

well depend the wisdom of his subsequent function of the actual investment of funds.

Now, it is into this area that it is proposed, through this bill, to introduce the regulatory functions of the Securities and Exchange Commission. That it is a relationship where fraud can wreak havoc is only too apparent. Yet, there are countless other areas in American life where fraud can be equally damaging, and yet where Federal regulation would hardly penetrate. The dentist, for example, who deliberately makes work for himself, would hardly be the subject of Federal regulatory authority.

Senator WAGNER. Did you say "dentist"?

Mr. BERLE. Yes, sir.

Senator WAGNER. Well, of course, the dentist does not deal in interstate commerce. However, he is regulated, is he not?

Mr. BERLE. Oh, yes; indeed, sir. There are a great many educational requirements he must pass, and which I hope at some time investment counsel will have to pass.

Senator WAGNER. Well, with him it is not a case where he is engaged in interstate commerce but there are regulations controlling the practice of the profession of dentistry.

Mr. BERLE. There you introduce an element of technical constitutionality which I preferred not to go into here.

Senator WAGNER. Well, I think it would be better to leave that to a court, but I was wondering why the one should be regulated or controlled and the other should not, in your opinion.

Mr. BERLE. I will say that I believe in the principle of Federal control of interstate commerce, and it is now construed a great deal more broadly than 15 years ago it was thought to extend. On the other hand, my thinking about this question is not along the line of interstate quality of the transactions involved but the professional quality.

Senator WAGNER. But you spoke about dentists, and I interrupted to remind you that of course the dentist has to have certain educational qualifications.

Mr. BERLE. Yes, sir.

Senator WAGNER. And he has to register.

Mr. BERLE. Yes; but my comment was in regard to the Federal regulatory authority. You can take care of the other question as you like.

Senator WAGNER. But you do not think there should be any regulation of investment advice?

Mr. BERLE. No Federal regulation.

Senator WAGNER. How about State regulation?

Mr. BERLE. With respect to that, since we are anticipating a bit, this is frankly my feeling: There is going to come a time, but I think that time is not yet, when the States have got to do for investment counsel precisely the same thing they do for doctors, and the same thing they do for lawyers. At some time in the future we have got to look forward to figuring out some method for determining the capabilities of those individuals who go into the profession of investment counsel.

Senator WAGNER. Then your view is: Why shouldn't you leave it to the counselors themselves to regulate the profession?

Mr. BERLE. Well, we would very much prefer to have the counselors themselves do it, but I do not think necessarily that is going to be the ultimate answer to the problem. As soon as the profession reaches a period of greater maturity than at the present time doubtless something will have to be done.

Senator WAGNER. Is that the reason why you say they should not be regulated, either by State or Federal authority, because the profession has not reached a stage of maturity?

Mr. BERLE. I think probably at the present time you could not effectively work out a system for examination of investment counsel. We have not as yet had sufficient experience with respect to just how those examinations should be written.

Senator WAGNER. All right; suppose we say we are not to have any examination of investment counsel, that it is a little early and we have not developed sufficiently to determine just what the test should be. How about having it known in some book in some public way who these gentlemen are—at least a registration of the fact that they are engaged in that particular profession, and I think a very important profession—something to do with their character and experience—merely having it recorded somewhere, showing conviction for a felony if that is the case, and not having the right to reject the application but having the information on record somewhere. Do you see any objection to that in view of what you have said?

Mr. BERLE. Mr. Chairman, you are now making a suggestion that is quite different from this bill I take it.

Senator WAGNER. I do not know how different it is; but I am trying to get your point of view.

Mr. BERLE. I am addressing myself more particularly to this bill because I think, as previous witnesses have indicated, it goes far beyond anything of that kind.

Senator WAGNER. These bills are always rewritten after we hear everybody concerned, and some very valuable testimony has been given on these different points. Surely the testimony adduced here before us has been very enlightening. The difficulty I am laboring under is this: I have had about 28 years' experience as a legislator, as you probably know.

Mr. BERLE. Yes, Mr. Chairman; I know that.

Senator WAGNER. And no matter how stupid a man may be he learns something. Very often one finds when there is a desire to regulate a particular class that is a little new, and the representatives of that class do not like the idea, if it is in the Federal Legislature they want the State to regulate them, and if it is in the State legislature they want Federal regulation. We are constantly confronted by that type of argument. In view of your own statement of what your hopes are in this profession—and I agree with you and think it very important—if I should have occasion to go to someone, in event I had anything to invest, in order to get advice, certainly I would want to know that they did know something and that they were reliable. As to the 61 members of this association, I suppose they are competent, and yet there are a lot of outsiders that I do not know anything about. I just wondered if you would object to a simple form of registration of some kind, to the end that we do not put a man who is just out of jail in that work, or somebody who has been engaging in all kinds of practices and has been enjoined. Probably he has not gone

to the point of being a thief but the court has decided that he should not engage in the sale of securities. I am sure you agree that one of that type ought to be exposed; that inquiry ought to be made as to whether he is a fit person to be so engaged. Now would you say that a simple form of that kind would be objectionable?

Mr. BERLE. The difficulty involved in that is simply this: I do not think you can escape this fundamental question of policy, of the application of Federal authority to what is essentially a highly professional personal relationship. I do not want to take refuge behind the comment you have made, that when in a State legislature, they want the Federal Government to do it, and vice versa, but it does seem to me it is definitely the kind of thing, involving as it does a highly and purely personal relationship, especially a professional relationship, that ought to be left within the area of State authority.

Senator WAGNER. I am afraid that is where I am dull. I cannot get that. If it is important that there be some form of registration we will say, and these gentlemen deal in activities that are under the jurisdiction of the Federal Government, I cannot understand why you say the Federal Government should not do it but the State might. In many cases the State would not have any jurisdiction at all. What is there here that produces that important distinction? I do not get it.

Mr. BERLE. The answer, sir, I think lies in a question: If that is true, then it seems to me you must be prepared to take the logical next step, and there is no reason why you should not require Federal registration of accountants and Federal registration of lawyers.

Senator WAGNER. Well, that does not follow unless you present a very good sound reason for doing it. You take these matters step by step, and turn only to Congress because it seems the sound policy to pursue. The one thing does not necessarily lead to the other.

Mr. BERLE. Is there no distinction between the two cases? Take for example our own case——

Senator WAGNER (interposing). We are just raising this question: Suppose a man is an investment counselor and—then there comes in the additional question—Suppose he is engaged exclusively in interstate commerce; what you you say about him?

Mr. BERLE. I cannot see——

Senator HUGHES (interposing). And he is engaged in giving advice throughout the country.

Mr. BERLE. I cannot conceive of such a case, because the essence of investment counsel is that he has personal contact with a personal client. The entry into interstate commerce is the second step in this relationship. The first step is when the client walks into the counselor's office and says, "I have this money and do not know how I should invest 't." I think it is a human problem.

Senator WAGNER. Would you say that an investment counselor is not engaged in interstate commerce if he writes a letter to a prospective client in New Jersey and suggests to him that he come over to New York if he wants advice, or if he is in New Jersey and writes a letter to a prospective client in New York? Is there any aspect of interstate commerce involved in that at all? I am not sure myself but would like to have your view.

Mr. BERLE. I do not believe so in the simple case you put. I mean that that whole question, as to where the dividing line comes in the matter of interstate commerce—and you know so much better than I

do about it—is a very highly technical point. We have been extending the lines for the last few years. In many cases I think the lines have been very soundly extended to things that never previously were thought the subject of interstate commerce; but in connection with investment counsel I cannot get away from the fact that the essence of this thing lies in the personal contact between man and man, and that is the situation when the two get together and sit down and talk over the problem. Now, that is the heart of my whole point. If that is not true you have a wholly different set of considerations.

Senator HUGHES. You are talking of one class and I am talking of another class. You are thinking of the class that you come in contact with and that you represent. There appears to be another class, who advertise all over the country, hold themselves out that at so much a year they will advise clients, and that advice goes through the mails, and there are advertisements in newspapers. Almost everybody receives such circulars, and see the advertisements in newspapers sent through the mails. I do not have much money to invest but I know something about that. And there is another class of people who would not come into your association, could not comply with your requirements, I dare say.

Mr. BERLE. You are quite correct about that, sir.

Senator HUGHES. Those people are holding themselves out to people all over the country, and those are people whom we want to protect.

Mr. BERLE. I am making the distinction—

Senator HUGHES (continuing). Doubtless they are not engaged in the same kind of business, but they are making money out of people, and I do not know just how to approach that problem.

Mr. BERLE. I do not think you will find among all these investment counsel one but who will cavil as a matter of fact at your suggestion that they are holding themselves out as doing the same kind of business.

Senator HUGHES. Of course, I do not say that. You are doing a legitimate business. I have a high regard for the people you represent, but am speaking of the other class that try to come in under the same umbrella, not by your invitation it is true, but you cannot kick them out.

Mr. BERLE. Should you necessarily, for the sake of dealing with that kind of people, ignore the varied things I have already been preaching better than you so far as these highly professional men are concerned? Is there any reason why—

Senator HUGHES (interposing). I am not saying so at all.

Mr. BERLE. Is there any reason why, in order to deal with this question of investment advisers that you should start with a definition which is so all-inclusive that I do not believe even Mr. Schenker, with all due respect for him, and whom I regard very highly, can tell now who is going to be included. Shouldn't there be some of that thinking first?

Senator WAGNER. All distinguished lawyers can find words to convey what they mean if they have an objective in view. Going back again to the State legislature, and I do not like to go back too far, I remember when nurses were not registered and they themselves insisted upon legislation providing for registration because they thought it would give dignity to their profession. I also remember the case

of the osteopaths, where they insisted upon being registered, and in my time a bill was enacted into law and they were licensed.

Senator HUGHES. And the doctors.

Senator WAGNER. Yes; but I am now speaking about later days. Before that time there were the physicians. They themselves drafted legislation so as to give dignity to their profession. As Senator Hughes has said, I think yours is an important and difficult profession, and while commendable efforts have been made by your organization to put the profession on a high standard, I do not see how you can supervise—and you might challenge that word, so I will say how you can provide some form of bringing them together—to the end that somewhere there will be a record as to who they are. The words of this bill may be too indefinite or too comprehensive, but I do not quite understand why there is resistance to doing anything about it. You yourself admitted that sooner or later you hoped the time would come when there would be something provided.

Senator HUGHES. Would not you gentlemen who are more deeply interested than anybody else probably, even suffer a little sacrifice or maybe a little hardship in order to bring in this other class that is now doing wrong things?

Mr. BERLE. If I interpreted correctly what has already been said here this morning, it is more than a little sacrifice. I think it is a serious problem.

Senator HUGHES. I mean in order to get them on record and know who they are.

Mr. BERLE. Well, I cannot do more than I have already said. That is to say, it seems to me when you get into the area of the purely professional relationship that ceases to be a function of Federal regulation. If you include that within the area of Federal regulation you must necessarily logically be prepared to include a great many other things. Perhaps in my next few paragraphs here I can summarize that statement.

Senator WAGNER. All right. You have been very generous.

Mr. BERLE. My function is to be helpful if I can.

Mr. ROSE, Mr. Chairman, if I might interrupt for a word?

Senator WAGNER. Certainly.

Mr. ROSE. When I mentioned in my statement that Mr. Berle would testify I did not mean to stop you from asking me questions about the association and pass them on to an attorney. At any time during this hearing I will be glad to discuss these matters that you are interested in as affecting our association.

Senator WAGNER. We asked you some questions.

Mr. ROSE. Yes; but I will be glad to try to answer any additional questions.

Mr. BERLE. Mr. Chairman, shall I proceed?

Senator WAGNER (chairman of the subcommittee). Yes.

Mr. BERLE. Whether investment counsel lie on some dividing line—and I think this will answer the point of view of the members of the subcommittee.

Senator WAGNER. All right.

Mr. BERLE. Whether investment counsel lie on some dividing line, conceivably falling within the area of Federal regulation, involves a very fundamental question of political importance, and by political

I do not refer to politics. There is a real question whether the science of government properly embraces an extension of these regulatory functions to a highly personal relationship, such as is involved in that of the investment counselor to his client. For regulation in an area too vast and too intricate in its ramifications, where the vastness and the intricacy spring from the purely personal equation, may make the regulation so impossible of effectiveness that the result is worse than if it had never been undertaken.

I question seriously whether the conception of Federal government in America has reached or should reach a point in which personal professional relationships should be made the concern of Federal supervision. Yet, in dealing with this matter of the Federal regulation of investment counsel, I believe that Congress may actually be dealing with this highly fundamental problem. If the step is taken across the line with reference to investment counsel, the taking of that step may fairly be regarded as determinative of the policy involved in taking other similar steps into the field of personal relationships.

I realize fully that in the last 10 years we have witnessed in the United States a legislative extension of Federal authority into many fields previously untouched. I likewise realize that that extension of Federal authority really has been simply the recognition of changes and developments in social and economic structures preceding the legislation. In that respect, those extensions of Federal authority have been a response to a need. But that need has developed over the preceding two or three decades, and has corresponded to the development and changes in the financial and economic structure of the country.

No similar situation, however, applies to investment counsel. Actually, investment counsel as a profession is a thing of very recent growth. Investment counsel have sprung into being in response to the requirements of individuals for individual personal advice with respect to the handling of their affairs. It is perhaps not accidental that in the early stages, and to a very great extent today, when the problems of investment became as complex as they are, individuals sought this advice from lawyers and not from specialists. They sought that advice from lawyers because of the fact that in dealing with their lawyers they felt that they were dealing with people having professional responsibilities and to whom they could confide fully their own personal private problems.

Consequently, the whole genesis of investment counselling is a personal professional relationship. The inception of such a relationship has nothing to do whatsoever with interstate commerce or anything else. It primarily has to do with the solution of an individual's problems by a person whose advice he could trust.

If such a relationship is to be made the subject of Federal regulatory action, then there is no logical reason for the exclusion of many other personal relationships where advice and expert service is being obtained for compensation. Once it has been established, and I believe that this legislation may furnish the point at which the principle is established, the road is free on any logical basis for a wide expansion into many other fields. Before that barrier is hurdled, it seems to me that its implications should be very carefully thought out.

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Closely related to this is another phase which cannot be emphasized too strongly. I have sometimes felt that the Securities and Exchange Commission has not fully recognized the extent of its power over men's reputations. I feel quite strongly that not enough thought has been given to the application of the Commission's investigatory powers to the case of investment counsel, and its power to destroy men's reputations by the mere process of investigation.

It is the stated purpose of title II, as expressed in section 202, to protect the public against fraud on the part of investment advisers in their dealings with their clients. In support of the stated purpose, the bill gives to the Securities and Exchange Commission that same set of powers of investigation which it has under the Securities Act of 1933 and the Securities Exchange Act of 1934. These investigatory powers are virtually unlimited. The pattern, which in the enforcement of these acts has been followed, has been one of extensive and thorough search of all the facts in any given case in advance of any formal action by the Commission. The Commission's trained investigators ferret out every possible lead which contributes to the building up of a case against the person or concern investigated, and in doing so have the support of subpoena powers and of taking testimony under oath. Theoretically, these investigations are "private" until such time as the commission is prepared to formulate its charges. These preliminary investigations may extend over a substantial period of time and may involve the interrogation of large numbers of witnesses and the examination of vast quantities of records. The witnesses interrogated may have little or nothing to do with the major issue in hand, but their testimony is sought for corroborative evidence.

No such investigation can fairly be regarded as "private" after it has progressed beyond the very initial phases. In the financial district, at least, it rapidly becomes a matter of common knowledge that the commission is "investigating" something.

Should the investigation prove unfruitful in the production of evidence sufficient to formulate formal charges, there is no exculpation of the individuals investigated, presumably on the theory that no charges have ever been formally made. The investigation simply lapses.

But the rumor and the stigma which goes with the rumor does not lapse. In fact, it hangs as a cloud over the persons who were drawn in question, until such time as it becomes apparent that nothing has come of it. That time may be many months. It may even run into years.

Now, when you are dealing with investment counsel, you are dealing with reputation. Men who depend for their livelihood upon the opinion of others as to their integrity and their capabilities, are really dependent upon a thing of utmost fragility.

May I impress upon this committee that the mere commencement of an investigation by the Securities and Exchange Commission of an investment counselor, if attended by even the slightest public knowledge, carries with it the virtual certainty that the man's reputation will be damaged if not worse. The mere fact that his integrity has been brought into question, and the knowledge of that fact by even a few people, will instantly raise doubts which will lead clients to cancel their connections and to seek their investment advice elsewhere.

You may say that this would be unjust, but there is no sense in not being realistic about it, because one of the first people that an investigator would seek to interrogate would naturally be the man's own clients. People are sensitive and have a right to be sensitive on the score of the integrity of the people to whom they may entrust their fortunes for investment. If a suspicion of lack of integrity has been raised, the investment counsel's client will very likely take the position that he would rather be safe than be sorry.

What is even more serious, the investment counselor thus made the subject of investigation has no satisfactory way of combating the suspicion aroused by the commencement of the investigation. He may not even know what the charges formulated against him are to be. He has no means of answering anything. An investigation even may be started on one ground and followed up on another, for the initial authorizations are broad enough to cover many matters.

The result is that though an investigation may be dropped before it is fully under way, the damage done to the subject of the investigation may prove to be almost as irreparable as if it had been pursued through to the stage of public consideration by the Commission. When you are dealing with questions of character, let me repeat, you are dealing with the most delicate and at the same time the most valuable thing which investment counselors, or indeed anybody, has. The slightest unskillful use of the Commission's powers in its investigatory field can reek a savage and most unjust result.

Yet this bill takes no account of these facts and simply treats the investment counselor, whose character and reputation lie at the foundation of his success, precisely as you would treat a share of stock or a bond.

These things are being said with the full realization that no regulatory power is worth the paper that it is written on unless there is coupled with it a full kit of punitive powers, and further that punitive powers are ineffective unless they in turn are coupled with full investigatory authority. I realize fully that there is no sense in being sentimental when faced with the task of uncovering and punishing fraud. In some instances, perhaps, the paramount public interest in defeating fraud may justify injuries which nobody wishes to inflict. But as has been pointed out, where the subject of the regulation rests so fundamentally upon personal character and reputation, it is of an equal paramount public interest that that reputation shall be fully protected until justification for its destruction has been established beyond a reasonable doubt.

In the light of the general conditions which have been expressed, detailed discussion of the clauses of the bill would serve no useful purposes. Should the committee determine, nevertheless, that some legislation of this character is called for, we are ready to give out specific suggestions in the effort to attempt a correction of some of the more serious problems arising from its terms as drafted. But the major question of policy of course comes first.

Much for example has been said here in the hearings on title I, concerning the rule-making authority under section 36 (a). Certainly some comprehensive treatment of that should be made in any redrafting of the bill. Administrative agencies admittedly must have rule-making authority, for without it they cannot function effectively. But I believe it to be a sound principle of administrative law that the



rule-making authority should always be circumscribed by the specific grants of authority in the enabling legislation. Only in that way can the fundamental doctrine that the statement of policy is the prerogative of the legislature be preserved.

In conclusion may I emphasize again our approach to this whole problem of the regulation of investment counsel hinges on the determination of a fundamental question of policy in the extension of Federal regulatory authority. There is no disposition to duck the responsibility which any profession has in the development of sound standards and clean practices in the exercise of that profession. But in a nascent profession, such as that of investment counsel, in the first analysis and in the last analysis the main spring of improvement and growth must come from within.

Senator HUGHES. I am sorry that the representatives of investment counsel have the feeling they may be injured by even raising the question as to whether they should be regulated or not. I am not as much alarmed about its reputation as I am about what you may do in your association to cure the evils that exist, and try to get into your association all members who are engaged in your profession, or as many of them as you can, to the end that we may in some way if necessary deal with those who do not want to come in. They are the men who have offended. We will grant all that you have said about the excellence of your organization and all that, but still there remains the duty to protect the public.

I am not going into your question of whether it is constitutional or not, or whether the State should regulate you or the Federal Government should regulate you, but certainly it is something that should be looked after, now or later, to the end of having the people who are engaged in your business, live up to the standards you have established, and your standards are good. That is the way I feel about it.

Senator WAGNER. Senator Hughes, I am with you on that. Are Mr. Loomis or Mr. White here?

Mr. WHITE. I am here, Mr. Chairman.

Senator WAGNER. Did you want to speak again?

Mr. WHITE. I wanted to say something about title II.

Senator WAGNER. Oh, you do. Then you want to say something in addition to what you have already said?

Mr. WHITE. Yes, sir. I spoke on title I.

Senator WAGNER. Against this provision?

Mr. WHITE. Yes, sir.

Senator WAGNER. No compromise? [Laughter.] You will be brief I take it, because we had hoped to finish this line today. It is half past 5 o'clock now, and doubtless some of the folks present are a little weary. As you gentlemen know, there is much to be done when we get back to our offices.

Mr. WHITE. It would take 15 or 20 minutes to make my statement.

Senator HUGHES. Won't you be here tomorrow?

Mr. WHITE. Oh, yes.

Senator HUGHES. I will leave that to the chairman, as to whether we will go on any longer this afternoon.

Senator WAGNER. We will have time to hear you tomorrow morning.

Senator HUGHES. He says he will be back here tomorrow.

Senator WAGNER (chairman of the subcommittee). Mr. White, you are on the list and we will hear you tomorrow morning.

The subcommittee will now adjourn until 10:30 o'clock tomorrow morning.

(Thereupon, at 5:35 p. m., Monday, April 22, 1940, the subcommittee adjourned until 10:30 o'clock the following morning.)

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