C A L V I N B U L L O C K F O R U M

New York City

September 24, 1953

CURRENT THINKING AT THE SEC

Address by

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The Securities and Exchange Commission, as an administrative body charged with the regulation of such a sensitive, important and dynamic segment of our national economy as the capital markets, should keep examining and reexamining its major premises. Yesterday's problems are not necessarily today's. Stampeding buffaloes no longer bother the transcontinental traveler.

A five-man Commission with three Commissioners appointed by the new national administration has a special responsibility to appraise the work and the attitudes of the agency and its staff. The two Commissioners who hold their appointments from the previous administration have a wealth of experience to bring to bear on the problem. The three new Commissioners coming from the outside should furnish some freshness of outlook.

It goes without saying that the Commission as presently constituted does not intend to sabotage the statutes it administers. The Federal securities laws are not in the hands of their enemies.

I want to talk about how the Commission is approaching its task and to indicate in fairly specific terms what it is doing.

But first, let me paint the backdrop against which our action takes place:

1. The statutes administered by the Commission have not been substantially amended since their enactment. The Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, the Investment Company Act of 1940 and the Investment Advisers Act of 1940 have not been amended at all. This furnishes some foundation for the observation that Congress over a number of years has accepted the basic approach to securities regulation represented by the Acts which the Commission administers.

2. Neither is there a ground swell of public demand for a sweeping change in the Acts administered by the Commission. There are some elements, perhaps more vocal than representative, who advocate the abolition of the Commission and the repeal of the Acts administered by it. And there are many representative, responsible and informed people who think that the Commission in certain areas has from time to time gone beyond its statutory powers in an excess of regulatory zeal; that it has been dominated by its staff; that both staff and Commission have sometimes been high-handed; and that the Commission has been careless of other peoples' time and money in imposing on issuers and underwriters useless and duplicative paper work. There are also many representative, responsible and informed people who think that some legislative changes are necessary to remedy defects, ambiguities and impracticalities in the Act which experience has shown to exist.

3. The capital markets and corporate issuers have become accustomed to the pattern set under SEC regulation. Business, corporate, legal, underwriting and accounting morality have improved as a result of conformity to standards imposed by the Acts and by the Commission acting thereunder.

4. The Hoover Commission's Task Force found that the Commission "on the whole has been notably well administered", that the critics of the Commission"concede that its staff is able and conscientious, and that the Commission generally conducts its work with dispatch and expedition where speed is most essential". It also said: "There are of course some weaknesses . . . but in evaluating them, one should keep in mind the basic fact that the Commission is an outstanding example of the independent commission at its best."

5. The Commission in the Acts administered by it is given unusually broad powers to make rules and regulations which have the force of law. This rule-making power is characteristic of administrative agencies, which are quasi-executive in their enforcement functions, quasi-judicial in their decisional functions and quasi-legislative in their rule-making functions. The ingenuity of the American business community constantly creates new problems with which conventional legislation must necessarily deal in general terms, leaving to the administrative agency as a quasi-legislature the job of filling in the details to meet changing conditions and particular types of situation. There are more than 100 instances in which the Commission is expressly granted rule-making power. For example, the Securities Exchange Act forbids stabilizing in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. The Public Utility Holding Company Act provides that the Commission by rule, regulation or order exempt both companies and transactions from certain provisions of the Act.

The $300,000 exemption from registration under the Securities Act stems from a power granted to the Commission to provide such exemption by its rules and regulations.

The existence of this rule-making power, however, creates recurring problems which will never be solved to the satisfaction of all:

(a) There is danger of adding new rules to old rules, a revision here and a revision there, until a literal jungle of regulations has grown.

(b) Rule-making power imposes a duty of restraint but it also imposes a duty to use the power to strike down abuses as they develop.

(c) There will always be room for argument on both sides as to whether or not a specific power is being abused.

So much for the backdrop. Now let me discuss our approach to our job.

First, as to the philosophy of the present Commission:

Let me start by eliminating any distinction between the two pre-Eisenhower Commissioners - Paul Rowen and Clarence Adams - and the three new appointees - Sinclair Armstrong, Jackson Goodwin and myself. The Commission is in harmony as to all basic objectives. Its members have had frequent informal, long and serious discussions at which they have explored each other's thinking. Naturally, there are shades of opinion, but I can assure you that the Commission is composed of five highly normal middle-of-the-roaders. As such, we all have considerable pragmatic blood in our veins.

Second, as to a legislative program:

In the hearings before the Senate Banking and Currency Committee on the confirmation of each of the three new Commissioners, it was made quite clear that Congress and not the Commission is the legislative arm of government. However, it was inherent in the colloquy between each nominee and the Committee that the Commission, because of the technical nature of the subject matter, could properly act as a catalyst in any legislative program.

Representative organizations in the fields regulated by the Commission are formulating a definite program for legislation and for rule changes. Some items of the program have been forwarded to the Commission. As programs are formulated, representatives of the participating organizations will confer with the Commission in an endeavor to determine areas of agreement. The Banking and Currency Committee of the Senate and the Interstate and Foreign Commerce Committee of the House will be kept advised of progress. This general method of approach has been informally cleared with the Chairmen of both the Committees mentioned above.

It would be premature and inappropriate for me to speculate as to what kind of legislative program will be offered to the Congress with or without the Commission's blessing. Certainly there is room for some clarification in the statutes. For example, there is a strong case for spelling out in the statute a proper practice as to the furnishing of a prospectus which will make that

document the medium of information for the prospective investor that it is intended to be.

Third, as to regulations - forms - details:

It is recognized that a considerable part of any program will be effectuated by rule changes and form changes. Entirely apart from a willingness to consider suggestions by regulated groups, the Commission acknowledges an obligation on its own part to initiate steps to improve and simplify its own regulations and forms. This responsibility is easier to affirm than to carry out. Each change of a rule or a form is likely to necessitate some change in another rule or form. Each requirement that is given up finds a strong and usually a logical defender.

The Commissioners have been meeting among themselves and have also had frequent conferences with staff members. Guiding the discussion at such conferences have been agenda of specific and detailed proposals. Certain Commissioners have been delegated to examine, and report back to the full Commission their recommendations with respect to specific matters.

Out of these discussions have emanated some of the specific proposals which I shall discuss later.

Fourth, as to organization and programs:

The Commission has under study the organizational set-up of its staff. Lines of command, particularly with respect to the regional offices, are not clear. Autonomy of regional offices represents desirable decentralization up to a point. However, the independence of action which this permits has resulted in insufficient liaison between the regional offices and Washington and among the regional offices. The reconstituted Commission hopes to provide for more effective coordination of regional office activities and for more accurate knowledge in Washington of what is happening currently in the regional offices, and to do these things without making Washington a bottle-neck.

Effective administration of the regional offices is the key to effective enforcement. And you may rest assured that the Commission proposes to enforce the law. A vigorous program to detect and punish fraud is no deterrent to legitimate enterprise.

The Acts provide for enforcement via investigation, discipline, criminal prosecution and injunction. The enforcement machinery is stirred to action either by private complaint or Commission investigation. Many violations are turned up as a result of so-called broker-dealer inspections. When the Securities Exchange Act

of 1934 was under consideration in Congress, there was some thought given to having regular inspections analogous to bank examinations. This idea was abandoned and in its place was substituted a provision for investigation at the discretion of the Commission.

The legislative direction is such that the Commission can do as much or as little inspecting as it determines. As a matter of practical fact, the extent of the broker-dealer inspection program depends primarily on the availability of funds. Unfortunately the general public labors under the impression that brokers and dealers are examined pretty much the same as banks. That isn't so. Under present budgets, it can't be so. The Commission is anxious that the investing public and the Congress understand this fact.

The Commission and the National Association of State Securities Administrators are engaged in a cooperative study to determine the extent to which over-lapping of the State and Federal broker-dealer inspection programs can be eliminated. The SEC inspection covers both financial condition and trading and selling practices. State inspections vary widely from state to state, and in some states are non-existent or nearly so. Since neither the SEC nor the State Commissions have available funds to make regular, periodic inspections of each registrant, there should be some coordination designed to avoid harassing multiplicity of inspections of some and long-time omission of inspection of others.

In addition to official inspections by the State authorities and by the SEC, there are inspections by the National Association of Securities Dealers and, in the case of the members of national security exchanges, by such exchanges. A public agency cannot, of course, abandon its functions to private agencies nor would the members of a private agency support the use of their inspectors as informers to the public authorities with respect to matters not involving defalcations or insolvency.

Considered in the aggregate, dealers in securities are subject to multiple inspections but from the standpoint of the public, the whole scheme is somewhat haphazard. This subject is receiving serious consideration. I hope that our Commission and the other inspecting authorities can come forward with some helpful and intelligent recommendations.

While on the subject of organization and programs, let me mention the matter of statistics. The Commission publishes monthly a Statistical Bulletin which covers, in some cases monthly and other cases quarterly, the following subjects:

New Securities Offerings for Cash
Sales on Securities Exchanges
Indexes of Common Stock Prices
Short Interest in N. Y. S. E. Stocks
Transactions in Round Lots on the New York Exchanges for Members and Nonmembers

Transactions in Odd Lots on the New York Exchanges
Effective Registrations of Securities
Underwriters of Registered Issues
Managers of Underwriting Groups
Investment Company Transactions and Assets
Special Offerings on Exchanges
Secondary Distributions
Working Capital of Corporations
Saving by Individuals
Expenditures on New Plant and Equipment

It also publishes on Official Summary of Security Transactions and Holdings covering trading by persons subject to Section 16 of the Securities Exchange Act, Section 17(a) of the Holding Company Act and Section 30(f) of the Investment Company Act.

In addition, there is a quarterly financial report of the United States manufacturing corporations published cooperatively by the Federal Trade Commission and the SEC.

None of these statistical reports is required by statute. Some of them are made for the use of other departments of the government. Others are compiled in the normal course of keeping track of our own day to day operations. Commissioner Goodwin has been delegated by the Commission to make a thorough study of our statistical programs and to consult with the Bureau of the Budget with a view to determining whether or not any of the Commission's statistical activities are unnecessary, duplicative or primarily for private benefit.

While on the subject of programs, may I allude briefly to the Commission's authority under Section 30 of the Public Utility Holding Company Act to conduct studies to determine the size, type and location of public utility companies which can operate most efficiently in the public interest so as to further wider and more economical use of gas and electricity. Except for studies made in connection with administering other sections of the Act, the Commission has never done any of the overall economic planning contemplated by Section 30. While my predecessor proposed a program to initiate staff work under this section, it is the view of the present Commission that as a part of an administration dedicated to less government, not more, it should not ask the Congress for funds to make studies to which no one would be bound to pay any attention. This view is, of course, actuated in part by the fact that the use of gas and electricity has without such studies increased so vastly since the Act was passed in 1935.

Now let me discuss briefly some currently pending proposals to simplify our rules, regulations and forms. Please let it be

understood that I am speaking in terms of present intention and that what I say is neither a representation nor a warranty as to what will happen or when.

First as to registration procedure under the Securities Act of 1933. A new and shorter form for registration of investment company securities is about to be adopted. The Commission has under study the use of other simplified forms for registration of securities in certain special situations; for example; extended availability of Form S-8, the short form now available for only certain types of offerings to employees; the adoption of an abbreviated form of registration statement for institutional grade debt securities of issuers already filing reports with the Commission; the curtailment in all registration statements of the requirement for filing contracts. As a corollary to the adoption of a more simple form of registration statement, the Commission is studying reduction of its examining procedures with respect to registration statements for institutional grade debt securities and a consequent shortening of the normal 20-day waiting period. This should have the effect of making public offerings more competitive with private placements. In addition, work is being done on the subject of a consolidation of forms.

The Division of Corporate Regulation - formerly the Division of Public Utilities - under it new Director, Robert A. McDowell, is making a study, the result of which we hope will be to eliminate some duplication of filing as between the Securities Act and the Public Utility Holding Company Act. A study is under way to determine whether in case of securities sold to underwriters at competitive bidding, a method can be worked out whereby the underwriters can re-offer without waiting for post-effective orders of the Commission. This would eliminate some of the nerve wracking and expensive last minute scramble which follows the opening of bids and in some cases would shorten the carry by the underwriters. It would not, however, deprive investors of any protection presently afforded.

The Commission may soon circulate for comment a proposal to eliminate entirely with respect to companies soliciting proxies, all of the Form 10-K annual report except the financial statements. This should not only be a relief to issuers but it cuts down by many pounds and pieces the amount of paper which the Commission staff must handle, examine and file. The proposal removes no protection from security holders because the items which constitute the text of the 10-K report call for information which is already available in 8-K current reports or proxy statements. It is also proposed to reduce the list of transactions in respect of which a Form 8-K current report will be required. As you know, the Commission has already circulated a proposal to eliminate the 9-K quarterly report

of gross sales or revenues. The report is felt to have a misleading effect because the current trend of a company's gross sales may be contrary to the trend of its earnings. These steps should enable the staff to clear the backlog of unexamined material and thereafter to keep current.

It is proposed shortly to circulate for comment changes in the proxy rules, largely clarifying changes. A controversial item, however, has to do with security holders' proposals. Keeping in mind that proxy solicitation by management represents an expenditure of corporate funds from which management benefits by prospective election to office, the Commission does not deem it fair to choke off the submission of security holders' proposals. After all, the submission of such proposals and the tabulation of votes thereon are at worst a comparatively inexpensive burden considering the size of the corporations subject to the proxy rules. It is recognized, of course, that personal publicity motivates the makers of some proposals, and also that defeat of a proposal by an overwhelming majority furnishes justification to deny the use of corporate funds for repetitive submission. In addition, some proposals cover matters which are obviously not proper subjects for action by security holders.

The Commission intends to suggest that management need not print in its proxy material the name and address of the proponent of a proposal (this should quench the ardor of the publicity-seeker). Another intended suggestion of the Commission is to change the present rule which permits non-inclusion of proposals which within one year received less than 3% of the votes cast. A somewhat higher percentage will be proposed. The staff will continue to screen out proposals which are not proper subjects for action by security holders and consideration is being given to administrative directives to use a screen with a somewhat closer mesh.

The rule requiring inclusion of security holders' proposals in management's proxy material has been availed of frequently by a few professionals and seldom by the general run of stockholders. The Commission does not propose to choke corporate democracy. Neither does it propose to encourage abuse of their privilege by those who use it as a grindstone for their own axes.

Another field to which our attention is being directed is the intervention of the Commission in proceedings under Chapter X of the Bankruptcy Act. The statute itself provides for mandatory intervention at the request of the Court and for discretionary intervention on the Commission's own motion. While the jurisprudence under Chapter X was being developed, the Commission and its staff, as a body of presumed experts, had a greater duty than at present to press upon the Courts the benefit of their experience

and special competence. Now that the jurisprudence under Chapter X has been developed over a period of 15 years, the Courts and the litigants would not suffer substantially from a curtailment of discretionary intervention by the Commission. The Commission's policy on this subject will be on a case for case basis, as it has been in the past, but it may be anticipated that budget limitations and the fact that the Courts and litigants are able to take care of themselves will cut down somewhat the number of interventions. My observations on this subject are necessarily general and are dictated more by budgetary considerations than by philosophy. After all, bankruptcy is a field which is constitutionally allocated to the Federal Government.

What I have said up to this point should indicate the direction in which the Commission is travelling. I think it only fair to prophesy that the pace may be slow. The Acts administered by the Commission were enacted over a period of 8 years, 1933 to 1941. Its rules, regulations, forms and policies have grown up over a period of 20 years. Almost every rule, regulation, form or policy has a plausible reason behind it and has its staunch defenders either among the public or on the staff or both. It may be that in cutting our way through the brush we can do some work with axe and scythe but, keeping in mind the complex character of the capital markets, I am inclined to thing that most of our cutting will be with sickle and pruning shears.

Moreover, it must be borne in mind that high-level staff members and the Commissioners themselves must participate actively in the rule changing process and that such participation must be worked in to a fairly tight schedule of day to day work. The Commission must necessarily sit for several hours each day to dispose of quasi-judicial matters and to pass upon policy questions propounded by the staff. It may be that the latter function can be effectively delegated - - eventually. However, for the time being it is felt that the only way that the philosophy of the Commission can be communicated to the staff is to keep a fairly close check on the handling of specific problems of the Commission's "customers".

In conclusion, let me make a passing reference to the suggestion made from time to time that the Securities Act of 1933 be supplanted by what amounts to a fraud statute implemented perhaps by a filing with some Federal agency of unexamined offering literature. This involves, of course, a reversal of the philosophy which underlies the present Act, namely, that of preventing fraud by enforcing standards of disclosure. That, of course, is a question for the Congress. I would prophesy, however, that such legislation is not likely to be enacted. So long as our Acts are based on disclosure, there will be forms, rules, details, problems and arguments. The modern corporation and the mechanics of the

capital market are not simple. The aim of the Commission is to perform with vigor and alertness its statutory duties for the protection of investors without adding unnecessarily to the inherent complexity of capital formation.