ADDRESS

of

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at

CORNELL UNIVERSITY

"INFORMING THE INVESTOR"

Ithaca, New York

April 6, 1950

I was glad to be able to come up to Cornell to talk to you today. Your present interest in the Securities and Exchange Commission is likely to be that of the student. But as citizens and as future business men and lawyers, you will find the Commission of more than academic interest. Its importance in finance and in corporate practices is now firmly established. If I can help to give you some insight into the general nature and importance of the statutes we administer my effort will be more than justified.

These statutes rarely present clear-cut problems either of law or of economic policy. Our best lawyers at the S.E.C. are keen financial analysts and our best financial analysts are adept at legal interpretation. It makes sense, therefore, that I should be talking to a combined group of law and business students.

It is no accident that the work of the Commission requires a combination of legal and business talent. The statutes under which the Commission works set out broad objectives in the regulation of finance and corporate practices and were intended to provide to an expert body the working room it needed in order to achieve those objectives. That does not mean that the Commission improvises business policy. It does mean that the Commission must take seriously the command of these statutes that their provisions shall be construed in order to carry out

their stated purposes. Those purposes are basic to our economic welfare and, in the course of this talk, I hope to show how we must constantly keep those broad purposes in mind and view them in historical perspective.

I can't hope to give you any more than a sketchy picture of the Commission's work. The separate pieces of complex legislation under which we operate range over the field of investor protection and call into play a wide diversity of regulatory techniques. The names of these laws will give you some notion of their scope: The Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, Chapter X of the amended Bankruptcy Act of 1938, the Trust Indenture Act of 1939, the Investment Company and Investment Advisers Act of 1940.

The first statute in this roster is the Securities Act of 1933. Its dual purposes are to make available reliable and adequate information about newly distributed securities and to prevent fraud in securities transactions generally. Unless exempted, securities cannot be publicly offered until they are effectively registered with the Commission. While the Commission has the power to apply sanctions in cases of materially false or inadequate registration statements these powers are seldom used. Instead, the Commission places great reliance on careful examination of registration statements before they become effective and on informal and voluntary methods of correcting them before the securities are sold.

This statute goes further than merely requiring the central filing of information. It aims at bringing information directly to the investor by providing for the receipt of prospectuses by purchasers of recently registered securities. I will return to a discussion of the prospectus requirement, for it is one of the keystones of the Act and poses some of the most basic legislative problems which the Commission faces today.

The Securities Exchange Act of 1934 contains a natural extension of the Securities Act. The Congress recognized that it was important to provide current, reliable information about securities being traded on our exchanges as well as to require information about new issues. The 1934 Act requires the filing of initial and current information about listed securities, prohibits fraud and the manipulation of securities prices, and extends the disclosure principle to the proxy procedure and to management and insider trading in the issuer's securities. In addition it deters abuse of inside information by members of management and large stockholders by providing for civil suits to recapture profits made by such persons in short-term trading.

These laws are essentially "disclosure" statutes. They do not penetrate into the financial operations of the companies whose securities are covered by their provisions. In contrast, the Commission has been given the duty of fairly intimate regulation of the financial practices and operations of public utility holding company systems and to a lesser extent of investment companies.

The Public Utility Holding Company Act of 1935 affects all the major holding company systems that have been built up in centralizing control of electric and gas utility properties. The dramatic collapse in values of these paper structures was one of the marked features of the crash and depression following 1929. Utility holding company systems were the subject of one of the most exhaustive studies ever made of a single industry. In that study the Federal Trade Commission laid bare the sordid stories of many of these empires: control, by small cliques, of vast and unrelated operating properties acquired with other people's money; complex financial monstrosities created in order to increase speculative values and to assure control without investment; utility operating and financial policies dominated by holding companies thirsty for the earnings they could siphon out of the operating properties; huge profits arising from transfers of assets to controlled companies at inflated prices bearing no relation to underlying values; useless services performed by affiliates at huge profits to the service companies.

Point by point, these evils have been spotted in the Holding Company Act. The statute has two main features: first, regulation of the normal financial operations of system companies and second, a directive to the Commission to undo, through fair and equitable reorganizations, the tangles created in the building of these empires -- to bring about simple and integrated system patterns and, whenever necessary, to abolish holding company systems. We are particularly proud of the fact that since we began actively to administer these requirements, we have processed companies controlling about $12 billions of assets through the reorganization machinery.

Of parallel interest is our function under the Investment Company Act of 1940. While this law does not penetrate as deeply into the financial operations of investment companies, it is based on a somewhat similar philosophy as that underlying the Holding Company Act.

The investment company attracts public capital by representing, essentially, that it can provide better investment management of the investor's funds than he can himself. As a matter of morals it follows that the investment company stands in a special fiduciary relation to those who have committed to its hands the management of their investments. Unfortunately many investment companies did not live up to this

fiduciary standard and, as a result, the S.E.C. was directed by Congress to make a study of the investment company field.

The Investment Company Act of 1940 grew out of that study. The aim of that statute is to embody in our federal law some of the minimum standards which should apply to the management and operation of investment companies and to correct the abuses disclosed in the study. Abuse of investment company control for business advantage by brokers, security dealers and bankers; radical changes in investment policy which could transform the nature of the company overnight without security-holders' consent; discrimination in favor of insiders; ruthless switching of investors in and out of different companies -- each time at extensive loads (or initial charges) - were some of the practices disclosed in the study made by the Commission.

The Investment Company Act itself was worked out in full cooperation with the investment company industry and it had the distinction of being passed in both Houses of Congress without a dissenting vote.

While both the Holding Company and Investment Company Acts are, in a broad sense, products of the depression, they were based on the _special_ problems presented by _special_ segments of the corporate community. However, it was the purpose of the information requirements of both the Securities Act of 1933 and the Securities Exchange Act of 1934 to correct

evils growing out of general customs in securities distribution and trading. These were not isolated customs but applied to the financing of all segments of industry and to trading in all types of securities. In order to appraise the effectiveness of the prospectus requirements of the Securities Act the subject I particularly wish to discuss this evening, we must therefore lay a somewhat broader background.

Few of you are likely to remember the crash of 1929. From a human point of view the suicides, the despair, the utter collapse of values were real. When it became clear that we were in a steep incline to depression rather than in a temporary crisis from which we would rebound quickly, we found ourselves doubting the very premises of our economic and social organization. Pools of capital dried up, the machines lay idle and many of you are personally familiar with the story from there on.

Economists are still searching for the key to understanding of business cycles, and I don't pretend that our securities laws alone are any guarantee of permanent economic stability. But if we look back at the facts it becomes clear that the practices which our present statutory information requirements are designed to correct had a good deal to do with the collapse.

Underwriters and dealers scrambled for new issues of securities, often knowing little and caring less about the business of the issuer as long as a gullible public could be induced to take the issue at high prices. Having unloaded at inflated prices the temptation was ever present to maintain those prices by manipulation of the market. Uninformed buyers were ready to pay fantastic prices created purely by manipulation. The usefulness of the securities markets as measures of value and as indices of economic activity was destroyed. The crash was inevitable.

The main staple of this illusory banquet of prosperity was ignorance. Even the dealers had no opportunity to defend themselves against pressure to take new issues by resort to current reliable information. The customers were utterly helpless. With a market cut from its tie to reality (and that tie is information, pure and simple) and without the information they needed they were easy victims of the current hysteria.

Disclosure is a small word; but I hope I have indicated that it has a big purpose. Now, how do the disclosure requirements of the Securities Act work? Section 5 of the Securities Act requires that a registration statement be effective before the securities are offered. (Let me caution you at this point to bear in mind that the Commission does not pass on the merits of securities, that registration with the Commission does not reflect the merits of the security in any way, nor does it guarantee the accuracy of the registration statement.)

Central filing of the registration statement makes the information publicly available. But it was obvious to Congress that mere central filing of information would not meet the needs which were demonstrated

in 1929. It was recognized that dealers and customers must be provided with the facts directly if they are to be in a position to make their investment decisions intelligently. The Securities Act was intended to provide for this through the prospectus requirements of Section 5.

However, through an unfortunate choice of language the main objective of the prospectus has been lost, and it has been possible to avoid the clear Congressional intent that the full information outlined in the statute be the basis for the sale of new issues. This results from two factors: first, the distinction in the law between talking and writing, and second, the provision of the statute that prospectuses may be withheld under certain circumstances until the securities are delivered pursuant to sale.

The Securities Act is so worded that substantially any offering in written or radio broadcast form is deemed a prospectus, and unless it conforms to the statute and rules governing the contents of prospectuses its use violates the statute. Other written material may be used only if it accompanies or follows a prospectus conforming with the Act. These provisions add up to the requirement that the first written offer of a security must contain the full complement of prescribed information. Clearly the statute aims at giving the investor a shield against selling pressure by giving him the full story in advance. You will note however that the statute does not require the prospectus to accompany or precede oral as distinguished from written or broadcast, offering. Those who proposed that permission be granted for oral discussion of forthcoming

securities offerings argued that it would be unrealistic to make it unlawful to talk about pending issues when friends met on the golf course or at cocktails. No reasonable person would object to a provision permitting oral discussion under proper safeguards. But without those safeguards reasonable lee-way has become an unreasonable loophole. Today most securities transactions are conducted by word of mouth, including the interstate use of the telephone so that the legal requirement to use prospectuses as a primary offering vehicle is avoided. As a result, the customer generally sees the prospectus for the first time after he is either psychologically or financially committed to the sale.

It has been obvious to many of us at the Commission that project number 1 in any program of improving this law is to eliminate this dilemma. It is for this reason that I consider it worthwhile to spend a few minutes on a problem that has become a Commission classic - the revision of Section 5 of the Securities Act. How to improve the Act has been the subject of serious differences of opinion not only within the financial community but within the Commission itself.

It has always seemed to me to be a logical answer to amend the law to provide for delivery of prospectuses to the buyer in advance of committing him to the sale. Other proposals, such as that to permit securities to be offered before effectiveness of the registration statement, cannot to my mind be considered separately from this major project. And the major project is, to my way of thinking, of more importance than other proposals which have created considerable dispute. At one time I recommended, together with members of the staff, that prospectuses be

delivered before sale, or - in the alternative - if the sèller wished to withhold the prospectus until delivery of the securities (as is usually done today) that the buyer have a short period within which he could, after getting the prospectus, rescind the transaction - that is, elect not to go through with it. This election to rescind (or "the out clause" as it has been called) was widely misunderstood and criticised; it generated more rancor than it was worth. Thus, since it is only incidental to what I regard as our major purpose, advance delivery of simple and useful prospectuses, I would be willing to forego it if doing so will help to get the important job done.

The proposal of advance delivery of prospectuses has been criticised. But in patient and arduous sessions with representatives of the underwriting fraternity we have shown how fairly simple adjustments in practice could be adopted to overcome the alleged difficulties. Opposition has developed from those who have questioned the basic principle that every buyer should get a prospectus and who would adopt a system of "prospectus on request." I have been opposed to that abandonment of one of the cardinal features of the Act. Our stake in the disclosure principle is too great to leave it to the uninformed customer to decide, after a session of oral salesmanship, that he does not need full information; or to subject investors who ask for prospectuses to the risk that they will be by-passed in the distribution of an issue of securities in favor of buyers who will take their securities sight unseen.

Nor do I agree with the contention that investors will not read prospectuses. Under our present system the prospectus is delivered so

late in the course of the sale that it is a token to the average investor, not a selling document. The average investor has not therefore had the chance to develop the habit of self-protection by advance reading of the pertinent information. It is true that the length and complexity of many prospectuses has deterred the average investor from using them. But it does not follow that the prospectus should be abandoned. It does follow that we should continue our efforts (which have had considerable success in the recent past) to get those responsible for the preparation of prospectuses - (the issuers' and underwriters' lawyers predominantly) to simplify them.

The very corporate executives who argue that investors will not read the prospectus are likely to go to great effort and expense in preparation and mailing of annual reports to stockholders which contain detailed facts but which set the facts out in a way designed to invite reading. It is hard to believe that these pains would be taken unless managements really believed that their efforts resulted in actual reading of the reports by stockholders. However, in many cases, instead of taking similar pains in preparing prospectuses to make them useful selling documents the tendency has been to make of the prospectus a means of avoiding sellers' liability by cramming it with every conceivable representation that some court might deem material.

That tendency I am glad to say is on the way out. We have gotten prospectuses in recent months that have been models of brevity and clarity - that have so well told their story that they could be regarded as prime pieces of selling literature. There is no reason why this trend

should not continue. Neither the Commission nor its staff insists on a ritual of conformance in the preparation of prospectuses. Within the framework of adequate disclosure a good deal of flexibility is possible to cut out unnecessary detail. With some skill and imagination the lawyers' prescription of material information can be organized and presented in the prospectus in such a way as to make it a piece of selling literature of real interest rather than an exculpatory document. There are many cases in which a building by building description of the issuer's plant may be unnecessary. Even such technical matters as descriptions of preferred stock and the terms of the offering can be reduced, without sacrifice of materiality, to simple statements that people of ordinary intelligence can understand.

Two polar forces operate in this field: Rigid and universal requirements of detailed facts on the one hand, and complete flexibility in a case-by-case approach on the other. Each has its merits and dangers. As usual, the best formula lies somewhere in between. Revision of our forms toward simplicity and flexibility is constantly going forward; and our staff is at this moment making a special study of this problem. As our experience grows we discover new areas in which condensation, deletion, simplification help to make individual prospectuses more useful and readable.

I wish to make a point of the fact that I do not participate in the dim view that some people take of the intelligence or digestive capacity for facts of the average investor. Those who have had working experience with our complaint files and have dealt with investors' inquiries can

tell you that a great many investors are alert, and that they want and can use reliable information. However, I recognize that the average investor is not a trained analyst and that it would be fatuous to base a scheme of regulation on the assumption that he is any more than a man of ordinary intelligence.

Because of that fact I believe that we should continue our efforts to simplify and streamline prospectuses. Recently it was proposed to write into the law a provision which would have given the Commission power to order deletion and condensation in prospectuses on a case by case basis and to give immunity from legal action based on required omissions. This met with considerable controversy. Some felt that registrants might abuse this procedure by filing over-long prospectuses in order to prod the Commission into requiring condensation and thus giving immunity. Others felt that this provision would project the Commission into the undesirable role of prospectus drafting. Still others felt that it was an undue burden on the Commission to take case by case responsibility for dispensing legal immunity for material left out of prospectuses. I don't want to appraise these criticisms; there are many arguments on both sides. But I am willing, on the basis of our experience to forego this proposal now and to continue our present efforts to get voluntary cooperation in improving prospectuses.

It has been my feeling, throughout the controversies over amendment of the Act, that disputes about mechanics and principles, as diverse as they may have appeared on their face, are really rooted in doubts about the efficacy of the prospectus. The arguments about the practical

difficulties of making advance delivery (which were never impressive to me in themselves) lose a considerable amount of their force in the face of prospectuses that are clear, informative, and useful documents worth delivering in advance. To diminish the role of the prospectus in the scheme for protecting investors is to strike a blow at the foundation of the Securities Act.

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