S.E.C. LEGISLATIVE PROGRAM

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It is a great pleasure to visit Houston again and to have this opportunity to speak to an audience of varied professional backgrounds. As some of you may recall, I visited this city about a year ago in order to participate in the official opening of the Houston Branch Office of the Securities and Exchange Commission. I sincerely hope that those of you who have your offices in the greater Houston area have met the members of our staff here and have availed yourself of such assistance as you may have needed in the field of securities laws and regulations. From our viewpoint, our judgment to establish a branch office because of the growing importance of the securities business here has been adequately vindicated.

It has been suggested to me that you might be interested today in hearing about the current legislative program of the Securities and Exchange Commission. As background to our present program, let me first explain that in the summer of 1957 the Commission submitted to Congress certain proposals to amend an aggregate of 87 subsections of five of the six statutes which we administer. This was done pursuant to the statutory mandate that we make such legislative recommendations to the Congress as we may from time to time deem desirable in the public interest. For various reasons, when Congress adjourned in August, 1958, no action had been taken on the bills embodying these proposals. During the inter-Congress period, the Commission re-examined and re-appraised its legislative program in light of its further study and experience. In January of this year, we submitted revised recommendations to the Congress, which were duly referred to the Senate Committee on Banking and Currency and the House Committee on Interstate and Foreign Commerce, which groups are respectively charged with the duty of exercising watchfulness over the administration of the federal securities laws. These recommendations, which would amend an aggregate of 88 subsections of all the statutes we administer except the Public Utility Holding Company Act, were introduced in January and February of this year in the House of Representatives by Representative Oren Harris, Chairman of the House Committee, as H. R. Nos. 5001, 2480, 5002, 2481 and 2482. Companion bills embodying the same proposals were introduced in the Senate in February, 1959 by Senator A. Willis Robertson, Chairman of the Senate Committee, as Senate Bills 1178 to 1182, inclusive. The overall purpose of these recommendations is to strengthen the safeguards and protections afforded the

public by tightening the jurisdictional provisions of the statutes, correcting certain inadequacies, and facilitating criminal prosecutions and other enforcement activities. We are hopeful that hearings on these bills will be scheduled in the very near future. In the meantime, we are engaged in attempting to delineate any areas of conflict with the industry so as to simplify our presentation at the hearings.

A complete analysis of all of these proposals would necessarily include a recondite discussion of an intricate network of technical provisions and would carry this talk to inordinate lengths. I will limit myself, therefore, to some of what I conceive to be the more significant changes we propose.

First let me take up the Securities Act of 1933. One of our proposals would increase from $300,000 to $500,000 the size of offerings which may be exempted from registration by the Commission pursuant to Section 3(b), under which our Regulation A was adopted. We believe that this change is necessary under present day conditions in order to facilitate access to the public capital markets by small and medium-sized businesses. At the same time, we propose to amend Section 12 to add a new subsection which would impose civil liability upon those persons who may be responsible for untrue statements of, or omissions to state, material facts in any document filed with the Commission in connection with offerings exempt under Section 3(b) or Section 3(c).

Section 11 of the Act now provides for civil liability in the event of material misstatements or omissions in a registration statement, and Section 12(2) contains civil liability provisions applicable to the fraudulent sale of securities generally, regardless of whether they are registered. Section 12(2) provides that "any person who . . . offers or sells" a security by false and misleading statements is liable "to the person purchasing such security from him." However, under this provision, where, as very often happens, an issuer sells to a dealer and the dealer in turn sells to an investor, there is doubt whether the investor can go beyond his immediate seller (the dealer) and recover from the issuer, who may be the person actually guilty of uttering the misleading information.

There should be no defense of lack of knowledge of any untruth or omission by the issuer in a document filed with the Commission. On the other hand, it does not seem reasonable to impose liability for misleading statements or omissions in an exempt offering upon an officer, director

or other individual associated with the offering who can sustain the burden of proof that he acted in good faith and did not know of the untruth or omission. Thus we propose that those individuals would be liable only for actual misconduct or bad faith, whereas the issuing corporation would be absolutely liable. We think that enactment of this proposal would furnish investors with the additional protection which seems to be required in Section 3(b) exempt offerings.

In this same general connection, we propose to amend Section 24 to extend criminal liability for documents filed with the Commission to cover exempt offerings made pursuant to Section 3(b) or 3(c) and even further. This Section now makes it a criminal offense for any person wilfully to falsify a registration statement filed under the Act. The Commission now suggests that this section apply not only to a registration statement, but to any application, report or other document filed under the Act.

A further amendment of Section 12 is in our program, inserted in order to resolve a troublesome question which has arisen concerning the jurisdictional basis of the civil liabilities provisions of this section. It has been held in some jurisdictions that in order for such liability to attach, the mails or interstate facilities must be used in making the misrepresentation. Other courts have, we think more properly, held that the use of mails or interstate facilities in any part of the transactions is sufficient to create liability. We propose that the jurisdictional language be separately stated so as to make it clear that the section would be applicable if there has been any use of the mails or interstate facilities in connection with the transaction, thus conforming the jurisdictional requirements to those contained in Section 17(a), the anti-fraud provision of the statute of which Section 12(2) is essentially a counterpart.

Section 20(b) of the Securities Act now provides in short that the Commission may obtain an injunction when it appears that any person is engaged or about to engage in any acts or practices which constitute, or will constitute, a violation of the Act or any rule or regulation thereunder. The legislative program recommends amendments to this section which would authorize injunctions on a showing that a defendant "has engaged" in acts constituting a violation, instead of making us show that the defendant "is" so engaged. While past violations are considered a sufficient basis for an injunction by many courts, on the ground that they indicate the possibility of future violation, there have been some dissidents, and it

would materially assist the Commission in its enforcement activities if it were made very clear that Congress intends a past violation to form the basis for an injunction against future misconduct. In the last analysis, of course, the issuance of the injunction would still be a matter within the discretion of the court.

Finally, a new section would be added which would specifically prohibit persons from doing acts indirectly which they may not do directly, and would make it specifically unlawful for any person to aid, abet or procure a violation by another.

Changes are proposed in the Trust Indenture Act essentially to conform certain provisions of that statute to certain of the recommendations made in connection with the Securities Act.

Amendments concerning injunctions, indirect acts, and aiders and abettors similar to those proposed to the Securities Act are proposed to the Securities Exchange Act of 1934.

In addition, we propose to add a new Section 35 to the latter Act which would prohibit the embezzlement of money or securities entrusted to the care of an exchange member or a registered broker or dealer. The Act now contains prohibitions against fraudulently obtaining customers' funds or securities, but does not contain an express provision against embezzling or converting. Inasmuch as the distinction between fraudulently obtaining customers' funds or securities and embezzling or converting them frequently depends upon the technical question of whether the defendant had a wrongful intent at the time he induced a customer to entrust securities to him or whether the idea of converting the securities first occurred to him after he got possession, the Commission has recommended provisions which would prohibit such actions in words which will leave no doubt as to their being a violation of the 1934 Act.

A further proposed amendment to this Act would clarify and strengthen the statutory provisions relating to market manipulation without altering their general purpose or effect. We have recommended changes in the wording of Section 9(a)(1) concerning prohibition of manipulation by the use of so-called matched orders in order to overcome the effect of an extremely restrictive judicial interpretation, which would greatly narrow its scope.

Our program also suggests the amendment of Section 15(b) of the '34 Act with respect to the bases on which registration of brokers and dealers may be denied or revoked, the sanctions which the Commission may impose, and the procedures involved in postponing the effectiveness of registration. Under these proposals, the grounds for a denial or revocation of a broker and dealer registration would be broadened to include conviction of any "financial type" crime. As presently limited, convictions justifying such action by us must arise out of securities transactions or from conducting a broker or dealer business.

The Commission has also proposed that it be given the power to suspend the registration of a broker-dealer when, in its view, the testimony does not warrant the extreme sanction of revocation. Under present law, curiously enough, we have power only to revoke registration with the SEC or to suspend or expel from membership in the NASD. There are situations which come before us where revocation is really not called for, but where mere suspension or even expulsion from membership in the Association would not afford an adequate sanction. In some instances, where the broker-dealer is not a member of the NASD, the only alternative is revocation of registration. As it stands, when there are mitigating circumstances we are forced to revoke the registration and then hold a second administrative proceeding on the question of whether an application for new registration should be denied. The Commission might have no objection to readmission but a record must be made and the public given an opportunity to object. In appropriate cases, this cumbersome maneuvering could be eliminated by granting to the Commission specific power to suspend the broker's registration for a period of time.

We have further recommended that Congress extend the Commission's existing authority summarily to suspend a security from trading on a national securities exchange for a period not exceeding ten days when necessary in the public interest. Lately, this grant of power has been used to keep in effect a suspension of trading pending final disposition of delisting proceedings under Section 19(a)(2) of the Act. It has been useful where it has appeared that the current information available to the public concerning a security is misleading or is inadequate to permit investors to make informed judgments with respect to its purchase or sale, and it appears that the additional necessary information cannot be obtained and made available to investors until all the facts are elicited through the 19(a)(2) proceedings. These proceedings, because of their complexity,

often cannot be completed within a single 10-day period, and it has been found necessary to renew the suspension for successive 10-day periods. No express authority for such action is contained in Section 19(a)(4), and its proposed amendment codifies the current interpretation under which the Commission has acted.

The present statutory power of suspension of trading applies only to transactions on a national securities exchange and does not explicitly extend to securities traded only in the over-the-counter markets. Among the Commission's recommendations is included a new Section 15(c)(4) which will give to the Commission comparable statutory power summarily to suspend trading in a security on the over-the-counter markets.

The Commission has also proposed a new section which would authorize the Commission, in its discretion, to institute action on behalf of the United States to recover $100 per day in civil penalties for failure to file any required information or reports. A similar provision now covers delinquencies in filing reports under Section 15(d), and its extension to other reports is designed further to strengthen the hand of the Commission in enforcing timely filings. The present remedies, principally that of mandatory injunction, have shown themselves to be effective only after substantial additional delay and after cumbersome technical litigation.

In addition to the foregoing, we have proposed other amendments to the Securities Exchange Act of 1934, the details of which would probably not interest you particularly. Briefly, they would: (1) clarify and strengthen the statutory provisions relating to the financial responsibility of brokers and dealers; (2) authorize the Commission by rule to regulate the borrowing, holding or lending of customers' securities by a broker or dealer; (3) make it clear that mere attempts to purchase or sell securities are covered by the anti-fraud provisions of the statute; (4) authorize the Commission to suspend or withdraw the registration of a securities exchange when the exchange has ceased to meet the requirements of original registration; and (5) provide for the adjudication of an insolvent broker or dealer as a bankrupt in an injunctive proceeding instituted by the Commission.

The Investment Advisers Act of 1940 has, ever since its enactment, been least effectual of any of the Securities Acts in protecting investors and the public, due to certain patent inadequacies. For example, unlike the

Securities Exchange Act of 1934 the Investment Advisers Act gives the Commission no authority to require that adequate books and records be maintained by the regulated persons. In fact, the Commission has no adequate means of determining whether any investment adviser is mishandling his customers' funds or securities or engaging in other fraudulent practices in connection with his business. What is perhaps even more important, the anti-fraud provisions of the Act do not apply to investment advisers who have failed to register with the Commission.

Proposed amendments have been submitted which, in addition to remedying the foregoing inadequacies, would expand the basis for disqualification for registration because of prior misconduct; authorize the Commission to require the filing of reports; empower the Commission by rule to define, and prescribe means reasonably designed to prevent, fraudulent practices; extend criminal liability for a wilful violation of a rule or order of the Commission; and revise the provisions relating to the postponement of effectiveness and withdrawal of applications for registration. There is a very substantial place in the financial world for investment advisers, and they can be of immense assistance to the untutored public. We believe, however, that they have far too delicate a fiduciary relationship with their clients to permit us to condone the present rather ineffective regulatory pattern.

The Commission has also recommended a number of amendments to the Investment Company Act, the general objectives of which Act are to secure honest and unbiased management of the investors' funds; to give security holders a voice in the investment company and particularly in the selection of management; to assure adequate and feasible capital structures; to obtain fairness in all transactions between affiliated persons and the investment company; and to see that the shareholders are provided with informative periodic financial reports.

One of the more significant of our proposals to amend this statute would require the statement of policy of a registered investment company, which cannot be changed without the consent or approval of the holders of a majority of the voting securities, to include its fundamental investment objectives and investment characteristics. Under the present law every registered investment company is required to file a registration statement which includes a recital of the company's policy regarding diversification and redeemability of its securities, borrowing money, concentration

of investments in any particular industry and making loans, but omits to require statements of whether an investment company is a balanced fund, a bond fund or a common stock fund, whether company's investment objective is primarily capital appreciation or income, or whether it intends to invest in controlled companies, in special types of securities or in securities of corporations in peculiar geographical areas. Our proposal would require that these matters be included in its statement of policy.

We have recommended amendment of Section 10 of the Investment Company Act which now provides that:(1) not more than 60% of the directors of a registered investment company shall be officers, employees or investment advisers of the investment company or affiliated persons of an investment adviser of the investment company; (2) a majority of the board may not be directors who are regular brokers or principal underwriters of the investment company or who are investment bankers or affiliated persons of these persons; and (3) a majority of the board may not be officers or directors of any one bank. Thus, the general purpose of the section is to assure that an investment company will have a certain number of "independent" directors on the board of directors who can act as "watchdogs" over the conduct of management. Despite the elaborate limitations of these provisions, because of the limited scope of the first of the foregoing provisions and the fact that the first and second provisions are not keyed together, it is possible to have a board composed of no "independent" directors. Inasmuch as the Commission feels that the stockholders of the investment adviser, including those with less than a 5% interest, principal underwriters for the investment company and controlling or controlled persons of the investment company, adviser and underwriter and their affiliates are so closely related to the management as not to be disinterested, it proposes in its recommendation for amendment that these persons and their affiliates be placed in the same 60% category as the officers, employees and the investment adviser of the investment company. In recognition of the view that regular brokers for the company may not be as closely related to the management as the others I have described, the proposed amendment does not put regular brokers in the 60% category, but provides that the regular brokers and their affiliated persons together with the classes of persons previously referred to may not exceed 80% of the membership of the board.

Another problem which we are attempting to resolve by statutory amendment arises from the definition in Section 2(a)(1) of the Act of an

"advisory board" as a board:(1) which is distinct from the board of directors or board of trustees; (2) which has advisory functions but no power to determine that any securities or other instrument shall be purchased or sold; and (3) which is composed solely of persons who do not serve such company in any other capacity. Through the use of an investment advisory "committee" as an advisory "group of consultants" rather than a board and through the appointment on such committee or group of an officer or employee who does serve the investment company in another capacity, it has been contended that the resulting committee is not an "advisory board" within the terms of the definition and that consequently the limitations applicable to the composition of the board of directors which are by statute also applicable to the "advisory board" are inapplicable. Thus, persons in an advisory position with the investment company and who should be considered "affiliated persons" of the investment company would not be so considered and would not be subject to such important provisions of the Act as relating generally to prohibitions with respect to transactions by an investment company involving an affiliated person. The proposed change would bring all investment advisory boards, committees and groups within the definition of "advisory board," and the same limitations as to composition applicable to the board of directors would apply to members of such advisory boards. On the other hand, there would be a specific exclusion for committees composed solely of directors, officers or employees of an investment company or of its investment adviser. There is no intention that such management or executive committees be affected by the provisions applicable to advisory boards.

We have proposed other amendments to the Investment Company Act of 1940, but in the interest of time I will only describe them briefly. They would: (1) require that if an investment company chooses to keep its securities and investments in the "custody of the bank" such custodianship shall include the cash assets of the investment company; (2) impose limitations upon the proportion of common or preferred stock that may be acquired by face-amount certificate companies issuing fixed obligations (face-amount certificates) to prevent such obligations from becoming unduly speculative; (3) clarify certain exceptions to the definitions of an investment company required to register under the Act; (4) eliminate the exceptions from the definition of an investment company for a company subject to regulation under the Interstate Commerce Act when this

Commission finds and by order declares that such company is primarily engaged in the business of investing, reinvesting, owning, holding or trading in securities; and (5) clarify the terms "depositor" and "share of stock" used in the statute by adding specific definitions of these terms.

As you will note, few of the matters covered in this legislative program are, or at least should be controversial in nature. We hope that we will not encounter any very serious opposition in their enactment.

In closing, permit me to express our appreciation to the Houston Chapter of the Texas Society of Certified Public Accountants, the Houston Bar Association, and the Houston Members of the National Association of Securities Dealers for their sponsorship of this session on securities laws and regulations. We believe that seminars such as this are of significant consequence since they not only provide an up to date, first hand delineation of various aspects of our work but also because they help to promote and develop a cooperation and understanding between our agency and those on whom the securities laws impinge. It almost goes without saying that such a mutual understanding materially facilitates our task of achieving the aims and objectives of the laws.

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