corporation to repurchase shares offered, the liquidating value less \$1, providing always that the corporation will not redeem if payment for stock would render corporation insolvent or would impair any reserves for liabilities and charges. The corporation reserves right to demand written notice, make payment within 60 days, and deliver assets in kind in lieu of cash.
3. First Investment Counsel Corporation (Massachusetts corporation): Golder may require the corporation any time after 30 days to purchase the shares, provided that all liabilities and charges of the corporation shall first be secured by setting aside assets sufficient to secure the payment thereof \* \* \* and such payment shall not impair the reserves for liabilities and charges. The determination by the directors of the sufficiency of any reserves, and their appraisal of the stock to be purchased, etc., shall be final and conclusive. Redemption may be postponed for a period not exceeding 26 days.
4. Loomis, Sayles Second Fund, Inc. (Massachusetts corporation, 1934): Corporation required to redeem to the extent it has funds and/or assets legally available, but may defer such payment for 60 days. No transfer of stock can be effected without first offering same to the corporation at liquidating value and corporation shall have 60 days to accept.
5. Third Investment Counsel Corporation (Massachusetts corporation, 1929): Required to redeem any time after 30 days, as of a date not more than 16 days later than the date of surrender, payment to be made 10 days later, less 1 percent.
6. R. B. C. Fund, Inc. (Massachusetts corporation, 1929): Will redeem within 10 days of offer and pay within 10 days of appraisal.
7. Fidelity Fund, Inc. (Massachusetts corporation, 1930): Directors will repurchase class A upon demand at liquidating value less 2 percent.

<sup>19</sup> By section 19 of the Delaware corporation law every corporation is empowered to purchase its own stock, but not if such purchase would impair the capital of the corporation. An exception is made in the case of preferred or "special" stock subject to redemption, but the term "special stock" would seem not to contemplate the securities of a company with a single class of stock, such as is found in most open-end companies (see sec. 14).

No attempt was made to study the relative size of the surplus at present existing in the 14 Delaware corporations. However, in the case of American Business Shares, it was noticed that paid-in surplus is scarcely larger than capital—and this despite the fact that a reduction in capital has already been effected.

<sup>20</sup> See the provisions of California, Minnesota, and Illinois cited supra, note 14.

8. Quarterly Income Shares, Inc. (Maryland corporation): Will repurchase—until shares of its capital stock are listed on an exchange, New York Curb, Boston, Chicago, or any other 2,000,000 or more—and thereafter if the board of directors permits, to the extent that the corporation shall have surplus available for the purpose, and out of such surplus, if the New York Stock Exchange is open.

9. Dividend Shares, Inc. (Maryland corporation): Will repurchase to the extent that the corporation shall have any surplus available for such purpose and out of such surplus, in 4 days.

10. Maryland Fund, Inc. (Maryland corporation, 1934): Will redeem in 3 days at liquidating value, to the extent that the corporation shall have surplus available for the purpose and out of such surplus, until stock is listed on an exchange (in any city of 2,000,000 population) and thereafter in the discretion of the board of directors, but excluding the period that the New York Stock Exchange is closed.

11. Bullock Fund, Ltd. (Maryland corporation, 1932): Will redeem in 5 days to the extent that corporation shall have any surplus available for such purpose, and out of such surplus.

12. Income Foundation Fund, Inc. (Maryland corporation, 1934): Stockholders entitled to require the corporation to redeem to the extent the corporation shall have any surplus available for such purpose and out of such surplus, if New York Stock Exchange is open.

13. Nation-Wide Securities Co. (Maryland corporation, 1932): Will redeem to the extent that corporation shall have any surplus available for such surplus, and out of such surplus, if New York Stock Exchange is open.

14. American General Equities, Inc. (Maryland corporation, 1931): Will redeem at liquidating value on next day that New York Stock Exchange is open.

15. Spencer Trask Fund, Inc. (Delaware corporation): Charter merely empowers board of directors to repurchase stock at 99 percent, payment in 60 days in cash or kind, provided the corporation has assets legally available for such purpose. However, contract between corporation and the fund's manager provides that the corporation will purchase stock tendered provided it has assets legally available for such purpose \* \* \* after setting up such reserves as may be approved by the board of directors, in its uncontrolled discretion.

16. Selected American Shares, Inc. (Delaware corporation): Will repurchase to the extent that it shall have any surplus available for such purpose and out of such surplus to purchase stock at the liquidating value thereof; but redemption suspended for the period that the New York Stock Exchange or other exchange on which securities are listed is closed.

17. Commonwealth Investment Co. (Delaware corporation, 1932): Will redeem within 14 days of offer, at net asset value as of any date within 7 days following deposit of certificate, to the extent, and only to such extent, of the funds which the corporation at the time of purchase may legally employ for such purpose, but redemption privilege suspended for the period that New York Stock Exchange is closed.

18. Supervised Shares, Inc. (Delaware corporation, 1932): Will purchase in 5 days, but only in the event and to the extent that the corporation has assets legally available for such purpose, and while New York Stock Exchange is open.

19. American Business Shares, Inc. (Delaware corporation, 1932): A continuous market for its shares shall be maintained based on their current net asset value less a discount of 2 percent, to the extent of the assets of the corporation legally available therefor. (Paid-in surplus, approximately equal to capital, but a 50-percent reduction in capital was necessary.)

20. General Capital Corporation (Delaware corporation, 1929): Will redeem in cash or kind within 10 days.

21. Fundamental Investors, Inc. (Delaware corporation, 1932): Will redeem in cash or kind, provided it has assets legally applicable to the purchase of own shares, if New York Stock Exchange is open.

22. Investors Fund of America, Inc. (Delaware corporation, 1933): Will redeem to the extent the corporation has surplus available for the purpose and out of such surplus, if New York Stock Exchange is open.

23. Investors Fund C, Inc. (Delaware corporation, 1930): Will redeem out of any assets legally available therefor, on any day New York Stock Exchange is open for business in cash or kind.

24. Equity Fund, Inc. (Delaware corporation, 1932): Will redeem within 4 days if New York Stock Exchange is open, at liquidating value less 2 percent, to the extent it has assets that under the laws of Delaware may be lawfully used for the purchase of its own shares of stock.

25. Group Securities, Inc. (Delaware corporation, 1933): Will redeem in 3 days if New York Stock Exchange is open, utilizing for the purpose earned the paid-in surplus in such proportions as will maintain the same proportionate interest but merely by resolution of the board of directors.

26. Premier Shares, Inc. (Delaware corporation, 1930): Nothing in charter indenture (expired February 1, 1490) provides that company will redeem within 15 days, less 2 percent valued within 4 days after delivery, but company shall not be obliged to liquidate more than 15 percent of its stock in any given calendar month, thus carries over to next months. May suspend liquidation for 60 days.

27. Wellington Fund, Inc. (Delaware corporation, 1928): Nothing in charter bylaws (amendable by directors) states corporation will redeem in 5 days if it has assets legally available for such purpose, if New York Stock Exchange is open.

28. Administered Fund Second, Inc. (Delaware corporation, 1934): Required to repurchase within 3 days so long as it has sufficient funds available for such purpose, excluding days when New York Stock Exchange is closed.

29. United Gold Equities of Canada, Ltd. (Canadian corporation, 1933): Will redeem, but only in the event and to the extent that the company has any surplus available for such purpose, if the Standard Stock and Mining Exchange is open.

30. Canadian Investment Fund, Ltd. (Canadian corporation, 1932): Holder of "special shares" entitled at any time to require company to redeem to the extent that company has surplus available for such purpose and out of such surplus.

THE MARYLAND FUND, INC.

(Maryland)

JERSEY CITY, N. J., March 27, 1940.

MR. DAVID SCHENKER,  
Counsel, Investment Trust Study, Securities and Exchange Commission,  
Washington, D. C.

DEAR SIR: In response to your letter of March 22, I am enclosing copy of letter sent to the Securities and Exchange Commission under date of February 21, 1940, outlining present status of The Maryland Fund with respect to the repurchase of its own stock. We were derelict in that we did not send a copy of this communication to you.

Under date of June 20, 1937, I filed with your body a memorandum, the essentials of which are reproduced on the attached sheets. In this memorandum, written more than 2½ years ago, I set forth some of our ideas in connection with the dangers attending a deposit or repurchase liability of an investment fund. A portion of this memorandum was reproduced on page 27 in part 3, chapter III, of your report on investment trusts and investment companies.

The original charter of The Maryland Fund provides that the fund could be relieved of its repurchase or deposit liability after listing of the shares. This provision was inserted in the charter when the fund was brought out in 1934, because experience convinced us of the danger to all stockholders of a fund where the repurchase liability is present.

There is no doubt in my mind but that we failed to effect many sales because we did not have this liability and that many of the sales made were harder to make than they would have been had this safeguard not been present, but I am convinced that time will prove the wisdom of our position and justify our courage in accepting this selling handicap, to the end that permanent operation of the fund would be bettered.

You and your associates probably have a clearer picture of the investment fund field as a whole than anyone else, due to the minute study which you have given the field over the past several years. I think you will agree with us that the investment fund which is obligated to repurchase its own shares for cash on demand does not in fact have stockholders, but merely depositors. While the deposit liability is not strictly comparable with that of a commercial bank, there is, nevertheless, an analogy. It has always seemed to us that if an investment fund is to have the deposit liability of a commercial bank, it should confine its investments in large part to highly liquid items, such as those carried by a commercial bank, and should also keep a large cash position. A large cash position and a highly liquid portfolio would not be consistent with the goal of an investment fund. Therefore, we maintain that investment in a group of common stocks, coupled with a repurchase or deposit liability, is contradictory, and over a period of time will not prove workable in the best interests of stockholders.

When a fund is actively being sold, cash coming in from the sale of newly created shares is ordinarily sufficient to take care of the repurchase of outstanding shares

offered the fund for redemption. When the selling period is over, however, this situation no longer obtains, and it is necessary that the fund maintain sufficient assets in cash to take care of the repurchase liability, or that the portfolio be constantly shifted and earning assets sold off to raise cash to meet this deposit liability.

If the repurchase or deposit liability is on demand, or substantially so, and without a long period of grace, it seems to us that the tendency will be for a fund to sell off its more marketable assets in order to raise cash to meet its deposit or repurchase liability, with the result that stockholders loyal to the fund ultimately may find themselves owners of assets of less than average marketability.

We have had letters objecting to the removal of this liability from both stockholders and dealers. Generally speaking, the stockholders have appeared to be satisfied after an explanation somewhat similar to this letter. We say this because either we have heard further from such stockholders, or have had letters from them expressing satisfaction. In the case of dealers, the larger and better established dealers have not been upset, and in some cases have expressed approval of the action. In the case of certain small dealers there has been a very strenuous kick, based in some cases on a bona fide disapproval, but in other cases, in our honest judgment, based on the fact that their opportunities for trading out have been restricted.

Yours respectfully,

THE MARYLAND FUND, INC.  
By ROSS BEASON.

[Copy to dealers as information]

THE MARYLAND FUND, INC.  
(Maryland)

JERSEY CITY, N. J., February 21, 1940.

Re: The Maryland Fund, Inc. File 1-3035.

SECURITIES AND EXCHANGE COMMISSION,  
Washington, D. C.

GENTLEMEN: Pursuant to Rule X-13A-6 under the Securities Exchange Act of 1934, we transmit to you herewith an original and two (2) duplicate originals of "Form 8-K for Current Reports" in connection with the registration of the Maryland Fund, Inc., on the Board of Trade of the city of Chicago.

We had planned to make this filing at the end of the calendar month, as is customary in those cases requiring the use of Form 8-K. We are filing this before the end of the month because we plan to notify dealers of the change, but hesitate to do so in advance of notification to you.

Under the charter and under the prospectuses under which the stock of the Maryland Fund, Inc. was sold, the board of directors had the right, after the stock was listed as outlined in the prospectus, to withdraw the provision whereunder a shareholder might demand repurchase of his shares by the fund. Stock of the Maryland Fund, Inc. was listed on the Chicago Board of Trade on June 24, 1938. On June 7, 1939, the directors withdrew the right of resale to the fund, but instituted a regulation whereunder stockholders might deposit their shares with the fund, the liquidating value or repurchase price to be determined on the forty-eighth calendar day after deposit, and payment for the shares, less a discount of 3 percent, to be made within 3 full business days thereafter.

On February 15, 1940, the board of directors rescinded the regulation adopted on June 7, 1939, so that there is now no right of resale to the fund by shareholders.

Since no newly created shares have been issued since June 7, 1939, and since substantial repurchases by the fund have reduced outstanding shares since that date, it is believed that in the normal course of events a satisfactory secondary market can be created and maintained for the shares now outstanding, particularly so since elimination of the repurchase of shares by the fund automatically eliminates the 3 percent discount referred to.

One duplicate original of this report has been forwarded to the Board of Trade of the City of Chicago.

Respectfully yours,

B. E. LAWSON, Vice President.

RAY, JOHNSON & Co.,  
 Sunbury, Pa., July 19, 1939.

DAVID SCHENKER,  
 Counsel, Investment Trust Study,  
 Securities and Exchange Commission, Washington, D. C.

DEAR SIR: We are in receipt of your reply to our letters concerning the recent action of The Maryland Fund with respect to the 48-day liquidation provision.

All the information contained in your letter having as its origin The Maryland Fund, Inc., was known to us as this same information was given to all dealers, and we believe to all holders of the stock.

We, evidently, did not make ourselves entirely clear in entering our protest with your Commission. We realize that it is not the intention of the fund to liquidate, in fact the 48-day liquidation period was placed upon all outstanding shares to avoid liquidation.

The main point we wanted to bring to your attention was that these shares were sold by us upon information from the distributors of this stock, and with literature prepared, either by the fund itself or the distributors, which, regardless of what the official prospectus said concerning this provision, definitely and boldly stated that shares would be accepted for liquidation against next-day delivery without charge.

We realize that the prospectus approved by your Commission is the official description of the securities being offered, and that in using a prospectus they complied with your requirements. We do, however, feel that your requirements were evaded in other literature used in connection with the sale of these shares, which stated something as a fact that which was contrary to the charter provisions as outlined in the prospectus. In this literature they did not say that under the present set-up the stock would be liquidated immediately without charge, and that such a provision was subject to change as more fully outlined in their official prospectus, rather, they stated this condition as a fact.

We are not in a position to know whether the above procedure is contrary to the requirements of your Commission, but we still feel that whether or not it is, it most certainly has adversely affected the market for these shares with the holders being required to take this loss should they desire to liquidate immediately.

Very truly yours,

RAY, JOHNSON & Co.

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EXCERPTS FROM LETTER OF ROSS BEASON, PRESIDENT OF THE MARYLAND FUND,  
 TO DR. GOURRICH

The practice of liquidating to cash has four major weaknesses:

(a) It encourages and practically forces the use of unsound expedients in the matter of portfolio selection and cash position;

(b) It encourages trading from one fund to another, frequently at the expense of and to the hurt of the investor;

(c) It may penalize the investor who stays with a fund which is being looted by some competitive fund through trade-out operations, and in effect puts a premium on trade-outs; and

(d) It forces management to sell highly marketable securities and retain less marketable securities to obtain cash to meet liquidations.

Unfortunately during the selling period for an open-end fund where the liquidation clause is present it is necessary from a practical standpoint, or rather from a selling standpoint, to have the portfolio composed of companies more or less well known by name to the average investor, and consequently made up of a list found in similar competing funds. After the selling period is over, it is necessary to continue along much the same lines to avoid criticism and stop trade-out arguments of competitors.

Take the case of an investment fund with, say, \$100,000,000 of assets. If we should run into another period such as we did in late 1929 and the management should appraise the future and get into a cash position, they would promptly be penalized for their efforts because the assets of this particular fund being in cash and would show no shrinkage when the market fell and the shares of the fund would remain at a high level, whereas other securities would show a drastic decline. It is fundamentally true that people sell good securities to

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protect poor securities, and the result would be that the fund would be liquidated and a penalty put upon the foresight and acumen of the management for having appraised market action. Indeed, with a fund so large it would take several months to get into a cash position, and if the market were showing a steady rise up to the time of the break, as it did substantially in 1929, the competitors would call attention to the fact that shares of this particular fund were not increasing in value as fast as the shares of a less well-managed fund which was not getting into a cash position in anticipation of the market break. This again would cause liquidations. In event sincere management believed that a break was imminent and got into a cash position and the break did not materialize, the competitors would use this as an argument to get out of that particular fund because they had not called the turn.

Any way you look at it the management of funds with liquidating clauses are more or less forced to follow one another like sheep instead of giving the best operation which their studies and efforts may suggest.

Many sound and sizable corporations with fairly large capital issues outstanding do not have a broad market. It is a human thing for management to sell those securities which the market will take and retain those which have a thinner market in order to raise cash to meet liquidations, and carried to an extreme degree this would inevitably result in a portfolio of less-than-average marketability if any substantial liquidations took place. Believing as I do that the Securities and Exchange Commission will handle the situation from a realistic standpoint, I feel sure that this particular feature is fully understood.

Actually, the liquidation clause is a contradiction in a management fund. It represents a survival from the fixed trust, when the investor had no market for his securities except through liquidation. Shares of fixed trusts could not be listed because they were not issued in one shares and multiples but were issued in fixed denominations, and the investor who sold was held to mere liquidating value or all he could in event of a sale.

A fixed trust was merely a warehouse receipt, and might be likened to a situation where a ham, a sack of flour, a barrel of sugar, etc., were deposited with the warehouseman and a receipt issued therefor, which receipt could be exchanged for the warehoused property. The effort to apply warehouse-receipt practice to corporation capital-stock issues is not sound. If the shares of an investment fund be listed on some recognized exchange, the law of supply and demand will work, just as it does in other corporate securities.

Mr. L. M. C. SMITH. Just in this respect, and with regard to a statement by one of the gentlemen, who testified regarding the stockholders' being completely happy, I can say that the other day we got a letter—I shall not mention the company, but it is the company of one of these gentlemen here: He said:

With regard to this company, I paid these people \$8,300 for 100 shares of their stock on September 26, 1929. The stock's present value is \$1,550—a capital loss of over 80 percent. The stockholder has no vote nor voice in the management of the company. I am advised that their management fee is excessive.

I sincerely hope you will investigate this firm.

Very truly yours.

This is dated February 2, 1940.

We have a number of other stockholders who expressed the same sort of sentiment.

Mr. SCHENKER. And this is important, Senator, on the question of the supplemental literature—where this great charge of bureaucracy was made, where they charged that we are going to censor every letter they send out. This letter is from an investment-securities dealer which is annexed to the memorandum on suspension of redemption. He said:

I have sold a great many of my customers the shares of Maryland Fund.

The main point we wanted to bring to your attention was that these shares were sold by us upon information from the distributors of this stock, and with literature prepared, either by the Fund itself or the distributors, which, regard-

less of what the official prospectus said concerning this provision, definitely and boldly stated that shares would be accepted for liquidation against next-day delivery without charge.

We realize that the prospectus approved by your Commission is the official description of the securities being offered and that in using a prospectus they complied with your requirements.

We do, however, feel that your requirements were evaded in other literature used in connection with the sales of these shares, which stated something as a fact that which was contrary to the charter provisions as outlined in the prospectus.

Now, you can go ahead and say, "Well, he has a lawsuit and can sue them." However, we feel that the fact that it is an open end company does not make it any different from the closed end company: It should be subject to the same supervision, the same requirements, and the same safeguards for the protection of the investor.

Now just one other thing: There was some discussion here by the investment counselors with regard to title 2 which provides for their registration and regulation. In listening to what they had to say about those provisions for registration and regulation, I almost forgot the size of the title of the bill providing this regulation; I thought it must be quite a substantial affair.

However, the Senators will see that the title merely requires registration, and seeks to prevent frauds, and keep out jailbirds and security racketeers.

The approach these people have taken to the problem is curious. As I see it, it goes something like this: They designated themselves the Board of Regents of New York. They conferred upon themselves the degree of Doctor of Investment Counselors. They made themselves a profession, and said, "We are a profession; we have a confidential relationship with our client and therefore you cannot regulate us and cannot ask us any questions."

I know that in order to become a lawyer I had to go to public school, high school, college, law school, pass a bar examination, submit character evidence, have my character examined, and pass the Appellate Division. In addition, my conduct is subject to continuous scrutiny.

Why, tomorrow morning I can become an "investment counselor." All I have to do is just to get a printer to print some cards, "David Schenker, Investment Counselor." That immediately makes me an investment counselor.

Does that mean that I can take umbrage when some governmental agency wants to ask me some questions? The approach of the representatives of investment counsel is a peculiar one.

In the first place, we discussed this entire legislation not only with the people who were down here but also with investment counsel who are also in the investment-banker business and the brokerage business. They did not appear here. It is a queer thing that these people in the investment-banker business and the brokerage business, who did not appear here are subject to the S. E. C. regulation because they have to register under the Maloney Act as brokers and dealers. They evidently were not frightened to death about our peeking in their books and finding out the names of their private clients. They did not even show up.

Then there is another curious thing, Senator, that those people who are subject to supervision by some authoritative body of some kind, such as securities dealers or investment bankers have to register

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with us as brokers and dealers. People, who are brokers and members of stock exchanges and are supervised by the stock exchanges. Curiously enough, the people in the investment-counsel business who are supervised are not eligible to membership in the investment counsel association; because the association says that if you are in the brokerage or banking business you cannot be a member of the association.

So the situation is that if you take their analysis, the only ones who would not be subject to regulation by the S. E. C. would be the people who are not subject to regulation by anybody at all. These investment counselors who appeared here are no different from the over-the-counter brokers and dealers or the members of the New York Stock Exchange. All we ask them to do is file a registration statement which asks "What is your name and address, and have you ever been convicted of a crime?"

"If you have been convicted of a crime, you cannot be an investment counselor and you cannot use the mails to perpetrate a fraud."

That is the extent of the proposed law.

I should like to introduce as an exhibit the digest of the laws of the various States which require investment counsel to register. California had no difficulty with registration. Also I should like to submit a report of the Research Department of the Illinois Legislative Council, which has had a great deal of difficulty with that problem.

We should like to make that memorandum a part of the record on investment counselors.

Senator HUGHES (presiding). All right; it will be put in.

(Statement entitled "State Regulation of Investment Counsel Firms" is as follows:)

#### STATE REGULATION OF INVESTMENT COUNSEL FIRMS

Federal regulation of investment counselors as such does not exist at the present time.<sup>1</sup> Several of the States require that persons who furnish investment counsel advice be registered with the State Securities Commissioners.<sup>2</sup>

##### 1. CALIFORNIA

The State of California amended its Corporate Securities Acts in 1931 to provide for the registration of investment counselors.<sup>2a</sup> The act broadly defines an "investment counsel" as follows:

"Every person or company other than a broker, who in this State, for compensation, engages in the business of advising others either directly or through publications or writings as to the value of securities or as to the advisability of investing in or purchasing of securities, and every person other than a broker or certified public accountant who issues or promulgates analyses or issues reports concerning securities; *Provided, however,* That said term shall not be construed to include any licensed, practicing attorney who renders or performs any of said services in connection with the practice of law."

<sup>1</sup> However, sec. 17 (b) of the Securities Act of 1933 and sec. 15 of the Securities Exchange Act of 1934 contain provisions which may interdict to a limited extent some of the activities of investment counselors.

<sup>2</sup> Some States which have no statutory regulation with respect to investment counselors do, however, recognize the importance of having such regulation. For example, the Illinois Legislature has at present pending before it a bill with respect to the regulation of investment counselors. In Massachusetts the State Securities Division is apparently attempting to regulate counselors as brokers. In Minnesota, the Securities Division, at the last session of the legislature, attempted to have a law passed giving the division some regulatory powers with respect to investment counselors as exist concerning brokers and security dealers. In Missouri, the State Securities Division has taken the position that investment counselors should register as dealers in securities, since on advising clients they are believed to act in some manner within the scope of the statutory definition of dealer. In Texas there is a recognition by the Securities Commission that there is need for some regulation to prevent counselors from also acting as dealers in securities, in order to afford unbiased advice. (Report of Research Department of Illinois Legislative Council on Statutory Regulation of Investment Counselors, September 1939.)

<sup>2a</sup> See Appendix F.

The registration application of the investment counselors requires the following type of information: (a) The name and residence of the applicant; (b) the business reputation, experience, and education to qualify the applicant to act as an investment counsel and the training and background of the applicant who wishes to function as an investment counsel; and (c) the plan, character, and method of business.

The California Commissioner is empowered by the statute to deny the application or revoke registration if either the applicant does not possess the requisite training and experience, or any officer, director, or member thereof has or is about to engage in any fraudulent transactions.<sup>3</sup>

2. CONNECTICUT

The State of Connecticut on May 12, 1937, passed a statute<sup>4</sup> which, like the California statute, required investment counsel organizations to register with the State Securities Commission. The Connecticut statute specifically excluded from the scope of its definition certain financial units such as banks, loan associations, etc. The bases for denial or revocation of registration are closely similar to those in the California statute.

3. ILLINOIS

Illinois, in its rules and regulations respecting the sale and disposition of securities, apparently supports the practice of permitting brokers and/or dealers to give investment counsel advice in addition to their usual transactions in securities.<sup>5</sup> The rule which applies to investment counselors, however, defines the standard of fiduciary obligation which should obtain in cases where such broker and/or dealer attempts to furnish investment counsel advice in those transactions. The provisions in this respect read as follows:

"Investment counsel or advice, whether by one specializing solely in rendering investment counsel or advice, or by a dealer or broker, incidental to usual transactions in securities, shall be strictly on the basis of fiduciary relationship between the counselor or advisor and the investor or prospective investor. In no event shall such counsel or advice be influenced or colored by the element of profit or compensation through the sale or trade-out of any security held by the investor. Any advice or counsel given to an investor respecting the position of a security held by such investor must be solely on the basis of interest or pecuniary profit to the investor. Any investment counselor who in any manner, whatsoever, either directly or indirectly, places or assists in placing any contract for the purchase or sale of securities is held to be a registrant and must be qualified as provided by the provisions of the Illinois Securities Law."

4. MICHIGAN

The Michigan securities statute includes in its definition of "dealer" in securities one "who for any consideration acts as an investment counselor and advises the purchase and sale of securities." As a "dealer," therefor, he is required to be licensed by the State Securities Commissioner.<sup>6</sup>

<sup>3</sup> Some information on the operation of the California Statute was supplied in a letter from the Securities Commissioner of California to the Commission. This letter reads, in part, as follows:

"Since the Corporate Securities Act was amended in 1931 to make provision for the licensing of Investment Counsels, the number of applications have been as follows:

1931-----	42
1932-----	105
1933-----	102
1934-----	97
1935-----	89
1936-----	113
1937 (January to April)-----	33

Our records disclose that during the period from August 1931 to April 1937, two investment counsel certificates have been suspended, 20 investment counsel certificates have been revoked and 101 investment counsel certificates have not been renewed. Each certificate expires on the 31st day of December of the year in which it is issued."

<sup>4</sup> See Appendix F.

<sup>5</sup> See Rule 15 of Illinois Rules and Regulations under the Illinois Securities Law effective December 31, 1938.

<sup>6</sup> In addition, Rule 14 of the Michigan Rules and Regulations adopted Jan. 1, 1936, is similar to the Illinois Rule 15, above cited, defining the standard of fiduciary obligation to be maintained by an investment counsel.