Address By

THE HONORABLE MANUEL F. COHEN

Chairman, United States Securities and Exchange Commission

Before The

Georgetown Bankers Forum

Washington, D.C. - October 28, 1967

FINANCIAL SUPERMARKETS

Our affluent society has produced an unprecedented number of investors with ever increasing amounts of savings available for investment. Just as honey attracts bees, money attracts salesmen, and this great increase in the amount of money available for investment has accelerated the tendency for financial institutions to move out of their traditional lines and offer securities or other forms of investments which have been generally associated with other types of institutions.

Just to list a few current examples: commercial banks establish savings accounts, sell certificates of deposit (as well as lottery and football tickets), and establish commingled agency accounts to invest in equity securities; life insurance companies sell variable annuities, a means of investment in equity securities; savings banks sell life insurance and distribute mutual fund shares; mutual fund distributors sell life insurance; and department stores and other basically commericial enterprises sell a wide variety of financial services.

The markets for financial services have always been marked by a high degree of economic regulation. Unrestrained price competition has never really been allowed to prevail in this area, and for a very good reason. A customer can shop for the lowest price for a particular automobile or appliance with relative unconcern about whether the manufacturer or dealer can operate at a profit while selling at that price. However, in the case of a financial institution, the entire investment may be at risk because of the lack of business acumen or efficiency of the managers of the institution. For example, if a bank offers a higher interest than it can profitably maintain, and makes speculative investments to meet its interest requirements, it may wind up being unable not only to pay the interest but to return the principal amount invested. While not precisely parallel, if a mutual fund offers its shares below the net asset value of the underlying portfolio, the bargain for the incoming purchaser is achieved at the expense of diluting the interest of those who had previously invested in the fund.

Where the financial institution makes a separate charge for management services to an investment vehicle such as a commingled account or a mutual fund, there is of course some room for price competition in that end of the business. But the amount of the management charges is generally small when viewed solely in relation to the benefits which an investor in the fund or the account hopes to realize. Of course, this is the reason for the creation of the fund or account - the pooling of many interests should make available economies of size and institutionalizedmanagement. As a consequence, there really is no effective competition for the favor of ultimate consumer, the investor. But while these charges may not seem large to the individual participant in the fund, they can become very large in the aggregate unless the expected economies which led to creation of the fund to begin with are in fact shared equitably with the fund. But this result is not always enough. Consequently, in a situation where the normal controls cannot operate effectively, there is a special burden on the regulatory agencies to see to it that the prices charged for financial

services to the investment vehicle which, of course, are borne by the many individual investors, are not excessive.

No industry is homogenous, and the regulatory agency charged with responsibility to prevent, or to mitigate the effects of, overreaching must be extremely careful to avoid favoring one legitimate and productive segment of the industry as against another. This problem is of course greatly complicated by the growing tendency of institutions to venture into areas traditionally served by other types of institutions regulated by other agencies. An agency must "regulate" its "constituents" with an eye to what their direct competitors are doing. Problems may arise if the agency regulates them without consideration of the possibilities that its "constituents" may be subjected to an unfair competitive disadvantage; on the other hand, it cannot permit the standards of the industry for which it is responsible to fall to the level of the worst or least regulated of its competitors.

A related question is the extent which a regulatory agency should seek to extend its jurisdiction over activities

which are functionally similar to those of the industry for which it has principal responsibility, but which are conducted by different people and in a manner which does not fit precisely the agency's traditional methods of regulation. In the recent past, we have asserted our jurisdiction over such diverse "securities" as an interest in beavers, variable annuities issued by life insurance companies or special accounts specially created, "scholarship funds," and bank commingled agency accounts. These "securities" have given us a good many headaches, and have required a good deal of our attention to accommodate them to the statutory requirements and need of investors for relevant information at a time when our regular function of maintaining public confidence in what are commonly recognized as the securities markets is complicated by what are referred to in many quarters as dangerous new trends. Yet, I think this activity is essential to our basic function. If we did not take prompt action on these off-beat types of securities, we would find that a substantial portion of the talent and efforts of those engaged in the traditional securities business were being

lured away--either to unregulated activities which offer the prospect (often unreal, or at least greatly overstated) of a greater immediate return precisely because they are unregulated, or to activities governed by different sets of rules which constitute a form of unfair competition and which is injurious to the public interest.

While the competition within a regulated industry may be relatively docile and nonprice oriented, the competition between industries is often extremely vigorous. Not all of it is aimed at the consumer. A substantial part of the effort of the competing industries, although not so identified, is directed at the legislatures, the courts and the regulatory agencies in an effort to establish rules which will favor the activities of one group and hamper the activities of another or to prevent such discriminatory treatment. The recent law suit by the Investment Company Institute to prevent the banks from competing with the mutual funds for investors' dollars by providing essentially similar services is a striking example.

A regulatory agency has a responsibility to those engaged in the business which it regulates as well as to

the members of the public with whom they deal. But the scope of that responsibility is frequently a matter of debate. On the one hand, it is urged that the agency should not be a lobbyist for the industry; on the other, that it should stand ready to inform the legislators and others of the contributions and problems of the industry as well as its shortcomings.

In the area of financial services, the securities firms, commercial banks, savings banks, savings and loan associations and insurance companies are regulated to a greater or lesser extent and in widely differing ways by federal, state and local agencies with varing juris-diction. Each of these agencies has the authority--and the responsibility--to apply its governing statutes, which vary widely in purpose and provision, and its implementing rules to anyone providing the kind of financial service which those rules were designed to regulate.

There is a good deal of overlap in this regulatory pattern. I suppose that regulatory agencies sometimes compete with one another just as do the industries which they regulate. I do not see anything wrong with this; in fact, it may be one of the most constructive modern

applications of the idea of federal government. Recent suggestions for some sort of deposit insurance for securities firms, and guidelines for regulation of bank advertising comparable to that imposed on securities firms, are but two illustrations of areas in which cross-fertilization may be productive.

It is clear that none of the regulatory agencies has a complete answer to the economic and other problems of the securities and financial markets--not even, I would venture to say, the SEC, the FDIC or the antitrust division--but out of the competition of different regulatory techniques developed in different contexts and at different times, approaches and solutions have emerged which serve the public interest. I hasten to add, as a final note, that this is and must be a continuing development in which the regulated industries can and should undertake an important role.