TWENTY-FIVE YEARS OF THE SEC -- THE UNDERLYING TRENDS

Remarks of

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As the current Chairman of the Securities and Exchange Commission, it is a rare and great privilege for me to welcome to the celebration of the 25th anniversary of the founding of that agency this group of present and past members and employees of the Commission.

It is appropriate and, indeed, the temptation is irresistible, on such an occasion to reminisce and philosophize a little about how the Commission came into being and what it has done over an eventful quarter-century. It would be inappropriate here, even were it possible, for me to deliver a treatise on the statutes and the regulations which implement them. Although it might be appropriate, it is unfortunately impossible within any reasonable compass of time for me to place before you a summary of all the events, the hard decisions, the careful analyses, the dramatic incidents and the plain hard work of so many, in and out of Government, which go to make up the history of the Securities and Exchange Commission and which make it what it is. All that I can attempt to do is to mention a few of the considerations which underlie the creation and the work of the Commission, and upon which the learned and able speakers whom we honor here as our special guests will doubtless expand.

The Federal securities laws, and the Commission they created, emerged against the background of a rapidly expanding economy and a financial system whose development had outrun its legal controls. The rise of the modern corporation as the principal instrumentality through which the business of the people was done, brought with it the modern capital markets. Tens of thousands of corporations were conducting business enterprises, often of great size, and were using and requiring vast quantities of capital obtained from millions of investors through the issuance and distribution of securities on a nationwide scale. Management was separated from control and an increasingly intricate mechanism of securities exchanges, investment bankers, brokers, dealers, financial institutions, investment companies and holding companies had come into being. In this setting, the opportunities for fraud, financial juggling, over-reaching and abuse of trust were manifold.

Three main legal mechanisms then existed which served in some measure to control the financial markets - state corporation laws, state securities laws, and common law principles developed and applied by the courts. Some of the state corporation laws, however,

were framed in an earlier and more disingenuous era, while others were unabashedly designed to attract incorporators and fees by providing for only a minimum of control over the use of other people's money. State securities laws likewise varied in their adequacy and in the vigor of their administration, and from their nature they could not control a nationwide financial system where securities transactions commonly flowed across many states. Common law doctrines, while furnishing a foundation of law and principle on which much of our present structure rests, could not in and of themselves regulate the capital markets.

All these chickens came home to roost in the great debacle of 1929. The demand for reform became irresistible. Searching and comprehensive investigations, notably that made by the Senate Committee on Banking and Currency under the leadership of its counsel, Judge Pecora, made it perfectly clear that something had to be done. Exactly what, was a question with which a fantastically able group of men struggled night and day for months.

In addition to the laissez faire concept, three principal approaches were contending for recognition. Under one of these, the job of reform would be turned over to the financial community, particularly the stock exchanges, perhaps under some Government supervision. The second approach, going perhaps to the opposite extreme, envisioned substantive Government control over access to the capital markets, as well as over the conduct of business. The third position relied primarily upon disclosure, on the theory that the light of publicity would deter misconduct, and that the investor could then protect himself, or at least could make an informed investment decision.

While it is usually said that the last of these approaches was adopted by the Congress, and this in the main is correct, the fact is that substantial elements of the other philosophies were incorporated into the final statutory structure. The first view, that of self-policing, finds expression in the considerable autonomy granted to the stock exchanges, and particularly in the 1938 amendments to the Securities Exchange Act which established the National Association of Securities Dealers as an instrument of self-regulation to define and enforce just and equitable principles of trade. Substantive Government control of various matters is provided in the Securities Exchange Act, and particularly in the Public Utility Holding Company Act of 1935, and the Investment Company Act of 1940 which are far from being merely disclosure statutes.

There first emerged from this philosophical struggle two Federal securities laws and the creation of the Securities and Exchange Commission. The first of these laws -- the Securities Act of 1933 -- was the famous "truth in securities" law. Essentially it enacted the principle of full disclosure to investors in connection with new offerings of securities and a Federal prohibition of fraud and misrepresentation in connection with all securities transactions. The second of these laws -- the Securities Exchange Act of 1934 -- dealt with a broader area and is of more intricate fabric. It proclaimed that the great stock exchanges were institutions vested with a public interest and hence subject to Federal regulation, extended the principle of disclosure into the trading markets by requiring current and adequate information about issues of securities traded in those markets, sought to curb abuses of their trust by corporate officials and other insiders and met the problems created by the diffused over-the-counter market through the registration and regulation of brokers and dealers. It provided for a Securities and Exchange Commission to administer this and the 1933 Act, which was to and did organize on July 2, 1934.

The subsequent history of the Commission thus created can perhaps be divided into three principal eras. The first seven years, from 1934 to Pearl Harbor, was a period of creation. The Commission and its staff were concerned with making this new machinery work and with filling in broad statutory directives with the detailed requirements which would implement the concept of fair dealing and fiduciary responsibility underlying the statutes. This was a monumental task. In the first place, nobody knew and many doubted whether this regulatory pattern could be superimposed upon the financial markets without bringing everything to a grinding halt. Such an outcome was predicted, and it could have happened. That it did not do so is a tribute to the administrative skill displayed at the Commission and to the willingness of many in the securities industry to lay aside their doubts and their natural repugnance to regulation and to pitch in with the Commission to make the new machinery work.

Perhaps the most interesting example of this is the working of Section 8 of the Securities Act. A visitor from Mars reading this Section would conclude that if there was anything wrong with a registration statement, the Commission would order a hearing upon the question of a stop order, and, if not, the deal would rest quietly upon the shelf for 20 days and then proceed without further reference to the Commission. As you all know, nothing of the sort happens or could happen. If every

deficiency in a registration statement was corrected by a stop order, there would be precious little new financing. Moreover, few underwriters can afford to stand hitched for 20 days while the market fluctuates in its habitual and unpredictable way. The solution, the technique of the deficiency letter and the price amendment, now so familiar that we hardly conceive of it being done any other way, overcomes these apparently insuperable obstacles while still fully complying with the letter and spirit of the law. This is cooperative administration of a high order.

During this period concepts were developed and embodied in rules, decisions and practices, which gave solid substance to the abstract idea of honest, orderly markets and investor protection. It was also a period of testing -- testing of the statutes and of the Commission. It was during this period that basic legal questions were determined and the pattern of the regulation and the scope of the statutes established. This period, which was nationally one of slow economic recovery and of rebuilding of public confidence, also provided an opportunity for the financial and business communities to reflect on the dangers of too rapid growth and the excesses resulting from unbridled self-interest. It further provided time for the securities markets to adjust themselves and their processes to the standards and the controls provided by the statutes.

For, implicit in this process was a substantial change in the methods by which the securities industry did business. Not only was it necessary to alter the machinery of distribution to comply with the procedural requirements of the Securities Act, but it was also necessary to modify the rules and procedures of the stock exchanges in substantial measure. This latter task was a difficult and delicate one. Firmness was necessary to overcome the natural resistance to changing the accepted way of doing things, but at the same time the trading market with its intricate mechanism is no place in which to rush about swinging a big stick. Essentially the job had to be done through cooperation, discussion and voluntary action of the financial community rather than by administrative fiat. Conflicting views were accommodated and in the process the Commission, as well as the industry, had to make adjustments and each became conversant with the problems of the other. The functions of brokers and dealers were not segregated but rather conflicts of interest were minimized. Unlisted trading was not abolished but survived as perhaps the life blood of the regional exchanges.

With the support of the Commission, this period also marked the development of accounting principles and practices and a practical acceptance of the need for real independence of certifying accountants which imposed

standards in American financial reporting which are unsurpassed anywhere in the world. These principles and practices, which were forged on the anvil of hard cases, have set up a standard for the financial and business communities everywhere. Finally, there was an immense amount of research and investigation into all phases of the financial markets, done with admirable thoroughness and skill and which resulted in further legislation -- the Public Utility Holding Company Act of 1935, Chapter X of the Bankruptcy Act, the Trust Indenture Act of 1939, the Investment Company Act of 1940, and the major amendments to the securities laws themselves in 1936 and 1938.

The second period of the Commission's history comprises the years of the War and the immediate Post-War period. At the SEC, as everywhere else, the focus of its endeavor was on winning the War. The Commission contributed in no small part to this effort, although much of its work was shrouded at the time by military secrecy, and is unheralded and unknown to this day. As far as the securities laws were concerned, the emphasis in what effort was called for was on the consolidation of gains, refining procedures, eliminating red tape and creating a tight and efficient operation.

It seems that we are now in a third era, though it is hard to say exactly when it began, let alone how long it will last or how it is going to turn out. At any rate, for ten years or more we have been engaged in conforming the institution of Federal securities regulation to a burgeoning and dynamic economy, rapidly developing, changing and growing to unprecedented heights. We have a securities market now whose size and variety dwarfs that of the 1920's. New records in volume of financing and of capital raised, of trading on exchanges, of security values and of number of stockholders, have been established practically daily. Under these circumstances, it has been necessary for the agency to revamp and expedite procedures and engage in constant reconsideration of substantive approaches. In addition to this essential program of dynamism, and as a direct result of the increasing importance of the securities markets, the Commission has been required to face what it has never before really met on such a scale -- the problem of enforcement in all its aspects, particularly the problem of detecting promptly and of punishing adequately those who think of this new financial era merely as an opportunity for lining their own pockets.

There is some basis for the position that this question of enforcement has become different, not only in degree but also in kind. Of course, the Commission has always had enforcement problems. In the earlier years, it was necessary not only to guard against the confidence man who is always

with us, but also to deal with diehards from the old days who would not conform to the new standards until they were compelled to. In more recent years, we have encountered, in the first place, that increase in crime which predictably accompanies an increase in the opportunities for fraud and the mouth-watering rewards of success. More significant, and more dangerous, is the fact that a new generation of offenders has sprung up, familiar with our statutes and procedures, astute to exploit any loophole they can find and to cover their traces by subtle and sophisticated means. Perhaps the problem is a little like that of the medical men who develop a wonder drug. After a while the germs develop an immunity and you have to change the remedy. Among other requisite steps in such a situation are amendments to the statutes, such as those now pending in the 86th Congress, which are designed to strengthen our enforcement powers, and for us to consider some changes in our own rules.

When I thus divide the history of the SEC into three periods, distinguishable in terms of their dominant themes, I do not wish to imply that there is any lack of continuity in its activities. The basic aims of the Commission have been the same throughout the years as they were established by the astute and skillful men who drafted these statutes. The emphasis has shifted as events have demanded, and different means have been needed at different times. However, as we look back, we can clearly see a basic continuity in concepts through time and change, change not only in the problems but in the people on the job here. Commissioners and staff personnel have come and gone over the years, but the newcomers have inherited the basic ideas and ideals of their predecessors. The deeply learned and facile opinions of Judge Burns are still looked upon with respect within and without the agency, and the opinion in Gold Producers, Inc., 1 S.E.C. 1, is still good law and perfectly consistent with our release in 1959 of new regulations governing assessable stock.

What then is the significance of all that has been done over this period of twenty-five years? One thing is clear. We, and by we I mean all those in and out of Government who had a hand in it, have changed the aspect of the financial markets and changed it for the better. The activities of the SEC have contributed notably to better informed and sounder securities markets. But what is perhaps more important than all of the developments and improvements so wrought is the achievement of the legislative purpose that those who seek to manage the funds of the American people shall assume fiduciary obligations of a high order.

This achievement, however, is not a thing past and done. The laws are a permanent addition to the statutory framework of our society, and the

fundamental thinking which has been done in the SEC, and which is the foundation upon which we currently operate, has stood the test of time and will endure. At the same time, there goes on the unending job of adapting the institution to changing times, of modifying statutes, rules and ways of doing things so as to keep the underlying ideals a practical reality. The future is as challenging as the past, although in a different way. As the Securities and Exchange Commission has been sufficiently resourceful to meet the challenge of the past, so it will, I am convinced, be adequately adept to meet the problems of the future.

As the SEC faces the future from the sturdy vantage point of its past, it is fitting to recall that any human institution is made up of persons, of living men and women. This agency is fortunate in having a large proportion of its personnel who have the benefit of long years of experience. Of those who make up the complement of our staff today, there are some thirty-seven who were members of the organization when it was first established twenty-five years ago. Many of them are here tonight. I think it is fitting to ask them to stand in order that we may recognize their long, faithful and effective services.

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In view of the fact that this is an occasion marking an anniversary, honoring the achievements of twenty-five years, it is necessary to confess that the present personnel of the Commission are only five among thirty-four men who have held such office. So, also, this is not essentially a meeting in recognition of ephemeral Commissioners, but rather in recognition of the work which has been done since 1934 by the past and present members of the Commission staff. Accordingly, it seems proper that the present Commission and I bow as gracefully as possible out of the picture and permit the proceedings to be carried on from here by an alumnus and a former staff man. I have, therefore, asked the former Director of the Division of Corporate Regulation and later Associate Executive Director, who was so invaluable to me for all too short a time, to act as chairman of this dinner. It is a great personal pleasure for me to introduce to you my very dear friend, Ray Garrett, Jr., of the firm of Gardner, Carton, Douglas, Roemer & Chilgren of Chicago.