RECENT ACTIVITY AT THE SECURITIES AND EXCHANGE COMMISSION

Address by

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The subject which Professor Ruder assigned to me affords an opportunity to paint with a fairly broad brush and to philosophize a little about recent history at the Securities and Exchange Commission. From your viewpoint, I hope that this will at least be a change of pace from the intensive discussion of concrete and pressing business problems which usually characterize an Institute such as this.

It was suggested that I explain why the SEC is more active, perhaps even more aggressive, than it was during certain prior periods. This, of course, raises the question of whether the Commission is, in fact, more active than it used to be, or whether this is merely an impression created by a greater degree of popular interest in the securities markets and in the institutions in those markets, including the Commission. This interest results in more press coverage and a more general awareness of what the

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SEC is and does. I can remember one of my predecessors telling me that when he left private practice to become General Counsel of the Securities and Exchange Commission, his secretary congratulated him on the opportunity to join an agency responsible for the national security. I hardly think that that would be so likely now. Although the impression of greater activity must be discounted to some extent because of this factor, I think that the answer to the first question is probably yes. The Commission is more active than it was at certain other times. The reasons for this are more complex and most of them have their origin outside rather than inside the walls of our new building in Washington. In any event, I can assure you that at no time have the Commissioners sat down in solemn conclave and adopted a resolution saying "we will be more active."

By way of background, it might be useful, if slightly presumptuous, to attempt a thumbnail sketch of the significant periods in the history of the SEC as I see them. I say presumptuous because during most of this time I was either in school or in private practice, and I cannot speak from first-hand knowledge. During the years from the Commission's creation in 1934 to the outbreak of World War II, the Commission was confronted with several obvious and major challenges. It had to make the new securities laws work, it had to embark upon a reform of undesirable practices in the securities markets, as revealed by the Pecora hearings, and it had to embark upon the truly monumental task of dismantling, rationalizing and reorganizing the top-heavy public utility holding company empires which were built up in the 20's and which often fell apart in the early 30's.

The war changed emphasis, both in the Commission and in the securities markets. The attention of the Commission, like the attention of the country, was diverted to the war effort and in any event, the markets were quieter and many of their participants had gone into the service or into defense production. After the war and commencing fairly slowly at first, there began a period of tremendous change and expansion in the securities markets and the financial community. I will not burden you with statistics to demonstrate a proposition with which you are all undoubtedly familiar. A few, however, are striking. Between 1952 and the end of 1965 the market value of all stocks listed on the New York Stock Exchange increased from 120 billion to 537 billion. According to the estimates of this Exchange, the number of individual stockholders in American industry grew from 6 million in 1952 to about 21 million at the present time. The number of registered representatives of member firms of the National Association of Securities Dealers increased from 29,824 in 1950 to 79,421 at the end of 1965.

Obviously growth of this magnitude entails not merely a quantitive but also a qualitative change in the functioning of the markets, in the securities industry and in the tasks of regulation. There has not only been growth, there has been change. The rising participation of institutional investors and at the same time, paradoxically, the increasing participation of small and often unsophisticated investors as compared with the comparatively wealthy and knowledgeable persons who were in the stock market during the 30's and 40's, the impact of automation, instant communications and electronic data processing, the increased international-

ization of the securities markets, and the rise of New York and the New York Stock Exchange to an unquestioned primacy in the world's securities markets, all of these things and many others, made it seem reasonably apparent that regulation could not be the only thing in the securities markets which would stand still.

To be more concrete, the Commission's principal functions fall into three areas. Two of which are relatively easy to define and one isn't. The Commission is charged with the enforcement of the federal securities laws. Although we receive invaluable help from the Department of Justice, particularly in criminal matters, we are and always have been, in part, a law enforcement agency. We do not rely on other people, such as the FBI, to do our investigations for us, we generally do them ourselves. We conduct our own civil litigation, most of which has an enforcement purpose, and we of course conduct administrative proceedings of a disciplinary nature. We also have what, to descend to "governmentalese," may be called a "processing function." The great volume of registration statements, reports, proxy statements and other material designed to provide disclosure to investors concerning the business and financial affairs of corporations, as well as reports by broker-dealers, exchanges and others, are filed with us. It is the Commission's responsibility to review these documents to see that they are in proper form, to take such steps as are reasonably open to us to see that they are accurate and adequate, and to obtain corrections where necessary. This function is unspectacular. It has little connection with our reputation for activity or inactivity, but it goes on steadily day after day, occupying the time of a substantial portion of our skilled people and making, in my judgment, an invaluable contribution to the

adequacy and reliability of the system of disclosure which uniquely characterizes and strengthens the American securities markets.

Finally, we have what could be referred to as the regulatory function, which is almost indefinable. For present purposes, it may be said to involve becoming as well informed as possible about the functioning and activities of the significant institutions in the securities markets which are subject to our jurisdiction, reaching judgments as to the impact of all this upon investor protection and the public interest and seeking, in such ways as are practicable and within our authority, to bring about such changes as seem necessary and desirable. Of course our work cannot be thus divided into watertight compartments. Regulation and enforcement overlap to a very significant extent and the effectiveness and adequacy of our processing significantly influences both the need for and the success of our enforcement and our regulation.

I think, that to the extent that the SEC has become more active in recent years, this has been primarily in the field of regulation and to a somewhat lesser degree, in enforcement. The extent of activity in enforcement depends essentially upon two things. First, the extent to which those in authority, in this case the Congress, are prepared to commit funds to this task and second, the judgment reached by the enforcement agency as to the level of enforcement activity which is necessary in order to insure a tolerable degree of obedience to the law. Perfect enforcement, in the sense of catching every violator, is never possible and its pursuit would require not only inordinate expense but an oppressive degree of policing. On the other hand, if the level of enforcement falls to the extent that

crime clearly pays, the situation will tend to get out of hand. The Commission's Annual Reports in the late 50's convey the impression that the latter danger was greater than the first one. The re-emergence of so-called "boiler rooms" peddling worthless securities by high-pressure telephone selling campaigns and the machinations of such characters as Alexander Guterma, Lowell Birrell, Ben Jack Cage, et al. highlighted an enforcement problem. This does not necessarily mean that the securities markets had become more immoral, rather it meant only that they had become larger, affording more room for fringe operators, and also, I think, that the greater opportunities to make a fast buck attracted the attention of those who specialize in that pursuit. To the extent that the Commission has been more active in enforcement than it was in the immediate post-war period, this was a reaction to a felt need, recognized not only by the Commission but by the Congress, which provided greater resources. It is difficult to generalize about the degree of crime, particularly undetected crime, which may exist at any given time, but I definitely have the impression that the more active enforcement of recent years has had its effect and that while the con man and the manipulator will apparently always be with us, the rather blatant activities which we used to encounter are now substantially less frequent.

At the same time, certain of our enforcement problems and cases have become more subtle and sophisticated. In part, this reflects the fact that malfactors in this field seem to have become a little smarter and more skillful in covering their tracks. Unfortunately, we have also seen certain

practices, which seem to us to raise serious questions, engaged in by people who are by no means malfactors but on the contrary are responsible and often of standing in the financial community. We, nevertheless, have taken enforcement action whenever we felt we had to, and this has been productive of a certain amount of significant litigation.

As I have mentioned, regulation and enforcement tend to overlap. A striking example occurred in the early 1960's. During 1960 we commenced an investigation of the American Stock Exchange specialist firm of Re & Re. This commenced as a normal enforcement operation. We had evidence indicating that this firm had violated the Securities Act and the Securities Exchange Act in various ways and we set about to look into it. We found violations, a good many of them, and in May 1961 the Commission revoked the broker-dealer registration of the firm and expelled the partners from the Exchange, and in 1963 they were convicted in federal court. But in the process of conducting that investigation, we discovered some rather disturbing conditions on the American Stock Exchange. Within a week after the expulsion of the Res, the Commission ordered an investigation of the adequacy for the protection of investors of the rules, policies, practices and procedures of that Exchange. Some six months later, Congress authorized and directed the Commission to make what became the Special Study. While the Re & Re case and the American Stock Exchange problem were not by any means the principal impetus which led Congress to take this step, they were, I think, a factor.

At the beginning of 1962 the staff report on the American Stock

Exchange was issued. It concluded that on the American Stock Exchange the process of self-regulation in the public interest had not worked out in the manner calculated by Congress and that the abuses described in the report made it clear that the problem amounted to a general deficiency of standards and a fundamental failure of controls. Following this, the American Stock Exchange reorganized itself in a thorough-going way with a new constitution and under new and able management. This latter phase then was a regulatory activity and a major one which attracted considerable attention, but it emanated from a problem encountered, not from a decision to be active for the sake of activity.

I mentioned the Special Study. As former Chairman Cary has pointed out, the initiative for this undertaking came not from the Commission but from the Congress, which was concerned about conditions then prevailing in the securities markets and aware that the Commission did not have the resources to undertake a thorough study of those conditions on its own. The Commission, however, welcomed and endorsed the proposal for such a study. Whatever one may think of the final recommendations, and I believe they were reasonable and on the whole well conceived, the Study clearly accomplished two things which are pertinent to my subject. In the first place, it accumulated a vast amount of significant and often detailed information concerning the functioning of the securities markets and the activities of the variegated participants in those markets. I do not believe that all this information had ever before been known to any single person or group and certainly it never before had been collected, analyzed

and presented in an organized way. Secondly, both the purpose and the consequences of this collection of data was to present the Commission and the financial community with a bumper crop of problems, some more important than others, but all warranting attention. Milton Cohen, the Director of the Study, has suggested that it would be a good idea to make such a reexamination about once every twenty years. While there is considerable merit in this suggestion, I sometimes shudder at the idea. It seems altogether possible that we will still be wrestling with some of the problems presented by his Study when the twenty years expire.

In any event, the Commission believes that rather than engaging in periodic special studies, we should make a greater effort to keep continuously and currently informed concerning changes and developments in the securities markets as they emerge. One aspect of that policy has been the effort of our present Chairman to work out a plan by which we can be better informed concerning the economics of the securities business itself and the firms in it. Although the securities industry is extremely well informed concerning the economics of industry generally, there is a rather surprising gap in available information concerning the economics of the securities business itself, and this we would hope to remedy. The Special Study, among other things, dramatized the changes that had occurred and were occurring in the securities markets and the Commission inevitably had to do something about those of the Special Study recommendations, and there were many, which called for action by the

Commission itself or by organizations in the industry, such as the stock exchanges. Here then is a considerable source of activity. As in the early days, the Commission was confronted with the fairly clear challenge presented by the formal submission of an agenda of problems following an extensive investigation. Of course the two situations are not the same. The Special Study did not disclose the gross abuses which characterized the situation portrayed in the Congressional investigation of stock market practices in the early 30's. But it did disclose, as the Commission concluded in its last letter of transmittal to the Congress, that "although serious problems do exist and additional controls and improvements are much needed, the regulatory pattern of the securities acts do not require dramatic reconstruction."

Since the publication of the Special Study, the Commission has been engaged, often in conjunction with the stock exchanges and the National Association of Securities Dealers, in dealing with the problems raised by the Study. As is only to be expected some of the clearer problems were taken up first. Thus the Commission and the New York Stock Exchange some time ago put into effect revised rules which substantially restrict the activities of floor traders on the New York Stock Exchange, and the National Association of Securities Dealers, with Commission approval, has revised its system of newspaper quotations for over-the-counter securities of national significance so as to eliminate the arbitrary price adjustments which formerly prevailed. It seems to me that many of the recommendations of the Special Study presented the Commission with more complex and more subtle problems than those which confronted it thirty years ago.

A striking example is the commission rate structure of the New York Stock Exchange and the other exchanges. This is an institution of central importance in the securities markets whose ramifications spread widely beyond the Exchange itself, affecting such matters as the manner of executing customers' orders in the over-the-counter market and the pattern and system for distributing mutual fund shares. It is also exceedingly sensitive and exceedingly difficult. As the Special Study noted "commissions are the life blood of the brokerage business today." Consequently, they cannot be approached casually either by the Commission or by the exchanges. Nevertheless, the existing structure does present problems, many of which arise from its rigid and inflexible character. The situation is complicated by the recent interjection into the commission rate area of antitrust questions. Of course those questions have been just under the surface all along, but somewhat surprisingly, no one seemed to worry about them, at least in public, until after the Special Study. I have often wondered why some enterprising plaintiff's lawyer in the antitrust field did not think of this one before.

In any event, the basic problem of the legality of the fixed minimum commission rate system under the antitrust laws is presently before the Court of Appeals for the Seventh Circuit here in Chicago. If that Court, as we have urged in an amicus brief, affirms Judge Hoffman's decision that a fixed commission rate structure may legally exist, there will remain for subsequent resolution a good many more detailed, but perhaps more difficult, problems involving the relationship of the antitrust laws to the functioning of the exchange markets. We have suggested

to the Seventh Circuit that the Commission rather than the antitrust courts may be a more appropriate forum to attempt an accommodation between the antitrust laws and the Securities Exchange Act, at least in the first instance. If the Court agrees with us, some further activity on the part of the Commission will be mandated.

There are other lines of action which are not attributable to the Special Study. For example, there is the matter of corporations purchasing their own shares. This has been done for a long time, but the pace of it seems to have accelerated. According to a study in the Harvard Business Review, during 1963 the corporations whose shares are listed on the New York Stock Exchange, in the aggregate, spent more money buying their own shares than they raised by selling new shares. It appears that only a minority of corporations purchased their own shares in any regular or significant way but some of those who do, purchase on a very substantial scale.

This raises certain problems. A substantial purchasing program can be used, in effect, as a device to manipulate the market in order to serve the purposes of the corporation or of those who control it. We believe that this in essence was what happened in the recent Georgia-Pacific case which attracted considerable notice. Even when no manipulative purpose exists, or at least none is evident, there are still significant questions. Fortunately for us some of the more fundamental do not come within our purview. Whether such purchasing should be engaged in and on what scale is essentially a matter of management judgment limited to

whatever degree is deemed appropriate by state corporation law. We have no particular ambition to get into that question which, insofar as it presents a regulatory question, would involve economic regulation in which, by and large, we do not engage. There are, however, questions for us too. A corporation's purchase of its own shares on an extensive scale and particularly on a continuing basis can have a material effect on the market, and particularly where the corporation's incursions into the market occur sporadically, the effect can be rather unsettling. Partly, this can be dealt with by disclosure, and such disclosure is called for in the reports which are filed with the Commission. This may not be the most effective way to do it. I note an increasing tendency upon the part of some corporations embarking upon stock purchase programs to voluntarily give public notice of their intentions to their shareholders. Continental Insurance Company is a recent example. To some extent, however, the problem may go beyond disclosure and involve the taking of steps to minimize any unnecessary market impact of such purchases. Here again the initiative has come from industry itself. Some corporations, General Motors for example, are in the market almost every day purchasing their own shares for various employee plans. For a good many years General Motors and other such corporations have had carefully worked out plans governing the timing and the price of their purchases so as to minimize market impact and to avoid causing unnecessary fluctuations. It was upon this foundation developed by industry itself that the Commission built in dealing with the purchasing activity of Genesco in another recently publicized incident. This represents another example of a rather common approach on the part of the Commission—that is to make use of standards and procedures voluntarily

adapted by responsible businessmen as a basis for developing standards of conduct of more general application.

Another and somewhat related problem which, unlike corporate purchases of their own shares, has so far received surprisingly little attention in this country, is the organized purchase by one corporation of the shares of another, either by means of an invitation for tenders or, as is called in Great Britain and Canada, a take-over bid or by substantial open market purchases, in either event with a view to obtaining control and perhaps with a merger ultimately in prospect. The take-over bid seems to be the currently popular substitute for the somewhat old-fashioned proxy contest. In this country about the only control over take-over bids is provided by prohibitions against fraud in state or federal laws. By contrast, Ontario has just amended its securities laws to provide a rather detailed regulation of take-over bids and similar steps have been taken in England. It struck some people in the business community in this country that, in the midst of a general scheme of full disclosure in the American securities markets, it was rather strange that take-over bidders could operate with substantial secrecy concerning their intentions and even their identities, and they arranged for the introduction of a bill, S. 2731, in the current session of Congress. While the initiative for this bill did not come from the Commission, we were, of course, very much interested in it and have filed a detailed comment with the Senate Committee on Banking and Currency. Our suggestions are primarily designed to bring about improvements in the functioning of the bill and, in part,

to obtain the objectives sought without placing on proposed bidders burdens as onerous as those contemplated by the original bill. In general, persons who have acquired, or obtained the right to acquire, ownership of substantial amounts of equity securities of a company registered under the Securities Exchange Act would have to file a statement with the issuer and the Commission disclosing their activity, the number of shares they held, the source and amount of funds to be used and their plans with respect to the conduct of the business. A public invitation for tenders would have to contain similar information and there would be certain substantive controls, such as a requirement that if more securities are tendered than bought, the securities to be bought would be taken up pro rata from each tendering shareholder rather than on a first-come first-served basis, thus avoiding pressure upon tendering shareholders to deposit in haste.

I am, of course, unable to predict what action Congress will take on this bill and it is not likely that it will act in this session, but I think that in the course of time the United States will probably follow the example of the British and Canadians and provide additional investor protection in this area.

By this time you may suspect that I have been engaged in attempting to demonstrate that much of the recent activity of the Commission results not from a simple desire to be active, or from bureaucratic empire building, but rather was a response to conditions and circumstances which appeared to call for action. If this is your suspicion, it is in large measure correct.

That, however, is not the whole story. Human institutions do not function independently of the people in them and around them.

One of the great satisfactions of my 12-year connection with the SEC has been the caliber and the ability of the men I have been fortunate enough to work under. Nevertheless, individual tastes and interests do differ. For example, William L. Cary, who was appointed Chairman of the SEC early in 1961, was, and is, a great teacher and scholar in the field of corporation law. Consequently, it is not surprising that since he came to the Commission there has been rather more concern with the interrelationship between securities regulation and corporation law, including standards of corporate conduct, than might otherwise had prevailed. Similarly, Chairman Cohen, who has worked most of his active life with the federal securities laws and also studied abroad, is interested, among a great many other things, in the international aspects of the securities markets and securities regulation and in avoiding or eliminating any unnecessary burdens involved in the process of securities regulation. As I have mentioned, he has also concerned himself with the effort to see that the Commission is continuously and currently informed concerning trends in the securities markets, instead of having to make periodic special studies after the fact, and in order that regulatory decisions be taken as needed on an informed and responsible basis. He has further concerned himself with the unique pattern of regulation which exists in the securities markets involving as it does the federal government, each of the fifty states and institutions having express self-regulatory responsibilities,

such as the exchanges and the National Association of Securities Dealers. By improving coordination and avoiding duplication of effort by these various bodies, he feels that securities regulation can both be more effective and less burdensome upon those who are subject to it.

In February of this year, Mr. Cary delivered the Cooley lectures at the University of Michigan School of Law. He dealt with the functioning of independent regulatory agencies in recent years, with particular emphasis upon the SEC. He concluded, if I interpret his remarks correctly, that the relative vigor and effectiveness of an independent regulatory agency at various periods depend essentially upon two things. First, the desire on the part of those in position of leadership in the agency to make a contribution beyond the mere honest discharge of routine responsibilities, and secondly, the existence of an environment, in the executive branch, in Congress, and I believe among the general public as well, which encourages or at least permits them to do so. During my experience at the SEC, we have always had the first of these requisites and in recent years, we have had both of them. This no doubt is also a factor in Commission activity, but not an independent one. It merely influenced the Commission's response to the conditions and circumstances it encountered.