REMARKS OF RICHARD B. SMITH, COMMISSIONER
UNITED STATES SECURITIES AND EXCHANGE COMMISSION,
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"A Little Perspective, Backwards and Forwards"

This afternoon, having been given free choice, I thought I would talk with you about the past and future at the SEC. Many of you are familiar with our history, and so would already know a good part of what I shall be discussing. But for most of us a review of the Commission's principal activities, with some historical perspective, may be helpful. Perhaps it will help explain the evolution in the nature of the Commission's work. And point to where its principal activities may lie in the 1970s.

To some extent then, I shall be speculating with you about future directions of the Commission. And I shall be attempting to place some of the Commission's past activities in perspective. Because of that, I emphasize that my remarks are spoken from my own viewpoint. They do not necessarily reflect the views of my colleagues on the Commission or the Commission's staff.

I think it important to note at the outset: that what the Commission has done, and what it is doing, and what it will do, are reflective of and responsive to developments in the financial community that have a basis and origin outside of the Commission. The Commission cannot take the credit for the success of our private investment system. Nor can it properly be the scapegoat for problems of the securities industry. I say this because all of us should recognize, perhaps most of all we at the Commission, that our role is limited. At the same time, we do have a role to perform. It is incumbent upon others to recognize that role, and upon us to perform it as expeditiously and as well as we can.

Past is prelude, so first let us take a look at what has dominated the work of the Commission over its history.

SEC Beginnings

The Commission was created in 1934, now almost thirty-six years ago. The new agency was charged -- among other things but none more important -- with taking over the administration of the Securities Act of 1933. That first piece of federal securities legislation, significantly, required disclosure of financial information by corporate issuers of securities. The 1933 Act required disclosure at the event of a public offering of securities. The Congressional decision to require disclosure at the event of offering was purposeful. It was directly responsive to the assertion that during the 1920s almost $25 billion of new securities floated in the United States had proven to be worthless.

The statute creating the Commission the next year carried disclosure principles beyond the offering. They were extended to the filing of periodic financial reports by corporations with listed securities outstanding, and the furnishing of information to their shareholders in connection with voting. The 1934 Act also provided for the regulation of securities exchanges. But the principal burden of manpower in the Commission, in those first years, was in disclosure activities. The initial rules and forms for registration statements, reports and proxy material, and the necessary accounting requirements, were devised and developed.

Now let's observe how the Commission's focus was enlarged and the rhythm with which its prime attention shifted from one area to another.

Holding Companies

In 1935 the Public Utility Holding Company Act was passed. Once its constitutionality was upheld by the Supreme Court in 1938, the principal manpower of the Commission was thrown into the work assigned by that statute. The job was to break up the holding companies into integrated utility systems, and to simplify the resulting companies' capital structures. The financial abuses of the holding company empires of that era are legendary today, with their watered values, self-dealing, pyramided leveraging and undue concentrations of control.

1941 was the first year in which the Commission administered all the acts which it presently administers. In that year it had some 1700 employees, and its largest division in terms of manpower (as had been true for the two preceding years) worked under the Holding Company Act. For those of us more latterly familiar with the Commission's work, that is hard to believe or remember. The Public Utility Division (as it was then called) had about 250 people working in it and there were additional numbers in the General Counsel's office involved in 1935 Act litigation. In 1941 there were 53 sprawling utility systems comprised of almost 150 holding companies required to register under the Act, and 1500 individual holding, subholding and operating companies. There were few public utility operations in the country that were unaffected by the 1935 Act.

By the end of the 1940s the back of the job of reorganization and divestiture had been broken. Today there are but 17 registered holding company systems remaining, comprising only about 175 companies, virtually all fully integrated. The Commission now has only about 15 people in 1935 Act regulatory work. Most of that work deals with acquisition approvals, the reverse of the earlier work. Legislation is currently pending to transfer administration of the regulatory provisions of the Holding Company Act over to the Federal Power Commission.

Underwritings

About the time, during the second half of the 1940s, that the last of the utility holding companies were being brought into compliance with the 1935 Act, a shift of Commission attention occurred. New underwritings required to be registered under the 1933 Act mounted in volume and number. The demand for public capital that had been pent up for the war years and the depressed 1930s burst out. In the last five years of the 1940s about $24 billion of new offerings for cash were registered and made effective by the Commission, compared to only $21 billion in all the preceding eleven years. And the pace quickened appreciably into the 1950s. In 1955 more new equity securities were offered for cash than had been offered in 1929, the previous all time high. It was in that year also that for the first time total equity offerings (including investment company shares) exceeded in dollar amount corporate debt

securities offered publicly for cash. This has remained the case each year since 1955 by a substantial margin. Last fiscal year alone almost $87 billion in total securities were registered with the Commission, of which $52 billion were for cash sale.

The burst of underwriting activity beginning the mid-1940s shifted the burden of manpower in the Commission back to disclosure work. It was during the early 1950s that the present format of the well known prospectus was developed, the current accounting requirements were solidified, and the rules governing the conduct of underwriters during distributions were formalized. The Division of Corporation Finance became the largest division in terms of manpower, and it has remained such. We now have about 300 out of our approximately 1400 employees engaged in disclosure work for issuers other than investment companies. About another 70 are engaged, in part, in processing registration statements and proxy material for the investment companies. Because of the sheer bulk of registrations, because standards have been fairly well established, and because of the pressures on the Commission's calendar from the other matters I shall be describing shortly, clearance of all registration and proxy statements has been delegated by the Commission to the staff, except in those relatively infrequent instances when new policy issues arise.

Mutual Funds

A major phenomenon appeared towards the end of the 1950s that resulted in a new shift. In fiscal year 1959 seventy new investment companies registered with the Commission under the Investment Company Act of 1940. That year saw a $3 billion increase in assets of investment companies. That was the largest increase since the passage of the 1940 Act, and put aggregate market value of investment company assets at $20 billion. Since then, as you know, investment company assets have increased at a spectacular rate so that by the end of last fiscal year they aggregated more than $72 billion. A total of 222 new investment companies registered last year.

With the emergence of this new and powerful vehicle in the securities markets, the prime attention of the Commission began to turn in the late 1950s and early 1960s. It went from the traditional prospectus disclosure area to the mutual funds, the open-end version of investment companies that accounted for the bulk of the growth. Several major studies were devoted to the mutual funds. They tended to focus principally on fiduciary concepts and management and sales practices and compensation, and eventually resulted in the reform legislation now (or should I say still) pending in the Congress.

Back in 1941 the Commission had assigned only 34 people to the administration of the Investment Company Act. By comparison, that was only half the number involved at that time in the Commission's participation in reorganization proceedings under Chapter 10 of the Bankruptcy Act, another job we have. The number of staff assigned to investment company work did not increase appreciably until the late 1950s. Today we have some 100 people so assigned, and I add only 6 involved in reorganization work. (That, I suppose, is something of a happy comment on the state of our economy today.)

Markets

By the end of the 1950s it also became apparent that the Commission would have to devote more attention to events that were occurring in another area, trading in the nation's securities markets. For one thing, after the war and during the 1950s the over-the-counter markets grew with increasing rapidity. The actual volume and sale prices for unlisted trading were (and still are) mostly unknown. The unregulated atmosphere of trading then existing in those markets, and the paucity of information about a number of over-the-counter issuers, contributed to concern. By the late 1950s "boiler rooms" were at full steam, and by the early 1960s the aftermarket speculative excesses of "hot issues" raised real problems of enforcement for the Commission. Concern about conditions in the trading markets was not limited to over-the-counter when the scandal involving specialist activities on the American Stock Exchange was uncovered.

Moreover, the growth of secondary trading volume on the nation's securities exchanges -- from $16 billion in 1945 to $52 billion in 1959, a more than threefold increase -- even then was outpacing the growth in primary underwritings. In 1959 new equity securities offered for cash by issuers for their accounts aggregated only $2.4 billion, less than 5% of the investment dollars spent in exchange trading. The proportion has widened more since then. Thus, when you look at securities transactions as a whole, trading transactions are vastly more significant in the aggregate than underwriting transactions.

There were a number of responses to these various developments in the trading markets. The self-regulatory response at the American Stock Exchange was vigorous and effective, and at the National Association of Securities Dealers a stronger role was asserted during the 1960s. The Commission expanded its Trading and Markets Division, which carries out the SEC's regulatory responsibilities under the Exchange Act. It went from a low point of about 75 people in 1955 to more than 150 by 1963. The majority of our staff in the nine regional offices of the Commission are involved in the inspection and enforcement aspects of this work. (Today, I might add shell company spin-offs have replaced the now largely eliminated boiler rooms as prime enforcement targets.)

Congressional reaction was evidenced by the authorization of the Special Study of the Securities Markets to be conducted at the SEC. Completed in 1963, that Study was the first important analysis of the securities markets as a whole that had been conducted for the Commission. It was that Study that first acquainted the Commission with the existence of the "third market", involving the trading in the over-the-counter market of listed securities. The Study led to the important 1964 amendments to the Exchange Act. Those, as you know, extended the periodic reporting, proxy solicitation and insider trading requirements to a substantial number of companies whose securities were traded only in over-the-counter markets.

The preponderant significance of the trading markets, to which the Commission responded, I believe, underlies the rather explosive development of the law during the 1960s under the Commission's well known antifraud rule, 10b-5. In some part

judicial developments under that rule can be seen as responsive to inadequacies of state corporate law in this area. The development of implied rights for shareholders under the federal securities legislation is sometimes referred to as the development of a federal corporate common law. Its course is still being charted. I believe it is the Commission's job -- in its own administrative proceedings, in injunctive actions, and in appearances in private suits as a friend of the court -- to be sure the development of the law in this area is on a sound and constructive course.

More recently, of course, in the later 1960s, the operational aspects of the securities markets have come under examination. The back office has become front burner for the whole securities industry. Consummation of each trade under prevailing practice requires extensive documentation and handling. The sustained increase in trading volume simply pushed the industry beyond the paperwork saturation point in 1968. When looked at as a whole system (or more accurately lack of system) --that includes securities firms, exchanges, clearing houses and bank transfer agents and registrars-- it was apparent that the methods for recording and clearing securities transactions and for transferring ownership were largely archaic. Sellers failed to deliver stock certificates when required and many brokers fell behind in their recordkeeping. Some fell into net capital deficiencies. The integrity of market processes depends upon timely consummation of contracts and the financial responsibility of the transacters of orders. Consequently, the operations side of the securities business necessarily became a prime area of Commission attention and concern, as it has for the industry.

Finally, by the later 1960s it had become apparent to thoughtful observers of the securities markets that the price structure for brokerage services in listed securities transactions was out-of-phase with the costs of those services and the growth of institutional business. The rigid commission schedule appeared itself to be contributing to inefficiencies in execution and a fragmenting of the market place. The Commission instituted hearings to examine the commission rate structure and matters related to it. This is turn led to an interim commission change at the end of 1968, and the abolition of "give-up" practices that had developed in the handling of institutional business. The New York Stock Exchange at the end of

last week proposed a substantial further revision of its commission schedule. It is currently under consideration by the Commission, as is the Justice Department's generalized attack on any fixed commission schedule.

I have referred several times to institutional business. The Commission presently has underway an economic study of institutional investors authorized by the Congress. The enormous growth of institutional ownership of securities and the more aggressive trading by institutions are having the most profound effects on the securities markets. One effect has been the emergence of block trading, the purchase and sale of large blocks of securities as distinct from the 100 or 200 share (or smaller) lots usually traded by individuals. This has put considerable pressure on the specialist system for the exchanges.

The need to increase the industry's capacity to handle the larger volume of securities transactions, to weather periods of market price and volume downturns, to replace the capital of aging "money partners", and to meet the competitive inroads of other financial services, has accentuated the need for additional and permanent capital in securities firms. Hence, the pending proposals for public ownership. This in its turn, as does the commission rate structure, raises the issues of institutional membership in, or institutional access to, the exchanges. These are also under current study at the Commission.

The catalogue I have just given should indicate that the direction of prime attention of the Commission in the coming period, out of sheer pressure from the course of events, will be in the markets area. It should mean, I think, that the role of economic analysis at the Commission will become more crucial.

Now

As I traced the evolution of the Commission's prime attention from the financial restructuring of the utility industry in the 1940s, to the disclosure requirements and distribution rules for underwritings in the 1950s, to the fiduciary obligations of mutual funds in the 1960s, and to the condition of the securities markets in the 1970s, I have doubtless oversimplified.

Nevertheless, I hope I have given you some sense of the momentum of the agency in response to basic developments outside it. At the same time I do not want to leave you with the impression that work in areas other than the securities markets should stand still.

Holding companies, for instance. It seems likely that substantial attention will be required by the Commission to act on the recently growing volume of applications under the Holding Company Act for approval of acquisitions or joinders. To the extent the electric utility industry shifts from fossil fuel sources of energy to hydro and nuclear sources, the larger size of such plants, coupled with the high capacity transmission lines now available, seem to point in the direction of larger units, or combination of units, in the utility industry. This is the background of new activity under the 1935 Act. Even if the legislation to transfer such functions to the FPC proceeds, the legislative process itself requires time and attention.

With respect to underwritings, it would seem to me the emphasis in corporate disclosure must continue to shift from the fulsome information in connection with offerings to the quality and availability of continuing information -- information periodically provided about the company's affairs that is material to the investment decisions being made each day in the trading markets. As you know the Commission has pending now proposals for substantial administrative revision of disclosure requirements. These proposals mark the beginning of a shift from reliance on prospectus type disclosure to greater reliance, for companies with securities already outstanding, on periodic reporting by those companies under the 1934 Act. This would require greater efforts on the part of the Commission to insure the adequate dissemination of periodic financial information to investors. The American Law Institute is sponsoring a project for the legislative codification of the patchwork of federal securities legislation. The objective would be primarily to achieve a better integration of the disclosure provisions, and, presumably, of the various liability provisions. Continuing work would also seem to be required in connection with disclosure pertaining to conglomerate enterprises, and the accounting treatment given to business combinations, to mention but two problems.

With respect to mutual funds, if (I would like to say when) the pending bill is adopted by the Congress, attention would have to be devoted to working out procedures and rules under the new legislation (just as any new legislation requires).

But I come back to what I expect will be the main burden of the Commission's attention in the 1970s. That will be dealing with different aspects or parts of the basic question: what will be the character of our securities markets? The increasing role of institutions in those markets and the enormous impact of new technology are forcing change, and raising some old questions anew.

The Commission's model of course through all this remains, in the language of the 1934 Act, "to insure the maintenance of fair and honest markets in [securities] transactions" . . . "in the public interest or for the protection of investors."

Thank you.