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CURRENT FUNCTIONS AND OBJECTIVES

OF THE

SECURITIES AND EXCHANGE COMMISSION

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Securities and Exchange Commission

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THE SECURITIES AND EXCHANGE COMMISSION

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In a sense I feel like a returning prodigal son this afternoon, both because of your generous and gracious welcome and because of my close ties to Oklahoma. I was born and brought up in your neighboring state to the Northward -- Kansas.

But my affinity to and affection for Oklahoma rests on something more than adjacent geography. It rests on many happy days spent as a child on a farm in your Panhandle between Guymon and Hooker in Texas County. My Grandfather foresaw great opportunities in Oklahoma, and he homesteaded that farm. Grandpa was right, for he was richly rewarded -- perhaps not in the financial sense, but in the more important sense of a full and satisfying life which spanned more than 80 years. The farm, I'm glad to say, is still in our family.

Like the prodigal son I have done some wandering since my Panhandle farm days, hopefully in a manner less profligate. The wandering included a tour of duty with the Navy during World War II, 12 years of private practice of law in New York City and, in June of last year, to Washington and the Securities and Exchange Commission. During his roaming I am sure the prodigal son encountered more experiences of interest to a tabloid newspaper than I. But as a matter of professional interest and personal satisfaction his experiences cannot match mine -- particularly my venture into the bureaucratic wonderland of Washington. Perhaps this afternoon I can convey something of what I mean.

Before going with the Commission I would have been dismayed to have been described as a bureaucrat. On more occasions than I can recall I have characterized bureaucrats in terms unsuitable for gentle or tender ears. The last year and a half, however, has caused a metamorphosis, and today I wear the bureaucratic mantle with more than a little pride.

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My switch last year from representation of corporate clients on matters pending before the Commission to the other side of the table at the Commission naturally produced a different perspective. As my experience with the Commission increased, Governmental attitudes which had previously been obscure to me became understandable and sensible. I could not avoid a reexamination of some of my prior attitudes, and the reassessment found many of them lacking in substance. This is not to suggest that the Federal Government -- indeed our Commission -- does not move ponderously and imponderably with distressing frequency. But it is to suggest that the public servant usually has good reasons for action which on the surface may appear unrealistic or arbitrary.

Before indicating what our Commission hopes to achieve, perhaps it would be well to outline our functions and briefly describe some areas of their impact on you and your clients. Our statutory responsibility is imposed by the Congressional mandate for administration of six great Federal securities laws. These 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 and the Investment Advisers Act of 1940. To a large degree, each of these statutes is integrated with one or more of the others. In addition we have certain judicial assistance responsibilities pursuant to the corporate reorganization provisions of Chapter X of the National Bankruptcy Act.

Functionally our responsibilities fall within three broad and basic areas -- disclosure, regulation and enforcement. In terms of numbers of people affected, the disclosure function has the greatest public impact. Its thrust is to insure that there is made available to every prospective purchaser of a publicly offered security, with certain exceptions, information concerning the issuer of that security which is sufficiently full, fair and complete to enable the prospect to reach an informed investment decision.

The public significance of the disclosure program is easily seen by one statistic. It is estimated that there are now over 17 million Americans who hold shares of corporations which have offered their stock to the public. The figure would be materially increased if there were added in other persons to whom disclosure is equally important. These would include public holders of other types of securities, such as bonds, debentures and fractional undivided interests in oil, gas and mineral rights (a security by statutory definition) and persons who have been asked, but who have declined, to buy securities.

While disclosure elements are inherent to some degree in all six Federal securities laws, the basic concept springs from the Securities Act

of 1933. Here is created the requirement of registration with the Commission of any securities proposed to be sold in interstate commerce. The Act prescribes the extensive nature of the information required to be included in the registration statement and prospectus, civil liabilities for any false or misleading statements which they may contain, anti-fraud provisions and remedial and criminal penalty provisions.

Refinements of disclosure concepts were included in the Securities Exchange Act of 1934, although this was not the principal object of the 1934 Act. Among the refinements are requirements for the filing of detailed financial and other information by larger issuers of securities and the authorization of the Commission to adopt comprehensive rules on what must be disclosed and explained to stockholders by companies soliciting votes for elections of directors and approving various proposed corporate action at annual or special meetings of stockholders.

Disclosure obviously cannot and was not intended to assure the investor that he will make a successful investment. Indeed, I would welcome a plan which would provide such assurance for myself. Should I find it my wealth would soon be the envy of the aggregate of the nation's tycoons. But disclosure can, if utilized, place the investor in a position to make an informed decision.

I emphasize the "if utilized," for all we can do is make fair, complete and accurate information available to the investor in as understandable a form as feasible. We cannot force him to study, read or even glance at it. We cannot make his decision for him. Nor can we in any way pass on the investment merits of any security. We do not have these powers, we do not want these powers, and I would be surprised if any responsible individual would feel easy about having such powers lodged in a Federal agency.

Our second broad functional area -- regulation -- has a more pervasive effect than disclosure on those falling within our jurisdiction. In this area we are empowered to break up huge, unwieldy and unconscionably uneconomic public utility holding company structures pursuant to the Holding Company Act; to have a measure of control over those who enter the broker-dealer and investment adviser business and, more important, a measure of control over their conduct once they enter the business pursuant to the Exchange Act and the Advisers Act; to regulate some aspects of the structures, operations and transactions of investment companies; and to advise Federal courts concerning various phases of proceedings for reorganizations of corporations under Chapter X of the Bankruptcy Act.

The Holding Company Act is, in my opinion, an outstanding example of a well conceived and superbly drafted Federal regulatory statute capable

of administration to carry out the Congressional purpose with precision. The Commission's major Holding Company work has been accomplished, though there remain subject to its jurisdiction 17 active holding company systems controlling aggregate assets of approximately \$12 billion. One of these, the \$767 million Central and Southwest Corporation empire, has an important utility subsidiary here in Tulsa -- Public Service Company of Oklahoma.

The Commission does not participate in all Chapter X corporate reorganization proceedings. We participate if there is a public interest in outstanding securities of the debtor corporation which are likely to have an interest in the securities ultimately to be issued by the reorganized debtor and if our participation is requested or approved by the Federal judge before whom the proceedings are pending. In the last fiscal year the Commission participated actively in 64 Chapter X cases involving 101 companies with total assets of over \$600 million. Three of these cases are pending in Oklahoma federal district courts.

Our present most active regulatory sphere involves investment companies -- both closed-end companies, those which neither redeem their shares nor make a continuous offering of their shares, and open-end companies which hold themselves ready to redeem or repurchase their shares at their then net asset value and which normally make a continuous offering of their shares to the public. Open-end companies, usually called "mutual funds," have received accelerated attention from the press since the release at the end of last August of a study prepared for the Commission by the Wharton School of Finance and Commerce of the University of Pennsylvania.

At the time of the adoption of the Investment Company Act in 1940 I doubt if anyone anticipated the rate at which the industry assets would expand. At that time the aggregate net assets of both closed and open-end investment companies amounted to approximately \$2.5 billion. On December 31, 1961 this figure had increased to over \$31 billion. The increase in assets of open-end companies during this period has been particularly spectacular. From net assets of approximately \$475 million in 1940, the open-end company figure grew to about \$24.5 billion by the end of 1961 -- an increase of over 5,000%.

This increase in size has naturally increased the magnitude of our regulatory workload. And, like the Internal Revenue Code, once the Investment Company Act was adopted the inventive genius of the Bar devised a nearly infinite variety of imaginative methods of working within its framework. Many of these pose serious regulatory problems and require intensive study to determine whether additional legislation is necessary.

I should add in this connection that there has been no major amendment to the Investment Company Act since its adoption over 22 years ago. The phenomenal growth of the industry during the intervening period was one reason why the Commission retained the Wharton School to do its study.

Our third principal function -- enforcement -- stems from a variety of civil and criminal sanctions contained in each of the Acts we administer. These include stop order proceedings under the 1933 Act, the effect of which is to ban the sale of a security until the cause for the stop order has been cured; revocation of a broker-dealer's registration under the 1934 Act which effectively puts the broker-dealer out of business; civil injunctive actions brought by the Commission against violations of any of our Acts; and fines or imprisonment for wilful violations. All civil remedial action is handled directly by the Commission. Criminal cases are developed by the Commission and referred to the Attorney General. If the Attorney General concurs that the Commission has established criminal violations, the case will be tried by the appropriate United States Attorney with the assistance of the Commission's staff. All of our enforcement proceedings, including criminal prosecutions, are at a new high. For example, as of last June 30th there were pending 219 proceedings in the broker-dealer revocation or denial of registration category alone. To me this is a shockingly high figure when compared with the total of 5,868 effective broker-dealer registrations at the same date. The 219 figure is actual active proceedings. It does not include investigations which may mature into proceedings.

Investigations may result from several sources. They may result from checking out complaints to the Commission by public investors. They may arise from suspicions of irregularity by the staff in the course of routine examination of documents required by law to be filed with the Commission. Often they are the result of suspected violations uncovered by an on-the-spot inspection. The Commission has an extensive program of inspections of broker-dealers, investment advisers and investment companies where our inspectors visit the company, check its records and interview officers, directors and employees to ascertain the extent of compliance with our laws. If reasonable grounds for suspicion of violations occur, the Commission may issue an order of investigation, and the investigators probe the matter more thoroughly. The investigation is conducted privately, and great care is taken to see that no one knows of it except the subject of the investigation. We try to take all possible precautions to guard against any publicity unless sufficient evidence of violations is disclosed to warrant institution of an enforcement proceeding.

These, then, are the three basic functions. An appropriate question is which of our activities is likely to affect you and your clients, or, in this context, which may cause a client to consult you on a securities law question?

It would be rare if it involved the Holding Company Act, for, as I indicated previously, because of past accomplishments our holding company activities are on the wane. I will footnote this by adding, however, that our work in eliminating and simplifying complex and uneconomic holding company structures has had and will continue to have a happy effect on both your gas and electric consumers and Oklahoma holders and purchasers of utility securities.

You may be consulted on a Chapter X reorganization matter, for members of the Oklahoma Bar are currently representing clients in at least three of these proceedings. In view of its enormous size, you may be consulted on investment company problems. Although at present there are no registered investment companies domiciled in Oklahoma, I am sure that over 100 thousand Oklahoma residents own investment company securities. Mutual fund salesmen would hardly overlook such a fertile field. And may I add a word of caution here. Whenever a client comes to you with an idea which even remotely involves the pooling of cash or other resources of a number of persons for the purpose of investing, reinvesting, trading, owning or holding securities of any type, I urge you to study carefully the Investment Company Act. It is easy to create or become an investment company required to register under the 1940 Act inadvertently. We are repeatedly faced with unravelling these situations which have occurred in entire good faith and much to the surprise of everyone concerned, including the lawyers. Should there be any question in your mind it would be wise for you to check out the proposal prior to consummation with our Fort Worth Regional Office whose jurisdictional area covers Oklahoma.

Certainly many of you repeatedly encounter broker-dealer questions. As of last September 30th, there were 44 registered broker-dealers headquartered in Oklahoma. And I have noted from my brief stay in Tulsa that one need not walk far from here to learn that branch offices of other brokerage firms have proliferated in Oklahoma.

But no doubt the single statute with which you are most frequently involved is the Securities Act of 1933. A state as vigorous and prosperous as this could not fail to have a plethora of alert businessmen vitally interested in the availability of additional capital through the public offering of securities.

While many of you here have an intimate knowledge of the securities laws, perhaps for the benefit of some others it would be well to mention briefly what is involved in a public offering of securities which crosses state lines, for if your offering is a security of something other than an investment company and is intrastate to Oklahoma in the strict, literal sense, an exemption is available under Section 3(a)(11) of the 1933 Act, and the Federal registration requirements can be avoided.

But another word of caution, if I may. In all too many instances this so-called intrastate offering exemption is abused. All too often securities are purportedly sold intrastate when the principals know or should know that the ultimate destination of some of the securities is to non-residents. If this is the fact in a single instance, the availability of the intrastate offering exemption is lost, and Federal registration of the securities is required. The Commission is keeping a watchful eye on use of the intrastate offering exemption, and I say to you if you plan to utilize it -- be wary. Caveat venditor -- not caveat emptor -- applies here.

But suppose you have a group of clients who are interested in going public and who are interested in raising more capital than is normally available in an intrastate offering and also more than \$300 thousand so that they cannot take advantage of the more abbreviated disclosure requirements available under the Regulation A offering circular provisions. Assume that they are in the oil drilling and production business, and they are organized as a partnership which handles a part of their operations, but in some separate drilling ventures there are separate partnerships with one or more of the basic partners participating with other partners unconnected with the basic partnership. Assume all partners, basic and outside, wish to consolidate into a single entity and raise capital from the public. Suppose you decide to incorporate the entire venture and make a public offering of a portion of the new corporation's common stock. The process of consolidating the entire properties of the various partnerships is not easy -- either in working out the mechanics of doing it, adjusting the share interests in the corporation of the various participants, making certain the principals will retain the power to control the new corporation or in avoiding adverse tax consequences. However, many of you have organized this type of operation with exceptional competence before, and I would not presume to be able to advise how to do it more effectively.

But what is involved in the public offering process? First, a registration statement must be prepared and filed with the Commission. Normally this will be on Form S-1, but there are other registration forms which may be required to be used in lieu of Form S-1. This will depend in some instances on the nature of the offering, the type of the securities offered or the type of company issuing the securities. In the latter connection, for example, there is a separate registration form for investment companies, another for small business investment companies and still another -- Form S-11 -- for real estate investment trusts. May I add that a pioneer in the use of Form S-11 -- and a very able pioneer indeed -- was Liberty Real Estate Trust of Oklahoma City.

Form S-1, as well as most of the other registration forms, requires, among other things, broad narrative and statistical disclosures of every material facet of the business of the issuer, detailed financial statements certified by a recognized firm of independent public accountants and the filing of every material contract which the issuer has with anybody. In the course of preparation of a registration statement the lawyer must acquire an intimate knowledge of the business of the issuer and spend a great many long and hard hours with its executives and employees obtaining the necessary information for proper disclosures.

When your client sees what is involved in a registration his enthusiasm may be somewhat dampened. He may be appalled at the extent of the required disclosures both on the psychological ground that it is nobody's business but his own and on the ground that he does not want the information available to his competitors. The point is that if he is asking the public to buy his securities broad disclosures become the public's business. A further point is that if he fails to make the required disclosures he will subject himself to civil liabilities and possibly criminal penalties. And the lawyer may subject himself to disbarment from practice before the Commission or even more serious sanctions. The lawyer must be prepared to resist his client's reluctance and often hostility to disclosure. And never be trapped with a suggestion that you try out a partial disclosure or an omitted disclosure in a filing to test the Commission's reaction. A client's suggestion to try it out and "if they ask for it give it to them" may sound plausible. Actually it is a snare. It is your responsibility and your client's responsibility to provide us with full and complete disclosure. It is not ours to ferret it out.

Once the painful process of registration statement preparation is completed and it is filed with the Commission the lawyer has a period of relaxation while he awaits a letter of comments from the staff after it completes its examination of the statement. The letter of comments will normally indicate areas where more disclosure is required, raise certain questions and suggest points where the statement should be improved. In rare instances the lawyer may receive a so-called "bedbug" letter which in substance says the filing is so deplorably inadequate that it will not even be considered in this condition. In other words, start over.

But the usual letter can be complied with rather quickly by preparing and filing an amended registration statement complying with the comments. This may occur once, or several amendments may be required. Ultimately the statement is satisfactory to the staff, and it is submitted to the Commission which, if it finds no objection, will declare it effective.

At this point the securities may be sold to the public, assuming, of course, that you have also complied with the securities laws of the states in which you intend to sell. I must add in this connection that I have studied the Oklahoma securities laws with much interest. In my opinion it is one of the most enlightened of all state blue-sky laws.

The time which will elapse between the filing of the registration statement and its being declared effective will vary. It will depend in part on the Commission's workload and in large part on the quality of the filing. An inadequate, careless filing naturally will take more time to process than one competently prepared. During fiscal year 1962, which saw appreciably more registration statements filed than in any other year in the Commission's history, the mean number of calendar days between the original filing and effectiveness was 78.

Many consequences flow from once having offered securities to the public. Time does not permit me to explore them with you. Suffice it to say that the entrance of public stockholders imposes on the management many additional responsibilities. If the role of counsel were insignificant before, it now becomes indispensable.

I have described as our basic functions disclosure, regulation and enforcement. I emphasize that these are operating functions. I would be remiss if I did not mention before closing a non-operating function which is vital but which is all too easy to defer.

In view of the behemoth proportions to which the Federal Government has grown, it may come as a surprise to you that many Federal agencies are seriously understaffed and overworked. I do not suggest that our Commission is seriously understaffed, and we are not asking the Congress for substantial increases in manpower, for we have no interest in bureaucratic empire building. I do suggest that our workload is such that it heavily taxes our available manpower.

Under these circumstances there is a strong and almost unavoidable tendency to devote your entire energy to the ad hoc matters before you. There is little time to reflect, study, reassess and plan for future direction. Yet plan we must -- study we must -- or the agency will soon become sterile. Our usefulness in serving the public interest would come to an abrupt end if we were not constantly studying changes in the securities industry and developments in relation to the laws we administer to see that they do not become outmoded. Put another way, we must always be aware of the movement of the times so that we may move concurrently in protecting the public interest. Because of pressing workloads this is easier said than done. But we are doing our diligent best, and I believe we are having at least partial success.

One great help in this connection was the passage of the Mack Joint Resolution of the Congress last year which created our current Special Study of Securities Markets. This Study is sweeping in scope, and its report to Congress is due next April 3rd. The information it is producing will be invaluable in assisting the Commission to determine whether investor protection requires new legislation and in developing such new legislation as may be required. At the minimum the Special Study should enable us to determine the present effectiveness of our statutes and set guide lines for future planning.

Even a Study of this nature has its limitations, among them its April 3rd deadline. To the extent that it cannot be comprehensive, the fields omitted will be covered by studies by the permanent Commission staff. For example, in the investment company area the Special Study has confined itself largely to selling practices and matters related to the marketing of investment company shares. A special task force of the Commission's Division of Corporate Regulation has underway a much more comprehensive study -- a study legislative in nature analyzing on a case-by-case basis the structure of the industry and probing into whether additional safeguards for the investor are necessary.

Our constant aim is the raising of standards of the securities industry as a whole and in each of its segments. Human nature and human knowledge being imperfect, we cannot expect perfection. But we can try for the best. And should we achieve high standards satisfactory to all of us, our job would not be ended. Constant vigilance would then be required to maintain those standards.

One final word before closing. When one thinks in terms of Federal Government activities there is an automatic inclination to think in terms of billions of dollars of spending. May I assure you that this is not remotely approached by our agency. The budget in the current fiscal year for the entirety of our Commission's activities, including those in Washington and those handled by our 16 regional and branch offices, is less than \$13 million. Considering the range of our activity this is hardly fiscal extravagance.

I suppose the day will come when I will leave Government service. If so, I hope it will be a voluntary departure with mutual regret rather than a enforced departure caused by a national electoral mandate similar to that curious Oklahoma gubernatorial result of three weeks ago last Tuesday. And I certainly hope I can avoid a situation encountered by a public servant of enviable distinction on the occasion of his resignation. This was a man of rare ability who was held in affectionate esteem by all except a few immediate subordinates, at least one of whom considered

his treatment harsh. The public servant had been highly successful representing the United States before the Supreme Court, particularly in tax cases. Upon learning of his resignation the then Chief Justice wrote a gracious letter which the public servant found on his desk open with the rest of his correspondence awaiting his perusal. The letter of the Chief Justice referred to his successful tax cases and remarked "Your leaving will cost the Government at least \$500 million." In the margin the disgruntled subordinate had inscribed "AND IT'S WORTH EVERY PENNY OF IT."