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FOREWORD

The past three years have been enormously active ones in the field of securities regulation. This period has seen the introduction of a major legislative program, the completion of the *Report of the Special Study of Securities Markets* (called "the most ambitious and comprehensive study since the passage of the securities acts thirty years ago"), publication of the Wharton School of Finance and Commerce's *A Study of Mutual Funds*, and a stream of landmark Commission and court decisions. In recognition of the great activity in the field, *Law and Contemporary Problems* decided to devote its Summer 1964 issue to a symposium on "Securities Regulation." A number of articles in this symposium touch on two developments whose impact on the structure of the capital market has been and will probably continue to be major. The first development relates to the fashioning of standards of conduct for the broker-dealer community which are consonant with the image of professionalism which that community has tried to project. The second development relates to the growing importance in the equity markets of the institutional investor. I would like to raise and briefly discuss some of the questions posed by these developments.

A prime concern of the Securities Act of 1933 is the sale to the public of securities by companies which need new money. Unlike the approach of some state laws, the Securities Act does not erect any standards by which the investment merits of such securities can be judged—and by which those failing to meet the standards can be barred from the capital market. The theory of the Securities Act is that if investors are provided with sufficient information to permit them to make a reasoned decision concerning the investment merits of securities offered to them, investor interests can be adequately protected without unduly restricting the ability of business ventures to raise capital. The primary responsibility for providing such information is placed on the company issuing the shares which are to be sold. Thus, thinking about the distribution of securities to the public has traditionally focused on the preparation and dissemination of the prospectus—the document which contains the basic information an investor should have. One of the important contributions of the Special Study was the emphasis it placed on the importance of point of contact selling in the distribution of securities to the public. The Special Study underscored what many people knew: That individual investors frequently did not use the prospectus as a

in equity purchases to their portfolios. Nowhere has the growth of the institutional investor been more dramatically shown than in the field of corporate pension plans. In 1949 they held \$500 million in stocks. Their present holdings of \$21.7 billion in stock represent an increase of over 4,000 per cent. Mutual fund assets (most of which are invested in equity securities) increased roughly eight times during the same period. These figures contrast sharply with the Special Study's report that in the eleven-year period 1951-61, individuals, together with personal trust funds and non-profit organizations, were net sellers of stock (excluding investment company shares) in the amount of \$400 million. The Special Study also pointed out that between 1951 and 1961 the net acquisition by institutions (excluding personal trusts and non-profit organizations) of equity securities slightly exceeded the total amount of corporate stock (excluding investment company stock) issued during this period. One of the characteristics of institutional investing noted by the Special Study is the tendency for holdings to be concentrated in relatively few securities—primarily in the securities of seasoned enterprises.

It is by no means clear what impact the institutional investor will have on the structure of the equity market. However, a few observations can be made. There is an increasing tendency for institutional investors (particularly institutions other than investment companies) to negotiate their purchases and sales in the over-the-counter market where they can avoid the minimum commission rate structure of the exchanges. In addition, the tendency to deal in large blocks of stock imposes strains on the existing specialist system. Institutional investors (particularly when investment companies are excluded) tend to have turnover rates lower than that experienced for all stocks listed on the New York Stock Exchange and, thereby, may eventually contribute to a thinning of the market in certain issues. Moreover, competition among various institutions for a limited number of stocks may be pushing the price of those stocks (and correspondingly lowering their yield) beyond the point where they will remain attractive to individual investors.

The discernible shift from direct investment by individuals in the equity market to indirect investment through financial institutions (a trend which probably will deepen because of the ability of such institutions through promotional campaigns and large, aggressive sales forces to tap public savings) should theoretically be a boon to the economy. Since financial institutions usually command the services of skilled financial counsel, they should be able to invest the money entrusted to them in the economically most promising enterprises. However, there does not seem to be any clear evidence of the over-all validity of that theory. Indeed, one of the special problems concerning institutional investors is their unwillingness to consider investment in smaller and more speculative enterprises.

To the extent that individuals invest in corporate securities through the medium of financial institutions rather than directly, their participation in corporate affairs becomes increasingly attenuated. On the other hand, corporate management becomes responsible to a smaller and more sophisticated group of persons. One of the

questions which grows out of this development is the extent to which the management of the financial institution has a right (or responsibility) to utilize the combined economic power it represents to influence the management of its portfolio companies. Moreover, the concentration of economic power in relatively few hands suggests the need to focus on the public responsibilities which the managers of these financial institutions acquire. Traditional corporate concepts concerning the duties of officers and directors to their corporations and shareholders may not be adequate.

One of the disturbing aspects of the growing importance of financial institutions in the equity markets is the paucity of informed discussion of some of the major problems connected with this development. To some extent such discussion may be inhibited by the inability to secure necessary information. For example, since only investment companies and insurance companies are generally required to make periodic, detailed disclosures of their portfolio holdings, it is impossible to get precise information concerning the portfolio holdings of financial institutions. Often there seems to be an unwillingness (for one reason or another) to grapple with what are tough questions. For example, when the Comptroller of the Currency expanded the regulations governing the activities of bank commingled funds to permit them "to compete more effectively with mutual funds and other investment companies," there was very little public discussion of the desirability of permitting banks to enter this aspect of the securities business. The problem which received public attention was whether the banks had to adhere to "mutual fund ground rules" when they went "the mutual fund way." The proposed legislative solution to the problem, the Bank Collective Investment Fund Act of 1963, sought to exempt interests in bank commingled funds from the application of the federal securities laws. It did so by stating that these interests did not constitute securities; and, thus, tried to obscure the important question of the extent to which banks should, in the light of the type of policy considerations underlying the Glass-Steagall Act, operate such funds.

Effective regulation requires an awareness that the activity subject to regulation is not static. Certainly, as the articles in this symposium make clear, the securities business has not remained static in the past thirty years. One of the important achievements of the Securities and Exchange Commission during William L. Cary's chairmanship has been its evident concern to find out what changes had occurred in the securities business and what changes were likely to occur and then to furnish appropriate regulatory responses. In his article, "Administrative Agencies and the Securities and Exchange Commission," Mr. Cary indicates that carrying out what he termed the program of rethinking problems of the Securities and Exchange Commission was not an easy one in light of the numerous forces which tend to make an agency confine its goals solely to the "conduct [of] its day-to-day work honestly and thoroughly without getting into any trouble." When an agency departs from the

“dusty road” and travels the broad boulevard of future development, it should be able to count on the academic community for companionship. In an effort to help provide some additional insights into the problems which the Commission is rethinking, the Duke University School of Law is sponsoring on November 6 and 7, 1964 a conference of lawyers, businessmen and academicians at which the questions raised in this Foreword will be discussed in depth.

ROBERT H. MUNDHEIM.