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A BRIEF HISTORY OF FEDERAL INVESTMENT COMPANY LEGISLATION*

*Walter P. North***

I. Introduction and Scope

As its title implies, this article is devoted primarily to furnishing a brief, but hopefully an accurate and reasonably complete, factual chronology of federal legislation and proposed legislation dealing with investment companies. In addition, at least the more important background materials which are parts of the legislative history in that area will be outlined. No pretense is made of providing critical analyses or legal interpretations of any aspect of either existing legislation or bills which have been introduced in Congress from time to time but failed to be enacted. Presumably, however, some apparent expressions of views will result, at least impliedly, from the process of narrating this history. Also, to a lesser extent the content, objectives and purposes of various bills designed to provide regulation of the investment company industry will appear.¹

II. Developments Prior to the Advent of the Original Investment Company Bill

The Securities Act of 1933² and the Securities Exchange Act of 1934³ mark, of course, the beginning of securities legislation at the federal level, and, to this day, they are the basic Acts covering the issuance and purchase and sale of securities generally. It was recognized virtually from the start, however, that these Acts were essentially designed to protect investments by the public in traditional types of securities, such as those commonly issued by commercial and industrial corporations and sold to the public and traded on exchanges and in the over-the-counter market. They were not geared to the protection of those who invest in mutual funds or other types of investment companies. The full disclosure requirements and the antifraud provisions which are the basic concepts on which the 1933 and 1934 Acts are founded do not, standing alone, provide all of the types of protections needed in the investment company industry — an industry which is made up essentially of large liquid pools of funds entrusted

* Editor's Note: At Mr. North's request, many of the references that would ordinarily be contained in footnotes are included in the text of this article.

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The author is very much indebted to Francis M. Divilio, a colleague of his in the Office of the General Counsel, who has been a staff attorney at the Securities and Exchange Commission since 1946 and who in recent years has devoted much of his time to legislative matters. "Frank" has spent many hours on the spadework which necessarily precedes the publication of an article such as this. While the author assumes full responsibility for everything stated herein, he is deeply grateful to Frank for much helpful assistance.

¹ To the extent that views are expressed in this article, they are solely those of the author. The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication by any of its employees and such publications do not necessarily reflect the position of the Commission or of other members of its staff.

² 15 U.S.C. §§ 77a to 77aa (1964).

³ 15 U.S.C. §§ 78a to 78hh-1 (1964).

by the investing public to investment companies and their managements for investment in corporate enterprises, hopefully at a profit to the public investors.

The first true investment companies of any size in the United States were formed in 1924. There was a fairly rapid increase in such companies, particularly of the closed-end variety, during the next few years, but speculative frenzy in the late 1920's, the market crash in November of 1929 and the depression in the early 1930's combined to deal them a nearly fatal blow. As these events transpired it became evident, at least by the mid-1930's, that there were evils, abuses and deficiencies in the organization and operation of this industry which needed to be ferreted out and dealt with in some effective manner which would restore public confidence in the industry — a manner which would provide public investors with safeguards beyond those afforded by the first two federal securities laws. *Investment Companies* 1968 contains a brief but, for present purposes, adequate account of these developments.⁴ The specific abuses and shortcomings which existed in the investment company industry during this period are recited and documented throughout the reports and hearings which are hereinafter cited and discussed.

The need for additional regulation directed to the particular problems then existing in the investment company industry was recognized, or at least strongly suspected, by Congress as early as 1935, the year in which it enacted the Public Utility Holding Company Act.⁵ Section 30 of that Act directed the Securities and Exchange Commission to make a study of investment trusts and to report to Congress the results of its study and its recommendations by January 4, 1937.⁶ This congressional mandate resulted in such an exhaustive study (commonly called the Investment Trust Study) that it could not be completed and fully reported to Congress by the date originally specified. Indeed, the Commission's *Report on the Investment Trust Study* was submitted in several parts over a period of time and was accompanied by six supplemental reports.⁷

4 ARTHUR WIENBERGER SERVICES, INVESTMENT COMPANIES 1968 at 10-12 (1968).

5 15 U.S.C. §§ 79 to 79z-6 (1964).

6 The full text of the relevant portion of this section reads as follows:

The Commission is authorized and directed to make a study of the functions and activities of investment trusts and investment companies, the corporate structures, and investment policies of such trusts and companies, the influence exerted by such trusts and companies upon companies in which they are interested, and the influence exerted by interests affiliated with the management of such trusts and companies upon their investment policies, and to report the results of its study and its recommendations to the Congress on or before January 4, 1937. 15 U.S.C. § 79z-4 (1964).

7 Officially designated *Report of the Securities and Exchange Commission on Investment Trusts and Investment Companies*, Part I of this *Report* was transmitted to Congress on June 10, 1938 and was ordered printed as H.R. Doc. No. 707, 75th Cong. 2d Sess. (1938). Most of the other parts and supplemental reports followed in 1939, and in early 1940 when the first investment company bill (discussed *infra*) was introduced in Congress. (A table listing all of the parts of the *Report* that were transmitted to Congress up to the time the Senate Hearings on the original investment company bill began on April 2, 1940 and all six of the supplemental reports, together with the date of transmission and the House Document Number of each, is set forth in *Hearings on S. 3580 before a Subcomm. of the Senate Comm. on Banking and Currency*, 76th Cong., 3d Sess., pt. 1, at 307 [hereinafter cited as *Hearings or Senate Hearings*].) However, chapter VII of part III of the *Report* (Abuses and Deficiencies in the Organization and Operation of Investment Trusts and Investment Companies) was not transmitted to Congress until February 24, 1941 — after the Investment Company Act was passed and parts IV (Control and Influence Over Industry and Economic Significance of Investment Companies) and V (Conclusion and Recommendations) were not transmitted until June 9, 1941. These portions of the *Report* were printed as H.R. Doc. Nos. 136

On a narrow view of what constitutes legislative history it can sometimes be said that the history of a law does not begin until its first version is introduced in Congress and hearings are commenced on it. Such a test would peg the legislative history in this instance as starting March 14, 1940 when the original version of a bill to regulate investment companies was simultaneously introduced in both the Senate and the House of Representatives during the third session of the seventy-sixth Congress (S. 3580 and H.R. 8935) and April 2, 1940 when the Senate hearings began. (The record of those hearings is captioned *Hearings on S. 3580 before a Subcomm. of the Senate Comm. on Banking & Currency* [hereinafter cited as *Hearings* or *Senate Hearings*].) Such a narrow view of legislative history is, however, totally unrealistic with respect to the Investment Company Act. At the latest its legislative history began when the Commission conducted its Investment Trust Study and prepared and submitted to Congress its voluminous *Report* and supplemental reports thereon.

Any attempt to summarize or outline in any detail the substance of such an extensive *Report* and its supplements is beyond the scope of this article. Nevertheless, the importance of these documents as integral parts of the legislative history of the Investment Company Act cannot be overemphasized. They provide the immediate backdrop for the initial investment company draft bill which the Commission submitted to Congress and which, as just noted, was introduced in both houses on March 14, 1940. It is also significant that these reports were repeatedly cited and quoted throughout the hearings on the bill (discussed *infra*) and are prominently referred to in the opening section of the Investment Company Act of 1940 as finally enacted.⁸ This section is entitled "Findings and Declaration of Policy" and both of its subsections, (a) and (b), recite that they are founded "[u]pon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 30 of the Public Utility Holding Company Act of 1935" as well as on facts otherwise obtained.

Despite the limitations on this article which have just been noted, attention is directed to the fact that many thousands of man-hours of persons on the Commission staff were devoted to the Study and to the ensuing *Report*. From start to finish this extensive project was conducted under the guiding hand of the late Commissioner Robert E. Healy, affectionately known to all as Judge Healy. He was one of the five original Commissioners who took office when the Securities and Exchange Commission was created in 1934 and he continued as a Commissioner until his death in 1946. His tenure on the Commission was the longest in the thirty-five years of its existence. Numerous members of the staff of the SEC (notably David Schenker, who was Chief Counsel throughout the Investment Trust Study) made major contributions, and they received a vast amount of information and assistance from many people outside of the Commission who were knowledgeable in

and 246, 77th Cong., 1st Sess. (1941). In a technical sense these parts of the *Report* may not be a part of the legislative history of the Investment Company Act, which had become law before they were transmitted to Congress. Nevertheless, they shed much light on the aspects of the investment company industry problems with which they deal.

⁸ 15 U.S.C. §§ 80a-1 to 80a-52 (1964). This Act was approved on August 22, 1940 as Pub. L. No. 76-768, 54 Stat. 789.

the investment company industry. Anyone who really wants to know the "whys and wherefores" of the Investment Company Act must necessarily familiarize himself with this *Report* and its supplements.

III. Steps in the Enactment of the Original Investment Company Act of 1940

The draft bill which the Commission submitted to the seventy-sixth Congress and which Senator Robert F. Wagner of New York⁹ introduced in the Senate as S. 3580 on March 14, 1940 was entitled as a bill "[t]o provide for the registration and regulation of investment companies" and for other purposes not germane to this article.¹⁰ This bill was the original version or, perhaps more accurately, the forerunner of the Investment Company Act of 1940. However denominated, original version or forerunner, the Commission's draft bill which was introduced as S. 3580 underwent very material changes (a development discussed *infra*) before the Investment Company Act of 1940 ultimately emerged. Moreover, the bill which was later reported out on the Senate side after lengthy hearings was not S. 3580 but a substitute bill, S. 4108, which embodied the numerous intervening changes. In fact, though of historical interest only, it was a House bill, not a Senate bill, which was finally enacted and approved by the President as Public Law Number 76-768 on August 22, 1940.¹¹ Nevertheless, by far the more significant part of the story of the enactment of the Investment Company Act of 1940 [hereinafter the Act] unfolded on the Senate side where the original and much more detailed hearings were held as a result of which the Commission's original draft bill evolved into the ultimate Act. Indeed, this evolution had already occurred before there were any hearings in the House of Representatives and the hearings there were not much more than a formality after the fact.

For the reasons just stated this article dwells largely on the Senate pro-

9 Senator Wagner was then Chairman of the Subcommittee on Securities and Exchange of the Senate Committee on Banking and Currency, the subcommittee which held the Senate hearings on this bill.

10 Both S. 3580 and the Investment Company Act of 1940 as finally adopted contain provisions which are not pertinent here. As to the latter this article is concerned only with Title I, captioned "Investment Companies," 15 U.S.C. §§ 80a-1 to 80a-52 (1964), not Title II covering "Investment Advisers," 15 U.S.C. §§ 80b-1 to 80b-21 (1964), or Title III which was an amendment to section 8(a) of the Securities Act of 1933, 15 U.S.C. § 77h (1964), dealing with the effective date of registration statements generally, not just those covering investment company shares. Although the vast majority of investment companies employ investment advisers, the Investment Advisers Act is not generally relevant for present purposes because section 203(b)(2), 15 U.S.C. §§ 80b-3(b)(2) (1964), of that Act exempts from registration under it "any investment adviser whose only clients are investment companies" The antifraud provisions of that Act as amended in 1960 (Act of Sept. 13, 1960, Pub. L. No. 86-750, § 8, 74 Stat. 887) do, however, apply to all investment advisers including unregistered ones whose clients are investment companies. Investment Advisers Act § 206, 15 U.S.C. § 80b-6 (1964).

11 On the House side the counterpart of the original S. 3580 was H.R. 8935, but here too the bill eventually reported out was a substitute, H.R. 10065, the counterpart of S. 4108. S. 4108 was reported to the floor of the Senate without amendment. While H.R. 10065 was reported on the House side with numerous amendments, most of these were technical and clerical in nature, and it was this House bill, rather than its Senate counterpart, which was ultimately enacted into Public Law Number 76-768, 54 Stat. 789.

ceedings, which led to the passage of the Act, not the House proceedings. For the sake of completeness, however, the following developments on the House side are noted briefly. The original House bill, H.R. 8935, introduced March 14, 1940, was supplanted by H.R. 10065, an exact counterpart of the substitute Senate bill, S. 4108, which was forthcoming after the Senate hearings. House committee hearings on H.R. 10065 were held on June 13 and 14, 1940. *Hearings on H.R. 10065 before a Subcomm. of the House Comm. on Interstate and Foreign Commerce*, 76th Cong., 3d Sess. This bill was reported out of committee to the floor of the House of Representatives with numerous, though mostly non-substantive, amendments (H.R. REP. No. 2639, 76th Cong., 3rd Sess.) and, as stated earlier, this bill eventually became the Act when the President approved it on August 22, 1940.

Returning to the Senate, hearings were held by the Securities Subcommittee of the Banking and Currency Committee for four virtually solid weeks in April of 1940. In fact, between April 2 and April 26 there was only one weekday when the hearings were not in session (parts I and II of the *Hearings*). Judge Healy and Chief Counsel Schenker pulled the laboring oars for the Commission and were ably and extensively assisted by other members of the Commission and its staff and numerous written statements, memoranda and exhibits were put into the record on behalf of the Commission. On the side of industry there were dozens of witnesses and again many statements, memoranda and exhibits. Without belittling the important role of many others it should be noted that Alfred Jaretzki, Jr., Esquire, of New York City was lead counsel for the closed-end investment companies (*Hearings* at 1107, 1130) which at that time represented more than half of the entire industry in terms of total assets though in more recent years the open-end companies, the so-called mutual funds, have far outdistanced the closed-end segment of the industry.¹² Warren Motley, Esquire, of Boston, Massachusetts, who originally testified only in his capacity as counsel for Massachusetts Investors Trust, emerged as the principal spokesman for the open-end companies. *Hearings* at 651, 1109.

Review of the entire contents of these hearings is beyond the scope of this article but, like the Commission's *Report on the Investment Trust Study*, they are a must for any serious student of the Act as well as for any attorney whose clients have investment company problems. Without attempting to deal with them substantively, two aspects of these hearings are noted as outstanding, if not unique:

- (1) They disclosed virtually no disagreement between industry and the Commission on the question of the need for regulation of some kind to curb abuses and correct deficiencies in the investment company field.¹³

12 After 1929, closed ends lost much of their former favor with investors, but not until 1944 did the aggregate assets of mutual funds exceed those of the closed-end companies. By June 30, 1966, the assets of mutual funds were almost six times those of the closed-end companies. On that date there were 379 mutual funds registered with the Commission, with total assets of approximately \$38.2 billion, as against 149 active closed-end companies with total assets of about \$6.6 billion. SEC, REPORT OF THE SEC ON THE PUBLIC POLICY IMPLICATIONS OF INVESTMENT COMPANY GROWTH, H.R. REP. No. 2337, 89th Cong., 2d Sess. 43-44 (1966).

13 Near the close of the April 26 session of the hearings, which was the last session at

(2) They led to a jointly sponsored bill which had the firm endorsement of both the Commission and the industry.¹⁴

The first of these two points must not be over-read. Although practically everyone acknowledged that the industry was plagued with ills, indeed with evils and abuses in some instances, and that some measure of regulation was necessary to protect public investors and restore public confidence, the hearings brought out a wide divergence of views as to the *nature and extent* of the regulation required to cure those ills. The extent of this difference of opinion is reflected, in part at least, by the changes which evolved between the introduction of the Commission's original draft bill as S. 3580 and the Act as finally approved. A Note in an issue of the *Yale Law Journal* which was published soon after the passage of the Act recites what happened in this regard rather aptly and succinctly. After observing that some extremists thought that "[t]he whole investment company industry was a parasite" which presumably should be abolished, this Note continues:

While it was never seriously proposed to outlaw investment companies entirely, the original bill for federal regulation, submitted by the SEC to Congress last March, surpassed even the Holding Company Act in grants of discretionary power to the Commission. Whether it would have been politically possible to pass the bill in its original form is questionable. At any rate, the present Act is a drastic modification, rewritten entirely by the Commission and the industry, and passed by Congress without debate as a tribute to the cooperative spirit which fathered it. Where the original draft left the Commission with power by rule and regulation to implement the broad policies of the bill, the present Act generally sets certain maxima of regulation, leaving in the Commission a discretionary power only to exempt and minimize.¹⁵

Near the end of the May 31st session of the hearings, Mr. Schenker indicated "broadly what are the differences between the revised proposals and the original proposals." *Hearings* at 1110-22. Subject to cautionary considerations this testimony is helpful in understanding the principal changes. It is interspersed, however, with colloquy in which he was drawn into discussing aspects of the bill other than changes from its original version and, to the extent that there were a few changes even after May 31, his testimony is not to be relied upon. In this latter category, for example, is his discussion of the rule-making provisions of the bill which were altered after that date. *Hearings* at 1120-22.

which witnesses were called to testify, Judge Healy who had been present throughout the hearings remarked: "I have heard but one witness, out of all those who appeared here, who went on the witness stand and said that there should be no regulation." *Hearings* at 1051.

14 At the May 31 session of the hearings, in announcing that agreement had been reached between the industry and the SEC as to recommendations to be made to the subcommittee, Judge Healy said: "[A]s the bill is now written it has the endorsement of the Securities and Exchange Commission, and it has the endorsement of the industry." *Hearings* at 1106. Mr. Jaretzki, who followed Judge Healy, stated on behalf of the closed-end companies that "I want to endorse thoroughly everything that Judge Healy has said." *Id.* at 1107. He also remarked that "we feel that this bill is not only a workable bill, but a bill which is a good thing for the industry. We would like very much to see it passed, and we hope very much that it can be passed at this session." *Id.* at 1109. Mr. Motley, who followed Mr. Jaretzki, expressed his "complete endorsement of everything that has been said, both by Judge Healy, and Mr. Jaretzki." *Id.* at 1109.

15 Note, *The Investment Company Act of 1940*, 50 *YALE L. J.* 440, 442-43 (1941).

Turning to the second outstanding aspect of the hearings — the emergence of a bill sponsored by both the industry and the Commission — it has frequently been said in the corridors of the SEC and by old timers in the legal profession who had a hand in fashioning it back in 1940 that the Act became a reality only because the Senate Subcommittee which considered the original bill, in effect, “knocked heads together” and forewarned that if there were to be any investment company legislation during the seventy-sixth Congress it would have to have the endorsement of both industry and government. There appears, however, to be little or no recorded legislative history to justify this position.

Perusal of the record of the April hearings which are in excess of one thousand pages discloses a generally congenial atmosphere as between witnesses for the Commission and for the industry. As indicated earlier, however, there was a wide divergence of views throughout the April sessions. Perhaps even more significantly, this record does not appear to contain any testimony from anyone on either side or any suggestion from any member of the Subcommittee which specifically stated that they should try to or could get together to agree on a jointly sponsored bill. Indeed, as of the close of the April 26th session the Subcommittee did not adjourn temporarily or go into recess to permit industry and Commission representatives to confer. On the contrary, after the last witness had been heard that afternoon, Senator James H. Hughes, who was then presiding in the absence of Chairman Wagner, announced simply: “The hearings are closed. If there is a further meeting the chairman will call it.” *Hearings* at 1059. Finally, when Chairman Wagner submitted the Subcommittee’s Report recommending enactment of S. 4108, he wrote on the opening page:

Almost immediately after the conclusion of the hearings, representatives of the investment companies and of the Securities and Exchange Commission advised the chairman of the subcommittee that they believed it might be possible for them to reach a common ground and to submit a joint recommendation as to the scope and provisions of the bill. The chairman encouraged them in this endeavor, and as a result of their cooperative efforts, the substitute bill (S. 4108) was drafted.¹⁶

Thus again there was no reference to the fact that resolution of differences had been urged from Senate sources. However, one must not be so naive as to overlook the possibility that in an area such as this at least a little something and perhaps a lot may have gone on “off the record.” This possibility finds some support in a statement made after the fact, namely, in the final part V of the Commission’s *Report on the Investment Trust Study* which, as noted earlier, was transmitted to Congress June 9, 1941, nearly a year after the Act had become law. After relating that there were extensive Senate hearings and vigorous industry opposition to some features of the original bill, this portion of the *Report* states on page 383:

The Banking Committee suggested that the Commission and the investment company industry work out a measure which would be acceptable to both the Commission and the industry. Such a bill was prepared and was jointly

16 S. REP. NO. 1775, 76th Cong., 3d Sess. 1 (1940).

recommended by the Commission and the industry for passage by the Congress.

Whether the jointly sponsored bill was prompted by Senate suggestion or was solely the spontaneous result of the desire of industry and the Commission to secure mutually acceptable legislation, it was assuredly an amazing accomplishment. Indeed, at least one member of the Subcommittee, Senator Sheridan Downey, found it very difficult to believe that such a thing had happened. Near the close of the last day of the hearings the following colloquy occurred:

Senator DOWNEY. Do I understand that the representatives of the investment trusts and of the Securities and Exchange Commission are virtually in agreement now?

Senator WAGNER. Not virtually but actually in agreement.

Senator DOWNEY. That is a most amazing thing in this chaotic world right now.

Senator WAGNER. I think it is.

Senator DOWNEY. It is really the first encouraging thing I have heard in several weeks. How was this miracle brought about? *Hearings* at 1130.

One final observation about the original Act stems from this very unusual manner in which it came into being, namely by agreement between the industry which was to be regulated by the remedial provisions of the Act and the government agency which was to administer those provisions and, when necessary, to enforce them against members of that very industry. That singular background has led to conflicting arguments that have been urged by legal advocates and adopted by courts in construing the Act. This has gone on for over twenty-eight years in instances too numerous to cite, but the principal thread of the opposing positions may be stated briefly. On the one side it is argued that the Act is remedial in character and is a marked extension of the concepts underlying the earlier federal securities laws enacted in 1933 and 1934 which proved to be inadequate in the investment company field and that this Act should accordingly be construed broadly to accomplish its remedial purpose of affording adequate protections for public investors in that particular field. The argument to the contrary is that it is ridiculous to assume that representatives of the industry to be regulated by the Act would ever consent to broad sweeping restrictions and prohibitions and that this position is supported by the fact that the harsh regulatory pattern of the Commission's original draft bill was very materially watered down by extensive compromise to which the Commission had to agree in order to secure industry's concurrence in the Act.¹⁷

¹⁷ A single example of these contrasting views is presented by two leading cases in this area. In *Brouk v. Managed Funds, Inc.*, 286 F.2d 901 (January 1961), when considering whether the Act should be construed to provide implied causes of action, the Court of Appeals for the Eighth Circuit quoted from the statement of Senator Henry Cabot Lodge on the floor of the Senate on June 21, 1940:

This bill . . . was agreed upon after very painstaking and careful study, in which really almost a miracle occurred . . . an agreement which is embodied in this bill was reached between those engaged in the industry and the members of the S.E.C. I submit that that is a very unusual and very beneficial occurrence—. *Id.* at 912.

The opinion then concluded that "[i]t seems improbable that there would have been such

IV. Amendments to the Act Since 1940

Difficult as it may be to realize that the Act ever came into being in the manner in which it did in 1940, it seems equally incredible that this Act has never been substantively amended in any really significant way during the intervening twenty-eight to twenty-nine years. Lack of any very noteworthy amendments is particularly hard to understand in view of the compromise nature of the original Act which would seem to suggest that it might well prove to be inadequate in ways which would require substantial amendments. Nevertheless, Congress has seen fit to amend it in only a few respects which are largely technical in character or at most procedural rather than substantive. In the interest of completeness, however, all of these amendments are here listed, but without discussion except in the few instances in which a substantive aspect of the Act appears to be affected to at least some extent. On a section-by-section basis the amendments to the Act are as follows:

1. Section 2(a)(30) was amended in 1954 so that "prospectus" as used in section 22 means a written prospectus such as is required by section 10(a) of the Securities Act of 1933¹⁸ rather than by Section 5(b) of that Act,¹⁹ as stated in the original Investment Company Act. Act of Aug. 10, 1954, Pub. L. No. 83-577, 68 Stat. 683, 689. The original reference to section 5(b) instead of to section 10(a) of the Securities Act is believed to have been an inadvertent error. Section 5(b) prohibits the use of the mails or interstate facilities to transmit a prospectus relating to a registered security "unless such prospectus meets the requirements of section 10" or to transmit a security pursuant to a sale thereof unless it is "accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 10,"

unanimity for the passage of the Act if it had been thought to impose any such per se liability on directors as is claimed by plaintiffs here." *Id.* at 912. About two months later in *Brown v. Bullock*, 194 F. Supp. 207 (March 1961), District Judge William B. Herlands of the Southern District of New York noted this view in *Brouk* and said: "This court is in respectful disagreement with the views expressed in the *Brouk* case to the extent that they restrictively interpret the 1940 Act. The opinion herein articulates the basis for such divergence." *Id.* at 247. Elsewhere in his opinion Judge Herlands further refuted the view that "the Act was a 'compromise' accepted by the industry and that industry would not voluntarily submit to such duty or to such a cause of action." *Id.*, n.1 at 240. He also went on to say that

The indifference to federal civil liability for "gross misconduct or gross abuse of trust" attributed by defendants to Congress cannot be reconciled with the emphatically expressed purpose of Congress to eliminate those very evils and to protect investors against those very abuses. *Id.* at 246.

Although noted here primarily to illustrate arguments made by advocates and reasoning used by courts in construing this so-called "compromise" Act, what subsequently happened in these two cases may be of interest. Judge Herlands' decision in *Brown* was affirmed on appeal, on narrower grounds in certain respects, 294 F.2d 415 (2d Cir. 1961), but the upper court nevertheless noted that it did not necessarily regard *Brouk* as distinguishable from this case and stated that "[s]o far as it is not, we must respectfully disagree, to the extent indicated herein." *Id.* at 422. Meantime certiorari was granted in *Brouk*, 366 U.S. 958 (1961), but before the case was argued there was a settlement between the parties which prompted the Supreme Court to vacate as moot the decision below, 369 U.S. 424 (1962). Later, after the Supreme Court in *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964), rejected the principle of *Howard v. Furst*, 238 F.2d 790 (2d Cir. 1956) — the case on which the *Brouk* court had principally relied — the Eighth Circuit in *Greater Iowa Corp. v. McLendon*, 378 F.2d 783 (1967), virtually acknowledged that its decision in *Brouk* was no longer sound law. *Id.* at 793.

18 15 U.S.C. § 77j (1964).

19 15 U.S.C. § 77e (1964).

but does not purport to prescribe what shall be contained in a prospectus. It is section 10, headed "Information Required in Prospectus," which performs that function. Thus, this amendment merely corrected what was apparently a technical error in the drafting of the original Act.²⁰

2. Section 2(a)(37) and section 6(a)(1) were amended to eliminate references to the territories of Alaska and Hawaii when they were admitted to statehood. Act of June 25, 1959, Pub. L. No. 86-70, 73 Stat. 141, 143; Act of July 12, 1960, Pub. L. No. 86-624, 74 Stat. 411, 412. References to the Philippine Islands in these two sections have also been eliminated, but their elimination was by Presidential Proclamation Number 2695, effective July 4, 1946, granting independence to the Philippines, and not by statutory amendment.

3. Section 3(c)(4), a provision in the original Act which exempted bank holding company affiliates of the types therein described from being investment companies within the meaning of the Act, was repealed in 1966. Act of July 1, 1966, Pub. L. No. 89-485, 80 Stat. 236, *repealing* 15 U.S.C. § 80a-3(c)(4) (1964), reported at 15 U.S.C. § 80a-3(c)(4) (Supp. III, 1968). This amendment was but one part of a bill (H.R. 7371) which was designed to strengthen the Bank Holding Company Act of 1956²¹ in numerous respects. Its details are not relevant here but may be explored by reference to the *Senate Report of the Banking and Currency Committee on H.R. 7371*, which is S. REP. No. 1179, 89th Cong., 2d Sess. (1966). (This *Report* is reproduced in 1966 *U.S. Code Cong. & Adm. News* 2385.)

4. Section 3(c)(13) was amended in 1942 by adding to the reference contained therein to section 165 of the Internal Revenue Code the words "as amended." Act of Oct. 21, 1942, Pub. L. No. 77-753, 56 Stat. 798.

5. Sections 8(e) and 40(a) were amended in 1960 to authorize the use of certified mail (which did not exist in 1940), as well as registered mail, in giving notice under those sections of the Act. Act of June 11, 1960, Pub. L. No. 86-507, 74 Stat. 200.

6. Section 18 was amended in 1958 by the addition of a subsection (k) which exempted from certain provisions of that section of the Act "investment companies operating under the Small Business Investment Act of 1958" (Act of July 18, 1958, Pub. L. No. 85-536, 72 Stat. 384) which had just been approved on July 18, 1958. This amendment (Act of Aug. 21, 1958, Pub. L. No. 85-699, 72 Stat. 690) reflects an apparent belief by Congress that certain provisions of section 18 of the Act did not need to apply to a company that was both an investment company and a small business investment company in

20 The House Report suggests that this amendment was "for purposes of clarity and simplification." H.R. REP. No. 1542 ON S. 2846, 83d Cong., 2d Sess. (1954), reprinted in 1954 *U.S. Code Cong. & Adm. News* 2973, 3002. From a realistic viewpoint, however, it is difficult to regard this amendment as anything except a correction of an error in draftsmanship.

21 12 U.S.C. §§ 1841-48 (1964).

view of the extensive manner in which the Small Business Administration Act of 1953 was rewritten by the 1958 Act.²²

7. Section 24 was amended in 1954 by adding what is now the last sentence of subsection (d) and by adding all of Subsection (e). Act of Aug. 10, 1954, Pub. L. No. 83-577, 68 Stat. 683. This was a truly substantive amendment though of somewhat limited scope. For present purposes it may be stated briefly, but perhaps not too precisely, that the effect of the addition to subsection (d) is to require the use of a prospectus by dealers in investment company shares offered on a continuous basis over a period of time longer than is required for other types of securities, except to the extent that the Commission may relax this requirement by prescribing rules. The addition of subsection (e) to section 24 was probably the most significant substantive amendment which has thus far been enacted. It was a boon to a very wide segment of issuers, underwriters and dealers in investment company shares, not to mention the staff of the Commission. Indeed, it applies to all redeemable securities issued by open-end management companies (which constitute by far the major part of the whole industry) and by unit investment trusts as well as to all securities issued by face-amount certificate companies. The original Act called for registration of investment company shares in compliance with the registration provisions under the 1933 Act. That pattern of registration requirements was tailored to fit the registration of securities by typical commercial and industrial corporations which ordinarily issue a separate block of stock each time they wish to raise additional equity capital and it proved to be highly burdensome and unwieldy when applied to continuous offerings by investment companies. Through a combination of staff ingenuity and industry cooperation in voluntarily entering into various undertakings, an administrative practice, the details of which are not important here, was devised which afforded considerable relief from an otherwise virtually intolerable situation. It was not until the advent of subsection (e), however, that there was any statutory basis for registering continuous offerings in a manner specifically geared to their characteristics and yet assuring protections to the investing public comparable to those afforded by the 1933 Act registration system. This subsection provides simply and in essence that the original registration of a continuous offering may remain in effect quite indefinitely, provided it is updated periodically by the filing of appropriate amendments and the payment of additional registration fees as the amount of the securities covered by that registration is increased from time to time.²³

8. Section 43 was amended in 1949 to change the original reference to "circuit court of appeals" to read "court of appeals." Act of May 24, 1949, Pub. L. No. 81-72, 63 Stat. 89. This section was

22 Though not pertinent here, the legislative history of this development may be examined by reference to 1958 *U.S. Code Cong. & Adm. News* 3071.

23 For further details, see H.R. REP. No. 1542, 83d Cong., 2d Sess. (1954), reprinted in 1954 *U.S. Code Cong. & Adm. News* 2973, 3002-04.

further amended in 1958 as to certain procedural steps which follow the filing of a court petition for review of an order of the Commission. Act of Aug. 28, 1958, Pub. L. No. 85-791, 72 Stat. 941.

9. Section 46(b) has been directly and indirectly amended by a number of subsequent developments which are not of any particular interest here. Suffice it to state that this is the section which originally empowered the Commission to hire and fix the salaries of certain personnel needed to administer the Act "without regard to the provisions of other laws" and to hire and fix the salaries of other necessary officers and employees subject to the then existing civil service laws, including the Classification Act of 1923, as amended. The civil service concepts of what government employees belong to what categories, both grade-wise and salary-wise, have been enlarged and changed very materially since 1940. Some of these changes supersede *pro tanto* earlier provisions of various laws such as those contained in the original text of section 46(b) of the Act. See, e.g., the Classification Act of 1949, Act of Oct. 28, 1949, Pub. L. No. 81-429, 63 Stat. 972.

It is apparent from a quick glance at the above numbered items that item 5 and the 1958 amendment in item 8 are procedural, that item 9 is a matter of internal operation of the Commission, and that all of the rest are technical changes — except items 3, 6 and 7 which do have some, but not really a very extensive, effect on the substance of the Act. This paucity of truly significant changes in a period of nearly twenty-nine years, remarkable as it may be, should not be regarded as indicating that there is no room for improvement in the Act. Indeed, certain intervening studies which are next considered were designed in large part to uncover its possible shortcomings.

V. Recent Studies in the Investment Company Area

Investment companies, particularly mutual funds, grew rapidly after the Act was passed in 1940,²⁴ and the Commission had its hands full in trying to administer and enforce it adequately.²⁵ Factors such as these may account at least partially for the fact that until 1958 no comprehensive study was made with a

24 The Commission's *24th Annual Report to Congress* (covering the fiscal year which ended June 30, 1958) contains a table which shows that the estimated aggregate market value of the assets of all investment companies registered with the Commission on June 30, 1941 (the close of the first fiscal year during which the Act was in effect) was \$2½ billion and that by June 30, 1958 this value had burgeoned to \$17 billion. SEC, 24th ANNUAL REPORT 147 (1959).

25 The Commission's REPORT, *supra* note 24, at 148 recites that "the Commission has initiated a regular program for the periodical inspection of investment companies" under which nine companies were inspected in fiscal 1957 and seven were inspected in 1958. With 453 companies registered at the close of the latter year and at the average rate of eight inspections a year, it would have taken over fifty-six years to complete one cycle of inspections of all investment companies. This presents a shuddering contrast with inspections of national banks and federal savings and loan associations, all of which were then, as now, audited once each year. It is all the more shocking in view of the ease with which the very liquid assets of investment companies, if improvidently managed, can dwindle away in one fashion or another while banks and savings and loan associations are restricted to investing in assets which are considerably more stable.

view to evaluating the effectiveness of the Act or discovering ways in which to improve it.

In 1958 the Commission requested the Securities Research Unit of the Wharton School of Finance and Commerce of the University of Pennsylvania to make a study of mutual funds and to report the results to the Commission. This was done under section 14(b) of the Act which grants the Commission authority to study and investigate certain aspects of the investment company industry whenever it "deems that any substantial further increase in the size of investment companies creates any problem involving the protection of investors or the public interest." As this study progressed, certain practices and developments were revealed which led to enlargement of its scope. As a result, it was not completed and the report on it was not transmitted to the Commission until August 9, 1962. The Commission, in turn, transmitted the report to Congress where it was printed as a House Report. H.R. REP. No. 2274, 87th Cong., 2d Sess. (1962). This report is commonly referred to as the *Wharton School Report* and its scope and depth are indicated, in some small measure at least, by the fact that it is nearly 600 pages in length. Large portions of it are required reading for anyone who desires not only to understand what happened in the mutual fund field in the first twenty years that the Act was in effect but also to appraise what may need to be done to strengthen its effectiveness. It also contains a major part of the legislative history of recent unsuccessful attempts to amend the Act in various substantive ways, a subject discussed later.

The next, in fact an overlapping, development in this area originated with the adoption of H.J. Res. 438, 87th Cong., 1st Sess., which was approved on September 5, 1961 as Public Law Number 87-196, 75 Stat. 465. This was in the form of an amendment to the Securities Exchange Act of 1934. It added subsection (d) to section 19 of that Act,²⁶ which authorized the Commission to make a study of the "adequacy, for the protection of investors, of the rules of national securities exchanges and national securities associations."²⁷ A special staff was set up to devote full time to this study and the report on it. Portions of the exhaustive report, which is known as the *Report of the Special Study of Securities Markets* or, more briefly, the *Special Study Report*, were transmitted to Congress on April 3, 1963. Other parts followed on July 17 and August 8,

²⁶ 15 U.S.C. § 78s (1965).

²⁷ The study was much more far-reaching than this reference to "rules" would seem to call for, but its wide scope had the full blessing of Congress. Congressman Peter F. Mack, Jr., the author of H.J. Res. 438, the "Mack Resolution," which became the new subsection (d) of section 19 of the Exchange Act, may have been prompted to cast his resolution in terms of the adequacy of rules because his resolution came at a time when a Commission investigation of the American Stock Exchange had just revealed apparent inadequacies in its rules. Nevertheless, Congressman Mack had in mind from the start something "very broad" in scope, the subject matter being "extremely wide in breadth." The House Report recommending passage of the Mack Resolution, a report which was submitted by Mr. Mack himself who was then Chairman of the Subcommittee on Commerce and Finance of the House Interstate and Foreign Commerce Committee, makes these matters entirely clear. H.R. REP. No. 882, 87th Cong., 1st Sess. (1961). If there were ever any doubts that others also shared Congressman Mack's views as to the broad areas which this study was to encompass, they were dispelled by both the Senate and House Reports about a year later. S. REP. No. 1703, 87th Cong., 2d Sess. (1962); H.R. REP. No. 1778, 87th Cong., 2d Sess. (1962). At that time the deadline for reporting on the study was extended by three months and the money appropriated for conducting it was increased to \$950,000. Act of July 27, 1962, Pub. L. No. 87-561, 76 Stat. 247.

1963. This entire report is printed as H.R. Doc. No. 95, pts. 1 to 4, 88th Cong., 1st Sess. In September of that year the Commission submitted to Congress the Special Study's "Summaries, Conclusions and Recommendations," and in July of 1964 it submitted a detailed index of the entire report. These were printed as parts 5 and 6 of the same House Document and are particularly helpful since the report proper contains nearly 3,000 pages.

Unlike the *Wharton School Report*, which dealt only with the mutual fund segment of investment companies, the *Special Study Report* is concerned with the securities markets as they relate to all types of securities, not just investment company shares. For that reason many parts of it have no direct relevance here. However, very considerable portions of it are of much interest in the investment company field and it has often been cited and referred to in hearings and reports on investment company bills which have been before Congress since it was submitted. By reference to the chapter headings, the summaries and the index it is not too difficult to ascertain what portions of the *Report* are germane to various aspects of legislation involving investment companies. The pertinent areas on which the *Special Study Report* dwells most extensively are sales of mutual fund shares, particularly sales methods and practices, and the so-called "front-end load" on periodic payment plans for accumulating mutual fund shares.

Valuable as both of them are, neither of the above reports represents the work or the conclusions of the Commission itself.²⁸ It is for this reason, among others, that a third and later report is generally considered to be the most significant document in the investment company area since the Commission's report on the original investment trust study which preceded the passage of the 1940 Act. Officially known as the *Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth*, (H.R. REP. No. 2337, 89th Cong., 2d Sess. (1966)), it is often referred to as the *Investment Company Growth Study* or, more briefly, the *Growth Study*. Like the earlier Wharton School Study, this study was undertaken under section 14(b) of the Act. As will become evident in the next part of this article, this *Growth Study* is also a *sine qua non* for any real understanding of the most recent attempts to secure further investment company legislation.

VI. Unsuccessful Attempts to Amend the 1940 Act

As noted earlier (pages 685-88) the Act has been amended in several respects since 1940 but few of these amendments were substantive to any significant extent. Although all amendments, even strictly technical ones,

²⁸ As to the *Special Study*, this was changed somewhat when Congressman Oren Harris, Chairman of the House Committee on Interstate and Foreign Commerce, wrote a letter dated April 5, 1963 requesting an indication of the Commission's views on the conclusions and recommendations of its Special Study staff which had thus far reported to Congress. William L. Cary, Chairman of the Commission, responded to this request by a letter dated April 19, 1963. As further parts of the report were submitted to Congress, Chairman Cary expressed the Commission's views on them in two subsequent letters dated July 23, 1963 and August 8, 1963. All four of these letters are reproduced in a supplement to part 5 of the *Report*. H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963).

were set forth in that portion of this article because they represent actual changes in the law, the instant part of this article does not purport to be exhaustive as to all unsuccessful attempts to amend the Act by bills which have been introduced between 1940 and now. On the contrary, except for passing references largely in footnotes, only the major efforts in that area will be discussed here.

The first bill to amend the Act which obtained enough support even to be reported out of committee²⁹ was H.R. 2481, introduced at the first session of the eighty-sixth Congress on January 15, 1959 by Congressman Oren Harris.³⁰ This bill would have defined certain terms used in the Act, redefined and enlarged the scope of other terms and clarified the meaning of still others. It also would have further restricted assets which qualify for a diversified company, prohibited change in or deviation from any investment policy without stockholder approval and made numerous technical amendments. This bill was not only reported out by the Interstate and Foreign Commerce Committee (H.R. REP. No. 2178) but was passed on the floor of the House and transmitted to the Senate where it died in committee.

The next bill which made equal progress was S. 3772, which was introduced at the second session of the eighty-sixth Congress on June 29, 1960 by Senator Harrison Williams. It would have clarified certain exceptions from the Act, defined certain of its terms, increased the requirements for statements of policy as to certain types of mutual funds, enlarged the scope of the requirement of "bank custody" and imposed additional limitations on investments which diversified companies and face-amount companies are permitted to make. This bill was reported out by the Banking and Currency Committee (S. REP. No. 1759) and was passed by the Senate and transmitted to the House where it died in committee.

It was not until the ninetieth Congress, to which attention will be turned shortly, that any other bill to amend the Act ever got out of committee, although one such bill was introduced later in the second session of the eighty-sixth Congress (H.R. 13041), three were introduced during the first session of the eighty-seventh Congress (H.R. 2799; S. 1117, a counterpart of 2799; and H.R. 6591) and one was introduced in the second session of the eighty-seventh Congress (H.R. 11410). The eighty-eighth and eighty-ninth Congresses were even less

²⁹ Earlier bills which died in committee included: H.R. 4344, 77th Cong., 1st Sess. (1941); H.R. 6668, 83d Cong., 1st Sess. (1953); H.R. 11129 and S. 3915, 84th Cong., 2d Sess. (1956); and S. 2769, H.R. 9329 and H.R. 9387, 85th Cong., 1st Sess. (1957). H.R. 4344 would have amended other securities acts much more extensively than the Investment Company Act, but it would have had a substantial impact on companies registered under this latter Act even with respect to the changes which it would have effected in some of the other acts. H.R. 6668 would have increased the ceiling for exemption of closed-end companies from \$100,000 to \$300,000. H.R. 11129 and S. 3915 were companion omnibus bills sponsored by the Commission which would have made numerous amendments to three of the other federal securities laws both to strengthen them substantively and to clarify and improve them technically. These bills are included here only for the sake of completeness since they did contain a few, largely technical, proposed amendments to the Investment Company Act. All three of the remaining bills, listed above as being introduced in the 85th Congress, first session, were counterparts of each other and again represented a Commission-sponsored program. In this case, however, the program was one to amend only the Investment Company Act, not other securities acts, in several ways, some of which were substantive and others purely technical. In substantial part, but not in toto, these three bills were like H.R. 2481 and S. 1181 introduced in the first session of the 86th Congress, the contents of which are next outlined briefly in the text.

³⁰ S. 1181, a counterpart of this House bill, was introduced in the Senate on February 26, 1959, but was never reported out of committee.

active in this area. No investment company bills were introduced in the eighty-ninth Congress and in the eighty-eighth Congress the only bills which would have altered the Act were directed primarily to providing additional regulation of small business investment companies (SBICs) and bank collective investment funds in which so-called managing agency accounts are pooled. The aim of these bills was to strengthen and enlarge the pattern of regulation, by the Small Business Administration in the one case and by the Comptroller of the Currency in the other, sufficiently and in such ways as would presumably warrant exempting such companies and funds from the federal securities laws including the 1940 Act, as to which a specific exemption was to have been provided for SBICs and bank collective investment funds.³¹

Oddly enough, the attempt to amend which came closest to succeeding and yet failed — it was halted only by Presidential veto — was not a frontal attack on the Act but rather a bill to amend the District of Columbia life insurance laws. After losing the final round in test litigation in which the Supreme Court held that a variable annuity contract is a security, thus making the issuer of such annuities an investment company which would have to register under the Act,³² one such company (VALIC) which was organized under the laws of the District of Columbia decided to seek relief in Congress. It had a bill introduced to amend the District's insurance laws so as to relieve such companies which are incorporated in the District of Columbia from certain aspects of the Act which were asserted to be unduly burdensome and difficult to comply with without running afoul of requirements in insurance laws. The bill was H.R. 7482, 87th Cong., 1st Sess., introduced June 6, 1961. It would have had the indirect effect of amending the Act to the competitive advantage of such District of Columbia companies as against those organized under the laws of any of the states. It would also have been detrimental to variable annuitants who purchased their contracts from a District of Columbia company since they would be deprived of the protections of the Act. Were it not for the unique fact that Congress is the law-making body both for the United States and for the District of Columbia, this kind of situation would never have arisen but it did, and both houses of Congress passed the bill and sent it to the President for his approval. The Commission recommended that the President veto the bill and he did so on September 26, 1961.³³

VII. Mutual Fund Reform Bills in the Ninetieth Congress

The ninetieth Congress was the first Congress to convene after all three of the studies and reports discussed above had been completed. Although the last of these reports (covering the Investment Company Growth Study) was not submitted to Congress and ordered printed until December 2, 1966, by the

³¹ The bills which would have exempted SBICs from the Act were two companion bills, H.R. 2422 and S. 1427, both introduced in the 88th Congress, first session. The proposed exemption for bank collective investment funds was contained in H.R. 8499, S. 2223 and H.R. 9410, three identical bills which were also introduced in the first session of the 88th Congress.

³² *SEC v. VALIC*, 359 U.S. 65 (1959). The decisions below had been to the contrary. See 257 F.2d 201 (D.C. Cir. 1958) and 155 F. Supp. 521 (D.D.C., 1957).

³³ The President's veto message appears as H.R. Doc. No. 244, 87th Cong., 1st Sess. (1961), *reprinted in* 107 CONG. REC. 21486 (1961).

time the ninetieth Congress convened in January, 1967, the Commission was already preparing draft legislation to implement recommendations contained in that report. The Commission's draft bill was introduced simultaneously and in identical form in both the Senate and the House of Representatives on May 1, 1967.³⁴ In fact, two identical bills were introduced in the House as well as one in the Senate. These were S. 1659, H.R. 9510 and H.R. 9511, 90th Cong., 1st Sess.³⁵ Hearings were held in both houses. On the Senate side, lengthy hearings were conducted before the Banking and Currency Committee starting July 31, 1967 and continuing through additional sessions on six days in August.³⁶ On the House side, the Subcommittee on Commerce and Finance of the Interstate and Foreign Commerce Committee held hearings that started on October 10, 1967 and continued for eight subsequent days that month. Like those on the Senate side, these hearings were of an exhaustive character.³⁷ Except for a one day hearing that was held on November 16, 1967, before the Banking and Currency Committee on an amendment dealing with the subject of bank "Commingled Management Agency Accounts," there was no further formal action in either congressional body during the first session of the ninetieth Congress.

When the second session convened in January of 1968, Congressman John E. Moss promptly introduced an amended version of the bills which had been considered during the first session. His bill, H.R. 14742, was introduced on January 22, 1968. This bill was referred to the Interstate and Foreign Commerce Committee where hearings were held on it before the Subcommittee on Commerce and Finance on March 14 and 15, 1968. Again, however, there was no further formal action in the House of Representatives. On the Senate side, S. 3724 was introduced on July 1, 1968. This, too was an amended or revised version of the earlier bills.

The record of developments with respect to investment company legislation then pending indicates that there was at all times a friendly cooperative attitude between the industry and the Commission as well as a recognition on the part of the former that rather extensive amendments to this twenty-eight-year-old

34 The introduction of these bills was presaged by the President's Message to Congress on February 16, 1967 on "Protecting the American Consumer," in which he stated that the "spectacular growth of the mutual fund industry is an indication of its popularity" with investors including those "of modest means." He noted the "thoughtful and exhaustive" analysis contained in the Commission's Growth Study Report which was submitted to Congress "two months ago" and said: "I urge the Congress to give careful consideration to the report and recommendations of the Securities and Exchange Commission." This portion of the President's Message is printed as H.R. Doc. No. 57, 90th Cong., 1st Sess., reprinted in 113 CONG. REC. 3529 (Feb. 16, 1967).

35 Quite understandably both Congressman Harley O. Staggers, Chairman of the House Interstate and Foreign Commerce Committee, and Congressman John E. Moss, Chairman of the Subcommittee on Commerce and Finance of that Committee, wished to share in sponsoring this proposed legislation which probably accounts for the fact that the former introduced H.R. 9510 on the same day that the latter introduced H.R. 9511, an identical bill. On the Senate side S. 1659 was, equally understandably, introduced by Senator John J. Sparkman, Chairman of the Senate Banking and Currency Committee.

36 *Hearings on S. 1659 Before the Senate Comm. on Banking & Currency*, 90th Cong., 1st Sess. (1967). The exhaustive nature of these hearings is apparent from the printed record of them which is in excess of 1200 pages, and from the fact that approximately 70 witnesses testified and supplied supporting documents while numerous other interested parties submitted statements, letters and data for the record.

37 *Hearings on H.R. 9510, 9511 Before a Subcomm. on Commerce & Finance of the House Comm. on Interstate & Foreign Commerce*, 90th Cong., 1st Sess., ser. 90-21 (1967).

Act were needed. There were, nevertheless, many important areas in which there were divergent views. The process of resolving these many differences resulted in changes in the bill so numerous and extensive in both houses of Congress that new "clean" bills such as H.R. 14742 and S. 3724 were apparently felt to be preferable to retaining the original bills with a multitude of proposed amendments tacked on to them. The new S. 3724 was immediately sent to the floor of the Senate without further hearings and with no amendments on July 1 (S. REP. NO. 1351, 90th Cong., 1st Sess. (1968)) and after certain floor amendments it was passed by the Senate on July 26, 1968 and transmitted to the House where it died in committee.

The foregoing is admittedly a rather sketchy account of the legislative history of what came to be known informally in the ninetieth Congress as the "Mutual Fund Reform Bill." Arguably at least, this history of the first major effort to "reform" the Act which had been on the books for twenty-eight years might seem to deserve a somewhat fuller recital of its details. Exhaustive treatment is, however, out of the question here and the above will perhaps suffice to assist a practitioner who desires to probe the legislative history in this area in finding his way around fairly readily, and, after all, that is perhaps the principal justification for an article of this kind. Moreover, further demonstration of the importance of these developments in the ninetieth Congress will probably be accomplished most effectively by turning to a thumbnail sketch of what this reform bill was all about substantively, despite the fact that the thrust of this article has thus far been, and must continue to be, principally to narrate legislative history rather than to dwell upon the substance of the law in the investment company field.

The foremost objective of the bill was to protect the rapidly increasing number of public investors, who were entrusting larger and larger amounts of their savings to mutual funds, against excessive or unreasonable fees and charges. The bill struck at this problem in three ways which are here mentioned in terms of the version of the bill ultimately passed by the Senate (S. 3724), though brief parenthetical references to the original version recommended by the Commission are also made to illustrate the contrast. First, the bill would have required that all compensation which was to be paid to an investment adviser, officer, director or controlling person or principal underwriter (or to affiliates of any of them) for services to a registered investment company be "reasonable" as measured by specified standards. The courts, not the Commission, were to judge the reasonableness in suits brought by the Commission or, if the Commission failed to act within six months after a written request, in actions brought by private litigants derivatively or representatively on behalf of investment companies or their shareholders. Such suits were to be subject to numerous restrictions and limitations not detailed here. (The Commission's original proposal included more extensive standards of reasonableness which on the whole tended to be more favorable to investors. It also provided that actions for recovery could be brought by shareholders without first requesting the Commission to sue, and provided less stringent restrictions on suits by both stockholders and the Commission.) Second, sales commissions to be paid by purchasers of shares were to be regulated and limited under the existing industry-government framework of

self-regulation in conformity with standards which included "reasonableness to investors." (The original bill included a flat maximum ceiling on all sales commissions of five per cent subject only to discretionary authority in the Commission to grant exceptions where appropriate.) Third, front-end loads were to be cut back substantially so that, under contractual and installment plans, the sales commission would be more nearly leveled off over the duration of the plan rather than be loaded heavily during the first years of the plan. (The Commission's original bill proposed that front-end loads be abolished entirely.)

In addition to these three prime target areas, both the original bill and the final Senate version contained numerous other provisions designed to facilitate administration and enforcement of the Act in the interest of public investors, to remove anomalies, inconsistencies and technical shortcomings which had been revealed as the Act had been administered over the years, and to update and improve certain provisions of it which had proved inadequate in their original form.³⁸ The final Senate version also contained certain provisions requested by the banking industry with respect to commingled managing agency accounts and provisions as to both banks and insurance companies dealing with collective trust funds and separate accounts maintained to handle certain types of stock bonus, pension and profit-sharing plans — provisions which were not in the original bill.

Finally, it should be noted that the significance of the bills which were introduced and extensively considered in the ninetieth Congress consists not only of the breadth of their substantive provisions but also of the fact that they, or close cousins of theirs, are apparently destined for further serious consideration and possible passage in the ninety-first Congress which convened in January of this year. The developments which took place in the ninetieth Congress in the mutual fund reform area are certain to have a marked impact on what transpires and emerges in the same area in the ninety-first Congress.

VIII. Developments to Date in the Ninety-first Congress

Shortly after the ninety-first Congress convened for its first session, Senator John J. Sparkman introduced a bill which is exactly like the one that the Senate passed in the ninetieth Congress (S. 3724). His bill is S. 34. It was introduced on January 15, 1969 and was referred that same day to the Committee on Banking and Currency of which Senator Sparkman continues to be the Chairman.³⁹ The very next day Senator Thomas J. McIntyre⁴⁰ introduced S. 296 which was

38 On the same day that the "reform" bills were introduced, SEC Investment Company Act, Release No. 4942 (May 1, 1967) was issued, stating their principal features. This Release is reprinted in 113 CONG. REC. 11531 (May 3, 1967). It recites the content of the proposed legislation in considerably more detailed fashion than is possible here, but it must be borne in mind that the Release relates to the Commission's original proposals, not to the bill which was ultimately passed by the Senate.

39 115 CONG. REC. S221 (daily ed. Jan. 15, 1969).

40 Senator McIntyre is a member of the Banking and Currency Committee and was much in the forefront when the ninetieth Congress was considering mutual fund reform legislation. In fact, he proposed to offer a series of amendments to S. 1659, the Commission's original bill (113 CONG. REC. S16284 (daily ed. Nov. 13, 1967)), which led to certain of the substantial changes which occurred as that bill evolved into the revised S. 3724, the bill finally passed by the Senate — particularly changes and additions in the area of a bank "common

likewise referred to the Banking and Currency Committee.⁴¹ This bill differs from the one sponsored by Senator Sparkman in only three respects. First, it would go all the way in abolishing front-end loads. Second, it would not limit the authority of the Commission to enjoin breaches of fiduciary duty by persons identified with investment companies in certain named capacities to breaches involving "personal misconduct." (Both of these differences are in keeping with the Commission's original proposals in the ninetieth Congress.) Third, the McIntyre bill would repeal entirely the present section 22(d) of the Act, a provision which has provoked considerable controversy because it has the effect of stifling competition in commission rates charged for the sale of mutual fund shares. This feature of the McIntyre bill varies from the Sparkman bill, which would give the National Association of Securities Dealers authority to regulate sales commissions to prevent "an excessive sales load" by rules which would be subject to specified scrutiny and review by the Commission. This feature also varies from the Commission's original bill which would have put a flat ceiling of five per cent on sales commissions. From the standpoint of the public investor there is obviously something to be said for the McIntyre approach to this subject as against either the original proposal or the Sparkman bill. The latter is, however, undoubtedly more palatable to the industry than either of the other two.

IX. Conclusion

Although there will very likely be further developments, including congressional hearings, before this article appears in print, they may not occur to any significant extent before the deadline for going to press.⁴² The probability

trust fund or other pooled or collective fund maintained by a bank." — See Amendments Intended to be Proposed by Mr. McIntyre to S. 1659, 90th Cong., 1st Sess., Nov. 13, 1967.

41 115 CONG. REC. S424 (daily ed. Jan. 16, 1969).

42 Since this article was originally written there have been three noteworthy developments in the ninety-first Congress:

1. On March 6, 1969 SEC Chairman Hamer H. Budge testified before the Subcommittee on Securities of the Senate Committee on Banking and Currency on a number of matters of current concern to the Commission. A substantial portion of his testimony, that captioned "Mutual Fund Legislation," consisted largely of a discussion of the differences between the Commission's original bill in the ninetieth Congress and the present S. 34. His conclusion was that the Commission bill "might more effectively ensure fair treatment to investment company shareholders" but that "enactment of S. 34 would accomplish a great improvement over the present situation and would constitute an important reform" and that "if this Committee prefers to accept S. 34, I would gladly accept that decision and support that bill." Statement of Hamer H. Budge before the Subcommittee on Securities of the Senate Committee on Banking and Currency on Certain Questions Arising under the Federal Securities Laws 30, March 6, 1969 (on file with the *Notre Dame Lawyer*).
2. On March 13, 1969 Congressman Williamson S. Stuckey, Jr. introduced H.R. 8980 in the House of Representatives and made a statement on the floor of the House explaining the principal differences between his bill and the Commission's bill in the ninetieth Congress. According to his own statement these differences are mainly a reflection of his view that the management, as well as distribution and sales organization and personnel, of mutual funds should be subject to less scrutiny by the SEC and the courts, particularly as to management fees and sales loads, and that certain restrictions should be placed on suits brought against them by both the Commission and private plaintiffs. 115 Cong. Rec. H1727-28 (daily ed., March 13, 1969).
3. On April 15, 1969 the full Senate Committee on Banking and Currency commenced hearings on S. 34 and S. 296. The Committee called as its first witness

of enactment of a reasonably effective bill, patterned in substantial part after one or more of the bills considered in the ninetieth Congress and thus far introduced in the ninety-first Congress, is anyone's guess. Perhaps the strongest affirmative indications are the promptness with which the principal advocates of such legislation on the Senate side of Congress put the wheels in motion shortly after the ninety-first Congress convened, and the remarks which they made on the floor of the Senate when they introduced their bills on this subject.⁴³

Presently there does not appear to be quite the same unanimity as was evidenced back in 1940 when investment companies seemed about to "die on the vine" and therefore understandably wanted some form of federal regulation at once in order to restore public confidence. There is, however, a frank recognition on the part of the industry that, after nearly twenty-nine years during which it has grown by almost unbelievable leaps and bounds, the time has come when some updating and improving are needed in the basic Act which regulates investment companies. A single incident will perhaps serve to illustrate this point. On January 23, 1969 John C. Bogle, President of the Wellington Management Company, was installed as the Chairman of the Board of Governors of the Investment Company Institute. In his remarks on that occasion, after noting that currently there are seven areas of major importance to their industry, he continued by stating:

It is obvious that the most important issue coming before us is the Mutual Fund Bill. As Institute President Augenblick has said, "the issues raised by this Bill will not go away. . . . Our Institute has never taken the position that after 28 years without amendment the Investment Company Act of 1940 should be left as it is." I agree wholeheartedly with his thinking, and the implicit conclusion: that we should bend our efforts to resolving promptly the issues that remain, so that the form the mutual fund legislation takes will be constructive and will foster our industry's sound growth rather than obstruct it. Sooner or later, we are going to have a mutual fund bill, and I hope I can make a constructive contribution

During the course of the ninety-first Congress we may witness a repetition of the industry-government cooperative endeavors which produced the original Act

senior Commissioner Hugh F. Owens who testified in the absence of Chairman Budge. Commissioner Owens noted that S. 34 contains significant compromises as against the Commission's original bill in the ninetieth Congress. He readily conceded that these compromises do not entirely satisfy industry objections, but stated: "I respectfully submit that no further compromises in S. 34 are necessary." Testimony of Hugh F. Owens on S. 34 before the Senate Committee on Banking and Currency 11, April 15, 1969 (on file with the *Notre Dame Lawyer*; ultimately available in printed form in the record of these Hearings). He expressed some misgivings about the provision in S. 296 which would repeal section 22(d) of the Act, the section which provides retail price maintenance for mutual fund shares, and placed the Commission squarely on record as supporting S. 34. *Id.*

43 While the remarks of Senator McIntyre were directed largely to the subject of removing from the Act any barrier to allowing sales commissions to be determined by unrestricted competition, he and Senator Sparkman are both apparently intent upon securing mutual fund reform legislation during the present session of Congress. See 115 CONG. REC. S289-90 (remarks of Senator Sparkman), S430-31 (remarks of Senator McIntyre) (daily ed. Jan. 15 & 16, 1969). A portion of Senator Sparkman's statement is particularly significant. He told his fellow Senators that "[t]he Banking and Currency Committee of which I am chairman intends to give these proposals prompt consideration so that a bill may be reported to the Senate at the earliest possible date." *Id.* at S290.

in 1940, but which this time would have the added significance of further serving the best interests of over five million Americans who today look to mutual fund shares for the investment of many billions of dollars of their lifetime savings. We are today concerned with a situation of vastly greater proportions and much more importance to the investing public than that which prevailed on the eve of the 1940 Act, when only a few hundred thousand of our people had a little over one billion dollars at stake in all types of investment companies combined.