

ADDRESS

BEFORE THE SIXTH ANNUAL MUTUAL FUND SALES CONVENTION

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Securities and Exchange Commission  
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To begin with, I wish to extend to you the greetings of Ralph Demmler, Chairman of the Securities and Exchange Commission, and the greetings of the other members of the Commission. Chairman Demmler regrets that he cannot be here with you in Chicago at your Sixth Annual Mutual Fund Sales Convention, but previous commitments make this impossible. In the same breath, I want to tell you how pleased I am to have been able to accept your gracious invitation for this occasion. I am happy to be here and have greatly enjoyed the activities of your Convention.

Last year Chairman Demmler talked with you about the why and how of Federal regulation of the investment company business. He stated that the Commission proposed to re-examine rules and forms and to do its regulatory job in a workman-like fashion without any unnecessary red tape and free from what might be unkindly termed as "harrassment." He added, we at the Commission "have no intention of scuttling the ship that we are hired to steer." As you know from your side of the table, many of the proposals that he outlined to you last year have been accomplished, and we on the Commission's side of the table earnestly believe that there has been no abasement of our regulatory responsibilities and that the securities laws are being administered with vigor. The previous year in New York at your Fourth Annual Convention, Donald C. Cook, who was at that time Chairman, outlined to you some of the problems that the S.E.C. is continuously pondering and about which he said, "They are not problems of easy solution."

On this occasion today, with your permission, I will not talk with you about the responsibilities of working in an independent government agency -- nor about the problems of being a regulator -- nor about the complexities in our work of administering the necessarily complex securities acts. Rather, I want to talk with you about you, about the phenomenal growth experienced by your industry in the short span of a relatively few years, and about how, in my opinion, you can make a contribution to your industry, regulated as it is by Federal statute, in its responsibility to the public investor.

In order that we might take off on a common footing and in what I consider the proper perspective, let's glance at the growth that mutual fund investment companies have achieved since the enactment of the Investment Company Act of 1940. In 1941, there were 73 mutual funds registered with the Commission under the requirements of the Investment Company Act and total assets then aggregated a little over \$400 million. Now, there are 172 registered mutual funds, with total assets of almost \$5 billion. Mutual fund shareholder accounts have increased at the average rate of 18% a year since 1949 and now total 1,600,000 -- in other words, the number of shareholder accounts has about doubled in the last five years alone. Recently, I noted a prediction by a recognized writer in the investment company field. His prediction was that by 1960 -- that is, in another five years -- assets of investment companies will double, and there will be four million investor accounts served by investment companies.

Let me digress for a moment at this point. Capital formation -- that is, investment in the physical sense -- results in the final analysis from savings on the part of individuals. These savings may be invested in the purchase of a home or in the expansion of a family business; or may be turned over to institutions like banks and insurance companies which institutions accumulate the savings of thousands upon thousands of individuals and then supply business with needed funds. On the other hand, savings may be used to purchase securities, such as stocks in mutual funds, where the investor is seeking a common stock type of investment in which risk-taking is an essential ingredient. Mutual funds, in their accumulation of savings of thousands of people, constitute large liquid pools of capital and hence have a very definite place in the financial community and a potential effect on the national economy.

That the Congress recognized the role of investment companies in the process of capital formation is apparent from the following quotation from the Senate Committee Report accompanying the Investment Company Act of 1940:

"Investment trusts and investment companies are vitally associated with the national economy. \* \* \* a most significant function of investment companies in relation to the immediate needs of the national economy is their potential usefulness in the supply of new capital to industry, particularly to small and promotional ventures. Although in the past investment companies have furnished but comparatively little capital to industry, it is the hope of the committee, as well as the investment company industry and of the Securities and Exchange Commission that regulation of investment companies, as provided for in this bill, may stimulate venture capital and the financing of industry." (Senate Report 1775, 76th Cong., 3rd Sess., June 6, 1940)

It is apparent that the great expansion of industrial facilities occasioned by American industry during the past 15 years, during which we have experienced periods of wars and periods of social and economic stress, has been made possible only by the ability of our industries to raise new capital. But capital formation is not a problem to be considered as a matter of past economic history but, in a dynamic capitalistic system such as ours, is an ever present one, one of continuing consideration.

Now, the growth and the increasing importance of the mutual fund apparently was contemplated by the Congress, for in passing the Investment Company Act of 1940, it included a section which authorized the Commission to make a study and an investigation of the effects of size of investment companies. This study was contemplated for such time as the Commission deems that any subsequent further increase in size creates problems involving the protection of investors or the public interest. I might ask: Why were the authors of the Act concerned by the possible problems accompanying growth and bigness, and at a time when, according to the record, the public -- big investors and small -- had lost confidence in the investment company idea? The answer, I believe, is a simple one -- that is, it was realized, as has in my opinion since been proven, that the investment company concept has much to support it. It offers the small average investor two advantages: diversification and expert management. In the case of the mutual fund, it also offers the advantage of liquidity.

There should certainly be no question about the fact that the investment company has an important place in our modern financial scene and that it plays a vital role in the investment processes. The lusty infant of yesteryear is, today, a young Herculean giant, destined for still greater growth in the future. The reason for that, in my opinion, is that today more people have more money than at any time in our entire history, the results of economic and monetary factors which need not be discussed here. We are living today in an era of great and expanding scientific and industrial development which offers great opportunities to all. We are fortunate to live in a nation that espouses free enterprise, and that permits the accumulation of wealth to any one who possesses the ability, the ambition and the willingness to work for it.

We should glance briefly at the relationship of your industry to the Securities and Exchange Commission. Before the enactment of the Investment Company Act, the Commission, under a mandate from the Congress, spent many, many months on a long and exhaustive study of investment trusts and investment companies. In conducting this study, the Commission sought and received the cooperation of your industry, of other business men, government officials, and legislators. When this piece of legislation became the law, by unanimous action of both houses, there were a few who decried the statute and who felt that a death sentence had been passed on the investment company industry.

Again, in 1950, when the Commission, with the assistance and cooperation of the industry, prepared and issued the Statement of Policy pertaining to the sales and advertising literature of the industry, the cry went up that the mutual fund could not survive under such far-reaching and onerous restrictions.

The constant growth in mutual fund assets and shareholder ownership has amply demonstrated how baseless these fears were. Rather than a handicap, or an impediment, these legislative and regulatory actions have, if anything, resulted in greatly increased public confidence, and a growing public interest and understanding in the mutual fund technique of investment. The cooperative teamwork and effort between the mutual funds, your dealer organizations, the S.E.C. and state agencies have been an effective element in bringing your industry to the healthy position it enjoys today.

In his book on investment companies, 1954 edition, Arthur Wiesenberger stated:

"Despite the occasional inconvenience and red tape incurred by the companies and their sponsors in observance of and compliance with these Federal and state regulations, the net effect has been beneficial to both the companies and shareholders. The issuance and enforcement of the various routine safeguards have helped greatly to strengthen public respect for and confidence in the entire field."

Experience under the Act has been a good example of balance between the regulator, the regulated and the public interest.

The Commission once described the regulatory provisions of the Investment Company Act as being designed to accomplish five main objectives:

- (1) honest and unbiased management;
- (2) greater participation in management by security holders;
- (3) adequate and feasible capital structures;
- (4) sufficient financial statements and accounting;
- (5) proper selling practices.

In administering this Act and in the Commission's constant endeavor to satisfy these objectives, management of the mutual funds have remained free to exercise their business judgment in respect to investment policy.

The expanding opportunities of your industry inevitably mean an ever-increasing responsibility on your part to those who buy the mutual funds. This responsibility must be shared by your industry as a whole -- the funds, the sponsors, the investment dealers, and, in many ways, especially by the sales representatives.

Now, I wish to emphasize the role of the dealer -- the salesman -- and his corresponding responsibilities. There can be no doubt but that he is a keystone to the entire structure of the investment company. It is the man who makes the sale, who sells the security, and he alone, who must in the final analysis translate into action on the firing line the regulations which have been created by the Commission, regulations which are concerned with full disclosure and fair dealings. In this area I speak with insight, for prior to my first appointment to the Commission in July 1953, I was a country banker in the South, talking and doing business with the same members of the general public that you



come in contact with in your daily routine. I know and understand your problems down at the grass roots.

Again, in the last analysis, it is the salesman who makes the sales, and we must not lose sight of the fact that, during the sales process, violations may occur.

So that my position is eminently clear, I wish to state that I believe that mutual fund salesmen, by and large, are cognizant of their position of trust. Indeed, it is my belief that violations, if and when made, are normally not wilful or deliberate, but rather can be charged to ignorance of the law and unfamiliarity with the regulations, which regulations the salesman must realize that he must observe as a member of the investment industry and as a mutual fund representative. Admittedly, there are some violations that may never come to the Commission's attention, but we are aware that sometimes they do exist, and it is a matter of concern to us at the Commission.

The philosophy and object of the mutual fund salesman ought to be one calculated to induce investment on a sound basis in an atmosphere of confidence. The statutes, and regulations resulting therefrom, can at best only cover partially certain areas where sins of omission and commission can develop -- in that twilight zone of gray.

We in the Commission are interested in seeing to it that this investment vehicle is maintained with as little interference with management as possible. However, this interest is secondary to our primary obligation and responsibility under the law -- that of the protection of

the investor.

Every salesman should know the principles of mutual funds and the various purposes which they are designed to serve. He should know the needs of his prospects and how specific funds provide for those needs. He should know the Statement of Policy as well as he knows his ABC's -- not just the words, but the meaning and intent behind it.

It might be well for the mutual fund industry itself to focus greater attention on this subject, directed towards the possibility of developing for the sales representatives adequate training and techniques in order to ensure maximum protection for the investing public. I believe the mutual fund industry as a whole, at this stage of its existence, is well equipped to ensure that proper knowledge is supplied to the salesman who is in direct contact with the investing public.

In developing this approach, the mutual fund salesman might be schooled toward asking himself these questions, among others, that may be pertinent to the particular customer:

1. Does the investor understand the risks of buying mutual funds, as well as the advantages?
2. Does the investor understand his investment circumstances and needs?
3. Does the investor understand the need for cash reserves for emergency and the need for a reasonable amount of insurance?
4. Does the investor contemplating a growth-type fund understand the limitations on earned income?

5. Does the investor understand that a high-income fund has comparable limitations on growth potentialities?
6. Does the investor understand the sales load?

Thus, it seems to me that a really smart and conscientious salesman would be desirous of bringing home to his customer all the facts, bearing in mind at the time of the sale such questions as the above and others that may be pertinent. In this manner the customer should clearly understand what he is purchasing and what the advantages of that purchase are.

I offer these comments and suggestions as an individual member of a Federal regulatory body. And, in the second place, I offer them as an individual with a banking background, as one who strongly believes that your industry is making and will make a contribution to the future of our economic progress by broadening the base of securities ownership among millions of Americans in the middle-income bracket. You, as sales representatives, make a definite contribution directly and indirectly towards capital formation for the continued expansion of our economy -- expansion that creates more business more jobs, better pay and a better standard of living for more people

If you are to realize your potential and adequately meet the challenge that faces you, you as sales representatives must be men who have the knowledge and an uncompromising attitude that the customer's best interest must be paramount. You must honestly feel that you can recommend with confidence the fund you are selling. The customer has much at stake in terms of his money and his savings and relies heavily

upon you as his basic source of knowledge concerning mutual funds. When we consider the numerous opportunities offered to the American public for saving and investment, it is apparent that the mutual fund salesman has more than a mere selling job to do. With so many choices open to the investor, the salesman must practically take on the function of a financial consultant. This I feel is the beginning of a new era in mutual fund selling in which you will unquestionably meet ever-increasing competition, both within and outside your field, and success, if it is to come, must and will stem from proper selling practices aligned with the objectives of the Investment Company Act.

In my opinion, the true mutual fund salesman sees in mutual funds a great opportunity for rendering genuine service. He should share the vision of an even greater future for the industry, and should contribute his efforts toward solidifying that future by creating a better understanding and greater confidence in the mutual fund idea.

All of us in the recent years have witnessed many changes in our democratic capitalistic system. More and more in this process, it is becoming apparent that millions of people are desirous of owning their share of American industry. The growth and success of the investment company is contemporary with these changes, and you gentlemen will play a major role in these developments. May your job be done well.