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TODAY'S CAPITAL MARKETS AND THE WORK OF THE SECURITIES AND EXCHANGE COMMISSION

Address of

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before the

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It is a great pleasure for me to be here this afternoon to address the Calvin Bullock Forum. As a person with deep roots in New York, I know the outstanding contribution which the Calvin Bullock Forum has made over the years since its founding in 1937 to the thinking of New Yorkers whose stature is recognized and whose influence felt not only throughout America but over the world. Consequently, I feel honored to be here. The title of my remarks is "Today's Capital Markets and the Work of the Securities and Exchange Commission." Let me start with a few words about the Commission.

A little short of two years ago, on September 24, 1953 to be exact, our Chairman, Ralph H. Demmler, addressed your Forum about "Current Thinking at the SEC." During the summer of that year, the membership of the Commission had been in part reconstituted by the appointment of three new Commissioners by President Eisenhower. We came aboard ship in June and July and spent the summer working hard in the development of a new program for the Commission. Mr. Demmler's talk to you that day in September two years ago set forth in broad outline our basic legal philosophy and also described with a considerable degree of specificity particular phases of the program upon which we were then embarking.

We are now at about the middle of the Presidential term and, in addition, Mr. Demmler's resignation as Chairman has been announced. These two things make it appropriate, I think, to look back at our projected program of the fall of 1953 and see just what has been accomplished in the administration of the Commission in the intervening months. I don't propose to do this with any degree of preciseness of detail, but I do want to describe some highlights.

First, as to philosophy, all of us at the Commission - members and staff alike - adhere to the basic premise which has come to be accepted by the responsible leaders of the securities industry in the past twenty years of the underlying legislative soundness of the Securities Act and Exchange Act under which our capital markets function today. The broad purpose of these statutes was to provide to investors and prospective investors in securities sold in interstate commerce or traded on national securities exchanges and in the over-the-counter market a broad basis of pertinent financial information about the issuing companies, and also to place on the companies issuing and selling new securities to the public, on brokers and dealers, on national securities exchanges, and on certain others, civil and criminal responsibility for misrepresentation and fraud. In the two years that I have been a member of the Commission, as well as during the previous ten or so years when I was engaged in the practice of law, mostly in the field of corporation finance, I have heard very few people seriously challenge the soundness of this legislation. The emphasis which our Commission, under Mr. Demmler's leadership, has tried to give to the administration of these laws has been toward fair and reasonable construction of the statutes and strong and effective enforcement policies.

Second, Mr. Demmler told you in September of 1953 that our Commission could properly act in an advisory capacity to the Congress in connection with a number of statutory revisions which various segments of the industry had long sought and which, indeed, were very much needed. I think one of the lasting accomplishments for which Mr. Demmler will be remembered as Chairman is the leadership which he gave before the Senate Banking and Currency Committee and the House Interstate and Foreign Commerce Committee in the Second Session of the 83rd Congress in helping those Committees fashion a bill, which went through the Congress unanimously and became law on August 10, 1954, which eliminated a number of unnecessary and technical complexities in the securities acts, and which also gave a sound statutory basis for the first time for the broad dissemination to the investing public promptly after a registration statement pertaining to a new issue of securities has been filed with the Commission of a preliminary prospectus describing the securities. The familiar 20-day waiting period was originally intended by the Congress as a period during which information about a new issue could be broadly disseminated. In practice, however, generally speaking, only underwriters, dealers and a few selected institutions received the prospectus during this period because of the doubts as to whether pre-effective distribution of prospectuses to the public generally might be regarded as an illegal offering. The amendments to the statute removed these doubts by making it clear that during the pre-effective period securities might be offered by means of the preliminary prospectus and, under rules to be adopted by the Commission, by means of a summary of the prospectus which had been filed with and reviewed by the Commission. I think this statutory change in the Securities Act is one of the great contributions of the Congress to making more practical and workable the statutory provisions governing the offering of new issues of securities.

Third, two years ago we projected an ambitious program of revision, consolidation, simplification and streamlining of the rules, regulations, and forms which had grown up at the Commission over the previous 18 years. In part, the purpose of this rule and form revision program was to make more simple and more certain the requirements imposed by the rules upon registrants and others under our jurisdiction. In part, the rule revision program was designed to make the information required more pertinent and easy to understand. In part, the program was motivated by the necessity of simplification of administrative techniques at the Commission to permit the reduction of our staff to fit reduced budgets. I don't propose to discuss all the rule and form revisions that have been adopted, but I will mention just two that are of major significance.

A new form (known as Form S-9) was adopted for the registration of non-convertible fixed interest debt securities. Informational requirements of this form are limited to five basic items, namely, financial statements of the issuer consisting principally of a balance sheet and a five year summary of earnings and surplus, a brief statement of the principal business of the issuer and related matters, a description of the use of proceeds of the financing, a description of the securities being offered, and the offering price information. Because of the substantially shorter prospectuses permissible with this form, the Commission is in a position to consider favorably requests to reduce the waiting periods between the filing date and the effective date for registration statements covering issues which qualify to use the form. The form is available only for use by an issuer which has been in business at least ten years, has a prescribed substantial earnings history and has filed annual and other periodic reports with the Commission under the Exchange Act. This form, I think, contributes toward the simplification of the financing process without in any way diminishing the investor protection intended by the Act.

Another rule which was revised during the early months of Mr. Demmler's chairmanship was the so-called Regulation X-14 pertaining to the solicitation of proxies for listed companies. Two basic clarifications were made. First, the shareholder proposal provision of the proxy rules was amended to conform to what had always been intended as the administrative practice sanctioned by the Courts to make clear that unless a proposal was a proper one under the laws of the state of incorporation it need not be included in the management's proxy soliciting material. Secondly, the shareholder proposal rule was revised so as to permit the omission of repetitive submissions and proposals which had received in prior submissions only very modest shareholder interest. These clarifications have been of considerable help both to the Commission, registering companies and shareholders in handling proxy material during the past two proxy seasons.

In the summer of 1954 the Commission considered whether the proxy rules should be further revised to provide more specifically for the processing of proxy soliciting material in proxy contests, but we decided to wait through the 1955 proxy soliciting season. This is now about over, and the staff is presently drafting additional rules to cover proxy contests more specifically than the general rules heretofore in effect. I might add, however, that these general rules in effect up to now have been applied so as to require each side in a proxy contest, whether the management or the outsider, to make disclosure of certain basic information to the shareholders from whom proxies were solicited.

Many other rule and form revisions have been made. They are described in detail in the Commission's 20th Annual Report to the Congress, issued in January, 1955, as well as in the releases by which they were put out for public comment and the releases by which they were adopted after such comment had been received and considered.

In addition, in the past two years the Commission's internal organization has been to a considerable degree revised, thus permitting a reduction in the number of the staff. In two years we have gone from 775 to 675 employees. We think this reduction has gone far enough and with the approval of the Bureau of the Budget have asked for a modest increase for the 1956 fiscal year. The increase in personnel is in part needed because of the thinness of our broker-dealer inspection program in our field offices and because of additional enforcement work brought about by the present high market activity.

These are but a few of the accomplishments of the Commission during the past two years. I will now turn to a direct discussion with you of some of the factors affecting the capital markets today and the impact of the Commission on the functioning of these markets.

The proper functioning of the securities markets is indispensable to a healthy and sound economy in America. Our Commission is not an economic agency. Our function is the regulation of the securities markets according to legal standards laid down by the Congress. The agencies of the Federal Government whose impact is economic -- so far as the securities markets are concerned -- are the Treasury and the Federal Reserve System, not the Securities and Exchange Commission. Nothing that I say here today has anything to do with past, present or future prices, or price levels of securities.

However, our Commission as a regulatory agency is in a position to observe how the securities markets function and whether they are fairly conducted. Sometimes a market that is generally functioning well, that is generally fairly conducted, develops soft spots at which sharp dealing and improper or illegal practices show up. I will make a few observations at the end of this talk on some influences in the marketing of certain types of securities that are unhealthy and should be corrected.

The attention of the American people was recently directed to the stock market by the study made by the Committee on Banking and Currency of the United States Senate. I'm sure most of you followed the news accounts of the daily parade of witnesses at the hearings which lasted for several weeks, from March 3 to 23. Those who testified before the Senate Banking Committee were recognized leaders in Government, business, economics and labor, or were "elder statesmen". They gave a great deal of interesting testimony about how the securities markets operate, their relationship to the Government and the public, and their relationship to the national economy.

Also, thousands of individuals, bankers, brokers, dealers, stock exchanges and others received questionnaires from the Senate Banking Committee, and supplied answers, on the subject of recent and not so recent rises in the market prices of stocks. Thus, an enormous amount of expert opinion was gathered into the hands of the Committee. This is presently under study by the Committee and by the Committee's professional staff. Further hearings on one phase of the study -- proxy contests for control of listed corporations -- have been scheduled for early in June, and, of course, more hearings may be held after that if the Committee so decides. What ultimately will result from the study, no one not connected with the Senate Banking Committee, least of all I, could possibly say.

In addition to the testimony of the witnesses taken at the hearing (which comprises a document of over 1,000 pages), there has also been released by the Senate Banking Committee a very interesting staff report entitled "Factors Affecting the Stock Market". Information for this report was supplied to a major extent by the Securities and Exchange Commission, the Federal Reserve System and the New York and American Stock Exchanges. Some of the basic data which I will be giving you in the next few minutes is based upon information supplied by these government agencies and securities exchanges. Incidentally, two of our Commission's top staff people, a lawyer and a financial analyst, were loaned to the Senate Committee to help with the work.

What are the factors affecting the stock market today and why are they important to the economy?

First, in the 16 months between September 1953 and January 1955, common stock prices had a sharp and rapid rise. A characteristic of this rise in stock prices was that the increase in common stock values was unusually persistent and did not suffer the recurring setbacks which took place during the other extended advances that have occurred since 1915.

A result of this was that dividend yields on industrial stocks declined from an average of 5½% in 1953 to 4-2/3% in 1954 and were only moderately above 4% in January 1955. However, the differential between industrial common stock yields and yields on triple A corporate bonds was still more than 100 basis points and this was in marked contrast to the relationship of industrial stock yields and high grade corporate bond yields in the twenties and thirties.

Another interesting relationship is that the 1953-54 rise of stock prices was not confined to the United States. It also took place in other countries. For example, between September 1953 and December 1954 the percentage increase in industrial stock prices was 54% in the United States, 44% in the United Kingdom, 38% in Canada, 85% in France, 50% in the Netherlands, and 25% in Switzerland.

During the same period there developed a considerable increase in the volume of trading activity. For example, the number of reported shares traded on The New York Stock Exchange totaled 573 million in 1954, the largest annual volume during any sustained period of rising prices except the late twenties. Daily volume increased from about one million shares in July 1953 to 2.2 million in mid-1954, and then went on up to between 3.2 and 3.5 million shares in the closing months of 1954 and January 1955. Recently the daily volume has been at about 2 million shares.

At this point, I should remind you that I am not an economist by profession nor is the Securities and Exchange Commission an economic agency. But in 1952 the people of America elected a president and a party who believed that a sound and expanding economy could support the sinews of a strong national defense and yet avoid the tragic erosion of the people's savings in monetary inflation. The President has often expressed his abiding belief in the importance of the individual and of individual initiative.

These propositions are rather simple to state but much more difficult to achieve. At any event, in the past two years the awful drain of lives and resources in Korea has been ended, our defenses have been placed on a sustained long range basis of strength, and a continuous effort made to ease the world's war tensions. Government expenditures have been brought under control. The purchasing power of the dollar has been stable, and a sound and flexible monetary policy pursued. In early 1953, the inflationary trend was halted. The readjustment incident to controlling expenditures and halting inflation was accomplished by the fourth quarter of 1954, when the reduction of business inventories and the decline in Federal expenditures leveled off. The gross national product rate recovered from $355.8 billion in the first three quarters of 1954 to $362 billion in the fourth 1954 quarter, and moved on up to $370 billion in the first quarter of 1955. It seems, if I may venture an opinion, that it is possible to have peace, full employment and a high standard of living for the people of America, all at the same time. This is one of the great accomplishments of the past two years.

Can there be any wonder, then, that the people of America responded by showing confidence in the economy?

The confidence of the American investor in the economy is of extreme importance. For on that confidence depends the willingness of the people to channel their savings into productive investment, and the willingness of management to commit to capital outlays the enormous amounts needed to serve our people's requirements. For example, industry's capital expenditures for plant and equipment in 1953 were $28.3 billion, in 1954 were $26.8 billion, and are estimated for 1955 at $27.1 billion. The second quarter of 1955 is expected to show the upturn in the rate of plant and equipment expenditures following the decline which began late in 1953.

During the post war period through 1954, corporations invested $172 billion in new plants and equipment and increased their net working capital by $44 billion. Almost three fourths of the funds needed for this $216 billion of capital expansion were provided from internal sources, that is, depreciation accruals and retained earnings.

The managers of American corporations would not think of investing these enormous sums, obtained both from the capital markets and generated internally, did they not have confidence in the continued soundness, expansion and growth of our economic system.

Another economic factor undoubtedly at work is the use of bank credit in the securities markets. The mechanics of stock market credit and the control which the Federal Reserve System has over this are important. The Securities Exchange Act grants to the Board of Governors of the Federal Reserve System power to fix margin requirements, and after a period of two years at 50%, the Board raised the margin requirement to 60% in January 1955 and in April to 70%. Also, the volume of credit which at any time may be available through the banking system is affected by actions taken by the Federal Reserve System in the areas of discount operations, open market operations and changes in reserve requirements.

Another factor undoubtedly at work is the impact of taxes on the market - corporate taxes, excess profits taxes (which expired in 1953) and individual income taxes (including the somewhat more favorable tax treatment since 1954 accorded income from dividends), and the capital gains tax. Two particular problems in this area are worth thinking about, though no solutions are in sight. First, that the structure of the Federal corporate income tax tends to encourage use of borrowed funds rather than equity capital has been strongly asserted by some people. Whether this is so or not, the maintenance of a strong equity position by American industry in my opinion is important. In a recent interview, Dr. Arthur F. Burns, Chairman of the Council of Economic Advisers, stated that he thought "our growth will rest on a sounder foundation if equity capital accounts for a larger part of the private investment than has been the case in recent years". Second, some people and organizations have argued that there is a "lock-in effect" brought about by the capital gains tax. Whether this is true or not, I don't know. Let me emphasize again, I mention these as being questions or problems about which people are thinking.

Another factor affecting the stock market about which less is probably known than should be is the impact of institutional investment in stocks. Eliminating inter-corporate holdings, the total market value of outstanding stock of all American business corporations at the end of 1954 was about $268 billion, of which over $150 billion were listed, that is traded on the exchanges. Of this total, it is estimated that individuals held 73%, or $196.4 billion. Institutions held an estimated $66.5 billion or 25% of the total.

The New York Stock Exchange estimates that at the end of 1954 7.5 million individuals owned shares of publicly held companies. This figure is about a million more individuals than a 1952 estimate made by

The Brookings Institution. It is also significant that during the past 14 years there appears to have been a pronounced upward trend of common stock buying by institutions. These include life insurance companies (legal investment laws having been liberalized), banks acting as fiduciaries, both open-end and closed-end investment companies, and pension funds. Statistics developed by the Trading and Exchanges Division of our Commission show the net purchase of common stock by institutional investors as running between $1.2 billion and $1.5 billion in each of the past three years.

Another factor perhaps at work in the market is the extent to which speculation by the public has increased. Various statistical data supplied by the New York Stock Exchange indicate considerable and increasing public participation in the market.

Now, how does all of this fit in to the economic conditions existing and which we must expect and hope for in the years ahead? What are the conditions we must look for?

Let us think for a moment of what The Economic Report of the President to the Congress of January 1955 calls "the growth potentials of our economy". This report contains two prophetic paragraphs about the future:

> "The American economy has created new jobs and produced marvels of abundance in the past. It should be able to do so in equal or even greater degree in the future. Our population is rapidly increasing, educational levels are rising, work skills are improving, incomes are widely distributed, consumers are eager to improve their living standards, businessmen are actively engaged in starting new enterprises and expanding old ones, the tools of industry are multiplying and improving, research and technology are constantly opening up new opportunities, and our public policies generally encourage enterprise and innovation. With so many favorable factors, a continuation of rapid economic growth may reasonably be expected.
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> "An arithmetical calculation, based on a number of technical assumptions, the most important being that the average annual gains in productivity that we have had in recent times will occur in the future, shows that our country can within a decade increase its production from a current annual level

of about 360 billion dollars to 500 billion or more, with the figures expressed in dollars of the same buying power. Of course, the record of the past sets no limit to our future achievements. Nor should we permit arithmetical projections to obscure the basic fact that an economy succeeds only as people succeed. Our economic future depends on the full use of the great treasure house of intelligence, skill, energy, and confidence of the American people."

The enormous amounts of money, saved by the American people, which are invested in the brick, mortar, machine tools, equipment and research of American corporations would not be invested were it not for the underlying confidence of the American people in the political, economic and social system which we have developed under our representative form of Government. That means confidence in American management, in our labor organizations, in our Governmental institutions, in the laws and in the people themselves. The continued confidence of the people in the future of America and in our free institutions is of vital and basic importance to the economy. The rising standard of living, the rising rate of population, the increase in the gross national product, the increase in the number and productivity of our working people expected over the years ahead can be provided for so long as the confidence of the American public in its privately owned capitalistic system is maintained.

This in turn requires the proper functioning of the capital markets. It is the duty of the Securities and Exchange Commission to administer laws which are designed to assure to the American investing public certain basic legal protections. The Securities Act, for example, requires that fair disclosure of pertinent financial facts be made to prospective investors by corporations selling new issues of securities in interstate commerce to the public. The Securities Act contains civil and criminal liabilities for misrepresentation and fraud.

The Exchange Act, under which the Securities and Exchange Commission has jurisdiction over corporations whose shares are listed on national securities exchanges, over the exchanges themselves and over brokers and dealers, also gives the Commission power to regulate for the protection of investors. For example, annual and certain interim financial reports are required to be filed and made public by listed companies. This requirement has led to the development of the enormous reservoir of financial information, available in the statistical services, about the companies whose shares are listed. Listed companies must also meet certain disclosure rules in connection with the solicitation of proxies to vote at meetings of their shareholders. Profits by corporate "insiders" in certain short-swing trading transactions are under severe legal restrictions. The conduct of market activities is under the Commission's constant surveillance. Pools, manipulation and rigging of stock prices in the markets have been substantially eliminated.

Also, the securities laws adopt as the policy of the Congress the philosophy that industry self-regulation to the extent possible and feasible should be encouraged. Most of the stock exchanges have rules of conduct and actively supervise their members. The National Association of Securities Dealers, Inc., representing the over-the-counter dealers, is also a fine example of a self-regulating industry organization operating under a statutory mandate. Thus the American investor should be entitled to have confidence that the capital markets through the medium of which he invests his savings are run with certain basic standards of decency and good business conduct.

However, this is not to say that the enterprises coming to the capital market to attract investors' money are all good or all sound or that the means of attracting the money are fair. The soundness of the enterprise - or lack of it - is the responsibility of business, not of Government, so long as the pertinent financial facts are fairly disclosed.

Within the past ten days I have spoken to various groups of business and professional men in New York, Chicago and Boston calling to their attention some activities in the marketing of certain types of securities today which should give the securities industry pause. I have mentioned some of the practices occurring in the marketing of promotional uranium issues. Many of the domestic and Canadian uranium issues have been sold to the public on a capitalization basis that reflects a promotional participation heavily weighted against the public investor who furnishes the initial cash capital. We have strengthened our field office in Denver and are attempting to increase enforcement activities generally in an effort to seek out and prosecute those who attempt to sell promotional issues without compliance with our registration requirements or without compliance with our so-called Regulation A exemption procedures, in purported reliance upon the intra-state exemption, but in actual violation of the Securities Act. Many uranium common stocks sold to the public in compliance with the disclosure requirements of the Securities Act are sold under terms which grant promoters and underwriters options and warrants which, even if the venture is successful, provide the insiders and underwriters with riskless potential profits at the expense of the public stockholders by diluting their investment and share of profits. Most of these issues are underwritten on a "best efforts" basis rather than a firm commitment basis, and there is no assurance that there will be enough money raised to explore or drill. Often underwriting fees and commissions account for 25 per cent of the offering price. Often large additional amounts are paid to cover legal and selling expenses.

Finally and perhaps worst, trading activities and market prices undoubtedly are affected by the puffed up and alluring advertising appearing in the newspapers and over the air waves as "sucker-bait". I would like to leave with you leaders of industry the thought that it would be a shame for American business and for the American securities markets generally to forfeit investors' confidence that has been built up over the last several years because of the activities of the kind I've just described.

Finally, as Mr. Demmler leaves and, as the President has announced will occur, I succeed him as Chairman, let me make this observation. Mr. Demmler brought to the Commission twenty-five years of legal training and experience at the Pennsylvania Bar. His colleagues on the Commission and all the staff have been stimulated and their thinking enriched by the contribution which, as a lawyer coming into Government from the outside, he has made to the work of this Government agency during the past two years. I think the inter-change between business and the professions on the one hand and Government on the other of well-trained and highly competent men is good both for the business community and the Government. Government gains by having available on its side the experience of men whose point of view has been hammered out on the anvil of practical business experience. There should be more such inter-change between Government and business. Incidentally, I'm expressing a point of view which a very great business leader of my home town of Chicago, now an adviser to the President, Clarence B. Randall, set forth in his recent book, "A Creed for Free Enterprise". Let me read a few sentences to you from a chapter of that book dealing with "The Businessman and the Government":

> "One problem that as businessmen we have been a little loath to share is that of government. At every echelon, from the ward and precinct in which we live up through Congress and the foreign service, we have been inclined to leave the job of government to others, though reserving to the full our right to criticize, and to assume that somewhere there is a great leisure group of able men who can and will do these things for the love of them. We have raised ridicule of

office holders to a fine art, and have demanded in no uncertain terms that there be more government for the people, but have laid less emphasis on the fact that government is also supposed to be by the people, and that we are those people. . . . .

"We need a new tradition of public service, a new habit of mind by which businessmen actively seek participation in public affairs at every level. . . .

"The federal government is continuously in urgent need of competent staff. . . .

"Lend-lease of talent is the answer. I hold the earnest belief that it is a proper function for business to supply staff to government on a term basis, and that this is a proper charge against our cost of production. If the job is being badly done, and our management brains and skill can help to do it better, everyone gains. Take our junior executives, for example. Over the long pull, wouldn't it be a fine thing if every young man with a future, and we all know who some of them are in our companies, should go to Washington for two years and take a government job, either here or abroad? . . .

"Government would steadily receive a new transfusion of blood and at the same time meet its huge staff deficit, to say nothing of the general increase in mutual understanding that would be brought about. Career people would develop new respect for the standards of ability and integrity that prevail in business, while the young men would come back broadened by the impact of unusual responsibilities, and perhaps a little more humble than we are with respect to understanding the difficulties of public administration." (Pages 78-83)

The willingness of men of high professional and business ability to take positions in Government represents a great contribution to the essential functioning of the American Government under which we all live and to which everyone of us is proud to owe allegiance.

Thank you very much for this opportunity to speak to the Calvin Bullock Forum.