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"CAPITAL FOR DEVELOPMENT - THE ROLE OF THE UNITED STATES SECURITIES ACT"

Address of

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The Montreal Stock Exchange

Windsor Hotel
Montreal, Canada

May 30, 1950

Mr. Chairman, this is my first visit to Montreal.. It has been a truly memorable experience, and not the least of the memories that I shall carry away with me will be that of your warm and gracious hospitality. Although I admittedly have been slow in first coming to your city, I hasten to assure you that in common with most of my countrymen, I have long admired Montreal and its citizens. Commissioner McCormick and I bring you greetings from our fellow Commissioners.

It seems to me that in a sense, your beautiful city of Montreal is somewhat a city of paradox. Out of the best of tradition it has blended a culture uniquely its own and charged with the zest of new world optimism. The ties that make Montreal the apex of two continents, cross at this gateway into the vast and richly endowed land of Canada. Progress in the fulfillment of Canada's economic destiny is already impressive; but no one who contemplates its tremendous potentialities, measured in both material and spiritual resources, can doubt that Canada's future is more impressive still.

It takes a lot to make a nation. Headlines and history tend to stress its diplomacy, its wars, its scientific and technological achievements. Somewhat less dramatic perhaps, but no less important, is its finance. You and I, interested in the financial aspects of our modern economy, naturally see the importance of finance which our fellow citizens often fail to appreciate. Therefore, while I may be somewhat biased, if I were to rewrite history, I would rank double entry bookkeeping near Newtonian physics and the common stock above the diesel engine in appraising the growth of modern civilization. Were I to measure the prospects of an area, I would be as concerned with its potential of credit flow and credit reserves as I would be with its rivers and mines.

Along with our advances in the control of physical energy has gone an advance in the science of what one might call "credit-energy." To create the techniques necessary to preserve savings, and to direct their flow into investment has required a skill as impressive as any for which the physical scientists can claim credit.

This development has been borne of necessity. Without this flow of savings into investment, our kind of economy is simply impossible of achievement. Without it, we would be, from the standpoint of industrial and scientific progress, back somewhere in the early part of the industrial revolution.

It is this vital process in which we have a part. I say "we". You have a very direct and important role. I, as a regulator, or what is frequently called, with more candor than flattery, a "bureaucrat", am involved in many of its aspects. Of course, your role is that of a stock exchange. The major function of the stock exchange is to provide a trading market for securities rather than a source of new capital.

But without security trading markets our modern system of capital investment would be as impossible as a city without streets. The capitalist is no longer merely the man who has ventured on an enterprise to which he is willing to commit his wealth and his energies. Today's capitalists are millions of people whose possible need for ready cash some time in the future has made them extremely conscious of the need for liquidity and who therefore insist on being able to transform investments into cash or to switch investment at will. These people would not have ventured their capital at all, if making an investment meant to be indefinitely locked in with a venture.

Providing liquidity, and thereby making securities investment palatable to broad areas of the public, is one of the prime contributions of modern securities exchanges, of which the Montreal Exchange is certainly an outstanding example. But the service of an exchange does not end at that point. Quotations on a fair and orderly market have become prime indices of underlying values and economic behavior. Trading on a well-managed exchange not only determines the levels at which people buy and sell, but at times determines the values at which large amounts of wealth are merged and transferred through the medium of one of our new forms of capital-currency - i.e., the corporate security.

Industrial enterprise and financial capital meet at the vertex of two lines of individual endeavour. The triangle has always been completed by another line - that of government regulation. In some form or other, government regulation of finance is as old as finance itself. The ancestors of our modern rules against stock-watering will be found in rules against the clipping of gold coins. And indeed, protection of coin of the realm against clipping and the integrity of a share of stock against dilution are pretty much of the same basic character.

In its elementary stages financial regulation may be administered as a code of "thou shalt nots". But as our economies grow and expand, as we discover that open channels of investment require a strong measure of public confidence in our financial processes, we have come to recognize that regulation and business are not counteracting forces, but that those of us in business and government alike share the common purpose of keeping our economy growing and prosperous.

There is a high premium on that growth and prosperity. It is one of the ironies of our time that a sound economy is no longer a mere internal fact. It has become, in a sense, a major job in the maintenance of our common security - in fact in our very survival. And I do not need to remind this audience that public confidence in our finance, the maintenance of a free flow of savings into investment, and the development of our maximum economic potentials, are locked together like the fingers of clasped hands.

Just as an independent Canada and an independent United States share most of a continent and a mutual border, so have we been highly and increasingly interdependent. Our geographical relationship, our common problems, our common concepts of justice, of human rights and dignity, and our common disdain for those forces in the world which stand for the exact opposite of our beliefs - all of these things provide a common ground of understanding and cooperation.

The extensive commerce between our countries is symbolic of this common bond. Every day the goods of life cross our boundaries in a two way stream. And with this interflow of goods is an accompanying interflow of credit. It is important to the basic good will that has pervaded our relations that we should each have an understanding of the other country's ways in the fields of finance. Therefore, I should like to discuss the philosophy and the operations of the federal regulation of securities in the United States.

To many of you my remarks will seem elementary. But so much seems to have been said and written in our two countries about this subject which is so patently wrong, that I trust you and I are justified in spending a little time together tonight to get the record straight.

The history of regulation of securities sales, as we think of such regulation today, started in the United States with action by the various state governments, just as it did in Canada, with the enactment of provincial statutes. I speak with a little local pride, if not with any particular authority on the subject, since it was my own State of Kansas which passed the first such law in 1911. Interestingly enough, it was the Province of Manitoba which enacted the second such law in 1912. Following these enactments, over a period of years, 47 of our 48 states and all 10 of your provinces have done likewise.

I might mention in passing that it was my task to deal with the Kansas statute when for seven years I served first as a staff attorney and later as Chairman of the State Commission which administers the securities law along with public utility, railroad and other regulatory functions.

Our state laws vary widely. These statutes run the gamut of regulatory devices from the simplest general power given to a state attorney general to enjoin fraud, to the most detailed prescriptions of qualification of securities to be offered. In between are notification statutes, and variations on the notification, fraud, and qualification themes.

Important as were these state laws, the constitutional limitation of the authority of our states, and the complex nature of our modern economy, made a federal approach to the problem necessary. That fact was dramatically demonstrated in the crash of 1929 and the depression that followed. The only word that can describe the feeling that permeated the markets before the crash is hysteria. Without adequate and current information about what they were buying, without the anchor of information that keeps markets close to reality, investors were tinder for the fire of tip, rumor and hunch.

In the rush for business, and often as uninformed as many of their customers, some securities houses had brought out issues at prices ballooned away from any relation to facts, and were impelled to give the markets a helping hand to keep those prices up. More conservative and informed houses had no choice but to do business at current market levels, or to stay out altogether. It was a banquet, and, as my fellow Commissioner Ed McCormick recently had occasion to say, it was a banquet whose main staple was ignorance.

It took many years and a war to get us through the attack of indigestion that followed that banquet. None of us would like to partake of another one. Faced with this problem, the Congress took steps to meet it in 1933. It had before it a whole range of possible plans - as varied as were the state statutes. Many ideas were advanced. In the main, there were two points of view. One of these urged a "regulatory" form of statute, where an agency would be created and, in effect, empowered to pass upon the merits of security issues - to sort out the good from the bad - the sound from the unsound - and to achieve protection of investors by the exercise of judgment concerning the wisdom of investment in an enterprise and the likelihood of its success.

The other viewpoint was simply to require that the relevant and pertinent facts be made available to the public, that such facts be placed in the hands of the potential investor - and nothing more. In a word, that there be achieved full and complete "disclosure". After that, having available those facts, the individual would be left entirely free to buy or not to buy, depending on his own judgment.

The Congress considered these two schemes, and chose. I think that it chose very wisely. It enacted the Securities Act of 1933, which is a disclosure statute. It invests the Securities and Exchange Commission with absolutely no power to pass upon the merits of security issues. It permits anything - I repeat, anything - to be sold, requiring only that information necessary to make possible a fair appraisal of the securities be given to those who are invited to purchase.

I trust that I can make this one point clear, and I emphasize it because first, it underlies the whole philosophy and operation of our system, and secondly, because so much misinformation seems to be extant concerning it. So often we see or hear comments about getting our "approval", or having us "pass upon" an issue of securities.

Not only are we neither required to, nor allowed to, "approve" a security, but the law even makes it a criminal offense to represent to anyone that an issue has our "approval".

If I may be pardoned for another purely personal word, I would like to mention another thing in this connection. A moment ago, I said that I thought Congress had chosen wisely in providing for a disclosure procedure instead of a regulatory formula. I meant that with all my heart. I have no quarrel with state or provincial laws giving administrative discretion and providing for the exercise of administrative judgment, when the availability of a limited market only is involved. Indeed, as I have said, I administered such a law in my home State. But in so doing, I was affecting the possibility of sale to the people of that state, and only those people.

However, it is a very different thing to be dealing on a nationwide basis, and I do not believe that it is wise or proper in normal times to invest any group of five men (or fifty men for that matter) with the power and the responsibility to sit in judgment on the economic life of any and all enterprises which find it necessary to go to the public for capital. For myself, I would not undertake such a task, and I am sure that my colleagues on the Commission feel the same way that I do in this regard.

The Securities Act of 1933 is not the only one which our Commission administers, but since it is the one which has primary relationship to new issues and hence to the process of capital formation, I have so far, and will largely hereafter, confine myself to it. Let me repeat, that this law calls for nothing more than a disclosure of the pertinent facts. It is some times called the "truth in securities" law. It gives no authority to any governmental agency to decide on the merits or lack of merits of a security to be issued. It requires that the truth be told, and leaves with the individual investor the responsibility of investment decisions.

While time does not allow a detailed recital of this statute in its entirety, I should mention that it carries certain exemptive provisions, it provides penalties for selling securities fraudulently, and it gives to a purchaser certain legal rights where a security has been sold in violation of the statute. All these are common provisions, going no further than the common concepts of legality and morality which both of our countries and our peoples hold.

How does the Securities Act work? In general, before a security can be publicly offered the issuer must file with the Securities and Exchange Commission a registration statement. That statement is, in effect, a series of responses to prescribed items calling for material information about the business and financial record of the company. This filing is inspected by our staff of experts. If it appears that the statement needs to be corrected or supplemented the staff will send a letter of comment to the issuer, suggesting the matters upon which fuller disclosure is necessary. This letter is sent within a short time after we receive the filing - usually within ten days.

I may note here that this technique of informal comment on registration filings is itself a deliberate choice of administrative method. The Commission has the legal power to wield the big stick. It can, without sending such a letter of comment, institute a formal proceeding under the law, alleging the deficiencies in the registration statement and (if after a hearing, the record sustains the allegation of deficiency) issuing a stop-order which prevents any securities from being sold.

However, that technique is very rarely used, and is used only where we are convinced that a willful attempt has been made to flout the disclosure requirements, or there has been such gross negligence as to indicate that a letter of comment would serve no purpose. We have found that most issuers are anxious to give a full and correct statement and that more progress could be made, with less interference in programs of business financing, by the informal and cooperative technique of the letter of comment.

If the issuer's response to the letter of comment satisfactorily corrects the registration statement the staff will recommend that it be declared effective; and, upon effectiveness, the securities may be offered. Here, too, let me add a comment. Under the statute the Commission can either require an issuer to wait the statutory twenty-day period, after its registration statement is put into shape, or it can hasten the time of effectiveness - a procedure known as "acceleration."

I have sometimes heard people accuse us of animosity against mining and petroleum developments securities issues; while they may concede that we cannot disapprove speculations, they do often insist that we strangle them in the red-tape of delay.

It is true that the registration process in this type of issue, as well as other types, is sometimes delayed by the time taken by the registrant to comply with the letter of comment. But once the statement is conformed it is in the Commission's discretion how long a waiting period should elapse - up to the twenty days provided by the law.

So that I could appraise these arguments against the facts about some of the registrations, as a test of a representative sample I had the twenty-eight mineral and petroleum issues originating in Canada, and registered with us in the past three years, surveyed on this score. Of that total, only two statements were held for the statutory period after being corrected according to the letter of comment. The average waiting period for all of the issues was 6.5 days and the median 5 days, as against the twenty days provided by law.

Our Congress recognized that a piece of paper resting in a central file in Washington, D. C. was bound to be of limited use to investors. In order to bring the information to those who need it, distributors of registered securities are required to provide to investors prospectuses which contain the salient facts set forth in the registration statement. This requirement attaches to all securities registered under the Securities Act and it attaches to newly distributed securities as long as they are in the process of distribution.

To adapt an old aphorism, regulation is as regulation does. Disclosure, like any other form of regulation, can be made an instrument of oppression if ruthlessly administered. It can become a facade if supinely administered. We are neither ruthless nor supine. In early days, while we were still new at the game we tended to insist on more disclosure rather than less. As we gain experience we learn to pick the wheat from the chaff and we learn too that neither business nor the investor is served by over-doses of disclosure.

The cry for simplifying our disclosure requirements used to come from business predominantly. Today the Commission itself is without doubt the single strongest exponent of simplification and streamlining. We want the basic purpose of our law fulfilled - i.e., that the prospectus containing the essential information shall be given to the prospective investor. And we have recognized clearly that the investor is

little benefited by a formidable document filled with details and technicalities that discourage him from extracting the information he needs and can understand. Consistently, therefore, the Commission has jettisoned, paragraph by paragraph, much of the cargo with which prospectuses once were laden.

The task is not over by far. And those of us who have been in the middle of this can state that paradoxically enough, the major objections to streamlining are made on behalf of business itself. Lawyers who profess to fear possible civil liability of their clients for omissions will often insist on cramming prospectuses with minutiae that may have little relevance to the basic investment merit of the security.

I am glad to be able to report considerable progress in simplifying prospectuses. The progress has resulted not only from our efforts but from those of the issuers who have worked with us. On our part, we have maintained a constant, never-ending study of our disclosure requirements in order to simplify them. As a result of patient education many attorneys and others have learned how to draft prospectuses which are models of brevity and clarity. Right now, our staff is working out recommendations for further simplification which we expect to have before us for early consideration.

We at the S.E.C. would have to be deaf not to hear the persistent and baseless criticism that the registration process is expensive. Quite apart from its exaggerations, that criticism often makes the rather startling error of confusing us with underwriters; for analysis demonstrates quite clearly that registration itself is not expensive. In a recent study by the Commission it was shown that for all issues of securities registered and offered for cash over a representative period the average cost, other than compensation to distributors - but including all registration costs - was only 1/2 of 1% of the aggregate offering price.

Expenses, other than distribution fees are a minor factor. Yet, only part of the items in the cost of distribution, other than distributors' commissions and discounts, is attributable to registration. Expenses such as issuance taxes, registrars' fees, cost of compliance with state securities laws and so forth are attributes of any distribution whether or not registered. The filing fee is one of the few expenses directly attributable to the registration process. It is, by law, one one-hundredth of one per cent of the maximum offering price of the securities to be registered.

Independent audits of financial accounts are made regularly by most corporations of any appreciable size, whether or not required by law - and we do not require special audits in connection with the basic registration form, although frequently the underwriters will insist on special audits for their own protection. Counsel fees are a traditional part of the underwriting process which long predates the Securities Act. So too are underwriter's commissions and discounts which, as I have indicated, are usually, by far, the largest part of the cost of a registered distribution.

The expense of printing and distributing the prospectus is frequently hammered at as one of the expenses incident to registration. But that criticism loses considerable force when it is considered that many corporations, without the prodding of regulation, are lavish in their expenditures on annual reports to stockholders and, when they feel free under the law to do so, spare no expense in preparing and distributing selling literature apart from the prospectus.

The plain fact is that the vast bulk of the expense loosely attributed to registration under the Securities Act is inherent in a public distribution whether or not registered.

Registrations with the Securities and Exchange Commission have represented every industry type and size. Securities in every step of the range, from gilt-edged to hopeless, have been registered to the tune of billions of dollars annually. The $57.5 billions of securities effectively registered under the Securities Act since its passage are a standing answer to any criticism that the registration requirements are a bar to securities offerings.

We are proud of that record, and we are proud of the fact that the laws we administer have become part of the working code of American business. We still hear complaints of course, as you do, and many of them come from the adventurous frontier of economic development represented by the wild-catters and prospectors. I have a soft spot in my heart for the wild-catter. I come from a part of the world where oil and gas resources were brought to the light of day by incorrigible mavericks (as the Texans call any non-conformist) who had the itch to search and the optimism to keep doing it in the face of disappointment. They are the men who are not so much in business as they are infected by one of nature's most intractable viruses - men who are either one foot from a million dollars or a million miles from one dollar.

I expect that kind of man to chafe at regulation. If he were the kind of fellow who obeyed the voice of caution and could live with the restraints of convention he would probably not be wild-catting or prospecting in the first place.

Canada stands on the eve of her century, and the wild-catter and prospector are important to her as they were, and are to us. For one of the hopes that she can bring to a world that needs the metals and hydrocarbons of the earth, is her still untapped vast resources. I said, earlier tonight, that it takes a lot to make a nation. Optimism, that conservative folks might call irrational, a sense of adventure foreign to the bond and guaranteed investment buyer, and dreams and hopes that get lost in the complexities of debits and credits, are essential ingredients in the making of a nation. We, south of the boundary, are proud of a tradition that I believe also exists in Canada. Even in the crowded cities our childrens' heroes whom they emulate in play and dress are the optimists, adventurers, and dreamers who carved our nation out of the frontier.

But from the range out in your west and ours the prospector may have to convince a conservative banker that he, the prospector, has something worth putting hard money into. Often, the process of financing carries the deal to the public. The banker will not, and we believe that the investor should not, be expected to buy blind.

Fortunately this does not mean a bar to mineral development in any sense of the word. The promoter of a mineral development may be impatient with the requirements of disclosure, but when he discovers that these requirements permit him to tell the investor the objective facts upon which his own optimism is based he will be reconciled to them.

I have tried to outline for you some of the simple premises underlying our approach to securities regulation. We are not, and cannot afford to be, smug about our way. Year by year we accumulate experience that teaches us that changes should be made. What we can do by improving our rules and regulations we do that way. Sometimes the change we think necessary is basic enough to take to the Congress as a recommendation for legislative amendment. But the essential wisdom of disclosure as a working formula for securities regulation is confirmed by our continuous experience.

Our experience confirms the further fact that world security and well being are no respecters of boundary lines. North and south of our mutual border, we share a common stake in continental prosperity and in the free flow of goods and credit. We share a common need to pull from the earth the resources necessary for security and prosperity.

We, at the Securities and Exchange Commission, are very sensitive to that fact. We want, neither wittingly nor unwittingly, to stand in the way of the fullest exploitation of our skills and resources on either side of the border. The enterpriser on one hand, and the risk taker on the other, are essential parts of the process. We don't conceive it to be our job to discourage exploration or to prevent investors from taking risks. But we are committed to the idea that the risk should be an informed one.

It is an idea that forward looking enterprise shares with us. An investor who has been the victim of another's concealment and his own ignorance is likely to be a wasted field. The legitimate enterprise with some hope of development for the benefit of its economy and its shareholders is likely to find him unwilling to venture again. I couch my statement in less than positive terms because I know that there are confirmed psychopaths who, like Hindu believers, just cannot be burned. But their overall effect on priming the economic pump, as 1929 demonstrated, can be small indeed.

Our proximity, our common language and traditions, and our heavy interchange of people and ideas give Canadian enterprise an enviable advantage in the attraction of United States capital. I read recently an estimate that $5 billions of United States capital was already invested in Canada (both by United States Corporations and individuals) and I have no doubt that the future will and must see an increase in that volume.

I have tried to demonstrate that I don't think of our countries as parties to isolated business transactions. Below the debits and the credits; below the exchange balances, is an economic organism living in a world environment that calls for stress on an organically unified purpose and attitude.

I have tried to drive home the point that we, at the Securities and Exchange Commission, view our task under the Securities Act in a broad framework. We do not conceive ourselves as policemen patroling a beat. We believe that what goes by the name of protecting the investor is fostering the maximum fulfillment of our best economic potentialities. For Canada and the United States that is what I have called an organically unified purpose. We have administered the law in that spirit. Our regulations and prescriptions are uniformly administered with respect to securities issues from either side of the boundary. And the maintenance of high standards in securities selling is at heart a common problem.

In a way, the part that my Commission plays in the big scheme of things has an importance that transcends the day to day problems we face. One cannot be committed, as we are, to the idea that the full realization of our economic potential depends on free markets - both capital and trading markets - and be expected to put much of a premium

on such characterizations as "strictness" or "leniency" of administration.

The job we have to do, the goal for which we reach is bigger than a reputation for being back-patters or wrist-slappers. The standards have to be kept high, surely, but rather than talk of strictness or leniency, let us remember that ultimately the business of securities regulation is to help the securities business play its important part in the big scheme of things. And securities regulation that strangles legitimate securities business is little better than the lack of regulation that permits the high-binders to strangle it.

I am not a cosmopolitan. I come from a relatively small city in a region of my country that is proud of its regional flavor. Let me add, if I must, that as much as I believe that circumstance has made us joint venturers in the big business of history I do not believe that circumstances either now or ever will require either of us to lose our unique national flavor or the opportunity to make our individual national contributions to the world.

To that common purpose we are, as we must be, commonly dedicated.