REMARKS OF RICHARD B. SMITH AS PARTICIPANT ON A PANEL ON THE IMPLICATIONS OF THE INSTITUTIONAL INVESTOR'S STUDY, WASHINGTON, D. C. APRIL 22, 1971.

Will you take your seats, please? We are running a little late and we would like to get going.

As you know, the next feature of our program is something we have all looked forward to very much, and our Panelists here have put a tremendous amount of work into preparing this Panel, and I know that, I for one, am tremendously interested to hear what they are going to say.

I am here only to introduce the moderator, who is a gentleman that you all know very well indeed, and requires very little introduction. And that is the gentleman on my immediate right, Commissioner Richard Smith of the Securities and Exchange Commission.

Commissioner Smith is a graduate of Yale University, with a Law Degree from the University of Pennsylvania, where he was a Law Review editor. He was associated with a New York City law firm for many years; before that it was W. R. Grace, and for four years has been here on the scene in Washington with the Securities and Exchange Commission.

It's very appropriate that Commissioner Smith should head this particular panel in the Institutional Investor's Study, since he was the Commissioner in charge with the direct responsibility for the study, from its conception to its completion.

And I know I speak for all of us here when I say that he did a remarkable job. Dick, the floor is yours.

(Applause.)

MR. SMITH: Thank you, George.

I'd like, initially, to correct two misimpressions. One is that I was the creator and designer of the Institutional

Investor Study. There is a man sitting in the back of the room who had a great deal more to do with the original creation and design of this study than I. I am speaking about my former Chairman, Manny Cohen.

And, of course, there is somebody here on the Panel who had a great deal more to do with its final design, carrying out and the product that the study represents than I did, and that's its Director, Donald Farrar.

The other misimpression I want to correct is that contained in the program, which you can entirely disregard, both as to starting time and as to the arrangement of speakers and so too the subjects we are going to cover.

(Laughter.)

MR. SMITH: We have an excellent Panel here, and an indication of its excellance is the fact that I have been entirely unable to control what they want to say, how they want to say it. So, the only thing I am going to try to control is the ten minutes that each are allotted.

I would like now to indicate who the Panelists are. The first one that you will hear from is Al Johnson, who is the economist for the ICI, and was a member of the Institutional Investor Study's Advisory Committee. Second on the program will be Dr. Farrar, who was the Study's Director, and is presently at the University of Pennsylvania.

The third on the program will be Milton Cohen, who was, you will well remember, the Director of the Commission's Special Study of the Securities Markets in the early '60's, and who is an attorney practicing in Chicago, and was also a member of the Study's Advisory Committee.

And last on the Panel will be Howard Stein, who is the President of Dreyfus Corporation, and was in no way associated with the Study, and will be entirely free-form in his comments on it. On Howard's behalf, I'd like to say that he has a plane to make, and so if you see him running off the Panel at exactly 3:25 p.m., it is only to catch a plane, and not because he disagrees with everybody else up here.

I was delighted to see in the program that my good friend, Marty Proyecht is last on today. And since we're starting a half hour late, he's going to have to carry almost into the cocktail hour to finish up. But you won't mind that, Marty.

Obviously, the most that we can do today is to incite your interest, if it is not already incited, in the Study. It is not going to be possible for us to give you anything approaching a full or systematic exposition of the study report. It's a long-term kind of document and, I think, well worth the reading.

The panel will welcome written questions. We would like to organize it in such a way that we will have rather short presentations by those here, and we will encourage discussion among ourselves, and questions and answers from the audience. But we do ask that the questions be written on cards that I understand are available. I can't promise we'll get to all of them, but we will do the best we can.

I thought that I would take only a few minutes -- and I have to hold myself to ten minutes -- to say just a bit about the nature, background, and structure of this study.

I hope that most of you would have read by this time the transmittal letter the Commission sent to the Congress with this study, and perhaps, at least perused the summary volume. Hopefully, you may have even had a chance to get into some of the chapters.

The study, you remember, grew out of a growing concern in the country, and in the Congress that was reflected in various bills with which they were dealing involving the securities industry and critiques being made of it; concerns about the growth of institutions in the country's equity markets; about institutions gobbling up all the available stock; about the speculative management of funds; about the potential control of corporate issuers by financial institutions; about the inadequacies of the market structure, and particularly the specialist system. And, perhaps, behind all this was a strong concern and feeling that there was a great need for additional information, precise information, about this phenomenon.

There was, I thought, a very sensible feeling that before one could deal with specific aspects of the phemonenon, there was needed a comprehensive economic study of it. That was the basic mandate behind the Congress' resolution authorizing the study. The study was deliberately designed to provide a basic, systematic, analytic look at equity-oriented institutional managers and their impacts on markets, on issuers of securities, and on the public generally.

The report is structured in four parts. The first part is built around an economic study that was performed for the Commission's study staff by the National Bureau of Economic Research. It's a long-term look at the role of financial institutions in the equity markets, going back to the late 19th century, and gives, I think, a very valuable perspective on the problems that lean so large on us today. It permits them to be seen in their long-term historical perspective.

Part two of the study was a look at institutions today, like trust departments, insurance companies, investment advisory complexes, the major managers of institutional funds that are oriented towards the equity markets. That was a current look and was a follow-up of the background work in Part one of the Study.

Part three of the study looked at the impacts of institutions on the equity markets, on the market-making function, the securities industry. Indicative of the changes in the markets is the fact that a full and rather large chapter was devoted to the phenomenon of block positioning, block trading, that received only a few pages in the Commission's Special Study less than a decade earlier.

Part four of the study looked at the relationships between institutions and the companies whose securities were held in the portfolios of the institutions, including a look in some degree at the primary issue market as distinct from the secondary markets that were the subject in Part three.

I hope, again, that most of you would have read the transmittal letter by this time. It's been variously described as bland or provocative, and varying shades in between. I think it's a letter that reflects a careful construction, and with careful reading there are some rather significant directions that are pointed to in that letter which contained, I emphasize, initial recommendations.

The study was performed in about 18 months, and the result, the analytic work, did not really become available to the Commission until close to the end of 1970. The Commission had limited time for such a vast study to develop recommendations. A number of areas that the Commission looked at in the study involved financial institutions that were not under the direct regulatory jurisdiction of the Commission. Any recommendations and conclusions we thought about in these areas, we felt, needed to be discussed and reviewed with regulatory agencies of the Government that had direct jurisdiction over these institutions. We have an obvious lack of expertise about the banking system, for instance, and in other areas where conceivably future recommendations may develop following such consultations.

I'm going to serve a role only as moderator here, although I may inject some comments along the way. I would first like to call on Al Johnson to say a few words, and then we will proceed through the rest of the panelists.

* * * *

MR. SMITH: Here's a question, I think, for everybody. Do any of the Panelists agree with Howard Stein that institutions should not be members of exchanges? If he does agree, could you articulate as to the conflicts of interest question? And a second question, where is the conflict where a mutual fund has its own trading department, and deals directly with over-the-counter market makers, and wishes to deal directly with the New York Stock Exchange specialists?

* * * *

*　　*　　*　　*

MR. SMITH: If I may just contribute a little to that question, it's clear, I think, from the Commission's transmittal letter that it is troubled by this question. I think that it felt quite strongly along the lines that Don Farrar indicated, that a number of the artificial incentives towards institutional membership should be removed so that the question can in some way be distinguished from that of reducing commission expenses. Hence, the step into competitive rates, because clearly a large part of the incentive for large institutions towards membership on exchanges was the brokerage cost of transactions.

"Institutional membership" is like most buzz words. It has a lot of breakdown questions contained in it. Does it mean simply access to the market-maker? Does it mean participation in the governance of whatever the trading market is? You can think of a number of breakdown questions, all of which are somehow bound up in the phrase institutional membership, that don't necessarily lead to the same answers.

Clearly, this also is part of the larger question of whether brokerage and asset management should be separated. I think any time that a study of the size that Don directed here is conducted, the full analysis or data that one would like to see to answer all the important questions, just can't be provided. But institutional membership is not the only question that this study had to deal with. And so, I think any of us connected with this study, including its Director, felt he would have liked to have more emphasis, more analysis in one area, perhaps, than in some others. But with limited resources balances have to be struck.

I think that the effort here was to get a comprehensive view of what this phenomenon means in American economic history, and where the real pressure points are, I feel, and perhaps I'm too close to it to give an unbiased judgment about it, that it really has given an indepth panoramic picture of institutional investing that will permit a far more intelligent reasoned approach to particular questions.

On the issue of separating asset management from brokerage, there was a question I read here that is pertinent. "Where is the conflict where a mutual fund which has its own trading department and already deals directly with over-the-counter market-makers? Where is the conflict in access to the New York Stock Exchange specialist who is the market-maker in that market?"

If you're thinking in terms of asset management and brokerage, as there being an inherent conflict in the association of those, you have to force your mind to think logically about that. Does that mean that securities firms should not have discretionary accounts? Does it mean that trust departments should be separated from the commercial operations of banks? Because clearly there is the same principle involved, the principle being, I assume, in separating any asset management from brokerage, to create in the fiduciary that direction of his sole attention and duty to managing the other person's money and not to have that duty clouded with other types of profit centers that could in some way affect and divide his loyalty -- basic loyalty -- to the beneficiary.

When you think about spreading that principle through the whole equity market system, you're really talking about some very profound rearrangements. Howard Stein would carry it to that logical extreme, separating trust departments from banks. I'm not sure that everyone who is arguing and asserting that asset management and brokerage should be separated, have themselves gone to its logical conclusion. But at least Howard Stein has faced up to the logical conclusion to which that line of reasoning leads.

Let my try another question here. What preconceptions of the SEC were disputed by this study? In other words, what were the big surprises, if any?

I think that's a good question. I'll make that the last question, because we're already crowding others on the program. And I think it's a very pertinent question to ask each of our panelists. I'm sure that Don Farrar came with some preconceptions about the SEC. And I'm sure that Milton, with his emersion in the special study and the concepts developed there, probably came to this study with some developed views, and perhaps had some of his thinking about markets adjusted by this study.

I, of course, had no preconceptions at the outset.

(Laughter.)

So, it didn't affect me in any way.

I think two very significant shifts occurred.

The Commission had historically been thinking in terms of competing market places. I think that was a concept that showed a concern about the dominance of the New York Stock Exchange in this industry. I think it showed a concern for the survival of regional stock exchanges and, given the technology and the communications arrangements that existed in earlier days, for having some areas of competition in this business. Now, the transmittal letter, and the thrust of this study, and to me the data bears this conclusion out perhaps a little more strongly than it would appear to Milton, are saying that we really now have to think in terms of a single market system, not a two-tier market, not competing markets, but a single, central market system. We are now in the fortunate position of not being tied to historic or physical locations. Modern technology has made it possible to think of a central market system in far more sophisticated terms. And instead of having competition among markets, having a market with competition within it.

And I think there is an increasing emphasis both in the Commission's rate structure proceeding and in this study, on relying to as great an extent as possible upon competition to do the regulation, rather than upon Government or self-regulatory rules. I think that market competition is far more, to me, responsive to both the needs of the business and the needs of regulation, in many ways, than Government regulation can be. I'm not saying that one should not have Government regulation, or that that regulation can't be good, but that competition is an extremely efficient regulator.

Well, I've given the panelists some time to think about what preconceptions have been disputed by the study.

Al, let me start with you on that one.

* * * *

MR. SMITH: Thank you.

I would like to emphasize as a last comment something that Howard Stein alluded to, and that is I don't think there is anybody who had any connection with this study who feels as though it's the end of the road. The subject is so massive. The initial pangs of collecting data, where none previously existed, absorbed a great deal of the energies and time of this study, and undoubtedly ate into the analytic time that all of us felt we would have liked to have had more time to do. I, myself, would have liked to have seen a bit more of, what I call, pathology analysis in this study. Too often in the past, Commission studies were that -- pathology analyses -- without looking at the whole body of the healthy animal. I think that this study did that. But one learns a lot about health by examining problem areas, and I think there are a number of problem areas that more analytic time could be spent in.

And I'm very hopeful on one of the major recommendations of this study -- which necessarily accompanies the important recommendation about continued and expanded reporting of information by all categories of institutions. That is, to expand the economic research capability of the Commission, which will need very major budget additions in terms of computers, and staffing, and so on. I think that's an important thing to do. I think the work that this study began should be, -- really has to be, continued. That can't be done by waiting another five or ten years for a special study or institutional study again. It should be done on a continuous basis without the traumatic effects that these once-every-ten years studies provide. If the Congress, in its appropriating mechanism, sees fit to give us that kind of resource, we will all be better informed about ourselves and about the markets, which is an objective, I am sure, we all share.

I don't think any of us look at this study as the end of the road. It's really the first step.

Well, thank you very much for your time and patience.

(Applause.)