File

ADDRESS OF
COMMISSIONER JACK M. WHITNEY II
OF THE
SECURITIES AND EXCHANGE COMMISSION

Before the
INVESTMENT COMPANY INSTITUTE

At New York, N. Y.
May 3, 1962

Informal reference to Mr. George Whitney: He and I are not "affiliated" within the meaning of the Investment Company Act of 1940, by the laws of consanguinity or in any other manner of which I am aware. Accordingly, it should be clear that I did not ride into this hall on his coat tails. Also, I think I am entitled to make the point that neither on this occasion, nor any other, will it be necessary to discount any statement of his or mine by reason of our fortuitous sharing of a surname.

After I accepted your invitation to meet with you tonight it occurred to me that this event is by way of being a silver anniversary. In the spring of 1937, at the annual dinner of the Capital City Philatelic Society of Jackson, Mississippi, held in the Roof Garden of the Robert E. Lee Hotel, one of the scheduled speakers was an awkward adolescent, to wit, myself. That was the first prepared speech that I have ever given. That fact, together with my recollection that my remarks on that occasion had something of a classic character, suggested that I should favor you with a repeat rendition. My topic on that occasion was, "Why I Collect Stamps." However, before playing that record back, I have a few notes here which I should like to get out of the way first.

I think nearly everyone here is familiar with the name of Alfred Jaretzki and the part he played in the drafting of the Investment Company Act. Following the enactment of the statute he published an article in the Washington University Law Quarterly in which, among other things, he concluded that, "In the long run it will be the measure of good faith with which the industry endeavors to live up to the spirit of the Act which will determine to what extent moderate governmental regulation can be successful and to what extent, granting the need for regulation, extreme measures may be necessary."

Now how does a silver anniversary combine with Mr. Jaretzki's prophesy to become a matter of common interest to all of us here present? The Investment Company Act is the consequence of a study which the Congress, in Section 30 of the Public Utility Holding Company Act of 1935, directed the Commission to make. That study really was not in full swing until, as Garry Moore would put it, "that wonderful year, 1937." As a consequence of that investigation and the several reports which the Commission submitted to Congress, the Commission produced its own draft of an Investment Company Act and an Investment Advisers Act. Thereafter representatives of various parts of the industry and their able counsel, including Mr. Jaretzki, joined the act. The Senate report probably understated the matter when it said: "Representatives of the companies affected expressed considerable opposition to some features of the Bill." However, those representatives joined with the Commission in advising Senator Wagner that it might be possible for them to reach a common ground and submit a joint recommendation as to the scope and provisions of the Bill. This joint

effort was remarkable if for no other reason than that five weeks of intensive work produced a substitute Bill which was, again in the words of the Senate report: "strongly endorsed both by the Securities and Exchange Commission and by almost every company which appeared in opposition to the Bill as originally drafted."

It is no longer helpful to decide whether the Act should be characterized as a "compromise," "a shotgun wedding," or by the use of any other catch phrase. The most significant fact is that this Act was accorded the blessing, the laying on of hands, if you please, of both the industry and the Commission officially and out loud. The Congress accepted and relied on this joint effort in good faith, and enacted the statute.

One may ask why the statute cannot be said to represent the happy end of a rather difficult and tedious story. Why should not both the Commission and the industry now be able to take a backward glance over two decades and beam with pardonable pride on a record of growth achieved within the confines of this Act? Indeed, why not, when at the least that record reflects, in my unsophisticated judgment, an almost unparalleled vote of confidence by the investing public?

Well, for one thing, we started together in 1940 in an atmosphere characterized by a large measure of harmony. However, one of the problems with harmony is that it permits everyone to sing a little off-key and still sound good. If, today, we play back in hi-fi stereo the record of our last 20 years and listen with more critical and sensitive ears, we might find that it is high time to weed out the choir. On a more serious note, however, it seems to me that the structure of the Act and its history provide the answers.

The Act does not purport to be a model statute for all time, but is, and this was implicit in Mr. Jaretzki's comment, a point of departure for the industry and the Commission for a continuing effort to determine how best to achieve the purposes of the Act. In effect, the Act prescribed for the industry a structure which the parties concerned, depending on their own points of view, assumed, hoped, predicted, speculated or gambled would achieve the statutory purposes. It was an experimental solution to a set of problems which the Congress was persuaded had to be solved. Time and experience were to test the effectiveness of the solutions--and certainly enough time has run. The policies and purposes set forth in Section 1 of the Act are broad and sweeping. On the other hand, the operative provisions of the Act, while complex, are nevertheless restricted in their scope. It could well have been expected from the outset that the gap between broad purposes and tightly drawn working provisions would constitute an area to be filled in part by the voluntary application of developing standards of business ethics. Such voluntary action would be a valued supplement to the Commission's obligation to exercise its powers under the Act so as to further its purposes.

In an article in Esquire Magazine for the month of April of this year, Mr. Burton Crane, a financial writer for the New York Times, attributes to a general partner of a Wall Street firm this statement: "90% of the people in Wall Street are shoe clerks. There is no question of ethics. If you give them a high enough fee they will undertake to sell almost anything." The rest of the quotation is not suitable for a co-ed audience, but even so much as I have quoted is to me an irritating statement. I suspect the speaker was rather irritated when he made it. I am not prepared to admit the truth of it and I am sure that you are not either. Still we might at least concede that any slice of humanity almost invariably assumes the form of a pyramid because the very best are always in the minority, and those who are merely good are the more numerous. Implicit in the Act has been and is the challenge to both the industry and this Commission to raise continuously the standards which you observe in the conduct of your business. None of us can be content with mere conformance to the literal and minimum operating provisions of the Act. And so, although it would be foolish optimism to suggest we can eliminate the pyramid, we are most assuredly required and able to change its shape by narrowing its proportions and raising its base.

This pyramid should tower and not squat.

Of course, after more than 20 years it must now appear improved in our eyes to the extent that those in the industry who were not observing the standards of the Act prior to 1940 have since jacked themselves up or else have departed from the scene. More significant is the contribution of those who have already responded to the challenge, those who have applied an ethical standard to the conduct of their business which would make the Act, to the extent directed at them, a gratuitous insult. I have faith that both categories of persons exist. My difficulty is simply one of ignorance. How effective have the housecleaning chores of the Commission and the industry been? How pervasive has been the influence of the most responsible elements of the industry? If we already had answers to show that the operative ethical standards of the industry have achieved the purposes of the Act then, in truth, our task would be done. I hesitate to assume that the Commission has these answers. On the contrary, the Commission's inspection program occasionally discloses distressing facts concerning the operations of some funds which, I am confident, represent the base of the pyramid. To the extent the industry has these answers, I can only ask that you pass on your knowledge--and promptly.

The Congress has made very clear to the Commission its obligation in this context. Legislative directives to us not to rest on our oars can be found in several places in the Act. For example, Section 14(b) authorized the Commission to make a study and investigation of (and to report on) effects of size on the investment policy of investment companies and on security markets, on concentration and control of wealth and industry, and on companies in which investment companies are interested. Also, Section

46 directs that the Commission's annual report to Congress shall include such information, data and recommendations for further legislation in connection with matters covered by the Act as the Commission may find advisable. More recently, it appears from the hearings held in connection with the Mack Resolution that certain activities of the industry may appropriately be considered under the authority of that Resolution.

From time to time the Commission has recommended further legislation to the Congress. Some amendments to this Act were enacted in 1954 but they were largely technical or clarifying in character. The amendments of a more substantive nature which were before the Congress in 1959 and 1960 failed of enactment because of differences between the House and Senate versions of the Bill which were not resolved in conference.

So far as the study of the consequences of size is concerned, I would be surprised if everyone in this room had not at one time or another had occasion to examine the questionnaire forms used by the Wharton School in its study which has been conducted over the last several years pursuant to a contract with the Commission.

That study is substantially complete and is expected to be delivered to the Commission in final form later this month. Speaking for myself, I have been doggedly slogging my way through an earlier draft of the report and the only reaction on which I would be willing to be quoted at this point is that I have not had to use many exclamation points in my marginal notes.

In a more general way, the Commission uses its routine inspection and enforcement program as a source of continuing and current information about the industry and its affairs. We are trying to shorten our cycle of inspections. Our budget for the current year and also for next year reflect this effort. We still need much more money to do the job properly. Early last year the Commission directed the Division of Corporate Regulation to undertake a general survey of the investment companies, their underwriters and advisers, an activity which is, of course, superimposed upon the routine inspection program.

Also, we are keeping a close watch on the so-called fifty cases which are suits brought by private parties in which various charges have been leveled against particular investment companies or affiliates. Plaintiffs in three of these cases have made application to the Commission for a determination whether certain unaffiliated directors of each of the investment companies involved are in fact controlled by someone else. Such a determination is of considerable moment in each case and is novel, so far as the Commission's exercise of its powers under the Act is concerned. Accordingly, the Commission has determined to settle certain legal issues presented by the applications before proceeding, if at all, to the resolution of the delicate factual questions presented. You know, we might be entitled to think,

when we read Shakespeare or Sean O'Casey or even Ernest Hemingway, that the English language is God's gift of tongues. On the other hand, and with all deference to the distinguished draftsmen, when we read certain sections of the Act, it would seem that they are emissions from the Tower of Babel.

Finally, in the current Special Study certain projects have been undertaken which are designed to supplement the information available from the other sources I have just mentioned.

It should be apparent that the Commission intends today, as in the past, to discharge its obligation to the Congress and to the investing public seriously and responsibly.

What then is the corresponding obligation of the industry? Whatever else your spokesmen did in 1940 in urging the adoption of the Act, they conceded in your behalf that the conduct of the business of investment companies, their advisers and underwriters is "affected with the public interest" and those words cannot receive too great an emphasis. It is appropriate to refer at this point to the Invest in America program which is being celebrated this week. The investment company industry has, at the very least, an enlightened self-interest in the consequences of such a program. Even more, however, it has a responsibility so to conduct itself as to justify its assertion of that self-interest. It is also worth noting that the very existence of this Institute serves as a recognition of the industry's responsibilities. I gather from your own published materials that the Institute and its predecessor share a table of genealogy tracing back to thirty-three individual "parents." A fledgling organization, the National Committee of Investment Companies, immediately picked up where informal industry cooperation in the drafting and enactment of the Act had left off, to assist the Commission in the drafting of forms and regulations required to implement the Act. The helping hand extended by the industry to the Commission has continued without interruption to the present day. One of the most conspicuous recent examples of this assistance relates to the Wharton School Study. Your representatives have had a substantial and constructive role in that project from its inception. Starting with a collaborative review of the scope of that Study and of each of the questionnaires which the School has used, and continuing until recent weeks during which a select group of your representatives has had the opportunity of making a critical review of the drafts of the several volumes to be issued, the Commission and its staff have had the benefit of your resources of talent and experience and we are most grateful.

Another recent activity of the Institute which deserves particular mention is the Guide to Business Standards which has recently received the endorsement of nearly all of your members.

What more should the Institute or its membership be asked to do in the discharge of their duties to the investing public? At this point it might be helpful to take another look at the statute itself. Contrast its structure for a moment with that of the Securities Act of 1933. The 1933 Act is a disclosure statute which states with reasonable specificity the character of the disclosure to be required of each issuer. The burden is on the individual issuer with the assistance of his financial advisers, attorneys and accountants and with the final assistance of Commission review to produce a registration statement meeting the statutory standards. Since the spectrum of disclosure is as broad as that of all American industry, these issuers have little in common which suggests a grouping of them for any self-regulatory purpose. Your industry by contrast, although it contains elements of variety, is much more closely bound together. The various components of your industry, investment companies, their advisers and their underwriters do share many common problems. The Act itself by regulating the relationships among these different elements of your industry, creates in large part their common bond. The existence of this Institute and the broadening of its membership in the last year reflect this situation.

Now look if you will at the Securities Exchange Act of 1934. That statute too reflects and indeed intensifies the bond between securities dealers generally and also that between those broker-dealers who are members of securities exchanges. Both as to securities dealers generally and as to exchanges and their members, the 1934 Act provides the Commission and the public and indeed the members of the industry, the assistance of organizations armed with specific statutory powers and responsibilities. Under that Act there came into existence the National Association of Securities Dealers, Inc. as a national securities association registered under Section 15A. Also under that Act we have the principal stock exchanges registered as national securities exchanges under Section 6. In each case groups of private firms and individuals whose business has been found to be affected with the public interest have been afforded the opportunity of accepting the authority and responsibilities spelled out in the statute. More importantly, those private groups have responded to the challenge and seized the opportunities afforded to them. It seems to me, a novice in the field, that the absence of a similar organization in the scheme of things for your industry may have been an unfortunate omission. If the absence of such an organization for your industry has done nothing else, it has placed a greater burden on the Commission in assessing the effectiveness of the regulatory scheme set up by the Act and in carrying, largely unassisted, the full responsibility for enforcement. These difficulties are compounded by the fact that the Commission's role is somewhat more limited under this Act than it is under the others that I have mentioned. I seem to get the feeling in the course of a few months of service on the Commission that all too much of the daily grist of work under the 1940 Act consists of considering and acting upon requests for exemption.

I come back again to the quotation from Mr. Jaretzki. The thoroughgoing examination in which the Commission is now engaged will have as its principal result the reaching of conclusions as to the success of moderate governmental regulation as demonstrated by the history of the last two decades. In reaching that result the Commission is entitled to ask for, and indeed it must have, the benefit of an intensive self-examination by the industry itself even as the Commission must appraise its own performance as well as yours. As I have suggested, I believe our parallel tasks would be much simpler if this Institute or its predecessor had been occupying a status loosely comparable to that of the NASD. However, even in the absence of such an organization, there is no question in my mind as to the resources of talent and, if you will, funds available to you for the purpose of such a self-examination. Without doubt there is already available to you as a result of your own research and fact-finding activities, a valuable accumulation of information and judgments. I am not prepared, of course, to suggest to you the manner in which you afford to the Commission and the investing public the benefit of such a process of self-examination. I most certainly have not with me here tonight yet another questionnaire. You may charge me with presenting a hard question without providing an easy answer, and I can only plead guilty. If lacking the expertise and experience of others whom I could name, I cannot define in full measure the extent of your responsibilities and obligations under the statute, I nevertheless think it appropriate to call to your attention one facet of that responsibility which has the quality of immediacy to distinguish it. Time is running short. I would hope that the Commission would have the benefit of your self-portrait to take into account as it considers the other materials and information which are in the process of being gathered. We should not be asked to risk a false judgment on any aspect of the conduct of your affairs for lack of the benefit of information and judgment which lie peculiarly and especially in your own hands.

Toynbee tells us that civilizations survive and prosper only as they succeed in responding to the challenges of their times. It is fair to assume that the continued prosperity of a great industry such as yours is subject to a like test. In this testing process, you will, I trust, justify my congenital optimism.

A glance at the clock suggests that I have digressed too long. The stamp speech will have to wait another 25 years on my hopeful assumption that you will allow me so to observe the golden anniversary.

Thank you very much.