

**SOME COMMENTS ON THE OBLIGATIONS
OF THE
SECURITIES AND EXCHANGE COMMISSION**

by

**ANDREW DOWNEY ORRICK
Commissioner
Securities and Exchange Commission**

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Description of Commission Activities

On the twenty-third floor of a New York skyscraper two intent men on the Commission's staff are studying the ticker tapes of the New York and American Stock Exchanges. They are looking for any unusual market activity, either in trading volume or prices, that may indicate the existence of manipulative practices.

A warehouse loft in New York's garment district is buzzing with an exceptional kind of activity. Thirty or so telephones are clanging. Stockteering salesmen are touting to sucker prospects across the nation highly speculative securities that have not been registered with the Commission for public sale. A task force of Commission investigators enters the loft. They demand to see the business records of the firm. They take the names of the salesmen, many of whom have criminal records, and within a few days a court injunction is obtained to stop further illegal sales. The preparation of a criminal case against the firm and its salesmen is immediately commenced.

In its San Francisco Office the Commission's Regional Administrator advises the president of a small electronics company how to comply with Regulation A, governing small offerings of securities. In Fort Worth a Commission enforcement attorney interviews a confused widow. She has squandered her life savings in a promotional scheme based upon a "doodlebug" stick, which was represented as being capable of detecting the location of oil reserves. In Los Angeles an inspector is examining the records of a broker-dealer. He is checking to determine whether the customers have been fairly dealt with, whether the firm is adequately capitalized, and if the business is generally being conducted in accordance with the standards of the securities laws. Enforcement action will be recommended where serious or continued violations are uncovered. More commonly, the inspector concludes his examination by giving the firm helpful advice on how to comply with the requirements of the securities laws.

The five members of the Commission are meeting in almost continuous session around a large oblong table in Washington, D. C. They are conferring with representatives of a prospective issuer of securities regarding the necessity for registering its offering with the Commission. They are consulting with the Commission's staff about the institution of stop order proceedings against a registrant who had omitted to state in its prospectus that its uranium claims were located only 200 miles from

the Arctic Circle and 150 miles from the nearest railroad. They are sitting as an administrative court, listening to arguments on the question of revoking the registration of a broker-dealer firm for churning the accounts of its customers.

These types of activities, carried on by the Commission and its approximately 800 employees throughout the country illustrate some aspects of its work. Each of us, in his particular capacity, is doing a job to protect for the public the citadel of honesty and fair dealing in securities transactions.

The Commission is entrusted with extensive authority over the affairs of the financial community. Its regulation of the processes of capital formation, the securities markets, the large public utility holding company systems, and investment trusts have a direct and significant impact upon the economy of the country. It must, therefore, have a clear understanding of its fundamental responsibilities and obligations. These are inseparable from its broad grant of powers and must be judged in the context of the ultimate statutory criteria - the public interest and investor protection. An appraisal of the nature of these obligations, and to whom the Commission is accountable in executing its public trust, will clarify the guidelines for its operations.

The Securities and Exchange Commission, like all Governmental agencies, bureaus and departments, has, as its primary obligation, the responsibility of serving and protecting the public. This obligation to the public has two facets - one involves its basic duty to protect public investors, the other concerns the legitimate needs and interests of the regulated industries.

Obligations to Investing Public

The investing public is entitled to the protection afforded by a vigorous and aggressive, not apathetic or passive, administration of the securities laws. The Commission must continue to implement its energetic enforcement program to compel the registration of securities proposed to be distributed to the public in interstate commerce. It has an obligation to impose high standards of disclosure upon issuers whose securities are offered and traded in the public markets. Persons who solicit proxies from shareholders of listed securities should be required to inform them fully of the nature of the matters to be considered at shareholders' meetings and to afford them the opportunity to vote for or against proposals. It must be vigilant in enforcing the timely filing of accurate and complete reports by issuers respecting their financial condition and operations and by insiders respecting their holdings of, and dealings in, the company's securities. In short, the Commission has the obligation to persist in enforcing the principle of corporate publicity for the benefit of public investors, both present and prospective.

The Commission has the duty to preserve and enforce high criteria of conduct for brokers and dealers and investment advisers. Its responsibility to prevent the perpetration of frauds on investors by promoters and securities salesmen, which take many ingenious forms, requires alert and prompt action by the Commission. Its program to protect the public from the nefarious operations of "boiler-rooms," must drive forward.

The Commission must regulate, with faithful adherence to the statutory prescriptions, the financial structure and transactions of registered public utility holding company systems and investment companies. It must strictly enforce the protective standards established in the Trust Indenture Act for safeguarding investors in debt securities. In bankruptcy reorganizations it is obliged to defend the interests of public investors by assisting the courts in determining the fairness and feasibility of proposed reorganization plans.

Obligations to Regulated Persons

The public also consists of persons who have subjected themselves to the jurisdiction of the securities laws. To issuers who make public distributions of securities in interstate commerce and to registered brokers and dealers, the Commission has the obligation to restrain from imposing any type of regulation that is not clearly required to provide adequate investor protection. In the exercise of its licensing and regulatory powers, the Commission must conduct its business equitably and expeditiously, under consistent policies of interpretation.

As an administrative body exercising broad rule-making powers, it has an obligation to adopt and modify its regulations and forms, subject to the intentment of the statutes, to meet the changing conditions and requirements of the economy. With the recent adoption of the amendments to registration forms applicable to industrial and mining companies in the promotional or developmental stages, the Commission has nearly completed its present program for form simplification. A proposed amendment to delimit the use of the "no sale" theory in connection with certain mergers, consolidations, reclassifications and exchanges, embodied in Rule 133, is being actively studied.

The Commission has a continuing obligation to enunciate its interpretations of various provisions in the statutes, which at times prove to be troublesome in determining their proper application to particular factual situations. The meaning which the Commission ascribes to the requirements and prohibitions in the statutes under its jurisdiction should never be shrouded in mystery. The principles underlying their application should be clearly, frequently and publicly explained for the benefit of all persons who are, or may become, subject to the Commission's regulation. Our experience has shown that issuers of securities, brokers and dealers and the financial bar normally wish to

comply with the requirements of the securities laws, provided they know what these requirements are and how the Commission construes the statutory provisions and its own rules and regulations.

Obligation to Carry Out Congressional Mandate

The Commission has the obligation to administer the laws under its jurisdiction in scrupulous conformity with the mandate from Congress as set forth in the statutory language. It must not attempt to use powers which were not granted nor shirk from exercising any authority which was conferred. Obvious as this principle may seem, against the broad panorama of the economy or in the narrow perspective of a particular case, there is sometimes a tendency to overlook the fact that the Commission is a creature of law entrusted with specific but limited powers.

The perplexity that frequently faces the Commission in interpreting Congressional policy and the extent of its statutory powers is vividly illustrated by the rules promulgated under Section 16(b) of the Securities Exchange Act. This subsection, together with the reporting requirements prescribed in 16(a), is designed to prevent the unfair use of corporate information by insiders - officers, directors and 10% stockholders. 16(b) provides for the recapture by the issuer of profits realized by insiders from the purchase and sale, or sale and purchase, of the securities of the issuer within any six months period. It grants to the Commission the power by rule to exempt from its coverage any transactions that the Commission determines are not comprehended within its purpose. Pursuant to this authority, the Commission exempted from the recapture provisions the acquisition of shares or non-transferable options "acquired pursuant to a bonus, profit-sharing, retirement, or similar plan," if the plan meets certain detailed conditions. It is apparent that the exercise of exemptive powers involves a balancing of interests. The possibility of abuse in using inside information in these transactions must be weighed against the interference that the statutory prohibition imposes on the right of individuals to trade in securities. Recently, the United States Court of Appeals for the Second Circuit, in Greene v. Dietz, raised a question as to the validity of this exemptive rule and expressed doubt that it could be relied upon. The Commission is presently considering a modification of the rule.

Obligations to Inform Public of its Activities

As administrators of disclosure statutes, the Commission has the obligation to afford ready accessibility, for the press and all interested members of the public, to all public filings and applications and Commission opinions and rulings. Proposals to adopt or amend its rules must be widely disseminated in order to give all interested persons the opportunity to submit comments. With the exception of its investigatory proceedings, which are generally conducted privately in order not to injure reputations needlessly or to preserve evidence for possible prosecution, all of its operations must be conducted openly and under the full

glare of publicity. The public should be kept fully informed of the underlying reasons for all of its actions.

Obligations to the Congress

The Commission is, of course, directly accountable to Congress for the administration of the statutes committed to its care. It has the statutory duty to make annual reports to Congress on its activities and a continuing responsibility to report to two standing Congressional committees - the Banking and Currency Committee of the Senate and the Interstate and Foreign Commerce Committee of the House of Representatives. In addition, a third Congressional committee, known as the Special Subcommittee on Legislative Oversight of the House of Representatives has been invested with powers to investigate the conduct of various independent agencies, including the Securities and Exchange Commission. The stated purpose of this special subcommittee is "to see whether or not the laws as intended by the Congress were being carried out or whether they were being repealed or revamped by those who administer them." Frequently summoned to testify before various committees of Congress to report on its administration or comment on proposed legislation, the Commission has the obligation always to give candid reports and honest opinions.

The Commission has an obligation to recommend to Congress further legislation on matters within its jurisdiction. This year, the Commission has submitted to Congress a broad amendment program designed to close loopholes, clarify language and strengthen investor protection in five of the seven statutes administered by it. A total of 87 sections and subsections of the various laws are affected. Among the more important, and for some of the industry groups the most controversial, are the following proposals: the establishment in the Securities Exchange Act of the status concept for brokers and dealers, under which the act of registration with the Commission would create its jurisdiction over brokers and dealers without the necessity for proving use of the mails or other interstate facilities; the grant of authority to the Commission to adopt rules regulating the segregation of customers' securities and excess collateral held by brokers and dealers; the imposition of a requirement that an investment company obtain stockholder approval where fundamental changes in investment policy are made and that it state its investment policy in its prospectus; the requirement that investment advisers keep and maintain records and make such reports as the Commission may prescribe; and the grant of inspection powers to the Commission over the activities of investment advisers.

Obligations to the Economy

The Commission has an obligation to function in accordance with a fundamental and generally accepted concept of Government regulation. This concept has two aspects. First, the Government must provide sufficient regulation of business to protect the public from recognized evils. Where private rights may be threatened or jeopardized, public opinion demands the protections afforded by Government regulation. Second, regulatory power must not be exercised in a manner that would tend to suppress economic growth or unnecessarily interfere with the free enterprise system that is the basis of the American economy. On the contrary, the regulation that the Commission exercises over the processes of capital formation, the securities industry and public utility holding company systems should be conducted in a manner that will strengthen our economic system. The ultimate obligation of the Commission to our economy is to preserve the confidence of the American public in the integrity of our financial and industrial institutions.

Obligations to Protect Constitutional Rights

The Commission has the obligation to administer its various powers within established legal principles, both substantive and procedural. One of the procedural safeguards which the Commission has always carefully observed, even prior to the enactment of the Administrative Procedure Act of 1946, is the separation of adjudicatory functions from its other responsibilities.

The observance of internal controls, which insulate prosecutory and investigative duties from its decisional processes, affords important protection to the constitutional rights of litigants before the Commission by preserving independence of decision in adjudicative matters. The advice and assistance of one set of specialists is obtained by the Commission in administering its investigatory and prosecutory activities. Another staff group, which has not taken any part in the adversary proceedings, assists the Commission in its decisional processes.

The combination of powers entrusted to the Commission has not been prejudicial to individual rights. On the contrary, the power to make quasi-judicial decisions on the basis of substantive evidence, which are subject to court review, has been conducive to careful and responsible initiation of objective investigations and to the development of fair and complete records. The exercise of adjudicatory powers by the Commission has been an important factor in the development of a generally consistent body of securities jurisprudence and has made uniform interpretations of the statutes possible.

The question whether administrative agencies can render fair and impartial justice has topical significance, because a bill has been introduced into the Congress which is designed to establish an administrative court and to transfer the adjudicatory functions of certain

Independent regulatory agencies to this special court. Although this bill is not applicable to the Securities and Exchange Commission, its philosophy should be recognized as a threat to the effectiveness of the administrative process.

Conclusion

The Commission and its staff are, and must continue to be, alive to these obligations which have been discussed. The Commission is constantly re-examining its substantive and procedural rules in the light of these obligations. However, in order for the Commission to give the utmost possible protection to public investors and serve the public interest in the most effective manner, it is essential that the investment industry and the financial bar recognize and fulfill their own obligations to keep informed as to the standards prescribed under the securities statutes and to cooperate in attaining the Commission's objective of full compliance with these statutes.

During the next two days the Commission and some of the key members of its staff will have the opportunity to discuss with you many important and complex problems arising under these laws. The continuing search of the Commission for the sound answers to the variegated questions that are daily met in its administration will be greatly assisted by the discussions with you at this conference.

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