ENFORCEMENT PROBLEMS UNDER THE SECURITIES ACT OF 1933

address by

JAMES C. SARGENT

Commissioner
Securities and Exchange Commission
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It is a great pleasure for me to have this opportunity to represent the Securities and Exchange Commission at the 43d Annual Conference of the Association of Better Business Bureaus. It is a particularly delightful experience to be here with you in the City of New Orleans, so famous for its traditions, charm, and commerce. I also would like to tell you that I had the great pleasure last week of appearing before your distinguished senior Senator from Louisiana Allen J. Ellender.

Let me at the outset discuss in broad outline the work of the Commission and the Acts which it administers. The Commission administers and regulates the securities industry under seven different statutes. They are: the Securities Act of 1933; the Securities Exchange Act of 1934; the Public Utility Holding Company Act of 1935; the Trust Indenture Act of 1939; the Investment Company Act of 1940; the Investment Advisers Act of 1940; and Chapter X of the Federal Bankruptcy Act.

The first and most basic of these statutes was the Securities Act, to which I shall confine my discussion today. That Act provided for registration of new securities to be offered for sale by corporations to the public. The provisions for registration were designed to cause corporations issuing such securities to disclose the basic underlying facts about the company's finances and operations. The Commission is not required by the Act to guarantee the accuracy of the information disclosed in a registration statement. In fact, the opposite is true. The Congress in promulgating this statute, in my judgment, wisely determined that the Commission should have no power to pass upon the merits of a security, and it is a criminal offense for a person offering securities to represent that the Commission has approved them.

The purpose of the Act is to subject new issues to the "scrubbing" process of registration in which our Division of Corporation Finance, which processes such registrations, seeks to have all pertinent financial and background information about the corporation seeking to raise capital included in the prospectus which must be sent to prospective purchasers of the security. It is then up to the investor to make his decision whether to buy the securities on the basis of the information which the statute requires that he receive. Thus, it is apparent that the Securities Act was designed to supply the necessary information from which an informed judgment could be made by the public investor.

I am sure that the Better Business Bureaus throughout the country are vitally concerned with this Act, its aims and its purposes, for it seeks to give to public investors through the registration process all the basic underlying facts upon which the public investors make their decision as to whether to purchase the particular security or not.

In my course of duties with the Commission, I served for a period of time as the Regional Administrator of our New York Regional Office. As your members know, the "front-line" of this Commission's investor-protection battles takes place in the fourteen Regional and Branch Offices maintained by this Commission throughout the United States. Because of limited personnel and other cost factors, our Commission in enforcing the seven statutes administered by us must necessarily rely a great deal upon the cooperation and assistance of various State authorities. In addition, and perhaps more important in the practical sense, we must rely upon public cooperation to report to us at the earliest opportunity any course of conduct that may appear to be in violation of the antifraud provisions of the various Acts which we administer. It is in this area that we have had the wholehearted cooperation of your fine nation-wide organization. Very frankly, your dissemination of warnings and admonitions to the public have helped us immeasurably in our assiduous desire to protect public investors against fraud, misrepresentation, and manipulation in the purchase and sale of stocks and bonds. It has helped us do this by making the public aware of the fact that we cannot operate in a vacuum.

As you well know, the American public does scrutinize the purchase of a washing machine, air-conditioner, or other appliances with a great degree of thoroughness. I rather doubt that they would ever purchase an appliance by the long-distance telephone based upon representations made by a total stranger, the truth of which cannot be readily checked. This is not the case with securities.

All of you no doubt have recently heard of our problem involving the so-called "boiler rooms". A "boiler room" may be defined as an office, without windows, with phones continuously ringing, and coupled with the din of circus pitch type voices which all together cause the generation of much steam, like unto that created in a real boiler room, in the sale of securities.

I want to take this opportunity to commend your organization, which has been most helpful in warning the American public against buying securities from unknown persons making attractive-sounding representations over long-distance telephones.

I believe it is most important for me at this time to bring out certain very vital facts that confront us in today's money-market.

You all must realize that the savings of the American investing public, which are funneled into the securities industry, serve to supply the "muscle" to the expansion of American corporations. We must assure ourselves of this continued flow of investment in American industry. Such assurance cannot be given if a segment of the investing public has been "burned" by the purchase--under the guise of sound investment--of securities of questionable value, illegally sold without registration and, in many cases, as a result of misrepresentations and fraud.

At the S.E.C., we have a Section of Economic Research which currently estimates that the expenditures of American corporations for plant and equipment additions will reach about $38 billion for the year 1957. In 1956, this figure was $35 billion, which in turn was 22 per cent more than industry required in 1955, the pre-record year. It almost seems astronomical when we talk in terms of these figures; yet they are the bare facts and represent a realistic evaluation of the practical success of the American capital system.

Of course, much of the estimated $38 billion industry requirement will be raised internally; that is, as a result of depreciation accruals, retained earnings, short-term bank loans, mortgage financing, and from other similar sources. The balance must be raised by external sources, such as through the sales of debt and equity securities--stocks and bonds, if I may use the layman's vernacular.

When we discuss internal sources of money, we must keep in mind that the Federal Reserve System has taken action reflecting a firm desire to curb inflation; this is known as "tight money". There is certainly a serious doubt as to whether bank loans and mortgage financing can be looked to hopefully as a means of raising the $3 billion of additional money required in 1957 over 1956. Without doubt, a good portion of this increase will have to be raised from the savings of the American public who will be asked to invest in new securities to be offered in 1957. This is the area of the capital markets in which this Commission is vitally concerned.

Let us look at 1956 to see how this $35 billion was raised. $11 billion of new securities was sold for cash. Of this $11 billion, only $8.7 billion was directed towards plant and equipment uses; the remainder, $2.3 billion, being used to retire securities previously issued. These statistics indicate that the capital markets normally will provide about one-fourth of the funds necessary for plant and equipment expenditures. In the past, industrial concerns and railroads, as a general rule, tend to raise the major portion of their capital requirements from internal sources. Public utilities, on the other hand, have had to obtain well over one-half of their requirements from the securities markets. American industry must compete with others in seeking funds through the capital market formation process. Agencies of the Government raised $5.7 billion from the American public, while states, municipalities, and other principalities accounted for $5.4 billion of bonds sold in the year 1956.

Thus, in 1956, $22.1 billion was raised in the sale of securities of all types to the American public. I offer these figures, not to confuse you but to illustrate how very much the American capital system is everyone's business. For the continued expansion of the American capital system, each and every American investor must contribute towards the continued improvement of our high standard of living. As a corollary to this expansion of our capital system, it is essential that we maintain the integrity of the capital markets so that no forces of evil can threaten the confidence of American public investors which could in any way slow down the flow of capital necessary to meet the needs of our economy.

American corporations today, more than ever in the history of this nation, are relying upon the American people to invest in new issues of corporate securities, and every segment of American industry must be supported in these efforts. At the same time, this Commission has a reciprocal responsibility to assure investors of the availability of facts about these corporations so that such investors may exercise informed judgments before making security purchases. Confidence of investors, on the one hand, and assurances of availability of capital markets, on the other hand, are intimately related to each other, and the sum of this is the proper functioning of this nation's capital economy.

To further illustrate the function and the means of our capital system, we need only to compare it with the figures available of stocks and bonds offered by private business organizations in the other leading capital formation countries of the world. Industry in the West German Republic issued stocks and bonds for cash to the extent of $820.6 million in 1956. In Great Britain, $626.3 million in stocks and bonds were sold in 1956 to the public for cash. Our figures, as noted above, for the same year (1956) indicate that private business in this country sold $11 billion of securities for cash, which further indicates the outstanding accomplishments of our people who make up the capital formation markets.

At this time, in the battle of ideologies in all parts of the world, we have a moral responsibility to illustrate to the people of this earth that our system can succeed and provide for its citizens the highest measure of proper and good living that is denied other individuals who must live in the Communist world of secrecy and non-disclosure. If there is one area in which our nation can point to, as distinguishing it economically from other nations, it is this magnificent system of investment by the public in our nation's industry. The securities markets represent the bulwark of the capital system. It is the capital system which has resulted in this nation's magnificent progress and all the free world which it has carried with it. It is the capital system, and, therefore, the securities markets which are condemned as the evil of our way of life by the overlords of the Communist world.

Investor confidence at this time must be preserved. Since the formation of this Commission in 1934, and the enactment of the Securities Act the year before, there has been a successive effort to maintain and develop investor confidence. Immediately after the tragic stock market break at the turn of the decade in 1930, investor confidence was at a low ebb. History only points to the fact, therefore, that the confidence which exists today was developed concurrently with the enactment of the various Securities Acts.

Within the last year, this Commission, as I have noted above, has been confronted with "boiler rooms" and they have caused us great concern. We are presently conducting a drastic enforcement campaign, utilizing every legal means available to put such operators out of the securities business. The losses of the investing public at this time cannot be determined, but I may say that the word "enormous" may describe the situation. These "boiler rooms" have caused great concern because they are weakening investor confidence and bringing into the capital markets a feeling of disfavor by the American investing public. Public confidence brought about by painstaking work in the securities markets in recent years could quickly be forfeited, if these conditions are not corrected.

May I be more specific and illustrate the size of these operations. Nine million shares of highly speculative stock were sold in six months all over the United States by the use of the long-distance telephone by six "boiler room" broker-dealer firms located in New York City. The securities were concentrated in four issues, three of which were Canadian oil stocks, and 24,000 public investors throughout the United States invested their savings in these securities upon the oral representations made by total strangers over the long-distance telephone. The aggregate proceeds from these sales totaled over $30 million, and these firms have realized profits of $4,500,000.

The telephone bills of these companies alone, for this period of time, were in excess of $425,000. In a recent computation, it appears that as of March 1956 the securities are worth approximately 37 per cent of their original cost.

As part of this over-all campaign, false reports were filed with this Commission which overstated the oil reserves of two of these companies, which reports in turn formed the basis of the misrepresentations upon which these sales were touted.

These frauds present difficult enforcement problems because there may be little or nothing to arouse the suspicion of an investor at first glance. Upon being first informed of the misrepresentation and fraud, we undertake an extensive and thorough investigation because our only resort is through courts and we must prepare our cases accordingly. Investor protection, therefore, sometimes cannot come quickly enough to preclude damage to members of the public.

But, in order to help public investors help themselves, the Commission has engaged for the past year in a broad program of public information warning the public of the dangers. In November of last year, the Commission adopted--in cooperation with the New York Attorney General, now United States Senator Jacob K. Javits from New York--a ten-point guide, urging the public to be cautious in purchasing securities as a result of long-distance telephone solicitation by persons of whom they have had no prior knowledge, and suggesting that public investors consider these ten points as guides before purchasing securities:

1. Think before buying.

2. Deal only with a securities firm which you know.

3. Be skeptical of securities offered on the telephone from any firm or salesman you do not know.

4. Guard against all high-pressure sales.

5. Beware of promises of quick spectacular price rises.

6. Be sure you understand the risk of loss as well as prospect of gain.

7. Get the facts -- do not buy on tips or rumors.

8. Request the person offering securities over the phone to mail you written information about the corporation, its operations, net profit, management, financial position and future prospects. Save all such information for future reference.

9. If you do not understand the written information, consult a person who does.

10. Give at least as much thought when purchasing securities as you would when acquiring any valuable property.

In the dissemination of this information, and in assisting the public, no organization in this country is better suited than yours to complement and assist this Commission in achieving these ten safeguards. The Commission stands ready to cooperate and assist in any way it can to maintain investor confidence. Our objective is to preclude any vital damage to American investor confidence. The best way to do this is through "prevention" and not "cure". We must prevent the damage before it occurs. It is difficult to cure in this area because once "burned" a public investor may never return again to the capital markets. The American public investor must continue to have the confidence of our capital formation process. We at the Commission therefore, ask your assistance in "passing the word" to the American public.

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