INDUSTRY REPS CRITICIZE, STUDY PEOPLE DEFEND
SEC'S INSTITUTIONAL INVESTOR STUDY AT ICI MEETING

Panelists expressed some disagreement about the utility of the SEC's recently issued Institutional Investor Study at the General Meeting of the Investment Company Institute here in Washington last week. Milton H. Cohen, who headed the SEC's Special Study in 1963, characterized it as "thin in recommendations." He noted that it was "weaker in those areas, some of them of extreme importance and urgency, that did not lend them selves to statistical analysis." Howard Stein, chairman of the Drefus Corporation, also criticized the Study, saying that he would have preferred "deeper answers to broader questions than found in the study." Richard B. Smith, SEC Commissioner in charge of the Study and Donald E. Farrar, director of the Study, defended it.

Mr. Farrar said he did not agree that a data oriented study, which he admitted this was, does not lend itself to policy conclusions. One important over-all conclusion that the Study reached, be said, was that there was a need for a central market-place composed of competing dealers. Mr. Smith also emphasized that the Study, whatever its shortcomings, was the "only organized body of research on this subject," and said that it would serve as a basic research tool for any upcoming securities acts. He also stressed the difficulties of making a study such as this.

Not the Last Step

Commissioner Smith said of the Study that "no one regards it as the last step." He himself, lie said, would have liked more examination of the problem areas, more "pathology analysis." According to Mr. Smith, this sort of analysis should be done on a continuous basis, not just once every ten years or so as it is now. In order to do this, however, the Commission would need more money and more staff than it presently has, he said.

Howard Stein also stressed the need for further study by the Commission. "I recognize," he said, "that issues that I personally hold important were [only] touched upon in this Report, from separation of function to the concept of a central market. The lack of time and resources may be the chief reason why these matters were not fully explored. Mr. Stein said that the industry should be ready to support the Commission's request for more money to increase its research capability. With regard to the Study's conclusion that negotiated rates will serve to mitigate the conflicts of interest caused by integrated financial activities, Mr. Stein said that "I have serious reservations that there will be more competition and less possible conflict of interest at the end of the negotiated rate trail than now."

For this reason, he said, "I was disappointed that this ultimate question of market structure and separation of functions was not probed to the depth." The Study seemed to give too much attention to relatively unimportant matters such as performance fees, valuation of restricted securities, hedge funds, etc., Stein contended. "I have no disagreement with the findings in these areas, but if studies of this magnitude come along only once in a generation, it is vital that they address questions basic to the industry's progress."

Mr. Stein said that "[i]t is time to take a new look at the financial industry and the laws and regulations that govern it." Alfred P. Johnson, ICI vice president and economist, agreed, saying the regulatory standards in the securities industry are not equitable.

Conflicts of Interest

With regard to conflicts of interest, Mr. Stein asked: "Should an investing institution have any responsibility other than to those who entrusted their money to it? I do not believe so.

"Should those who manage other people's money do anything else -- have corporate or other financial relationships that give the appearance of a conflict? I do not believe so.

"Should those who invest other people's money be in brokerage process itself? I do not believe so.

"Should one corporation be involved in both trust and commercial operations? I do not believe so, for even though conflict may not be prevalent, its appearance is there.

"And beyond this, if it is technically possible to create a real central market system in this country, with rules more understandable and access more in keeping with other traditions of the free society, would it not be in our interest to aggressively pursue this concept? I think so."

Too Few Conclusions

Mr. Cohen stressed that the Study needn't have been just economic or just regulatory, that it should have been both. He noted that the Study was very strong in its statistical data, but pointed out that Chapter 15, which was not looked at statistically, resulted in some fairly concrete recommendations in contrast to the other chapters. Chapter 15 concerns the relationship of institutional investors to portfolio companies.

Mr. Cohen also said that the Study was unable to express regulatory conclusions because its research design was more suited to other kinds of conclusions. During the question period, Mr. Cohen said that the consequences of unbundling, which is recommended by the Study, are unknown. No one knows what new equilibrium will develop after unbundling, he said, or what the problems of this new equilibrium will he. He mentioned the problem of block positioners as one that would have to be solved in light of negotiated rates and unbundling.

Institutional Membership

On the question of institutional membership, all speakers agreed that it is not a desirable development.

Howard Stein said that "institutional membership is but another step toward potential conflict of interest, and the lessening of shareholder credibility in our definition of the fiduciary relationship." Donald Farrar agreed, saying that institutions should not be forced to become members of the exchanges in order to protect their competitive position. Although he agreed with this, Mr. Cohen felt it unfortunate that the Study didn't give a better basis for making this decision. There is an indication, he said, that this problem is being dealt with by inaction. Commissioner Smith advanced the opinion that some of the artificial incentives to membership should be removed and probably will be removed with the institution of negotiated rates. He also noted that institutional membership was not the only question the study had to deal with.