

SECURITIES AND EXCHANGE COMMISSION HISTORICAL SOCIETY

THE ROUNDTABLE ON INVESTMENT COMPANY REGULATION

Wednesday, December 4, 2002
2:00 - 5:00 p.m.

William O. Douglas Open Meeting Room
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

PARTICIPANTS:

BARRY P. BARBASH
JOHN A. DUDLEY
JOEL H. GOLDBERG
ANNE P. JONES
STANLEY B. JUDD
MARTIN E. LYBECKER
KATHRYN B. MCGRATH
ALLAN S. MOSTOFF
EDWARD T. O'DELL
ALAN ROSENBLAT
PAUL R. ROYE
DAVID SILVER
MARIANNE K. SMYTHE

P R O C E E D I N G S

MR. ROWE: I'm Dick Rowe, a member of the Securities and Exchange Commission Historical Society's Advisory Council, and the chair of its Oral Histories and Acquisitions Committee. I welcome you, our participants, to this, our fourth Oral Histories Program. This Roundtable will focus on investment management regulation.

Once again, thanks to technology, our Roundtable is being broadcast by live audio stream at www.sechistorical.org, and I welcome all of you that are listening in. I also invite you to visit the web site for our virtual museum to listen to and read the transcripts of other Roundtables and oral histories, as well as review original historic documents and photos. The museum is open 24/7, and is free of charge to all.

Our thanks to the Commission for its continued assistance to the Society and helping to preserve and share the history of the SEC and the securities industry. Thanks especially to Jack Katz, Secretary of the Commission, and other staff members for helping to facilitate this Roundtable.

My fellow volunteer leaders and I would like to

express our special appreciation to the members of the Securities Law Committee of the Federal Bar Association, who have generously supported the society's oral histories activities during 2002. Thanks also to the many members of our Society who have helped to make this program and other activities possible.

If you're not currently a member of our Society and wish to join, it's easy as listening in on this live audio stream. Please go to www.sechistorical.org; click on "join in support and give online" by our secure and confidential server. Your much welcome contributions will help make more programs like this Roundtable possible.

And now, without further ado, I'll turn the program over to Kathy McGrath.

MS. MCGRATH: Hi. I'm going to introduce who our participants are for this afternoon's Roundtable. And I'm going to do it in alphabetical order, because the list I have is not the same as the seating arrangement.

First, we have Barry Barbash -- he's on my far right -- who was Director of the Investment Management Division from 1993 to 1998. He's now at Shearman & Sterling, in Washington,

D.C. And a little-known fact, Barry was a young snuffly in the Division of Investment Management some years before that.

Next to Barry is Alan Rosenblat. He joined the Division of Investment Management in 1964, and was there until 1976 as its chief counsel. He then moved up to the General Counsel's Office as an assistant general counsel for the next 10 years. And in that capacity, one of his responsibilities was keeping an eye on helping out and watching over the Division of Investment Management.

Jack Dudley was in the SEC's General Counsel's Office beginning in 1958, and he was there until 1964, and then moved to be associate director of Investment Management from 1964 to 1968. He has been a partner with Sullivan & Worcester, and I believe Jack is now retired.

MR. DUDLEY: No.

MS. MCGRATH: Yes?

MR. DUDLEY: Not yet.

MS. MCGRATH: Not yet. Okay. Still there. He's practicing in the investment management field. Sorry.

MR. DUDLEY: That's okay.

MS. MCGRATH: On my immediate right, and always very

■ near and dear to my heart -- because he was in the division
■ while I was there, and it wouldn't have functioned very well
■ without him -- is Stanley Judd. He joined in 1964, and he was
■ there for 30 years. Served as deputy chief counsel and senior
■ special counsel. Since leaving the SEC, he's been a senior
■ manager for PricewaterhouseCoopers, and works as an
■ independent consultant helping develop securities markets in
■ eastern Europe.

■ David Silver, who is on my left, came to the SEC in
■ 1960 to work on the investigation of the American Stock
■ Exchange, and also participated in the SEC Special Study, and
■ in the Division of Market Regulation, was responsible for
■ implementing the study's stock exchange-related regulations.
■ He was president of the key Investment Company Industry Trade
■ Association, the Investment Company Institute from 1977 to
■ 1991, and president of ICI Mutual Insurance from 1987 to 2000.

■ He is a member of the Advisory Council of the SEC Historical
■ Society, and currently serves on the boards of several private
■ organizations who are still in this business.

■ Allan Mostoff, who is next to Dave on Dave's left,
■ also participated in the 1963 SEC Special Study, then worked

in the General Counsel's Office, and what was then called the Division of Corporate Regulation. He then was named to be the first director of the Division of Investment Management in 1972, and he did that until 1974. He's now with the Dechert law firm in Washington, and is a member of the SEC Historical Society's Advisory Council, and chairs its Investment Management Operational Committee.

Next to Allan, also one over -- I can't see quite -- oh, Joel, hi -- is Joel Goldberg. Joel came to the SEC in 1968 in what was then the Division of Corporate Regulation, and also worked as a legal assistant to Commissioner --

MR. GOLDBERG: No, I think you've got somebody else, Kathy.

MS. MCGRATH: No. Sorry.

MR. GOLDBERG: Yeah.

MS. MCGRATH: Joel joined in 1973, and was division director 1981 to '83. He also was over at DOL, and he's in private practice in the investment management field with Shearman & Sterling in New York City.

And now I've got the person who joined the SEC in 1968 in Corp Reg, and that's Anne Jones, who was an assistant

to Commissioner Needham, and the first woman director of the Investment Management Division, a post she took in late 1975, and currently serves on fund boards and corporate boards, and has a wonderful perspective on this.

Next to Anne is Ed O'Dell. Ed was in trading and exchanges, the Division of Trading and Exchanges, from 1962 to '63; and Corp Reg 1963 to 1966; and then was engaged in practice for many years in the fund field with Goodwin & Proctor.

Marty Lybecker is next to Ed O'Dell. Marty was in the Division of Investment Management 1972 to '75, and then came back again after a stint teaching, I think, from '78 to '81 as associate director. He's now with Wilmer, Cutler & Pickering in D.C.

And next to Marty is Paul Roye, the current division director. A little-known fact about Paul is that he didn't just join the Commission in November 1998, when he became director of the division, but he started out as a young snuffly in the division years before that. And in between, he was a partner at the Dechert law firm in Washington, D.C.

And last, but certainly not least, is Marianne

Smythe, who was in the division from '87 to '93, and served as its director from '91 to '93. She is currently with Wilmer Cutler in Washington, D.C.

And that's who we are. Dave, do you want to start off with picking some history out of the brains of these old gray heads up here?

MR. SILVER: Well, thank you, Kathy. I do have to emphasize and reemphasize something that Kathy said. I am here as a ringer. My experience at the Commission was with the Division of Trading and Exchanges and the Special Study of securities markets. My only contact back then with the then-Division of Corporate Regulation involved an investigation into the New York Stock Exchange minimum commission rate schedule, and how mutual funds allocated brokerage dollars.

However, for about 35 years, I have interacted with the staff and the Commission in the investment company area from my vantage point, the Investment Company Institute, and then later, ICI Mutual Insurance Company.

Let me say a word about the law. It's with great trepidation that I say anything about the Investment Company Act to this audience. But we are speaking for the ages, and

■ what we say will be recorded here.

■ I also have to say that although I regard everyone
■ here as a good friend, there were periods in my life, had I
■ seen all these faces at once, I would have believed I was in a
■ terrible nightmare, and hastened for the Pepto Bismol.

■ MS. MCGRATH: And you thought this was an historical
■ society program that we invited you to.

■ MR. SILVER: This is the third of these panels I've
■ been involved in, and I have to say that history is a little
■ like the elephant. Even with the best of good will, it's
■ amazing how we remember and perceive historical events very
■ differently from one another, even assuming we remember
■ accurately from our own point of view. So also, we all have
■ formed our own views of the law.

■ And I guess everything here starts with the
■ Investment Company Act on this panel. It was, of course, the
■ last of the three major securities laws to be enacted. It's
■ unique in several respects. It was preceded by a SEC study, a
■ massive study conducted by the SEC, the Investment Trust
■ Study. And I would be remiss if I didn't put one name into
■ the historical record, and that is the leading staff member on

■ that study, who also helped negotiate out the Act with the
■ industry in 1940, and that is David Shenker, a long-time
■ dedicated staff member who was responsible on the staff level
■ for the Act.

■ Second, the Act is the most clearly regulatory of
■ all of the Federal Securities Laws. It subjects a wide range
■ of business activities to SEC regulation. It becomes so
■ detailed on the corporate governance side, and on the
■ corporate side generally, and the accounting side, that it
■ might be really viewed as a federal corporation law for
■ investment companies.

■ Finally, unlike the Securities Act or the Exchange
■ Act, the Investment Company Act was the product of SEC
■ industry negotiations. The final text was hammered out in six
■ weeks of negotiations between representatives of the SEC
■ headed by, on the Commission level, Commissioner Healy, and on
■ the staff level, as I have mentioned, David Shenker. And a
■ group of industry leaders and their counsel, most notably
■ Alfred Jaretski of the firm of Sullivan & Cromwell, and Warren
■ Motley of the Gaston & Snow firm in Boston.

■ The underlying imperative for speedy enactment in

1940 was probably the desire of the administration to turn from economic reform to preparations for war. So in that sense, the Investment Company Act probably stands as the last piece of reform legislation coming out of that great era of the New Deal.

We are not here today to discuss -- and I want to make this clear -- the details of the Investment Company Act or the regulatory activity under it. However, to provide a framework -- and again, this is idiosyncratic on my part -- I've always thought that there were about seven principles under which you can group the regulatory provisions of the Act.

The first is obviously full disclosure of investment objectives, risks, fees, and costs at the time of purchase and on an ongoing basis. The second is the requirement for a net asset calculation for incoming and retiring investors. The third is regulation of compensation paid to investment managers, distributors of fund shares, and affiliates. The fourth is prohibition of or regulation of various conflict of interest transactions. The fifth is prohibitions against unfair capital structures. The sixth is segregation and

■ protection of fund assets. And the seventh, and something
■ which is of continuing significance, and even more
■ significance today, is independent director oversight of fund
■ activities.

■ Now, others may have other formulations. But I
■ believe that everything we will say here today will fall under
■ the rubric of one or more of these principles.

■ Let me speak -- since I guess I am, in a sense, the
■ senior staff member here, having come to the Commission in
■ 1960, the modern era of investment company regulation starts
■ with two interrelated actions taken by the Commission. The
■ first was a decision of the Commission in 1958 to engage
■ Professor Irwin Friend of the Wharton School, pursuant to the
■ authority contained in Section 14(b) of the Act, to study
■ whether the growth of the mutual fund industry, which had
■ reached the unprecedented figure of \$12 billion, had created
■ any pressing public policy concerns.

■ The second was the decision by Chairman Cary in the
■ early 1960s to reorganize the Division of Corporate Regulation
■ to emphasize the primary role of the Division in the
■ regulation of investment companies. Until that time, mutual

fund regulation within the Division was, I recall, under the supervision of an Associate Director, who also held that title within the Division of Corporation Finance.

As part of that reorganization, a branch of inspections and investigations was created in 1963. Concurrently, the responsibility for conducting investigations into violations of the Investment Company Act was transferred from the Division of Trading and Exchanges to the Division of Corporate Regulation. Ed O'Dell, who is here today, is a surviving veteran of that change, and we will hear from him about that period later.

If I may end with a personal observation, it is clear to me that veterans of the Division of Corporate Regulation, under whichever name it sails, can view their work and their legacy with great pride. When the division was reorganized in 1963, mutual fund assets were about \$20 billion. Today, they hover around seven trillion. While regulation cannot force success on an industry, it can facilitate or inhibit industry growth. Inappropriate regulation can stifle growth, while wise regulatory measures, which impose and enforce high standards, can create and

■ nurture the ever-fragile public confidence, which is the
■ bedrock for the success of any industry composed of financial
■ institutions.

■ It is no accident, in my view, that there has not
■ been a major scandal in the fund industry on the Commission's
■ watch. The good work of the Commission in mutual fund
■ regulation over the past 62 years also serves as a powerful
■ and convincing refutation of those ideological theorists who
■ lament that the securities laws prevent the crucible of the
■ market from working its will uninhibited by government
■ regulation.

■ In this area at least, it is clear that the public
■ has been better served by regulation than otherwise. Much of
■ the credit must go to the people sitting here today, and the
■ many others who have gone before and cannot be with us except
■ through their legacy of achievement.

■ Now, I'd like to start substantively with Allan
■ Mostoff, who is the dean of regulators here today, the first
■ division director that we have on this panel. And I'd like to
■ ask a question involving the early days of the division, and
■ the publication of that seminal document in 1966 called Public

Policy Implications of Investment Company Growth.

Allan went over to the Division of Corporate Regulation after his stint in the Special Study and in the General Counsel's Office, and he worked on that 1966 report. And the study formed the basis for a comprehensive legislative program, which ultimately resulted in the Investment Company Amendments Act of 1970. There were recommendations in the management fee area, sales charges, contractual plans, among many others. What, Allan, can you tell us about this major episode in the history of investment management regulation?

MR. MOSTOFF: Thank you, Dave. I'd first like to correct the record a little bit. I was the director of what is now the Division of Investment Management from 1972 to the end of 1975, not 1974. And at that time -- and I guess I can claim to be the only director of -- the first and only director of the division that was called Investment Company Regulation in 1972, and then Investment Management Regulation toward the end of 1972 and into '73, '74, and '75. And when we got around to 1976 and Anne took over the helm, the word regulation went out the window, and it became the Division of Investment Management.

“Public policy.” Well, you really set the stage for your question in your introductory remarks, Dave. Public Policy began with the Wharton Report, the impetus coming from suggestions in the Wharton Report that the industry had grown to the point where there were economies of scale in the management of large pools of assets, and those economies of scale, arguably, were not being shared with the shareholders.

That coincided with and spurred on the instigation of private litigation, claiming excessive management fees. The Special Study focused on an aspect of the fund industry, the selling practices and contractual plans. And all of that evolved into an agenda that the Commission formulated in developing the Public Policy Report.

The Commission was firm in its views that it would not regulate management fees, but that it wanted to have some reasonable standard for management fees, and hence the suggestion and recommendation in the report that the statute be changed to assure that the fees be reasonable.

On the sales load side, the Commission wanted to control sales loads in some way to prevent them from escalating to unfettered limits. And so, it could be argued

■ facetiously, there were five commissioners, each one got a
■ point, and that resulted in the recommendation that the sales
■ loads be set at five percent maximum ceiling.

■ On the contractual plan side, the Commission sought
■ to regulate contractual plans and control them. There were
■ other recommendations in Public Policy, too, such as
■ controlling the fund-of-funds structure. And that set the
■ stage for an intensive set of negotiations and lobbying
■ efforts with the industry and on the Hill by the industry and
■ by the Commission, which ultimately resulted in the Investment
■ Company Amendments Act of 1970, which I guess you want to lead
■ into.

■ MS. MCGRATH: I have a question. During your
■ tenure, was the disclosure unit in the division shipped to the
■ eastern front, Corp Fin, or --

■ MR. MOSTOFF: Yes. Well, in the beginning, when
■ Chairman Casey -- then Chairman Casey got the idea that the
■ division should be reorganized, and the Commission should be
■ reorganized, the enforcement activities of the Commission were
■ split off into a separate Division of Enforcement, and the
■ Investment Management Regulatory Activities were split --

■ taken away and consolidated. And so at first, when the
■ division was created, it was just Investment Company
■ Regulation. Investment Advisor Regulation was moved over from
■ the former Division of Trading and Exchanges and put into that
■ division, which then changed its name to Investment Management
■ Regulation.

■ Disclosure was moved up to the Division of
■ Corporation Finance, where it had been originally until, I
■ guess it was, the early '60s.

■ MS. MCGRATH: Why did they do that? Why did they
■ ship it up? And then Anne got it back, I guess.

■ MR. MOSTOFF: Anne got it back, very necessarily, in
■ order to do the job more --

■ MS. MCGRATH: She traded the "R" for disclosure.

■ MR. MOSTOFF: That's right.

■ MS. MCGRATH: She got rid of "Regulation" and got
■ "Disclosure."

■ MR. MOSTOFF: In order to do the job more
■ effectively. Well, that's not necessarily so. It could be
■ argued that disclosure is one of the most effective regulatory
■ techniques that the Commission has, if it's used effectively.

■ And I think there was such an industry concern based on
■ experiences that the industry had dealing with regulators who
■ were administering disclosure through the end of the '60s and
■ the early '70s with the regulatory impact of disclosure, that
■ the Chairman was persuaded that when he was doing this, he
■ should get disclosure back amongst the disclosure folks. And
■ so it was moved up there for that temporary period.

■ MR. GOLDBERG: Or maybe to be slightly more crude,
■ Allan, wasn't the issue that it was perceived that where the
■ staff didn't care for a particular proposal, but they couldn't
■ find anything in the 1940 Act that was illegal about it, they
■ would use the disclosure process to force the registrant to
■ comply with their views. Wasn't that essentially what the
■ allegation was?

■ MR. MOSTOFF: And that's what I mean by being a very
■ effective regulatory technique. Exactly right.

■ MR. ROSENBLAT: I think there may well have been
■ another reason, which is that the tradition in the Division of
■ Corporation Finance is "you've got a bunch of issuers who want
■ to make public offerings. They have underwriters champing at
■ the bit." And the tradition in that division is get the

adequate disclosure and get the thing out, so that industry can finance itself. And the Division of Investment Management's view was if you have a regulatory problem that can't be cured by disclosure, you can't let that prospectus go effective. So that there was always this tension before the consolidation and after the split, because the Division of Corporation Finance could say, "Well, we're making this registration effective, because we believe there's adequate disclosure. You can deal with the regulatory problems on your own in your own way."

MS. JONES: Now, somebody told me in point of fact, the reason the disclosure was sent to Corp Fin was -- Joel hit the nail on the head. I mean, the perception, regardless of what the staff thought, the Commission thought the division was using disclosure inappropriately.

MR. MOSTOFF: The Commission thought or the industry thought? And then the Commission agreed.

MS. JONES: I don't --

MR. MOSTOFF: I think Bill Casey was sold on that idea. I argued with him as mightily as I could, and the issue really came down to whether I was going to take the job as the

■ director of the division without disclosure, or whether I was
■ going to leave the Commission. I just chose to stay and make
■ the best of it.

■ MS. MCGRATH: We're glad you stayed. Can I ask a
■ question?

■ MR. SILVER: Just one question. Anne, you were the
■ one that got it back. How did you get it back?

■ MS. JONES: Well, I suppose now that enough years
■ have passed, and I no longer practice before the Commission, I
■ can be -- it was a trade-off. Allan said, you know, it was a
■ question of whether he was going to leave the Commission or do
■ it without disclosure. I said I did not want the job without
■ disclosure, because I felt it was a very important part of the
■ function of the Commission. And that's really how it came
■ back.

■ MR. JUDD: I'd just like to add to this a little
■ different viewpoint of what the staff's position may have
■ been. In all the years I've been with the Commission, I don't
■ remember anyone ever saying, "There's nothing that is illegal
■ here, but we don't like it, so we're not going to make the
■ registration statement effective."

I think the more likely position was that there was a dispute between the registrant and the staff as to whether certain activity was illegal. And in attempting to deal with that matter, there were then compromises and resolutions of those types of problems, which is probably one of the most effective and important aspects that the disclosure function plays, that these problems get ventilated at an early stage before there's any actualization of the proposal.

Now, of course, people who had different opinions about the matters, they probably felt that they were being treated unfairly.

MS. MCGRATH: Stan, didn't you tell me that when you first came to the division, you thought that the work was organized so that you were in a branch. And it wasn't a disclosure branch; it was a branch branch. And it would handle the exemptive applications and the interpretations and the disclosure review for a group of registrants, the thinking being that -- I don't remember what --

MR. JUDD: That's absolutely correct. We had a branch chief in the branch. We had a special counsel in the branch, whose responsibility was to deal with the applications

■ for exemptions and other matters by companies whose work was
■ reviewed by the branch. And we had examiners and accountant
■ and so on, all based within the branch. In addition to that,
■ there was also the office that Ed was in, and Bob Routier, and
■ --

■ MR. GOLDBERG: Syd Mendelsohn.

■ MR. JUDD: -- the Office of Investigation
■ Inspections. And they also played an enforcement part.

■ MS. MCGRATH: So enforcement was separated out, and
■ inspections were separated out, but everything else was --

■ MR. JUDD: Right.

■ MS. MCGRATH: So you really got to know that fund.

■ MR. JUDD: There's also general counsel, who at that
■ time, even, had no action function.

■ MR. MOSTOFF: Chief Counsel, you mean. Chief
■ Counsel of the division.

■ MS. MCGRATH: Chief Counsel.

■ MS. MCGRATH: So Anne, why did you get rid of the
■ "regulation" in the name?

■ MS. JONES: It seemed a better title for what we
■ were doing with the disclosure. It was actually because --

MS. MCGRATH: It became DM.

MS. JONES: I'm sorry?

MS. MCGRATH: It was DMR, and then became DM.

MR. MOSTOFF: The acronym was "DMR."

MS. JONES: It seemed a more appropriate -- and I think it was the perception, and perception becomes reality. The division was seen as being -- by the Commission. You can say it came through the industry, probably so, but by the Commission -- as having been too heavy-handed and too slow in a lot of interpretative positions, and sort of dotting too many i's, i's that weren't necessarily there, and crossing t's that weren't necessarily there, and things took a long time to get out. And I think the desire was to still have effective regulation of the industry, but to streamline it. But I felt, as I said, that disclosure was a necessary -- and I think we all probably agree with that -- disclosure was an important part of it, but it was an attempt to make it sort of user friendly, user in the sense of both investors and industry.

MR. SILVER: We had planned to roughly go through the history of the division and regulation on a chronological -- roughly chronological basis, but the best laid plans always

■ give way to other exigencies. So we're going to break here
■ and go forward 40 years or so to the --

■ MS. MCGRATH: Forty?

■ MR. SILVER: -- tenure of Marianne -- no, 30, I
■ guess -- Marianne Smythe as division director.

■ The I guess it was '92, after two years of study,
■ following a request of Chairman Breeden, the division
■ published a white paper with a red cover on the state of
■ investment company regulation with recommendations for the
■ future. In your covering letter, you stated that the
■ fundamental protections of the act had worked out very well
■ over the past 50 years. However, you also stated -- and I
■ quote -- you do "recommend changes that we believe will
■ promote investor protection, encourage innovation and
■ flexibility, and facilitate competition and capital formation
■ by removing unnecessary regulation."

■ Can you give us one or two of the major
■ recommendations, what happened, and how did they work out in
■ practice? And then you can escape to the airport before
■ anybody descends upon you.

■ MS. SMYTHE: Well, I don't have the reputation for

■ answering questions immediately or directly, so first let me
■ digress and say that I didn't write the study, obviously. The
■ division did. People like Matt Chambers played a tremendous
■ role, Nancy Morris, a lot of people on the staff. Stan Judd
■ was always there to make sure that we didn't digress too far
■ from historical truth. And so it was a group effort.

■ Chairman Breeden's major contribution, in addition
■ to insisting that the study be done, was to insist that the
■ cover be red. He went to Stanford. I went to Chapel Hill. I
■ presented him with a Carolina blue color. A fight ensued. He
■ was the chairman. He won. So the Carolina blue book is
■ really a red book out of an egregious power play by the
■ chairman of the SEC.

■ Now, what two or three recommendations did we make?

■ The truth was that when we did the study, the more we
■ studied, the less we were interested in recommending any
■ changes, because it was the fiftieth anniversary of the
■ Investment Company Act in 1990, when we got started. And the
■ more we looked, the more we thought that, you know, that old
■ adage, "If it ain't broke, don't fix it." And it didn't seem
■ like it was very broke. It had worked nicely.

But we had to come up with something. And the things that we came up with that I think were sensible and smart and have had some life after the study, I'd say the advertising substance of the proposal, which we always thought was kind of silly to have to put into an investment company ad, the substance of the big prospectus. I know that the current division has proposed a rule that essentially picks up on that idea from the study. I'm sure that it's not just from the study. There were intervening factors that made that idea have some life, the idea being that to the extent that you can simplify and make sensible those documents that investors read, you have a better chance of encouraging them to read those documents. So the advertising rule, I think, was one I would say we had.

The second, we thought then -- I still think now -- that Congress needed to change the statute to require that investment company boards have a majority of directors who are truly independent -- not just disinterested, but independent -- of the advisor or any affiliates of the advisor.

Paul figured out a much more ingenuous way than bothering Congress with this. He simply tied the requirements

of certain desirable deregulatory rules to an obligation that the fund have a majority of directors that are independent. I think that was very, very ingenuous.

Then the third thing that I'm particularly pleased with, although I don't think that everybody at this table would agree, is we recommended that a couple of things be kicked out of the Investment Company Act. Qualified investor funds. That is, funds that were invested in by rich people. We never could quite figure out how to say smart people. But in this country, money is sometimes a proxy for brains, so we said rich people.

And then secondly, we recommended that asset-backed and collateralized mortgage obligation securities be exempted from the Investment Company Act. So some of our recommendations were in the direction of increasing investor protections. Others were deregulatory. And they all had a life.

I could go on, but I won't.

MR. SILVER: You leave yourself open for five minutes of cross discussion. So if anybody has any comments about the '92 recommendations and the way they've gone, this

is your chance to get Marianne before she races off to the airport.

MS. SMYTHE: You know, I have to just say, having been mostly raised in this agency, and my heart still being there, in the interest of full disclosure, I just got an e-mail from my assistant saying my flight is delayed an hour, but that I should get out to the airport --

MS. MCGRATH: Oh, no.

MS. SMYTHE: -- but that I should get out to the airplane anyway. So I'm going to be leaving very soon.

MR. ROSENBLAT: I was especially interested in Marianne's mentioning that when they did their study, they concluded there was very little that they needed to change. And I remember that when I came to the Commission in 1964, we believed that if the investment company was great, it was great for investor protection. And another thing that changed over time was that if something was in the Investment Company Act, even though it might seem a little bit irrational or against the grain, that it had to be good, it had to be fair.

And one of the examples of that was our insistence on no quantity discounts for mutual fund sales. They would

have been, as Section 22(d) requires, that you have a fixed price disclosed in the prospectus. There had been some minor adjustments for pension plans and other kinds of arrangements where you committed to buy a certain amount during a time. But then ultimately, we saw the light, and we said, "Well, how about quantity discounts?" So we proposed the rule to the Commission.

Now, Kathy McGrath wanted to go all the way and have fully negotiated prices. But I was in the General Counsel's office, and we told her, "No, you can't repeal Section" --

MS. MCGRATH: We got close. We are close. Any old price stated in the prospectus.

MR. ROSENBLAT: You can't repeal Section 22(d). You can modify it and almost repeal it, but you can't get rid of it. So --

MR. MOSTOFF: On that point, Kathy, shouldn't we give credit to Phil Loomis? Wasn't he the person who read the statute carefully for the first time, and came up with the idea that it's not "the" public offering price, it's "a" public offering price.

MS. JONES: You know, that may very well be right,

but I think that was a really serious mistake on the part of the division to buy that. I think it has introduced so much confusion into the industry.

MR. MOSTOFF: Well, there is - effectively - no 22(d) any longer.

MR. ROSENBLAT: Well, it's 12(b)1 that did the real damage.

MR. MOSTOFF: We'll get to that.

MR. ROSENBLAT: But anyway, I just wanted to end on a humorous note, which is I think that was the only -- our memo to the Commission had a cover -- it was a blue cover -- and the cover had --

MS. SMYTHE: Was it Duke blue or Carolina blue?

MR. ROSENBLAT: I don't know. It was kind of pale blue. It was Dechert blue, actually. And we had a cartoon on the cover. And the cartoon showed a scoutmaster and some Boy Scouts in an ice cream shop. And the scoutmaster was saying, "Do you give any discounts for group sales?" So we made our point.

MS. MCGRATH: Well, you know, this leads into an overall question that I have always had, and that we've

discussed to a certain extent, which is why has the fund industry stayed relatively clean over all these years compared to the other segments of the financial services industry, both those regulated by the SEC, the banks and S&Ls, and insurance companies. You know, is it that big problems, massive scandals haven't been detected? Or is there some weird combination of culture in the industry, this statute, the rules, all the cooks that have to get involved in complying with it that has made this work so that business can go on and grow, while at the same time, the money isn't getting stolen?

MR. GOLDBERG: Well, a cynic might say that this is such an enormously profitable industry, you don't have to steal.

MS. MCGRATH: Well, that's true. So much for 36(b).

MS. JONES: I think part of it is where the fund industry sort of started, sort of a trustee concept. As a Bostonian, I would point out that a lot of them started in Boston, and we Bostonians are very proper. And I think the trustee concept carried forward, and people really felt there was a stronger fiduciary obligation to the kind of money that was put in with someone else investing it than there was if

■ you were just buying stock. I think a lot of it is how the
■ industry started.

■ MR. DUDLEY: But I think the statute had things
■ built into it that encouraged that --

■ MS. JONES: I know. Absolutely. Yes, I agree.

■ MR. BARBASH: I think, Kathy, Jack's point is well
■ taken on the statute. The statute, in essence, has a number of
■ fundamental principles that seem over time to work well as a
■ regulatory framework, and then you add to that this ability in
■ Section 6(c) to exempt out important changes, or to respond to
■ important changes in the industry. I think that combination
■ gets you where you are where you have a vibrant statute that
■ works.

■ If you go through the history of the fund business,
■ I would venture to say that most of the significant, or a
■ number of the most significant elements of change have been
■ facilitated by the exemptive order route. So it's the
■ combination of the exemptive order procedure and fundamental
■ regulatory principles that work over time that accepts it.

■ MR. GOLDBERG: You know, I think the exemptive
■ orders and exemptive rules have a flip side, which is

■ sometimes overlooked. Because the industry is completely
■ dependent on the Commission's use of its exemptive authority
■ and the modern fund couldn't work without some exemptions, it
■ really gives the Commission, also, the ability to add whatever
■ requirements it feels it needs to the statute simply by
■ putting them in as a condition to an exemption.

■ I think we saw that in the recent rules the
■ Commission adopted regarding fund governance. And whether a
■ purist would think that's the best way to legislate or not, it
■ certainly has allowed the Commission to both expand and
■ contract the Act over the years.

■ MR. SILVER: Well, since we've gotten to Section
■ 6(c), I think that Marty Lybecker and Stan Judd can cast some
■ light on where it came from and how it's been used over the
■ years. It was, of course, until very recently that the
■ exemptive power in the Securities Laws was confined to the
■ Investment Company Act. So Marty, why don't you kick off.

■ MR. LYBECKER: When you look at investment companies
■ and compare the regulatory scheme to any kind of bank
■ regulatory scheme, the first thing that surprises you is that
■ we've got a 6(c) and they don't, or nothing quite like it,

■ certainly, and not a process like we've got.

■ And there's certainly a huge benefit to having a
■ 6(c) and a staff and a Commission that's prepared to exercise
■ judgment and authority, and the examples are very easy. Money
■ market funds, we discussed in detail, but using 6(c) to
■ basically create exemptive relief, and then ultimately, have a
■ Rule 2(a)7. And even you who live through the variable
■ annuity and variable life years knows that without a 6(c),
■ whatever anybody says about how well insurance fits within the
■ act, without that authority, it would have been virtually
■ impossible.

■ On Kathy's watch, we had probably the first reaction
■ that I can remember to the Commission being concerned about
■ whether it had authority were the two dissents in the Vanguard
■ Star Fund proceeding. I remember being not the only one who
■ got a call from Kathy saying, "Can you please go talk to these
■ people? Tell them what you did with money market funds,
■ because they're not prepared to deal with funds-of-funds.

■ And the best part about 6(c) compared to what any
■ other divisions got is that if you're prepared to support what
■ the person wants, you don't have to find some way to torture

the words in Section 3(c) or 3(a) or 2 or anywhere else to make it fit, and you get the benefit when you recited all the things that you're allowed to do in 6(c) by saying it's in the public interest for the protection of investors. So you can say policy, not just law. And that's the good part.

The bad part is that we've all had to process applications here -- I mean when we're on the Commission's staff -- that were filed by idiots who asked for things that were appalling. And so the down side is you simply can't control what people do. And in a broader sense, it always forces regulatory change, or at least it creates the dynamics of putting regulatory change on the Commission's staff.

Looking at the process, you've only got two choices too, although we've all made them go from black to white. But you can support it, which often means you just negotiate forever until you finally have got something you're prepared to support. And if they get tired in the process, you know, that's kind of their problem.

Or you can tell them from the beginning you're going to oppose it. And there was a while -- a time in the late '70s and '80s when we simply sent things back and said there's

no way we'll ever support this. You know, withdraw it. Go away.

But those don't give you -- the benefit is what I said, that I think the division has always used it well to deal with things where 6(c) could help create a regulatory framework before the '40 Act was there. And it's made the '40 Act dynamic in the way the banking laws never were. Instead, those guys had holes punched in the Glass-Steagel Act until Congress finally made most of the Glass-Steagel Act go away with Gramm-Leach-Bliley. The bane is that other people can set your agenda. And whether you're an associate director or director, you hate it when all of a sudden, you're forced to commit a whole bunch of resources to something that you would want to have a fight about.

I did it to Kathy with Stanford in requesting a hearing right in the middle of the TIAA-CREFF application. I'm sure you didn't like submitting the staff to a year-and-a-half hearing. And I believe --

MS. MCGRATH: No. But fortunately, Stan Judd was in the division. That saved the day.

MR. LYBECKER: Well, actually, it was the October

'87 crash that did it.

(Laughter.)

MR. LYBECKER: It became a lot less interesting to fight with TIAA-CREF after the universities were worried about their --

MS. MCGRATH: Yeah. But you've got to admit that having a bunch of college professors with buckets of time on their hand harassing you daily was not fun.

MR. LYBECKER: They were my problem.

MR. SILVER: Well, before we stray from 6(c), Stan, I think you had some comments.

MS. SMYTHE: It was never good to get her mad, Marty.

MR. JUDD: Several years ago, I came across a seminal essay by James M. Landis, who had served as Chairman of the SEC between 1935 and 1937. The essay was published in 1938 under the title "The Administrative Process." At page 52 of that essay, I found this observation by Mr. Landis.

He said, "Many administrators who have had to struggle with the problem of translating a statutory scheme of regulation into a working reality would have welcomed, at

■ least in the limited form, the power conferred by the so-
■ called Henry VIII clause in English legislation. These
■ celebrated clauses," he went on to say, "give the
■ administrative power to modify the provisions of legislation
■ insofar as it may appear to be necessary to bring the scheme
■ of regulation into effective operation."

■ That was the first time I had ever heard of a Henry
■ VIII clause, so I did some research to find out a little more
■ about it. It seems that in England, a legislative clause that
■ gives the executive power to amend the law by order in order
■ to bring the law into effective operation or to remove any
■ difficulty is called, perhaps in disrespectful commemoration
■ of Henry VIII, a Henry VIII clause.

■ Henry VIII clauses have been used to confer power to
■ alter financial limits, to bring lists up to date, to make
■ exceptions to the operations of a statute, or to alterations
■ of detail within a narrowly-defined field. Their use seems to
■ date not from the age of Henry VIII, but from the Local
■ Government Act of 1888.

■ In his essay, Mr. Landis also had the following to
■ say, at pages 66 and 67, phrases such as "public interest,

■ protection of consumers and others are bound in the law. In
■ and of themselves, they have, of course, exactly the meaning
■ that we put into them. But as portfolios bearing the form of
■ a thought, they do not reach the administrative in an empty
■ condition. Rather, they have already been lined and fitted so
■ that it becomes impossible for the administrative to pack
■ bricks into what is ostensibly an overnight bag.

■ "For the administrative, the task of grasping the
■ legislative thought should not be difficult. The meaning of
■ such expressions is, of course, derivable from the general
■ tenor of the statute of which they are a part. To read them
■ properly, one must catch and feel the pace of the galvanic
■ current that sweeps through the statute as a whole.

■ "Of significance in this connection is the practice
■ recently adopted in statutory drafting of reciting the
■ conditions that lead to and make imperative particular
■ legislation before setting out the provisions of the statute
■ itself. Despite the occasional cavalier and cynical treatment
■ of these recitals by the court, they do help to create the
■ frame of reference within which the administrative is to
■ operate, and to pose the objective that was intended to be

reached."

MR. SILVER: Stan, if I may borrow from our Congressional friends, can you revise and extend your remarks for the record, or rather Dean Landis's remarks for the record?

MR. JUDD: I've finished reciting Landis's remarks. I read them because I thought they were a very apt and lucid description. For me, reading Section 6(c) and Section 1 of the Investment Company Act of 1940 in which the purpose of the evils of the act was intended to eliminate or mitigate are stated, it seems more than possible to me, even likely, that they reflect the influence of the Landis essay on the drafters of the Investment Company Act of 1940.

MR. SILVER: They certainly may. But I think I recall that the practice of the long introductory sections which are contained, of course, in all of the Federal Securities Laws and other of the New Deal legislation, was, in part, at least, designed to show a national interest and the effects on interstate commerce and other jurisdictional provisions which would aid the administration in the inevitable legal challenges in the Supreme Court.

MR. JUDD: Yes, that is true about the '33 Act, the '34 Act, and to some extent, about the '40 Act. But the '40 Act is different in that there was stated there the evils that the Act was intended to mitigate or eliminate. And it is stated specifically that the purpose of the act should be interpreted with that intention in mind. That is in the '40 Act. I don't believe it's in the '33 Act.

MR. ROSENBLAT: I have a very brief comment. I think that either the 1996 or 1998 amendments gave all the divisions federal exempt --

MR. SILVER: Yes.

MS. MCGRATH: Yes. And I told Corp Fin not to take it.

MR. ROSENBLAT: And it's very interesting. I don't know to what extent they've used that power. And I recall that in earlier times when that suggestion was made, Corp Fin was really strongly against it. They just didn't want to be badgered by people.

MS. MCGRATH: Well, that's because they came up and looked at the exemptive application offices, and Investment Management went, "Good God. We don't need that."

MR. ROSENBLAT: Right.

MS. MCGRATH: Because it may be beautiful for conforming the act and making it work and all this stuff. But I think consistently, it has been an administrative nightmare, because the resources of the division never, ever, ever match the workload that comes in through the exemptive application process.

MR. LYBECKER: It's been used under the '34 Act, Alan, after Gramm-Leach-Bliley. The evangelical Christians, something or another, filed an application of the '34 Act on its sweep vehicle to try and get exemptive relief.

MR. SILVER: Paul, if I may ask you. I certainly think that the use that you have made out of Section 6(c) has surprised me, and I thought I was surprise proof after all these years. And I don't mean that in any pejorative sense it surprised me. I thought it was quite an ingenious use of Section 6(c). Where did the idea come from? How did it develop?

MR. ROYE: You're referring to the corporate government effort?

MR. SILVER: Governance.

MR. ROYE: Well, actually, before I get started, let me make the standard disclaimers, since I still work for the Commission, that these are my views, not the views of the Commission. And I'll make the disclaimer for you guys, since your views probably don't represent necessarily the views of the Commission.

MR. GOLDBERG: No. I think they should be --

MS. JONES: Well, they should. They should.

MR. ROYE: But, actually, I think a lot of people in this room had a lot to do with the thought process on that. But, actually, I think we got the idea really going back to the work that was done on 12 b-1 by Joel Goldberg and Dick Grant, wherein 12 b-1, the concept of self-nominating directors is reflected there. And then the Commission did ask for comment about the notion of independent counsel, and there were suggestions along those lines in the 12 b-1 of proposing and adopting releases. And, you know, we, I guess, came to the conclusion that if you can have self-nominating directors as a requirement for 12 b-1, why not a majority of independent directors? Why not encourage the notion of independent counsel for independent directors, and looking at a series of

rules that involve conflicts where we thought the role of independent directors was important that we could extend those concepts into those rules?

MR. GOLDBERG: So I inspired this?

MS. JONES: I think it's interesting that it only took an hour to get to who it was who was responsible for 12 b-1.

MR. LYBECKER: That's the first time I've ever heard him admit it too.

MR. SILVER: Well, I think that we should get back to, in a sense, where Allan left off, and that is the recommendations in the 1970 amendments. But things, as I mentioned earlier, didn't start there in the history of the Division. Ed O'Dell, what insights and what memories do you have as to the reorganization of the Division in those early years when Chairman Cary made the determination to enhance the responsibilities of the then-Division of Corporate Regulation.

MR. O'DELL: Thank you, David. I came to the SEC in 1962, and I went to work in the Enforcement Division, then called Trading and Exchanges. One of the cases I worked on there involved a registered investment company, and so I had

the opportunity to work with and for Syd Mendelsohn on that particular case. And once that case was completed, Syd was delighted to accept my offer to join him.

And in those days, Syd's branch was really divided into two segments: the inspection group and the investigation group. The inspection group took on as its responsibility educating the regional offices on the fundamentals of the Investment Company Act. And that involved principally Syd and Bob Routier, with the help of some others, going around to each one of the regional offices and putting on a two- or three-day seminar on how the '40 Act was constructed, and what its principal purposes were, and so forth.

They also created an inspection outline, which raised all of the various regulatory issues that the regional staff should look for. That outline happened to end up becoming the outline for Form N-1R, one of the first annual reports.

Separate from that, there was an investigation group, of which I was a part. And what we would do is when one of the regional offices would come upon a particularly material violation, we would go from Washington to the

regional office and help them with the legal issues that they had not previously encountered. And so really, for the first time, the '40 Act enforcement was being supervised by lawyers that spent full time in the '40 Act. While it was in the Division of Trading and Exchanges, you would typically get lawyers who had never worked before on a '40 Act matter. And the statute being as complex as it is, and the issues being so much different than the issues you find under either the '33 or the '34 Act, enforcement of the '40 Act was not a top priority.

Once we started out, you would get all kinds of either basic violations on -- some came close to or actually amounted to fraud. A common thing that you would find is that a management company would forget to renew its advisory contract on an annual basis. And you would go in, and they didn't have an effective advisory contract, and they've been collecting fees under that contract. And then you would have to try and find out how to resolve that in a way that was fair and equitable.

Some of the cases I worked on came up under the Small Business Investment Company Act, where SBICs that were

regulated by the SBA were also registered under the Investment Company Act. And some very ingenious promoters found various ways to take the SBA's money in the SBIC and put it to their own use.

For example, on two or three different occasions, they would be in control of the SBIC. They would invest -- the person controlling the SBIC would invest in a portfolio company and take the bulk of its equity, and then they would use the investment company's money to promote the venture.

And usually, they would put their money in as a subordinated venture, so that there would be no dilution of equity.

We even had a case where the promoters actually put the stock of the operating companies into nominee names, either of relatives or of particular friends, and again, then use the money from the SBIC to go out and buy operating companies, and in that way, try to profit. So that was the -- it was that type of thing that we found.

I mean, one final example I will give you, and it happened not to be one of my cases. But one of the people who worked on the Investigation Unit went to a fund that was headquartered in Philadelphia, open-end fund, and it had a

■ six-month certificate of deposit on a company called something
■ like Consolidated Industries and Enterprises.

■ And the investigator said, "Well, what is that
■ company all about?" And when he did, the president got
■ flushed and concerned, and the investigator's instincts took
■ over. And upon investigation, they found out that it was a
■ sham company, and that what the officer of the fund had done
■ was to sell phony paper to the fund, and then kept rolling it
■ over every six months. And so it went from there.

■ But it was an interesting and an exciting time. And
■ the people in the Division of Inspections and Investigations
■ traveled all around the country bringing some very interesting
■ cases, which got publicity, and I think which made the
■ industry stand up and take heed. Because the publicity, if it
■ ever hit you, was quite adverse. Let me stop there, David.

■ MR. SILVER: Well, you did mention in the course of
■ your remarks one name, and that was of Syd Mendelsohn. I must
■ say that securities regulators, like regulators of all
■ financial institutions, usually do not invoke any affection
■ among the people they regulate. But in the history of the
■ Division, I think there are two figures who evoked the

■ affection and admiration of all they dealt with, and Syd
■ Mendelsohn was certainly one, and Sol Freedman, of course, was
■ the other.

■ You used the term, in describing one of your cases,
■ of finding a "fair and equitable" resolution in a situation in
■ which a fund merrily went along without renewing its right to
■ exist, in effect. And that could be used as the epitaph for
■ both Syd and Sol.

■ Syd and Sol were, among other things, most keenly
■ interested in all the rules they worked on and in all of the
■ matters that came before them to find a fair and equitable
■ result. And once Sid and Sol were convinced that the people
■ who were before them or the transactions that were being
■ proposed to them were fair and equitable, their attitude was,
■ "Well, let's find a way to do it, rather than find a way to
■ block it."

■ One anecdote about Sol Freedman. Sol wore bowler
■ hats. Some of you sitting here may remember that. I guess
■ I'm one of the few people who knew where he got those bowler
■ hats. Alfred Jaretski of the firm of Sullivan & Cromwell, who
■ was Sol's opposite number back at the times when the act was

being negotiated, wore bowler hats, which he got in London. It would probably violate all kinds of Commission rules and government regulations today, and indeed, probably be felonious, that Alfred Jaretski was the source of Sol Freedman's bowler hats.

I think there are others here who remember Sol and Syd. And please, I'd like to have some of you --

MR. O'DELL: David, I would certainly like to second and third your comments on Syd Mendelsohn, who I worked much more closely with than I did with Sol. Syd Mendelsohn was a gentleman to the core, honest and straightforward as could be.

His word was his bond. I mean, he had all the classic personality traits that a good government worker should have, and he set an outstanding example for everybody that came in contact with him. And he's missed greatly by all of his many, many friends.

MR. MOSTOFF: Absolutely. Both of -- go ahead, Jack.

MR. DUDLEY: Sol Freedman, of course, was my first boss in the division. But I worked with Syd, and I felt very strongly that the enforcement that Ed and that group had was

■ much more important and very effective because they were
■ familiar with the '40 Act, and knew the difference between
■ what was an important violation and what was not renewing your
■ contract annually. What does that mean, 365 days, 12 months?
■ That kind of thing. So I think it was good.

■ My favorite Sol Freedman story was we had a
■ conference with Joe Levin, who used to work at the Commission
■ in the General Counsel's Office, Sol said, "You can't do what
■ Joe proposed because it violated Section 59 of the statute."
■ And Joe was looking down at his book to find Section 59, and
■ he said, "Sol, there's only 58 provisions in the act." And
■ Sol said, "That's it. You're not going to be able to do it."

■ MR. LYBECKER: Syd was a good boss. He was mine.
■ He was such a genuinely nice person, it was possible to have
■ fun with him. His wife Trudy would make a sandwich for him
■ every morning, and he would come in in the car commuting with
■ three other people, including a person who was a commissioner.
■ He was a close personal friend of his. And because he was
■ sitting right next to him, he couldn't much get out of the
■ driveway without getting right into lunch. And then, of
■ course, he would go out for lunch.

When we were at 500 North Capitol, the spiffy place to go was over to the Hyatt. It was only a couple blocks away, and we would get Syd to go along with us every now and then. And he also was penurious. He didn't spend much on lunch. So he always ordered something like a tuna fish sandwich, and the rest of us would always order something a little more expensive. But he always had ones in his wallet. So we would make sure that we could get his wallet out on the table when we started making change to pay the tab. And he never could figure out how his tuna fish sandwich always seemed to cost \$12 to \$15. And I made sure he paid the tip for all of us. He got so convinced that I was shortchanging him on the change that he brought Goelke along with a calculator one time.

(Laughter.)

MR. MOSTOFF: I want to say about both of them, Sol and Syd, that they were the models, really, for civil servants. They were both career people. It's important to remember that. Syd started as a messenger, and rose to the level of director of the division. And Sol started in the '40s as a young attorney, and rose to the level of division

■ director. They gave their entire professional career to the
■ government and to public shareholders and public investors.
■ Terrific people.

■ MS. JONES: Let me say about Syd that I told you one
■ of the conditions of my taking the job as division director.
■ Another condition was that Syd be associate director. And Syd
■ was a remarkable person. Because I was a little younger than
■ Syd. I had been at the Commission a lot less time. I knew a
■ heck of a lot less than Syd knew about investment companies
■ and regulation. But he never let that show up in any of the
■ dealings when I was technically his boss. At least I was
■ smart enough to know that I needed good people around me.

■ And Sol Freedman, I had met. I was in private
■ practice in Boston before I came to the SEC, and I had met Sol
■ at a couple of conventions of the North American Securities
■ Administrators, the blue sky regulators.

■ MR. MOSTOFF: In those days, women lawyers did blue
■ sky work, right?

■ MS. JONES: That's right. That was one of the chief
■ things.

■ So I had met Sol there, and decided that I wanted to

work at the SEC if I could, and wound up in Sol's section.

Well, I was viewed with a lot of suspicion, I think, at first, because Sol knew me and had known me under social circumstances, and was very friendly. And everyone looked at me sort of with a jaundiced eye, because who was this person who Sol knew? But he was a terrific -- just a wonderful -- both of them were just superb human beings.

MR. DUDLEY: I told Sol that Anne would never stay with the Commission. She would leave after getting experience in one year, and go back to Boston.

MR. ROSENBLAT: We thought she was an industry spy. But because Sol was such a fabulous guy, and I worked under him, I really fell in love with everyone he fell in love with, and that certainly was the case with Anne. And when she went up to Commissioner Needham's office from the division, we stayed in touch.

MR. MOSTOFF: One of the conditions for my taking the job of Director was that Anne come down to the division as associate director.

MR. O'DELL: Before we leave, Syd Mendelsohn -- I want to tell what I think is one of the funniest stories about

■ Syd, and it was told to me by his wife Trudy. One day, Syd
■ was home, and they were sitting at the dinner table. And one
■ of his sons, who will go nameless, says in the middle of
■ dinner, "Mom and Dad, I've decided to drop out of college."
■ And Syd says, "Well, why do you want to do that?" And his son
■ says, "I've got to find my head."

■ Syd stops for a moment and says, "Don't worry about
■ it. I know just where it is."

■ MR. JUDD: One thing about Sydney that I'm not sure
■ was mentioned, but I think that he had a great role in the
■ general education of the bar and the investment company
■ industry to the investment company law. He had a, I guess you
■ call it, a dog-and-pony show that he took around the country
■ and city after city for the ALI-ABA in which he presented a
■ series of panels on the Investment Company Act. Now, those
■ had actually started -- Syd started them as a form of
■ informing the staff about the Investment Company Act.

■ MR. SILVER: That's the point you made earlier.

■ MR. JUDD: And from that, these other programs,
■ which lasted for many years, took place, and I believe played
■ a real role in informing people about the act.

MR. O'DELL: And the trips he made to the regional offices was really the genesis of the ALI-ABA courses that he taught later on.

MR. BARBASH: David, Paul and I were baby lawyers when Syd was the director, and he was this person on high, because he was the division director. We were just out of law school. And I have always thought and I think I will always think of Syd as being the most knowledgeable person on everything relating to the investment company industry. He knew everything about the business. He knew everything about the people. He knew everything about the law. And he was everything everybody said. His word was his bond. He's just a terrific guy.

He had a direct bearing on my tenure as the director of IM. When I was a baby lawyer, I was here for about six months, and I got a job offer to come to New York, which I decided to take. And as a result, I left one week short of being with the Commission staff for one year. I had been at the Department of Labor earlier. And I used to refer to myself as having been here for a year. And whenever I'd see Sydney, he would correct me and said, "You weren't here for a

■ year. You weren't here for a year. You were here one week
■ less than a year."

■ So when I was the division director, and I knew I
■ was going to leave because of some testimony up on the Hill, I
■ was able to insure that my tenure at the Commission as
■ division director was five years and a week. I went back to
■ Sydney, and I said, "Sydney, it's your damn week. Now I think
■ we're even."

■ MR. SILVER: And with that, I think Carla is giving
■ me the sign here. It's time for a break. When we return, we
■ will, as Gerry Osheroff used to say, among other things, plumb
■ the depths of Section 17(d).

■ MS. MCGRATH: They'll never come back, Dave.

■ MR. SILVER: And that guarantees to clear the room
■ of anybody that has any lingering affection for what we're
■ doing up here. So we'll return here in just 15 minutes.

■ (A brief recess was taken.)

■ MS. MCGRATH: I'd like to remind our listeners that
■ there is a lot of interesting material on the web site for the
■ SEC Historical Society, www.sechistorical.org. There's a very
■ interesting discussion of Section 17, if you can stay awake

■ for it.

■ And David, in the Roundtable on Securities
■ Regulation and the Global Internet Economy, you raised a point
■ as to whether this 60-year-old law, which is already plastered
■ over with band-aids, is a prime candidate for a model
■ changeover, or merely requires a few more band-aids. And
■ listeners can also find that discussion by clicking on the
■ same web site.

■ Bob Pozen, at that same Roundtable, got into talking
■ about the Section 17 debate, including a major policy question
■ about how we want new investment management firms to be
■ organized. And you can find that on the web site as well.

■ So anybody that's interested, it's
■ www.sechistorical.org. Even I can punch that into the
■ computer.

■ MR. SILVER: Thank you, Kathy. Resuming our trek
■ through the history of investment management regulation, one
■ area in which the Division has always been active is the
■ regulation of advertising by fund organizations. Let me give
■ you the two polar examples, if you will, of how things change
■ over time.

When I first came to the Commission, there were staff members who knew more about type size than most printers. And I mean that quite literally. And so there was always great concern as to whether things were being disclosed in proper type size.

Today, when you watch television advertising of mutual funds and other products, even drugs, in a millisecond, all kinds of disclosures flash by on the screen. In the drug area, probably what you're missing is that the most prominent side effect of this drug is death. But I challenge anyone to be able to see it. And certainly, all of the stuff which the Commission apparently feels very content is being disclosed because it's in a commercial on mutual funds is subject to the same limitations. So it's a long trek from then to here.

But let's go back to the beginning. Because I think we have with us the person who vetted the first mutual fund ad ever to appear on television, and that would be Jack Dudley. So Jack, why don't you tell us about some of the early activities.

MR. DUDLEY: In the good old days, a lot of the ads, we'd meet with the NASD every week and review ads, I as the

assistant director. And even some of these ads would go before the five commissioners and make decisions.

But the one I think Dave is referring to, there was a certain prominent fund that sponsored a lion, and the lion wanted to walk down through lower New York City. And, of course, this is what we called a tombstone ad. And as you know, tombstones can't move. So that was our first question: Can the lion walk?

Well, we passed on that and said that was okay. But then as the lion was coming up out of the subway, there was the sign "Wall Street" on top. No, you can't have Wall Street there. We objected to that, and --

MS. MCGRATH: What did you want, Burger King?

MR. DUDLEY: About that time, I thought maybe my place in life was not at the SEC passing on these ads.

MR. MOSTOFF: Jack, my recollection of that was that the staff said the lion couldn't walk up out of the subway; he had to walk down to the subway.

MR. DUDLEY: No. It could walk up, but it couldn't have Wall Street.

MR. ROSENBLAT: That reminds me of a logo problem

■ that we had. There was a fund that had a rocket as its logo
■ in the prospectus, and Sol Freedman said they couldn't use it
■ unless the rocket was pointing down.

■ MR. DUDLEY: But the other one, too, was the pot of
■ gold. They had a rainbow with a pot of gold at the end, and
■ the staff knew enough to get the pot of gold out. So we
■ actually went to the Commission and said, "Can they keep the
■ rainbow shape?" And the Commission, in its wisdom, decided
■ well, if they straighten it out, they can keep the colors.

■ MS. MCGRATH: Well, by the time I came along, we had
■ a phenomenon where every fund in the country was number one in
■ performance in its category. It was an amazing phenomenon.
■ And so Bob Plaze and Gene Goelke assembled what we used to
■ call the A-Team, and tried to standardize performance numbers.

■ And that was an incredible long process, and, you know, we
■ finally had to concede there is no right way to calculate
■ yields and total return. We just want a way.

■ MR. DUDLEY: But in the days when I was there in the
■ '60s, you had the statement of policy, which was very strict.
■ Capital gains had to be shown separate from dividends, and it
■ was very restrictive. And I'm sure those people are turning

over in their grave if they could see some of the ads.

MR. MOSTOFF: This discussion reflects an evolution in thought that took place throughout this time period from the idea that the prospectus was a disclosure document to the idea that the prospectus should be a selling document. That was a major sea change.

MR. GOLDBERG: Well, you know, another sea change was, as Jack suggested, there were very severe restrictions on showing performance at all, and they moved all the way from that to requiring it in the prospectus.

MS. MCGRATH: But always with that legend, past performance is no guarantee of future results.

MR. SILVER: Well, before we leave the war stories completely, I think the rocket ad was finally compromised by having the rocket go across the page, level flight. But then I remember another ad which had an oak tree, and that was decided to be improper because mighty oaks from tiny acorns grow. And therefore, the implication is that there would be growth. And I don't remember who vetoed that ad.

MR. MOSTOFF: It was perfectly logical. My recollection is that the name of the fund was the Acorn Fund.

MR. DUDLEY: The five commissioners sitting there deciding these issues, I think that's, to me, you know, not what they should be doing.

MR. SILVER: Well, I'd like to hear from some of you with how we went from there to here, and the "here," as I define, the millisecond disclosure on television. I mean, you folks were the ones that were here during all these years as this all developed, as it happened.

MR. GOLDBERG: I think that the single person most responsible, and he might not want to hear this, was Stan Judd. I think Stan came up with what I thought was a tremendously creative solution to a problem that had stymied the staff for years.

You know, you go way back. The only ads that were allowed for mutual funds were tombstone ads. And over the years, the Commission had expanded what was allowed in tombstone ads. Besides putting the name of the fund, you could put a brief description of the fund's investment objectives.

But conceptually, a tombstone ad had to be something that was so brief, it wasn't a prospectus. And the Commission

had already stretched the concept of what isn't a prospectus so far it just couldn't be stretched any more. And the big thing the industry was interested in was advertising performance. There just wasn't any way to put that in and still think it was a tombstone ad.

MR. SILVER: The industry used to be interested in advertising performance.

MR. JUDD: Well, yeah.

MR. GOLDBERG: And Stan came up with the idea of having an omitting prospectus, what we now call a Rule 482 ad, which was a prospectus -- and that's where the "the substance of which" requirement came in. The statute says you can use an omitting prospectus that omits things that are in the full statutory prospectus, and that opened the door eventually to TV ads. When we first did the rule, Stan, I don't think we allowed TV ads.

MR. JUDD: I think there are a lot of factors that play together here. There's a funny kind of nature of the investment company. You think about it in comparison to any other business. What is the product of the investment company? I mean, they don't make cars that can be advertised

or anything. They basically sell their shares.

But the law basically said that the only way you can sort of use the means of interstate commerce in order to promote the sale of the shares was basically through a prospectus. And there was this exception to that, which was that if you had something created under Section 210 of the Securities Act, that was not a prospectus. And that was the tombstone ad. That was not a prospectus. And therefore, it was not a document that would give rise to potential liability under Section 12 of the Securities Act of 1933.

But when we were thinking about how could people learn more about investment companies other than by reading the formal prospectus, and it became sort of we were thinking well, we have funds that are sold through brokers. There were high sales loads. And there was the rising of the no-load funds. And some of us thought that if we could make it more possible for funds to get their messages across, that would further the no-load funds, and perhaps serve to reduce load overall.

So in 1977, Sol Freedman asked me to draft a rule under the Securities Act of 1933 that would permit investment

companies --

MR. GOLDBERG: Syd, I think -- Syd Mendelsohn. Syd asked you, I think.

MR. JUDD: Yeah.

MR. GOLDBERG: You said Sol. It couldn't be Sol.

MS. MCGRATH: Not in '77.

MR. JUDD: Syd asked me to -- that's what happens with memory -- permit investment companies to include information about their past performance in their advertising.

Well, as Joel mentioned, it seemed to me that Section 210 of 1933 Act, which excepts from the definition of prospectus a notice, circular, advertisement, letter, or communication in respect of a security that does know more than identify the security, state the price thereof, state by whom orders will be executed, and contains such other information as the Commission by rules or regulation may permit, and which had already given rise to Rule 134, which permitted any investment company registered under the Investment Company Act to present extensive information about the company in an expanded tombstone advertisement, could not

properly be stretched to embrace within the exception of the definition of a prospectus material that would include performance information.

But in Section 10(b) of the 1933 Act, however, I found the basis for a rule that would permit investment companies to advertise their performance, subject to appropriate restraints and in accordance with the protection of the interest of investors. That section authorizes the Commission by rule or regulation to permit, for the purposes of Subsection (b)1 of Section 5 of the 1933 Act in relation to any security with respect to which a registration statement under the 1933 Act has been filed, a prospectus that satisfies Section 10 of the 1933 Act.

Section 10(b) provides that in addition to the prospectus referred to in Section 10(b) -- that is, the prospectus that contains all of the information included in the registration statement -- the Commission may permit the use of a prospectus for the purposes of Subsection (b)1 of the Section 5 that is to be circulated from interstate commerce, which omits in part, or summarizes, the information in the prospectus specified in Subsection (a).

■ The Commission had already adopted a rule on summary
■ prospectuses, which was not much used. I thought that what
■ would do the trick would be a rule on what I called an
■ omitting prospectus, i.e., a prospectus that was limited to
■ information, the substance of which is included in the Section
■ 10(a) prospectus, but would not have to include all of the
■ information in the Section 10(a) prospectus.

■ Such a prospectus would expose a person using it to
■ sell a security by the means of interstate commerce for
■ liability under Section 12.2 of the 1933 Act if the prospectus
■ was untrue or materially misleading. That's different from
■ the 134 ad.

■ In addition, such a prospectus, while not itself
■ subject to Section 11 of the 1933 Act, would be limited to
■ information, the substance of which is included in the Section
■ 10(a) prospectus, and thus to information whose substance is
■ subject to liability under Section 11.

■ Now, Section 11 liability is quite different than
■ Section 12.2 liability in terms of the people who are liable.

■ Under Section 12.2 -- under Section 11, that liability would
■ potentially extend to, among others, one, every person who

signed the registration statement; two, every director of the issuer; three, accountants who have consented to be named as having prepared or certified any part of the registration, or as having prepared or certified a report or valuation which is used in connection with the registration, and every underwriter with respect to --

MR. SILVER: Stan, I think at that point, you talk about the potential liabilities which can flow from misleading, inaccurate advertising. Let me cut to Barry, who is the most recent division director we have present right now, and ask him, as an effect during your tenure, has these restraints on advertising had any real effect. And second, during your tenure, did the Commission contemplate or did they bring any actions based on false and misleading ads as the -- of the offense.

MR. BARBASH: Answering the second question first, I don't recall during my five-year tenure, David, that we brought cases on advertising. There have been some cases brought since, but I believe there weren't any at that point in time.

In terms of the approach towards 482, or what should

■ be done with 482, Marianne mentioned earlier that during the
■ course of doing the redbook study, the issue came up of the
■ substance of requirement embedded in 482, which, for many
■ participants in the fund business, became something of an
■ administrative nightmare. And the question there was is
■ everything in the prospectus -- does everything in the
■ prospectus -- if you put out a particular ad, does the ad have
■ to be limited to just -- every word has to be limited to
■ what's in the prospectus.

■ So, for example, the problem in the ad that people
■ would note was you have an advertisement you want to put out
■ about a fund that invests in Japanese securities. Can you put
■ out an ad that talked a little bit about the Japanese markets?

■ And the question was well, gee, if you did that, would that
■ be not consistent with the substance of requirement? Because
■ if there was nothing about Japan in the prospectus or the
■ statement of additional information, then how could you do the
■ ad?

■ And a number of people in the fund business were
■ talking about being whipsawed on ads, and not being able to
■ have ads that talked about information that really didn't

■ address the fund particularly, but information about the kinds
■ of securities. And that had been picked up in the redbook
■ study as something that probably should be taken into account
■ to modernize advertisements and get away from the idea that
■ every ad had to mirror what was in the prospectus, get away
■ from that concept and broaden out the information.

■ That's where we were heading during the tenure.
■ It's really been during Paul's tenure that the staff has made
■ more progress in getting out a role proposal on that subject.

■ During my time, things were really quiet on the
■ advertising front, generally, probably because most of the
■ time and attention we were spending in the disclosure area was
■ on the prospectus itself and trying to simplify it.

■ MR. SILVER: What role did the NASD play during your
■ tenure, of course historically being very active in this area?

■ MR. BARBASH: Well, the NASD continued its role of
■ looking at advertisements generally during the time that I was
■ the division director in the advertisement area, where the
■ largest issue was the issue of manager performance and
■ portfolio managers and their results over time, and portfolio
■ managers moving from a particular fund group where they

developed a record of performance wanting to go over to an organization and wanting to bring the performance record with them.

And we were faced on the staff with the question of whether doing that was consistent with the securities laws, or precluded by the securities laws. And I would argue that it's pretty clear under the securities laws that are applicable here that moving performance records, so long as there's clear disclosure of what the role was of the portfolio manager and other material information about what that portfolio manager did and what his or her record was, that you could move it, and it was not an issue under the Securities Laws.

The NASD saw it differently, and the NASD members thought that there was still a possibility for misleading information about having track records filings. And most of time during my tenure, it was a debate about that particular subject. That was an issue of advertising.

MR. ROSENBLAT: Well, the SEC has actually delegated virtually all the responsibility for review of advertising of mutual funds to the NASD. So one might ask them why you see television ads where you can't read the stuff that you have to

■ put in a 482 ad.

■ MS. MCGRATH: That's because -- all design them, and
■ you can't read it. That's why you can't read it.

■ MR. SILVER: I think it's just advancing age, Al --

■ MS. MCGRATH: Yeah, that's right.

■ MR. SILVER: -- that we can't read those millisecond
■ disclaimers.

■ MR. ROSENBLAT: No. But I've had some dealings with
■ the NASD on various issues, and they are very strict on print
■ stuff. I mean, they can drive you crazy on print stuff. But
■ the television area seems to be not -- they seem to be letting
■ it all go.

■ MR. SILVER: They're good on print stuff. You ought
■ to see them on quill pens. Really absolutely terrific.

■ MS. MCGRATH: Are you going to get after Joel
■ Goldberg and get an explanation here of 12 b-1?

■ MR. SILVER: A total and complete explanation of 12
■ b-1. But let's pick up first where Allan left off. He sort
■ of got off the hook early, because Marianne had to leave.
■ Allan, there were a whole series of recommendations in the
■ public policy report. They were in the sales area, sales

loads specifically. They were in the management fee area.

They were in the contractual plan area.

Of those three major groups of recommendations, the contractual plan problem seems to at least have been solved by the '70 amendments which changed the structure of contractual plans without getting into what the old front end load was. It really doesn't seem to be a live problem today.

The one that's open continuously, and was opened in 1970, was the management fee area. There was immediate litigation on the private side claiming fees were excessive under Section 36(b).

But there is one curiosity about Section 36(b) specifically that I think I mentioned to some of you at lunch today. In the negotiations which led to the enactment of the '70 amendments, the Commission and the staff were very firm on insisting that the Commission have a right to sue on its own, that Section 36(b) should not be left wholly to private enforcement, but that the Commission could bring a case quite independently under Section 36(b) in the case of excessive fees.

And this was a major bone of contention in the

negotiations. And finally, the Commission prevailed, and the Commission does have the right to bring an action for excessive fees under Section 36(b). From that day in 1970 to today, the Commission has never brought an action under Section 36(b) alleging excessive fees. Does anybody here have any explanation?

MS. MCGRATH: Must be reasonable, those fees.

MR. GOLDBERG: No excessive fees, I guess.

MR. MOSTOFF: Well, one way to look at this is that the statute, as enhanced in 1970, has worked reasonably well.

And with the increasing intensity of independent directors in their performance of their duties generally that fees have been kept under control enough so that there's not a situation that's come to the Commission's attention, presumably, that is shocking enough to warrant the Commission taking the initiative and bringing an enforcement action, or a legal action.

MS. JONES: As an independent director, I hope that the publications who are here present today will quote you accurately and distinctly and fully.

MR. MOSTOFF: What did I say?

MS. JONES: Well, you know, the fees also have stayed across the industry within a certain close range of one another. And so if the Commission were to sue them, they have to sue them all.

MR. ROSENBLAT: Yeah, there's one oddity --

MR. MOSTOFF: If you look at the tests of reasonableness as they've been articulated by the courts, a lot depends upon the concept of profitability, and profitability gets you into the question of whether you penalize someone who's running an efficient business, and therefore enhancing the profitability because of the efficiency of the company. And I think it takes you around in a circle.

So that it does seem to me that the statute is working, and it's reasonable to presume, absent Commission action, that nothing has come to the Commission staff's attention that warrants initiating an independent challenge to a sort of advisory fee.

MS. MCGRATH: Now, Allan said "around in a circle."

MR. ROSENBLAT: Well, one oddity of Section 36(b) is that it says that the investment adviser has a fiduciary duty

with respect to the fees. But the case law as it developed, although there was some attention given to profitability, the focus was on what the directors did -- whether they were fully informed and whether they consider the appropriate factors, and whether they felt that the advisory fee was reasonable, not that anybody else did.

And Dechert has a lot of investment company clients, but I have to tell you -- and it's all in the cases -- when you look at the profitability figures in at least several of the cases -- profitability is rather high. And the courts said, "Well, no, the directors felt that was okay. And they were fully informed, so that means that there's no violation of Section 36(b)."

MR. GOLDBERG: Well, you know, I think Alan, both you and Allan Mostoff have kind of equated a highly-profitable fee with a potentially excessive fee, and I don't think that's what the courts have said. I think they've said profitability is one of several factors that you consider.

MR. MOSTOFF: I certainly didn't mean to create that implication. My point is that I'm not sure that profitability is a factor that you should consider, because a dramatically

profitable company could be profitable as a result of the operating efficiencies of management, as opposed to the unreasonableness of --

MR. BARBASH: If you go back to the legislative history of 36(b), I think what you have is these days what the statute was intending to get at. When the '66 public policy implication study came out, that asked for or recommended a substantive reasonableness standard that somebody made a finding that this particular fee is excessive.

And what happens with the negotiation process is you've got a standard written into 36(b) that is generally process-oriented, I would argue correctly interpreted by the courts to be process-oriented. And the result is that in a process-oriented context, it's very hard to challenge the fee if the process is followed. This is an industry that pays close attention to the process.

And I think the reason why the SEC hasn't been able to bring or hasn't brought cases over time is simply that. The process is well-developed. It's talked about all the time in court cases. It's talked about at every conference. And most of the people in the industry get it right. And it would

■ be very hard, given the way the court cases have come out, for
■ the SEC to bring a case.

■ And since the Commission is always under resource
■ constraints in all of its areas, particularly in the
■ enforcement area, to bring a mega-case and lose it is worse
■ than anything. And I think there's been a reluctance.
■ Clearly, that's what we felt during my tenure.

■ MS. JONES: I would like to irreverently suggest,
■ however -- and I include myself in this comment -- that if any
■ one of us -- if all of us were sitting on the panel as
■ Commission employees 15 years ago, this would be a very
■ different discussion of whether management fees are too high
■ or not too high. I think it depends sort of, frankly, where
■ you sit.

■ MR. LYBECKER: The last point I would make -- I
■ don't mean this to be the last point that's made about this,
■ but the point I'd like to make is if you look at the litigated
■ cases, the ones that have been actually where you've got
■ District Court and appellate opinion, I think we're talking
■ less than 10. If I'm not wrong, seven or eight of the ten are
■ money market funds, the last one was a bond fund. And the

process in that last case was by far the worst of all of the processes that were carried on.

Think about -- and then there's always the suggestion that money market funds, that they become more profitable. It's just more money under management, and there have to be break points. The original case against Gartenberg, the break point, if I'm not wrong, is at a billion dollars, and it's never been changed. There's one break point. That's it. From the time they put it in place to the time they got sued in that lawsuit till today, it's one break point, same place.

Okay. Rosenblat takes out, opens an account at a brokerage firm, and he puts a thousand dollars into a money market fund. And let's just say it's got a hundred basis point expense ratio. So he pays 10 bucks for his thousand dollars, and he gets all the services that they're supposed to get. All of them.

Barbash, of course, is much more highly compensated, so he puts his hundred thousand bucks in the same brokerage firm and in the same money market fund, and he pays a whole lot more for exactly the same services.

■ If what was intended to be attacked under 36(b) was
■ the idea that small shareholders shouldn't subsidize large
■ shareholders, the reality is it's exactly the other way
■ around. Large shareholders of money market funds subsidize
■ small shareholders.

■ And so what we're seeing today is the leakage back
■ out of money market funds in bank deposit accounts, where
■ small shareholders who end up in the deposit account are going
■ to be charged at the account level on amount of money that
■ supports the services they're actually receiving. I don't
■ think there's anything wrong with the way things are today.

■ MR. SILVER: See, that just proves that 15 years on,
■ we're all much wiser.

■ MS. JONES: Maybe that's it.

■ MS. MCGRATH: So can we get Joel to tell us about 12
■ b-1?

■ MR. SILVER: Before we get to that, Joel --

■ (Laughter.)

■ MR. GOLDBERG: Take all the time that you need,
■ Dave.

■ MR. SILVER: Because the first great debate about 12

b-1, as I recall, took place in a room between Alan Rosenblat and myself. It had been the industry's position, from time immemorial, that the Investment Company Act did not preclude a fund from using its own assets to promote the sale of fund shares. One can argue ad infinitum about the validity of that position on both sides, whether it's a good thing or a bad thing.

But the first argument, I think, was purely the legal argument that there was no prohibition in the Act against the fund using its own assets for distribution. Alan, what was your position?

MR. ROSENBLAT: Well, I don't remember speaking about this. But I think the way it came out, and that's why it's a 12(b) rule, is that 12(b) says you can't act as -- a fund can't act as an underwriter of securities, except under rules adopted by the Commission. So that's why -- and 12(b)1 says you can, in effect, act as an underwriter of your own shares if you meet these conditions.

Now, whether the conditions really are realistic anymore is another question. And whether there should have been some cap on the amount you could charge and whether you

could charge a sales load and a 12 b-1 fee, which I would have thought was not the case when it was proposed or adopted, is another question too.

MR. SILVER: But we can conduct a second round 20 years later of that legal debate and the bearing of Section 10 on the issue. But even without the debate the stage is set for Joel explaining to us everything he knows about 12 b-1, when and how, the circumstances under which it was adopted.

We do have to go back to the time when the open-end segment of the mutual fund industry was in dire straits. The industry was in net redemptions for a period. Nobody thinks that's a good or healthy condition for shareholders who remain. And the industry was looking for a source of funds to finance distribution. And Joel, how did you come into the act?

MR. GOLDBERG: Well, without entering into the question of who was responsible for the rule, I will admit to being near the scene of the accident.

I think that a couple of myths have to be punctured right from the start. Everyone talks about Rule 12 b-1 as being the rule that permits funds to pay for distribution. It

■ isn't.

■ For years, as Alan and Dave have suggested, the
■ Commission and the staff took the position that mutual funds
■ shouldn't pay for distribution, that there was an unacceptable
■ conflict of interest. But they never could quite find a
■ section of the act saying that. There were various theories
■ advanced. You know, it was a per se breach of fiduciary duty,
■ or it was a 17(d). Or, if there was a sharing of the advisory
■ fee, it was an assignment of the advisory contract. But none
■ of these theories really stood up to analysis.

■ But it was kind of like the elephant in the living
■ room. Nobody really wanted to say that there wasn't anything
■ illegal about funds paying for distribution until the pressure
■ to increase sales became so great that some in the industry
■ effectively challenged the Commission's position. You had
■ several money funds organized where they were saying in their
■ prospectus that they would share half of the advisory fee with
■ dealers who sold their shares. And obviously, it's a very
■ small step from that to saying, "Well, we'll just charge half
■ the advisory fee, and we'll have the fund pay what would have
■ been the other half directly to the salesperson."

It had become clear that the sort of in terroram statements about it being generally inappropriate or immoral to pay for distribution were not going to hold back the tide forever. And I think that's what prompted the Commission, or at least the staff to recommend to the Commission that they regularize and limit the practice.

That was done, as Alan suggests, by adopting a rule under Section 12(b) of the act. The Commission defines the term "acting as your own underwriter" to include paying for distribution. So if you pay for distribution, you're acting as your own underwriter. Section 12(b) says you can't do that in contravention of Commission rules. There had been no Commission rules until then. But the Commission adopted one, and it restricted the circumstances under which a fund could pay for distribution.

So I think the first myth is that Rule 12 b-1 allows funds to pay for distribution. The second myth is that it was in response to the net redemptions that were prevalent in the industry, and that there was sort of a desperation attached to it. In fact, by the time the rule was adopted in 1980, the money funds had brought the industry back to unprecedented

■ prosperity, and there were even increasing sales of equity
■ funds. The net redemptions had ended years earlier. The real
■ impetus for adopting Rule 12(b)1 was the fact that the lack of
■ any intellectual basis for preventing payments for
■ distribution had surfaced. And to mix the metaphors, you
■ couldn't get the genie back into the bottle.

■ Now, I think if I had it to do over again, or even
■ if I had it to do the first time, the big mistake the staff
■ and the Commission made at the time of Rule 12 b-1 was we did
■ not foresee that payments out of fund assets would be used as
■ a substitute for a sales load, you know, in the form of a
■ contingent deferred sales charge.

■ And when you think about it, it was so obvious, it's
■ just astounding that we never thought of it. Because the
■ insurance industry had been doing essentially the same thing
■ for years by having contingent deferred sales charges on
■ variable annuity contracts, and then using the mortality and
■ expense charge to cover that. It's astonishing that we never
■ thought that that could be -- or we never thought about the
■ fact that that could be easily transferred to the conventional
■ fund industry.

MR. ROSENBLAT: On your point about -- and Dave had mentioned it -- about the assignment of the advisory fee, there is actually a no-action letter that I wrote, where they said, "We want to share with the -- share our advisory fee with the broker dealer," and we said that was an assignment. And there's a subsequent letter signed by Joel Goldberg that said, when somebody wrote in again, "No, don't worry about that. We're thinking about it."

MR. GOLDBERG: Well, we were.

MR. ROSENBLAT: We're talking about an intellectual basis. I think there's nothing wrong with saying that it's an assignment of the advisory fee. If you look at the definition of "assignment," it includes assignment of a choice in action, which is the right to receive proceeds.

MR. GOLDBERG: You better help, Allan.

MR. MOSTOFF: Well, I recall Sid Mendelson explaining 12 b-1 when it was done as just putting on top of the table what was being done under the table.

MR. LYBECKER: Exactly. Joel's history is more than fair. We had such problems --

MR. MOSTOFF: Except you're going to want to go back

■ a little bit further. Because I remember in the middle '70s
■ when the industry was in net redemption being visited by fund
■ representatives, I remember an appearance that a former
■ chairman made before the Commission pleading the poverty of
■ the fund industry. And I remember commissioners at the
■ conclusion of that saying to me, as the division director,
■ "We've got to do something," and the staff began thinking
■ about it.

■ MR. LYBECKER: But you can follow the record. It's
■ very clear the staff went to the Commission over a period of
■ years, almost five years, and constantly asked either to sue
■ the people who were breaching the Commission's unwritten rule,
■ or to do something, and putting it on the table. I absolutely
■ was right next to you when that decision was being made. It
■ was right. We had --

■ MR. GOLDBERG: Oh, so it was you.

■ MR. LYBECKER: It's Dick Grant who did it. It's
■ Grant. But the money market fund example, it was the worst,
■ and we could not get Commissioner Pollack to see his way clear
■ to an enforcement case. It was the one where the unnamed
■ investment advisor, for 10 basis points, would advise the

fund. Regional broker dealers, unnamed, would have Class A, B, C, D, E shares, and the advisor that was -- dividends paid on Class A would be exactly equal to 20 basis points in every damn dollar the broker put in the fund. How could you not say that that was using fund assets to pay for distribution? We either wanted to sue them, or we had to do something.

The intellectual record is that there were three or four commissioners who absolutely wanted to stick with you can't use fund assets for distribution. And I absolutely agree with Joel. It's very fair on the history of how it happened, and I will also agree that none of us foresaw that you get level loads. It wasn't on the list.

MR. GOLDBERG: Well, if I can just finish up on the thought of the level loads. I think that's the great flaw in 12 b-1 as it exists. Because the rule really assumed, you know, you would have a payment of maybe 20 points, 25 points tops, and it would cover advertising or training of sales personnel, or that kind of thing.

So the requirements of the rule make absolutely no sense in the context of contingent deferred sales loads, especially the requirement that the plan can't continue for

more than a year at a time, and it can be terminated at any time. I think that all of these underwriters who have advanced millions of dollars for payments of sales commissions would be quite surprised to be told that there isn't any assurance they're going to get the money back through a 12 b-1.

MS. MCGRATH: How about the folks who securitized them?

MR. MOSTOFF: Well, yeah. They get a guarantee from the advisor.

MR. BARBASH: You know, it's interesting, Joel, you talk about what you think the big mistake was or the oversight was in 12 b-1. And my recollection is, just as an aside, that it was an Allan Mostoff client that had --

MR. MOSTOFF: It certainly was.

MR. BARBASH: -- first contingent deferred sales charge. I remember --

MR. MOSTOFF: And it didn't do that. It couldn't do that without the exemptive order that we were able to obtain after persuading the staff that the concept was fair and in the interest of investors.

MR. BARBASH: And I was a young practitioner, and we were all astounded at the step that was taken. We never thought --

MR. LYBECKER: It seemed perfectly natural.

MR. BARBASH: -- that that was the way 12 b-1 was going to go. But I once had occasion -- I had Sydney Mendelsohn, who was the division director then. When 12 b-1 was adopted, Sidney was the division director. Joel was an associate director. Dick Grant was, I think, special counsel to Sidney. Marty was an associate director. All of them had something to do with this project. I can tell you. I was there.

And Dick used to make me -- I was a young staff attorney, and Dick used to make me drive him out to his house in Arlington because I lived out that way. And he was complaining the whole time about it. So in the name of Dick, I would say he didn't like it either.

But I once asked Sydney in the context of having him come over and talk to the staff about various issues, I asked him what did he think of 12 b-1. And he was totally convinced it was the right thing to do. He always agreed that there was

no legal basis. He could see in the '40 Act that said that you couldn't have distribution payments made out of fund assets.

But interestingly, the thing that he was always troubled by was that there was no cap on 12 b-1 payments. That was the one --

MR. GOLDBERG: Well, you know, I think that the reason there can't be a cap -- I don't think there can ever be one. And the reason there can't --

MR. BARBASH: Did you tell the NASD that?

MR. GOLDBERG: What?

MR. BARBASH: Did you tell the NASD that?

MS. MCGRATH: That's a bucket, not a --

MR. GOLDBERG: No. The reason there can't be a cap on the charge to the fund, I think, is this. Before the Commission permitted, if you will, fund assets to be used for distribution, there were no-load funds. And they used to sell through advertising. They obviously had some distribution expenses. Even the load funds would operate at a loss as far as the underwriter was concerned. Typically, the distribution for load funds cost more than the sales load would compensate

■ for.

■ Who paid for this? Who paid for the distribution of
■ the no-load funds or for the load funds? The answer was the
■ investment advisor. Well, where did the investment advisor
■ get the money? Ding, ding, ding. From the fund.

■ MR. MOSTOFF: Through the advisory fee, you mean.

■ MR. GOLDBERG: Right.

■ MR. MOSTOFF: Yes.

■ MR. GOLDBERG: And I think if you say all right.

■ The 12 b-1 fee can't exceed -- I don't know -- 50 points, do
■ you prevent the investment advisor from kicking in another 50?

■ And if you do, have you outlawed no-load funds?

■ MR. DUDLEY: Could I just -- isn't it not the
■ government's position and the best position to set caps on
■ what's happening in the market place? Hasn't the industry
■ really set the caps, and doesn't that answer the question why
■ there's no suits under 36(b), and why 12(b)1, the cap has come
■ out to one percent?

■ MR. GOLDBERG: I think that's right.

■ MR. DUDLEY: I mean, the government becomes the bad
■ guy when they get involved in setting price.

MR. MOSTOFF: You're absolutely right. But 12 b-1 has led to a situation where today, people are confused and find it somewhat awkward to deal with constraints of the rule and the business constraints that they find themselves in as a result of taking advantage of the rule. But I want to speak on behalf of the rule for a minute.

Without the changes that resulted in 12 b-1, and also without the contingent deferred sales charge, there would not have been, in my view, an embracing by the retail brokerage industry of the mutual fund concept. And I don't think they would have distributed mutual funds the way they ultimately have, and I don't think mutual funds, which I believe are a wonderful product, would have been embraced by the public investor the way it has. 12 b-1 has allowed that to happen.

Now, that's not to say that there isn't room for improvement of the current situation. But it allowed and caused, I believe, a C change in the attitudes toward mutual funds as a form of investment that the retail industry was willing to merchandise.

MS. JONES: I was intrigued to see that the

Commission indicated maybe an interest in looking at -- recently looking at 12 b-1. And, you know, without going into it in any great depth, I would hope they would. I would doubt that it's going to happen any time soon, but I would hope they would.

I remember, because a precursor of 12 b-1 was on the table when I was director. And one of the ugliest meetings I ever attended, Commission staff, was between investment management and enforcement over 12 b-1. I mean, the Commission was always a very wonderful place to work, and great relationships between all of the divisions. And I want to tell you that this one meeting with enforcement taking -- practically accusing us of being criminals, it was the ugliest meeting -- I think maybe the ugliest meeting of staff I have ever attended at any agency. And I've been to two others, as you know. It sticks with me.

But I was happy to leave before 12 b-1 was adopted. My hands are clean.

MR. JUDD: I'd just say that the concept, as you mentioned, and this sort of coming out of the trust in Boston and so on I think is very significant in creating the idea

■ that -- the purpose of these funds are to serve the interests
■ of the participants, and that their interest is in the growth
■ of their investments and returns, and that they are not
■ particularly -- they're interested in the business aspect of
■ the growth of the fund if there is no, for example, growth in
■ the net asset value per share.

■ Now, I've done some work in the last nine years
■ around the world, and I must say that I don't think that I've
■ ever occasioned, come across anyplace, a concept of funds
■ bearing sales distribution costs.

■ MR. SILVER: Well, Stan, I think I'll exercise my
■ prerogative, closing this part of the discussion with a very
■ quick anecdote.

■ I was privileged to have in one of his later years
■ in teaching the law of trusts Professor Scott, who some of you
■ probably have heard of. And on the question of who pays who
■ for what, Professor Scott dealt with that. And he said that
■ in the typical Boston situation, the husband goes to his
■ reward, the widow goes to Europe and has a grand tour, does
■ the opera, sees the Mona Lisa, comes back on the Mauretania,
■ or whatever it is that docks in Boston, and there is a young

man from the Harvard Trust Company waiting on the dock with flowers, et cetera.

At that point, Professor Scott would lean forward over the glasses and say, "Who do you think was paying for those flowers?" So it really is the same question that always exists. Ultimately, of course, it's the customer who pays.

MS. MCGRATH: But which customer, Dave?

MR. SILVER: Well, who paid for the widow's flowers?

MS. MCGRATH: She did. But the 12 b-1 fee --

MR. ROSENBLAT: The other shareholders who came in before they started paying the 12 b-1 fees, they paid.

MR. SILVER: Well, I think we're at a point where I want to give each of you, really, a very short period -- there are a lot of us here -- say a minute, two minutes at most, on sort of the triumph and tragedies. What do you regard as the greatest positive event in the time, your time, on the staff?

What do you think is an opportunity that was foregone that should have been done? And although you're the most recent, Barry, you happen to be sitting there, so let's start with you and go around the table.

MR. BARBASH: I look back fondly, I think -- the

■ thing that strikes me about having worked in this building is
■ having worked in this building. I look back on every day as a
■ terrific experience, and I just enjoyed the five years
■ immensely here.

■ In terms of substantive matters, a lot of our time
■ during my tenure was spent on disclosure and trying to make
■ the prospectus easier to use, more understandable for
■ investors. And I have to say, looking back, it reminds me
■ something of Don Quixote. I'm not sure you can ever win that
■ one. I think you go out and you try to get prospectuses to be
■ somewhat simpler. I think it's in the interest of
■ shareholders that they are. But inevitably, someone else is
■ going to have to do it five years down the road, or six years
■ down the road.

■ Because I think there's a tension with disclosure,
■ and it's a continuum between wanting materials that are
■ understandable and useful, and then using disclosure as a
■ means to effect some kind of regulatory purpose. And
■ inevitably, when you're trying to engage in the latter
■ endeavor of trying to effect a regulatory purpose, you end up
■ with documents that are really not understandable. They're

not designed to be understandable. They're designed to regulate.

So as I look back, I'm glad we tried to simplify the prospectus. I wish it had been longer standing.

In terms of what I regret not having the opportunity, going back to a theme from earlier, I would have liked, and it just didn't come up that there was anything at the time -- I was always amazed at what the division's staff did in the money market area, and facilitated a product or service, whatever you want to call it, that was so different, so beneficial. I regret not having the opportunity of having worked on something of that sort. It just didn't come up that we worked on that. We tended, over my five years, to work on other themes, and we didn't have an opportunity to do something like that. And I admire the staff who did.

MR. SILVER: Alan Rosenblat?

MR. ROSENBLAT: I think by far, the thing I remember as the most -- had the most fun on and found most rewarding was the '70 amendments, which I think we've covered adequately. But I think a close second is the so-called Mini Account Rule, which is the basis for the wrap free accounts,

■ which have grown enormously.

■ And that has a curious history, because we saw ads
■ in the paper and other media by investment advisors who were
■ managing small accounts as low as \$5,000, and supposedly gave
■ personalized service. And we couldn't believe that that could
■ be the case, and we tried to stop it with some warnings and
■ no-action letters. And William Casey thought that that was
■ wrong, and he said to Allan and myself, you know, "Get rid of
■ that. Stop it. There's no reason why you can't bunch
■ customers and have their funds managed on this sort of basis."

■ And Allan came up with a very original and innovative idea,
■ which is let's have an advisory committee.

■ Now, happily, the Advisory Committee Act had been
■ adopted, but it was not yet effective. Otherwise, we couldn't
■ have done this in such a short time, because we would have had
■ a charter approved by the Commission, and meetings would have
■ had to have been open. So we got all the foxes into the
■ chicken coop.

■ We got Merrill Lynch, who had been doing something
■ similar. We got Debevoise, who had represented Citibank when
■ they advertised something that was like a managing agency

account, or a common trust fund, but it was for very small investors. And when the Commission looked at it, they found there are really only eight securities they ever invested in. So they sued Citibank, and there was a settlement in which Citibank agreed to mend its ways.

Well, the interesting thing about the advisory committee was the people on it were really terrific. We found out that one of the main offenders, a guy named Danforth we thought was a main offender, who was advertising \$5,000 accounts, we went up to Connecticut and went to his office and found he was actually doing it and giving individualized service.

And the advisory committee was very useful, because they really believed that they could help work out a regulatory scheme to deal with this. And there was some -- and which were ultimately adopted as Rule 3a-4, which says you can run parallel trades. You can bunch people's money. You can pool people's money. It won't be an unregistered investment company, just so long as some basic principles are followed, including the ability to instruct the advisor not to invest in certain types of securities, and also the ability to

take your assets out in whole or in part at any time, which you cannot do with an investment company.

So I think that worked pretty well, and that set the stage for the wrap free accounts that are very common now.

MR. SILVER: In a couple of sentences, greatest tragedy.

MR. ROSENBLAT: Well, the greatest tragedy was losing the Lowe case. And that was a case in which we went after a really bad guy whose advisory registration had been revoked by the Commission because he, among other things, made misrepresentations to a court. He had stolen money from his clients. And then when he settled the case, he had falsified a check -- he had taken a check for a thousand dollars and changed it to \$10,000 and presented a copy of it as evidence in the court that he had settled the case.

And so we went after him and tried to enjoin his acting as an adviser. It went to the Supreme Court, and the Supreme Court held that the Advisers' Act does not cover newsletters that do not give personal advice tailored to the individual needs of the client. That completely deregulated a whole segment of the industry that we had been regulating for

■ years and thought that we had the right to regulate.

■ Interestingly enough, three Justices in the case
■ concurred in the result but said, "No, the Commission is
■ right, but this statute is unconstitutional."

■ MR. SILVER: I remember arguing with Bob Block that
■ at some point, the First Amendment does trump the Advisors'
■ Act. Jack Dudley, triumph and tragedy.

■ MR. DUDLEY: Dave, I look at, and being an assistant
■ director, associate director of the division, and as a
■ government employee, I just thought it was my responsibility
■ to treat people fairly that came before the Commission, and
■ not to abuse the power that a government person has.

■ And it was a simpler time. There didn't seem to be
■ any great issues. As a personal triumph, I think it was in
■ appearing before the Court of Appeals for the Second Circuit
■ and upholding Rule 17(d)1 on the promise that the Commission
■ would revise the rule, and it wouldn't be as complicated as it
■ now appears, as I promised Judge Friendly.

■ My biggest failure, you know what it was. I never
■ could convince the Commission to change Rule 17(d)1. I still
■ have a solution.

MR. SILVER: Stanley, triumph and tragedy.

MR. JUDD: I'd just say that I've enjoyed the almost 30 years that I was at the Commission. There was a lot of interesting things that developed on a day-by-day basis. And I'm not prepared to say which child is the most beautiful.

In terms of --

MR. SILVER: The most ugly.

MR. JUDD: All I can say is that as you age, you continually discover things, and you find out things that you did may not have been as wise as you thought they were when you did them.

For example, there was a request once that came in for a no-action position with regard to the situation where you had a person abroad who sold an interest in a foreign investment company who had a brokerage account in the United States. And the sales efforts to sell the fund was made from abroad to where this person lived. And there was no connection with the United States except that the instruction would go to his brokerage account in the United States to pay for the sale of the mutual fund. And I wrote that we would not in that circumstance see that this was a sale through

jurisdictional means of the sale of the mutual fund share.

Well, last spring, I was in Panama. And I find that in Panama, they have sort of -- and I suppose throughout the rest of the Caribbean, they have taken this as the way in which to sell sort of funds patterned after American funds, but they are not American funds. But they are sold like American funds. They are usually promoted by people who come down from Miami -- from what I've heard, good-looking women who give lectures on them. The securities are then --

MR. SILVER: I don't know what side you're coming out on, Stanley.

MS. MCGRATH: SEC versus good-looking women. I can see it now.

MR. JUDD: Well, the point is that the result of this is that you have people in that whole area who think they're buying American funds. But what they're doing, basically, is buying a foreign fund, which is the way it's being sold, the only connection being with a payment coming out of a United States broker's account, that in those circumstances, there is none of the protections that we think of as applying. That is, the Investment Company Act doesn't

■ apply; the '33 Act doesn't apply; nothing applies. And these
■ people all over the world nevertheless are putting their
■ confidence in these types of securities.

■ MR. ROSENBLAT: What about Regulation S?

■ MR. SILVER: Kathy, you don't get off the hook
■ because you're a moderator. Greatest triumph, greatest
■ tragedy.

■ MS. MCGRATH: Okay. I guess the rule that I like
■ the best was the fee table. But I think that the thing that I
■ like the best was the fact that in the seven years that I was
■ at the division, it got to be a very popular and happy place
■ to work, with everybody producing a lot of stuff. And I think
■ we had real high morale, and a good time, and managed to get a
■ fair amount of quality work done.

■ My biggest failure, I think, was trying to tackle
■ and clean up Rule 12 b-1, and see if we could get findings
■ that the directors had to make straight, and CDSCs. We did
■ get the NASD, I guess, by scaring the hell out of the industry
■ to come up with their buckets rule. But that was a hard
■ lesson. There was too much money flowing through 12(b)1 fees
■ to make it touchable.

MR. SILVER: Allan?

MR. MOSTOFF: Well, I had the same experience that others have had. I had a terrific career. Really had a lot of professional gratification from the eight years or so that I was in the division as special counsel, assistant director, associate director, and then director.

I guess, you know, I was privileged to work with people who had institutional memory. They went back to 1940. So I learned from them and was able to work with them, and some of the changes that led to the public policy, the changes in view that led to the public policy report. And the '70 amendments were an exciting time for me, and the '75 amendments were very exciting.

Clarifying the Commission's position on insurance products, to the extent one could - and variable annuities and variable life were a challenge for the division - I thought we did a reasonably good job with the assistance of the General Counsel's office in dealing with them. And while it was over by the time I became the division director, a good part of my career in the division was spent giving some attention to the problem of unregistered funds in the context

of the fund-of-funds, which was a real live demonstration in the '60s of the wisdom of 1940 that led to the enactment of a statute that is intended to protect investors in a pooled vehicle from the kinds of abuses that went on in the '30s, because we found them again in the context of the fund-of-funds.

Disappointments? I'm not sure I'd qualify this as a disappointment, but really a strange situation which I thought you might have wanted to talk about, the position of the Commission with respect to the -- I thought you might be leading into this when you talked about Mr. Scott. The question of the fiduciary obligation or responsibility of the investment advisor with respect to the company he or she is managing in the context of the transfer of control of that company. That was a problem that the Commission has wrestled with, as we know, for ages, going back to the ISI case.

And a young lawyer, when I joined the division in '64, I got a big lecture about the importance of the Commission finding the right case to reverse that decision. And I spent a lot of time finding the right case. And when we thought we had the right case, we went up to the Commission.

■ And lo and behold, the Commission didn't want to reverse the
■ decision.

■ MR. SILVER: We had the right cases, but the
■ Commission didn't want to --

■ MR. MOSTOFF: That's right. And that turned around
■ into the Public Policy report, where the Commission said that
■ on the one hand, there is a fiduciary obligation, but on the
■ other hand, the advisors should be compensated for the
■ entrepreneurial efforts and wisdom.

■ And then all of a sudden, we had Judge Friendly and
■ the Rosenfeld v. Black case giving the Commission what it
■ wanted in the ISI case. And Casey called me into his office
■ and saying, "We've got to do something about this. Let's get
■ this reversed. This was the position the Commission wanted."

■ And that led to Section 15(f) and the '75
■ amendments, which was amazing.

■ MR. DUDLEY: Just something real quick. They came
■ in -- at that point, Lazard came in to us and said, "We want
■ to have an agreement that we'll not compete, and that's what
■ we are selling." And at that point, the Commission had given
■ up on bringing the perfect case, and we let them walk out of

the office. And the private lawsuit did what the Commission had been asking the staff to do all along.

MR. MOSTOFF: Now, one other thing. I was really a convert to the concept of regulation as an important vehicle for the protection of investors. And when I started to look at the Investment Advisers Act, I felt that it was sort of an empty vessel, and I wanted to see the Commission do more there. And we did work on the concept of an expansion of the Advisers Act to build into it some minimum qualifications for investment advisor activity. There was a legislative proposal which was hatched, I guess, while I was the director of the division. And, of course, that went nowhere. So that might qualify as a disappointment.

MR. SILVER: Joel?

MR. GOLDBERG: One of the things I was the most proud of was probably a negative accomplishment. A fund was filed during my time as director that was going to be sponsored by VISA International. And this was at the time that the banks still weren't allowed to sponsor funds.

VISA filed a money fund that they proposed would be sold through banks that were members of VISA International.

■ And what was unique about the fund was it would invest in CDs
■ issued by the banks that sold the fund in an approximate
■ portion to the amount of shares that the banks sold.

■ There was enormous pressure from both inside and
■ outside the Commission to make this fund effective. They
■ weren't asking for any kind of exemptive order. They wanted
■ only to be made effective. This was sort of the heyday of the
■ Reagan years. It was very difficult to resist the pressure,
■ but we did. Eventually, VISA withdrew the fund.

■ I think had that fund been permitted to commence
■ operations, it could have profoundly changed the mutual fund
■ industry, because it would have established the notion that
■ the investment of the fund's portfolio can be determined, at
■ least in part, by who sold the shares of the fund. VISA was
■ proposing to have restrictions. The CDs would have to be of a
■ certain quality, and the bank would have to have certain
■ financial strength.

■ But the basic principle that the investments of the
■ fund have to be chosen with an eye single to their investment
■ merit would have been lost. And I think that was --

■ MR. SILVER: We've got to move along. But one

sentences or two sentences, greatest tragedy.

MR. GOLDBERG: I don't know if it was a tragedy. I think with 20/20 hindsight, where we had a number of money funds that were at risk of breaking the buck. You might recall, Dave, you and I had some late-night conversations where I would tell you someone's about to break the buck, and you would go out and find some sugar daddies in the industry to step up and make sure it didn't happen.

I don't know whether that was the right thing. I think maybe if one or two funds had gone down to 99 cents for a short time, the world would have been conditioned to the fact that it's not awful. You don't lose all the money. You just lose one or two cents on the dollar, and it will come back. And perhaps we wouldn't now have to have a Rule 2(a)7 quite as restrictive as it is.

MR. SILVER: Anne?

MS. JONES: We are just about at the twenty-fifth anniversary of the time I left the SEC. So my recollection -- and unlike everyone else at this table, I have really basically left the practice of securities law and became an FCC commissioner and what-have-you, and since then have

practiced mostly in the communications field. I have been an independent director of fund groups for 18 years. But my recollections are not nearly as vivid as yours, because I don't live with these things.

My overall recollection is, as has been stated by several, a wonderful place to work, with great people. The only negative of the whole -- and what really didn't turn out to be a negative. But when I was nominated for a seat on the Federal Communications Commission, the Wall Street Journal editorialized against my appointment, because I had tried to bring some kind of regulation of the Wall Street Letter. And they said I clearly was against the First Amendment, because I was trying to regulate the written word, and I should not be an FCC commissioner. Fortunately, no one paid any attention.

But that is a tragedy, that that whole area is so clouded with First Amendment obligations.

But I think probably the best place I ever worked. It was 10 wonderful years, and history speaks for itself. I met great people. And I am responsible for Joel Goldberg being an alderman. Anyway, that's really all.

MR. SILVER: It's a mixed blessing. Ed?

MR. O'DELL: Since it's been more than 35 years since I left the Commission, I'm not going to restrict myself to comments of things that happened while I was at the Commission.

In terms of positives, one of the things that has really been of substantial benefit to the industry is the advancement and proliferation of series companies. And I think the staff has done a great deal in terms of interpretations and no-action letters to facilitate that. And I think that has gone a long way towards helping the industry grow as rapidly as it has. And it has also been very helpful for the smaller complexes to create a larger variety of funds at a reduced cost.

A second major development happened very recently, and it's the move to corporate governance and the strengthening of the role of directors and getting them independent counsel. I think the down side of that one is it should have happened 20 or 30 years earlier than it did, and I think it would have been a positive to the industry.

The final positive, I think, just in general is the money market funds. And they have been, in my judgment, one

of the key reasons why the fund industry has developed and acquired so much assets during the '80s and '90s and so forth.

On the down side, 12(b)1, I think, really needs to be revisited. I think that it's now becoming a method for the brokerage industry to siphon off assets out of the funds. And I think that so much of the money just goes right through to pay brokers, and I think that whole thing ought to be reconsidered.

Secondly, I don't think that the staff has paid enough attention to emphasizing disclosure relative to after-tax returns. And I think that there has been talk about it and so forth, but I think it's much more significant to issue to investors than anybody realizes. Similarly, I don't think there has been enough attention to after-expense returns if you would include 12(b)1 as an expense.

And I think those two things, if they were better known, would make people realize why a no-load S&P 500 index fund may in the long term be the best investment that you could make. But that just hasn't really come to pass yet.

MR. SILVER: Marty?

MR. LYBECKER: I got to lead the life that Barry

■ wanted to have, because I got to be the regulatory father of
■ money market funds. Nobody else wanted it. It started with
■ Allan, it went through part of Anne's administration, and
■ ended up in Sid's. And, of course, what we had is people
■ challenging the Commission's position, which was very
■ conservative: mark-to-market, or else. We had the choice
■ between amortized cost and penny rounding. We also had people
■ filing applications like crazy. So we had to figure out what
■ to do with it. And after the Commission set it down for
■ hearing, there was no way to stop the applications from coming
■ in.

■ So we ended up at one point in having 40 people, 40
■ different fund groups, in a hearing, and trying to figure out
■ how to deal with each of them as a party. And the party kept
■ getting larger. So the first thing we did was settle out
■ everybody who would swallow penny rounding on the grounds that
■ if something could develop later in amortized cost, they could
■ have that too.

■ It is not fun, Barry, to have your boss be an
■ administrative law judge. He could care less about policy and
■ have ex parte rules where you can't talk to the five

commissioners who appointed you. When you were trying to make decisions, and the ALJ is the next person you get to talk to, it sucks. And Dr. Goelke did a great job of being our expert witness, but it wasn't easy. Corralling all those people, getting them to settle, and then getting them to waive the ex parte rule so that I could go talk to commissioners privately was incredibly hard.

We didn't get the -- we started the process -- it was started in 1975 by the Commission telling people to mark-to-market. We didn't settle the thing until August of '79. For most of the year that we were in the hearing, I built a triangular stack of Maalox bottles demonstrating which of the people had been the most unpleasant for the last week.

MR. SILVER: Marty, is this the triumph or the tragedy?

MR. LYBECKER: This is the triumph.

MR. SILVER: Okay. I just wanted to make sure. Get to your tragedy.

MR. LYBECKER: The result is we watched money market funds be something that was astonishing. Well, at one point, they completely destabilized the banking industry. Right now,

the money is going absolutely the other way. So my proudest achievement is the money market fund. The tragedy is the same thing. Somebody insisting on getting what they wanted, instead of getting it administratively, they went to the Hill, and we ended up with the BDC amendments that have been used by very few people. It's unbelievably complicated. You and I and three other people who also like baseball can probably figure them out. And it's been ill-used, and it was all the result of one person wanting his way.

MR. ROSENBLAT: But if I can add a footnote to that, it's ironic that we went along and tried to work out something for the industry, and we made it so complicated they couldn't use it, which is what we wanted from the start, I think.

MR. SILVER: On that, I'm not sure, down note or up note or sideways note, I think we're about at an end. If I can cast a positive. On the positive side, I would agree with Barry, Ed, and Marty. I think the most extraordinary achievement of the division was the creation, by definition of the modern money market funds in Rule 2(a)7. Really, almost out of whole cloth.

And with that, Carla, I think you have your tape.

■ And thank you all, and we can adjourn.

■ (Whereupon, at 5:00 p.m., the Roundtable was
■ adjourned.)

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