FOR RELEASE UPON DELIVERY OF SPEECH

ADDRESS

of

ALLEN E. THROOP

General Counsel, Securities and Exchange Commission

before the

20th ANNUAL CONFERENCE

NATIONAL ASSOCIATION OF SECURITIES COMMISSIONERS

French Lick, Indiana

October 14, 1937 - 2:00 P.M.

COORDINATE ADMINISTRATION OF FEDERAL AND STATE SECURITIES LAWS

I have a double pleasure in being here today. During the past three years of my participation in the work of the Securities and Exchange Commission, I have followed with interest the activities of your Association, but this is the first opportunity which I have had to make the acquaintance of its membership and to profit from the discussions of a convention such as this. Moreover, I regard it as a high privilege to talk to the members of this Association about some of those matters which I believe are of deepest concern to all of us who are engaged in a great common undertaking.

After acceptance of the gracious invitation of your President to speak here, it was not without some trepidation that I selected the subject of "Coordinate Administration of Federal and State Securities Laws". In the first place, this general topic is one to which considerable attention has already been given at earlier meetings of this Association. This fact, however, seemed only to create a hazard that you who are here might feel that the problem which confronts us is one as to which all the answers have been found. Such a hazard I felt willing to risk; for I was satisfied that you would share the view that the problem is recurrent and in no small measure an elusive one. We cannot too often explore its intricacies in the hope of achieving progress. My further hesitation in the selection of this topic arose from the fact that any exposition of the subject which I have selected might be regard as pre-supposing experience in the administration of *both* federal and state securities laws. But then I came to the conclusion that a more effectively coordinated technique in our mutual administrative task could best be evolved through the free exchange of views between state and federal officials and the subsequent open-minded appraisal of the views thus expressed. It is therefore in an exploratory spirit that I tender such suggestions as may be made in the course of these remarks.

In his address to this Association a year ago, Dean Landis, then Chairman of the Commission, in emphasizing certain aspects of our common task, pointed out that the administrative technique involved in securities regulation passes beyond the realm of punitive sanctions and seeks to achieve its ends not merely through strengthened provisions for detection and punishment of the wrongdoer, but especially in the prevention of economic waste through an adequate process of control effected before harm has been done.

This need for control has resulted in the creation, in the first instance by the states, and in these latter days also by the federal government, of various administrative processes designed to afford some scrutiny, by an expert and independent agency, of a newly offered security in advance of its public distribution, or of the distributor of a security in advance of his undertaking, or of both the security and the distributor.

The consequence of such control is that where a security is to be distributed not merely across state lines, but also within one or more states, the issuer or distributor is faced with diverse requirements for the registration or qualification of that security, imposed not only by the federal

government, but also by each of the states in which such distribution is to be effected. We are all aware of the plea which issuers and distributors of securities have made for the minimizing of this physical task of registration or qualification. It is a justifiable plea, which should be heeded in the interest of honest enterprise, to the end that state boundaries may not constitute insurmountable barriers to the proper ebb and flow of investment funds. How this plea may be adequately met through the better integration of the federal and state process is a problem calling for our most earnest consideration.

The time is propitious. In Massachusetts, a Commission was created at the last session of the General Court for the purpose, among other things, "of making a survey and study of the laws of the commonwealth regulating or otherwise pertaining to the promotion and sale of securities, with a view to bringing said laws into harmony with the Federal Security Act of 1933". The Pennsylvania House of Representatives in May of this year, noted in a resolution which it adopted, that "during recent years there has been not only a marked and substantial change in the method of dealing generally in securities, but also an offering to the public of many novel types of investments and the furnishing of services in connection with securities", and directed the Department of Banking and the Pennsylvania Securities Commission to make a survey of such dealings and activities, and to report to the next session of the legislature, with recommendations and suggestions for legislation. In Michigan, consideration was given at the last session of the legislature to a law designed to effect such integration; and in Maryland the problem has received some consideration from state officials.

Great credit is to be given to this Association for the steps which it has already taken, under the leadership of its Committee on Coordination and Uniformity, toward minimizing the burden involved in the furnishing of information required for state qualification.

Valuable as is the work of this Committee, it of necessity cannot afford a solution to certain aspects of the problem which inhere in the presently diverse substantive requirements imposed by the laws of the several political units under our federal system of government.

There is no magic formula for the effecting of an adjustment of these requirements. It must be accomplished with the fullest regard for the separate spheres of jurisdiction which obtain not merely between the states, but between the states and the federal government. It must give recognition to those methods which the various states, in the carrying out of their respective policies, have deemed best calculated to afford to their citizens protection against security frauds. It must give proper acknowledgement to the social interests reflected in the requirements of federal and state law, and at the same time yield to the proper demands of industry and business for the smooth functioning of the investment process.

In our survey of this problem of adjustment, let us first direct our attention briefly to certain specific situations, projecting them against the three general forms of state regulation - as reflected in state acts of the "fraud", "disclosure", or "qualification" type,

Consider first the altogether proper desire of issuer and underwriter that the various steps to be taken in the qualification of a security for distribution be so timed that the issue may be offered simultaneously in the various states in which distribution is to be effected. The federal Act, as you know, provides for a "cooling period" of twenty days following the filing of the registration statement, at the expiration of which, in the absence of the prior filing of an amendment, the statement becomes effective. The filing of an amendment within the twenty-day period (a so-called "pre-effective amendment") starts the twenty-day period running anew, except that if the Commission consents to the filing of such an amendment, the statement becomes effective on the twentieth day from the date of original filing. Prior to the effective date of the registration statement, neither the issuer nor any underwriter or dealer may offer the security for sale or solicit purchases of the same, except that the issuer may, during that period, enter into preliminary negotiations or agreements with the underwriter. In consequence of this requirement, which was designed to prevent the precipitate "forced feeding" of securities to dealers and the public, subunderwriting groups and selling groups may not be formed prior to the effective date of the statement. In a state having only a "fraud" type of statute, this limitation presents no problem. But in a state which has a "disclosure" or "qualification" type of statute, it is evident that, prior to the effective date, only the issuer itself or the principal underwriters -- that is, those distributors who are purchasing directly from or selling directly for the issuer -- are in a position to initiate steps for state-qualification of the issue. Since in many states qualification must be by a registered dealer doing business in the state in question, difficulties may arise in the initiating of steps looking toward state-qualification with sufficient timeliness to permit clearance of the issue at a date corresponding substantially with the effective date under the federal act. This may not be a serious problem in the case of a large issue having a far-flung network of wholesale distributors; but the difficulties may be genuine where it is desired to effect a reasonably wide distribution of a small but sound issue, having only one or two principal underwriters. One possible solution would be to permit the out-of-state underwriter to file the necessary application and thus to qualify the security, such qualification, however, being conditioned upon the adoption of the application by a local dealer, prior to any sale of the security in the state. An alternative would be to permit qualification by the out-of-state underwriter upon his appointment of the state commissioner as his agent to accept service of process on suits based on the purchase of such security. Either solution would make possible the filing of the state application in ample time to permit adequate examination of the data submitted, and would not deprive any state of its fair portion of sound issues publicly offered upon or immediately after the federal effective date.

Let us review next certain considerations which may properly be weighed in determining whether, assuming that a state has an established policy of investor-protection, the existence of the federal Securities Act may justify any modification of that policy in particular situations. Consider first a case where the securities of corporation "A", incorporated in state "X", are offered exclusively to residents of state "X". As you know, the registration and prospectus requirements of the federal act are not operative as to such an offering, even though the mails are used. Here, obviously, there is no necessity for any departure by the state from that principal of investor-protection which, in the light of past experience, it has deemed to be most effective.

Consider, in contrast, the case presented by the distribution within a state of a security which is also being made the subject of interstate distribution and is registered under the federal act, turning our attention first to the nature of the requirements to be imposed by the state as a condition to the sale of the security, and then to a consideration of the duties and responsibilities which are to be imposed upon intrastate distributors of the security.

In its requirements as to qualification, the state law might require merely the filing of a notice of issue, possibly with an accompanying statement that the security is registered under the federal act. This would of course be sufficient if the state securities act were merely of "fraud" type, and might be deemed sufficient even if the state act were of the "disclosure" type. Obviously, it would not be sufficient if the state policy were that evidenced by a state act of the "qualification" type. However, the state law might go somewhat further and require the filing of an appropriate notice of issue, accompanied only by the federal prospectus or registration statement. In a state whose policy of investor-protection is the disclosure principle on which the federal act itself is based, such a requirement might well be deemed adequate; assuming of course, a concurrence in views as to what information is material, and even though established state policy were to require the affirmative sanction of a state officer, acting under a "qualification" type of act, it would appear that the federal statement or prospectus, particularly in the case of non-speculative securities of issuers enjoying a record of sustained earnings, might well provide the state commissioner with data which he would regard as adequate for the proper performance of his task. As a third alternative, the state law may of course go further and require either the filing of data specified by the state act or state commissioner, or may permit the filing of the federal prospectus or registration statement, if accompanied by such further data as may be called for by the law itself or the state commissioner.

In this type of situation, where some intrastate distribution is being effected of a security registered under the federal act, what duties and liabilities are properly to be imposed upon intrastate distributors? The limits of federal power are such that the prohibition against the use of a prospectus other than one meeting the requirements of the act, applies only where the mails or some means or instruments of transportation or communication in interstate commerce, are utilized. Consequently, even though a dealer is distributing a security registered under the federal act, it is possible for him, by a scrupulous avoidance of the mails and interstate instrumentalities, to solicit the purchase of that security, and in fact to consummate its sale, without giving to the purchaser any informative material upon which the purchaser's judgment may be based. Under these circumstances a state act, even though it be of the strict "fraud" type, might appropriately be integrated with the federal act by requiring that any solicitation of the purchase of a federally registered security, no matter how effected, be made initially by means of a prospectus meeting the requirements of the federal act. I realize the existence of some possible difficulties in coping with certain types of offerings, as, for example, where a prospective purchaser is solicited purely on the basis of an oral or telephonic communication. However, this difficulty is not an insuperable one and might be met by limiting the imposition of the requirement to a case where written soliciting material is given to the prospective purchaser, or, in the alternative, by requiring the delivery of the federal prospectus a reasonable

period of time in advance of the obtaining of the purchaser's order of the acceptance of payment from him. Furthermore, I suggest that in such a case the state, regardless of the mould in which its law is cast, might subject those who deal only within the state to that same standard of civil responsibility to the purchaser which is required by the federal act.

Another facet of the problem of correlation related to that just discussed, is presented where the security, instead of being registered under the federal act, is exempted from registration by reason of compliance with the regulations of the Commission relating to offerings limited in amount to less than $100,000. Time will not permit me to develop this phase. I mention it only to indicate that adequate adjustment of federal and state requirements cannot ignore such special problems as may be created by this type of exemption.

The existence of federal securities legislation may not only justify the imposition in particular situations of additional intrastate requirements, framed to mesh with a program of interstate distribution, but may also call for a re-examination of the grounds for exemption afforded under many state acts.

By way of illustration, I mention one type of exemption which I believe is still provided for by a large number of state laws -- namely, the complete or partial exemption of securities listed on one or more designated securities exchanges, an exemption which not infrequently extends to securities senior to those thus listed.

This exemption apparently stems from the theory that, since listing on one or more specified exchanges assures availability of information as to the financial affairs of the issuer, adequate investor-protection is afforded. This theory is obviously difficult to reconcile with the "qualification" principle. If the theory is sound, it would justify a comparable exemption of newly offered securities registered under the federal Securities Act and of outstanding securities registered under the federal Securities Exchange Act, regardless of the exchange on which such securities are listed. It may be urged, on the other hand, that this so-called stock-exchange exemption is consistent with the "qualification" principle in that certain of the exchanges have had minimum standards as to the quality of securities to which they would grant a listed status. If this is the basis for the exemption, one cannot help but question the soundness of this delegation of function to a non-governmental agency operating not infrequently outside the state in question and owing not the slightest allegiance to it.

A further item which calls for the most searching scrutiny in any revision of securities legislation, whether federal or state, is the very definition of the term "security". The ingenuity of the swindler whose heart is set on fraud is at its best in devising new means to accomplish his purposes. The thwarted vendor of gilt-edged stock certificates may turn his efforts to silver-lined whiskey warehouse receipts; the dishonest distributor of oil and gas interests may seek to make his activities less perilous by purporting to sell separate tiny tracts of land afloat on a sea of oil instead of the customary undivided royalty or leasehold interest; the dishonest frog-farm promoter, unsuccessful in his efforts to persuade the courts that each participant in the enterprise will at any moment find his personally-owned frog family eager to welcome him, may hope to cloak his efforts in some subtler guise.

We who are the listening posts of the public in our particular sector should together be eternally vigilant to close both federal and state channels to the efforts of the unscrupulous, by their use of new tools, to sap and undermine the savings of the honest citizen.

I have already referred to the disclosure principle upon which the federal securities acts are based. Except in situations arising under the Public Utility Holding Company Act, where the federal government is appropriately concerned with the use of the holding company device in far-flung utility enterprises, our Commission, as you know, is without discretion to pass upon the quality of the security which is offered to the public, its function being limited to requiring the adequate disclosure of facts essential to the exercise of intelligent investment judgment. This limitation, proper as it is, makes it urgent that the states exercise constant vigilarce to cope with many of those vices which the federal process does not reach.

We cannot over-estimate the value of publicity and the vital protection afforded by giving to the purchaser information on which he may base an intelligent investment judgment. However, many of our inquiries -- and I am sure that many of yours, too -- come from those who, although possessing limited resources, have been persuaded to invest small but precious savings in enterprises obviously highly speculative in character where the financial set-up has been such as to assure that the public investor would carry a maximum of risk in order that the inside promoter might have an opportunity for the maximum of profit. It is certainly not the appropriate function of federal or state government to undertake to stifle new enterprise, and we must recognize that new enterprise necessarily carries with it concomitant financial risk. However, I believe that the states may further explore the various techniques which may properly be applied in affording at least a minimum of protection to the uninformed investor. Certain states now make provision for the escrowing of promotional stock upon terms such as to assure that the public investor has at least as even a chance as the promoter himself. Others have devised means whereby the investor's funds will revert to him unless cash is obtained in an amount at least sufficient to give nourishment to an infant enterprise until it may be weaned. Under other state laws, authority may exist to prevent the sale of securities where the promoter's commission or distributor's spread is so excessive as to make it clear that the promised enterprise is but a cloak for its sponsor's profit. Other devices through which the states might seek to further the protection of their citizens would involve the imposition of appropriate restrictions upon the sale of assessable stock, and the creation of adequate controls to prevent abuses in the inducement of purchases through the holding out of a fictitious market price as evidence of the value of and demand for the security offered, or through the unwarranted use of the step-up price scale.

Some of the restrictions of the character suggested obviously should not be resorted to without a careful analysis of their necessity and effect. I mention them merely as possible methods whereby the states may complement the federal process with appropriate local control.

I have referred to certain substantive problems which confront us. No less important is the problem with which your Committee on Uniformity has been wrestling, -- namely, coordination in the character and form of information required to be filed with the state commissions. Much has been

accomplished in this field. But I venture to suggest that the full realization of this program may require some appropriate alteration of statutory requirements, the character of information to be required depending of course upon the type of security involved and the type of regulation which the state has adopted. The forms proposed by your Committee permit substantial reduction in the amount of material filed with the state commissioner provided a copy of the registration statement filed under the federal Securities Act accompanies the application for state qualification. It is beyond my province to suggest any limitations upon the material which you who are administering state security laws may require for the effective performance of your duties; but it occurs to me that in the case of certain securities meeting stringent "blue-chip" standards, the offering prospectus, the use of which is required under the federal act, might afford an adequate basis for your examination of the security offered, thus minimizing to some degree the issuer's or underwriter's task of state qualification.

A study of the proposed forms suggests certain fields where further discussions by your Committee with those members of the Commission's staff whose special task it is to struggle with similar problems, would be of mutual advantage. Your Committee has apparently felt that the state form for investment trusts and investment companies, unlike the form for general issues, should not make provision for incorporation of the federal statement. An exchange of views as to the character of pertinent information which should be called for in this type of issue, might well eventuate in some mutual adjustment in requirements so as to permit incorporation similar to that provided for in the case of general issues. The trust whose assets consist principally of oil and gas royalties or working interests has presented peculiar problems, and the Commission is now engaged in the preparation of rules and forms covering this particular type of offering. Here is a further place where the work of your Committee and that of the Commission could appropriately be correlated.

I note that your Committee for the time being has made only general suggestions with reference to the information required in connection with certificates of deposit and reorganization issues. This is a field in which security regulation is fraught with unusual difficulties. You are no doubt all familiar with the extended study made by the Commission under the direction of our present Chairman into the subject of protective committees and corporate reorganization. This study has eventuated in three measures which were under consideration by Congress at the conclusion of its last session. It is our expectation that they will be brought up again and it is our confident hope that they will be adopted in substance. Time does not permit me to do more than refer to the general character of these proposals. - First, the Barkley Bill which requires compliance with minimum standards to assure the existence of an independent and active fiduciary in security issues under which a corporate trustee is appointed; second, the Chandler Bill, which provides for a more adequate procedure in reorganization under Section 77B of the federal Bankruptcy Act; and third, the Lea Bill, which pertains to the activities of protective committees in both voluntary and involuntary reorganizations. Obviously, any considered program relating to the qualification of securities issued in connection with reorganization proceedings should take into account the possible applicability of the regulatory features of the Chandler and Lea bills, as well as the requirement of existing legislation.

The specific questions which I have discussed in some detail are but illustrative of the character of those problems which confront us. Further questions present themselves, for example, in our thwarting of the attempted evasion of legislative safeguards, in the clarification of standards dividing the isolated transaction from the public offering, in the evolution of a more uniform treatment of secondary distribution, and in the appropriate supervision of dealer practices and the activities of the increasingly populous profession of investment counsel.

There is no Baedeker which will chart the route to be taken. In all likelihood, there will of necessity be alternate routes, each depending upon the method of control which a particular state has found best adapted to its needs. Let us recognize that the basic principle of state securities regulation may be that found in a "fraud" law, a "disclosure" law, or a "qualification" law, and let us endeavor to work out a common program which will most effectively and most simply integrate state and federal regulation in the achievement of the policy of investor-protection which each state has heretofore expressed.

The possibilities of accomplishment through coordinated effort have already been demonstrated to us by the work of the Securities Violation Section, which was organized at the suggestion of your Association nearly three years ago. This Section has now compiled data relating to more than 26,000 individuals, to which additions are being made at the rate of several hundred a month. It is a joint undertaking, which, as the result of mutual effort, has been highly successful in achieving the objects of its creation.

The price of success in this undertaking is constant vigilance both on your part and ours in reporting promptly those items of information which will be helpful in effective enforcement; and we are now engaged in the preparation for distribution to state commissioners and to all cooperating agencies, of certain suggestions as to how the most effective contributions may be made to the efficient functioning of this undertaking, and as to how the greatest benefits may be obtained from it. In furtherance of this program, I cannot stress too strongly the importance of the regular transmittal to this Section of complete reports of actions taken by you and of criminal actions instituted or concluded in your respective states. Furthermore, I believe that the information in the Securities Violation file might be much more effectively utilized if the state commissioners would, in connection with applications made to them for dealer registration, make more immediate inquiry as to whether the Section has any information pertaining to the applicant.

The designation by your Association of a special committee to develop a clearing house of valuable information has resulted in specific accomplishment. Similarly, I believe that the present designation of certain of your members as a committee to consider with us in Washington the many troublesome problems confronting us, of which today's remarks may have given a few illustrations, would result in constructive achievement. If your Association should determine to appoint such a committee, I assure you the Commission in Washington will join with you in an earnest effort to attain our common objectives.

---oOo---