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DRAFT - 10/31/73 Institutional investor Insider
CSW Roundtable Nov, 2, 1973

Although the Commission has been very active since Al Sommer and I came aboard in August -- some might say perhaps a little too active -- we still have much to do, and I thought I would go over with you this afternoon a few of the items we think of as high on our priority list.

As you know, for some time the Commission has been interested in general back office questions, ever since our Unsafe and Unsound Practices Study was delivered to Congress in December 1971. Although we have been unable to obtain legislation clarifying responsibilities for regulation of transfer agents, depositories and clearing agents, we have put out a uniform net capital rule, rules relating to the use of customers' free credit balances and securities left with brokers, and other measures dealing with general bookkeeping. As the back office is the single most important expense item for the brokerage business, we continue to consider this a priority problem and hope that we can obtain the much needed legislation that escaped us at the end of the legislative session last year. Only by removal of costs can we hope to keep brokerage services a profit center for the securities industry.

The exchange membership question, also the subject of proposed legislation at this time, is still a hot potato, although the Commission's famous -- perhaps I should say infamous -- Rule 19b-2 has survived preliminary court scrutiny in Philadelphia. At the time 19b-2 was promulgated the Commission left open the question of foreign access to exchanges and the question of entitlement to the 40% access offered to the broker-dealers who were not members of the exchange. As you know, both of these reserved questions have caused an immense amount of controversy, and we hope to take action on them soon. On the foreign access point, we will be having a position paper by the end of the year on which we hope to get your comments and those of the investment community. We are still studying the qualifications of brokers to obtain the 40% access, the provision that has caused much concern within the NYSE membership. Hopefully this too can be resolved by early 1974.

In the hopper are also a re-examination of our position *vis-à-vis* investment advisers, a field that lay fallow pretty much until Commissioner Owens' speech on the subject last year. Our Division of Investment Management Regulation will be suggesting new approaches in this area in the first part of 1974.

Two committees at the Commission hope to get their work done by the end of this year. The first is an industry advisory committee set up by former Chairman Casey to work on a model compliance manual. Hopefully, this group will put forth suggestions to reduce the amount of effort and expense caused by myriad reporting to different regulatory agencies. Connected with this result, and internal Commission committee under the guidance of our Executive Director is also considering the reduction of paperwork through consolidation of reports and deletion of information either duplicative or unuseful in a modern reporting system.

Our Enforcement people continue to consider problems of the burgeoning markets. With the return of higher volume, we may have a new "hot issue" period, hopefully without the evils exhibited in earlier booms of this kind. An SEC and NASD task force has been looking into the old hot issue markets with an eye towards prevention of the recurring problems without a regulatory overkill that prevents new capital from being raised legitimately.

Two items I think will be of particular interest to you. The first is the problem I have mentioned in testimony before Congressman Patman last month and elaborated on

two weeks ago before the Bond Club of Chicago. I refer, of course, to the new controversy over securities-related activities of commercial banks. I wish to reiterate what I said in Chicago, the Commission has no authority to regulate or interpret the Glass Steagall Act. That responsibility lies with the banking agencies which are considering these new developments in the light of their own statutory mandates. But the uproar caused by the introduction of the Automatic Investment Plan does raise the question of whether or not the Commission should have some say in this area. As I indicated in Chicago, we intend shortly to request comments on the various issues raised by the bank programs, from the public, the banks, the securities industry and the banking agencies. We do believe, of course, that all persons competing for securities investment dollars should be subjected to comparable reputation. To that end, we propose that this area be given careful study.

My other point concerns a problem that has a long history -- starting from the early 1960's which brought the rise of the institutionally dominated market. From a participation in

but 24% of all trades on the NYSE in 1960, institutions in 1973 now account for more than 70%. This fact alone cannot help but have some influence on the way prices change and stability obtained in the market. There is, however, no proof that the presence of institutional investors has destroyed or unfairly influenced market choices. The SEC's Institutional Investor Study, release [sic] in March of 1971 and based on data from the 1969 and 1970 markets, was inconclusive as to the extent of effects of the market from institutional investors. Since then the market has been through a lot and has recovered, and the new cry is that the institutions are causing the two-tier market, whereby the religion stocks -- the favored 50 -- sport price earnings ratios over 30 while many solid companies exhibit such ratios below 10. The state of affairs has produced some panicky commentary and a number of days of hearings before the Senate.

As I recently indicated before Congressman Patman's Committee, the Commission does not, at this time, believe that limitations on the amount of shares of companies that can be held by

institutions or other limitations on the amount of shares of a company that can be disposed of by an institution at any particular time provide a realistic answer to the problem. We have always had a free market economy, and without any compelling indication of an economic nature these restrictions cannot be justified; they might even lead to the departure from the market of many investors who are at present supporting it. On the other hand, the Commission does favor reporting by larger investments of their holdings and their transactions.

The institutional disclosure legislation currently under consideration is not a new idea. Such an act was strongly suggested in the Institutional Investor Study. The Commission decided for reasons of internal economy in 1972 not to push for such a statute, but we are now better financed and we believe an institutional disclosure bill can be of much benefit. After all, the mutual funds have been reporting their holdings to us over a long period of time without suffering as a result. The SEC formulation of a suggested bill has been transmitted to the House and Senate, but has not yet been introduced in either body. An

institutional disclosure bill, S. 2234, that incorporates many of the features of what the Commission would like to see in the final bill was introduced by Senator Williams on July 23 of this year. Many aspects of S. 2234, we feel, go too far and make reporting burdensome. I should like to summarize our own suggestions and tell you what we think of particular parts of the legislation we are sponsoring.

One new feature is our proposal that reporting be done manager rather than by portfolio. This concept flies in the teeth of the way the industry is currently organized. But the real effect in the market is produced by aggregate control of managed money: if the research department of the manager of a number of mutual funds or a large insurance company or a bank trust department changes its view about a stock, the effect will be felt in all of the portfolios related to that research department. Reporting by single portfolio would tend to disguise the aggregate effect of such an action. Hence, the public learns more about the activities of institutional investors by disclosure of the activities of the entire group of portfolios.

I pointed out before that mutual funds have been reporting their holdings for some years. Requiring transactional data is a new twist even to them, yet we feel that transactional data, even coming some time after the event of the trade, is information that could be useful in the market. The problem here is as to what limit to set on the transaction so that all meaningful transactions are reported yet a huge paperwork burden is not imposed. S. 2234 has set its limits so low -- any trade of the lesser of 2,000 shares or 1% of the outstanding shares in a company -- that virtually half the trades on the NYSE will have to be reported. We believe that the limit of $500,000 a trade that we have suggested is adequate to do the job.

We also wrestled with the size of the institutional cut-off. Everybody knows there are a number of small funds that arguably can be said to be institutional investors. Unfortunately collating responses for every such investor in the country would be impossible. We have had to set a dollar figure of $100,000,000 subject to Commission power to go down to 10,000,000 if it desires which we think adequately covers the institutional investors that have the most effect on the market.

I am sure you all have noted that we intend to gather bank trust accounts, insurance-managed pension funds and professional investment advisers under the heading of institutional investors. If the information is to be useful, there can be no exclusion for any particular class of investor, and we do not see where such an exclusion could be warranted under existing laws. We are not trying to use the proposed bill as a wedge towards regulating the trading of banks or insurance companies -- contrary to some of the published comments eminating from those entities. But in the same way that we feel different persons engaging in similar securities-oriented transactions should be subjected to the same rules, we believe that these disclosure laws should cover everybody.

A final problem that concerned us was the dissemination of the information received from filings under the statute. For example, some pension funds now report certain data about their transactions to the Department of Labor. These reports are filed in an obscure place and are virtually unobtainable, thus vitiating any positive effect from the requirement in a central location at reasonable cost to any member of the interested public.

We favor centering the reporting function at the Commission, which is already oriented towards the availability of public documents. We are also hopeful that private services will wish to pick up the information and publish it in one form or another as a reporting service. We have had discussions with a number of people in this business and we believe their response may be favorable.