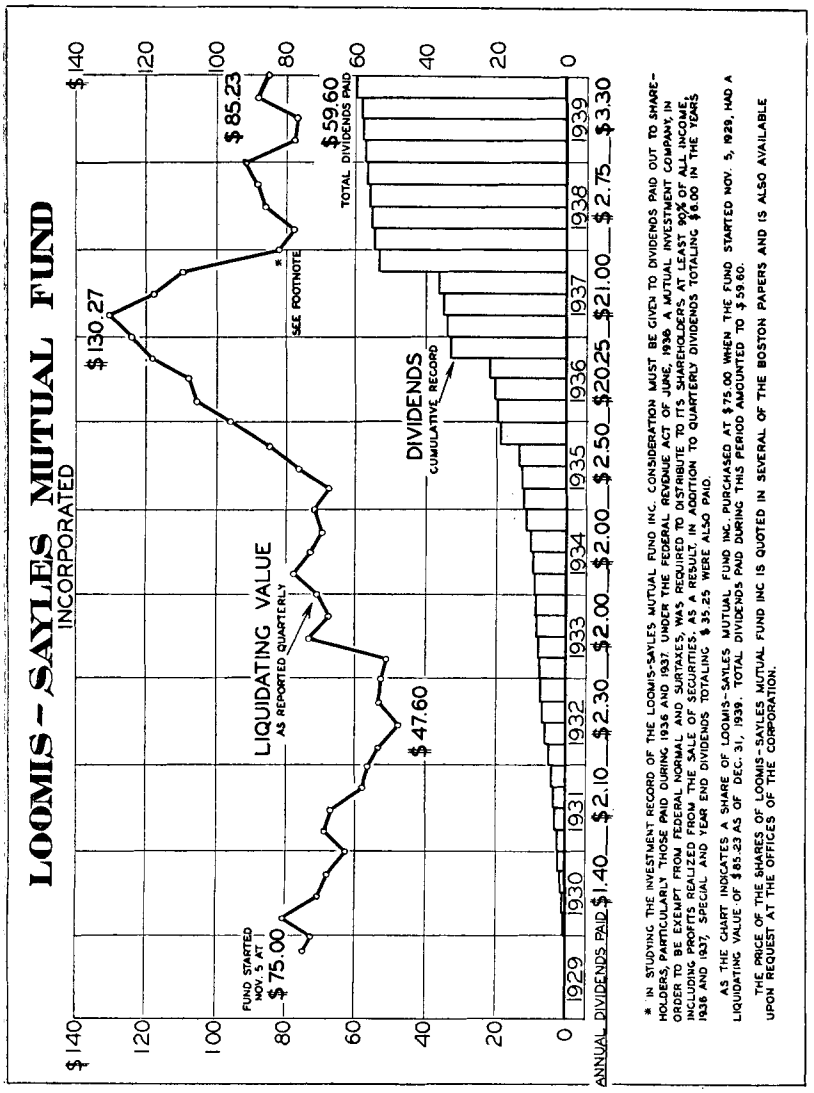
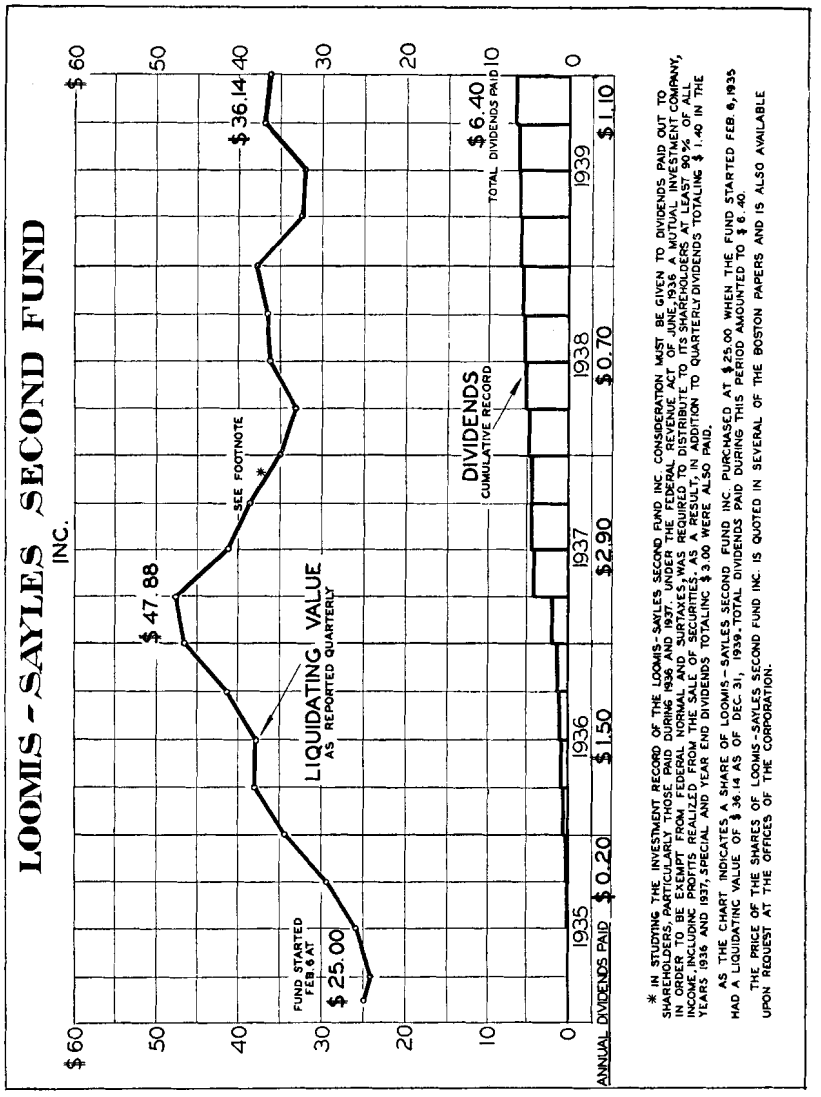
holders, as well as of themselves, to restrict the transfer of the shares in this manner. If it were not possible for the shareholder to secure an actual liquidating value of his shares, if he so desired, such a restriction might well be improper. However, we cannot see any justification for a change in this contractual arrangement already agreed upon by the purchaser of the shares of our funds.

Section 10 (b) (3) (a) raises the question of whether we would even qualify under this subsection since it limits the exemption to investment advisers engaged in no business other than that of investment adviser, and we, as well as Scudder, Stevens & Clark, do act as managers of investment trusts. I maintain that this is an unnatural divorce and not in the interest of the investors themselves.

(The charts referred to and submitted by the witness are as follows:)






Senator WAGNER. This, I take it, is what is generally known as a diversified trust?

Mr. LOOMIS. An open-end.

Senator WAGNER. It is open-end, yes; but do you go into any risky ventures?

Mr. LOOMIS. No; ours is the usual diversified type.

Senator HUGHES. You do not pay your directors anything, you say?

Mr. LOOMIS. No.

Senator HUGHES. You charge 1 percent, do you?

Mr. LOOMIS. Yes.

Senator HUGHES. Is that 1 percent of the earnings?

Mr. LOOMIS. No; 1 percent of the asset value.

Senator HUGHES. That pays the officers?
Mr. LOOMIS. Yes, sir.
Senator HUGHES. And the other expenses?
Mr. LOOMIS. It pays the secretarial expense; it pays most of the legal expenses; it pays rent, light, and all the expenses except custodian charges and taxes. I think that includes them all.
Senator WAGNER. Where do the taxes come from?
Mr. LOOMIS. The trust has to pay those.
Senator WAGNER. They come out of the trust, of course?
Mr. LOOMIS. Yes.
Senator WAGNER. Are there any other questions? (No response.) Thank you very much.

## STATEMENT OF DOUGLAS T. JOHNSTON, PRESIDENT, JOHNSTON & LAGERQUIST, INC., NEW YORK, N. Y. AND VICE PRESIDENT OF THE INVESTMENT COUNSEL ASSOCIATION OF AMERICA

Mr. JOHNSTON. The statement which I am making is purely introductory to the testimony to be given by other representatives of the investment counsel profession and is designed to outline the points that will be covered by them in more detail. My remarks will be very brief.

The bill which is the subject of the present hearing is aimed "to provide for the registration and regulation of investment companies and investment advisers and for other purposes."

Title I of the bill covers investment companies; and title II, the hearings on which are now starting, covers investment advisers.

The definition of "investment adviser" as given in the bill, in spite of certain exclusions, is quite broad and covers a number of services which are entirely different in their scope and in their methods of operation. For example, as we read the definition, among others, it would include those companies which publish manuals of securities such as Moody's, Poor's, and so forth; it would include those companies issuing weekly investment letters such as Babson's, United Business Service, Standard Statistics, and so forth; it would include those tipsters who through newspaper advertisements offer to send, for a nominal price, a list of stocks that are sure to go up; it would include certain investment banking and brokerage houses which maintain investment advisory departments and make charges for services rendered; and finally it would include those firms which operate on a professional basis and which have come to be recognized as investment counsel.

Just why it is thought to be in the public interest at this time to require all the above services to register with, and be regulated by, the Federal Government we do not know.

At a hearing in Washington 2 years ago we were told that there was incomplete information as to how many and what companies and firms were included in the investment advisory field. Possible abuses that might exist in the field were mentioned rather than specific ones definitely requiring action.

We all know that abuses exist, or may occur, in practically every field of endeavor; existing laws against fraud already cover the most flagrant, and the balance ordinarily do not require Federal regulation in order that the public interest may be best served.

At that hearing we were asked if we did not think that the taking of a census to determine what the field consisted of would be a good thing. Having at that time given little thought to the matter we either agreed that it probably would, or at any rate raised no objection except to point out the difficulty of making any such census all-inclusive.

Title II of the present bill is a far cry from the simple census proposed at that time. If a simple census can develop into a bill with the broad regulatory provisions included in title II, can one not be excused for wondering how the discretionary powers given in the bill would actually be used?

If there exist abuses in the broad field of investment advisers, then first, those abuses should be specified; and second, it should be considered whether the public interest requires the enactment of Federal legislation to correct those abuses; or whether some other and perhaps better and more effective way can be found. Here the cart would seem to be before the horse—a bill is being proposed to include all investment advisers with certain important exceptions, not to correct predetermined abuses, but to discover whether they exist.

I have mentioned certain important exceptions or exclusions in the definition of "investment advisers"; one of the principal of these is lawyers. Probably in the aggregate more investment advice is given by lawyers than by all other advisers combined. I only want to point out that in so acting they are not functioning strictly as lawyers. So far as I know, no courses on investments are part of a law school curriculum, nor in passing bar examinations does a lawyer have to pass a test on investment. So if a census were to be taken, why not include lawyers?

There is one other point that I would like to bring to your attention. In the attempt to cure many of the abuses that have existed in the securities markets Congress has quite properly gone to the source of many of the troubles, namely the original issue of securities. Investment advisers do not issue securities. They only advise as to securities already issued. If they advise one person to sell a certain security some other person must buy it. If the seller is benefited the purchaser may be hurt, but as far as the general public is concerned the matter washes out. The bringing out of a new issue of securities however if it is either unsound itself or unsoundly issued, does adversely affect the public interest.

I, and those testifying immediately after me, belong to the profession of investment counsel, which has been included in title II of the bill, by definition. We speak only for those practicing in the profession of investment counsel and do not attempt or presume to speak for the other groups also included in the bill by the same definition. We shall attempt in our testimony:

(1) To describe the profession of Investment Counsel for the benefit of those of the committee why may be unfamiliar with our functions and how they are performed;

(2) To show why, in our opinion, regulation of investment counsel at this time would not be in the public interest but possibly actually against it; and

(3) To bring to your attention the steps that have already been taken within the profession itself toward self-regulation.

Senator WAGNER. Thank you very much, Mr. Johnston.

Senator HUGHES. On page 96 of the bill there is a statement of facts found under paragraphs 1, 2, 3, and 4. Have you anything to say about that, as to whether those are correct?

Mr. JOHNSTON. I felt that they were not very specific as to possible abuses.

Senator HUGHES. Will someone else cover those things?

Mr. JOHNSTON. Yes; they will be covered later.

## STATEMENT OF CHARLES M. O'HEARN, VICE PRESIDENT AND DIRECTOR OF CLARKE, SINSABAUGH & CO., INVESTMENT COUNSEL, CHRYSLER BUILDING, NEW YORK, N. Y.

Mr. O'HEARN. I am Charles M. O'Hearn, vice president and director of Clarke, Sinsabaugh & Co., investment counsel, with principal office at New York in the Chrysler Building. We are a privately owned corporation.

We believe this bill proposed for the regulation of the investment-counsel profession is against public interest and will be seriously damaging to our business.

We should like to describe our profession. Investment counsel performs very definite functions quite different from those performed by many firms or businesses which are also included under title II of this bill.

It is a personal-service profession and depends for its success upon a close personal and confidential relationship between the investment-counsel firm and its client. It requires frequent and personal contact of a professional nature between us and our clients. We must know them well. It is the professional character of our business which establishes the basis for charging fees. There are many services we render which cannot be directly related to the amount of our compensation. As a matter of fact, our fees are charged as a percentage of the total market value of the securities under supervision. We do not share profits.

The financial program and objectives of an investment trust are predetermined before it begins to operate. Its operating problems are primarily those of security selection and timing of action. With us, however, these are not the first consideration though they are very important. Our first task is to prepare and maintain for each client a broad plan for his general financial objectives and for the methods appropriate to their accomplishment. We cannot advise him properly on the development of his financial affairs in the future without such a plan. In making the plan, we must determine the soundness of the relation of his income to his standard of living. We must also consider his capacity to assume financial risks, his probable future expenses for educating his family, the number of his dependents, and so forth.

We must establish with each client a relationship of trust and confidence designed to last over a long period of time because economic forces work themselves out slowly. Business and investment cycles last for years and our investment plans have to be similarly long-range. No investment counsel firm could long remain in business or be of real benefit to clients except through such long-term associations.

Our relationship with each client requires a direct and continuous supervision over the securities in his fund. Most firms follow the

same general procedure. In our firm, we keep separate records for each client containing a list of all his securities. The client's identity is represented by a number to preserve the confidential relationship. The records also reflect all changes which take place or are recommended either as a result of our initiative or, as sometimes happens, as a result of a client's initiative. Having this complete record of our client's financial position available at all times, we are able to take appropriate action in the light of new developments.

Since we have a cold-blooded, objective approach, we tend to exercise a restraining influence that discourages speculation and helps clients to avoid hasty and emotional decisions.

I should like to say something about the mechanics of our operation.

Within the framework of our plan for him and based upon the information in our records, we make recommendations from time to time to each client for changes in his account. These are always designed to place it in a stronger position with respect to his major objectives. He considers these recommendations and accepts or rejects them. He may then act upon them himself or instruct us to send them to his broker who executes them accordingly. Some clients prefer to have us transmit our recommendations to their brokers directly in the first place. When purchases and sales have been confirmed, corresponding changes are made in our record of the client's holdings. We make frequent reports to the client about his position, his income, the general economic situation, the position and prospects of particular securities, and about anything else relating to his financial affairs on which he may desire comment. In these reports, we also comment, as the need arises, upon the progress which is being made in executing our long-term plan for his affairs.

This is the sum of what we do. We do not take custody of securities or of cash balances. We do not act as brokers. We do not receive any income directly or indirectly from any broker or dealer in securities. We have no incentive to suggest unnecessary transactions, as our fees are not affected by the turn-over of securities in an account.

I should like to emphasize the conservative, rather than the speculative, nature of our approach.

As we conceive our function, it is primarily to conserve a client's means. Our objective is to maintain and, to the extent which is consonant with his ability to assume risk, to raise his standard of living in terms of the income received by him over a long period of time. It is not our objective to make money for him in a series of spectacular moves. Of course, conservation in the financial sense requires an effort to achieve gains in order to offset the inevitable losses resulting from unforeseeable changes in economic and industrial conditions. Also, investors face such risks as a possible rapid rise in the cost of living. For persons depending substantially upon fixed income returns, as do most of our clients, this requires an attempt on their part to seek a return beyond the amount permitted by general interest rates. Within these limits, however, we do not seek to "make money" for our clients.

An essential feature of the conservative approach is limitation of risks. It is axiomatic, of course, that all investing is an assumption of risk for the promise of return. One investor however may be able to assume large risks for the prospect of commensurate reward while

the widow and the orphan should not be speculators in even the best wildcat propositions. The ramifications of this principle however often get lost in the shuffle. Therefore, the need to evaluate the capacity of an individual to assume risks is the chief reason for a carefully studied and balanced investment plan.

It will be clear to the members of the committee that the heart of the service we offer to our clients is experienced and well informed judgment. No act of Congress nor any power of the Federal Government can add or detract one iota from our experience or our judgment. Judgment, carefully trained, sincerely applied, and well supported by adequate data, is our stock in trade: Judgment of the client's circumstances and of the soundness of his financial objectives and of the risks he may assume. Judgment is the root and branch of the decisions to recommend changes in a client's security holdings. If the investment counsel profession, as we have described it, could not offer this kind of judgment with its supporting experience and information, it would not have anything to sell that could not be bought in almost any bookstore.

The requisite experience and training we try to assure by the care with which we select our associates and our staff. In addition, however, our judgment must have the benefit of research to permit us to make intelligent decisions. We employ research staffs to study the general economic situation at home and abroad; to study and know industries, their problems and their prospects; to investigate particular companies, and over long periods of time and under varying conditions, to know their character, methods, managements, soundness, and prospects. In addition, also, we study the position of particular securities in relation to all of these other factors and in relation to the prospect that they will provide some cash return in the form of dividends or interest in the future.

This proposed bill provides for the registration and regulation of investment companies and of investment advisers. It seems to us that investment advisers were "brought along with the crowd." We fail to see that there is any essential similarity between the investment trusts and investment advisers.

All the testimony about abuses presented to this committee has been confined to the investment trusts. It seems to us, therefore, that legislation affecting us is proposed on the basis of actual or inferred evidence relating solely to investment trusts. Furthermore, our clients are not unsophisticated in financial matters. They are resourceful men and women of means who are very critical in their examination of our performance. If they disapprove of our activities, they cancel their contracts with us, which eliminates our only source of income.

We are not in a position to pass upon the charges which have been leveled against the investment trust business. We do know that a large portion of that business is motivated and governed by the same principles and sense of responsibility that govern our operations. However, we also know that the desirability of some regulation for the investment trusts has been pretty well established and has been accepted by the investment trusts themselves. The implication is that there is a need for such regulation. We are lumped with investment trusts in the bill in a way which attaches this implication to us as well. This is damaging to our profession. To paraphrase an old

saying, "If you give an investment counselor a bad name, you might as well close up his shop."

I should like to attempt to distinguish investment counselors from others who aid the people to invest funds.

When investment advisers were included under this proposed legislation, many persons and firms were included who, in our opinion, are more notable for the differences between them than for their likenesses.

We are quite clearly not "hit and run" tipsters, nor do we deal with our clients at arms' length through the advertising columns of the newspapers or the mails; in fact, we regard it as a major defeat if we are unable to have frequent personal contact with a client and with his associates or dependents. We do not publish for general distribution a statistical service or compendium of general economic observations or financial recommendations. To use a hackneyed phrase, our business is "tailor-made."

Whatever may be the merits of a plan to regulate the activities of the tipsters and others on the fringe, it seems to us that what they do is so different from what we do, in principle, in purpose, and in method, that they constitute a separate category in which we should not be involved merely because we also give financial advice. The whole effort of our business life has been to offer a service which, because it avoided the superficialities and instability characteristic of the tipster service and related enterprises, could establish for itself an enduring professional reputation.

However, we would not have the committee believe that we think we should be immune from regulation merely because we conduct a business which is different from that of others who are or perhaps should be regulated. Our case for believing that the business we conduct does not need to be regulated in the manner provided by the proposed legislation, rests on other grounds. We and our profession have a good record for honest dealing with the public and with our clients. We have gone to great lengths to protect our clients from a wider range of abuses than could possibly be covered by law. We do not claim unique virtues for the profession. We do not claim exemption from the supervision which "ordinary mortals" must endure. The outstanding fact of the investment counsel profession is that unless it can demonstrate that it possesses these virtues, it will pass out of existence in the long run for the most cogent of all reasons—it will be worthless.

Thus, from a selfish standpoint alone, we have the best of reasons for exercising a high degree of self-discipline. We have established and have published codes of professional practice. The profession has bound itself to policy-standards to protect its clients and the public. In many instances it has voluntarily assumed strict limitation of the right of its principals and employees to buy and sell securities in the normal way if there is any chance at all that to do so might seem to operate against the interests of clients and the public. This we have done because the success of the procession depends upon the success with which we establish in the minds of our clients and with the public in general the conviction that we are able, conscientious, honest, and impartial. Legislation of the sort proposed would weaken the initiative which now encourages these self-disciplinary efforts. They would no longer bring us the reward of an unqualified reputation for fair and honest dealings which now leads us to make them. Under the bill, only a long record of freedom from governmental action against us

could bring the same reward, and then only in the negative sense. The "honor system" breaks down under supervision which implies that it is ineffective.

The professional character of the investment counsel business results in the fact that our greatest asset, namely, reputation and public confidence, is an asset very easily destroyed by inadvertent acts. A kilowatt of electricity produced by one kind of management is just like a kilowatt produced by another kind: Not so with the advice given by investment counselors. Any event which harms our reputation, therefore, will destroy our principal asset and be tantamount to a confiscation of plant in the industrial field. The legislation now under consideration by this committee gives great power to the Securities and Exchange Commission and could easily result in the Commission unintentionally destroying our reputation and the public's confidence in us. The mere knowledge that a firm in the investment counsel business had been presented with a show-cause order issued by the Commission would raise serious doubts in the public mind as to the firm's probity and integrity, even though it were subsequently proved that there were no grounds for action against the firm or, in fact, no real reason for the order having been issued.

We do not know all of the facts available to the committee about the demand which has been made for inclusion of our profession under legislation of the character proposed. As far as we have been able to determine from our own resources, there is little serious public demand for such action. This squares with the fact that there is little or no record of abuses established against our profession. It is not in the public interest to establish supervision and regulation of a profession which is so peculiarly vulnerable to the incidental effects of contact with the regulatory and supervisory process. We think this last point bears closer examination.

Other organizations can be subjected to supervision and regulation without loss of more than reputation for the time being. If it subsequently proves that the investigation was needless, the loss of reputation can be restored on a public showing that the profession or company was guiltless. In our case, an examination, however well intentioned, of the foundations upon which our clients' and public confidence in us rests can, and we believe would, result in our loss not only of reputation but of our clientele as well. When our problem is viewed in this light, it will doubtless be clear to the committee why we regard the prospects raised by the proposed legislation with grave concern.

Regulation of this profession by the Securities and Exchange Commission is not necessary for the protection of small, uniformed investors, since they do not use investment counsel service. There is a marked difference between the owners of investment trust securities and our clients. While investment trusts sell securities in amounts sufficiently small so that even the poorest may buy, our services are designed for and limited to a group of persons who are a minority in the community. We do not deal with the general public. Our clients represent substantial amounts of capital and have adequate means to inform themselves about us through their banking and legal affiliations. They make careful investigations of the ability and integrity of investment advisers before employing them.

A principal advantage of our service to our clients is that it is confidential as against all third parties. Were this bill in force, many of