

"SOME THINGS DONE AND TO BE DONE"

ADDRESS

of

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Securities and Exchange Commission

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It might be expected that, after the experience of the last few weeks, a speaker from the Securities and Exchange Commission addressing this convention would outline theories and state conclusions as to the causes of the market break and whether the regulation of trading practices has a place among those causes. That I am not going to attempt. We are too close to the times of market distress to feel certain that causes could be appraised calmly and accurately, even if all the data necessary for their ultimate listing and measuring were now available.

It is important that opinions which may be largely determinative of the course which regulation shall take be reached by as close an approach to the scientific method as lies within our capabilities. The "nervousness" of the market, its reaction to hope and fear, to rumor and mood, emphasizes the importance of having opinion founded on knowledge and of expressing opinion only when all available sources of that knowledge have been examined.

I have accepted the invitation to talk to you because I think you ought to have an opportunity to get some suggestion of the point of view and attitude of a member of the Commission and in the hope that in some measure this meeting will serve to improve our understanding of each other.

I know that some of you will have ideas quite different from what I shall try to express, but I think a better understanding of how we look at things must be helpful when we approach problems that both you and the Commission must try to solve.

What I want to talk about today relates to some phases of control of securities markets, to some of the things that have been done, to some things that are being done, and to something of what should be done in the future through the common effort of the securities fraternity and the Commission. Many things must be omitted for lack of time, even though the circumstances are appropriate for their presentation. Those to which I shall refer are picked in the hope that they will be helpful in attaining an understanding, and with full recognition that their discussion will leave many important questions not referred to.

If we are to understand where we are, we must first consider the background of our present circumstances. It seems to me that a comprehensive program for regulating the sale of securities was inevitable and that the enactment of the legislation which we have was only one step in the evolution, compelled by conditions in our economic system, of regulation of business. Their particular form and provisions, of course, are stamped with the views of those directly concerned with their enactment, but the development of a program to regulate the sale of securities was bound to come. The same irresistible forces that have brought regulation of railroads and public utilities, that have resulted in workmen's compensation laws covering industrial accidents, in food and drug legislation, and in control of competitive practices, brought them along. Their enactment was only the political recognition of economic and social forces that would not longer be denied.

Major regulatory legislation in this country, in any of the principal fields which it has reached, has been the result of the deep-seated conviction of the public that conditions under which business had been done must not be continued. Legislation has not been a spontaneous thing nor has it resulted from a political drive not backed by real public demand. The party platform and the legislative campaign have only served to make that demand articulate and somewhat to determine the form of its expression.

I think that many times an earlier recognition by business that it could not expect to go on uncontrolled might have greatly affected the form of regulation. Perhaps it is too much to expect that the business which must be brought under control should realize as readily as the lawmaker or the economist when that control must be asserted. Characteristically, the course has been to oppose all regulation, to fail or refuse to realize the strength of the current of popular demand until it has been too late to affect the trend of public thought or the actual construction of the mechanism of control. Then it was unavoidable that the framework and mechanics of regulation should be developed in an atmosphere of bitterness and animosity.

I hope it will be understood that I am not speaking of this as a condition peculiar to the securities business nor as one to which many exceptions might not be cited. I am only trying to point out that business has not permitted itself to play the part it might have played in shaping the program of restriction and regulation. It has not had the politician's sensitiveness to the forming of popular convictions or his awareness that when the public demand was really aroused that demand was bound to be fulfilled.

A different attitude might often have made it unnecessary for an industry to pin its faith on a lawyer's assurance of constitutional protection -- an assurance which often has to assume a static world and to ignore the evolution of thought as public problems change and new demands and needs compel recognition.

Now we have the Securities Act and the Securities Exchange Act. I believe in the purposes which those Acts seek to have accomplished. I think most of you are in the same position. They have changed many methods of doing business. They have made the conduct of your business more expensive and they have imposed obligations which ethical business has always realized it had but which were frequently not accepted in practice.

In the light of this general background, let us turn to an appraisal of our more immediate and particular situation and see where we are going. As I see it, the investment banking business has a dual function in our national life; to furnish the means whereby the savings of the people are made available for productive enterprise; and to guide those savings into meritorious channels of investment. In the Twenties, the investment machinery of America was extremely effective in the performance of the first of these functions. Its organization and technique were adequate to dispose of millions of dollars worth of securities in a few hours and of many billions in a year. But, as

we all know to our sorrow, its record in regard to its second function was unfortunate in the extreme. Millions of dollars of our people's savings were dissipated in worthless or over-valued domestic or foreign securities. This failure of our investment mechanism, and by "mechanism" I mean to include much more than the business of offering securities for sale, helped to bring about the profound dislocation in our national economy which came to focus in the crisis of the early Thirties.

I think no student of the situation would be so optimistic as to expect the program of regulation to bring anything like a perfect performance of this second function. That would pre-suppose an expertness on the part of investors which even highly skilled analysts could not claim on their records. Also, no student can fail to recognize that many contributing causes of that collapse were far beyond the control of even an ideally constituted investment mechanism.

The Securities Act of 1933 and the Securities Exchange Act of 1934 were designed to minimize deficiencies in our investment system which stood thus revealed. A purpose of these Acts was to give a better balance to our machinery of investment by increasing its effectiveness in directing the people's savings to useful purposes. In this effort, the government needed the earnest support of the thoughtful and responsible members of your business. Unfortunately, however, there was no adequate meeting of minds. The proponents of the laws naturally centered their attention on the second function, while many of the more outspoken representatives of the securities business seemed still to be unable to see clearly the great importance of that function. The proponents of the laws justified them by arguing that they were essential to assure soundness of investment; the opposition charged that they would choke up the capital markets and prevent the offering of securities. We do not need very long memories to recall how insistently it was contended that the liability provisions of the Securities Act made financing impossible.

Since then, events have proved that the administration of measures intended to promote soundness of investment can be pressed energetically without stifling investment itself. Indeed, activity in the capital markets since that time has demonstrated so forcibly that the liabilities imposed by the Securities Act do not act as a brake upon legitimate financing as to remove the question from the area of controversy. The figures are interesting. During the period from July 27, 1933, to December 31, 1933, the total of securities registered under the Securities Act of 1933 amounted to but \$401,965,000. In the year 1934, the total was only \$340,573,000. In 1935, the total rose to \$2,377,694,000, and in 1936, to \$5,064,737,000. For the nine-month period ending September 30, 1937, securities registered amounted to \$3,012,130,000. The grand total for the period from July 27, 1933 to September 30, 1937 comes to \$11,797,099,000. These amounts, of course, have not reached the levels of the previous decade, but there is no longer any basis for a claim that the flow of capital is blocked by the Securities Act. Minor amendments of the Act, developed largely by discussions with investment bankers who were genuinely interested in improving and not weakening it, helped to relieve the fears of its consequences.

It is revealing to contrast the volume of securities registered with the amount of securities to which registration has been denied by stop order or refusal order, or which have been withdrawn from registration. Total withdrawals have amounted to \$303,000,000. Some statements were refiled so that the gross amount somewhat overstates the actual total. Withdrawals fall into three general classes; first, those due to unfavorable market conditions; second, those due to the institution of stop order proceedings; and third, those withdrawals which were due to such defective statements having been filed that it seemed hopeless to attempt to complete the registration. Stop orders and consent refusal orders account for about \$160,000,000 more -- but here again, in some cases, refilings or amended statements became effective. I have not attempted to determine accurately a net figure but it is safe to say that withdrawals and the refusal and stop order procedures have prevented something on the order of \$900,000,000 in amount of securities from reaching the market.

This, of course, does not tell the whole story. Undoubtedly many issues which would have been offered if there had been no Securities Act were kept from the market by the unwillingness of a certain type of promoter to undergo the scrutiny inherent in the registration process, but we have no way of estimating the total. That these large amounts of securities have not passed successfully through the registration process does not mean that the Act stood in the way of honest financing. Except for those issues which were withdrawn from registration because of market conditions, the causes of failure to accomplish registration are causes which I am confident you would agree, if you had all the facts before you, should properly have kept them from reaching the market.

During this period I think a better understanding has come about between those who are directly affected by the legislation and the Commission because in a great many ways we have worked together. In the preparation of forms and regulations, we have not been content to rely merely upon the work of our experts, but have at all times invited criticism and suggestions from the business world. No important form or regulation has been issued until it had been submitted to representatives of your business or to lawyers and accountants experienced in the problems which were being considered. We have sought criticism at the stage when criticism does the most good -- before action was taken. We have endeavored at all times to make the forms and rules as simple, as compact, and as concrete as possible, having due regard to our paramount obligation to obtain information for investors and to protect them against fraud, and I think they present no great difficulty to those who have had experience in their use or have specialized in a study of them, but I admit they must still look very intricate to those who have to deal with them for the first time. Their subject matter is complex and the necessity for precise statement so great that there seems no reasonable prospect for what we might call a "layman's" version. The necessity of proceeding in large part by general rules rather than by opinions and orders has at once made simplicity more important and harder to secure. To the expert legal mind, reasonable simplicity seems to have been attained. I doubt if others have reached the same conclusion.

As weaknesses or difficulties in forms or rules already adopted have been revealed by experience, and many have been, we have not hesitated to make changes. We have prepared separate forms for different classes of issuers, so that each form might be as far as possible adapted to the needs of the particular issuer, but this program has by no means been perfected. Paradoxically, we have sought operating simplicity through the multiplication of forms. At first glance, in surveying the number of forms which have been promulgated by the Commission, a registrant might well imagine that his worst fears concerning the development of red tape had been confirmed. On looking further, however, and selecting the particular form to be used by the kind of issuer which he represents, he will find that form simpler, more economical, and better adapted to bringing out pertinent information than could possibly have been true had a single general form been promulgated for all classes of issuers.

At present, as many of you have heard, we are engaged in a general revision of our forms, designed to retain the advantages of specialization for different situations and different classes of issuers, and, at the same time, to eliminate duplication and needless variation in detail, some of which has crept in despite the care which was exercised.

I have said that in the formulation and revision of our rules and regulations and forms, we have invited criticism and suggestions from the business world. The results have shown beyond question the wisdom of this course. Truth requires me to say, however, that the advice and criticism received have not always been as realistic and helpful as we had hoped they would be. In many cases the comments have in effect amounted to no more than a complaint that the particular rule or form would impose an added burden. I can illustrate this by referring to the criticism of proposed proxy rules submitted on behalf of one of the greater business organizations. That criticism consisted of nothing more or less than the statement that they could find no good in any proposal which in any way would change what they asserted to be existing practice.

It would not be fair, however, to leave the impression that this was characteristic of the general run of the suggestions which we received. In a great many cases the finest spirit of cooperation was shown. Many able men devoted a great deal of time and effort to the job of helping us. Many mistakes were avoided as a result, and I am sure that rules and forms as finally issued were much better than it would have been possible to make them without the help which we received. And I think that this situation is improving steadily. In the formulation of the over-the-counter rules which took effect on October 1st, for example, we were greatly assisted by criticism from informed members of your business which was just as realistic and constructive as it was direct and forthright. Representatives of the industry sat down with us in what seemed to me a spirit of wholehearted cooperation to help make the rules sensible, workable, and sound. The need for such rules they acknowledged from the start. Then the only problem was to frame the rules.

I should like to speak briefly also of progress which has been made in securing a better presentation of financial facts. So far the Commission has not availed itself of the power over accounting matters

given to it by Section 19(a) of the Securities Act, to prescribe general rules of accounting. A number of accounting questions have been discussed in stop order opinions but mostly these opinions have dealt only with rather elementary phases of accounting error. A few releases of opinions of our chief accountant, dealing with important accounting matters of general interest, have been published, and it is planned to continue a policy of issuing releases of that character. Papers have been presented before a number of accounting organizations in which the purposes of the Acts as related to accounting have been discussed, and the nature of many accounting practices which the Commission has criticized has been pointed out. Constant touch has been kept with representatives of leading groups of accountants and a great deal of work has been done in conjunction with such groups. We have had no purpose to cast accounting into a rigid mold but have recognized that there are many limitations on the usefulness of inflexible requirements. We have only recently reached the point where serious consideration is being given to the use of the powers conferred by Section 19(a) for the purpose of announcing rules to govern the handling of certain accounting matters. To the extent that these powers are invoked, I anticipate that their use will be a matter of gradual development. The attempt to secure a general recognition of sound principles and practices should not blind us to the dangers of rigid standardization. If the purpose of accounting is to secure a correct picture of financial condition and results, great care must be taken that the picture be not distorted by the application of rules which may defeat the purpose.

I think it is true, however, that there should be recognized certain fundamentals, on which accounting practice has not become uniform, and if the use of the powers granted by Section 19(a) seems to be the appropriate way to secure that recognition, I should expect them to be utilized.

Definite progress has been made in accounting matters. Probably only a small part can be attributed to direct action of the Commission as reflected in stop order opinions because, to a considerable extent, those opinions have dealt with violations of accounting principles which are generally recognized by reputable accountants. Much more has been done informally, partly by utilizing the advice of reputable accountants regarding financial requirements in registration forms, partly through conferences between representatives of the chief accountant's office and those representing registrants and by public statements of the chief accountant, and partly as a result of the examination of statements by the Registration Division.

All of this has two results; first, to improve accounting standards and practices without resort to rules; and second, to show in what respects resort to rules and definitions may be necessary.

I have not attempted to review all that has been done, even within the limited field covered by the Securities Act of 1933. I have mentioned certain of the accomplishments largely because they indicate that the Commission has not been disposed to act arbitrarily or to rely only on the thinking of its members and staff. It has sought the benefit of

the knowledge and experience of interests affected by its administration. It has had to weigh and appraise the suggestions it has received. That is its duty. It has been helped especially by the type of critic who was willing to recognize where the duty of the Commission lay and to help in reconciling the performance of that duty with the facts in the conduct of honest business.

At this point, I should like to take the opportunity to re-examine with you the whole concept of cooperation between the Securities and Exchange Commission and the financial community. Many of you, perhaps, have felt from time to time that the phrase "cooperation between business and government" is remarkable more for the frequency with which it is uttered than for its actual relevance to any practical situation. I think it is well for us at the outset to recognize the existence of this attitude, and to acknowledge that it is understandable. But I am convinced of the essential significance and validity of the concept. In explaining this conviction and considering its implications, I shall address myself to the relationship which I think should continue between the Securities and Exchange Commission and that section of the financial community in which your Association is particularly interested -- the broad group of investment bankers and over-the-counter dealers.

Cooperation has as its objective the enforcement of law with a minimum of interference to the normal processes of business. It springs of course, from the responsible citizenship of the majority of business men on the one hand, and from the genuine concern of the majority of public officials for the needs of the group being regulated, on the other. Beyond that, however, cooperation rests upon a practical basis of self-interest on the part of investment bankers and dealers. Your technical assistance and advice constitute a most valuable lubricant in the machinery of administration.

To make this clear, I shall ask you to bear with me while I briefly rehearse the essentials of our investment system, on which I have already touched. At the risk of belaboring the obvious, I want to stress the fundamental outlines of that system, which are so elementary that we stand in constant danger of forgetting them.

In any form of economic society, a way must be found for putting the savings of that society to productive use. All of us today are familiar with societies in which the basic decisions as to the allocation of the nation's savings are made by a central authority. Under the competitive business system of this nation, these decisions are left to unnumbered individual investors, each of whom determines the channel of industrial effort into which he will direct his own savings. Patently, it is vital to the successful operation of this system that the individual investor be well informed, and that his judgment should not be misled by misrepresentation. Investment judgment, led into error by fraud or ignorance, contributes to the mis-direction of the nation's savings. Such mis-direction means that capital is invested in industries that do not need it, and that soundly growing industries which need and can make effective use of capital, are deprived of it. It means overcapacity in certain lines of industry and shortages of capacity in others. It means

the kind of dislocation of which the cumulative effect is felt in economic depressions. In consequence, the swindling of an investor by an unscrupulous dealer involves something more than a personal injury to that investor. It involves something more than unfair competition against honest dealers. It strikes a blow at the very heart of the structure of capitalism.

In a triple sense, therefore, you are interested in the most practical way, in the achievement of the purposes of the laws administered by the Commission; to provide full information; to eliminate fraud and manipulation; and, in general, to perfect and lubricate the mechanism of the free and open market. You are injured by any factor which leads to fundamental dislocations in our economy. You are the direct and immediate victims of unfair competition by fraudulent bankers or dealers. As an essential part of the investment machinery of capitalism, you have a vital stake in the successful maintenance and operation of that machinery. Clearly, then, cooperation on your part with the Commission in the realization of its objectives cannot be regarded merely as extra-curricular activity, inspired by your sense of public responsibility as citizens. It must be recognized as an integral and necessary part of your business itself.

As a matter of practical business operation, as well as of realistic governmental administration, your cooperation is important. The laws which the Commission administers, and the rules promulgated pursuant thereto, must become the pattern of action of thousands of investment bankers, dealers and brokers, scattered throughout the length and breadth of the land. The rules must be based upon technical knowledge and understanding, and must be realistically adapted to fluid and changing situations; they must be understood; and they must be policed. How much easier for your vast business it is to operate under a system of rules which you have assisted in drafting -- rules which have not been promulgated without the benefit of the technical advice which you were able to offer.

The criticism and suggestions of the financial community may be offered either in a spirit of candid advocacy, or in a spirit of impartial and objective consideration. Both forms of criticism are useful, if frankly tendered for what they are. There is a definite place for organizations of investment bankers and dealers whose avowed purpose it is to represent and make articulate the attitude and desires of their membership, without pretense at impartiality, but with a firm intention to keep their partisanship intelligent and realistic, and not merely blind. There is also an important place for organizations of bankers and dealers which will conscientiously strive, within the admitted limits of human frailty, to give technical assistance in which the element of immediate personal or group desire is not allowed to dominate. Such organizations endeavor to adopt the point of view of a public body charged with the duty to take account of the interests of different groups which conflict, or appear to conflict, and try to make their technical equipment and experience available in the light of that attitude. We all of us know that there are organizations of both kinds in the field today, and no one familiar with the record will deny that they have done well in the discharge of their functions.

In the task of enforcement, education, and policing must be the converging courses of action. The desirability of your assistance in this field is no less acute, but the problem of making your cooperation effective is more difficult. The problem has two phases. The first relates to assuring compliance with the statutes and the rules and regulations promulgated thereunder. The second relates to the penumbra of inequitable and injurious methods of business which lies outside the area of definite illegality.

Let me illustrate the extent of the first phase of the problem by reference to certain recent experiences. Within the last year, the Commission, for sufficient reasons, sank probes into three areas outside the largest financial centers -- in Cleveland, Detroit, and in the Pacific Northwest. A few attorneys and accountants were sent into these areas, to inquire into certain complaints, and to make a flying survey. In the space of a few months, 13 individuals were criminally convicted, 16 more individuals were placed under indictment, 17 corporations and 41 more individuals were enjoined, and 2 firms were expelled or obliged to withdraw from national securities exchanges, all for elementary violations of the law. The effect of these efforts has, of course, been salutary, but it would be folly to imagine that nothing remained to be done, or that the problem is less serious in other parts of the country. Without vigorous assistance by representative organizations of investment bankers and dealers, the job which remains to be done, and which will be done, can be accomplished only through a very considerable increase in the expenditure of funds, and even then will be extremely difficult. Such an expansion in our organization, which would likewise involve a multiplication of branch offices, would inevitably increase the problem of preventing the evils of bureaucracy, the importance of which problem we fully realize. To avoid this expansion and to avoid a large increase in the expenditure of public funds, it is imperative that you recognize our need and your own interest, and give us the effective aid which you alone are capable of giving.

The second phase of the problem is harder to describe, but it is just as significant. We are all familiar with methods of doing business, which, while not technically illegal, are nevertheless unfair to customer and decent competitor alike, and are damaging to the mechanism of the free and open market. If necessary, these forms of conduct could to a large extent be brought within the proscription of law, either through amendments to the statutes, or through rules and regulations of the Commission. To accomplish this, however, we would have to involve ourselves in a minute, detailed, and rigid regulation of business conduct by law which would be certainly most disagreeable, and perhaps dangerous, to a free people. It is far better that such a program of extended and detailed regulation should be made unnecessary, and I am hopeful that the business can make it so, by self-regulation. In the rules and administration of well conducted stock exchanges, and in the discipline which they exercise over their own membership, one may perceive something of the possibilities to which I refer. With sound organization and methods, and under careful safeguards, I believe that self-regulation can be effective in this area of business conduct without being complex and rigid, and can remain reasonably general and fluid without degenerating into petty tyranny.

I do not mean to suggest that the development of proper organizations and procedures, and the definition of relationships between such organizations and the Commission, can be effected overnight. Only through a process of steady growth, in which full regard is constantly had both for the ultimate objectives and for the concrete realities of human behavior and current opinion within and without your ranks, can the result be achieved.

This, then, is the concept of cooperation of the financial community with the Securities and Exchange Commission as it appears to me. As long as we see our respective problems clearly, we will cooperate, because we will want to do so. When the vicissitudes of a trying period tend to cloud our judgments and to irk our tempers, I think we will nevertheless continue to cooperate, because we will have to do so. The course will be difficult, but I am not without confidence as to the outcome.

It seems to me that the immediate program should be to study the methods by which an effective system of self-regulation may be promoted. As I see it, there need be no surrender of the full and final authority of the government, but there must be a willingness to work with the industry and to realize that anything like perfection of the program must take time and study, a willingness to proceed gradually and, if necessary, to retrace steps which may prove to have been taken in the wrong direction. The business must be given encouragement to take over its share of the job and it must show its willingness and capacity. I do not think the appeal to the business need be based entirely on its obligation to the public or that it need rest entirely on the hope of certain remote and rather intangible business advantages.

Questions of rights, privileges, and obligations of organizations for self-regulation and of their members, of the means to assure that they be not dominated by any interest, group or clique, and that membership shall be open to all who are willing to work for a decently conducted market, and questions of the status to be afforded such organizations under the Securities Exchange Act, are all matters for study in what I hope may be a cooperative way.

No more than the general nature of objectives can now be suggested. We know by experience something of results to be sought and of methods and results to be avoided. We need to work together to complete a program and to put it into effect. The call for the business to take its place in working out the problems of the over-the-counter market must be directed to you but it must also go out to everyone in the securities business who wants that business to have the place of honor which alone is consistent with the public interest.