ADDRESS

of

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When it became apparent that the constantly increasing activities in Washington incident to our war effort would require the removal of many governmental agencies from the Nation's capital, it seemed most appropriate that Philadelphia should have been selected as the new home of the Securities and Exchange Commission, it being the Mother city and the original capital of our country. That a wise choice was made is apparent from the very sincere welcome you have extended to us, supported by the many sacrifices made to give us a home in Rittenhouse Square. For these we are grateful and deeply appreciative.

In order that we may become better acquainted I think you will be interested in a general outline of the Commission's work. This I shall attempt to give by way of introduction, but as time goes on I am sure you will come to know well both our people and our work.

The Securities and Exchange Commission itself is composed of five members. It will maintain a headquarters office staff here in Philadelphia consisting of seven separate divisions to handle the various administrative assignments which have been given to us. In addition, the Commission also maintains ten regional offices and a number of sub-regional offices throughout the country which assist in its administrative duties and its enforcement work.

The Commission was created by the Securities Exchange Act of 1934. This law gave to the Commission the jurisdiction originally prescribed by the Securities Act of 1933 over new issues of securities and the prevention of fraudulent sales of securities, which had been a function of the Federal Trade Commission during the previous year. The 1934 Act also gave the Commission jurisdiction over stock exchanges, market practices and persons acting as brokers and dealers. Since that time Congressional action has increased the Commission's responsibilities by further legislation. For example, the Maloney Act of 1938 placed under our jurisdiction certain functions in connection with over-the-counter markets; while the Trust Indenture Act of 1939 gave

to the Commission certain supervisory authority over trust indentures.

In addition to the original grants of authority, the Congress has delegated to the Commission other responsibilities in the field of finance, one of the most important of which was the Public Utility Holding Company Act of 1935. I want to discuss later one of the most urgent problems which calls for answer in this field.

Under the Chandler Act, which is the Bankruptcy Act as recently revised, the Securities and Exchange Commission was designated to act as a statutory friend of the court in certain corporate reorganizations. The Commission's function in this connection has been to advise the courts regarding the administration of the affairs of corporations in reorganization and to advise as to the fairness and feasibility of reorganization plans.

Other responsibilities were given to the Commission by the Investment Company Act of 1940 and the Investment Advisers Act of 1940. Under the former the Commission has regulatory authority over investment companies and their operation, while under the latter it is given authority over persons rendering ivestment advice to the general public.

This is a very brief picture of the responsibilities of the Commission. They are for the most part what may be thought of as ordinary peace-time functions of the government. They have not, however, lost their importance in this time of war. On the contrary, and notwithstanding the fact that they seem to have lost some of their emphasis, as responsibilities they have increased in importance. They involve objectives that must be maintained if the business life of the nation is to function smoothly at top speed during this period of emergency. For if vigorously pursued, they will insure a sound foundation for an orderly reconstruction when the present world emergency has passed. It is our job to protect and improve the framework within which the business life of the nation operates, both now and in the days to come.

The various programs for financial improvement that the Congress has entrusted to the Commission include essential safeguards of this nature and a sound basis for future improvement. We must see that the progress already made along the lines of beneficial financial reform be protected and that further progress which is helpful to the prosecution of the war be earnestly pursued.

Today, however, it is not enough that the Commission carry on its usual pursuits. If there is some phase of the emergency where it can be helpful, it must see the need and give unselfishly of its services. We have already accepted a great many special assignments from defense and war agencies and we expect to continue to give this service where-and whenever needed. We have also supplied a large number of our regular staff to agencies primarily concerned with the war effort. The commission is ready and eager to help all that it can in any phase of war work which will be benefited by its peculiar experience and capabilities. We have a particular responsibility in the field of finance with which, of course, our primary jurisdiction is concerned.

The Commission has already traversed a great portion of the controversial sea into which the reforms of the Securities Act and the Securities Exchange Act were launched. A well ordered system is now in effect for the administration of these Acts. The requirements of registration have become a standardized part of the process of issuing new securities. The investor is now furnished with the information required to appraise the security being offered, which was the objective sought by the Congress when it passed the law. In developing this process, care has also been taken, without relinquishing investor protection, to keep the burden upon issuers at a minimum. The Commission has exerted a special effort to prevent burdens falling upon small companies desiring to raise limited amounts of capital. The administration of the disclosure provisions of these Acts has had a most profound influence on the

accounting practices and business methods of the country. Perhaps I should emphasize at this point that these registration provisions are based entirely on a disclosure principle and do not involve any authority in the Commission to approve or disapprove the issuance of securities.

We have also rigorously enforced the fraud provisions of the Securities Act and, while fraud is never entirely eliminated, a large segment of the racketeer element has been driven from the securities business. Our job in this field now is one of eternal vigilance to see that this element gets out and stays out.

The initial problems of policy and procedure incident to the administration of the Securities Exchange Act have also been to a large extent determined. We feel that we have accomplished much in cleaning up our market places and developing standards of trade to protect the investing public. As a part of this program, persons found to be unfit for the fiduciary responsibilities of the business have been eliminated. The Commission's present task in this direction, like its fraud task, now is one of continuous vigilance.

Thus the Commission's job in the securities field has in large measure come down to one of continuing administration and enforcement in accordance with the pattern already cut out. The importance of this work, however, is as great as ever and we are continuously searching for ways and means to facilitate and improve methods both for the issuance of new securities and for the maintenance of honest markets.

In enacting the Public Utility Holding Company Act the Congress was endeavoring to meet a multitude of problems with which investors and consumers had found themselves confronted as a result of loose financial practices indulged in the utility field during the 1920's. Through following those practices many utility holding company systems had become unsound and uneconomic in the extreme.

In the first place, the properties of many holding companies were scattered all over the country. The effects of this scatteration confounded local

regulatory authorities and even made control more difficult by the owners of these properties, who were the holding companies themselves. These huge concentrations of power were clearly demonstrated to be contrary to the public interest, as well as harmful to the interest of the consumers who were dependent on them and that of the investors who had entrusted their savings to them.

In the second place, the common practice of the holding companies had been to have their subsidiaries issue as much debt and preferred stock as possible and have only the common stock owned by the holding company. The holding company, in turn, would issue as many senior securities as it could sell. The process was frequently repeated several times over with holding company pyramided on top of holding company.

When everything is going well, when earnings are rising and stock market averages are advancing, such a process does not appear to be injurious to security holders. Senior security holders receive their interest and dividends on time and the junior security holders — that is, the common stock holders of the holding company — find their earnings and the liquidation value of their securities increasing by leaps and bounds. This phenomenon you, of course, recognize under the familiar term, "leverage." As I say, all is well while things are booming, but this process works both ways, and woe betide the whole structure when things are on the down grade.

That's what happened in the depression following 1929 and, where such structures still exist today, that is what is happening again as our war economy constricts profits and earnings available for security holders. Many holding companies were forced into bankruptcy during the depression. The need for action was plain. The Congress responded to this need with the enactment of the Public Utility Holding Company Act.

There has been a widespread misunderstanding on the part of the general

public as to the meaning and effect of this statute. This misunderstanding has gained currency in all walks of life. On the point which I am discussing here it is particularly important that these misapprehensions be dispelled and that the public generally know what is the real problem involved and the advantages of the statute in bringing order out of things as they are. The Act is, in part, a regulatory statute controlling such matters as the issuance of securities, sales and acquisitions of properties, payments of dividends, transactions between affiliates, and the like; and it is also what might be termed a reorganization statute. The Congress required a complete and basic readjustment of the operations and structures of holding companies.

The provision in the law designed to accomplish this purpose is contained in Section 11 which is entitled "Simplification of Holding Company Systems." Briefly stated, the provisions of Section 11 fall into two principal categories. One envisions geographic and physical simplification. The other calls for corporate and financial simplification. Obviously, these two phases are not separate and distinct. On the contrary, they are closely interrelated in their substantive requirements.

For the purpose of geographic simplification the law requires that holding companies be limited in their operations to properties which are located in relatively contiguous areas. The retention of scattered properties is prohibited, and no group of properties can be kept under common control which is so large as to impair the advantages of localized management, effective regulation, and efficient operation.

The other requirement of corporate and financial simplification looks to the elimination of unnecessary holding companies, corporate complexities which involve inequitable distribution of voting power, and the maintenance of excessive amounts of securities in the structure.

There has been little enough recognition of the true problem which has existed in the past, and still faces holding companies -- the fundamental problem of complex structures which endanger the investors in these companies.

We are now at war, and the successful prosecution of the war effort requires production of essential war materials. Increased requirements of that production call for a tremendous increase in the output of electrical energy which, in turn, requires cash for plant expansion and maintenance.

Furthermore, the fiscal requirements of the government call for increased taxes on corporate profits. These two factors will tend to reduce the amount of cash available for the payment of dividends on equity securities and will create a consequent restriction of the holding company in its ability to service its fixed obligations.

Defaults on the debt securities of holding companies will lead inevitably down the road to bankruptcy and all of the inconveniences and expenses of bankruptcy proceedings. But the Congress has provided a procedure for avoiding such undesirable events -- the procedures contained in Section 11 for the reclassification and simplification of holding company capitalizations. As I have said, that was a problem which faced the holding companies in the early '30's when many of them were forced into bankruptcy. That is the problem which has faced the holding companies throughout all the years since 1935. And that is the problem which faces them today. Some few holding company managements awoke to a realization of this and availed themselves of the procedures afforded by the Congress and began to eliminate their difficulties voluntarily and during periods which were much more propitious economically. The Commission itself began in 1938 to encourage the filing of voluntary plans by the holding companies. When this was unproductive of substantial results it undertook the institution of formal proceedings under its own powers, some of which have resulted in satisfactory solutions being worked out between the companies and the Commission. Others have progressed near to the point of completion.

But most holding companies have blinded themselves to the realities and have devoted their energies to deluding their security holders into a feeling that the law and its administration were destroying their security values. They tell us today that recapitalization is out of the question at such a time as this when our markets have sunk to the lowest levels obtaining since March, 1938. But that has been said during every period since that time. And who is to say that there may not be still more unfavorable times ahead? There have been in the past. The Commission has done, and will continue to do, everything within its power to work toward the desired objective. But if the public investors in these companies are to be protected, it is incumbent on management to put its shoulder to the wheel in an effort to work out satisfactory capital adjustments. If values are to be salvaged from these enterprises without resort to the courts, now is the time to start forging ahead with plans for simplifying and strengthening their structures, before it is too late.