Speeches. SEC Staff

A D D R E S S O F

B A L D W I N B. B A N E

CHIEF, SECURITIES DIVISION

of the

FEDERAL TRADE COMMISSION

on

THE SECURITIES ACT OF 1933

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of

AFFILIATED BETTER BUSINESS BUREAUS

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SHOREHAM HOTEL

WASHINGTON, D. C.

Mr. Chairman, Gentlemen:

I am extremely glad to be with you this morning.

Almost two months have now passed since the flotation of new security issues has been governed by the Securities Act. Those two months have been months of stress and strain for the Federal Trade Commission, which Congress charged with the administration of the Act. It is still too early to give a complete accounting of the work of the Commission. But it is possible now to observe some tendencies and to comment upon some apparent effects of the Act. It is also possible to deal with some of the issues that the Act has raised, to allay some of the genuine misunderstandings arising out of the complexities of the situation with which it has had to deal, and to see truly its purposes and the possibility of their realization in the face of a new attempt to insist that the morality of high finance is not the concern of democratic government.

To deal adequately with these issues requires a few minutes in bringing out some of the principal features of the Act. In order to float a new issue it is now necessary to file with the Federal Trade Commission a statement setting forth certain prescribed facts which are basic to even an elementary judgment upon the value of a security. That statement cannot become effective so as to permit the security to be offered until twenty days have elapsed since its filing. During those twenty days, the Federal Trade Commission makes a preliminary check of the statement and if it finds it untrue or incomplete or inaccurate on its face, and the issuer fails to make the necessary corrections, the Commission will enter an order stopping the sale of the security. The Commission in no sense approves a security. It possesses no power to approve or disapprove. Nor can the Commission be regarded as guaranteeing the accuracy of any statements that may be made. It only requires the issuer to make certain statements.

Falsity in making representations in the registration statement is penalized primarily by holding the persons concerned in the flotation of a security responsible to the buyer for their untruths. Many misunderstandings have arisen as to the character of this liability. It is placed upon four classes of persons - the corporation that issues the security, the directors and chief officers of that corporation, the experts proclaimed as being associated with the security, who consist primarily of accountants, appraisers, engineers and lawyers, and, finally, the underwriters of the security. Certain defined statements are to be made by these persons or, if not actually made by them, these persons are held responsible for these statements. That responsibility, except for the issuer of the security, is not one of guaranteeing their accuracy. It is one of taking due care that they are accurate - that, considering the trust placed by investors in them, they used such care as can reasonably be expected of them to check the truth of these statements. To be satisfied with a lesser standard is impossible. To do so would be to invite again the misfortunes of an era that most of us would like to forget except for our determination that we shall build better. To say that such a standard is impracticable is to deny experience.

Some misunderstanding has arisen over the fact that the standard is couched in negative as well as positive terms. Omissions of material facts are penalized as well as misstatements of fact. This, it is argued, makes for unreasonableness because no one can ever be sure that he has stated every fact material to the value of a security. But such a contention neglects both the wording of the Act and its historical genesis. Omissions to be a ground for liability are those which make actually untrue, statements that are made and are literally correct. Congress saw fit to make it clear that half truths, which have been the stock in trade of many in the recent past, are untruths.

A second misunderstanding apparently has arisen as to the extent of this liability. Fear is expressed as to the amount of damages that will be recoverable, should a violation occur. But the measure of liability is as reasonably determined as the nature of the liability. It springs not from mere misstatements but from untruths of a material character - from asserting facts the falsity of which has added values where none exist. Losses that do not reflect the deflation that the discovery of the truth has brought are thrust upon the shoulders of those who speculated for gain. But those losses that flow from the reliance of the investing public in the character of the statements that the sponsors of the security have made, these the Act shifts to the sponsors whose carelessness or malfeasance was their cause. This is accomplished by giving the investor a right to demand back from any of them the price he paid for his security, but never in excess of the offering price because that value is the outside measure of the sponsor's representations. Or to an investor who has been forced to dispose of his security before he could avail himself of such a tender, a right of damages, measured in the same terms, is given.

This is a summarization of the investor's rights and the sponsor's liabilities. Its intrinsic fairness makes one somewhat impatient with the outcries against it. One fails to understand the complaints, the legal manifestations of an insistence upon misinterpreting plain meanings, unless one realizes that the irresponsible selfishness that launched the host of unsound and reckless securities is not dead. Unlike the small stock jobbers that scurry from the reach of the law, it often masquerades in a costume of righteousness, hopeful that beneath its folds its past will lie concealed.

Fortunately, there are many willing to assume the responsibilities of fair dealing. To them the Commission has consistently offered such aid as it can. Its attorneys have put their knowledge and their experience at the service of all inquirers. Its examiners have worked to aid those wishing to comply with its requirements, suggesting appropriate amendments, offering suggestions to facilitate more adequate disclosure, and assisting in the drafting of forms responsive to the various needs. But such cooperation stops and stops rightly whenever there is resistance to meeting the requirements of the Securities Act. Five stop orders have already been issued and the sale of securities thereby halted. But more than this, twenty-five registrants have at the suggestion of the Commission withdrawn their registration statements to avoid stop order proceedings being taken against them, thus suspending of their own accord the sale of securities until full disclosure is made.

The story of the acceptance of the responsibilities of the Securities Act is told somewhat in the registrations that have been filed with the Commission. To date 227 registration statements have been filed, 115 of which are now effective, 27 of which have been withdrawn, 5 against which stop orders have been issued, and 80 of which are now being examined. These registration statements cover issues aggregating approximately $226,200,000. The character of these issues varies much. First to register were the investment trusts - a fact necessitated by the circumstance that these organizations are continuously offering new securities to the public. There followed a series of highly speculative issues, consisting mainly of breweries, gold mines and oil participations. Within the past few weeks, staid and conservative issues have been registered, consisting both of new and old financing. Similarly recently a number of registrations have been received for certificates of deposit issued in connection with reorganization proceedings.

The sequence of these registrations and their rapidly changing character was to be expected. Hesitation naturally attends new legislation and the assumption of new responsibilities. But the speculative pressure in breweries and gold mines, intensified by the times, made flotation of securities in these industries irresistable. As the necessities for reorganization and refinancing pressed, registration in these fields ensued, and as hesitation disappeared and understanding of the Securities Act grew, new and conservative financing appeared upon the docket.

In the face of these facts, to talk of a capital strike induced by the Securities Act is either idle or deliberately intended to falsify. It neglects wholly the fact that the state of the capital market is such that financing is hesitant for reasons that go far beyond the Securities Act. Even in issues exempted from the registration requirements of the Securities Act the lack of financing is apparent. The hesitancy of short term financing has become a matter of national concern. Municipal long term issues have practically disappeared. Railroad financing, expressly exempted from registration under the Act due to its supervision by the Interstate Commerce Commission, is stagnant, and for refinancing the railroads turn to the Government and not to the public. These facts are significant in demonstrating the shallowness of the motives of those who proclaim that the Securities Act is a brake to needed financing.

Comments of this character deserve condemnation not only for their absence of foundation in fact but for their want of a theoretical justification. The requirements of the Securities Act are equally as stimulative of new and sound financing as they are protective of the investor. The facts required to be disclosed are neither voluminous nor burdensome except as unsound past corporate practices may have made them so. Topheavy and intricate corporate structures, with confused layers of various different types of securities, require many words to tell the story if, indeed, it can be told, of the relation of a particular security to the earnings of the company. But if it be true that analyzing these multitudinous facts be as difficult as a Chinese puzzle, shall the unsophisticated investor be required to gamble his little thousands that that the answer is right? Again, from some quarters have come complaints that the requirement of independently certified financial statements is

unduly onerous. But shall we permit companies and their bankers to appeal to the public for funds without rendering an adequate stewardship of their handling of other people's money in the past? Or if in the past the statements that have been made have been falsified, shall we now say that they have a vested right in concealing their wrong?

The legislative program of the last Congress was born out of the experience of the last few years. It might be said to focus as a whole upon two main ideas. The first springs from a determination that the economy of the nation can be ruled by the men who comprise it. It turns its back upon the conception of economics as at best a dismal science, of mankind as incapable of averting or altering the economic plagues that at intervals overtake a nation. And because of the rejection of such a conception, it is hope and not despondence that marks our progress. The second idea might appropriately be termed a moral idea, a realization that our ills have been due also to the weakening of our moral fibre, leading to easy temporizing with traditional and tried standards of right and wrong. The permeating character of such forces was slow to be comprehended, but with its discovery came a grim determination to restore to a numbed national conscience some semblance of sensitivity. It was of a spirit such as this that the Securities Act was born, free from the vindictiveness that might easily have been attached to it, reasonable in its demands and built upon tried experience in their formulation. It would be idle to pretend that it does not ask something of the security world, but it also promises much in return - the opportunity of creating a true and honorable profession by the assumption and adequate discharge of public responsibilities.

The Securities Act is not predicated upon the theory that the interests of investors are in conflict with the interests of the issuers. On the contrary, it embodies a recognition of the fact that the investor and the corporation are mutually dependent. Neither can continue to prosper at the expense of the other. A law which is founded upon this view of the matter and which seeks to give a practical meaning to the interdependence of these two interests, assuredly is a law that will work to the benefit of those corporations which, by telling their story to the public, can prove that they merit public confidence. Directly it will benefit them through helping to restore the confidence of their investors; indirectly also it will help them by making the distinction clearer between those concerns that do and those that do not deserve the continued support of the investing public.

We desire your cooperation in administering the law in that spirit.

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