ADDRESS

of

JUDGE JOHN J. BURNS

GENERAL COUNSEL OF
SECURITIES AND EXCHANGE COMMISSION

at

INVESTMENT DIVISION DINNER OF FINANCIAL ADVERTISERS ASSOCIATION CONVENTION AT ATLANTIC CITY

SEPTEMBER 10, 1935

§

Released for Morning Papers
September 10

Financial Advertisers Association
Lester Gibson, Chairman of the
Publicity Committee.

Address of Judge John J. Burns at Investment Division Dinner of FAA Convention at Atlantic City, September 10, 1935.

The Securities and Exchange Commission has strong convictions as to its policies in relation to the investing public and the business men who may be affected by securities legislation. One phase of its activities about which the Commission feels deeply is the necessity of assisting those on whom the Act may operate in order that friction may be avoided and proper business desires attained consistent with that protection to the investor which is, of course, the real reason for the Commission's existence. This assistance takes many forms. Some of you already have had occasion to confer with the Commission and its staff regarding your individual problems. I am sure you were struck by the earnest desire on the part of all to be helpful. One of the most valuable methods has been through conferences such as this. I should like first to explain a part of the statute and its application in certain fields. In that spirit I appear here tonight--not as a lecturer but as one who is anxious to indicate to this group the Commission's attitude and to discuss with you the problems of securities legislation as they affect your business.

It will be impossible to do more than discuss a few of the major problems involved in the advertising of security offerings -- a subject in which I assume you all have great interest, and I might add a subject which has been a major concern with the Securities and Exchange Commission. Adequate advertisement of new security issueshas been, and I regret to say still is, one of the most troublesome problems facing the Commission. The Commission and its staff has worked energetically toward devising a practical solution which will permit reasonable latitude to advertisers and thereby to increase the information available to the public and yet which will conform to the requirements of the Securities Act of 1933. This Act you appreciate is just as binding upon the Commission as upon the issuing corporations, underwriters and dealers. Unfortunately, the Commission's efforts to co-operate with advertising agencies, periodicals and newspapers in liberalizing, so far as may be permissible, the restrictions of the Act have been hampered and to some extent completely frustrated by the fears of issuing corporations and underwriting houses. One hesitates to be dogmatic about a question of law, particularly where contrary opinions have been expressed by firms whose standing gives an aura of wisdom even when they are wrong. But I am not the least bit hesitant in declaring that the fears which have occasioned the refusal of newspaper and periodical advertising of new issues are without reasonable foundation.

The Securities Act and the regulations of the Commission pursuant thereto have a simple single objective which can be best summed up in the word publicity. Many suggestions were made to the Congress early in 1933 as the appropriate concept for securities control. Of them all Congress decided that a publicity statute with appropriate safeguards would be adequate to control the unfortunate incidents of security distribution with which we are all too familiar. This objective of "information for the investor" the Congress sought to attain in a number of ways:

First, the law requires that no sale of an unregistered security by the issuing corporation and underwriter or dealer shall be legal unless at the completion of the sale the purchaser is furnished with a prospectus containing information which is deemed, not only by the Commission but by the financial interests themselves, as essential to intelligent appraisal of the security;

Secondly, Congress sought to attain publicity by requiring that advertisements of new offerings likewise contain similar information, the scope and extent of which was left to the discretion of the Commission.

In the administration of the Act the central problem for the Commission has been one of judgment--what information should be required which is necessary for the protection of the investor and at the same time can be furnished without unreasonable effort or expense. On the application of this standard no one can be certain in the mathematical sense and for many months the Commission wrestled with this problem, keeping in mind the interests of all parties involved and not making final judgment until representatives of all classes had been given an opportunity to be heard. If one dwells on that problem, it is understandable why very many of the Commission's critics feel we have asked too much, why very many feel we have asked too little. On the whole, reception of the new forms has given confidence to the Commission in its belief that the approach has been fair and sound.

The problem of the prospectus is still receiving the attention of the Commission in order that the goal of practicability and understandability may be attained in the use of the necessary documents. We hear some critics complain that prospectuses are growing so complicated that it is impossible for anyone except the most expert technician to understand them, and yet their counter suggestions leave out information which we honestly feel ought to be called to the attention of one whose money is sought in a public offering. The Commission only too well appreciates that investors may be deceived by an over-abundance of information quite as much as by a scarcity of it. The point I wish to emphasize is that there is no absolute right or wrong. Assuming competence, the attitude becomes most important, and I believe the history of the last year is eloquent testimony that the Commission seeks to favor no group but to make efficient a law, the objectives of which can be criticized by no man. Only recently we received a communication from a security analyst who felt a prospectus should contain normally only the following items:

1.- The offering price per share or unit.
2.- (a) In a stock the average earnings per share for a period of years together with the number of times earnings that offering price represents.
    (b) In a bond the average earnings over a period of years with a statement showing the number of times interest has been earned.
3.- The current and past dividend or interest payment record and the yield at the offering price.
4.- Working capital per share or per bond.
5.- Asset value per share or per bond.

6.- Schedule of leverage (analysis of capitalization). But little analysis is necessary to convince even one who does not possess expert knowledge that such a suggestion is inadequate. Where a company's history is well known, these factors in conjunction with the history already assimilated might be sufficient, but for a person learning of the company for the first time, and we must always make that assumption, the proposed prospectus requirements seem clearly insufficient. From a number of the large investment buyers whose judgment in the final analysis is decisive, the Commission has received many words of high praise, and the more recent prospectuses as developed by the Commission's requirements have even received favorable comments international in source.

One of the most disappointing features has been the fact that new offerings have not been advertised to any great extent in newspapers and periodicals. It is not entirely clear why this should be so. However, it is almost a truism that your interests and those of the Commission are identical in a desire to overcome the present reluctance of underwriting houses to employ the medium of newspaper and magazine advertisements in order to present new offerings of securities to the purchasing public. We administer a publicity statute; you sell publicity. In so far as we possibly can, we would like to have all possible publicity regarding offerings to the public.

I think it might be helpful to explain in a few words the extent to which the Securities Act of 1933 applies to the advertising of securities, but before touching upon the advertisement by issuing corporations and underwriting houses of new security issues which are required to be registered under the Securities Act, it may be well to point out that there are many new offerings which are not subject to the requirements of registration. By provisions of the statute many securities such as governmental and municipal obligations, those issued by railroads subject to the Interstate Commerce Commission, or securities issued only to residents of the state in which the issuing corporation is incorporated or doing business are exempt. Advertisement of securities exempt from registration, so far as concerns newspapers and advertising agencies, is unaffected by the requirements of the Act. The advertising restrictions which the Securities Act has imposed apply only to securities which are required to be registered. As to the advertising of exempt securities, it is controlled only by the general law as it existed prior to the Securities Act.

Section 5 of the Act not only forbids the sale of any unregistered security which is not exempt from registration, but also forbids the transmission through the mails or in interstate commerce of any prospectus which does not contain the type and degree of information which I think is now quite universally regarded as essential. I should like to point out, however, that it is the scope and content of "prospectuses" only which are subject to these requirements. Now a prospectus is defined in Section 2 of the Act as comprising any communication which offers a security for sale. Consequently, any ordinary newspaper or magazine advertisement would constitute a prospectus and would, therefore, be subject to the Commission's rules and regulations governing the use of advertising materials. The extent of the information which is required to be stated in newspaper or periodical advertisements I shall explain in a few moments.

Congress, however, specifically excluded from the definition of the term prospectus a bare notice which does no more than name the security, the price at which and by whom it is offered. You are, of course, all familiar with the use of these naked announcements. Such a notice is in many respects similar to a professional calling card, in that the only possible sales appeal lies in the name alone. This type of advertisement can do little or nothing towards achieving the purpose of the Securities Act--to apprise the investing public of the nature and background of the security offered. The only virtue of these statements of name and price and the seller of new securities, from the Commission's point of view, is a negative one. They can not err in the direction of lurid and over-persuasive language and thus can do the investor no harm. Yet such an announcement is of little or no value to the prospective investor faced with the problem of where to put his earnings. The problems of advertising can not be solved by any mere announcement of the name of the security. From here on in discussing the problems of advertising I shall disregard these mere announcements of the name of the security offered, which, in the true sense of the word, can hardly be said to constitute advertising. No important question exists as to the legality of their use.

In April of this year the Commission commenced a series of round table discussions with the financial editors of several of our larger newspapers and with the representatives of a number of advertising agencies. With the aid of these gentlemen we sought to evolve practical and workable rules which would not only permit the advertisement of new offerings but would encourage them. These rules which apply in the advertising of all securities in which the public generally might be interested, embodied almost entirely the suggestions of the newspapers and advertising agencies which helped us in the task of deciding what information and how much of it the public should receive through the medium of advertising in order to be adequately protected. The information required was, considered by all of us who studied the problem as the minimum that a prudent investor should have in order to make up his mind. In framing these rules the Commission was constantly aware of the practical limitations on advertising space and therefore strove to eliminate from the required information all but the necessary elemental facts. The following in substance is what a newspaper advertisement for a new offering must contain:

Besides the name of the issuing corporation and the state of its incorporation, a brief outline of the general character and developing of its business, and in outline form a short statement of the corporation's capital structure so that the investor may know the debts to which as a security holder he may be subordinated, and the stock issues to which he may be subjected or in which he may participate. Only the barest information about the corporation's outstanding capital issues is required, in general, only the title and the amount of the outstanding issues and the principal or par value amount. Of course, a somewhat more detailed description of the securities which are offered in the advertisement is required. The prospective investor should certainly be informed of the name and par value or principal amount of the issue, its retirement or redemption features and the security which underlies it and which will protect his investment. The rate and method of paying interest or dividends must, of course, be set forth, as well as the voting rights which go with the security offered for sale. In substance, it is only required that the prospective purchaser be informed of

the rights which are incident to the instrument for which he is asked to pay his money. The Commission has also required that the investing public be told who the underwriters are and what their profit for wholesaling the issue is to be. Inasmuch as the purchaser of the security is buying not only a piece of paper but a share in a business, the Commission also believes that he ought to know the purposes to which his money is to be put. If the investor's money is to go towards the acquisition of patents, it is felt that he should be told briefly of the nature and significance of the rights which the corporation purposes to acquire. No financial statements are required and no detailed information, the effect of which might be only to confuse the uninitiated. I think you will agree with me that the scope of the advertisement which I have just outlined contains no more information than each one of you would want to know before taking an action of such importance as the investment of your capital.

These prospectus requirements for newspaper and periodical advertising represented the efforts of our staff and the attorneys for the newspapers. At no time were we far apart even in our first drafts of items to be answered. We could appreciate the newspapers viewpoint that the items must be limited and the timidity of advertisers overcome, and your attorneys were appreciative of our views. In fact, I should like to compliment them, not only for their fairness but for their intelligence in understanding this complex problem of judgment.

The requirements are, therefore, only that a thumbnail sketch of the business and condition of the issuing corporation be published, if purchases are to be solicited through advertising. As a matter of fact, an advertisement for a recent fifteen million dollar bond issue, the proof of which I have here, made up into about a quarter page of generous type and spacing. This advertisement was of approximately the same compass as the regular offering advertisement which was in prevalent use before the passage of the Act, and contains no more information than would ordinarily have been given in connection with an offering of this size before Federal regulation went into effect. The most important aspect of the use of an advertisement such as I have just outlined is that it gives the customer something tangible on which to make up his mind on a subject which all of us will agree is of vital importance.

A few words as to the possible liability which may be incurred through advertisement of securities may be helpful. As you are no doubt aware, an advertisement of securities may be helpful. As you are no doubt aware, an advertisement may be illegal under the Securities Act not only because it fails to conform with the Commission's requirements promulgated pursuant to the Act, but also if it offers for sale an unregistered security which is not exempt from the registration provisions. This, of course, is because the Act in general forbids any offering of an unregistered security which the law requires to be registered. What I should like to emphasize to your profession is the fact that the possibility of liability being imposed upon a newspaper or advertising agency, even in the event that the advertisement is illegal, is practically negligible. The right of civil action which is given by the Act to persons who have been sold securities in violation of the law extends only against the person who thus sold him the security. Consequently, newspapers, magazines and advertising agencies

can have nothing to fear on that score, since in the normal case neither the advertiser nor the paper running the advertisement are engaged in selling the security for their own account. Criminal liability, of course, can only be imposed for a *wilful* violation of the Act. Consequently, any advertising agency, newspaper or magazine preparing or carrying an advertisement in good faith, believed to be legal, has nothing to fear either from the law or from the Commission. Although I fully realize the needlessness of mentioning it, I suppose I should point out that Sections 17 and 12 of the Act impose criminal and civil liability respectively for any false or misleading statement wilfully made in inducing the sale of a security. However, there can be no need for me to discuss that phase of the Securities Act.

Perhaps before I turn to other subjects I should explain the operation of Section 17 (b)--

> "It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof."

This subsection renders criminal the publication of any description (or advertisement) of a security where the publisher or writer of the description is paid for so doing by the issuing corporation, or any underwriter or dealer, unless the person responsible for writing and circulating the description states not only that he is paid to do so but states the amount of the consideration as well. This subsection was, of course, designed to prevent the former widespread use of so-called "tipster sheets" wherein supposedly disinterested and unbiased investment services were paid to tout the securities in which some particular underwriter or dealer was interested. In other words, the section is designed to prevent a secretly interested person, having his own pocket to serve, from masquerading as an impartial adviser of the investing public. You will note that the only affirmative requirement of the Act is that the person responsible for such a description or advertisement shall disclose the compensation paid to him. In my opinion the word "consideration" as used in the Act does not include the normal advertising rates which are charged by newspapers and magazines. Hence, publications accepting securities advertisements at their regular advertising rates need not disclose the amount thereof. Nor does this subsection, in my opinion, affect the role played by an advertising agency in drafting or revising the copy for the advertisement since the statements which may be contained in the advertisement do not purport to be made by the advertising agency. In fact seldom or never does the name of the agency handling the advertisement appear. The investing public is not asked to buy the security on the strength of what the advertising agency may think of its investment merits and therefore an agency which drafts or revises advertising material which purports to be a statement by, and of, an issuing corporation, underwriting house or a dealer is not affected by

this subsection. The liability of this subsection is imposed only on one who though not purporting to offer the securities for sale, describes such securities for a consideration but fails to disclose the fact of consideration. This liability is one which none of you will oppose. I am very confident that the minimum ethics of good business outlaws the recent popular practice of financial writers who, pretending to act impartially, recommended the purchase of securities on which they had options and calls. As a matter of fact I am inclined to the opinion that under the law antedating the Securities Act such a practice amounted to a common law fraud and was an indictable offense.

It seems perfectly clear, therefore, that the Securities Act insofar as the risk of liability is concerned, criminal or civil, can have no terrors for your gentlemen except in the case of the new business department. You are not vulnerable, but your clients may think they are. It is also quite evident that your profession and a Securities and Exchange Commission are both striving for a common objective. The publicity of facts essential to a reliable understanding of the securities offered for sale means business to you and is strictly in accordance with the Commission's desires to have adequate disclosures adequately available.

Some of those who criticize the requirements of the Commission for prospectuses claim that the information is over the heads of the average person. I frankly do not know how intelligent the average prudent investor is, nor do I know any method whereby we could ascertain the extent to which he can digest security information. It is no answer to the registration and prospectus requirements of the Act to say that many investors are at sea when confronted with a balance sheet or with technical terms. The market of securities in the normal case, as you know, depends upon the reaction of intelligent investors to the information available. Under the old order essential information was difficult to obtain in any form, even for the most expert of security analysts. The present law seeks to compel issuers and underwriters to make available essential information when funds are sought from the public. I could cite hundreds of instances to prove the advantages of the new order. Only recently the comptroller of a very large railroad which owns valuable non-carrier properties praised the Commission highly because he said that after his company had registered with the Commission he was able to find out for the first time important information about one of the company's subsidiaries. I will not belabor the point--investment is an exercise of judgment and that must be preceded by knowledge, and knowledge implies information made public. It has acted to cut down to a minimum the information which must be published in a financial advertisement. I see no way in which additional assurances can be given to the underwriter or to the issuer without removing from the Act one of its most important props for the protection of the investor. The Commission is very anxious to find in all cases a successful formula which will reconcile the differences of men of good will on whom the Act might operate. I can not emphasize too much the favorable attitude of the Commission towards a more general use of newspaper and periodical advertising of securities. This is not strange. It certainly would be an odd anomaly if that Act which seeks to force publicity of all relevant data in the public offering of securities should be the cause or still continue the occasion for the scarcity of newspaper advertising in the security field.

It has been suggested that the fear on the part of the underwriters might be overcome if the Commission should require a summarized prospectus to be placed in the front of the present prospectus itself. It is urged that although such a practice would not make any legal difference, psychologically it might have the effect of causing advertisers to take the risk they now refuse. I am not optimistic that such a device would be effective unless the underwriters' counsel are first converted. One factor which ought not to be ignored which I mention without taking sides, is that many believe that it is at least doubtful if the situation we now discuss from an advertiser's point ofview would have been very different had we no Securities Act at all on the statute books. We have recently witnessed a very strange period in American financial history. The experts say that money has never been so cheap in almost a hundred years. Large scale refunding was as logical as the coming of tomorrow and in the general financial state of the nation it was inevitably a buyer's market. As a consequence there was little talk, at least until recently, about sales resistance. The "Abnormal demand" was reflected in prices which were so low that should a normal period soon return, the rates will appear almost fantastic. It is argued, gentlemen, that in such a situation the underwriters were not subject to the pressure which makes for extensive financial advertising. When this situation is corrected by the influence of time and recovery, we shall be in a better position to make a judgment about the influence of the 1933 legislation on your business.

I have just one further point to make. It is unfortunately true that a Democracy such as ours which lives and acts by symbols and slogans is particularly susceptible to the art of propaganda which since the war has become almost an industry. In the great war of words and cartoons affecting proposed legislation when the campaign of assertion and denial, of prophecy and doom is over, the damage to society is not cured for some time, whether the battle is won or lost. The Securities Act of 1933 was passed without a dissenting vote and in that sense can be said to represent the will of the people if anything can. Despite this unanimous expression of Congress, the Act became the object of terrific attack from those who saw in it a sinister plot against property rights. While it is true that the amendments of last year and a more sympathetic administration have helped to dissolve the fears of many of those who opposed the legislation, it must be recognized that many persons particularly among those of the legal profession, still withhold a genuine assent to the purposes of the Act and its validity to achieve the social objectives. It is this lawyer's fear of liability which largely explains the refusal of underwriters to renew to some extent their financial advertising. Yet for all practical purposes these same law firms who now withhold their approval of the prospectus as outlined in Releases 351 and 357, approved thousands of prospectuses prior to the Act which carried liability substantially no greater than that of the Securities Act of 1933. Gentlemen, the present prospectus requirements for your business are fair. Less than these would seem to be inadequate. They call for information no more than was customary before the legislation and the inescapable corollary, apart from the claim that Act or no Act there would be no advertising, is that unwarranted timidity on the part of the legal profession is a decisive factor in the present condition of your business. Let me urge upon you will all possible emphasis that your profession do what it can to overcome this present apathy of underwriting houses toward advertising their new offerings. The Commission has given very definite indications of its attitude and its desires.

Let me add but one thought--if difficult questions should arise in preparing a form of any such advertisement, of course, we will gladly give you any assistance we can. We would do it anyway, and we are the more eager in your case because our interests are in a very real sense identical.