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SECURITIES AND OTHER FINANCIAL FIELDS

ADDRESS

of

EDWARD C. EICHER

Commissioner, Securities and Exchange Commission

before the

BUSINESS-CONSUMER RELATIONS CONFERENCE

ON ADVERTISING AND SELLING PRACTICES

sponsored by the

NATIONAL ASSOCIATION OF BETTER BUSINESS BUREAUS

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In appearing here today as a member of the Securities and Exchange Commission, I certainly do not feel any kinship with the strange merchant in a strange land who goes forth to peddle his wares to a hostile purchasing public of unpunctured sales-resistance, for the Association of Better Business Bureaus and the Securities and Exchange Commission are fellow-travellers on the same road. We are both seeking to prevent the sale of securities by fraudulent techniques, and to protect and encourage those who employ legitimate methods. If there is any one phrase which connotes the goal of your Association, I suppose it is "truth in advertising." The frequest reference to the Securities Act of 1933 as the "truth in securities" law emphasizes the striking resemblance in the objectives of our two institutions. Insofar as your activities relate to the field of securities, our aims are largely the same.

Community of aims, of course, does not assure compatibility of methods. Though they share the common instinct of self-preservation, the lion and the lamb lie down together only in the tomorrow; but in the case of your Association and our Commission, and I hasten to negative any inference that either is the lamb - I am happy to say that the parallel does not end with our respective purposes alone. In many cases, I believe, we have seen eye to eye, and have been of mutual assistance in the fulfillment of our common endeavors. The Securities Violations Section that is maintained by the S.E.C. constitutes in a very real sense a joint enterprise on the part of our two agencies. That section was set up in May of 1935 as a sort of clearing house for information on illegal or fraudulent practices in the sale of securities. Its Securities Violations File and its Monthly Bulletins afford data on arrests, indictments, convictions, injunctions, stop orders, cease and desist orders, and other official records of proceedings in the securities field covering the federal, state and local governments of this country and the several provinces of Canada. These files, which are complete almost as far back as 1925, including a few even earlier cases, now contain data on more than 32,000 names, including aliases. In assembling this collection of the life histories of a large portion of the country's most dangerous promoters the Better Business Bureaus have played no small part. Mr. Toadvine of the Syracuse Bureau, who was then president of your Association, assisted materially in organizing the files, and there have since been added a considerable number of entries that probably would not have found their way into this very valuable index had it not been for the cooperation of your Bureaus. Our Commission reciprocates by distributing copies of the Monthly Securities Violations Bulletins among the cooperating Bureaus and by responding to requests for data upon the official action that has been taken concerning specific firms or individuals. We both have had a hand in the assembling of this information and it is there for our common use.

The Securities Violations Section is just one example of the day-by-day cooperation that the Commission is afforded by your several Bureaus. They are helpful not only to our Washington office, but even to a greater degree to our nine regional offices throughout the country. I suppose it should not be surprising that some of the Bureaus leave a bit more to be desired in this respect than others. But by and large the Better Business Bureaus, both in this country and in Canada, perform an invaluable service for the investor - and the same is true of your National Association. Nor do your Bureaus duplicate the functions performed by the official federal, state and provincial regulatory authorities. Voluntary agencies such as yours serve as

an efficient link between the public and the regulatory authorities in many ways, e.g., by maintaining continual contact with the persons in their communities who have questionable records in the securities business, by apprising the authorities of the results of their preliminary investigations into questionable promotions or practices which would not be easily recognized by the average investor, and by promptly directing complainants to the properly constituted authorities. The war of the unscrupulous against the unsophisticated has too long been waged with a handicap on the wrong side; outside the realm of honest business we should not be too hesitant in tipping the scales the other way.

It is entirely fitting, therefore, that the National Association of Better Business Bureaus should sponsor a conference on advertising and selling. The four viewpoints to be presented at the conference, I understand, are those of business, the consumer, government, and education. My assignment is to discuss what government is doing in the financial field, particularly as it relates to securities.

The consumer interest in the world of finance is, of course, represented by the investor. The government's role, as usual, is that of referee. This role it performs in two ways. Our Securities Violations Section of which I have spoken is an illustration of the manner in which your national government is dealing with the discovery and punishment of fraudulent practices relating to the sale of securities. The Commission, however, is by no means concerned only with water that has already passed under the bridge. More important than punishment is prophylaxis. The S.E.C. has accordingly been charged with the duty of making available to the actual or prospective investor - the "consumer" of securities - information which will be of value to him in determining whether to buy, hold or sell a particular security. The S.E.C. administers, as most of you know, three principal statutes - the Securities Act of 1933, the Securities Exchange Act of 1934, and the Public Utility Holding Company Act of 1935. In addition, Chapter X of the Bankruptcy Act, as amended last year, gives the Commission a non-regulatory function in certain types of corporate reorganizations. Since this conference is concerned with advertising and selling, we can eliminate with this passing mention the public Utility Holding Company Act of 1935 and the revised Bankruptcy Act.

Except for certain phases of the two statutes last named the Commission's powers, unlike those of some of the state blue-sky commissions, do not extend to the approval or disapproval of any given security on its merits. So far as the Securities Act is concerned a promoter may offer for sale stock in a corporation that proposes to engage in highly speculative or even reckless enterprises; the only conditions imposed by the law are that the prospective security holder be given enough information to make clear what are the intended objectives, and that the surrounding facts are not presented to him in distorted or misleading fashion. Congress in passing the Securities Act and the Securities Exchange Act did not intend to substitute its own judgment for investor judgment. The public may still be invited to take risks; only now they must be informed truthfully and fully what the odds are. When we see in our work at the Commission what a furore is sometimes caused by a person who is required simply to tell the truth to those whose savings he solicits, we realize that the requirement of disclosure presents no insignificant obstacle. The truth sometimes does more than make one free; it is apt to prevent one from selling securities.

The disclosure of which I speak is obtained in a number of ways. The Securities Act of 1933 differs from the Securities Exchange Act of 1934, in that it is concerned primarily with the issuance of securities rather than subsequent trading in them. The disclosure required by the Act of 1933 takes the form of a registration statement which must be filed with the Commission prior to the offering or sale of any security through the mails or in interstate commerce. The registration statement contains specified information with respect to the issuer's business, promotion, management and control, its outstanding securities as well as those proposed to be offered, the methods by which the offering is to be made, the allocation of the proceeds and the issuer's financial position. At least twenty days must elapse from the date of filing before a registration statement can become effective and securities can be offered or sold thereunder. During this waiting period, and thereafter, the statement is open to public inspection at the office of the Commission in Washington, and photocopies of any portion are sent to any person upon request at the nominal charge of 10¢ per page. The collection by the Commission of more than $21,000 from the sale of photocopies during the fiscal year ended June 30, 1938, indicates that at least 210,000 pages of all types of information under the several statutes were photostated and distributed to members of the public in this manner.

Of greater significance in giving the prospective purchaser ready access to adequate information is the further requirement that each purchaser receive a copy of the official prospectus, which contains the most essential information in the registration statement. So far as the contents of general advertisements relating to security offerings are concerned, the Commission has by rule provided that only the most vital of the information contained in the official prospectus need be included in newspaper advertisements of securities that are registered on Form A-2, which is the form reserved for offerings by "seasoned" corporations. In the case of the general run of securities which do not meet the requirements for the use of that form, the Commission does not permit the omission from newspaper advertisements of any of the information required to be included in the official prospectus. In any case, however, the Act permits notice advertising by means of the so-called "tombstone ad," which is limited to identifying the security and stating from whom copies of the official prospectus may be obtained.

When we turn from the Securities Act of 1933 to the Securities Exchange Act of 1934 which regulates the trading in securities after their initial issuance, we find a greater variety of provisions. Many of them have a much broader aim than the mere disclosure of relevant information to the investor. I refer, for example, to the sections on manipulation, short selling and margin trading. A provision that is of primary interest is the requirement that a registration statement be filed with the Commission for every security which is listed on a national securities exchange. That means every securities exchange in the country with the exception of a few which have been exempted by the Commission by reason of their very limited activities and importance. These registration statements contain essentially the same types of information as are called for in the registration of new securities under the Securities Act. The Exchange Act goes further, however, and requires in all cases that the data appearing in the registration statements, including certified financial statements, be kept up to date through annual reports, and in certain contingencies by monthly reports. Under the Securities Act, it is only from a limited class of issuers that annual reports are required.

There are other provisions of the Securities Exchange Act of 1934 that are chiefly designed to give the investor, present and prospective, an opportunity to become fully informed. One of them is that brokers and dealers in the over-the-counter markets are required to register. Another is that the officers, directors and principal security holders of corporations with securities listed and registered on a national securities exchange must file reports of their ownership of equity securities. The remainder of my allotted time, however, I should like to devote to the proxy rules, which are intended primarily to provide *existing* security holders with sufficient information to enable them to exercise independent judgment in voting at stockholders' meetings.

The Commission first exercised its authority to regulate the solicitation of proxies, consents or authorizations with respect to securities registered on a national securities exchange, by promulgating rules that became effective on September 24, 1935. The present rules which have been in effect since October 1, 1938, represent a complete overhauling of the original rules, and provide, in substance, that any person engaged in soliciting proxies from owners of listed securities, shall file with the Commission and furnish each person solicited a copy of written "proxy statement". A schedule appended to the rules specifies the information that is required to be included in the proxy statement in the light of the purposes for which the proxies are intended to be used.

Naturally the relative length of the proxy statement will vary with the complexity of the agenda of the proposed meeting. In any case the rules are designed to supply the security holders with the information that is essential to permit them to reach an independent judgment on the questions submitted to them. If action is to be taken with respect to the purchase or sale of property by the corporation, the stockholder whose proxy is solicited should know - and now is assured of an opportunity to find out - something about the general character of the property, the consideration to be paid or received for it and any relationship of the buyer or seller to the corporation. If he is expected to cast a vote on the question of modifying the terms of the securities he holds, he must be informed of all the material features of the proposed plan. If he is asked to participate in the election of directors for his corporation, he will want to know the relationship of each nominee to the corporation and to any outside interests, the extent to which each nominee is himself a security holder of the corporation, and the names of the persons who are responsible for his designation as a candidate. If action is to be taken at the stockholders' meeting on all of these questions or more, the proxy statement obviously must include the appropriate information with respect to each matter.

Another of the important features of the proxy rules is the machinery which is established to aid minority groups in contacting the whole body of stockholders. In order to permit the solicitation of proxies by minority interests in competition with the management, the rules include a provision for the distribution by the management of proxy statements and solicitations on behalf of any security holder upon written request and reimbursement of reasonable expenses.

As has been the case in some other respects, much of what the Commission has done in the way of regulating proxies has in the very nature of things been experimental, and like all experiments it has not always produced the

results desired. Next year's proxy rules, we hope, will be an improvement on the present regulation. But, aside from certain questions as to the requirements in the proxy statement, we are satisfied that the proxy rules have done more than probably any other single factor to counter the centrifugal forces that are tending to separate the ownership of corporations from their management and control. The new interest on the part of stockholders that has been awakened as a result of the information which they have received in connection with solicitations of their proxies is apparent from the letters the Commission receives every day. This correspondence, as I have recently had occasion to observe in another connection, makes it clear that many investors are learning for the first time through this process the most rudimentary facts about their companies. It is to be expected that the information they now receive should enable them not only to exercise independent judgment in voting, but should result in a wholesome interest on their part and a desire for more active cooperation in the affairs of their corporations and a healthier degree of actual owner-management that will distinctly promote the public interest.

These few examples that I have cited should serve to illustrate the manner in which the Securities and Exchange Commission seeks to make available to the consumer of the financial world the essential information about an article which all too often has been purchased blindly. I hope what I have said has served to demonstrate to my hearers the vital and helpful part which the national government has played in this field during the past six years. Occasionally critics of the disclosure theory that underlies the Securities Act and the Securities Exchange Act still maintain that governmental effort to immunize improvident investors against dishonest selling practices is a vain endeavor. It is my belief, however, that they are being rapidly relegated to the outmoded school that once scoffed at such prevention measures of medical science as vaccination. De Lesseps failed, but Col. Goethals succeeded because he banished the fever-infected mosquito from the Canal Zone. Certainly there must be no retreat by federal or state government in their campaign to eliminate from the field of distribution of corporate securities those unscrupulous mosquitoes whose only message is one of misrepresentation and deceit.