

**CURRENT DEVELOPMENTS AT THE  
SECURITIES AND EXCHANGE COMMISSION**

**Address of**

**J. SINCLAIR ARMSTRONG**

**Chairman  
Securities and Exchange Commission  
Washington, D. C.**

**before the**

**SOUTHEASTERN GROUP**

**of the**

**INVESTMENT BANKERS ASSOCIATION OF AMERICA**

**White Sulphur Springs, W. Va.**

**October 29, 1955**

It is a great pleasure for me to be with the conference of the Southeastern Group of the Investment Bankers Association here at White Sulphur Springs. Members of the Board of Governors and various committees of the Association were in Washington this week conferring among themselves and with various Government agencies. They met with the Securities and Exchange Commission on Wednesday, October 26. The Commission gains a great deal from such opportunities to meet with industry and other groups to hear about their problems and discuss our regulatory problems, all looking toward our better carrying out the statutory responsibility given us by the Congress of the regulation in the public interest of the vitally important securities markets. These periodic meetings have been part of our long standing practice at the Commission.

There were a number of topics of current interest discussed by the Commission with these IBA groups and, thinking that some of these will interest you, I am going to touch on them briefly.

Since the unfortunate illness of President Eisenhower occurred, stock market activity and prices have been very much in the public eye. You will remember that the Monday after the bad news came out of Denver the New York market suffered a severe break, and on several days in the succeeding weeks lesser breaks occurred. Taking the month as a whole, although much of the initial reduction in market values of the New York stock list has been regained, nevertheless, on certain days stock prices have varied up and down by considerable amounts.

So, first, thinking you may be particularly interested in learning something of the Securities and Exchange Commission's regular market surveillance work, I will discuss it briefly. The Commission observes market conditions so as to carry out the Congressional mandate against the types of abuses -- manipulation, rigging, pools and the like -- that were typical in the stock market before the Commission was created.

The Commission has in effect various rules directly regulating trading on exchanges, and the exchanges themselves have many more self-policing rules and procedures.

For example, the Commission has in effect a rule covering the prices at which short sales may be effected on an exchange which generally prevents short sales on a declining market. 1/ This serves to discourage

---

1/ Rule X-10A-1.

"bear raiding." Our rules also prevent persons engaged in the distribution of a security from paying other persons to solicit purchases of securities of the same issuer on an exchange except under specified conditions. 1/ The Commission recently adopted rules dealing with the stabilization of securities to facilitate distribution. These requirements, like the general anti-manipulative standards of the statute 2/, operate to prevent persons engaged in distributing a security from creating active trading or raising the price in order to facilitate a distribution except subject to requirements of disclosure and other controls which operate to prevent deception or unfair advantage being taken of the buying public.

In addition to these specific controls, the statute and the Commission's rules prohibit the use of manipulative or deceptive devices and contrivances in connection with the purchase or sale of securities. 3/ Under these requirements it is unlawful for any person to effect a series of transactions in any security creating actual or apparent active trading in the security or raising or depressing the price for the purpose of inducing the purchase or sale of the security by others.

The Commission enforces this prohibition of manipulative and deceptive practices in a variety of ways. We inspect the books and records of brokers and dealers and our inspectors, among other things, review transactions recorded in such books in the light of anti-manipulative standards. We investigate complaints coming to us from the public, from customers and from brokers and dealers. In addition to this, we carefully watch activities on the exchanges themselves. A considerable volume of reports and statistical material comes to us regularly from the exchanges, covering short selling, the activities of floor traders, and similar matters. These are published in the Commission's Monthly Statistical Bulletin. Beyond this we maintain a "market surveillance unit" in our New York Regional Office which watches the recorded transactions on the New York exchanges as they come over the ticker, and the quotations in the over-the-counter market as they are published in the National Quotation Sheets, for the purpose of detecting activity in any security which does not appear to be based on economic factors and may indicate the presence of

---

1/ Rule X-10B-2

2/ Securities Exchange Act, Sections 10(b) and 15(c)

3/ Rule X-10B-5

manipulation. When such a question arises, this "market surveillance unit" conducts a "flying quiz" with respect to the transactions in the particular security. In the "flying quiz" the identities and activities of purchasers and sellers are ascertained and reviewed. The market surveillance unit also investigates complaints coming to us from all sources concerning possible manipulative activity. Ordinarily none is found. But we feel that the very existence and activity of this surveillance group has a powerful deterrent effect on possible market manipulation. And on those rare occasions when a manipulation can be proved, the civil and criminal sanctions of the Exchange Act can be brought to bear. The statute provides a maximum penalty of \$10,000 fine and imprisonment for two years in a Federal penitentiary on conviction of manipulating the market, which is perhaps one reason why there are so few manipulation cases nowadays.

In addition to these direct controls, the light of full disclosure is brought to bear on many market activities where formerly inequitable practices flourished under the cover of darkness. Issuers of securities listed on national securities exchanges file with us and make available to the exchanges and thus to the investing public comprehensive reports of their financial condition as well as of events of major significance to investors. "Insiders" -- that is officers, directors and 10% stockholders -- report currently to the Commission and the exchanges changes in their ownership of their company's securities, which are published in the Commission's monthly bulletin on Ownership Reports, and "insiders" are required by Section 16(b) of the Exchange Act to pay over to the company profits realized by them on short-swing trading.

We feel that by all these methods the Commission, working in collaboration with the securities exchanges and the securities industry, has come a long way toward providing for investors an orderly market, free of manipulation, deception and other unfair practices. Public confidence in the integrity of the securities markets is high and sustained and these markets are in a better position than ever before to perform their important function of channeling the savings of the public into productive corporate enterprises.

I do not mean to suggest that there are no violations of law going on, or that those that do occur are all detected by the Commission. That would be too much to expect of any law enforcement agency, particularly one cooperating in the national policy of reducing the expenses of the Government. But I do mean to say that with the limited funds and personnel available to the Commission much has been accomplished.

Now let me tell you a little about some of our work which results from the stock market investigation conducted by the Senate Banking and Currency Committee last winter. In a report issued by the Committee in May, several areas for further examination by the Committee and by the Commission were suggested. Among these were the regulation of proxy soliciting activities of companies whose securities are listed on the exchanges. Problems arising out of the contests for control of some of the nation's large corporations which have been waged in recent years are very much in the spotlight.

Generally speaking the Commission's proxy rules have worked well in relation to the solicitation of proxies where there has been no contest. But criticism has been leveled at our rules as they have been applied in proxy contests. One of these, which the Commission has felt for some time should be remedied, is that the rules have not spelled out precisely who and what they covered when contests are involved.

It is said that the Commission's proxy rules do not elicit sufficient information concerning the background and motivation of persons who seek to wrest control of a corporation from its management. It has also been suggested that the Commission is not able to deal promptly with the many situations which arise in complicated and hard fought proxy contests. To meet this problem, it has been suggested that the Commission should be given by the Congress more specific power than it now has to stop by administrative order violations of its rules and to compel such remedial action as may be appropriate in the circumstances. At present the Commission cannot by its own administrative authority prevent the use of misleading soliciting material or compel the correction of such material. The Commission's only remedy now is to go into the Federal courts and ask for an injunction against the use of misleading proxy material or the voting of proxies obtained from stockholders by the use of misleading material.

To solve the first two problems, the Commission has announced a proposed revision of its proxy rules, designed to spell out precisely the persons, activities and the soliciting literature which the Commission deems to be subject to the proxy rules. The proposals are intended to state more specifically the administrative policies of the Commission in regard to proxy contests. They specify the persons who would be deemed to be participants in the solicitation and would require the filing with the Commission of comprehensive information regarding their interest in and connection with the issuer, and as to their background. The proposed rules would also spell out in some

detail the types of representation which in the past have created difficult problems of administration.

The Commission, as a governmental body charged with the responsibility of preventing misleading statements, is obligated to object to misrepresentations in the solicitation of proxies of companies under its jurisdiction. We are considering the many comments and suggestions received from interested persons and the public and made in the press.

Third, another concern of the Senate Committee and the Commission is the growth of speculative enthusiasm for penny stocks. We are, therefore, in the process of revising our rules pertaining to securities which, because the amount offered in any one year does not exceed \$300,000, fall under the conditional exemption provided by the Securities Act. 1/ The proposed revision pertains primarily to "promotional" companies.

We are aware that our regulation of the offering of these promotional issues should take into consideration the exemption which the Congress specified should be available. We recognize the necessity and desirability of not interfering with the raising of capital for speculative exploratory purposes in the extractive industries, such as oil and mining. But we also recognize that the exemption provided by the Congress was conditioned and was not intended to free issuers and underwriters of such securities of all regulation whatsoever.

There are difficult questions of judgment to be decided in acting upon our pending revisions of Regulations A and D. The Commission has been greatly aided in its consideration over the past few months of this difficult problem by the work of the Subcommittee on Commerce and Finance of the Interstate and Foreign Commerce Committee of the House of Representatives. The Subcommittee has been considering a bill introduced by Representative John Bennett of Michigan to repeal Section 3(b). 2/ The Subcommittee has held hearings on the problem in Washington, Denver and Salt Lake City and is holding hearings next week in New York. There is certainly a great deal to be said in favor of requiring issuers and underwriters of speculative promotional issues to comply with the registration provisions of the Securities Act. One particular advantage of requiring registration,

---

1/ Securities Act Release No. 3555.

2/ H. R. 5701, 84th Congress, 1st Session (April 20, 1955).

rather than continuing the conditional exemption techniques which the Commission has permitted under present regulations, is that the issuer and underwriter would be subject to the civil liability provisions of Section 11 of the Act for misstatements and omissions of material facts required to be set forth in the registration statement.

We are determined that our revision of these regulations shall reflect the Commission's best judgment as to how investors in new issues of securities of the speculative promotional type can be given a fair disclosure of the pertinent business and financial information in accordance with statutory standards without strangling the capital market for such issues. But I for one have never been aware that the registration requirements of the Act strangled legitimate capital formation, even for speculative purposes.

Fourth, the Commission is engaged in an objective factual study of the provisions and possible effects of the so-called Fulbright Bill. 1/ This bill, which was introduced in the Senate by Senator J. William Fulbright of Arkansas, Chairman of the Committee on Banking and Currency, and its counterpart 2/ introduced in the House by Representative Arthur G. Klein of New York, would subject companies whose securities are not traded on the stock exchanges to the financial reporting, proxy and insider trading requirements of the Exchange Act.

Shortly after the bill was introduced in the Senate, the Commission was asked to report on it to the Senate Committee. The Commission stated that it agreed with the broad principle of the bill but could not take a definitive position on such short notice and without careful study of the possible effect of the bill.

One problem raised by the bill which is of particular concern to the Commission is the question whether the application of the insider short term trading provisions of the Act to the securities of many of the smaller companies, which would be brought within the Commission's jurisdiction, would be detrimental to the maintenance of orderly and adequate markets for these securities. The Commission feels that an answer to this question is important to any conclusion as to the public interest and investor protection which would be served by enactment of the bill.

---

1/ S. 2054

2/ H. R. 7845

The Commission will shortly mail to about 2,000 corporations which it believes would be subject to the bill, if enacted, a letter asking two questions: (1) whether the company has within the past three years sent an annual report to its stockholders and requesting a copy; and (2) whether management has sent proxy soliciting material to stockholders and requesting a copy. The Commission hopes that on the basis of the information thus obtained and other information available it may be in a position to report to the Congress at the next session. It is hoped that officials of the companies concerned will cooperate with the Commission to the end of permitting as comprehensive, factual and objective a study as is possible.

Finally, before closing I will touch on another subject with which the Commission is presently dealing. That is the implementation by new rules and forms of the 1954 amendments of the securities acts. These amendments of the law had as a main purpose broader freedom in disseminating to the investing public pertinent information about new issues of securities prior to their actual sale.

The Commission has already adopted several new rules for this purpose. One of these permits communication by issuers to their security holders of information regarding forthcoming rights offerings. 1/ Another enlarges the types of information which may be included in the so-called "tombstone" ad. 2/ Another will give express sanction for the use by underwriters and dealers of the so-called "new issue" cards, which are prepared by statistical service organizations. 3/ We are also working on a draft of a proposed summary prospectus rule for use by underwriters and dealers to advise prospective investors more fully regarding proposed offerings. It is hoped that such a summary prospectus may be relatively short in size which may be conveniently and inexpensively sent through the mails. The Commission feels that the adoption of these rules, and the development of appropriate practices by underwriters and dealers under these rules, will give greater freedom to issuers, underwriters and dealers in approaching members of the public with new issues.

---

1/ Rule 135, Securities Act Release No. 3568

2/ Rule 134, Securities Act Release No. 3568

3/ Rule 434, Securities Act Release No. 3576