

**TWENTY-FIVE YEARS OF FEDERAL SECURITIES REGULATION:
THE GOVERNMENT VIEW**

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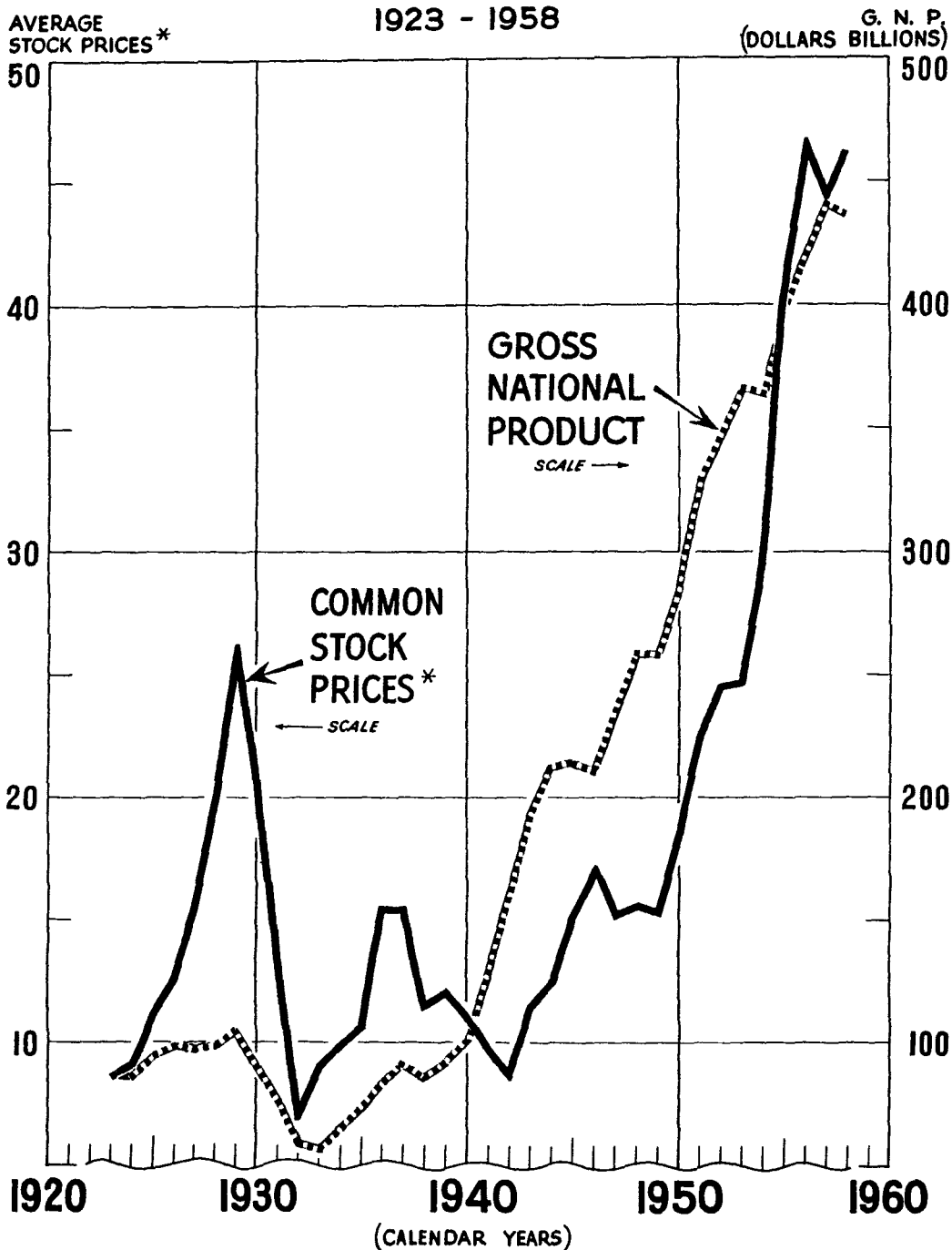
**Twenty-five Years of Federal Securities Regulation:
The Government View**

It is a great pleasure and an honor to participate in another of these briefing conferences given under the auspices of the Federal Bar Association, the Bureau of National Affairs and the other public minded groups who have cooperated to make this such a notable meeting. I attended the last of these occasions at San Francisco something over a year ago, when I was even more of a tyro in securities regulation than I now am, and I recall that it was of immense value to me in orienting myself amid the tortuous mazes of this legislation and its practical application.

Your program committee has asked me to talk with you for a few minutes today on the subject of "Twenty-five Years of Federal Securities Regulation: The Government View." When I speak on this topic, I do not have the depth of experience in the regulatory field which was so apparent yesterday in the instructive remarks which you heard of Mr. Arthur Dean, who is by way of being the Dean of the Securities Acts. However, I do have a personal and rather clear recollection of the situation as it existed before 1933 and immediately after, and some ideas, perhaps extra-sensory but possibly interesting, as to the effect as the regulatory agency sees it which this legislation has had upon that situation.

To give you a background from which to start, I have had prepared a chart on which is indicated the range of security prices on the New York Stock Exchange for ten years before 1933, and for the 25 years subsequent thereto. Just as a matter of interest, and since there is a space coordinate on the chart, there has been added a curve indicating Gross National Product over the same period.

CHART I COMMON STOCK PRICES AND GROSS NATIONAL PRODUCT



* STANDARD AND POOR'S COMBINED STOCK INDEX (1941-43=10)

The Securities Act of 1933 became effective July 1, 1933, a date roughly corresponding to the low point in the stock market, as well as in our general economy. There have been sizeable variations since that time in both curves, but the whole trend is consistently upward, and most certainly there has been no repetition or close approximation of the curves shown during the period from October, 1929 to July, 1933.

The Securities Act of 1933 was the first of the nexus of statutes which is now administered by the Securities and Exchange Commission. It is doubtful if history affords the example of more timely and necessary legislation than this. This is described in House of Representatives Report No. 85, 73rd Congress, 1st Session, as follows:

"During the post war decade some 50 billion of new securities were floated in the United States. Fully half or 25 billion worth of securities floated during this period have been proved to be worthless. These cold figures spell tragedy in the lives of thousands of individuals who invested their life savings, accumulated after years of effort, in these worthless securities. The flotation of such a mass of essentially fraudulent securities was made possible because of the complete abandonment by many underwriters and dealers in securities of those standards of fair, honest, and prudent dealing that should be basic to the encouragement in investment in any enterprise. Alluring promises of easy wealth were freely made with little or no attempt to bring to the investors' attention those facts essential to estimating the worth of any security."

Some writers have labeled this indicated loss of \$25 billion as conservative since the decline in computed value of stocks and bonds listed on the New York Stock Exchange alone from 1929 to 1933 amounted to more than three times this amount.

As a consequence of the stock market break of 1929, public confidence was shaken to its very foundation. As one author* described

*Schaffner, F. I. "The Problem of Investment"
(New York, 1936, P. 345)

this situation:

"There was a general feeling of bewilderment as to the exact nature of what occurred, an instinctive feeling that there had been injustice, that fundamental structural defects in the economic mechanism had revealed themselves, and that something should be done about it."

Into this state of financial chaos and hysteria came the Securities Act of 1933, with the broad stated purpose of protecting investors and restoring public confidence in the securities markets by a rigid surveillance, both of instruments offered in new financing and of the methods by which already outstanding securities were sold.

Now, I do not want to appear to attribute to the 1933 Act, nor to the group of statutes which we administer, the entire blame for the bull market which has culminated in the present security price level. I am aware that there are very numerous other factors which have contributed to the growth of America, and I, for one, have always thought of the stock market not so much as a cause of economic development as a reflection of it.

Nevertheless, there are certain aspects of the Securities Acts which have effectively prevented the repetition of certain phenomena which accompany a similar financial panic. Perhaps the most important provision from this point of view has been Section 7 of the 1934 Act, which empowers the Federal Reserve Bank to impose and the S. E. C. to enforce restrictions on margin accounts. This is especially significant today when there is so apparent a tendency to relax credit restrictions in retail and other commercial transactions. The thoughtful observer who recalls the snowballing effect of private undermargined debt upon stock exchange prices and private savings in 1929 may well be excused when he views this present tendency with askance. However, under the cash requirements of Section 7, distress sales in the security market cannot now have so serious an effect even in the event of relatively serious declines in securities prices. To be sure, there are still margin calls, and plenty of them, but they do not result in the unbearable strain upon our national credit resources which they did in 1929 to 1932, nor do they set off the same uncontrollable chain reaction.

I do not feel that it is necessary to review to this audience the history of the legislation successively adopted between 1933 and 1940

and which we all understand as constituting the Federal Securities Acts. This story is familiar to any lawyer who is at all at home in this field. Within the areas of their competence, these statutes are extremely ubiquitous, and no lawyer today can toy with corporate finance without continual sidelong glances at them. The violation of any pertinent statutory provision almost invariably involves the possibility of serious financial loss or criminal penalty, though the liability may vary somewhat as between statutes. The administrative power of the S.E.C. is very great and it has free access to the courts to enforce both the letter of the law and the rules which may have been adopted by the agency to implement the Acts of Congress.

These laws were enacted at a time when the industry was permeated by an atmosphere of suspicion and recrimination. They met with powerful and intelligent opposition and sometimes and in some respects with justifiable criticism. The extremist then foresaw the end of the world of finance, the stultification of the money market and the stifling of private initiative and endeavor. It is a high commendation which I offer to my predecessors on the Commission and to its staff when I venture to doubt that anyone in Wall Street or State Street today would advocate the repeal or vital amendment of the Securities Acts. A survey of the proceedings and of the administration of this legislation demonstrates the working of administrative law at its best, resourceful and flexible, yet firm and single-minded.

However, let us not delude ourselves that the past twenty-five years have not seen some truly Gargantuan struggles over the Securities Acts and their enforcement. The S.E.C. has been for 25 years, and still is, one of the most prolific litigants in the United States. A past general counsel to the S.E.C. is a battle-scarred veteran of many a running fight, on the one side with the horde of colorful and clever concoctors of new financial dodges and on the other side with the foremost legal talent in the country. One by one, the legal status of most of the important provisions of the Securities Acts has been determined and clarified. This classic struggle has left its imprint in some impressive statistical data, some of which we modestly append, year after year, to that graveyard of bureaucratic accomplishment, the Annual Report to the Congress.

As of June 30, 1958, the S.E.C. had since its birth instituted 1,060 cases in the Federal Courts, principally to enjoin violations of

the Securities Acts, and was either defendant or otherwise participated in 631 additional cases. As of the same date, it had accumulated in its files data concerning 65,563 persons against whom Federal or State action had been taken concerning securities violations. It had by then referred 696 cases to the Department of Justice involving 2,333 defendants, 1,295 of whom had been convicted and a substantial percentage of whom were eventually incarcerated. From September, 1938 to December 31, 1958, the Commission has participated in 364 reorganizations under Chapter X of the Bankruptcy Act.

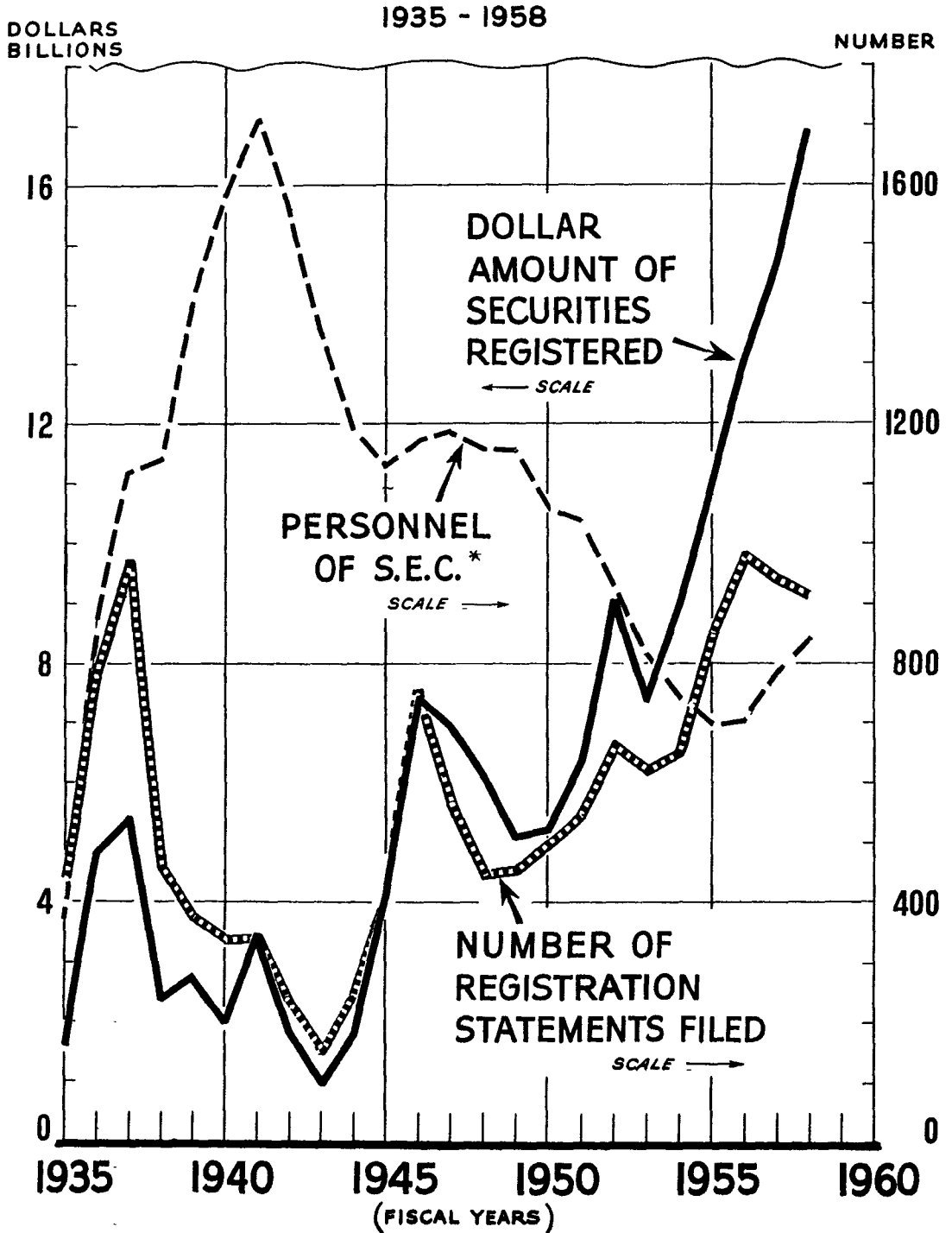
Of course, not all, and for that matter not a large part of the man hours of the S.E.C. and its staff have been spent in litigation, intriguing as that aspect of its activities may be to any group of lawyers. The most impressive statistics of performance arise out of the day-to-day work of the S.E.C. in dealing with the constant flood of material which flows over its desks. During the first full fiscal year of its operations, that ending June 30, 1936, it handled 781 registration statements involving a total of \$4,794,000,000. In the fiscal year 1958, the total number of statements was 913, and the face value of the securities registered thereby was \$16,914,000,000. From 1934 to the end of fiscal year 1958, it has processed 13,611 statements covering an aggregate amount of \$149,289,000,000 of all sorts of securities, foreign and domestic, large and small, speculative and conservative, first liens and fourth liens, seasoned and green as grass, representing the entire gamut of corporate financing in America.

Over the years, the emphasis in the S.E.C. work has changed, first to one facet and then to another. The first decade was one of experimentation, investigation of new fields, of exhilarating novelty. The second decade was marked by the rise and fall of activity under the "death sentence" provisions of the 1935 Act, by the war and a physical move to Philadelphia and back and by a consolidation of the agency's position firmly in the midst of the every day life of the financial community. The third decade, now half over, has been marked by a resurgence of enforcement problems, bred of a rising market out of human cupidity and by an ever-increasing tide of securities issues and administrative problems. Today, we are in the midst of the greatest efforts at financing by private capital that this country has ever seen. During the first seven months of the fiscal year beginning July 1, 1958, there were 554 registration statements filed with the S.E.C., representing \$9,215,638,845 of principal amounts of securities. This compares with 478 such statements in the comparable period during

the previous fiscal year, and a total of \$8,406,767,516 in value. You will remember, in this connection, that such figures for the fiscal year ending June 30, 1958 were at a then all-time high in all respects for the agency's history.

Just to see whether there was any correlation between the activities of the S.E.C. which I have noted and the personnel available to do the work, I have had plotted on a chart for your consideration three curves: first, the average personnel engaged in S.E.C. work; second, the number of registration statements filed; and third, their dollar value, in each case over the history of the S.E.C.

CHART II SECURITIES REGISTERED WITH S.E.C. AND PERSONNEL OF S.E.C.



* Average Employment

You will note that it is only within very recent years that there is any correspondence between the available personnel and the work load facing it under the 1933 Act.

The sheer volume of work for which the S.E.C. and its staff must be responsible is calculated to give some pause to a student of regulation. Let us look at a few of these statistics if for no other reason than to convey to you some sense of the administrative detail which we are required to handle. First, you will recall that we are charged with a general duty of supervising the activities of the securities markets and to prevent manipulative practices. There were a total of 4,171 securities issues listed on 14 national registered exchanges and 4 exempt exchanges at June 30, 1958, and during the year ending December 31, 1958, the total market value of securities traded on these exchanges was upward of \$40 billion, representing the sale of some 1,306 million shares and some millions of separate transactions. This is aside from the over-the-counter market, where upward of 11,000 issues are dealt in. There are no statistics as to the volume of such trading, but it is known to be very substantial by any standard. Insofar as the S.E.C. may be thought of as the statutory guardian of the American investor, it is also pertinent to note that public participation in corporate financing has resulted in a doubling and tripling of the number of corporate stockholders. The most recent estimate indicates that nearly 10,000,000 people have in this way acquired an interest in our industries and in the securities markets.

The S.E.C. is charged with supervising the operations of all broker-dealers of any size to make sure that the public is adequately protected in dealing with them. There were, as of June 30, 1958, 4,664 of these establishments, doing business in the (then) 48 states, in which some 17,155 persons were interested as partners, proprietors or officers. A total of 1,452 broker-dealer inspections completed during the fiscal year ending June 30, 1958, disclosed 1,737 violations of the Securities Acts, mostly technical, of course, but a substantial number sufficiently serious to warrant disciplinary or corrective proceedings. Out of fairness, it should be noted that there are many duplications in this last figure, and I am prepared freely to admit that the wonder is not that the S.E.C. has brought so many administrative proceedings: it is that there is such a small percentage of broker-dealers who cause us any difficulty.

The S.E.C. is charged with very numerous regulatory duties as to investment companies under the 1940 Act. There were 436 such companies registered at the end of the fiscal year 1941, the first year of the Act, with assets having an estimated aggregate market value of about \$2,500 million. Since then, about 370 new companies have registered and 353 have withdrawn from the field. As of June 30, 1958, there were 453 such companies registered with us, holding assets having an estimated aggregate market value of over \$17 billion.

I will bore you with only one more figure which may give you an idea of the activities going on behind the somnolent walls of the tar paper shack on Second Street. We have a central filing section which receives, notes and routes all documents received by the S.E.C. During the fiscal year 1958, this office noted the receipt of some 434,000 documents.

The S.E.C. feels, with Prospero, that: "What's past is prologue." As we pause for a moment in our silver anniversary year to look back, it is, I think, proper also for us to look ahead. The Securities and Exchange Commission has never showed any signs of debility. It displays no evidence of the working of what has come to be known as Parkinson's Law, - the thesis that an administrative agency ages over the years and gradually acquires all the symptoms of senility. On the contrary, I find among our staff, even among those who have been with the S.E.C. for many years, a certain élan, a feeling of vitality and growth. I suppose such a feeling is inevitable in an agency so closely tied in with the dynamics of the American financial scene. It cannot stop to listen to the hardening of its arteries; it has ever more and more important, difficult and complicated tasks before it.

Nor are the Securities Acts themselves rigid and unchanging, or graven eternally in stone. This legislation has been amended many times as new and unforeseen situations have evolved during the fascinating interplay of the great financial markets. We have presented to the current Congress a legislative program designed to amend 88 separate sections of the various Acts we administer, and there are and will be filed with Congress a host of other bills, some sponsored by us, some by the industry, some by students of our national economy, all designed to fit the regulatory pattern to the cloth of the democratic capitalistic society. This must necessarily be true, since the Securities Acts are not intended

to repress the flow of capital. On the contrary, they are designed to expedite such transactions, while holding them within well-defined bounds of decency and fair dealing and they must be treated not as inflexible and unyielding codes of law but rather as living rules of conduct fitting ever-changing economic concepts.

At an occasion of this sort, the incidence of a Silver Jubilee, the bureaucrat - or the regulator, whichever term you may wish to use - is naturally under some temptation to become self-laudatory and to review with complacent pride the accomplishments of his agency over its history. It is easy enough to gather statistics as to successful litigation and to the numerous other steps which have been taken to enforce the statutes. It is an equally great temptation for the Governmental officer to speak in terms of penalties, prohibitions, responsibilities and liabilities and to frame his thoughts in the terms of the current crop of problems and problem cases, since in the forefront of his mind are the daily cases, the daily problems and current irritations with which he is dealing in his office. It seems to me, however, that such an historical survey of the routine affairs of the Securities and Exchange Commission falls far short of representing a fair or complete summary of its accomplishments or to convey a real understanding of what it really stands for.

It seems far more rewarding to look upon the Securities Acts from the point of view of their philosophical origin and of their effect upon the relationship between the great corporate enterprises of the United States on the one hand and the investing and consuming public on the other. From this point of view, it is apparent that this legislation as a body constitutes a splendid example of the sound application of the principles of self-discipline and self-government in a difficult and complex economic field. The enactment of the Securities Acts brought to full expression a major change in the philosophy of American business enterprises. I doubt that this phenomenon has ever had adequate acknowledgment nor do I feel that the impact of this revolutionary approach as it has been applied to economic enterprise has met with as wide an understanding as it deserves.

It is true, of course, that the Legislative and Executive Departments were required by the massive uneasiness of the general

public to institute reforms in the nature of the Securities Acts in 1933 and thereafter. It is also true that out of this demand for reform came the creation of the Securities and Exchange Commission with its great responsibilities and powers and its armor of weapons designed to deter and to compel and that to implement these statutes, it has been necessary for the agency to use these powers vigorously and fearlessly.

However, the public demand for reform was not self-executing and had the formulation and implementation of the new philosophy fallen into the hands of persons of insufficient talent, irreparable injury might very easily have resulted to the entire economic and perhaps the social fabric of the country. As it turned out, men of great ability and of good will from the Bar and from the industry collaborated with the congressional draftsmen to frame these statutes in a manner which afforded a reasonable and sensible path to the objectives sought to be achieved. It has become perfectly clear over the years just how vital these contributions were to the creation of effective and practical legislation, effective in the sense of being properly designed and practical in the sense that under them a delicate financial mechanism could and did continue to function for the public benefit. Again and again, after the passage of the Securities Acts, extremely difficult problems of administration were confronted and solved with the aid of the industry and its counsel who assisted the early Commissions in meeting the practical difficulties of conforming existing financial practices to new patterns and standards.

There is a tendency to take the position that the disciplinary activities of the Commission have set the pace of conformity by the industry. This is a tempting approach but it falls far short of the facts. In the final analysis, the patterns of conduct and the standards of corporate morality at one time so widely disputed but now followed so uniformly, have more often than not become established by the voluntary and willing acts of responsible leaders of business and the professions.

There have been exceptions, of course. In any free country, there are a certain number of people who cannot by nature adapt themselves to a new point of view. However, the pioneering work by the leaders of the Bar and the industry in the establishment of this new approach has been followed by that of other thoughtful men, and there has gradually evolved the patterns of conduct now generally accepted by legitimate business and based upon principles of honesty, fair dealing and full disclosure. In a very real sense, business and government have, in this field, come to full maturity and understanding. The responsibility

of management to its stockholders and to the general public, involving the concept that all business is to some degree effected with a public interest, is, perhaps and more accurately, the measure of the accomplishment of the Securities and Exchange Commission during the 25 years of its life.

The development and application of this philosophy manifests itself in many directions. Corporations with enlightened management now vie with each other to issue intelligible and accurate annual and other periodical reports to their stockholders. The accounting profession has established standards for its members which are incomparably higher than those in effect anywhere outside of this country. Stockholders are becoming increasingly inquisitive as to the affairs of their corporations and management is becoming increasingly responsive to their demands. There is no doubt but that the adoption of the Securities Acts first gave form and expression to this philosophy and that the American investor is now the best informed participant in financial affairs to be found anywhere.

In the administration of the Securities Acts and above all in the exercise of the rule-making powers granted to the Securities and Exchange Commission under the various statutes, the financial community has cooperated freely and closely with the Commission. As the result, unnecessary and expensive mistakes have been avoided and there has been no disruption of the delicate machinery of securities distribution. The orderly development and administration of the Securities Acts over the years has required the cooperative leadership of responsible high-minded and public-spirited businessmen and professional men who have been willing to adapt themselves to novel concepts and to recognize that higher morality embodied in this legislation. Without this assistance, I do not know what the history of the Securities Acts would have been, but I feel sure that there would not be the free capital market which exists today.

It is true that I, a relative novice at this business, can feel a very substantial and justifiable pride in the work of my predecessors. Nevertheless, I think it is no more than just to make clear that much of what has been accomplished during the past 25 years, and which we look forward to carrying on in the future, has been dependent upon and will continue to depend upon the statesmanlike attitude of the lawyers and businessmen who have been willing to recognize the necessity for cooperation with Government in working toward the economic and financial development of our institutions.