

THE PLACE OF THE SEC IN AMERICAN BUSINESS

Address by

RALPH H. DEMMLER

Chairman

Securities and Exchange Commission

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The subject of my remarks was announced, I believe, as "The Place of the SEC in American Business." That will in fact be the subject, but I want to discuss it, if you please, against a somewhat philosophical background.

Life - personal, business, community, national - has grown so complex that it is easy to lose our sense of direction. We tend to become engrossed in working our way out of our private little mazes. I won't apologize, therefore, for using up some of your time trying to fit the particular type of federal regulation which the Securities and Exchange Commission administers into the general pattern of the nation's economic life.

The economic history of this nation since the Civil War is a history of reaction to forces of incalculable magnitude - growth of large aggregations of economic power, the availability, indeed the rush, of surplus wealth for investment, war, the struggle for world power, the responsibility of world power, the development of weapons of mass destruction. Let us try to classify, if we may, the techniques by which such forces are handled. At the risk of over-simplification we can say that two methods have been employed - sometimes alternatively, sometimes concurrently - the development of counter forces or the imposition of legal controls.

Let me illustrate what I mean. Take the development of large aggregations of economic power represented in our giant corporations. The counter forces operating to control that power are competition of rival businesses and the collective bargaining power of labor unions. The legal controls operating to control the power are the anti-trust laws, the labor management relation laws, and the securities laws. Sometimes there have been attempts at voluntary self-imposed controls such as the cartels of Europe or the old NRA codes under the short-lived and unconstitutional National Industrial Recovery Act.

Take another example - the struggle for world power. On the one hand, we set up counter forces, rearmament, EDC, the winning of the atom race. On the other hand, we attempt controls, the League of Nations, the Naval Disarmament Treaty of 1922, the United Nations.

The wisdom with which we select a method or combination of methods of responding to these great challenges of our time determines the strength of our nation and may determine our survival.

Let me illustrate again. In some European nations private business has met the pressure of competition by a system of privately imposed controls - cartels with price fixing, allocation of markets, resistance to efficient methods of production, low wages, feeble attempts to develop mass markets. The result? A dangerous lack of popular support for private enterprise.

Now let me get a little closer to the announced subject of my remarks. This country has generated surplus wealth - savings if you will - available for investment. Corporations have been developed as a legal vehicle to bring together the savings of millions. There are some 7,000,000 stockholders in this country. One corporation has over a million stockholders. If you consider the indirect investment represented by ownership of insurance policies and interest in pension funds, the savings of many more millions are invested in the American industrial economy. The result of this is a peculiarly American and Canadian phenomenon, a literal pressure of money saved by the general public to find a place for investment in business and industry.

What do we do with these forces? The corporations call for capital. The members of the public press forward to invest their savings. We might depend entirely on an automatic system of self-adjustment. Investors could learn by bitter experience; the buyer could beware; businesses which forfeited public confidence would fail; the strong would survive; there would be no restriction in gathering capital into enterprise. Any such concept involves an inexcusably naive confidence that good will always triumph over evil.

It is inherent in the nature of things that there must be some legal controls imposed on one man who gathers together and administers capital furnished others. That is true of trust funds. It is true of bank deposits and in its own way it must be true of corporate capital. Corporations are artificial entities, creatures of the state. They are empowered to do only what the law says

they may do. Their directors have duties both as to good faith and prudence. Their property must be handled with due regard to the rights of creditors and stockholders. These general concepts are incontrovertible, but an effective system of legal controls involves the development of detailed rules and effective techniques to insure compliance.

When we look at the function of the modern corporation in gathering and administering capital, what ends do we desire? What abuses do we seek to prevent?

(1) We want to encourage investment - money in the mattress, jewelry in a vault are static wealth.

(2) We want no foolish, meaningless obstacles to the accumulation of capital.

(3) We want opportunity for initiative and imagination to develop the full economic potential of an enterprise.

But there are a few other things that we want also:

(4) The investor should know what he is getting into when he buys securities. The Securities Act of 1933, the so-called "truth-in-securities law," requires the disclosure of information in the sale of new securities and prescribes standards for such information. The Securities Exchange Act of 1934 provides for periodic reports by companies listed on national securities exchanges.

(5) The owners of an enterprise are entitled to current information. The reports under the Securities Exchange Act of 1934 provide this in the case of listed companies.

(6) Financial information should be presented to investors with reasonable completeness and in accordance with generally accepted accounting principles. Under each Act administered by the Securities and Exchange Commission the Commission is given power to prescribe accounting rules.

(7) The investor should have a remedy against someone who deceived him by misrepresentation or concealment. The Securities Act of 1933 and the Securities Exchange Act of 1934 in the aggregate provide for civil remedies against a number of types of fraud and concealment in the sale and purchase of securities.

(8) A stockholder should have a chance to vote intelligently at corporate meetings - not blindly. The Securities Exchange Act and the proxy rules thereunder provide, in the case of listed companies, for information as to management's stewardship and for an explanation of matters to be acted upon at corporate meetings of listed companies.

(9) The markets for securities should be free of manipulation. The Securities Exchange Act provides for the regulation of national securities exchanges. It provides penalties for manipulative activity and provides for some controls of the over-the-counter market.

(10) People with inside information should not be allowed to make use of such inside information to the disadvantage of their fellow security holders, and transactions between such persons and the corporation should be subjected to careful scrutiny. The Securities Exchange Act of 1934 and the Public Utility Holding Company Act of 1935 provide, in the case of listed companies and companies subject to the Holding Company Act, for corporate recapture of short-swing trading profits made by officers, directors and controlling stockholders. The Public Utility Holding Company Act and the Investment Company Act provide controls on transactions with affiliated interests.

(11) People engaged in businesses involving recommendation of investments, sale of securities, handling of other people's money and securities, should be registered and should be required to file publicly available information about themselves. These things are required of broker-dealers and investment advisers by the Securities Exchange Act and the Investment Advisers Act.

(12) The corporate structure should not be allowed to become so complex that its financial soundness is threatened by the complexity or so complex that its voting power is given to a few people who may not even have a significant amount of money invested in the enterprise. The Public Utility Holding Company Act of 1935 and the Investment Company Act of 1940 provide regulation to prevent these types of abuse in the field of public utility holding companies and investment companies.

(13) Trustees for corporate bond and debenture issues should be sufficiently independent to assure conscientious performance of the duties of such a trustee and the trustee should be required to perform its obligations with prudence. The Trust Indenture Act of 1939, applicable in general to debt issues of \$1,000,000 or more prescribes standards for such independence, requires indentures to impose certain specific obligations on trustees and provides for mandatory reporting of the issuer to the trustee.

(14) In cases of reorganization of corporations in which there is a large interest of public creditors or public investors, there should be some assurance of administration by an independent trustee, a vigorous inquiry into the true financial status, and a sound, feasible, fair and equitable reorganization plan. Chapter X of the Bankruptcy Act imposes on the Commission a duty to intervene as a party in Chapter X reorganization cases if the Court requests such intervention and gives it discretion to intervene whether or not such a request is made. The Chapter also gives the Commission an opportunity to report on the reorganization plans of any corporations having obligations in excess of \$3,000,000 and the Federal courts may submit reorganization plans in other cases.

I have painted with very broad strokes. I have been guilty of over-simplification. I haven't begun to summarize the Acts which the Securities and Exchange Commission administers. The point I want to make is that in this dynamic

American economy there is a pressure of capital for investment; there is a drive by private enterprise to obtain the public's dollars; there is vigor and imagination in devising ways to raise capital; there is vigor and imagination in the operation of enterprise once that capital is raised; there is a lure of profit and power for the managers of capital and a lure of profit for the contributors of capital. These great forces must not be allowed to lose their vitality. Some reliance must be placed on the disciplines of failure and disgrace and competition but forces so strong must also be subjected to the discipline of law lest free enterprise become free exploitation.

To what specific parts of the economic body should this discipline be applied? Who should apply it? The state government, the federal government, the trade associations, the stock exchange? We can't rely on state regulation alone because the interstate character of capital formation permits too many loopholes in any purely state scheme. That was a demonstrated fact when the Securities Act was enacted. A private system of control via stock exchanges and trade associations is good as far as it goes but there must be some legal power behind that system. How much of it should be written into law? How much of it should be left to Commissions like the SEC to deal with by rules or on a case-by-case basis? Statutes are rigid. Rules are subject to quick change, and are therefore uncertain. Case-by-case handling involves a danger of administrative caprice and a government of men rather than a government of law.

These questions aren't simple ones. Neither are the answers. The answers may change from time to time. The Securities and Exchange Commission and its staff entertain no delusions that they will come up with a series of perfect solutions. Neither will anyone else. We are talking about problems which we will always have with us. All we can do is attempt a sensible, alert and conscientious job in the interpretation and administration of the laws which Congress gave us to administer.

I am delighted to have had the opportunity to tell you in a very general sort of way just where the SEC fits into our great American economy which, pray God, may continue - along with America's spiritual richness - to be such a source of strength to the free world.

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