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ADDRESS

of

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It would be customary for me to review the past year's efforts of our Commission, its relationship with the state agencies, and to discuss ways and means of further cementing what has already become a happy and a practical bond. It is my intention to pursue that theme but along lines that for the moment may seem to you somewhat removed from the present and daily problems of administration. Often it is wise for us to try to stand far away from our immediate tasks and to seek to view them distantly both in time and space, to see objectives broadly and not to have them submerged by the qualities either of the legislation under which we work or the needs that seem so eternally pressing.

Your legislation and our legislation spring from the desire of the public to restrict fraud and chicanery in the issuance and sale of securities. The prevention of these practices, which always were penal at common law, but ineffectively reached by its sanctions, led to the creation of various administrative mechanisms not so much penal and punitive in character as preventive. True, the punitive sanctions were retained and strengthened, but the fundamental hope of the sponsors of this kind of legislation lay in a desire to prevent the waste that existed rather than simply to punish those responsible for that waste. Consequently, an emphasis was placed upon the prevention of this waste from whatever source it might arise. If it arose from negligence and carelessness, its consequences might be equally serious as in the occasion when it arose from dishonesty. From the standpoint of the investor his losses were real whether they were due to the knave or the well-intentioned but incompetent financier.

Administration of these laws to be effective had consequently to draw from wholly different precedents than those of the simple common law tort of deceit. Whether it was the task of the administrative agency to qualify the security as being of a minimum standard grade, or to determine whether truthful disclosure of its nature and characteristics had been made, expertness in approach became essential. Without an understanding of corporate finance, neither of these two functions could be adequately performed. But with an understanding of the nature of corporate financing as well as of dealing in securities, the outlook of the administrator became wholly different. Not only could he apply the statutory standards with greater accuracy, but he was better able to see both where the business as a whole was weak or inefficient and where his control failed to accomplish objectives. With such an understanding, he became more than the mere policeman; his concern was primarily that of fostering and directing the industry under his charge.

It is primarily these aspects of our common task that are my theme - a consideration of the directions that our joint concern with this problem as a whole might most profitably take. Any consideration of security regulation along these lines discloses immediately that the problem is national in scope and one whose successful handling demands a community of thinking by both state and federal agencies. Whatever effectiveness we each can individually acquire dissipates itself immediately unless we both travel in the same direction. Whatever cooperation from the industry we may hope for cannot be forthcoming if our aims are not common, our administrative techniques not adapted toward achieving the same essential results.

First, let me deal with the ramifications of the problems relating to the issuance of securities. Here not only are we faced with the necessity for understanding the various interests that pass in commerce as securities, but our control over them varies. Consider merely the varied treatment accorded by the federal and state laws to such interests as certificates of deposit, whiskey warehouse receipts, oil royalties and producing interests, investment contracts and the like, and it becomes apparent what a divergence of outlook on the problem exists. Add to this the classes of securities exempted under the various laws, some created by the desire to absolve particular local industries, others by accident, and still others by the forces of special interest, the pattern of control, viewed from a national standpoint, leaves groups of investors sometimes only partially protected and sometimes wholly neglected. And if one projects the scene upon the confusion of our varied state incorporation laws - which strangely enough in the legislative and public mind are not the concern of agencies entrusted with the responsibility of protecting investors - the difficulties of our common task are enormously magnified. Indeed in some states the character of the corporation laws are such as to make it almost farcical for the same state to create an agency whose responsibility is the protection of security holders.

These are, however, the materials with which we have to work and the circumstances under which we are called upon to perform our task, and to begin its performance, one principle of action is essential irrespective of whether our function may be to disclose, to qualify or to prevent fraud. That principle is to understand for ourselves, at least, if not at the same time to portray to the investor, the character of the thing coming beneath our scrutiny. Such a portrayal has, of course, numerous ingredients. To take one of these alone - the record of management - how closely are we together in our judgments as to the methods of portraying this? For example, to what degree shall we insist that there shall be an accounting over the years as to the disposition of capital invested in the enterprise? What emphasis should be placed upon the historical record of the funds contributed by the security holders, the so-called "trust funds" of the enterprise, as distinguished from its current asset position and its present earnings as related to its capital liabilities? How should that emphasis shift with regard to the nature of the enterprise, as for example, between an ordinary competitive enterprise and a regulated monopoly, or between a going enterprise and one in the early stages of development? In matters such as these, we have worked out certain standards and you too have your standards. Variance along these lines, and it exists, has little justification from the standpoint of attuning our dual machinery to the needs of the nation. That the investor in Colorado demands something different from the investor in Connecticut, would seem to be a doctrine having as its only defense the desire to keep the picture of corporate finance a continued mystery to the public.

To move on from the consideration of what should be demanded as to the record of management to a consideration of just how that record should be portrayed brings us to the field of accounting. Here again are further avenues for joint thinking. To start simply with the question as to whether or not that portrayal should be purely the responsibility of management alone, or should in addition be subjected to the scrutiny of an independent expert, brings again before us an issue upon which we have as yet developed no consistent theory. But beyond this, when we come to the issues involved in accounting, our methods and theories are again diverse. Upon such a simple issue as to whether donated stock can be treated as an asset, opinions vary. Disclosures as to write-ups and the use of capital items created thereby, deserve more thought as to their treatment than they have hitherto received. Our agencies have, perhaps, the best equipment for creating comparability and correctness of treatment in these features, and yet to how great a degree have they been employed for this purpose? To concentrate on bringing about correct and adequate financial statements seems to me as worthy as any cooperative effort that we could make. For unless we advance, and rapid advancement can be made along these lines, the complexity attending the corporate security is too likely to frustrate any public understanding of its nature.

Tasks such as these, if performed adequately, bring the real joy of administration. The consciousness of not only being able for oneself to grasp the record of management, but of being a part in seeing that that record is adequately portrayed to security holders and prospective investors, brings a sense of creative achievement. To use our controls to buttress the aims of a profession, such as accounting, to maintain its traditions of stewardship, to find that both management and underwriters can consequently more truly gauge the nature of their proposed undertaking, to know that the investment critic at last possesses data adequate for the performance of his function, these are contributions significant to our national financial well-being.

Almost every angle of legislation dealing with the issuance of securities presents opportunities for thoughtful achievement along similar lines. In the underwriting field nearly all the various statutes entrust us with responsibility to guide its development. In the pricing field such devices as the step-up price, the sale against a market price where the market has been dominated by the underwriter, or other devices, are our responsibility to consider. In the distribution field, the nature and extent of stabilizing operations, the circumstances of a stand-off agreement, are again subjects of common concern. An understanding grasp of these and similar problems could accomplish so much in the field of directing the processes of underwriting and distributing securities.

I need not detail the many other situations involved in the issuance of securities where exploration of the desirable directions of control would be invaluable for our common efforts. One further problem, however, deserves notice because of its significance. This relates to the promoter and the manner in which he reaps his reward. To fail to penetrate the circumstances of promotion and make plain the promoter's contribution in relation to the public's contribution is, in the case of a new enterprise, to miss the spring of its being. And yet the ways and means now in existence are far from adequate. True, certain standards have been set in some states that will assure

each contributor not only some safeguard against excessive dilution, but some chance of return, if there be any, before the promoter receives a return on a contribution that too often has never been properly appraised. On standards such as these divergence in viewpoint is possible and rational; but on the matter of effective disclosure a difference in principle is hardly thinkable. And yet upon the means to bring about simply and effectively that disclosure, we still face both obstructions and variances. Their elimination is not only desirable, but a duty.

These observations naturally have to be interpreted by you variously as you see the potentialities of the different statutes under which you operate. Not all of the statutes give you the opportunity for insistence upon direct control over the means and methods of soliciting the purchase of securities. But practically no solicitation takes place without some descriptive literature. And, similarly, practically no statute fails to arm you with powers to deal with inaccurate and misleading literature. Here naturally is the lever for effecting improvements in the conditions that underlie the issuance of securities, for little that is patently undesirable can survive adequate exposure. Thus responsibility for concern with these problems is already thrust indirectly upon you as it is directly upon us. There remains only the insight to make that responsibility a common one and a real one.

Let me turn now in this discussion of the value of pooling experiences and ideas to a different field, that of over-the-counter dealings in securities. Unfair practices in this field, whether over-the-counter or on an exchange, still are far from being defined and completely understood. The most obvious of them naturally present no difficulty, but broad, unexplored territory still persists. We, for example, are now in a series of court contests where the facts are not in dispute but the nature of an admitted practice is charged by us to be fraudulent or deceptive and that charge is combatted in all good faith by the respondent. Here and elsewhere is disputed ground where only the method of inclusion and exclusion can make definite and concrete the content of terms such as "fraudulent", "deceptive", "unfair". But the judicial process is not the only process available for carrying out by specific definition the outlawed practices. We possess by statute an administrative power to define these practices by regulation. Similar administrative powers reside either expressly or impliedly in many state agencies.

Here again possibilities for exploratory research and conjoint administrative action are apparent. The significance of action along lines of this character is patent. Regulation here is truly constructive for it defines and by defining guides. But any examination of the field from a national standpoint will show a prevalence of various local customs and local ethical conceptions. Some resolution of these contrasting conceptions seems demanded. What is truly manipulative or deceptive cannot well be made to rest upon geography, and yet the lack of interchange of ideas, the failure to understand directions, permits irrational local divergences in what is basically a national system of ethics.

One method of working out concrete ideas in this field that has yet to be utilized to the full lies in the application of the administrative power possessed by most agencies, including ours, of revoking or suspending licenses or registration upon grounds of this character. In the handling of these cases both the raw materials for analysis and individual deductions are to be found. But how rarely do we make their content available to others. Opinions detailing the circumstances and the conclusions which would make plain the basis of action in particular cases are rarely written. What remains of an experience is too often only the bare order that buries all except a name.

The necessity for more efficient interchange of experience in this field appears upon examination of the way in which our powers can be used in aid of yours. You deprive an individual of his right to act as a dealer within your jurisdiction. He turns again frequently to some other state for a livelihood, employing the same tactics. But the conduct which underlies your removal of his right to continue business in your state in many instances is also a violation of federal law. As such it empowers us to deny the right to use federal instrumentalities - the mails and interstate commerce - to engage in selling securities. The flagrant situations deserve our notice and indicate our duty to see that the mischief you have excluded from your jurisdiction does not crop up elsewhere.

Part of this problem of trading ethics Congress in 1934 conceived might be in the prevalent tendency of security houses to combine dealer and broker functions. It insisted that we should explore that situation. This year we forwarded to Congress a report upon the facts that we had been able to amass. They were limited in the main to the situation as it existed on the exchanges. We found that much more material had to be accumulated before any deductions could justifiably be made of the effects of this combined broker-dealer relationship in the vast, unorganized security markets of this country. We pointed out that further study of the effects of this combination of functions in the over-the-counter field was necessary before recommendations for action or inaction could properly be made. Obviously any Congressional action calling for the segregation of these functions would change the very character of your problems. Here then is a further area for exploration, understanding and judgment, another instance where the direction of the ebb and flow of investment and speculative funds is a matter of our common concern.

I give you these examples of pressing present problems to point out concretely directions for mutual effort. The most significant of them are not those of the policeman but rather those of the scientist. What the answers are is not for me to say, had I the answers ready. But what procedures can be devised to assure informed solutions is a practical and pressing subject. I assume that we understand each other well enough to know that our jurisdictions are coordinate, not antagonistic. I assume further that our broad objectives are the same. But merely a spirit of goodwill and of cooperation is insufficient to achieve results. What are needed are techniques for translating desires of this character into concrete achievements.

In the field of enforcement of traditional and accepted standards the last few years have shown results of which any coordinated group of federal and state administrators might be rightfully proud. Our individual strengths have increased enormously through our growing ability to act in unison. Where one culprit flees the long and waiting arm of Pennsylvania to the supposed shelter of another state, we can reach him without useless legal complications that make for delay. Where a defendant on technical grounds persuades a federal judge to dismiss a meritorious case, he moves only into the hands of a Maryland court. Prisons, whether federal or state, have the same bars.

To apply different but as effective techniques to this other field is our present problem. Some of the possible lines of creative thought and activity I have already sketched. An equally important province for action is conforming our administrative procedures so as to eliminate the unnecessary costs and burdens of regulation. A multiplicity of forms without purpose, but growing simply from the failure to interchange experience, is an irritant besides being provocative of varying techniques of administration. Legislation is unnecessary to remove these impediments to an integrated system of control; cooperative and understanding administrative action is all that is normally required. The resultant benefit of coordinating administrative activities along these lines is well worth the effort entailed. Business in the way of finance would flow more easily; subterfuge and evasion drop to a minimum.

A program of joint administrative action, well planned and well executed, would obviously mean much toward the orderly flow of savings into enterprise. In turn, it would react upon administration to make it more professional and more significant. No student of administrative tribunals in American life over the last few decades, can fail to observe the increasingly expert character of administrative action and the respect that it has achieved for itself. This progress has come more from within than without. The men whose lives have been devoted to this work, whose vision has been broad, have added a dignity and a sense of justice to administrative law that the judicial process took centuries to achieve. But a prime problem in American administrative law is the effective synchronization of common effort in the states and in the nation. Neither under our system is adequate in itself to shape a rounded national program, and yet the need for just such a program in the field of national financing is imperative. The full realization of such a program so effectively begun by this association three years ago is a challenge of real statecraft that we dare not pass lightly by.