A QUARTER OF A CENTURY OF SECURITIES REGULATION

Address by

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We have now all lived for the last quarter of a century in a capital formation process regulated by an independent regulatory agency. To understand thoroughly and appreciate fully today's economy and to compare it with the past, we must consider the effect of this compartively new force on our securities markets. In these few brief minutes that I have to spend with you, I thought I would take the opportunity of reviewing the background leading to the enactment of the various federal securities acts, while at the same time taking into this perspective the conditions presently in the public money markets as well as considering what vital factors are present today that may affect future public financing.

Many of us were either too young to remember or have forgotten some of the bleak facts of 1929 and the years immediately following. In order truly to understand what took place, let me point to the record of the early thirties. The value of all stocks listed on the New York Stock Exchange on September 1, 1929 totalled $89 billion; in the days immediately following black Thursday in September of 1929 when the break in the market occurred, this value fell $18 billion. By 1932 the aggregate figure was down to $15 billion, reflecting a total loss in such value of $74 billion in two and a half years. There were also equally significant losses in the bond market. At the same time, American investors suffered similar substantial losses on investments in foreign securities. The first piece of federal regulation to come into what was a thoroughly demoralized capital formation process was the Securities Act of 1933, which became law in May of that year. It is almost twenty-five years since these grim figures were part of our national scene and constituted a most discouraging symbol of the capital system.

History indicates that long before 1929 the rumblings and danger signs of the stock market collapse were apparent to many and reform first began with the great utility study of the Federal Trade Commission commenced in 1928 pursuant to Senate Resolution. That memorable utility study published in 101 volumes in 1935 disclosed what was at the heart of the market weakness and the water in security values. As the study pointed out, these included inflationary market write-ups of assets; acquisition of properties at grossly inflated prices; excessive issuance of debt securities allegedly secured by such overvalued properties and assets; and the general preoccupation of management in financial manuevering predicated on "upstreaming" subsidiary earnings to the top-heavy holding company parent to support excessive dividends necessary to maintain market acceptability of the holding company's securities rather than on creating sound operating companies.

Significantly, this study pointed out what was actually the condition of the securities market in general and the publication of the study in 1935 led to the enactment of the Public Utility Holding Company Act of 1935. Prior to that, however, the Congress had enacted the Securities Act of 1933, which has been called by one writer the "truth in securities" Act. Basically, this legislation was designed to supply investor protection through disclosure of the basic facts, financial and otherwise, of corporations seeking to raise capital in this capital formation process so that potential buyers could be informed investors prior to their purchases. As a result, today, twenty-five years since the enactment of this first legislation, we find very different conditions. The evils of overstating assets are part of the past. The vast volumes of information which are filed under the various securities acts are constantly being analyzed by

independent financial advisory services, brokers and investment bankers, and thus investors are afforded the opportunity of deciding for themselves whether they wish to invest in any particular type of business, be it a "blue chip" or a highly speculative, newly organized venture. Securities are continuously being studied individually, or by comparison within industries, and in connection with particular financial investments all sorts of analytical yardsticks are employed by the financial community, which makes the securities markets ones based on relatively realistic values analyzed in the clear light of day. As you know, the Commission was denied by the Congress the right to make any such "value" judgment or to pass upon the merits of any securities and such determination was left where it belonged--with the investing public. Assuredly, it must always stay that way, for I cannot see how a capitalistic society can properly relegate this duty of value appraisal of securities to the regulator and still call itself a nation with a free market economy.

I recently stated in a talk before a Chicago organization that most people do not read a prospectus thoroughly. This is unfortunate, for the spirit behind the federal securities acts is one of self-help and self-regulation. Nevertheless, whether or not all or most prospective investors read prospectuses is not as important as it may seem. Thousands of investment banking and brokerage firms, trust companies, insurance firms, institutional investors, investment companies, investment advisors and statistical services do read the prospectuses from cover to cover so as to advise their customers as to whether to buy or not, on the basis of information contained in the registration statement of which the prospectus is a part. The fact is that services like Dow-Jones, Moody's and Standard and Poor's have permanent staffs at work

each day in the public reference room of the Commission in Washington, D. C., so as to give this data the broadest possible dissemination to the investing public. The work of these services is eloquent testimony of the importance of proper and fair disclosure and such services constitute a bulwark of the capital market process.

In our efforts to assist the marketing of securities and encourage the dissemination of information, this Commission adopted Rule 434A in November of 1956, which allows certain issuers to use a summary prospectus. Until 1954, the statute made no provision permitting the use of such a document. As a consequence of the 1954 amendments, which provided the necessary statutory authority, the use of summary prospectuses are now allowed and this affords corporations going to market with new securities issues an opportunity of providing a shorter, summarized document which can be mailed, printed in newspapers, and otherwise widely distributed to the investing public during the waiting period prior to the effective date of the registration statement.

This new rule was a great step forward. I can say this because distributions of securities in the 1920's were marked by "stampeding" tactics spurred on by single-page "tout" sheets which, at the very least, omitted to state material facts and in many cases were plainly false and misleading. Despite this historical record of danger, the Commission has determined that a supervised summary prospectus properly prepared would aid the capital formation process. Since November 23, 1956, at which time the Rule was promulgated, our experience with summary prospectuses has been most satisfactory.

In the area of dissemination of information about corporations, I thought it would be proper to discuss Commission's Release No. 3844 which has aroused a great amount of interest. As I

have told you, the entire theory of the Securities Act of 1933 was disclosure. This disclosure philosophy was further implemented by the Securities Exchange Act of 1934 which requires companies admitted to listed trading privileges on national securities exchanges or companies which have registered securities under the '33 Act to meet the financial reporting requirements of the Commission's rules. This information about such companies is now filed annually and periodically. As you see, public information about public companies is thus made constantly available.

Furthermore, this information is the basis and background of analytical reports made by investment advisory services of corporations. All in all, there is dissemination and digestion of vital investment facts.

During recent months, there have been occasions for the Commission to raise some questions about the timing and contents of certain literature mailed by companies, the investment banking and brokerage industry. Let me state that any sales effort as to a security before its registration statement is filed with the Commission would constitute an offer to sell as defined by the Securities Act of 1933 and accordingly would be a violation of Section 5. No one has ever questioned this point. The law is quite clear. The area in question arises where a company or its underwriter does indirectly what it is prohibited from doing directly. As a matter of law, there is no distinction. As a matter of fact, it is at times most difficult to prove the intent of a person in disseminating pre-filing literature and no exact rule of thumb can be followd in dealing with this problem. Any such activities must be dealt with on a case-to-case basis.

It therefore follows that dealers, underwriters or issuing corporations must be on the alert in their attempts to preclude any

charge that public information they issue may have been timed for dissemination at or about the period immediately preceding the filing of a registration statement as a part of a planned sales campaign. This does not mean that corporations and underwriters must close down advertising departments, gag their officers, and dismiss their public relations staffs. However, looking at the objective indicia of the disseminated facts, there can be reasonable doubts at times of what a person's objectives may be. Chairman Gadsby, of this Commission, made reference to some cases which have caused problems. One of these concerned the use of the Annual Report. It's one thing to issue the Report at or about the normal routine time and another thing to accelerate or delay such report so as to make its appearance coincide with a financing which report at the same time includes projections of earnings, optimistic growth predictions and highlighting only the favorable factors in the corporation's background. Someone, of course, will come along and assert that I endorse the elimination of annual reports or some other farfetched conclusion. Suffice it to say that the Commission has continuously encouraged the dissemination of information by corporations and the securities industry as part of the capital formation process. Nothing could be farther from our objective than to stifle such dissemination on information vital for investors.

This Commission does not and has never sought to interfere with the disclosure process and analytical reports prepared and distributed by corporations and underwriters, respectively, as a part of their normal routine of public dissemination of information which may be a valuable guide to investors.