For Release upon delivery

"TODAY AT THE S. E. C."

Address by

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About a year and a half ago I came home to Detroit to report, in a sense to report to my own people, on what was going on at the S. E. C. This I did in a talk at the Economic Club. There, in November of '48, I reviewed not only the work of the Commission but some of the cases which were at that time much in the limelight. With your permission, I would like to make a somewhat similar report tonight.

Back in November of 1948 everyone wanted to know about the Tucker case, and about the Kaiser-Frazer financing. They were interested, too, because of its local holdings, in the approaching break-up of The American Light and Traction Company. This break-up was being done under Section 11 of the Public Utility Holding Company Act. There was also considerable interest in registration problems, particularly where an officer or director or controlling shareholder sells all or part of his holdings; and in many other items of Commission business.

Now, eighteen months later, the Tucker case is history. The American Light and Traction Company, once the parent of such important local utilities as Detroit Edison, Michigan Consolidated and Madison Gas & Electric, is no more. Having disposed of its electric properties and constructed a new pipeline from the Hugoton fields, the company became an integrated natural gas company and accordingly changed its name to the more appropriate American Natural Gas Company. The great Detroit Edison Company is now an independent operating utility, with local management and extensive local ownership; while American Light and Traction's former parent, The United Light & Railways Company, is in the process of complete liquidation.

Now some new faces have come into the horizon which present, of course, different problems. Recently we have read much in the public press of the scarcity of equity capital. As you know, the Congress appropriated funds and instructed the Joint Committee on the Economic Report, of which Senator O'Mahoney is directing chairman, to study the problem; and some of the recommendations have been published. The S. E. C. is interested in all things which have to do with feeding capital into American industry.

We are also concerned about and charged with the responsibility of supervision over the different markets. By that I mean the New York Stock and Curb exchanges, and also, the regional exchanges. We are concerned with listed securities and over-the-counter securities --- a business which is conducted by some 4,000 broker-dealers, all registered with the S. E. C.

I would like to tell you in the time available to me as much as I can of these and other S. E. C. matters which I thought would be of interest to you.

I want also to talk briefly about the Public Utility Holding Company Act of 1935.

The Public Utility Holding Company Act of 1935 was, as you know, most controversial. It was a kind of specialized anti-trust law passed to cure the ills of a single industry. Many were skeptical of it, (as I recall, I was myself) but it has proved itself, so that today it is looked on in some quarters as the possible forerunner of other legislation which could be used to supplement our anti-trust laws.

It would be impossible for me to overstate the truly impressive job which has been done in reorganizing the giant utility holding companies, with full preservation of investor rights and no sacrifice of underlying values.

The task has been enormous. The figures we have had to deal with practically stagger the imagination: 2,152 companies registered under the Act, with combined assets of over $16,000,000,000.00. To date, under the Section 11 program, 1,510 of these companies (with assets in the neighborhood of $8,000,000,000.00) have been eliminated by exemption, sale, dissolution, merger or other divestment. Last year alone, holding companies divested themselves of 44 companies with assets just short of 2 billion dollars. All of these, mind you, were returned to the jurisdiction of the several states in which they operated.

Perhaps if I discuss what happened in just one system, I can give you some idea of the work we are doing.

I will discuss the Electric Bond & Share case.

The Bond & Share system is currently involved in important plans before the Commission. It is one of the four or five last remaining major systems.

When the Public Utilities Holding Company Act was passed in 1935, the Electric Bond & Share system was one of the largest brought under our jurisdiction. Its organization included 5 major subholding companies, with a total of 121 subsidiaries stretching the width and breadth of the land, plus innumerable subsidiaries in foreign countries. Combined assets of these companies totaled some $3,500,000,000.00.

The capital structure of the system was complicated. There were as many as 14 tiers of securities -- bonds, preferred and debt at the operating level, senior and junior securities in the intermediate subholding companies, and preferred and common issues of the top company itself. I have never lost my wonderment at the ingenuity and imagination which went into putting the elaborate holding company structures together. As a matter of fact, the voluntary compliance procedures im Section 11 were based on the notion, as expressed by one of the sponsors of the Holding Company Act that "the legal and economic imagination which put these holding company combinations together will devise means of taking them apart" -- and the prophesy was proved true!

When 1929, -'30, -'31, and -'32 came along, and earnings fell off during the depression, it was only to be expected that the extensive leverage in these systems would produce income stoppages at the upper levels. Bond & Share managed never to miss a dividend on its preferred, but almost no income was ever available to the common; and extensive arrearages accumulated on the preferreds of the intermediate companies - a total of some $315,000,000 in 1940.

Section 11 required the S. E. C. to simplify this system. It required its properties to be re-arranged into compact integrated utility systems. It required Bond & Share to dispose of unrelated operating and non-utility properties; to liquidate unnecessary or useless companies; and to rationalize and simply its capital structures. This, you may be sure, has been no easy task. Of necessity, hearings have been long and detailed. Commission opinions read like textbooks. Appeal has mounted upon appeal, interminable delays, requested extensions of time, and many other things have prevented us from proceeding as rapidly as some would wish. And even more troublesome have been the extremely complicated inter-company claims for damages resulting from alleged acts of mismanagement and detrimental acts on the part of the parent companies which had to be investigated, valued and settled.

During the past year or two we began to see substantial results, particularly in Bond & Share. Four of the 5 major sub-holding company of Bond & Share have now completed their major programs of compliance:- two are being liquidated; and two will remain in existence, after having re-arranged their properties and capital structures, as integrated holding companies. It is not generally known that the Holding Company Act does not require the complete elimination of all public utility holding companies. The original bill introduced into the Senate did provide that but, at the insistence of the House, it was modified to permit companies serving a useful purpose and meeting the standards of the Act to continue.

Two of the Bond & Share sub-systems will remain in existence as integrated companies --- American Gas & Electric Company, whose central system extends through lower Michigan, Ohio, Indiana, and parts of West Virginia, Virginia, Kentucky and Tennessee; and Middle South Utilities Company, the integrated holding company which emerged from the liquidation of Electric Power & Light and operates in Arkansas, Louisiana, and Mississippi. On the other hand, National Power & Light is in process of dissolution and has left only two or three small properties; and American Power & Light, whose plan went into effect last Wednesday, will be left with only a small group of companies in the northwest after it has distributed out its portfolio of such fine companies as Florida Power & Light, Montana Power and Texas Utilities.

This leaves, of the old Bond & Share system, only American & Foreign Power and Bond & Share itself -- which owns, in addition to remnants of the four systems, its major interests in American & Foreign Power, EBASCO Services, and United Gas. Bond & Share has filed a plan to continue in existence as an investment company. This plan has given rise to considerable controversy, and extended proceedings are now in progress.

This sketch of the gradual rearrangement of one of the nation's largest and most complicated business entities should give you some notion of the terrific impact the Holding Company Act has had. It has thus been possible to realize the full values which were inherent in these companies. Security holders have been the chief beneficiaries. Assisted by favorable economic conditions, cheaper debt money, and expanding demand for power, the Act has enabled them to realize substantial improvements in their investments. We made an analysis recently for a subcommittee of the Congress of the change in market value of the securities of three holding companies from 1935, when the Act was passed, to the date of final break-up in 1949. While the Dow-Jones utility average went from about 25 to 49, or rose about 100%, the common stock of Commonwealth & Southern increased in value 226%, of Electric Power & Light 483.5%, and of Engineers Public Service 914.4%.

I don't know whether these are typical or not. We analysed only these three. My own opinion is that these records are not unusual and are being duplicated in many other systems.

There have been many indirect benefits. For example, the healthy capital postion of the utility industry has made possible an enormous expansion of plant; rates to consumers have been declining; and the utility "trusts" which once were so roundly condemned, have passed from the national scene, thereby, to my mind, strengthening our free enterprise system and restoring public confidence.

Section 11, though its unprecedented powers, has made it possible for companies to modernize their security structures. It has made it possible to eliminate such archaic holdovers from past financial eras as perpetual bonds, perpetual warrants and non-callable preferreds. It has made possible the removing of securities which had voting control but no possible value, and which served only as instruments of speculation and a trap to the unwary.

Until the enactment of Section 11, such a clean-up could be accomplished only through liquidation or complete reorganization in an equity receivership, and even then emerging capital structures were often as cumbersome as what went in, or more so.

In many of these break-ups, portfolio securities are receiving their first public distribution. The Commission has had to decide what rights should attach to these securities. We have had the difficult decision of deciding which securities should be listed on an exchange.

Our role has been frequently misunderstood. We have taken the position that where a security holder gives up a listed security, fairness requires that he receive a listed security in return. There has been some difference in the Commission over whether listing should be immediate or might be delayed for short periods. That is only incidental and it has not questioned the basic principle. However, even that principle has been misunderstood. Some people believe that in our requirement that securities emerging out of utility reorganizations be listed, we have shown favoritism toward the exchanges. That is not true. Our job has been to see to it that the investor is fairly dealt with and that he gets the "equitable equivalent" of what he gives up.

Cases like these put the S. E. C. on a hot seat.

The exchanges and over-the-counter markets have been natural competitors. The Commission has tried to avoid being placed in the position of having to prefer one market over the other.

It is our view that our highly developed commercial society needs several types of markets to function properly. Each type fills a particular function -- the over-the-counter market, the regional exchanges, the New York exchanges --- all developed to meet the particular needs. Each has a definite purpose in the scheme of things.

Take the Detroit Stock Exchange, as an example. Since its founding back in 1907 by seven brokers holding forth in a small room in the old Moffet Building, it has had a long and honorable record of service to local industry, to the people of the Detroit area, and to investors generally. During the twenties it experienced a most rapid growth. I had a little research done in preparation for this talk and was rather surprised to learn how rapid that growth really was. In 1925 a seat sold for as low as $700. In November 1928 we have record of a sale at $60,200. And, believe it or not, in 1929 nearly 12 million shares were traded on your floor.

What is the place today of the regional exchanges in our national picture? I am often asked that question by people who seem to feel that all trading should be centered in one place and that the regional exchanges serve no purpose and have no justification.

My answer to that inquiry is usually a very simple one. We are a large country with manifold interests; we have different types of securities; we have businesses in different stages of development; and we therefore require different kinds of markets.

I am a firm believer in local sponsorship of local business and industry. A business begins and develops in a certain region. It is known to the tradespeople there, to the local banks and financial institutions, to brokers and to other business people. When it reaches the stage for public financing, the securities are frequently sold locally to these people who watched it grow. It is only natural, then, for trading to be local.

Of course, any company may grow to where its securities become nationally known and nationally distributed, and when it does, central trading on a New York exchange becomes logical. But even then the local interest frequently justifies continuance of local trading in that region, and, if the people want it, why should not they have it?

There is now pending before the Congress a bill introduced by Senator Frear of Delaware which would extend the investor protective features of the securities laws to the larger unlisted companies -- defined in the present bill as those with $3,000,000 or more of assets and 300 stockholders. If this bill becomes law, it may in time affect the volume of new listings on exchanges. We don't know whether it will or not. Only time will tell. But to keep this flow of securities between the several markets normal, the S. E. C. has consented to amendments which will take away some of the power we now have to grant unlisted trading privileges; and we plan to make a study of the feasibility of establishing standards for listing and delisting, and report back to the Congress in two years.

In my opening statement at the hearings on the Frear Bill, I said that the Commission favored the bill, among other reasons, because it believed that the reporting requirements which the bill would set up "may well spur legitimate investment in equity securities." Last year the Board of Governors of the Federal Reserve System through the Research Center of the University of Michigan conducted a survey of consumer finances. The survey disclosed that the most important deterrent to investment in common stocks is a lack of familiarity.

The Commission believes that the Frear Bill would assist the securities industry to remove much of the secrecy which sometimes enshrouds the financial activities of unlisted companies. This should render their securities more desirable as investments.

We hear a lot about the equity capital situation these days. Everyone "decries" what has about become a stock phrase, "the shortage of equity capital". I do not know really whether there is a shortage of equity capital as such.

In this post-war period we have had a phenomenal expansion of our industrial plant. Capital expenditures are being made at an unprecedented peace-time rate. Some of the money to pay for this expansion is coming from the sale of new equity securities, but only a small part. Some of it comes from bank borrowings and debt, but not enough to cause any serious unbalance in our over-all capital picture, because companies with the experience of the depression still fresh in their minds have been putting in healthy slugs of equity capital, - equity represented at the beginning by accumulated war-time reserves, and then by retained earnings.

Actually, I doubt if the over-all equity capital situation is as bad as some of our commentators and financial experts say it is. Going businesses, with good earnings, can usually get the capital they need, if they are willing to sell their securities in line with the going market for securities of companies of equal quality and earning power. Since the war, more common stock for new money purposes has been marketed than at any time since the late twenties, although admittedly it has not increased with the price level or commensurate with the general level of investment.

I think the problem this nation faces is more one which can better be described as a shortage of "venture" or risk capital - speculative money, if you please, - willing to take a risk in return for the possibility of exceptional gain.

The established companies don't feel this. The large companies are in themselves great pools of venture capital. U. S. Steel, for example, can finance exploration and discovery of the great Cerro Bolivar ore range in the South American jungles. And the oil companies are financing vast ventures in the Near East. Picture if you will, the risk capital being expended annually by large corporations in the development of new processes, new products, and new methods of manufacture. These should be considered when you talk about "venture" capital.

Traditionally in this country a small business at the speculative stage of development, before it has seasoned, has seldom gotten its capital from the public. From our studies of the markets, we are inclined to conclude that no more than 2%, maybe 8,000 or 9,000, at the outside, of our 450,000 or so corporations have over 250 stockholders; and not all of these 8 or 9 thousand corporations, by any means, have engaged in public financing.

The splurge of small issues that hits the market in times of rising prices, as in early 1946, are usually sales by people who wish to sell part of their personal holdings for personal reasons. Only a fraction are for new capital purposes. Businesses like this ordinarily get their new funds from the founders, from family or friends, from commercial sources, from trade loans and bank borrowings, from earnings. The general public has never been an important source of these funds and, in my opinion, never will. Nor would I consider it a healthy thing if they were.

In those relatively few instances where a new business or a speculation requires more capital than can be obtained from private sources, public offerings are in order. When this occurs, we must be sure that full and fair disclosure is made of what is taking place. That is where the S. E. C. comes in.

We have an interesting job at the Commission. My good friend, former Chairman Hanrahan sitting over there, can testify to that, and so can those of you who have had occasion to have matters before us. Let me assure you, there is never a dull moment. But equally important - we think we have a significant function in the economy of this great country.

The S. E. C. deals with every aspect of corporate and financial affairs. Its purpose, so simply stated in the preamble to the Securities Act of 1933, is

> "To provide full and fair disclosure of the character of securities sold in interstate commerce . . . . and to prevent frauds in the sale thereof. . ."

How well we do that job will in some measure determine the character of our securities markets, the confidence which the investing public will place in those securities, and the corporate welfare of this country. May I, by your leave, repeat what I said the last time I was here to express my understanding of the S. E. C. and its purpose:

As I see it, it is the function of the S. E. C. to guide the financial practices of America's publicly-owned corporations and those who deal in their securities. Its object is to maintain public confidence in these institutions. Its purpose is to facilitate the application of the nation's savings to the sustenance and growth of our economic life.

The invitation to come here as your speaker was most flattering, and it has indeed been satisfying to be with you, people I have known so well for so many years. I salute you all as friends. I thank you for your kind attention.

Good night.