FEDERAL REGULATION UNDER THE NEW ADMINISTRATION OF THE SECURITIES AND EXCHANGE COMMISSION

Address of

J. SINCLAIR ARMSTRONG

Commissioner,

Securities and Exchange Commission

before the

CENTRAL STATES GROUP CONFERENCE

of the

INVESTMENT BANKERS ASSOCIATION OF AMERICA

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I am very glad to be here at the eighteenth annual conference of the Central States Group of the Investment Bankers Association of America. I enjoy being in Chicago, which has been my home for so many years, and seeing so many of my old friends who are members of your Association. More important, I welcome the opportunity to account before this responsible segment of the investment banking industry for the stewardship the new Administration has given to the Securities and Exchange Commission since last July. When our Chairman, Ralph Demmler, addressed the full convention of your Association at Hollywood, Florida, last December, many of the things he mentioned were in the planning stage. I can now report the accomplishment of some of them and progress on a lot more.

I also welcome the chance to use this meeting as a forum for a general expression of the attitude of this Commission in regard to the acts of Congress with the administration of which we are charged.

At the outset, I want to affirm the strong belief of the present members of the Securities and Exchange Commission in the basic philosophy of the acts which we administer. The law provides that the five member Commission include no more than three members of one political party and for five-year terms of Commissioners, one expiring each year. So far as I have observed in nine months of close association with the other members of the Commission, there are no sharp underlying differences of viewpoint toward these laws as between the Republican and Democratic members or as between those appointed by the earlier or by the Eisenhower Administration. There have been differences of emphasis or interpretation, of course. But the five members of the present Commission have locked strong hands together to give a vigorous, practical and, we believe, intelligent administration of laws which, in their regulation of the securities market, have unquestionably improved the American system of free enterprise in the last 20 years.

I for one sincerely believe that the Securities Act of 1933 and the Securities Exchange Act of 1934 have greatly contributed to the restoration of public confidence in the securities markets and in privately owned and managed business and have led to the preservation of the free enterprise system in this country. After twenty years, it might be easy to forget the danger the country was in in 1933 when confidence in securities had been seriously undermined by the staggering losses which the investing public had suffered and the abuses which had occurred. The administration by the Securities and Exchange Commission of these laws and the related laws later enacted to complement them -- the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, the Investment Company Act and Chapter X of the Bankruptcy Act -- and the acceptance by the securities industry of the basic premise that the seller must assume responsibility of full and fair disclosure of the facts pertaining to the issuers of securities sold in interstate commerce, have helped preserve America as a free

country. When we look at the world outside -- socialist or worse -- we can shudder at what might have happened if confidence had not been restored. The investment banking fraternity, as well as other segments of the industry, has I think by steady statesmanlike approach to difficult problems, often in an atmosphere of public hostility, contributed greatly to that restoration of confidence.

Starting from this premise, however, the new Commission, reflecting the policy of the national Administration elected to office in November of 1952, has seen spread out before it a grand opportunity for improving the day-to-day administration of these laws in the interest of the American public, investor and taxpayer. To give you an idea of the approach, let me quote from President Eisenhower's Economic Report to Congress of January 28 of this year:

> "The Federal securities laws were enacted nearly 20 years ago and have remained largely unchanged over that period. Some modifications in these laws are needed which, while fully protecting the interests of investors, will make the capital market more accessible to businesses of moderate size. It would also be desirable to simplify the rules and thus reduce the costs of registration of new issues and their subsequent distribution." 1/

Our objective in inaugurating a broad program of revision of the rules, regulations and forms which have grown up at the Commission over the past twenty years is to simplify, streamline and speed up the orderly administration of the statutes. We believe that the basic protections afforded to American investors by these laws will be strengthened and enhanced by realistic, practical and vigorous administration. We hope that a proper administration of the securities laws will facilitate the free flow of investment capital into industry.

We have adopted rules under the Securities Act and the Holding Company Act which eliminate the delay in the offering of securities to be offered at competitive bidding and dispense with the necessity of the Commission's entering routine supplemental orders previously required. Under the new rules, the post-effective amendment to the registration statement becomes effective automatically on the filing in one of our regional or branch offices and no supplementary order under Rule U-50 is required if two or more bids have been made for the securities. 2/ This eliminates any possible inconvenience to the underwriters from the delay from several hours to several days which used to occur between the time the successful bid was accepted and the time the underwriters were free to make a public offering.

1/ Economic Report of the President, January 28, 1954, 83rd Cong., 2d Sess., House Doc. No. 289, page 88.

2/ Securities Act Release No. 3494, Holding Company Act Release No. 12298.

Our Division of Corporation Finance is also making every reasonable effort to meet the time schedules of issuers and underwriters on registered issues purchased by the underwriters by negotiated sale. In my opinion, the Division's performance has been distinguished over the years by its successful accommodation to financial time schedules. We intend to keep it that way. When delays do occur, they reflect differences with respect to matters considered substantial between the Division and the Commission on the one hand and the registrant on the other. We are doing our best to eliminate petty and insignificant comments from letters of deficiency and to limit deficiencies to matters of substance. In cases in which the difference of opinion between the Division and the registrant cannot be settled by them, the Commission itself is considering the matter and affording both the Division and the registrant's representatives a chance to appear at the table and discuss the matter. We believe that in this way we are affording expeditious administrative treatment of registration statements without in any way impairing or sacrificing the disclosure requirements laid down by the act for the protection of the investing public.

We have under consideration, and hope to release for public comment shortly, a simplified form which would be available for the registration of offerings of institutional grade debt securities. We hope that this form will make possible faster, simpler and less expensive registrations of such debt issues on a basis more nearly competitive with private placements. We contemplate using our acceleration power under Section 8(a) of the Securities Act to permit such issues to be registered more quickly than at present.

In considering the simplification of the debt issue prospectus, we have submitted to the Congress a proposed amendment of the Trust Indenture Act which would permit the Commission to make rules and regulations pertaining to the description in the prospectus of certain provisions required to be included in an indenture qualified under the Trust Indenture Act. This proposal would not in any way affect the provisions required to be included in the indenture, but would merely make it possible for the Commission to permit omission or modification of the description of such provisions now required to be included at length in the prospectus. These provisions are generally known to be included in the indenture because, indeed, the Trust Indenture Act requires their inclusion in indentures securing registered debt issues. Their description in the prospectus is not something that is of interest to anyone other than the lawyers, who would read them in the indentures if they wanted to refer to them at all.

I would like to suggest to you that there is a general misapprehension abroad in the land about the difficulty, expense and time consumed in the registration of a securities issue with the Securities and Exchange Commission. We read in financial papers, we hear from

investment bankers and the thought occurs in the public minds generally, that the difficulty of registering an issue with the Commission for public sale is contributing to the enormous volume of securities issued by American corporations directly to large institutional investors, thereby depriving the small individual investor of a chance to buy new high grade securities. I personally do not believe that the administration of the Securities Act is a substantial contributing cause to the popularity of private placements. If it is, I am hopeful that accomplishment of the form and rule revisions and the administrative procedures at the Commission will make it clear that the registration process is not driving corporations into the arms of the large institutional investors for their long term debt capital.

There was considerable testimony before the Subcommittee of the Committee on Interstate and Foreign Commerce of the House of Representatives in the spring of 1952, testimony both by representatives of issuers and of institutional investors, illustrating many situations in which the flexibility afforded by private placements was the factor motivating the issuer to avoid the public securities markets. 3/ I am sure those of you who have advised corporations in regard to private placement financing are aware of this. Two articles which appeared in the Monthly Review of the New York Federal Reserve Bank in March and April, 1952, went into the matter exhaustively. They recognize that the Securities Act may have been one factor. But private placements are not just a device to avoid registration. They have a real and valid place in the financial system:

> "The development and growth of the private-placement technique of financing is a further source of financial and economic stability, at least on the downside of the business cycle, in that flexible loan agreements arranged through this technique permit appropriate changes which, in period of business decline, can help stave off defaults and reduce losses. Equally important as a stabilizing element is the fact that corporations, as part of the private-placement arrangement, may obtain advance commitments for funds - a practice which may encourage the tendency on the part of corporate management to engage in long-range investment planning. The knowledge, too, that changes in loan agreements - such as the temporary waiver of sinking fund payments - may be made in periods of adversity without forcing a borrower into bankruptcy may also lead to greater willingness to borrow on long term, in order to plan business capital expenditures ahead."

3/ Hearings before a Subcommittee of the Committee on Interstate and Foreign Commerce, House of Representatives, 82d Congress, 2d Sess., May 20 and 21, 1952 ("Direct Placements of Corporate Securities").

Of the corporate securities offered in 1953, 62% amounting to $5.6 billion, were registered publicly offered securities, an increase from the year before, and 38% amounting to $3.4 billion were privately placed ($700 million less than in 1952). I would like to dispel, if I can, the popular notion that the difficulties and expense of registering an issue with the Commission, the waiting period provided by the Act, and the substantial legal liabilities imposed by the Act on the issuer, underwriter and others, are the cause of private placements. I think that argument has been greatly overstated.

However, our contemplated simplification of the registration process in respect of institutional grade debt securities should eliminate, to the extent legally permissible, such competitive disadvantage as registration may impose on public offerings.

Adequate financing of American enterprise in the year ahead will be of vital importance to the maintenance of the high level of economic activity. According to statistics prepared by the Commission's statistical branch, the expected expenditures of industry on new plant and equipment in 1954 will be $27.2 billion, compared with actual expenditures of $28.4 billion in the peak year of 1953 and $26.5 billion in 1952. 4/ In 1953 corporate offerings were $8.9 billion, in 1952 $9.5 billion. 5/ It is clear that there is a big job ahead for investment bankers in the current year.

The new Commission has eliminated the requirement for the filing of quarterly reports of gross sales and operating revenue. Because of short term and seasonal business changes and the frequent occurence of a net earnings trend contrary to the gross trend in a company, these 9-K reports were abolished. 6/ However, our statistical branch receives on a voluntary basis quarterly reports of net sales, net earnings and condensed balance sheets from over 1,300 representative corporations and analyzes them for the purpose of preparing statistics on expenditures on new plant and equipment and working capital of corporations, which are published in the Commission's quarterly Statistical Bulletin and for making special economic studies, in collaboration with other governmental agencies, such as the Commerce Department and the Federal Reserve System.

We have simplified the so-called "when issued" trading rules, eliminating fourteen rules and two forms. 7/

We are considering revision of the numerous forms used by officers, directors and others for the reporting of ownership or changes in ownership of securities of listed companies so that seven forms now used may be consolidated into two or three.

We are revising the reporting rules under Section 16 of the Securities Exchange Act which relate to short swing trading by

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4/ Statistical Series Release No. 1221.
5/ Statistical Bulletin, February 1954, Vol. 13, No. 2.
6/ Securities Exchange Act Release No. 4949.
7/ Securities Exchange Act Release No. 4989.

directors, officers, and 10% shareholders. The present rules and forms are needlessly complicated. To meet a particularly pressing problem which we felt was not comprehended within Section 16(b) of that act, we revised Rule X-16B-6 to exempt certain dispositions pursuant to mergers or consolidations and the like. 8/

We are studying the form for registration of employee stock offerings with a view to expanding its use. The present Form S-8 provides wide latitude for the use of the issuer's annual report to security holders and other published material readily available. We are considering permitting use of this form by a larger number and more varied types of employee stock offerings, and revising the form itself so as to make it available for offerings under employee stock option plans.

We have adopted new forms for registration under the Investment Company Act of management investment companies and for registration under the Securities Act of securities of open-end investment companies, together with related rules. 9/

We are considering a rule prescribing standards under which Canadian investment companies may register as investment companies and offer their securities for sale in the United States. 10/

We have adopted a new rule requiring brokers and dealers to file financial statements with their applications for registration; 11/ a new 9-item form for registration of brokers and dealers instead of the old 27-item form; 12/ simplified forms and reports of brokers and dealers associations to eliminate voluminous exhibits containing information otherwise readily available; 13/ and a new system annual reporting form for public utility holding companies. 14/

We have put out for comment proposed revised forms of quarterly and annual reports for registered management investment companies 15/ and applications, reports and other forms pertaining to registered investment advisers. 16/

8/ Securities Exchange Act Release No. 4998.
9/ Investment Company Act Releases Nos. 1932 and 1933.
10/ Investment Company Act Release No. 1945.
11/ Securities Exchange Act Release No. 4902.
12/ Securities Exchange Act Release No. 5000.
13/ Securities Exchange Act Release No. 4942.
14/ Holding Company Act Release No. 12430.
15/ Investment Company Act Release No. 1957.
16/ Investment Advisers Act Releases Nos. 71 and 72.

We have adopted a rule relieving exchanges on which a security is admitted to unlisted trading privileges from reporting information which duplicates information reported by the issuer where the security is fully listed on another exchange. 17/

We surveyed in a single broad sweep the over-all reporting problems represented by the annual reports of listed companies on Form 10-K, the proxy statements of listed companies soliciting proxies, the annual reports of the so-called "undertaking" companies, and the requirements for the registration of additional shares of a listed security on Form 8-A, and have attempted to deal with these reporting problems as a unified whole. 18/ There appeared to be no good reason why a company which solicits proxies should be required to duplicate the information contained in the proxy statement in an annual report which, in practice, is filed with the Commission in most cases within two or three months after the proxy material. By making a minor change in the proxy rules, we determined that the information required by these rules would be entirely adequate for purposes of an annual report with respect to the subject matters covered by these rules. 19/ We are hopeful that these revisions of the Commission's reporting requirements will give further impetus and incentive for the publication by listed companies of reasonably detailed annual reports to shareholders. Under the revised proxy rules, financial statements contained in the annual report to shareholders may be incorporated by reference in the proxy statement, provided they comply with the Commission's accounting rules. We sincerely hope that more and more reports to shareholders will include balance sheets and profit and loss and surplus statements which meet the Commission's accounting requirements. Such a development will be of mutual benefit to shareholders and managements alike.

Under the revised rules, the old requirement that applications be filed for the registration of additional amounts of a listed class of securities has been eliminated. Under the new rule, the original application is deemed to apply for registration of the entire class and the registration of unissued shares or amounts becomes automatically effective when they are issued. This change will eliminate approximately 500 applications a year and will materially simplify and reduce the issuer's work in complying with the Commission's requirements and the administrative burden of the Commission.

We have adopted rules permitting trading in validated securities of German issuers and are attempting to have made available more adequate financial information about these issuers. 20/

17/ Securities Exchange Act Release No. 4914.
18/ Securities Exchange Act Release No. 4991.
19/ Securities Exchange Act Release No. 4979.
20/ Securities Exchange Act Releases Nos. 4983 and 5011.

Finally, we are also considering rules relating to the stabilization of securities under the Securities Exchange Act. As you know, Section 9(a)(6) of that act makes it "unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exchange to effect either alone or with one or more other persons any series of transactions for the purchase and/or sale of any security registered on a national securities exchange for the purpose of pegging, fixing, or stabilizing the price of such security in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Regulation X-9A6-1 under this provision was adopted in 1940 and is limited to the narrow area of stabilizing the price of a security to facilitate an offering at the market or at a changing price related to the changing market price. The practice applicable to a fixed price offering has been embodied in a number of interpretations, some of which were contained in releases, but most of them rendered individually by letter or telephone, case by case. Thus the vast bulk of day-to-day stabilizing transactions in connection with new public offerings of securities have not been the subject of any Commission rules, other than the familiar bold face disclosure in the prospectus that stabilizing may occur 21/ and the requirement that stabilizing transactions be reported within 24 hours. 22/ The Commission's policy in the past was based on the feeling that the problems of stabilizing were so difficult and novel that no comprehensive rule should be promulgated until experience had been built up, case by case, over a period of time, like the common law. This process has taken place. It should therefore now be possible for the Commission's jurisdiction over stabilizing to be asserted by rules and regulations, published and available for all to see.

Because of the complications and difficulties inherent in the subject of stabilizing, the drafting of a stabilizing rule covering most of the usual types of stabilizing transactions has taken much time and study by our Division of Trading and Exchanges. I can now report that the Division has prepared three rules, the first dealing with underwriters' trading during a distribution, the second covering the times, methods and levels at which stabilizing transactions may be made, and the third covering distributions in connection with the purchase of rights, such as the so-called "Shields Plan." After study by the Commission, these will be promulgated for comment.

We hope that the promulgation of general stabilizing rules will lead to fewer informal interpretations, but recognize that interpretive questions will arise which underwriters should submit to the Commission.

21/ Securities Act Rule 426.
22/ Securities Exchange Act Rule X-17A-2.

This Administration is dedicated to the principle that administrative action should be based on direct and clear statutory authority, and not just on implied or fancied powers. We have looked at the statutes we administer carefully and will continue the process of looking to see if our jurisdiction in particular areas is to be found in the acts of Congress. This process of statutory self-examination and soul-searching has involved a study of one of our rules under the Public Utility Holding Company Act, Rule U-50, which provides, among other things, for the manner of offering new issues of public utility subsidiaries of public utility holding companies registered under the Public Utility Holding Company Act of 1935.

I would like to take this opportunity of describing how the proposal, on which we are presently holding hearings, developed.

The competitive bidding rule, Rule U-50, applies to issues of securities of registered public utility holding companies and of public utility companies which are subsidiaries of such holding companies. Section 6(b) of the Public Utility Holding Company Act of 1935 provides that "the Commission by rules and regulations or order, subject to such terms and conditions as it deems appropriate in the public interest or for the protection of investors or consumers, shall exempt from the provisions of subsection (a) the issue or sale of any security by any subsidiary company of a registered holding company, if the issue and sale of such security are solely for the purpose of financing the business of such subsidiary company and have been expressly authorized by the State commission of the State in which such subsidiary company is organized and doing business." The subsection (a) referred to provides for the filing with the Commission of a declaration regarding a financing plan and the taking of action by the Commission to make such declaration effective. Declarations relating to a financing plan may only become effective if they meet the requirements of Section 7 of that act, which lays down standards as to the types of securities which registered holding companies and their subsidiaries may issue.

We have recently put out for comment a proposed new rule which would exempt from the competitive bidding requirements of the Commission securities of subsidiary companies the issue and sale of which have been expressly authorized by the State commission. 23/ What did the Congress mean when it said the Commission "shall exempt" securities expressly authorized by State commissions?

When the Commission first considered this question of statutory interpretation in July and August of 1953, it was faced with two other factors. The first was that the Commission was engaged in a staff reduction imposed by the exigencies of a diminished budget. We were cutting the number of available people in the Commission's headquarters

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23/ Holding Company Act Releases Nos. 12217-X, 12314 and 12236.

office in Washington by 43, or about 8%, and we were looking for areas in which duplicative work could be eliminated without adversely affecting public interest. The approval by the Commission of securities expressly authorized by State commissions suggested itself as an unnecessary duplication by the Federal government of a State regulatory function for which an exemption had been specifically carved out by the Federal statute. Secondly, you will recall the very tight money market of May, June, July and August of 1953. During these months we were confronted by a number of requests, both formal and informal, for exemption from the competitive bidding rule by companies which, in the exercise of the best judgment their managements were able to bring to bear, felt that they could not successfully market securities at competitive bidding under the rule. Most of these requests for exemption we denied, but not without wondering if Rule U-50 itself was not deficient by reason of its failure to accord any recognition at all to the statutory exemption in cases in which the State regulatory authority appeared to be exercising the jurisdiction specifically referred to in Section 6(b) of the Holding Company Act.

Then another event occurred. On October 14, 1953, Judge Harold R. Medina, sitting in the United States District Court for the Southern District of New York, released his opinion in the anti-trust case against seventeen investment banking firms. The opinion raised very serious questions about some of the bases for the adoption by this Commission of Rule U-50 in 1941.

I can assure you that the proposed revision originated at the Commission table. It was not suggested by any utility company, banker, Government official or agency, or person outside the Commission.

At the present time, the Commission has made no decision in the matter and will not make a decision without further careful and exhaustive study in the light of the hearings held and the briefs, memoranda and oral argument that have been submitted and made, including those of the regulatory authorities of the affected States.

I will mention before closing one further part of the Commission's program, relating to broker-dealer inspections.

Under Section 17(a) of the Securities Exchange Act, the Commission is empowered to make "at any time, or from time to time, such reasonable periodic special or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors" of registered broker-dealers. The legislative direction is that the Commission do as much or as little inspecting as it deems necessary or appropriate in the public interest.

As a matter of fact, the extent of the broker-dealer inspection program depends primarily on the availability of funds, and unfortun-

ately the Commission has available for the current fiscal year, and expects to have available for fiscal 1955, only about 42 broker-dealer inspectors. When you consider that there are over 4,000 registered broker-dealers, this is a very thin inspection program. Unfortunately, the public may have the impression that broker-dealers are examined pretty much the same way as banks are examined by the Comptroller of the Currency. The Commission is very much concerned with the weakness of this program and is taking steps administratively within the regional offices to improve both the quantity and quality of broker-dealer inspections.

As you are aware, members of some of the national exchanges and members of the National Association of Securities Dealers are subject to certain audits and inspections. An additional weakness when you consider the problem generally is that in only ten of the 48 States is there any program at all for the inspection of brokers and dealers, and in only two of those States do the State authorities have sufficiently broad powers to engage in a program of routine inspections. This seems to place responsibility to act very squarely on the Securities and Exchange Commission whether we like it or not.

You might also be interested, and indeed concerned as we are, to consider that the number of violations turned up by our inspections is discouragingly large. In fiscal 1953, when 686 broker-dealers were inspected, 40 firms were found to be in financial difficulties, 154 were found to be charging customers unreasonable prices for securities purchased, 141 were violating Regulation T, 40 were violating the hypothecation rules, 360 were violating confirmation and bookkeeping rules, and a number of other miscellaneous violations were discovered.

Recognizing the seriousness of this situation, the Commission has conferred over the past year with representatives of the National Association of Securities Administrators, the National Association of Securities Dealers, Inc., and the New York, American and Midwest Stock Exchanges to see if all of the agencies and organizations making broker-dealer inspections could work out a coordinated program. Understandings have been reached in the last month which we hope will work improvements.

Duplication of examinations by more than one inspection within short periods of time not only are an unjustified harassment, but represent an unnecessary waste of manpower and money. Conversely, long term omissions to inspect some firms cannot be justified. Therefore, a plan has been worked out by which the regional offices of the Commission will make available to the State, NASD, and exchange inspectors information as to firms which have been recently inspected by the Commission. These cooperating agencies and organizations will make similar information available to the Commission as to inspections made by them. Scheduling of inspections by the cooperating agencies and organizations will be coordinated. Of course, a public agency,

such as the Securities and Exchange Commission, cannot abandon its functions to private organizations, nor would members of the private groups approve the use of their inspectors as informers to public authorities with respect to matters not involving defalcations or insolvency. But even though the scope of inspections made by the Commission differs from the scope of those made by others, we believe that this program of cooperation and coordination between Federal, State and industry broker-dealer inspectors will lead to better results from the total of manpower and money available for this phase of the regulation of the securities industry.

I submit to you members of the investment banking fraternity that the conditions which I described a moment ago are serious from the standpoint of the industry, and that renewed emphasis on the broker-dealer inspection program of the Commission is as much in your interest as in the interest of the investors and the public we are charged with protecting.

Finally, let me say a brief word about our legislative program. As many of you know, the Commission assisted the appropriate Committees of the Congress in the formulation of some technical non-controversial amendments of the Acts. The Commissioners unanimously recommended these proposals and they have received the approval of the Bureau of the Budget as being in accord with the program of the President. Identical bills were introduced in the Senate and House, hearings were held at which the Commission appeared and our Chairman testified at length. From here on the matter is in the hands of the Congress, and no comment by me as to the bill's chances of enactment would be appropriate or worth anything. The Commission's function is to administer the law, not to make it. The bill was passed by the Senate unanimously and is presently pending in the House Committee on Interstate and Foreign Commerce. The privilege of working with the Senate and House Committees and their staffs greatly impressed me with the ability and devotion to the public interest of our legislative leaders.

Thank you very much, gentlemen, for this opportunity of telling you something about what the new Commission has been doing and of its plans for the months ahead.