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Commissioner, Securities and Exchange Commission

Before

the

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The Vermont Bankers Association

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I am very happy to have this opportunity to return to Vermont and to address a group of citizens of my native State. I am happy also to be permitted to describe in broad terms the work of the SEC. Since I am back home I may perhaps be allowed to make more personal references than might otherwise be appropriate.

It is interesting to note how greatly our lifes are affected at times by events which at the time of their occurrence seem of no personal significance to us. Thus in March 1925 when we read in the newspapers that Vice President Charles G. Dawes had overslept at the Willard Hotel in Washington and had arrived at the Senate Chamber too late to break a tie vote on the confirmation of the nomination by President Coolidge of Mr. Charles B. Warren of Detroit to the office of Attorney General, it probably occurred to none of us that that event would mean much to Vermont or would greatly influence the lives of any of its citizens. Yet the important results were that Mr. Warren was not confirmed and that one of our associates whom we respected and loved so much, John G. Sargent, became Attorney General of the United States. I remember vividly how on St. Patrick's Day in March 1925, while General Sargent and I were trying to clear up a statutory snarl relating to the then embryonic Bennington College and while the legislature was still in session, the electrifying news swept through the old Pavilion at Montpelier and through Montpelier and Vermont that President Coolidge had nominated "Gerry" Sargent to that high office. For me, one of the important and unforeseen consequences of Mr. Dawes' nap was that in February 1928 I was invited to become the Chief Counsel of the Federal Trade Commission.

Likewise it seemed of little personal significance to most of us that in 1923 Senator Thomas B. Walsh of Montana had made an outstanding record in his investigation before a Senate Committee of the Teapot Dome scandal. It also escaped the attention of many of us that in 1927 the Federal Trade Commission, as the result of a resolution sponsored by Senator George R. Norris of Nebraska, had reported to the Senate the results of its study of the extent to which the General Electric Company monopolized or controlled the generation and transmission of electric power. In its report, the Federal Trade Commission had described in broad outlines the growth of holding companies and their control of electric operating companies, had called attention to their rapid growth and sounded some warnings regarding the practice of piling one holding company on top of another and the abuses and financial risks inherent in top-heavy pyramiding. Yet these events influenced the lives of some of us and quite directly mine. For in February 1928, eight days before I entered the employ of the Trade Commission, the Senate adopted a resolution directing the Federal Trade Commission to investigate the electric and gas utility industry. As offered in its original form by Senator Walsh, the resolution called for an investigation by a Senate committee. It was vigorously contested by the industry, many of whose members remembered all too vividly the thorough and revealing efforts of Senator Walsh in the Teapot Dome matter. The resolution was amended to provide that the investigation should be made by the Federal Trade Commission. There were many who thought this meant that the investigation was buried and I suspect that some members of the industry were among them. They were mistaken, for the Federal Trade Commission did a thorough job. In my opinion it was done impartially and fairly. The greatest complaint against it came from those to whom daylight was most offensive and injurious.

In March 1928 the Commission called its first public hearing and began the work of investigating. Early in 1929 Insull found that The Middle West Utilities Co. could not earn the charges on its debt and preferred stock. The Associated Gas and Electric Company, which under Hopson's management had grown from $6,000,000 in 1923 to $1,000,000,000 in 1929, began in that year to sway on its porous base like a "Galloping Gertie". Alarming fissures began to appear in the foundations of several other heavily pyramided holding companies. Foshay who obtained a slight foothold in Vermont was on his way from Minneapolis to Leavenworth. Prison gates were awaiting Hopson. The doors of the Bankruptcy Court were awaiting Associated. Both Hopson and Associated finally entered, though somewhat tardily. In October 1929 occurred the great stock market crash, the first nationally audible announcement of the advent of a major depression. At the beginning of 1930, the Federal Trade Commission investigation was still under way and evidence of improper financial and accounting practices of only a few companies had been introduced into its record, but voluminous evidence of the use of propaganda, influence, money and other means of building a body of public opinion favorable to the utilities over a period of years had been produced. As finally completed in 1935, the results of the investigation are contained in nearly 100 volumes. I shall say nothing of my part in the investigation except that I was in the thick of it from March 1928 until June 1934.

In 1932 Franklin D. Roosevelt was elected President. In 1933 Congress enacted the Securities Act of 1933 and in 1934 the Securities Exchange Act. It had become clear to all careful observers, including the better element in the business and financial community, that the lax standards which prevailed in the roaring twenties were undermining the integrity and health of our capital markets, were destroying investor

confidence and were leading the business and financial enterprises of this country to disaster. Everyone who honestly appraised the situation appreciated the pressing need for the preservation of high standards of conduct if the American system of private capital and democracy were to survive. Promoters of new enterprises and those soliciting additional capital were seeking other people's money. Corporate managements were managing businesses financed by millions of investors who had little or no voice in the management. Insiders were using other people's money to manipulate the markets for their own selfish ends to the detriment of innocent investors. It is trite but true that there was an orgy of speculation. Experiences of a decade of feverish activity subjected to little or no regulation by the federal government clearly revealed the need for legislation which would require those using or soliciting the use of other people's money to conform at least to the minimum standards of fiduciaries or trustees, to the end that investors might be protected. Tonight I shall try to tell you as much as I can in the twenty minutes allotted me of how the statutes administered by the Securities and Exchange Commission serve to protect the investor, an end in which I am sure all of you are vitally interested.

The Securities Act of 1933 calls for full and fair disclosure of material facts concerning the issuer whose securities are publicly offered and sold in interstate commerce or through the mails. The Act is also designed to prevent fraud in the sale of securities. Under it, the Securities and Exchange Commission does not pass on the merits of securities. One can offer for sale any security if he registers it and tells the truth about it. It is our job to see that the truth is told. With the exception of certain security offerings which are exempt from registration, an issuer must file with the Commission a registration statement containing adequate data concerning its management and financial condition. Dealers who

participate in the distribution of securities must provide their customers with a prospectus, which is a condensed summary statement of the information contained in the registration statement. The registration statement must be effective before the securities may be offered for sale. Both the registration statement and the prospectus are open to public inspection and to examination by the Commission staff immediately after filing. Members of the Commission's staff are available in Washington and in the regional offices to aid registrants in selecting the form to be filed and in filling it out. The registration statement goes to the Registration Division of the Commission, which is composed of a staff of accountants, security analysts, examiners, and attorneys, for their examination. If the statement appears to be misleading, inaccurate, or incomplete on its face, the issuer is advised as promptly as possible and may file amendments to meet such deficiencies. The examination of a registration statement is concerned only with the completeness and accuracy of the information furnished by the issuer and the fact that a registration statement is permitted to become effective must not be considered as a finding by the Commission that the security has investment merit. We believe that the technique of disclosure utilized by the Securities Act of 1933 does in a considerable measure serve to protect investors, even so-called sophisticated investors. You will recall the period when small banks throughout the country were loaded with bonds and other securities which had little behind them except the prestige of a big metropolitan bank which was slyly bailing itself out. You also will remember -- although the memory, I imagine, is a painful one -- the disheartening difficulties which bankers experienced in the performance of their function as administrators of trust funds. Today the requirement that a prospectus be furnished which conforms with statutory standards of disclosure serves to supply the investor

with information which gives him the opportunity to reach an informed judgment as to the merits of securities which are offered for sale. Perhaps of even greater significance to you, as bankers, is that you now have a fair chance to appraise the value of trust securities on the basis of fairly complete information which is highly likely to be accurate and that, consequently, your ability to select appropriate securities for investment in the administration of trust funds is heightened.

In June 1934, after extensive public hearings, the Securities Exchange Act of 1934 became law. The Securities and Exchange Commission was formed to administer that Act as well as the Securities Act of 1933, which theretofore had been administered by the Federal Trade Commission. The newly formed Securities and Exchange Commission consisted of Joseph P. Kennedy of New York, Chairman, George C. Mathews of Wisconsin, James M. Landis of Massachusetts, Ferdinand Pecora of New York and myself. The Securities Exchange Act of 1934, like the Securities Act, relies principally upon the technique of full disclosure. One of our most important functions under this Act is to prevent manipulative, deceptive, or other fraudulent practices in the trading of securities. In addition, the Act sets up administrative machinery for the regulation of national securities exchanges and, to some extent, the over-the-counter market with a view to providing reliable and current information concerning securities traded on the exchanges. It requires adequate and truthful disclosure in regard to the solicitation of proxies and transactions by insiders such as officers, directors and large stockholders of a corporation. Regulation of the use of the national credit to finance trading in securities is accomplished through margin requirements established by the Board of Governors of the Federal Reserve System and enforced by us. Like the Securities Act of 1933, the Securities Exchange Act of 1934 provides civil remedies for injured investors and imposes criminal penalties for violation.

People sometimes wonder what good it does to file registration statements in Washington. Who besides the Commission's staff looks at them, they ask? Yet the fact is that the Commission's files comprise a tremendous fund of information which is in constant demand. This information is digested by representatives of statistical services, experts from security departments of banks and insurance companies, representatives of state governments, members of stockholders committees and others and the information is passed on to the public in numerous ways and in a form which is readily grasped. The Commission itself issues to all who are interested statistical releases designed to make available analyses of stock exchange trading and other similar data. In addition, condensed financial statements and statistical analyses are published for most of the listed companies in the form of a Survey of American Listed Corporations. Perhaps one of the most important results of the requirements of full and fair disclosure is the effect which it has had on accounting practices. The responsible accountant feels that he owes an obligation to the public to prepare informative and accurate reports. The accounting profession welcomed the disclosure requirements of the Securities Act and the Securities Exchange Act because the passage of those acts and their administration by the Securities and Exchange Commission have been instrumental in bringing about numerous important reforms in accounting and auditing techniques. Furthermore, the disclosure requirements have aided accountants in their desire to adhere to high professional standards which formerly were sometimes undermined by unscrupulous competitors who were willing to compromise their principles for a fee.

By 1935 the intensive investigation of holding company systems conducted by the Federal Trade Commission had been completed. It was abundantly clear that the holding companies had outgrown the states and that national legislation was essential to protect investors and consumers from the effects of

abuses which had developed as a result of the practices of many unregulated holding companies and the inability of state commissions to cope with the problems created by vast systems scattered over many states.

I shall not pause to describe the huge arbitrary write-ups and profits to affiliated persons and corporations found in the accounts and records of several holding companies and their operating subsidiaries or to appraise the private system of inflation which several, not all, of them had established for the benefit of a few. I will not parade before you the unwinsome holding company practices which prevailed unchecked in the days preceding the enactment of the Holding Company Act. The investigation of the Federal Trade Commission revealed a number of such instances within the boundaries of our own State of Vermont. For example, The Twin State Gas and Electric Company was organized by Bickmore & Co. in 1906 to acquire the properties of Dover Gas Light Co., Brattleboro Gas Light Co. and Brattleboro Street Railroad Co. The latter three companies were owned by Bickmore & Co. When the Twin State company, controlled by the Bickmore interests, acquired the two Brattleboro properties from those same interests, it paid $743,690 for them although their total original cost was $317,870. In other words, these properties were given a value of 135% in excess of their total original cost. Similarly, when Bickmore sold the property of the Dover Gas Light Co. to Twin State, it was set up on the books of Twin State at a value of $1,655,310 although Bickmore & Co. had paid only $587,500 for the property. This represented a write-up of 182%. Representatives of Samuel Insull paid $66,453 for the property of the Bennington Gas Light Co. early in 1913 and in October 1913 sold it to Twin State, then controlled by Insull, for $366,000. They bought the St. Johnsbury Electric Co. for $357,662 in January 1913 and sold it to Twin State in October

of that year for $1,521,266. The story of intercompany profits in connection with the Connecticut River Power Company and the developments on the Deerfield River and the details as to the large sums improperly capitalized in their property accounts are all found in the records of the Federal Trade Commission whose authenticity is beyond dispute. The harmful effects of such practices upon investors as well as consumers need no elaboration.

In 1935 I was a member of the National Power Policy Committee and was asked to become Chairman of the subcommittee which was entrusted with the task of drafting appropriate legislation. I accepted on the condition that Mr. Benjamin V. Cohen participate in drafting the bill. Mr. Cohen is one of the finest legal scholars as well as one of the finest human beings I have ever met. He agreed to help and his thorough knowledge of the problems involved and his skill in draftsmanship were principally responsible for the drafting of the bill. We all remember the intense opposition of the holding companies and others to the enactment of this legislation. A long and bitter fight ensued before the Senate and House Committees and on the floor of Congress. Finally the struggle culminated in the enactment of the Public Utility Holding Company Act of 1935 and its administration was entrusted to the Securities and Exchange Commission.

The powers which we exercise in the public-utility field are somewhat different from those under the Securities Act and the Securities Exchange Act. We are a sort of public service commission for holding companies in the electric and gas utility field. Under the Public Utility Holding Company Act we supervise various activities of holding companies and their subsidiaries, involving not only the issuance of securities but also various types of financial practices. Our powers here are not restricted to requirements of disclosure but are more of a regulatory nature. However, one of the fundamental

objectives of this Act too is the protection of investors. I shall not attempt to describe the Holding Company Act and its administration in detail but will try to give you a picture of its salient features. The Act provides that a holding company cannot use the mails and instrumentalities of interstate commerce for specified purposes unless it is registered with the Securities and Exchange Commission. The registration requirement was upheld as constitutional in March 1938 by a Supreme Court whose membership then included only two justices appointed by President Roosevelt, one of whom did not participate in the decision. Mr. Chief Justice Hughes wrote the opinion and there was but one dissent. When the holding company registers, it and its subsidiaries become subject to regulation in their intercorporate dealings, in respect of the issuance and sale of securities, the acquisition of property or securities, the making of intercompany loans, the payment of dividends, and other matters. Control of accounting methods of holding companies is provided for and the Commission must pass upon all plans for the reorganizations of registered holding companies or their subsidiaries. It is the duty of the Commission to require the geographic integration and corporate simplification of public utility holding company systems. Service, sales and construction contracts are regulated and service within a system must be at cost. Mutual or subsidiary service companies may be formed with the approval of the Commission and we control the accounting methods of such service companies. With respect to some of these powers, we act in collaboration with state regulatory agencies. For example, if a state commission approves the issuance of securities by an operating company and the issue and sale of such securities are solely for the purpose of financing the business of the operating company, we must exempt such

issue from the provisions of the Act which would otherwise have to be met. We have not enacted accounting regulation for local operating companies although we have the power to do so. The regulation of service companies was placed exclusively within the jurisdiction of the Securities and Exchange Commission because they present problems which cannot be handled by any one state commission.

In the old days the service company was either the holding company itself or a wholly-owned subsidiary. They serviced or managed their controlled operating companies for a fee and a profit, often a large one. There was no semblance of arm's-length bargaining. The holding company in effect sat on both sides of the table. The service fee including the profit was sometimes capitalized in the operating company's property account. More often it was a part of the operating expense, deductible from gross income in computing the fair rate of return permitted by law, deductible also before interest on debt. The unearned or excessive service fee was a special dividend disguised as an operating expense. It was unjust to the consumer and the senior security holders of the company paying it. Even today, the fair allocation of service fees in a large holding company system is quite difficult, granted the best of intentions on all sides. When the holding company controls both the service company and the company being serviced it is not too easy to judge whether the company receiving services really needs them. For these reasons the Act provides that any State public service commission may call on us to investigate the question whether the operating company needs the services and whether the charges are fairly allocated. It was under this section that in the summer of 1940 the Vermont commission asked us to study the service fees charged by the New England Power Association's service subsidiary to two Vermont operating companies, the Green Mountain Power Corporation and the Bellow Falls

Hydro-Electric Corporation. At the outset, I wish to emphasize that there is no suggestion of dishonesty or fraud on the part of the New England Power Association or the Green Mountain Power Corporation or the Bellow Falls Hydro-Electric Corporation or any of their officers. It is my sincere opinion that the action of the Vermont commission in asking us to make this study was definitely in the interest of the consumers and rate payers in Vermont. Furthermore, the making of such a study was beyond the power of the Vermont commission or any other state commission. My reasons for saying so are that the New England Power Association is a Massachusetts association outside the jurisdiction of Vermont. It has five sub-holding companies and forty-five public-utility operating companies in the states of Vermont, New Hampshire, Massachusetts, Rhode Island and Connecticut, all served by the same servicing subsidiary. The Vermont subpoena does not run to those jurisdictions. The study was made and the results are described in a report by our staff which we published and submitted to the Vermont Commission and the company in May 1941. A hearing on it will be held before us in Washington next Monday. There was complete co-operation by the New England Power Association at every point. As the hearings developed they recognized several weaknesses and inequalities in the situation and proceeded to correct them at once. Other points will be the subject of discussion between us. The questions are -- and they are not easy for anyone to decide -- what services do the Vermont companies need? How much of them can they do for themselves? Are the charges equitably allocated between the holding companies on one side and the operating companies on the other, and are they equitably allocated as between the numerous operating companies themselves? Are the Vermont companies and therefore the Vermont consumers paying what is in reality and fairness the cost of running the holding companies and not of running the operating companies? None of these questions

would arise if all the companies involved were not subject to common control. To all of them with the continued co-operation of the Vermont commission and the companies involved we hope to find the correct and fair answer.

You have probably heard more talk about the provisions of Section 11 calling for the geographic integration and corporate simplification of holding company systems than any other feature of the Act. While the Holding Company Bill was being debated, opponents of the bill inaccurately but dramatically labeled the integration provisions of the Act the "death sentence". By the widespread publicizing of this misleading designation, an effort was made to create the impression that the Securities and Exchange Commission was about to destroy the utility industry. It has persisted to the present day and has caused confusion among investors. There is no basis in fact for that impression and it is entirely false. Our enforcement of Section 11 does not harm investors and I believe that compliance with its provisions actually will benefit investors. Only last Wednesday, the Wall Street Journal carried a story that the preferred stock of Commonwealth & Southern Corporation made a sharp advance immediately following the news that Commonwealth & Southern may take steps to comply with the Act and dispose of its northern properties. The law is designed to eliminate only the superfluous or injurious intermediate company, which has no real economic function but lends itself to manipulation of securities, the pyramiding of control, and the milking of operating subsidiaries. The Act also sets a limit to the concentration of power in the electric and gas industries and is designed to set reasonable limits to the area within which a holding company is permitted to control the management, organization and operation of gas and electric utility companies. If we bear in mind that utility companies are usually granted monopolies in the communities in which they operate, we see how important is the problem as to how many of these monopolies one holding

company may own. It is readily apparent that the policy of Section 11 is akin to the philosophy of the Sherman Act, which bears the name of a Republican Senator, is said to have been drafted by our own Senator Edmunds of Burlington and was signed by Benjamin Harrison, and the Clayton Act which was passed during a Democratic administration, and was signed by another great American, Woodrow Wilson. Parenthetically, I remind you that one of our greatest presidents, Calvin Coolidge, never spoke of the Sherman Act except to praise it and that without any ballyhoo Gerry Sargent hung up a record for injunctions and convictions under that Act which has been inadequately recognized.

The Holding Company Act is not designed to promote nationalization or public ownership of utilities. It is not being so administered. It is intended to remove from operating companies the shackles of remote control by holding companies so as to facilitate local regulation. Unless I miscalculate, I believe that the time is not far off when Connecticut will not have one electric light company owned by a foreign holding company. Furthermore, it should be remembered that the statute provides ample time within which compliance with our order may be effected. One year is given for compliance as a matter of right in all cases. In addition, upon a showing that the company has been or will be unable in the exercise of due diligence to comply within that time, the Commission must grant an additional year if it finds such extension necessary or appropriate in the public interest or for the protection of investors or consumers. Even then the time when we may apply to the courts for enforcement is entirely in our hands. Once the case is in the hands of the court of equity, we all have every right to believe that equity will be done.

Under the Holding Company Act of 1935 the utility house is being set in order. Inflation is being taken out of balance sheets. They are being dehydrated. Debt is being reduced by every legitimate device to establish conservative ratios. In the same way the depreciation reserve, that red-headed stepchild of the holding companies, is being built up to good health. We have the unpleasant duty of cleaning up behind the Foshays, the Insulls and the Hopsons and their kind. But the job must be done if the utility business is to be restored to health and sanity and protected against future infection from similar septic sources. It is being done. Its benefits will outlast us. The beneficiaries will be the operating companies. We are helping to build a better future for the operating companies, their investors and customers. To the conservatives among you, to the supporters of private capitalism I suggest that if regulation of these utilities does not succeed, the public will turn more and more to public ownership and operation.

Studies and investigations conducted after the enactment of the three statutes which I have already discussed indicated that additional legislation was needed to achieve more fully the object of protecting the investor. In 1934, Congress directed the Securities and Exchange Commission to make a study and investigation of the work, activities, personnel, and functions of reorganization committees and to report its findings. This was done under the leadership of William O. Douglas who came from Yale to the SEC staff, later became first a commissioner, then its Chairman and still later a Justice of the United States Supreme Court. The disclosures resulting from the Commission's investigation and reports to Congress gave

impetus to a reform of the National Bankruptcy Law. In 1938, Congress enacted Chapter X of the revised National Bankruptcy Act, known as the Chandler Act after its sponsor, Congressman Walter Chandler of Tennessee. Chapter X contains provisions authorizing the Securities and Exchange Commission to participate in bankruptcy proceedings as the investors' representative and as an aid to the court. The Commission is empowered to prepare for the benefit of the courts and investors advisory reports upon plans of reorganization submitted in such proceedings. This report, which is not binding on the court, is an independent analysis designed to provide the court with a non-partisan survey of the plan, appraising its fairness and soundness and revealing any weaknesses or inequities. In addition, the Commission, through its participation in the proceedings may make certain that adequate notice is given to the security holders and that other technical matters are observed such, for example, as the provisions requiring that committees disclose relevant information concerning their affiliations, appointment and security holdings. In brief, when a reorganization takes place which may affect the rights of a substantial number of investors, the Commission's staff is in court helping the judge get at the facts and exerting its influence to protect the rights of the investor, so often the great inarticulate.

In the same year the Maloney Act, named for its sponsor, Senator Francis Maloney of Connecticut, was passed in the form of an amendment to the Securities Exchange Act of 1934. In 1934 Congress had recognized the need for regulation of the over-the-counter markets but had not given the Commission specific instructions as to how such regulation should be carried out. In 1936 the first step was undertaken when a simple licensing

system for over-the-counter brokers and dealers doing an interstate business was set up. This licensing arrangement was little more than an effort to identify those who were engaged in the over-the-counter trade. It had little appreciable effect in raising business standards. It was obvious to everyone, particularly most of the over-the-counter brokers and dealers themselves, that a more effective supervision of the over-the-counter market was necessary. After discussion between the Commission and representatives of the over-the-counter group, an effective program of self-regulation was put into effect in 1938 with the passage of the Maloney Act. Under it an association of brokers and dealers may register by filing with the Commission its charter, by-laws, and other formal papers including the rules governing the conduct of its members. The Commission can not permit registration unless it is satisfied that the organization is actually representative and is to be conducted in a democratic manner. The rules of the association must be designed to prevent manipulation, promote fair trade, safeguard against unreasonable profit or commission rates, prevent discrimination and in general protect the investor and the public interest. To date there has been one association registered, the National Association of Securities Dealers, whose membership exceeds 2900 and includes nearly all of the well-established over-the-counter firms. It has worked closely with the Commission on its program and has become an effective representative of the over-the-counter industry.

Another step taken in the program for the protection of investors was the enactment of the Trust Indenture Act of 1939. Prior to 1939 most of the average indenture was devoted to exculpating the trustee. This Act aims to bring all indenture trustees up to the high level of diligence and loyalty maintained by more conscientious trust institutes and to place the trustee in a better and more strategic position to protect security holders. The means adopted is a requirement that bonds, notes, debentures and similar securities publicly offered for sale be issued under an indenture which meets satisfactory standards and has been duly qualified with the Commission. The Act provides for real and independent trustees and sets up their qualifications.

In the Holding Company Act Congress directed us to make a study of investment trusts and similar companies. The task of supervising it fell to me. The study was made and is covered in our reports to Congress, all of which are not yet printed. We recommended remedial legislation and in August of last year the President signed the Investment Company Act of 1940. The Act gives the Commission authority to supervise and regulate investment trusts. The investigation had confirmed widespread suspicions concerning existing abuses and revealed case after case in which investors' funds had been used to serve the selfish interests of unscrupulous promoters. In 1936 there were over 1,000,000 holders of investment trust securities and the assets of the companies ran into billions of dollars. The Commission's studies indicated that through their ownership of voting securities these companies exercised control and influence over banks, insurance

companies, aviation and steamship companies, oil and chemical companies, and other companies having total resources of approximately $30,000,000,000. There were several instances of outright looting and we have helped to convict some of the looters, but I do not believe that there is any need for describing in detail to this audience the gross mismanagement of many investment trusts and the dishonest practices which flourished among the promoters and managers of some of these companies. Neither do I wish to give the impression that all of these companies were handled dishonestly, yet bad practice was common enough so that the legislation which was adopted was desired by the investment trust industry itself. The terms and provisions of the Investment Company Act were worked out in conference between representatives of the Commission and of the investment trust industry and Congress. The honest and respectable elements in the investment trust business recognized that the abuses which had existed had cast discredit upon their operations and they joined in urging the passage of the Act. It passed both houses without a vote against it. It should help in the establishment of the investment trust as a socially useful and desirable instrument, though to be candid I must add that there are one or two unusual types whose desirability and usefulness are yet to be proved.

The Investment Company Act provides for the registration and regulation of all types of investment trusts and investment companies. It is designed to provide investors in all investment trusts with adequate information concerning the operations of their companies. Among other

things, it "will prohibit persons convicted or enjoined in connection with security frauds from being associated with these organizations, will insure the presence of independent members of boards of directors; will prohibit the unloading of securities by controlling persons and other insiders on their investment companies; will prevent the future pyramiding of one investment company upon another; will markedly simplify capital structures of investment companies and afford some measure of protection for senior security holders in these organizations; will tend to establish fair pricing and selling methods of investment company securities; will prohibit the issuance of stock for services and eliminate tricky management's voting stocks; and will provide a more reasonable sales load on instalment plans and insure these investors a more equitable interest in the fund". The Investment Advisers Act of 1940 which was passed at the same time, provides for the registration of all persons engaged in the investment advisory business and prescribes prohibitions against certain abuses which have been found to exist. Both of these acts became effective November 1, 1940.

At the risk of repeating many things which you probably already know, I have felt that it would be helpful to give you a general picture of the work of the Securities and Exchange Commission. Of course, I have omitted many broad aspects of our work but I hope that what I have said has been sufficient to make it clear that the fundamental purpose of practically all our work is to insure adequate protection to the millions of investors whose savings enable our industries to function. I believe that honesty and fair dealing are traditions among us. Such traditions are one of the integral assets of a nation.

Fundamentally all of the Acts administered by the Commission have as their objective the preservation of this national asset. The truth is that a substantial part of our activities is caused by the so-called liberalization of the corporation laws of the various states, the establishment of corporation Renos which has been due to the states' greed for incorporation fees in the race which Justice Brandeis has characterized as "one not of diligence but of laxity". Another part is due to the failure of so many fiduciaries whether trustees, officers, directors or members of reorganization committees, to discharge their obligations as fiduciaries, a failure to which our distinguished Chief Justice, Harlan Fiske Stone, not long since ascribed most of the mistakes and major faults of the financial era which had drawn to a close in 1934. Another part is due to the failure to live up to plain old-fashioned standards of honesty and fair dealing. Altogether these failures are as much a menace to our system of government and to the American way of living as anything that comes from Russia, Germany or Italy.

There are some who assert that the Securities and Exchange Commission is antagonistic to business and that its activities fetter the free flow of capital into industry. Such assertions I can deny on the basis of my own experience. I know that the Commission is not antagonistic to business, that it welcomes its cooperation and that it favors the flow of capital into industry. We will not, however, within the limits of our power, permit to go unchecked any activities and practices which are based on deceit even though they profess to be conducted for the sole purpose of improving the capital market. We all

know that investment of idle funds will rise in proportion to the restoration of the confidence of investors which was shattered by the shocking evils which prevailed in the 1920s. We shall do our part toward helping the Stock Exchange earn and deserve a restoration of the confidence which old practices weakened and which the imprisonment of its President routed. One way to restore such confidence is to deserve it; another is to make sure that corporate officers observe their fiduciary duties. That is in part the job of the Securities and Exchange Commission and I believe that with the continued cooperation of the great majority of honest men in business and finance we shall accomplish it.

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