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SOME RANDOM THOUGHTS OCCASIONED BY A BIRTHDAY

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The Securities and Exchange Commission met for the first time 30 years ago this month. Contemplation of that fact (and the marriage of my daughter last month) make me feel more mature. The Commission has processed many items, conducted many administrative proceedings, promulgated many rules, developed many policies and been involved in some conflicts in those three decades. Nevertheless, the need for and the popularity of this course reflect that a new generation of lawyers is concerned with securities law problems. But it also reflects, at least in part, the fact that the recognition of new problems and the process of developing solutions for them in the public interest is going on as actively today as it has in the past. After this morning's session it is probably unnecessary to emphasize that fact. As a sometime participant in this roadshow, I can assure you that the members of the panel will provide you with an effective and up-to-date discussion of the current details of this process. I shall not attempt to duplicate their efforts.

Our thirtieth birthday provides the occasion to review briefly some past history, to generalize about the Commission's operating procedures, and to mention certain current activities and goals, as they relate to the discussions here.

I believe that the history of the Commission can be divided into four periods. The creation of the Commission was followed by a period of rapid, initial development. In addition to the basic statutes--the Securities Act of 1933 and the Securities Exchange Act of 1934--administration of four other important statutes and responsibilities under the Bankruptcy Act were entrusted to the Commission. From the beginning, the Commission and its staff were concerned with making the new machinery work and supplementing the broad statutory directives with the detailed requirements necessary to implement the concepts of fair dealing and fiduciary responsibility underlying the statutes. Nobody knew--in fact, many doubted--whether these regulatory patterns could be super-imposed upon the financial markets. But the markets did <u>not</u> come to a halt; indeed, their functioning and tone were considerably improved. Many responsible and influential persons in industry laid aside their doubts and their aversion to regulation and helped the Commission make the new machinery work. This initial success is also a tribute to the skills of a young Commission and a staff that was generally considered to be the finest in Washington.

During this period, concepts were developed and embodied in rules, decisions, and practices which gave substance to ideals of honest, orderly markets and investor protection. It was also a period of

testing--testing of the statutes and of the Commission. Many basic legal issues were resolved and the patterns of regulation were established. At the same time, the securities markets and issuers adjusted to the standards and controls provided by the statutes. This period also marked the further development of accounting principles and practices, which had been set in motion by the New York Stock Exchange, and a practical acceptance of the need for real independence of certifying accountants.

The second period of the Commission's history comprises the years of World War II and the immediate post-war period. Of course, the focal point of our endeavors was the war effort. However, the Commission, where possible, consolidated gains, refined procedures, eliminated red tape, and created an efficient operation.

A third era ended on or about May 29, 1962, although many of the problems facing the Commission today stem directly from the practices of that period. Looking back, one must be impressed with the dynamic and growing securities markets of those years whose size and variety dwarfed that of the 1920's; records in volume of financing, capital raised, exchange trading, securities values, and numbers of stockholders were established almost daily. Investors became more familiar with the over-the-counter trading market, causing its rapid growth in size and importance. The Commission found it necessary to revamp and expedite procedures, to engage in constant reconsideration of substantive approaches and to contend with problems of enforcement on a previously unknown scale. Towards the end of this era, and almost at its zenith, the Congress authorized the Special Study of Securities Markets to make a thorough investigation of the securities markets. The report of the Study was submitted to the Congress about a year ago.

This brings us to the present. Since the market break of 1962, fewer new issuers have resorted to equity financing. Relatively speaking, a "cooling-off" period seems to have emerged, at least with respect to new issues, which has provided an opportunity to consolidate the advances in knowledge and efficiency achieved during the recent past and to consider the problems presented during those more frenzied months.

More important, the Commission has, with the aid of the Study, attempted a fundamental re-evaluation of basic issues and, where appropriate, to effect the advances necessary to keep abreast of the changes in the securities markets. With the cooperation of the securities industry, the difficult task of implementing the Study's recommendations has proceeded. In addition to the criticisms it leveled at others, the Special Study was critical of certain aspects of the Commission's work. In the spirit of this criticism, we have studied our practices and procedures and have embarked upon a continuing effort to revise, update, and improve our operations wherever possible.

Throughout each of these periods two characteristics of the Commission's approach to its responsibilities have been particularly important: (1) flexibility in its attitude toward problems and a willingness to develop informal working procedures, and (2) recognition of the legitimate needs of those subject to its jurisdiction with the result that a conscious effort has been made not to burden issuers, broker-dealers, or others with more regulation than is necessary to meet the statutory objectives.

An important example of this flexibility is the letter of comment technique used in connection with registration statements filed under the Securities Act of 1933. I am sure you will hear more about its details today and tomorrow. I wish to refer mainly to its genesis and application. The statute sets up no procedure for the processing of registration statements. It seems to offer only a choice between automatic effectiveness upon the lapse (or acceleration) of the statutory period or the institution of formal proceedings looking to a stop order banning the sale of the securities involved. If, in those cases where revision of the registration statement seemed required, resort could only be had to formal proceedings, serious delays would be caused and securities flotation would otherwise be hampered. Since this appeared to be contrary to the Congressional intent, and since the staff was, in any event, required to review the registration statement as a basis for Commission action, an informal procedure was devised which would make available to registrants the benefit of the staff review and permit appropriate revision or modification without formal proceedings. This technique (which received explicit Congressional authorization in Section 8(e) of the Investment Company Act of 1940, the most recent of the "securities acts") has, in the words of the Attorney General's Committee on Administrative Procedure, "proved to be an extraordinarily effective method of clearing up defects and permitting the statement to become effective."

The letter of comment technique was adapted to the additional duties undertaken as administration of new statutes was delegated to the Commission. It is now also employed in connection with analysis of registration statements and reports under the Securities Exchange Act of 1934, the qualification of indentures under the Trust Indenture Act of 1939, the processing of documents filed pursuant to the Investment Company and Investment Advisers Acts of 1940, and of proxy soliciting material filed pursuant to the Commission's proxy rules. Except during periods of exceptional activity or stress, it is possible for the Commission to meet the close deadlines invariably involved in securities and corporate matters.

The Commission's proxy rules reflect a similar response to a problem. In Section 14(a) of the Exchange Act Congress granted to the Commission very broad powers to regulate the solicitation of proxies from security holders of listed companies. The Commission here combined detailed administrative rules with the letter of comment technique on a greatly expedited schedule.

In recognition of the need for practicable rules which would best advance the statutory objectives without hampering the functioning of the corporate mechanism, the Commission has proceeded carefully in adopting and revising its proxy rules. The first rules, adopted in September 1935, required only a brief description of the matters to be acted upon and prohibited false or misleading statements. After some experience, the Commission, in October 1938, adopted rules of a more positive nature. Since that date, many minor changes have been made and the rules have been substantially revised on at least three occasions to correct deficiencies and to meet problems revealed by additional experience. Our recent revision of Rule 14a-3 concerning the form of financial statements in annual reports to stockholders, indicates that the process of refining the proxy rules is still going on. Regulation 14 now consists of a comprehensive series of rules and schedules which require the disclosure of facts relevant to a stockholder's evaluation of management and to informed exercise of his franchise, and provide limitations on what might otherwise take place in each year's crop of proxy contests. I believe that the proxy rules, and the Commission's administration of them, represent one of the Commission's important achievements. They are likely to have increasingly wider impact as a result of the recent Borak decision by the Supreme Court and enactment of the pending legislation to which I shall refer in a few moments.

The emphasis I have given to the use of informal procedures does not mean that formal procedures are not employed when required by law or as a matter of fairness. A large segment of our staff is engaged in the initiation and conduct of formal administrative proceedings. And we, at the Commission, have a not insubstantial decision calendar to dispose of each year.

We have recently taken certain actions in regard to the conduct of administrative proceedings which should improve the efficiency of adjudication as a tool for policy development within a system of internal separation of functions which insures that the statutory and administrative standards are applied fairly. We believe that both aims can be achieved by a careful system of delegating decisional authority within the agency. The Administrative Procedure Act authorizes agencies either to adopt an "initial" decision procedure, whereby the decision of the hearing officer becomes final unless it is appealed to the agency or the agency reviews the case on its own motion, or a "recommended" decision procedure, whereby the decision of the hearing officer is only advisory. In addition, specific authority was granted to the Commission in 1962 to delegate the power to decide cases, with certain limitations.

Until recently, the Commission employed only the recommended decision procedure. This course was viewed as necessary in light of the large number of important policy questions involved in adjudicatory proceedings arising under the statutes which the Commission administers. Many major policies have now been developed, and guidelines as to others have been enunciated and refined. And the Commission has a corps of experienced and competent hearing examiners. In consequence, the Commission recently changed its rules of practice and adopted an initial decision procedure. Under the new rules, initial decisions will be issued in administrative proceedings arising under any of the statutes administered by the Commission and in which a hearing officer is used.

The new procedure requires that the person appealing from the hearing examiner's decision establish that the decision included either a finding of fact or law which is clearly erroneous or some other important determination which the agency should review. Otherwise, the Commission may deny the petition for review or summarily affirm the hearing examiner's decision.

Decisional authority in other respects has been delegated to reduce the number of routine matters requiring Commission attention. The Commission had always followed an extremely liberal policy of considering appeals from rulings by hearing examiners on interlocutory motions during administrative proceedings, a policy which encouraged dilatory maneuvers by some respondents. Recently, the Commission changed its rules of practice to reduce the number of interlocutory appeals which it will consider. Authority has been given to the Office of Opinions and Review to affirm the refusal by hearing examiners to certify to the Commission rulings on these motions or to affirm the hearing examiners' rulings on motions when the hearing examiners do certify them to the Commission. This authority is to be exercised in regard to matters that fall within settled precedent. Where this is not so, or where the decision may otherwise be significant, the director of that office will bring the matter to the Commission for determination. These and other recent changes in our rules follow recommendations of the 1961-62 Administrative Conference.

I think these facts about the Commission's operating procedures point some lessons which may be useful to you. First, we are accessible and ready to consider your problem. Many matters are cleared up by telephone calls. If a conference is necessary, our staff will arrange one. We are as anxious as you to complete the review and disposition of your case without resort to formal procedures. This is best and most expeditiously achieved when you recognize our statutory responsibilities and assist us in finding a solution to your problem which is consistent with them. If you will permit an aside which is not intended seriously, I do not mean that you cannot argue that we are acting arbitrarily, even unconstitutionally. It may be the only argument you have. However, after thirty years certain arguments have lost some of their effectiveness.

I would like now to discuss a few of the problems which face the Commission in the immediate future.

For over a year, now, the Commission and the securities industry have been concerned with implementation of certain recommendations of the Special Study. One of the significant achievements of that period has been the formulation of the legislation already passed by the Senate and now pending before the House of Representatives. That legislation, now known as the Securities Acts Amendments of 1964, deals chiefly with issuers of securities traded in the over-the-counter market and the standards of broker-dealer firms and their salesmen. Most of you are probably more interested in the first group of changes which relate to matters under discussion in this course. The bill will extend to large over-the-counter issuers the registration, reporting, proxy, and insider trading provisions of the Exchange Act, which are now applicable only to issuers with securities listed on a national securities exchange and to a limited number of other companies.

The present disparity between investor protections in the two markets was not intended by the Congress which enacted the Exchange Act. In 1936, Section 15(d) of the Exchange Act was adopted. As you know, it requires many companies offering securities registered under the Securities Act to furnish an undertaking to file reports. However, Section 15(d) was never considered the ultimate answer to the obligations of publicly held companies whose securities are traded over-the-counter. The Study determined that many of the abuses it uncovered--irresponsible selling practices, uninformed investment advice, extravagant financial public relations, and erratic after markets--could be linked directly to the lack of adequate information. The Study's documentation of the tremendous growth of the over-the-counter market highlighted the increased need for investor protection.

The Securities Acts Amendments of 1964, which we believe will shortly be enacted into law, require the Commission to grapple with many problems, including the nature and quantity of information to be required from over-the-counter issuers not now reporting to the Commission. The Commission's annual report for fiscal 1963 indicated that over 5,000 companies were subject to the present reporting requirements (including about 500 under the Investment Company Act). Pursuant to the provisions of the pending bill, approximately 2,700 companies with more than $1 million in assets and 750 stockholders will initially be subject to the new requirements. When the limit drops to 500 or more stockholders, an additional 800 companies would be covered. Approximately 1,600 of these companies already report under Section 15(d) of the Exchange Act. These companies are not, however, subject to the proxy and insider provisions of Sections 14 and 16. The staff of the Commission is now considering the procedures which will be necessary when the bill becomes law. I might note that a review of existing forms and of certain provisions of the current proxy rules is also underway.

A matter about which you no doubt have heard or read concerns inclusion of banks and insurance companies within the bill. Many of the changes made in the bill as originally introduced have occurred in this area. For example, although the pertinent sections of the Exchange Act would be extended to banks, administration would be vested in the appropriate Federal bank regulatory agency--the Comptroller of the Currency for national banks, the Federal Reserve Board for state member banks, and the Federal Deposit Insurance Corporation for the non-member state banks which it insures. So far as insurance companies are concerned, there is a variance between the Senate and House versions of the bill. As passed by the Senate, insurance companies are treated exactly as other companies. Under the House bill, however, insurance companies which are subject to regulation of their reporting, proxy solicitation, and insider trading activities by the states would be exempt. Insurance companies which do not meet these requirements, and are not listed, would be subject to the provisions of the bill.

The Commission has always recognized the special problems which disclosure poses for insurance companies--problems originating in state regulatory requirements and in the different accounting techniques which are applied to such companies. We have made accommodations for insurance companies on these grounds in the past; where appropriate, we will continue to do so in the future.

A perplexing problem in the preparation of the legislation for submission to the Congress which vitally concerned some members of the broker-dealer community, was whether to extend Section 16(b) to the over-the-counter market-making functions and the sponsorship activities of broker-dealers. This problem applied only to the situation where the dealer who is making a market in a security is an insider of the issuer, usually a member of the board of directors. In view of the apparent need for such dual activity in the over-the-counter market, a new subsection (d) of Section 16 is proposed to exempt from Sections 16(b) and (c), over-the-counter market-making transactions by dealers. Thus, the dealer would have to show that the transactions arose in the ordinary course of business, were incident to the establishment or maintenance of a primary or secondary market, and that the securities were not held in an investment account. The Commission would be empowered to define the key terms used in this section and to prescribe terms and conditions for its application. We are currently considering this matter.

The second major aspect of the legislative program emphasizes strengthening both the qualification standards for entrance into the securities industry and the controls over those already in the industry. Self-regulatory bodies, such as the NASD, would be required to adopt rules establishing standards of competence, training and experience for members and their employees. As amended by the House, all brokers and dealers not members of self-regulatory bodies would be subject to similar standards to be enforced by the Commission.

Thus, the two main aspects of the proposed legislation are interrelated; the provisions concerning issuers are designed to provide the information necessary to informed decisions by investors and by the same token make it possible for broker-dealers and salesmen to provide better advice to their customers. The other part of the legislation is designed to raise the standards of competence and training of those who will use this information in advising investors. The legislation does not embody any new or radical ideas. It is the logical extension of the principles already embodied in the securities acts. The provisions concerning over-the-counter issuers mainly require disclosure of material facts regarding larger, publicly owned issuers not now reporting to the Commission, and those concerning qualifications of members of the securities industry further implement the idea that a high standard of knowledge and conduct is required of such persons in their dealings with John Q. Investor.

Although implementation of the Special Study recommendations occupies a large part of our time, we are giving continuing attention to refining our policies in other areas. For example, in February, we released a guide for the preparation and filing of registration statements. This publication set forth a number of administrative practices of our Division of Corporation Finance in the review of registration statements under the Securities Act. Later that same month, we issued a release reviewing the purpose and limits of Rule 154 which defines and interprets the exemption in Section 4(2) of the Securities Act for brokers' transactions. Within recent days we issued two releases in further implementation of this policy. One discusses the permissible limits of tombstone advertisements as used by investment companies and the other related to offerings abroad by domestic companies.

At least two of these releases provoked sharp criticism from some segments of the bar with whom we have since met and ironed out any difficulties. Mr. Shreve gave you some of the details this morning. The publication of these releases reflects the view of the Commission that it is desirable and important that the bar and the financial community be made aware of the Commission's position with respect to these, and other, practices and problems. They also serve a useful purpose in providing our staff with a fresh review by the Commission of practices and points of view which develop over a period of time. We chose to express these statements in the form of releases, rather than formal rules, to allow greater flexibility in their application. Of course, at an appropriate time and after full exposure these may ripen into formal rules or amendments of existing rules or forms. Despite certain difficulties we have encountered, it is my hope that we can continue to publish statements of our procedures, points of view and interpretations.

I wish to conclude with a few remarks concerning your activities and mine. The Special Study emphasized that under the Exchange Act self-regulatory bodies in the securities industry--essentially private organizations--are charged with public responsibilities. While this discussion dealt primarily with the activities of the NASD and the stock exchanges, it is important to remember that similar responsibilities are assumed by other groups. The concept of self-regulation was not first developed in the securities acts. It was adapted from activities of the professions to educate their members and to enforce ethical obligations. As members of the bar you are quite familiar with such activities. And your attendance at this course is good evidence that you take these obligations seriously. In the field with which I have been concerned for some twenty years, the bar has played a major role in developing the rules, the practices and the policies which have helped to transform the securities markets into viable economic institutions of significant size and importance. Much credit is due to the members of the bar who have combined integrity and far-sightedness with vigorous and able representation of their clients. Especial praise is also due those who have selflessly devoted many hours to the education of their fellow lawyers in this interesting, but admittedly complex, field of law.

Mr. Israels mentioned I will shortly receive a little more office space. Seriously, I am deeply honored by the President's action and very sensitive to the important responsibilities of the Chairman of the SEC. Although I could not ask for more fair-minded and capable colleagues on the Commission or a more dedicated and competent staff, I am in the unenviable position of succeeding William L. Cary, who will soon return to the New York academic and professional scene. Under his vigorous, forward looking and very fine leadership, the Commission and industry have achieved many important advances in investor protection, to some of which I have already alluded. Nevertheless, I look forward to new responsibilities with confidence that with your cooperation the Commission will continue to meet its obligations in the public interest. I am certain that the next thirty years will pose as many interesting, important and down-right knotty problems as have the last thirty years.