Address by

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before

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I want to discuss a few fundamentals connected with the sale of securities under the Securities Act of 1933, as recently amended.

This won't be a "how to do it" blackboard lesson but rather a statement about the philosophy of the Commission in approaching its task of administering the Securities Act as most recently amended. We start out with the basic aims of the Act as announced in its title which reads:

> "An Act to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails and to prevent fraud in the sale thereof and for other purposes."

That title is a summary of the philosophy which underlies the Act; namely, disclosure and prevention of fraud.

You all know that a number of the States have blue sky laws which provide for qualification of securities issues, that is, they provide in effect for the approval or disapproval by a state securities commission of particular offerings. That philosophy is not written into the Federal Securities Act. The Federal Act is based on the doctrine that the role of the Federal Government in policing the public offering of securities is to require issuers of securities to give the investor the facts and to give the investor a remedy in case of fraud. It does not provide for the Commission to approve securities issues.

This conclusion is confirmed by the provisions of Section 23 of the Act which reads as follows:

> "Sec. 23. Neither the fact that the registration statement for a security has been filed or is in effect nor the fact that a stop order is not in effect with respect thereto shall be deemed a finding by the Commission that the registration statement is true and accurate on its face or that it does not contain an untrue statement of fact or omit to state a material fact, or be held to mean that the Commission has in any way passed upon

> the merits of, or given approval to, such security. It shall be unlawful to make, or cause to be made, to any prospective purchaser any representation contrary to the foregoing provisions of this section."

Incidentally the same kind of basic approach is reflected in the Securities Exchange Act of 1934 which provides that companies subject to its provisions shall file periodical reports and support solicitation of proxies by the furnishing of material information.

Is that an adequate protection of investors? No one contends that every investor reads the prospectus any more than all people covered by insurance read their policies. Nevertheless a disclosure statute accomplishes two things in addition to getting through, at least to some investors, the information set forth in the registration statement. First, the very fact that transactions of a suspect character must be disclosed probably prevents many such transactions from ever taking place. Second, while prospectuses and reports may not be read by many investors, they are read by analysts and other specialists through whom the information is disseminated and whose appraisal contributes to the fixing of a market price more nearly fair than would be fixed if the information were not available.

This concept of disclosure as the basic protective technique is typically in accordance with American tradition. It represents an application to the financial markets of the basic American principle: "Give the people the facts and let them decide for themselves."

The problem for our Commission is--as it always has been--how to provide administratively for the best assurance that the facts are made available.

The problem is divided into two parts: First, what kind of processing should offering literature receive at the Commission, and second, what methods can be established to insure most effectively that the information gets through to the investor?

There are those who argue that the Commission should let the registrant file papers which it thinks follow the rules and forms, sell on the basis of the papers filed and assume responsibility, penal and civil, under the liability provisions of the Act.

Recall, if you will, however, the statutory power of the Commission to suspend effectiveness by stop-order proceedings or to

seek injunctions. It is impossible to reason honestly that such a power does not creat a correlative duty on the Commission to look at each registration statement to determine whether on its face it shows deficiencies. For a Commission to take any other attitude would be abandonment of its duty.

Now, if our staff looks at a registration statement and finds something which either is not in conformity with the legal requirements or which appears on its face to be a misrepresentation or a half truth, what should we do - should we lie in wait and surprise the issuer by a stop-order proceeding or by an injunction? If any such practice were introduced, I am sure there would be fighting in the streets.

The Commission's long-established practice, as you know, is to advise the issuer informally of deficiencies and to give it the opportunity to amend so as to avoid the necessity of formal proceedings.

The letter of comment advising the issuer of deficiencies is sent after an examination of the registration statement by members of the staff, including a securities analyst, an accountant, an attorney, and in some cases an engineer.

While the complaint is made that the staff sometimes compels issuers to say things that drive buyers of securities away, I submit that the staff is justified in warning registrants in those instances where it considers that the statutory standards of fair and adequate disclosure are not met.

It must be recognized that it is impossible to formulate for every business situation exact standards as to what are the material facts necessary to the making of an investment decision. Consequently, there are bound to be differences of opinion. Let us not deceive ourselves into thinking that any statute requiring fair and adequate disclosure can be administered without differences between the Commission and registrants. Those of you who work on registration statements know how many arguments take place among the authors of the statement before it is filed.

While in the heat of discussion of disputed positions, registrants may from time to time say harsh things and think harsh things. I think it fair to say that the comments of the Division have frequently resulted in eliminating from registration statements material which, if included, might have furnished ground for the successful assertion of civil liability.

This method of processing, which the Commission has developed over the years, operates as an administrative guide to compliance, but far more important, it has served to provide better information to the American investor about what he is getting for his money.

Of course, I don't need to tell you that the Commission and its staff have no mystic omniscience by which they determine that the statements in a registration statement are true. The ultimate responsibility both for the facts and the figures is that of the registrant.

As I indicated earlier, the formulation and administrative review of a prospectus solves only half the problem of informing the investor. The other half is getting the information to him. People cannot be forced to read prospectuses before they buy. But something ought to be done to give them a prospectus to read if they choose. A businessman acquaintance of mine, a man who is a typical intelligent middle-class investor, just last week told me that he couldn't see much use of all the work which the SEC did to assure adequate prospectuses, if the investor got the prospectus only after he had bought the security. I am sure that none of us would argue with the logic of the complaint. In fact that problem, over the years, has provoked more discussion than any other administrative problem confronting the Commission. As I will point out later, the 1954 amendments are designed to contribute to its solution.

The whole waiting period theory of the Securities Act was to provide a time after the registration statement has been filed and before it becomes effective during which a prospective investor may become familiar with pertinent facts relating to the issuer and the underwriting.

It was in furtherance of this objective of disseminating information about the issuer and underwriter during the waiting period that the "red-herring" prospectus mechanism, and more recently, the short-form identifying statement were devised. The 1954 amendment to the Securities Act, embodying principles on which there has been general agreement between the Commission and the industry since 1941, was intended to give a firmer statutory basis for pre-effective dissemination of information and to give the Commission greater flexibility in permitting summaries and condensations of the pertinent material set forth in full in the registration statement.

The amendment in no way affects the legal provisions which have existed up to now by which the full statutory prospectus must be furnished at the time the sale (as distinguished from the mere offer) is consummated.

I would like to stress, with as great emphasis as I can put on it, the fact that the 1954 amendment does not permit the pre-effective use of sales literature which has not been filed with the Commission and processed by the staff. We have been disturbed in the past several seeks since the amendment became law because in several instances issuers and underwriters have sent out unprocessed sales literature prior to effectiveness.

The amended law was not intended to permit pre-effective "free writing". This was a subject briefed by industry representatives and thoroughly discussed with the Commission when we were serving as advisor and consultant to the Senate Banking and Currency Committee and the House Interstate and Foreign Commerce Committee in connection with formulation of the bill. The proposal of industry representatives that the Securities Act of 1933 be amended to permit pre-effective "free writing" was rejected.

The testimony presented by me on behalf of the Commission and by various representatives of industry groups reflects clear understanding on the part of the Commission and the industry that pre-effective "free writing" was not intended to be permitted in the future any more than it has been in the past.

Speaking generally, the aim of the amendments to the Securities Act is to give a more definite statutory recognition to the practices which had been prescribed over the years by the Commission for pre-effective dissemination of information. The statute provides rule making power in the Commission to permit short-form summary prospectuses or preliminary prospectuses which, we hope, may be susceptible of more rapid processing than the so-called "red herrings". The definitive rules on the subject are currently in the process of formulation, and I am not prepared at this time to draw on my gift of prophecy to indicate the precise form they will take. However, administrative processing of summaries and preliminary material seems inherent in the concept of the amended statute.

Since that is so, the timing of the use of such material by the underwriters must be influenced by the practical fact that administrative processing consumes time. The flow of business into our Division of Corporation Finance is something we cannot control, and our staff is limited. Pressures build up at particular seasons such as the proxy season. But our intention, both as to formulation of rules and as to processing techniques, is to accomplish so far as possible the purpose of the amendment to foster broader dissemination during the waiting period of information about forthcoming issues.

I don't need to tell you that the perfect method of regulating the offering of securities has not yet been discovered. We are dealing in a complex area -- the process of capital formation. If we look at the various countries of the world we find, I daresay, more variation in methods of capital formation and capital ownership than in other aspects of social organization. That alone is evidence of the fact that there is no universally accepted method of pooling the resources of the people in order to increase the productivity of the general economy.

Our system in this country, with all its imperfections, does represent a method by which the savings of the people have been, and are being, reinvested in the economy. It has kept the economy growing and the standard of living rising. For that process to go on the public must have confidence in our capital markets. The laws which our Commission administers are designed to provide justification for that confidence. The securities laws are here to stay. They have improved the morality of our processes of raising capital.

There should, of course, be constant reexamination of administrative procedures so as to provide maximum dissemination of reliable information with the least practicable amount of "red tape". That happy medium is hard to strike. Complexities cannot be eliminated from something that is complex by nature. We, therefore, need more people in all parts of the country familiar with the complex processes of capital formation and the laws which regulate those processes. American business and American industry are scattered all over the country. American national wealth is broadly diffused. We need mechanics where the machines are located.

Capital must flow not only into big business but into smaller business. If the various elements of the economy grow too unevenly we run into the problems and controversies created by over concentration of economic power.

The problem of supplying capital to finance the growth of small and moderate-sized business presents a challenge to the investment banking fraternity. Putting together a little deal may involve more work and more risk than participating in a big deal, but there are satisfactions in creative accomplishment.

The resort by small business to government supplied capital indicates both a need and an opportunity for improvement in our private processes for supplying capital. That involves more education of management as to alternative methods of raising money. It involves reconciliation

to the ice-breaking process of public disclosure.

I need not outline in detail where your responsibility lies. Philadelphia from time immemorial has been both an industrial and a financial center. It has occupied that position since the very beginning of our urban life in America. You who are leaders in the field of finance in this great metropolis must contribute of your talents to preserve the integrity of the market place and to adapt our processes of capital formation to the requirements of all segments of our economy.

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