SOME RECENT ACTIVITIES OF THE SECURITIES AND EXCHANGE COMMISSION

Address of

Edward N. Gadsby
Chairman
Securities and Exchange Commission
Washington, D. C.

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It is a great pleasure for me to have this opportunity to discuss with you some recent activities at the Securities and Exchange Commission in which I believe we all have a mutual concern and interest. I am particularly happy to appear before this body in view of my long contact with local and federal regulation of securities, first as a Commissioner and afterward as General Counsel of the Massachusetts Department of Public Utilities, which has under its jurisdiction, among other things, the administration of the Massachusetts Blue Sky Law, and presently as Chairman of the United States Securities and Exchange Commission.

I expect in my discussion today to direct my attention to three phases of our work in which I think you may be interested, to-wit (1) to certain Commission rules possible amendments to which are now under study, (2) to our legislative program, and (3) to the progress in our enforcement program during the past year. Before I proceed any further, however, I should like to take this opportunity to congratulate your officers for their decision to convene your meeting this year in this beautiful city. This is my first visit to Mexico and, although I have only been here a little over twenty-four hours, I have already felt the grateful warmth of a most cordial hospitality. In the course of my duties I have travelled widely in order to review our widespread activities and have had occasion to visit many magnificent natural settings. As yet, however, I have not witnessed greater scenic beauty than that in the midst of which lies this beautiful capital city. To the Securities Administrator of this, our great sister country, I bring the most sincere thanks of those of us who are fortunate enough to be able to attend this session, and the most sincere pledge of complete cooperation in his difficult task from every person in our organization.

Turning to the subject of the proposed amendments to the Commission's rules, let me first remind you of some few axioms sometimes forgotten or overlooked by those who deal with the Securities and Exchange Commission on a day to day basis. The first and most basic of these concepts is the fact that our rule making power is not without its limits. The Commission may legislate by adoption of rules only within the framework of the powers entrusted to it by the Congress. It may not add to the statutes by rule, but it has the statutory duty to implement them. The remedy for an inadequate statutory delegation of power is by amendment of the statute, and not through the adoption of rules.

Except for matters of internal management and certain other things here immaterial, the Federal Administrative Procedure Act requires publication of notice of rule making and an opportunity for submission of views by interested persons. In addition, the Commission, as a matter of practice, directs numerous individual notices to persons who have indicated an interest in the subject matter of any proposed rule. We actively seek and greatly appreciate any constructive comment which may be pertinent either in favor of or against any proposed rule. Such opinions, particularly when expressed by the experienced members of your own organization, are given great weight when we consider whether a particular proposal is in the public interest.

With these few and probably unnecessary introductory remarks, I should like to direct your attention to the concept of a "single offering price" described in Section 22(d) of the Investment Company Act as it relates to the question of permissible variations in sales loads imposed on purchasers of investment company shares. In this connection the Commission issued a notice last May of a proposal to adopt a rule (Rule N-22D-1) to clarify and codify its practices of permitting varying sales loads either through administrative interpretation of Section 22(d) or through orders of exemptions from the provisions of that section granted under Section 6(c).

Section 22(d) of the Investment Company Act prohibits a registered investment company, its principal underwriter or a dealer in its shares from selling its shares to "any person" except "at a current public offering price described in the prospectus." This section was clearly intended to prevent discrimination among purchasers and to provide for orderly distribution of such shares by preventing their sale at a price less than that fixed in the prospectus. In an opinion of the Commission's General Counsel issued in 1941, Section 22(d) was construed as permitting continuance of a long standing practice of the industry under which graduated reductions in the sales load had been granted, depending upon the quantity of shares purchased provided that such quantity discounts were clearly described in the prospectus and were available to any members of the public on a non-discriminatory basis. Pursuant to this interpretation, the Commission has permitted quantity discounts to be quoted on purchases by an individual at one time of a dollar volume of shares in excess of a fixed amount, say $25,000. It has also allowed quantity discounts on volumes computed on the basis of the aggregate of the shares previously acquired and then owned plus the shares being purchased, and also on the basis of

so-called "letters of intent," in which the purchaser undertakes to purchase the required amount over a limited period of time in order to qualify for the reduced sales load. It has further permitted the aggregating of purchases by related individuals, such as members of a family, in order to make available the quantity discount. Questions have arisen under these arrangements as to the propriety of permitting quantity discounts to a trustee or other fiduciary or agent who purchases for more than one account. Quantity discounts have also from time to time been extended to a representative acting on behalf of a group of individuals such as members of a medical society or a college faculty. In rationalizing such a practice, the Commission has regarded the fiduciary or other representative making the purchases as a single purchaser and thus to be "any person" as the term appears in the statutory language, provided that the grouping of purchasers was voluntarily arranged without inducement by the issuer or its sales representative.

It has appeared necessary, however, to reconsider these determinations and to review existing industry practices in view of some complaints made to us in connection with such groupings of purchases. It has been found in many instances that the grouping has been solicited or encouraged by the investment company. It has become increasingly evident that reduced prices are not being granted to a single member of the public based upon the quantity of the shares being purchased, but rather to the aggregate purchases of several or numerous individuals comprising selected "classes" of persons, contrary to the spirit and intent of Section 22(d). An important consideration in this situation is the danger, if not the positive certainty, that prospectuses will not be furnished to all of the individuals comprising the group, in violation of the disclosure requirements of the Investment Company Act and the Securities Act.

As I mentioned, the proposed Rule N-22D-1 was drafted and circularized for comment among the industry in May 1958. Comments were received from some 45 persons, including several state regulatory authorities, representatives of various trade groups, investment companies, dealers and attorneys. Some ten appearances were entered at the oral argument held on the proposal before the Commission on July 23rd, including representatives of the National Association of Securities Dealers, the National Association of Investment Companies, various funds, management companies and other associations.

The proposed rule provides in part that quantity discounts will be permissible when granted in accordance with a scale of reducing sales load varying with the quantity of securities purchased by any person and based on (1) the aggregate quantity of securities being purchased at any one time or (2) the aggregate quantity of securities previously acquired and then owned plus the securities being purchased. The term "any person" is defined in the Rule to include (1) an individual purchasing securities with his own funds for himself and members of his immediate family and (2) a trustee or other fiduciary purchasing securities for a single trust estate but regardless of the number of beneficiaries. The proposed rule expressly provides "the term shall not include a group of individuals, acting jointly or through a trustee, agent, custodian or other representative." It also draws the line at the granting of special discounts to officers and employees of the issuer or the sponsor.

In the written comments and at the oral argument, objections to the proposed rule were raised in connection with the elimination of quantity discounts based on the so-called "letters of intent." It was pointed out that as a practical matter it would be impossible in most instances for a dealer or broker selling shares of a mutual fund to grant a quantity discount on the aggregate of the shares already purchased and then owned plus the amount being purchased, since there would be no way of ascertaining the total number held by the prospective purchaser. Aside from the few companies which have direct sales organizations and maintain complete records in their home offices of all sales and redemptions made by purchasers of their shares, there would be no source from which the seller could readily obtain information to verify the present holdings of a prospective purchaser. On the other hand, most of the representatives of the industry felt that purchases pursuant to a "letter of intent," if the practice is properly safeguarded, would be the most practical and effective method of offering a discount based on purchase of a certain quantity of shares. It was argued that the additional shares to which the purchaser might be entitled by reason of the saving resulting from the quantity discount couldbe held in an escrow fund until the entire program had been completed, or if the full sales load was to be charged on each purchase, the difference between the standard sales load and the lesser amount to which the purchaser would be entitled as a quantity discount could be held in an escrow fund to be delivered to the purchaser on the completion of the program. In such event, it was felt that there would be no possibility of the purchaser receiving a discount

to which he might not be entitled. In addition, it was suggested that the period to be covered by such letters of intent should be limited to some definite period, such as 13 months. It was also forcibly argued that the term "any person" should be defined so as to include the spouse and minor child or children of the purchaser so that the discount might be based on the total number of shares held by the entire family unit. Some criticisms were also advanced as to other parts of the proposed rule emphasizing the considerations which had led to the existing practices, and some further restrictions were urged such as a limitation upon special treatment of purchases by tax-exempt charitable organizations.

The proposed rule is now under active reconsideration by the Division of Corporate Regulation in the light of the comments so received, and it is probable that, after further consideration by the full Commission a rule of the general nature of that submitted will eventually issue, though possibly with some modifications to meet the more reasonable of the criticisms which have been made. In such event, it will no longer be necessary to petition for special orders in order to legalize special discounts in certain cases, as has been done repeatedly under the existing situation.

One troublesome problem confronting the Commission relates to the application of the Securities Act of 1933 to assessable stock. It is true that assessable stock is not used as widely as it once was, and it is not available under the laws in many jurisdictions. However, it is still issued occasionally in the western states usually by companies exploring for or exploiting natural resources. The purchaser of assessable stock not only pays an initial purchase price but also becomes obligated at the risk of losing some portion of his interest, to pay additional assessments if and when they are levied by the company. Properly employed, there is no doubt but that this feature serves a useful purpose. It permits a venture to be started on a relatively modest basis and gives some assurance that the enterprise will be able to obtain further capital when additional funds are needed in order to exploit favorable developments. It appears, however, that some companies having outstanding assessable shares issued prior to the adoption of our Regulation A-M have levied assessments against their stockholders without disclosing the status of the company or the purpose for which the proceeds are to be used. In some instances, stockholders have been able to obtain very little information from the company

and have sometimes even been met with a flat refusal by the company officials to furnish any information whatsoever. There have been indications that the funds raised by the assessments will not in some cases be productive of any present or potential benefit to the stockholders, and that some of these companies are operated chiefly for the personal benefit of insiders. There has been evidence in some other cases that companies with assessable stock outstanding are being used as vehicles to raise funds for the benefit of affiliated enterprises which are themselves unable or unwilling to make the disclosures required were they to seek funds directly from the public.

As a result, the Commission has recently invited comments on certain proposed changes in its Rules which would specify that the levying of assessments by these companies are within the purview of the Securities Act of 1933 by construing the definition of the terms "offer" and "sale" of a security to include the levy of an assessment. It seems clear that when a stockholder is asked to risk additional funds in an enterprise, he is being asked to make a new investment decision in connection with which he is entitled to appropriate disclosure by the issuer in order that the stockholder may have a basis for an informed decision.

It has been pointed out in some of the comments we have received, and the Commission is prepared to recognize, that these levies are frequently conducted on a small scale with the result that it may reasonably be considered to be unnecessary to insist upon the full registration process and that a somewhat lesser amount of information may be adequate in order to give appropriate protection to the stockholders. For this reason, the adoption of the proposed rule has been postponed, and the staff is considering the feasibility of a conditional exemption from registration allowing the raising on such a basis of limited amounts by means of assessments. It is believed that such an exemption, if properly drafted, would provide reasonable protection for stockholders in these cases with a minimum effort and expense for the companies concerned.

Turning now from the field of rule making, I should like to discuss for a few moments the somewhat related field of proposed changes in the legislation under which the S.E.C. operates. In the Summer of 1957, we submitted to the Congress proposals to amend an aggregate of 87 subsections

of the six statutes which we administer. The overall purpose of these proposed amendments was to strengthen the safeguards and protections afforded the public in their securities transactions by tightening the jurisdictional provisions of the statutes, by correcting certain inadequacies which continued experience has disclosed, and by facilitating criminal prosecutions and other enforcement activities. Considerable publicity has been given from time to time to these measures, but I think it might be helpful if I went over them again with you so that you may have them fully in mind if any question is raised with you about them.

The proposals to amend the Securities Act of 1933 would (1) provide a more workable procedure in administrative proceedings relating to pre-effective registration statements by providing for more time within which proceedings may be instituted and conducted, and authorizing the Commission to issue an order postponing the effective date of the registration statement pending the completion of the proceedings; (2) clarify the jurisdictional basis of the civil liability provisions of the statute; (3) permit a registrant to withdraw its registration statement except where the statement is subject to or about to become subject to a stop-order or similar proceeding or a Commission order in such a proceeding; (4) make it clear that a showing of past violations is a sufficient basis for injunctive relief and that aiders and abettors may be responsible in civil and administrative proceedings; (5) extend civil and criminal liability to documents filed with the Commission under the exemptive Regulation A as authorized by Section 3(b); and (6) increase from $300,000 to $500,000 the size of offerings which may be so exempted from registration under Section 3(b).

The proposed increase in the Section 3(b) ceiling to $500,000 was also the subject of two Senate bills filed separately from the Commission's recommendations. This proposal was favorably reported by the Senate Committee on Banking and Currency and passed by the Senate, but was not reported out by the House Committee on Interstate and Foreign Commerce in the current session of Congress. In addition, another bill was separately introduced to repeal Section 3(a)(11) of the Securities Act, which you will recall provides an exemption for intrastate offerings from the registration requirements of the statute. No action was taken on this proposal.

The Commission has proposed also to amend the Securities Exchange Act of 1934, so as to make proof of past violations adequate

basis for injunctive relief and also to impose responsibility upon aiders and abettors in civil and administrative proceedings. In addition, amendments were proposed to that statute which would, among other things: (1) make it a violation of this Act to embezzle money or securities entrusted to the care of an exchange member or a registered broker or dealer; (2) make the status of a person as an exchange member, a broker or dealer doing business through a member or a registered broker or dealer adequate basis for federal jurisdiction; (3) clarify and strengthen the statutory provisions relating to manipulation and to the financial responsibility of brokers and dealers; (4) authorize the Commission by rule to regulate the borrowing, holding or lending of customers' securities by a broker or dealer; (5) make it clear that attempts to purchase or sell securities are covered by the anti-fraud provisions of the statute; (6) revise the provisions relating to broker-dealer registrations with respect to (a) the basis on which action for denial or revocation may be taken, (b) the sanctions which may be imposed by the S.E.C., (c) the conditions under which an application for registration may be withdrawn, and (d) the postponement of the effectiveness of an application for registration; (7) authorize the Commission to suspend or withdraw the registration of a securities exchange when the exchange has ceased to meet the requirements of its original registration; and (8) provide that an insolvent broker or dealer may be adjudicated a bankrupt in an injunctive proceeding instituted by the Commission.

The changes proposed in the Trust Indenture Act of 1939 would conform certain provisions of that statute to certain of the recommendations made in connection with the Securities Act of 1933.

The amendments proposed by the Commission to the Investment Company Act of 1940 would (1) require an investment company to state as matters of fundamental policy, which generally could not be changed without the consent of its stockholders, the extent to which it intends to invest in particular types of securities and such other basic investment objectives which it represents it will emphasize; (2) strengthen the provisions requiring that there be a minimum number of independent or non-management directors; (3) limit the extent to which a face-amount investment company can include preferred and common stock in its "qualified investments"; (4) make clear the application of the statute to an "advisory board"; and (5) clarify the stated exceptions available to companies engaged in banking, insurance, small loan, factoring, discount or real estate businesses.

The amendments which we have proposed to the Investment Advisers Act of 1940 would (1) expand the basis for disqualification of a registrant because of prior misconduct; (2) authorize the Commission by rule to require the keeping of books and records and the filing of reports; (3) permit periodic examinations of a registrant's books and records; (4) empower the Commission by rule to define and prescribe means reasonably designed to prevent fraudulent practices; (5) extend criminal liability for a wilful violation of a rule or order of the Commission; and (6) revise the provisions relating to the postponement of effectiveness and the withdrawal of applications for registration.

In addition, the Commission has proposed a number of amendments to Chapters X and XI of the Bankruptcy Act which are designed to eliminate certain difficulties that have arisen under that Act. Among the more important and provocative of these suggestions is the proposed amendment to Chapter X [1/] which would allow the Commission to appeal from the District Court, provided leave to appeal is granted by the appropriate Court of Appeals.

Inasmuch as Congress adjourned in August without acting upon the bills embodying the amendments proposed by the Commission, it is our intention to re-examine these suggestions in light of the comments which have been made since their introduction and it is reasonable to predict that the proposals will be re-introduced in substantially the same form in the 1st Session of the 86th Congress which is scheduled to convene on January 7, 1959.

The last topic which I would like very briefly to discuss with you, that of progress in enforcement, is to some extent unrelated to the foregoing. I am certain, however, that it is always of continuing and vital interest and importance both to the Commission which I represent and to each and every North American Securities Administrator.

I have sometimes been asked why the Securities and Exchange Commission should place so much emphasis on this phase of our work and whether our increased enforcement activity indicates either some prior deficiency in this field or an increased disregard for the law. We are now approaching our twenty-fifth anniversary as a regulatory body. The securities industry as a whole is now firmly geared to the statutes we administer. As far as I have been able to see, the Securities and

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1/ Section 208 of Chapter X (11 USC 608).

Exchange Commission has never from its inception faltered in its insistence that the mandates of the statutes be explicitly observed. With habit and increased understanding, however, and in the rising market of many years' standing, and with the vastly wider base of investor interest and the enormous potential gain to be derived, there has been attracted to the securities industry a fringe element of confidence men, without conscience or scruple, who are determined to take whatever advantage they can of the American public, regardless of the controls which Congress has adopted for the express purpose of preventing such frauds. We are determined to thwart the ambitions of these gentry, which have become a serious threat to the investing public relatively recently. With your cooperation, we shall succeed. Most certainly, we do not intend to hesitate in any respect in this effort until it has been made clearly apparent to all illegitimate operators that their talents can be exercised with far more safety in fields other than the securities market.

In this vital field, I think the record of the past year is one of continuing progress in the refinement and improvement of techniques for dealing with these problems, and with the various schemes which these ingenious crooks have devised to hide their activities.

The "boiler room" is still with us to some extent, although in somewhat different form. Most of the big ones have disappeared under the simultaneous urging of the federal and state agencies. In their place, however, we find small outfits which spring up suddenly, sell one or two spurious issues quickly and then disperse, their fraudulent purpose accomplished. In our last annual report we referred to this phenomenon as a "cancerous diffusion." This tendency has made speed and alertness essential to enforcement activities. Under a cooperative procedure which has recently been utilized and which gives some promise of effectiveness, our investigators enter such a place of business as soon as it comes to our attention, take off a list of customers who live in a particular state, and furnish this list to the State Administrator of that state. That official proceeds to interview certain of these customers, obtains affidavits describing the representations made to them, undertakes local prosecution if this is feasible, and also furnishes us with such affidavits as may form a basis for a fraud proceeding. The diffusion which I mention is not limited by state lines, and we have noticed a tendency of the small boiler room to establish itself somewhere away

from Wall Street where the climate may be a little less rigorous. Those State Administrators whose laws permit them to consider the character and reputation of applicants for broker-dealer registration and to exclude the obviously unqualified or unsuitable may be in a position to perform a national service by careful scrutiny of the migratory applicant. We stand ready to assist to the limit of our power and knowledge.

Another area in which there is an opportunity for effective cooperative enforcement relates to the activities of certain syndicates who move from state to state, setting up an "intra-state" promotion in each new jurisdiction usually consisting of a securities corporation, a holding company and several satellite corporations in such fields as insurance, small loans, etc. Local participants are usually placed in actual or nominal charge, and the securities offering is stated to be limited to residents of the state. The appeal which these operators make to local residents based on the prospect of building local businesses and industries is very effective, and substantial issues have been floated whose value has subsequently declined materially, resulting in serious losses to investors. Our jurisdiction in most such cases is limited, and the promoters are generally careful to avoid any transactions upon which we could base any action. However, our experience and that of administrators in other states where these syndicates have operated may be useful to you, and we can and will act where we can find any jurisdiction under the anti-fraud provisions of the statutes we administer.

International enforcement is an appropriate topic for consideration by an international body such as this. We continue to receive the most heartening cooperation from the securities administrators of the various Canadian provinces, and we still encounter efforts to evade the impact of that cooperation. One manifestation of this is recourse to alleged open market purchases in Canada of securities intended for high pressure sale in the United States, in order to conceal the source of securities intended for distribution in violation of our securities laws. We may, I think, be properly skeptical of the ability of a broker in New York to round up 30% or 40% of the outstanding shares of a corporation by "open market" purchases without creating a ripple in the market or raising the price. It would seem that somebody on the supplying end planned it that way, and that somebody had effective control of the situation. In addition, some operators who have become _personna non grata_ in Canada have turned up in Cuba and elsewhere. Cuba, unfortunately,

lacks a regulatory agency in the securities field, although we have found the Havana Stock Exchange anxious to cooperate, and we have had some success in securing postal fraud orders. For the rest we must rely to a considerable degree upon warnings and publicity. I may remark, parenthetically, that we have not had any indication that these operators have turned up in Mexico, where they might very logically have gone. This, I think, is a tribute to the very able Securities Commission of Mexico.

In closing, permit me to express our appreciation of the cordial relationship existing between the North American Securities Administrators and the Securities and Exchange Commission during the past year since your fortieth annual meeting at Santa Fe. In April 1958, your Liaison Committee headed by Mr. John F. Hueni of Michigan conferred in the Washington offices of the S.E.C. with members of the Commission and its staff. Several very productive sessions were held at which a multitude of subjects of mutual concern were discussed. On May 2 and 3 of this year, your securities administrators from the Mountain and Plains States met in Denver, Colorado, where members of the Fort Worth and Denver offices of the Securities and Exchange Commission participated in sessions in which, among other things, were discussed problems involving instalment security sales, variable annuities, broker-dealer matters and Regulation A.

It has been a great pleasure to have this opportunity to talk with you for a few minutes, and to renew many friendships at this meeting. I now look forward to what I know will be a stimulating closed session.