PROPOSED LEGISLATION INVOLVING

ACCELERATION POLICIES

Address of

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Besides having the honor to appear before this meeting, it was my pleasure yesterday on this trip to your thriving city formally to open the new Houston Branch Office of the Securities and Exchange Commission. This office will be under the general jurisdiction of Mr. O. H. Allred in Fort Worth, and three of his staff will be stationed in Houston from now on. Frank M. Pinedo will be in charge of the Branch Office and act as attorney in this area, John Reed Scott, Jr., will assist Mr. Pinedo in the capacity of an Investigator, and we will also have a clerk assigned to the office. I sincerely trust that such of you gentlemen as have offices in Houston will make it a point to meet these members of our staff. They have been instructed to be of as much assistance as possible to the security dealers in this area and to be as vigilant as possible in the protection of the investing public.

The establishment of Branch Offices of this nature is a pure matter of economics. When it will use less of the taxpayers' money to maintain such an office than it would to pay travel costs, arrangements are made accordingly. You may judge from this that activity in the securities business in Houston has increased measurably to the point where we can afford to serve the industry more promptly and more efficiently and more cheaply through having a local office here. This office is located in Room 324 in the First National Bank Building at 201 Main Street where Mr. Pinedo will be very happy to discuss any of your problems with you at any time.

In making a brief appearance before an audience as distinguished as this, I am forced to choose between two unpleasant alternatives. Either I must give you some type of review of the general work of our agency, to attempt which in so short a time would necessarily be extremely unsatisfactory, or else I must focus my attention on a rather narrow portion of our many problems. I thought you might be interested today if I chose the latter path and discussed with you some of the difficulties which face us in the legislative field.

As you may know, pending legislation involving the interests of the Securities and Exchange Commission is frequently voluminous. Some of it in this particular Congress is quite important. The Commission itself has made a comprehensive review of its laws and has submitted to the Congress a complete program for some modifications in the Acts which it administers in order to expedite its work and to solve certain rather serious problems which have cropped up from time to time, while not seriously affecting the substantive conduct of your business. This legislative program is still pending before the Senate Committee on Banking and Currency and before the House Committee on Interstate and Foreign Commerce, many of whose members have been busily engaged in other and certainly more newsworthy activities in recent months. The Commission has also reviewed its activities under the Chandler Act, i.e., Chapter X of the Bankruptcy Act, and legislation designed to facilitate our participation in these matters was filed quite recently. This legislation also is pending in Committee.

In addition to these legislative activities which were initiated by the Commission, numerous bills have been introduced in Congress or have been prepared for introduction which are of interest to the Commission and, I believe, to the investment industry. One of the most important bills of this nature is doubtless the so-called Fulbright Bill. This proposal would extend to some of the larger corporations whose securities are traded in the over-the-counter market certain of the requirements now imposed by the Securities Exchange Act of 1934 upon corporations whose securities are listed on a national exchange. Such requirements would include compliance with the proxy rules, the reporting of insider trading and the filing of periodic reports with the Commission. This sort of legislation has long been favored by our Commission and the present bill has our active support. There are a number of other items of proposed legislation of mutual interest but I cannot now take time to discuss them.

I am especially concerned today in calling your attention to one particular situation involving, not a pending bill, but what I consider to be a most undesirable proposed bill to which we would pay little attention were it not ostensibly sponsored by a most reputable organization. The Section of Corporation, Banking and Business Law

of the American Bar Association recently announced that it had persuaded the House of Delegates of the A.B.A. to adopt a recommendation in support of legislation which would, in essence, amend that part of the Securities Act of 1933 which provides that the filing of an amendment to a registration statement starts anew the twenty day waiting period at the end of which the registration statement becomes automatically effective. The proposed bill would insert an exception from this provision when the amendment relates only to the offering price, the amount of commissions, the amount of the proceeds, the interest, dividend or conversion rates, the call price, or an identification of underwriters or similar matters.

The Securities and Exchange Commission is unalterably opposed to this proposal on the ground that it would interfere with the orderly processes now in effect within the Agency to the detriment of the work of the Agency and against the interests of the corporations, dealers and counsel with whom we have daily contact in the course of our duties.

In order to understand the effect of the proposal and the reason for our opposition, it might be helpful to recall to you some of the background history of administration of the Act. When the Act was passed in 1933, its legislative history clearly showed the intent of the Congress to have been that the run-of-the-mine registration statement would lie without amendment in the Commission's files and be available for public inspection for a period of twenty days, at the end of which time the issuer or its underwriters would be free to distribute the security. The first day on which registration statements were permitted to be filed under the Act after it became effective, there were eighty-five such documents filed with the Federal Trade Commission, the predecessor of our present Agency. Some few days later and after a great deal of concentrated effort, Baldwin Bane, who had been placed in charge of this work by the Federal Trade Commission, received from his makeshift staff eighty-five memoranda, each one of which contemplated that a stop-order would issue, since each registration statement was, in the opinion of the staff, inadequate in one way or another.

This situation was obviously impossible and would have effectively dammed up the entire capital market once and for all. The legislation, which was inherently desirable, would not have lasted two weeks. Faced with this situation, and without express statutory directive, Mr. Bane quickly decided to advise each issuer of the deficiencies in his particular statement and give counsel the opportunity to amend accordingly. The pending registration statements were appropriately amended in short order. It then became apparent that some action would have to be taken in order to enable the underwriters to arrange a definite time table which would include a specific date upon which the closing would take place and the securities offered to the public.

It will be recalled that prior to 1940 the Commission did not have its existing authority to "accelerate" the effectiveness of a registration statement within the initial twenty day period following the filing of the statement or any amendment. Nevertheless, despite many technical difficulties the Commission as a matter of routine advised underwriters that it would "consent" to the filing of amendments as if they had been originally filed as part of the registration statement to permit the filing of the price amendment at a time close to the end of the original twenty day period and to permit almost immediate effectiveness of the registration statement thereafter, which would allow the offering to be commenced at once.

Because of the inflexibility of the "consent" procedure and the statutory prohibition against the intiation of an offering by the issuers and underwriters until at least twenty days after the initial filing, the industry recommended, the Commission advocated and the Congress adopted an amendment to the statute in 1940 which authorized the Commission to "accelerate," that is, to permit the registration statements to become effective in less than twenty days after the original filing. Today the Commission regularly and routinely uses both the "acceleration" and "consent" procedures in order to permit you to go to the market on exactly the day and precisely the time you choose. But in granting this additional authority in 1940, the Congress contemplated that it would be used sparingly and to this end the Congress established in the statute six positive restrictions upon the Commission's exercise of this new discretionary authority. It stated, briefly, that

the Commission must take into account in so doing: (1) the adequacy of the information respecting the issuer theretofore available; (2) the facility with which the nature of the securities to be offered can be understood; (3) the facility with which the relationship of the securities to be offered to the capital structure of the issuer can be understood; (4) the facility with which the rights of holders of the securities to be registered can be understood; (5) the public interest; and (6) the protection of investors.

I shall not bore you with a technical dissertation on these provisions nor attempt to explain or defend the Commission's actions in particular cases in meeting legitimate business deadlines within the framework of the statutory standards. Suffice it to say that the procedure established in 1933 has since become the regular practice of the Commission and I think that the industry generally will agree that the experience over twenty-five years under the Act has been reasonably satisfactory. The result has been, of course, that practically every prospectus is amended in some respects after issuance of the deficiency letter, but that acceleration is granted thereafter almost as a matter of course unless the price amendment discloses some further reason for question. I might point out, in connection with this last proviso, that the Commission usually first learns the personnel of the underwriting group at the time the price amendment is filed, and hence is at that point first able to conclude whether the members of the syndicate, if permitted to participate in the underwriting, would be in compliance with the so-called net capital rule.

The Bar Association has given as its reason for suggesting the proposed amendment that under the present procedure the Commission is in position to force an issuer or an underwriter to comply with the Commission's wishes, even though they may have nothing to do with the element of disclosure. The proponents themselves admit that they have no criticism of the present administration of the statute, but claim to be fearful lest future Commissioners use the threat of this unquestionably potent weapon to impose unreasonable conditions upon the industry.

The fact of the matter is that, in 1957, in response to suggestions that the Bar was unhappy at not having any definite

guide as to Commission policy as to grounds for denying acceleration, we adopted a note to Rule 460 in which were set forth some of the grounds not theretofore formally published though used administratively upon which it was proposed to base a decision to deny acceleration. After hearing, some of the proposals which the Commission decided really had little to do with disclosure problems were abandoned, and the balance adopted. The inference is clear that, if the papers are otherwise in order and unless legal ingenuity has thought up some new gadget, acceleration will not be denied if these rules are satisfied. As a matter of fact, the note to Rule 460, if any intelligent analysis is made of it, merely details some particular facets of the general problem of effective disclosure. I would not impose on your time here to analyze this rule in order to make this point more emphatic, but I think that if you will reread it with this thought in mind, you will see that a corporation or an underwriter which is anxious to be perfectly honest and frank would never find itself in a position where it could be accused of any of the matters covered by this rule.

Aside from these considerations, however, the Commission is firmly convinced that those who propose this statutory change are doing you a distinct disservice. The legislative history of the amendment in 1940 which vested in the Commission a discretionary authority to "accelerate" the effectiveness of the registration statement indicates that the Congress intended that, apart from compliance with the disclosure concepts strictly speaking, the Commission was to be limited in the exercise of this discretion by the statutory injunction that it shall have "due regard to ... the public interest and the protection of investors." We cannot ignore this mandate of the Congress and we must give these words significant force in our deliberations. It is perfectly clear in the statute that the alternative to the denial of acceleration is the issuance of a stop-order. Such a stop-order, however, must be based upon failure of the issuer to comply with the disclosure provisions of the statute. We would consider that the various matters described in the note to Rule 460 are aspects of the disclosure standards of the Act. We submit that it is far better from your own point of view that we deny acceleration in an appropriate case, that is, that we resort to an administrative action which attracts little public attention rather than that we institute formal and public stop-order proceedings.

In the very nature of an administrative agency, it must be given broad discretionary powers, and the statute must provide a wide range within which the agency can administer it in accordance with statutory standards. I do not believe that any of you has any doubt but that the securities market will be subject to regulation as long as we have such an institution in operation in this country. In fact many of you have explicitly stated that you would not return to the free and easy pre-Securities Act days if you could. The whole securities market and industry is geared to these statutes at the present time. What you should want, and what I believe most of you do want, is not freedom from regulation but intelligent and flexible regulation within the framework of the statutes. I submit that the Securities and Exchange Commission has administered the laws in just such a manner, and to the extent that I can and so long as I can, I will see to it that you will continue to enjoy such treatment. But we cannot so act if the statutes are changed so as to deprive us of authority to be flexible and intelligent.

I happen to be a lawyer by profession. So are two of the other four Commissioners and so are many members of our staff. We are as devoted as is any American lawyer to the principle that government is and must be by laws and not men. I may say that I am aware of, but ignore as unworthy of comment, the cynical remark of an early critic that government is actually by lawyers and not men.

We at the Securities and Exchange Commission believe we administer the statutes in accordance with the law and not by personal whim. All the law, however, is not to be found in the Acts of Congress, though all law must be consistent therewith. Much of the law which guides us is found in our rules and in the policies adopted in accordance with the directives of the statute and announced in our decisions and releases. The statutes give us room for the exercise of discretion in adopting and changing these rules and policies either to expand or restrict the exercise of our powers as circumstances change and as we grow in wisdom and experience.

An important part of the basic law within which we act, and upon which our policies are founded is our choice of remedy,

by which I mean the choice which we are given between various means to enforce the law. Where we may act in one of several different ways in a given situation, either by denying acceleration, or by stop-order or by criminal reference, we may choose that course which is most appropriate to that particular set of facts. If we are to be denied this choice, we cannot thus adapt the remedy to the facts, and the registrants themselves must suffer if we are forced to an inappropriate course of action.

When one disagrees with the expressed policy of an administrative agency, and especially when one has recently lost a case, there is a tendency to conclude that the discretion given the Agency ought to be circumscribed by more specific definitions or by depriving it of procedural opportunities to enforce its views. But there is grave doubt of the wisdom of such a reaction. The result is often to throw the baby out with the bath. If we are deprived of discretion, we cannot adjust to the needs of a deserving case however worthy it may be.

I am convinced that the best interests of the securities industry lie in preserving the discretionary powers vested in the Commission within broad statutory areas rather than to lock us into mechanical procedures. From this very fundamental and practical standpoint, the proposed bill which I have described would be a step in the wrong direction.