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An Institutionalized Market: The Impact Upon Mutual Funds

I

What may properly be called the special report of the Securities and Exchange Commission on mutual funds is a compromise.¹ It is not an attempt to recommend those changes reasonably necessary to insure for the future adequate protection of fund shareholders, free securities markets, and proper safeguards in the funds' relations with portfolio corporations. The report attempts to meet present needs generally in terms of minimal remedies.²

But perhaps this is not unwarranted. The special report is, after all, a report not of the Commission's staff, but of the Commission itself, a body of five individuals, each with his own values, his own interpretation of the facts which are admittedly complex.³ In such a context the report of the Commission should not be condemned but praised. It has both integrity and vigor. Yet, this should not deter full inquiry into the state of the industry as the Congress intended when it authorized the Commission "at such times as it deems that any substantial further increase in size of investment companies creates any problems involving the protection of investors or the public interest to make a study and investigation * * * and from time to time report the results * * * and its recommendations to the Congress."⁴

II

We begin with fundamentals. A mutual fund purchases securities.⁵ Its ability to find and exploit investments successfully depends in no small measure on the actions of the underlying portfolio company and other security holders in that company. To test the behavior of mutual funds, to determine how they are fulfilling their statutory responsibilities, we must understand the implications of what the Commission acknowledges, namely, the growing institutionalization of the stock market.⁶

None would argue that institutions dominate the market. However, none should dispute the influence of institutions in specific major issues and industries. Consider the facts. In the aggregate institutional investors, which include mutual funds, pension funds, trusts, insurance companies, are a mighty force. To illustrate, the Wharton Report studied a mutual fund industry from the period 1952-1958 when assets jumped from \$3.9 billion to \$12.2 billion. The mutual fund industry of 1966 was more than triple the size of that in 1958.⁷ Similarly, "the \$105.8 billion of equity securities held at yearend 1965 by financial institutions was almost four times the \$28.2 billion held at the end of 1955."⁸

The monies flowing to the institutions are not scattered. Rather, they are invested in relatively few issues listed on the New York Stock Exchange. Measured not in terms of outstanding stock, but rather trading volume how imposing is the position of institutional investors. In New York Stock Exchange study for March 10, 1965 "the trading volume of institutional investors and intermediaries was the highest recorded since the (NYSE) transaction studies began.

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¹The report represents an attempt at Commission level to provide an evaluation of the investment company industry. Though the study has depth, it is a compromise. See, "The Prosecutors and the Judges", *Fortune*, December, 1966, 165, 210: "The details of the SEC's new mutual-fund study * * * were handled by a small group on the staff who gathered data, argued fiercely among themselves as to recommendations the study should make, and wrote drafts of all the chapters. But there was then some extremely heavy editing by the commissioners, who did not agree with all the recommendations of the staff—and also had a lot to argue about among themselves."

²SEC Report on the Public Policy Implications of Investment Company Growth, 89 Cong., 2d Sess., 6 (1966), hereafter referred to as Report. See also, text discussion under IV.

³It must be emphasized that the report is one of recommendations to Congress. It is addressed to a political body. By definition the report has limitations. In his letter transmitting the report to Congress Chairman Cohen noted, "Neither the Special Study nor the Wharton report was a report by the Commission. When those reports were published, the Commission undertook to evaluate the public policy questions that they raised. * * * This report is a result of that undertaking." Report at ix.

⁴Section 14(b), Investment Company Act of 1940.

⁵See, Hopper, "Antifraud and Disclosure Requirements in Selling Investment Company Securities," CCH Conference on Mutual Funds, 15 (1966).

⁶Report at 275. See also, Baum and Stiles, *The Silent Partners: Institutional Investors and Corporate Control* (1965).

⁷Report at 275.

⁸Id. at 277. Included in this figure are the equity securities held by mutual funds.