THE RELATIONSHIP OF THE SECURITIES AND EXCHANGE COMMISSION TO THE CONGRESS AND THE SECURITIES INDUSTRY

Address of

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Commissioner,

Securities and Exchange Commission

before the

ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK

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It is a real privilege for our General Counsel, William H. Timbers, and me to appear before the Association of the Bar of the City of New York. We welcome this opportunity to bring you an up-to-date story of the work of the Securities and Exchange Commission and to discuss the Federal laws this Commission administers. We are indebted to your Section on Administrative Law and Procedure, and its Committee on Post-Admission Legal Education, for the kind invitation to be with you.

If you will indulge me in a personal remark, in appearing before this Association I have a feeling of being in my own home ballpark. Although I am the first SEC Commissioner to be appointed from the State of Illinois, before I went west I spent the first twenty-five years of my life within a radius of a couple of miles of this building. I sweated through some of my preparation for the New York Bar Exam in your library. Even before that, one of my early associations, when I was in grade school, was with a great man of law of this Association, Charles C. Burlingham, your president from 1929 to 1931. I would like, here in this Association, to pay a personal tribute to Mr. Burlingham as a leader of the bar who in my formative years made the law seem attractive and challenging as an opportunity for public service.

Mr. Timbers and I are billed under the general title stated in the "prospectus" for this meeting as follows: "Some practical aspects of the relationship between the Securities and Exchange Commission as an administrative agency of the Federal Government and (a) the legislative branch, (b) the judicial branch, and (c) the securities industry and the bar." That is quite a comprehensive program. We will do our best with it in the time available. I propose to discuss the Commission's relationship with the Congress and the securities industry. Mr. Timbers will discuss our relationship with the judiciary and the bar. Before I begin, I would like to make a few general observations.

There is a rather nice sense of historical timing in your having a Commissioner and the General Counsel of the Securities and Exchange Commission to address you in 1954. Fifteen years ago, on May 5, 1939, your Section on Administrative Law and Procedure invited a then Commissioner and the then General Counsel for a similar evening of talk and discussion. The Commissioner was Jerome Frank, about whose distinguished career as lawyer and judge I know I do not have to expand on to you gentlemen who practice in the Second Circuit. The General Counsel was Chester T. Lane who, as Chairman of the Committee on Post-Admission Legal Education of your Section on Administrative Law and Procedure, extended the invitation to Mr. Timbers and me to be here tonight.

I pulled out of our files the talks which these gentlemen gave you in May 1939. I was struck by a reference which Commissioner Frank made to the then Chairman of your Association's Administrative Law

Committee. He referred to John Foster Dulles, who had recently published an article in the American Bar Association Journal on the development of administrative agencies. This disclosed (in Judge Frank's words) "an open-minded statesmanlike approach to the novel problems in the field of administration a repudiation of the panic stricken approach to the much needed development of the new administrative agencies."

The Securities and Exchange Commission was a new administrative agency, comparatively speaking, in 1939. It is interesting to think that part of the acceptance by lawyers of the administrative processes of the Securities and Exchange Commission is due to the foresight, wisdom and leadership of the great lawyer who today is making such an enormous contribution to United States policy and the effort for world peace as Secretary of State in the Cabinet of President Eisenhower.

Because this is an open meeting of your Association, not limited to lawyers engaged in securities practice, to set the stage for the evening's discussion I will begin by a brief description of the laws the Securities and Exchange Commission administers.

After the 1929 stock market crash and the start of the great depression of the 1930's, investigations of the capital markets and the practices of corporations and financial houses were made by the Congress in 1932 and 1933. These Congressional investigations focused attention on three of the many contributing causes of the crash. First, the public wasn't given adequate financial information about companies whose stocks were being sold and traded. Second, the securities markets were manipulated by insiders and other traders so the prices did not represent investment values based on free and open trading. Third, margin requirements were inadequate. Too much trading was done on borrowed money. The confidence of the American public in corporate securities as a medium of investment was thoroughly shaken.

In 1933, the Congress passed the Securities Act. This law was designed to make available to investors the business and financial facts they should have in order to make an informed decision as to whether to buy securities that were being offered to them. The primary concern of this law is with the sale by corporations of new issues of securities and the distribution of outstanding securities by controlling persons. This means, generally, securities being sold to the public for the first time. The law requires a company issuing new securities to the public in interstate commerce to register those securities with the Federal Government and make public pertinent facts specified in the Act regarding the business and financial affairs of the company.

In 1934, the Congress passed the Securities Exchange Act. This provided for the registration with the Federal Government of all national securities exchanges - that is the stock exchanges - and of

the securities listed on such exchanges. This law also did a lot of other things. It provided for the filing by listed companies of periodic financial reports. It imposed restrictions on officers, directors and large stockholders of listed companies from profiteering from "inside information" by short swing trading in the company's securities. It provided for regulation of the solicitation by listed companies of proxies from their stockholders. It gave the Federal Government broad powers to review the rules and regulations of the stock exchanges or to impose rules and procedures upon them. Manipulation of the securities market was prohibited. Both the Securities Act and the Exchange Act contained broad prohibitions, both civil and criminal, against misrepresentations and fraud in the sale of securities.

The Exchange Act created the Securities and Exchange Commission to administer the two statutes. The law provided that the Commission should be a bi-partisan independent agency consisting of five Commissioners appointed by the President with staggered five-year terms. No more than three Commissioners may be of the same political party. Under the present Administration for the first time three Commissioners are Republicans, but all five of us work together harmoniously.

In 1938, Congress amended the Exchange Act so as to give the Commission regulatory authority over securities dealers' associations and a limited supervision over the market for securities not listed on exchanges. Under this amendment, the National Association of Securities Dealers was organized. This is a voluntary association to which 3,151 of the total of 4,170 brokers and securities dealers in the United States belong. There are 1,068 members of this association with principal offices in New York and many more with branches or doing business here. The "NASD," as it is called, exercises disciplinary authority over its members. It has adopted standards for fair and ethical business conduct and actively inspects and supervises its members' business activities to assure conformity with its "Rules of Fair Practice." The NASD is an outstanding example of voluntary industry self-discipline.

Several other laws added to the Commission's regulatory power over specific types of business, such as public utility holding company systems 1/ and investment companies.2/ The Commission has continuing jurisdiction over 17 public utility holding company systems operating in 33 States of the Union. They have aggregate public utility assets of $6.5 billion, or about 20% of the privately owned public utility properties in the nation. Three of these, with utility assets

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1/ The Public Utility Holding Company Act of 1935
2/ The Investment Company Act of 1940

of $1.3 billion, do business in the State of New York. The assets of registered investment companies today aggregate $8.5 billion, and the shares of most of these are offered for sale in New York and many of them head up here.

Indentures under which publicly offered corporate debt securities are issued must be qualified with the Commission and meet statutory standards assuring independence of the indenture trustee.1/ So that the Commission's experience in corporation finance may be availed of in the public interest in corporate reorganizations under the Bankruptcy Act, the Court may call on the Commission and, in certain cases of broad public investor interest, the Commission may intervene to assure independence of the trustee, advise as to the feasibility of the plan of reorganization, and comment on the requests for fees and allowances.2/

The Congressional purpose of these Federal laws, appearing many times in the statutes, was and is "the public interest and the protection of investors." The job of the SEC under these laws is to carry out this broad Congressional intent.

Before I go further, I want to point out one very basic difference between the Commission's impact on the American economy today and in the 1930's, and the much more vital role which the Commission now plays as compared with its role in the 1930's.

Capitalism in America was undergoing an extreme crisis in the middle thirties. The economic, political and moral climate that then existed for the investment of capital was discouraging, to say the least. Yet on the investment of capital depends the development of prosperous and productive enterprise in America, both owned by the people and providing jobs for the people.

The impact of the Federal securities laws in those years, directed at reform of the capital markets whose financial practices had hurt the public, was on an economy in which the formation of capital was almost dormant. In 1934 new issues of corporate securities offered for sale were only $400 million. In 1939, the figure was $2.2 billion. For the six years, 1934 through 1939, only $13 billion of new capital was raised by corporations in the securities markets. The administrative procedures of the Commission, many of which were extremely complicated, technical and time consuming, were evolved in this period when, because of the economic stagnation, the impact of the Commission's work on the nation's economy was comparatively minor.

1/ The Trust Indenture Act of 1939

2/ Chapter X of the National Bankruptcy Act

Contrast this with the situation today. In the single year 1953, $8.9 billion of new corporate securities were sold to the investors of America, and the indication for 1954 is about $9.3 billion. And, for the six years, 1946 through 1951, $40.7 billion of corporate capital was raised by the sale of securities to the American public.

And, in the present favorable climate for investment, even larger amounts, generated by corporations from internal sources, are reinvested in the enterprises. In the six years, 1934 through 1939, the increase in net working capital of corporations was only $12 billion and the amount of money devoted by corporations to plant and equipment expenditures only $25 billion. In the six years 1946 through 1951, on the other hand, the increase in corporate net working capital was $34 billion and the expenditures on plant and equipment $100 billion. Of this total of $134 billion of capital expansion, $100 billion was provided by increases in depreciation reserves and earnings retained in the business. In 1953 American industry poured $28 billion into new plants and facilities and the indication for 1954 is about $26.7 billion.

In this context, the successful operation of the securities markets is enormously important to the economic growth of America and the welfare of our people. The economic activity the country now enjoys is sustained by the large and continuing flow of investment capital into the industry.

If the impact of Federal regulation of the securities markets were destructive, punitive, bureaucratic, or even slow, the sensitive mechanism of capital formation and investment could be thrown off balance. Our whole economy could be injured in the process. Investors, consumers and workers alike would be injured. It is in this context of the enormous importance to the people of America of the unimpeded flow of investment capital into industry that we who are responsible under the present national Administration for administering the Federal securities laws are working. We are aware that in great measure the success of our economic and free political system in America depends upon the successful formation of aggregates capital and their investment in productive enterprise. The securities markets provide the medium for this formation and investment of capital by the people.

Recognizing the importance of the capital formation process and of the maintenance of free, open and honest securities markets does not mean that the viewpoint of the Commission today is any less in harmony with the spirit of the Federal securities laws than were the Congresses which enacted them in the early thirties. We believe that the restoration of investor confidence during intervening years has been in no small measure due to the work of the Securities and Exchange

Commission under these Federal laws enacted by the Congress "in the public interest and for the protection of the investor".

This leads me right into the first main part of my topic - the relationship between the Congress and the Commission. The most natural place for the Congress and the Commission to meet is in the field of legislation, and this we did during the 2d Session of the 83d Congress.

For many years, dating back as far as 1940, there had been conferences, of which the Congressional Committees had been kept informed, between the Commission and representatives of the securities industry in regard to proposed legislation to amend and revise the basic securities acts. All of these efforts had failed of fruition. Without going too deeply into the background of these earlier negotiations for legislation between the Commission and the industry, we felt that it was appropriate for the Congress to work out legislative amendments.

When President Eisenhower addressed the Convention of the Young Republican National Federation at Mount Rushmore, South Dakota, on June 11, 1953, he spoke of the policy of cooperation between the branches of government in these terms:

> "In . . . /a/ spirit of constructive purpose have been shaped the relations between the Executive and Legislative Branches of the Government. I have had the pleasure of meeting at the White House with every Senator and almost every Congressman of both parties - a number of whom, though veterans in Government, had never before entered the President's house.
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> "These meetings have reflected a major purpose of this Administration. It is this: To do all that it reasonably can do to encourage cooperation and harmony between the Legislative and Executive Branches. For only such harmony can advance coherent, consistent policies at a time when all the world must be made aware of America's steady direction and aims. This effort has been shared by our party's legislative leaders." . . .

> "There is no compromise in principle involved in seeking to adhere to effective - and let me say constitutional - methods in Government." 1/

In the summer of 1953, three vacancies on the Commission were filled. At about that time, we advised the respective Chairmen of the Banking and Currency Committee of the Senate and the Interstate and Foreign Commerce Committee of the House that various groups wished to submit proposals for amendment of the statutes administered by the Commission. We suggested "that the Commission's responsibility is to administer the law, not to write it, but that the Commission could fulfill a valuable function by cooperating with Committees of the Congress and in studying legislation proposed by organizations or groups of citizens." Senator Capehart, Chairman of the Banking Committee, referred to the continuing responsibilities of the Committees of the Congress under Section 136 of the Legislative Reorganization Act of 1946 for appraisal of the Commission's administration of the laws subject to its jurisdiction and in the development of amendments or related legislation. He suggested that a program be worked out under the guidance of Senator Bush, Chairman of the Subcommittee on Securities, Insurance and Banking.2/ Representative Charles A. Wolverton was Chairman of the House Committee, a man of great distinction in the Congress. He was a member of the Commerce Committee when the Securities Act was passed in 1933. He wrote us in August 1953, commenting on our consideration of an amendment program with stock exchanges and others who might be interested, as follows:

> "It seems to me that no harm, and, indeed, much good might arise from a continuation of the discussions which you have had with industry and affected persons over the years in the development of technical changes which might be made to the acts and which you would propose to bring to our attention for consideration.
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> "On the other hand, you will appreciate, I am sure, that I am most zealous in preserving for the investing public the protection which was envisaged in the statutes when they were passed, both as they apply to investors in new securities and as they apply to purchasers on the exchanges and over-the-counter markets. I certainly would

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1/ New York Times, June 12, 1953, p. 12.

2/ Hearings before a Subcommittee of the Committee on Banking and Currency, U. S. Senate, 83d Cong., 2d Sess., Feb. 3 and 4, 1954, p. 3.

> feel that it was unincumbent upon any agency charged with administering these acts on behalf of the Congress for the protection of the general public, to initiate or sponsor any program which would weaken such protection, though conversely, it might well give thought to areas in which it could be strengthened." 1/

After this the Senate Subcommittee, led by Senator Bush, met with the Commission on several occasions and also held meetings with industry representatives who had proposed amendments.2/ At these meetings, the broad outlines of a bill which was believed would be acceptable to the Congress was indicated. It is a real tribute to the legislative skill of Senator Bush that all but one of the amendments that emerged from these meetings of his Subcommittee passed the Congress without a dissenting vote. The one amendment which failed, a proposal to increase the amount under which the Commission may exempt new issues of securities from the registration provisions of the Securities Act from $300,000 to $500,000, passed the Senate but failed in the House. The American public owes a real debt to Senator Bush for his hard work and fine leadership in developing and seeing through to a successful conclusion these amendments of the securities laws, the first in many years.

I also want to mention one of the staff members of the Senate Committee, Joseph P. McMurray, who participated in preparing the legislation and guiding it in the Senate. I mention him particularly because he played a valuable part in maintaining the fine relationship between the Commission and the Congress in the past session. In July of this year, Mr. McMurray assumed the office of Executive Director of the New York City Housing Authority, by appointment of Mayor Wagner. When he left Washington he received tributes on the Senate Floor from sixteen Senators of both parties, praising his fine work there, both as an aide to the late Senator Wagner and then as a member of the staff of the Banking Committee.3/ We at the Commission are very much indebted to Mr. McMurray for his guidance to us during this past Congressional session.

1/ Hearings before the Committee on Interstate and Foreign Commerce, House of Representatives, 83d Cong., 2d Sess., March 19, 1954, p. 13.

2/ Senate Hearings, p. 3.

3/ 100 Congressional Record, 83d Cong., 2d Sess., July 28, 1954, p. 11870.

I also want to mention one of the staff members of the House Committee, Dr. Andrew Stevenson, who advised Representative Wolverton, the Chairman, and the Committee, and whose guidance to the Commission in regard to the legislation and its course in the House was of immense importance.

It was not the purpose of the 1954 amendments of the securities laws 1/ to change or vary their basic scope.

The legislation which was formulated, we believe, represents a great step forward in furtherance of the original Congressional purpose expressed in the Securities Act and the Exchange Act of disseminating broadly to the public information about securities being issued and traded. The amendments, in the words of the Senate Committee, will also "reduce unnecessary delay, expense and complexity and result in more efficient, effective and realistic operation of these acts." 2/ And, in the words of the House Committee, "The amendments . . . fully preserve the basic philosophy and purposes of these acts." 3/

1/ P.L. 577, 83d Cong., 2d Sess., approved August 10, 1954, effective October 10, 1954.

2/ Sen. Rep. No. 1036, 83d Cong., 2d Sess. (1954) p. 2.

3/ H. R. Rep. No. 1542, 83d Cong., 2d Sess. (1954) p. 6.

I will now describe in more detail the provisions of these 1954 amendments of the Federal securities laws. The first of these amendments will permit wider use of offering prospectuses for new issues of securities, particularly short form prospectuses, and greater use of newspaper advertisements, particularly during the so-called waiting period after the registration statement has been filed with the Commission but before it has become effective. This period normally is about 20 days. The amendment should make it easier for investors all over the country to invest in new issues of securities whose distribution has up to now tended to be concentrated in a few cities having large capital markets. Briefly, here is how the amendment changes the law.

The good result produced by the Securities Act came in great measure from the fact that the issuer and the underwriter must come forward and make a public statement concerning the issuer's business, its finances, its securities, and the proposed offering, and all of this under stern statutory liabilities both penal and civil. This requirement of disclosure is itself a substantial deterent to transactions which would not stand the light of day. The imposition of liability for inaccurate and incomplete information and the administrative processing by the Commission of material filed with it have improved corporate morality, accounting standards, and standards relating to business information generally.

The Securities Act before the 1954 amendments made unlawful the offer or sale of a security to the public by the mails or the instrumentalities of inter-state commerce, such as the inter-state telephone, until the registration statement with respect to the security had been filed with the Commission and become effective. Oral offers prior to effectiveness were not made unlawful, that is, oral offers within the state. The seller of the securities must deliver to the purchaser a prospectus containing a summary of the information in the registration statement.

It is clear from the legislative history of the Securities Act that the Congress intended that by dissemination of information during the 20-day waiting period the public would become informed of the essential facts relating to a proposed issue of new securities before the effective date of the registration statement. 1/ However, the securities industry had contended for many years that the free flow of information concerning a new issue was, in fact, restricted because of the fear of issuers, underwriters, and dealers, not to mention their lawyers, that communications to prospective purchasers

1/ H. R. Doc. No. 85, 73d Congress, 1st Sess., (1933) pages 7 & 8.

might be construed to be illegal offers of the security before the effective date of the registration statement. In formulating the 1954 amendment, the Congressional committees recognized that the distinction between "dissemination of information" and "offers" is difficult to draw and still more difficult for a customer to appreciate, and the Commission has been concerned over the years because the objective of a wide-spread dissemination of information during the waiting period had not been more effectively achieved.1/ Accordingly, under the Securities Act, as amended in 1954, written offers to sell, and solicitations of offers to buy during the waiting period are permissible, provided such offers are made by means of a preliminary prospectus filed with the Commission prior to its use. The long standing prohibition against the making of an actual sale or contract of sale prior to the effective date of the registration statement is not changed by this amendment. Issuers, underwriters and dealers will have to regulate their conduct during the waiting period so as not to make contracts of sale before the registration statement becomes effective.

It must be apparent from what I have just stated, that the 1954 amendments do not work any fundamental change. In fact, they give specific authority for practices which have developed over the years under the present law. And, as I suggested a moment ago, to the extent that the media of information permitted by the amendments will be more widely distributed to the general public a larger segment of the investing public and smaller dealers all over the country will have a greater opportunity to participate in the important process of capital formation.

Furthermore, the amendments provide greater flexibility for the Commission in prescribing the form of prospectus which can be used and give the Commission the power to prescribe rules for short-form summary prospectuses to be used during the waiting period. It was not intended by these amendments, however, to open up the Act so as to permit the use by issuers and underwriters of prospectuses and sale literature during the waiting period which have not been filed with and processed by the Commission. In other words, pre-effective "free-writing" does not flow from the amendments. The Commission is presently engaged in drafting new rules to implement these provisions of the 1954 amendments and has already received suggestions of industry representatives for such rules. I will refer to these briefly in a few minutes.

1/ H. R. Rep. No. 1542, 83d Cong., 2d Sess., (1954) pages 7 - 9; Sen. Rep. No. 1036, 83d Cong., 1d Sess., (1954) pages 2 & 3.

As pointed out in the report of the Committee on Interstate and Foreign Commerce of the House of Representatives, the amendments will conform the statute to the present practice, encourage greater dissemination of information by relieving underwriters and dealers of fears connected with pre-effective distribution of written material, will make possible dissemination of more accurate information to the investor than he now generally receives, will not take away any of the protection heretofore afforded investors by the Securities Act of 1933, and will not change the liabilities for statements made or not made in the registration statement and prospectus.1/

Other technical changes made by these amendments may be summarized as follows:

(1) reduces from one year to 40 days after distribution of a new issue of securities has been commenced the period during which dealers must deliver prospectuses in trading transactions;

(2) simplifies the information required in a prospectus used in an offering that lasts more than 13 months;

(3) reduces from six months to 30 days after distribution of a new issue has been completed the time when a dealer can extend a customer credit on the new securities;

(4) clarifies the Commission's rule-making authority on "when-issued" trading;

(5) eliminates from prospectuses summaries of certain trust indenture provisions which have heretofore been required, thus permitting simplified, more readable prospectuses for debt issues; and

(6) provides simplified procedures for registration of securities of investment companies, the so-called "mutual funds."

1/ H. R. Rep. No. 1542, 83d Cong., 2d Sess., (1954) pages 10 - 14.

So much for legislation. I am sure you realize from what I have said that our relationship with the 83d Congress was fruitful and good.

There are other areas in which the Congress is involved in practical problems with the Commission. I will discuss two of these briefly.

A number of investigations made by the Commission pursuant to specific statutory authority have led to the enactment of specific legislation. The 1936 amendments to the Exchange Act,1/ the Trust Indenture Act,2/ Chapter X of the Bankruptcy Act,2/ and the Investment Company Act 3/ are examples of legislation flowing from investigations and studies made by the Commission under express statutory mandate. The reports of the Congressional Committees in connection with the 1954 amendments are interesting in this connection. This is from the Senate Committee:

> "Your committee, in accordance with its responsibilities under section 136 of the Legislative Reorganization Act of 1946, intends to keep itself fully informed concerning any practices developed in the industry, and the procedures devised by the Commission, as a result of these amendments. Your committee expects the Commission, in its periodic reports to the Congress, to advise concerning the steps taken in the implementation of the amendments and its experience under the acts as amended. Your committee also expects that the Commission will advise with it concerning any additional legislative authority deemed necessary to carry out the basic intent of these acts."4/

1/ Report on trading in unlisted securities upon exchanges, 1936.
2/ Report on the study and investigation of the work, activities, personnel, and functions of protective and reorganization committees, 1936 - 1940, Parts 1 - 8.
3/ Report on the study of investment trusts and investment companies, 1938 - 1941, Parts 1 - 5 and supplemental reports, 1939 - 1940, 6 parts.
4/ Sen. Rep. No. 1036, 83d Cong., 2d Sess., (1954) page 2

The House Committee said this:

> "The instant bill represents those areas in which the Commission felt it could concur with the industry and does not include other areas proposed in which the Commission at this time is not willing to recommend legislation. Subsequently the Commission intends to draft further amendments which will incorporate Commission proposals on matters growing out of its experience." 1/

Also, there are very many provisions of the securities laws delegating to the Commission power to make rules and regulations, in some of which from time to time Congressional Committees may take a particular interest. An example is the proposed rule designed to give effect to the so-called "brokerage exemption" provided by Section 4(2) of the Securities Act which I will discuss in detail in a few minutes. Another example is a matter with respect to which Section 9(a)(6) of the Exchange Act gives the Commission rule-making authority, namely "stabilizing." The Subcommittee of the House Interstate and Foreign Commerce Committee, speaking in the direction of "an early promulgation of rules" by the Commission or consideration of further legislation by the Congress, suggested in December 1952 that the subject of stabilizing rules "be given more definitive consideration."2/ And there are a number of sections of the acts we administer, for example Section 23(b) of the Exchange Act, which require the Commission, in its annual report to Congress, to include "such information, data and recommendation for further legislation as /it/ may deem advisable with regard to matters within /its/ . . . jurisdiction . . ."

The Commission exercises some judicial or quasi-judicial power. In this broad classification of judicial and quasi-judicial functions are administrative proceedings in which the Commission enters orders affecting particular individuals or companies. For example, under the Holding Company Act the Commission enters orders permitting applicants or declarants to engage in financing transactions which comply with the standards specified by the Act. Under the Securities Act the Commission enters orders suspending or stopping the sale of a registrant's securities. Under the Exchange Act the Commission enters orders revoking or suspending a broker's or dealer's right to engage in business because of a violation of the Act. Also, the Commission has appellate jurisdiction over certain disciplinary actions of the National Association of Securities Dealers. Without indicating which of these may involve rule-making or licensing functions, with respect to which there may be different procedural safeguards specified by the Administrative Procedure Act, it is clear that cases of the kind I have just mentioned are either judicial or quasi-judicial in nature. The line of demarcation between what is "judicial" and what is "quasi-judicial" is

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1/ H.R. Rep. No. 1542, 83d Cong., 2d Sess., (1954) p. 3.
2/ H.R. Rep. No. 2508, 82d Cong., 2d Sess., (1952) p. 116.

sometimes hard to define and the distinctions among "rule-making," "initial licensing" and "adjudication" involve different procedural consequences under the Administrative Procedure Act.

Turning from the relationship of the Commission to the Congress, to the relationship of the Commission to the securities industry, I will now mention briefly four important rule-making matters in which the industry has an interest and which are presently under active consideration and study at the Commission.

The first of these is the proposed rules relating to the stabilization of securities under the Exchange Act.

Section 9(a)(6) of the Exchange Act makes it "unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exchange to effect either alone or with one or more other persons any series of transactions for the purchase and/or sale of any security registered on a national securities exchange for the purpose of pegging, fixing, or stabilizing the price of such security in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Under this provision Regulation X-9A6-1 was adopted in 1940 and is limited to the narrow area of stabilizing the price of a security traded on a national securities exchange to facilitate an offering at the market or at a changing price related to the changing market price. The practice applicable to a fixed price offering has been embodied in a number of interpretations; some of which were contained in releases, but most of them rendered individually by letter or telephone, case by case. Thus the vast bulk of day-to-day stabilizing transactions in connection with new public offerings of securities have not been the subject of any Commission rules, other than the familiar bold face disclosure in the prospectus that stabilizing may occur 1/ and the requirement that stabilizing transactions be reported within 24 hours.2/ The Commission's policy in the past was based on the feeling that the problems of stabilizing were so difficult and novel that no comprehensive rule should be promulgated until experience had been built up, case by case, over a period of time, like the common law. This process has taken place.

1/ Securities Act Rule 426
2/ Securities Exchange Act Rule X-17A-2.

It is the feeling of the Commission today that the Commission's jurisdiction over stabilizing should be asserted by rules and regulations, published and available for all to see. Accordingly, after 10 months' intensive study by our staff, in May of this year the Commission put out for comment proposed rules X-10B-6, 7 and 8 under the Exchange Act.1/ The first of these deals with underwriters trading prior to and during the distribution. The second covers the times, methods and levels at which stabilizing transactions may be made and the third covers distributions in connection with which the participants purchase rights, such as the so-called "Shields Plan." These draft rules received many and detailed comments by industry representatives in the light of which the Commission held a public hearing in July. Thereafter all those who appeared at that hearing and any others interested were invited to form an ad hoc committee and our staff has had a number of conferences during the summer and fall with this committee. A revision of the draft rules has been completed, taking into consideration all of the comments received. This revision we hope will be again discussed with the Committee within the next few weeks. It is our earnest hope that the rule as now revised will represent sound statutory interpretation and will prove administratively feasible both from the standpoint of the Commission and the securities industry. A number of lawyers, members of this association, have rendered invaluable service in connection with working out the formulation of rules in a field inherently complicated but sensitive and vitally important in the capital formation process.

The second rule revision which is of importance to the securities industry which the Commission has under consideration is our so-called Rule 154 under the Securities Act which gives life and body to the brokerage exemption provided by Section 4(2) of the Securities Act. Section 4(2) of the Securities Act exempts from the registration and prospectuses requirements of the Act "brokers' transactions, executed upon customers' orders, on any exchange or in the open or counter market, but not the solicitation of such orders."

In the legislative proposals which I referred to earlier was included a proposed amendment of the Securities Act intended to "restore" the brokers exemption provided in Section 4(2) "so as to give relief from the popular interpretation of the opinion of the Commission in the case of Ira Haupt & Company (23 SEC 589 (1946))".2/ The Senate Committee however, did not include an

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1/ Securities and Exchange Act Release No. 5040.
2/ Senate Hearings, p. 4; House Hearings, p. 14.

amendment of Section 4(2) in its bill. The Committee report contains this comment:

> "Your committee has been advised by the SEC and by representatives of the securities industry that an amendment to Section 4(2) of the act, which affords an exemption for certain brokerage transactions, has been suggested so as to give relief from the popular interpretation of the opinion of the Commission in the case of Ira Haupt & Co. (23 SEC 589 (1946)). Your committee is hopeful that the SEC will give favorable consideration to a rule which will deal effectively with the problem and understands that the SEC has such a rule under consideration."1/

After much study during the winter and early spring, in May the Commission put out for comment a proposed amendment which was designed to make clear that the availability of an exemption under Section 4(2) does not turn solely upon the question whether the selling stockholder is a controlling person but involves also a determination whether such controlling person, to the actual or constructive knowledge of the broker, is effecting a distribution of his holdings.2/ For the purpose of the rule, distribution is defined as not applying to isolated sales by controlling persons in amounts not substantial in relation to the aggregate volume of trading in such security.

Once again, many comments were received and in order to bring the matter to a head, the Commission held a public hearing in July. After carefully considering all the views, suggestions and comments which had been submitted, the Commission put out for comment in September a further revision of the proposed rule.3/ This varied from the first proposal. In order to provide a ready guide for routine cases involving trading as distinguished from distributing transactions, the term "distribution" was further defined as not including a sale or series of sales of securities by the controlling person, which together with all other sales on his behalf of securities of the same class within any six-month period, will not exceed approximately 1% of the outstanding shares of the security, in the case of a security which is not traded on an exchange and, with

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1/ Sen. Rep. No. 1036, 83d Cong., 2d Sess., (1954) page 7.
2/ Securities Act Release No. 3501.
3/ Securities Act Release No. 3515.

respect to a security which is admitted to trading on an exchange, the lesser of either 1% of the outstanding securities of the class or the aggregate reported volume of trading during any one week within the preceding four trading weeks.

These percentages and trading volumes were based upon very careful studies made by our Division of Corporation Finance as to the amount of securities which, in the light of the Division's experience over the years, appeared not to represent distributions by controlling persons. There was no intent on our part to give these figures any more emphasis than a rule of thumb or a guide which a trader in a brokerage house could use before making a transaction for a controlling person in order to test if the brokerage exemption was available or a distribution was involved. Regardless of these figures, it would be perfectly open to the broker or the controlling person to seek advice of counsel or to ask for an interpretative opinion of the Commission as to whether in any given case the brokerage exemption was available or a distribution was involved.

Notwithstanding the long, earnest and sincere effort on the part of the Commission to solve what has been a long standing problem in the industry, the Commission still faces a number of objections to this solution of the problem. Representatives of national securities exchanges have taken the position that the exemption provided by Section 4(2) for brokerage transactions should be applied regardless of whether distribution by a controlling person is involved. If the Commission were to agree to this position today, it would mean overruling the decision of the Commission in the Ira Haupt & Co. case, 1/ decided in 1946, which followed many administrative precedents of the Commission over the years. Secondly, the exchanges have taken the position that to provide in the case of listed securities a rule of thumb which depends upon the aggregate trading volume over a week's time is to discriminate against listed securities in favor of securities traded on the over-the-counter market. No discrimination is intended. The failure of the proposed rule of thumbto include for over-the-counter securities a test based on reported volume of trading recognizes two facts. First, in very few of the cases in which the Commission has been called upon to render interpretative opinions in the last 20 years have over-the-counter transactions been involved. Perhaps this is because in the over-the-counter market dealers tend to trade as principals rather than as agents and often there is solicitation of the "buy" order. Second, there are no reports of trading volumes in over-the-counter securities.

1/ In the matter of Ira Haupt & Co., 23 SEC 589 (1946).

One of the regional exchanges also feels that a limitation to one week's trading may work an undue hardship on small local issues in which there is comparatively little trading. In the light of expressed objections of industry groups, we are still studying the whole problem intensely. The Commission sincerely hopes to be able to promulgate a rule which will satisfactorily deal with the problem as it is faced by the men at the trading desks in the great bulk of day-by-day trading transactions. We cannot, of course, promulgate a rule that will chip away or erode the basic legal principles affecting distribution by controlling persons. For the long range, it is possible that this problem may have to be dealt with by the Congress.

Next, I would like to discuss briefly the requirement, which we abolished in the fall of 1953, that listed companies file quarterly reports of gross sales or operating revenues, the so-called 9-K report. Many times the trend of a corporation's quarterly gross sales is contrary to its net earnings trend. Recently, this has been under study at the Commission because of objections by the financial analysts' societies to abolition of the quarterly report requirement. Consideration is being given by our staff to the problems which would arise if a new interim reporting requirement should be adopted. I think I should say to you, in line with the over-all policy of the present national Administration, unless a case can be made out that the American investor is not being adequately protected by the present annual and interim reporting requirements of the Commission, certainly a real question is presented whether the Commission should require listed companies to file an additional report.

So far as the accounting profession is concerned, there appears to be serious and substantial objection to quarterly reports of earnings. The accountants say, in substance, that you simply can't properly reflect the operations of a company on a quarterly basis - too many things are estimates. Tax accruals, inventories, depreciation, unusual non-recurring expenditures, and the like in some cases might distort a quarterly picture so that a quarterly report could conceivably misinform and mislead, rather than inform, the investor.

Finally, I want to refer briefly to the implementing rules which the Commission is now considering under the 1954 amendments of the Securities Acts. Our staff is working on draft rules, and also has received from industry representatives proposals of theirs. It is hoped that the staff drafts will be ready for Commission consideration soon and that these can be put out for public comment during this month or early January. I am not really in a position to discuss these in detail but I would like to mention one point.

The prospectuses and summary prospectuses provided for by the amendments are to be filed with and processed by the Commission before being released to the public. The amended law does not permit pre-effective "free writing." This subject was briefed by industry representatives and thoroughly discussed with the Commission when we were advising and consulting with the Congressional Committees in connection with formulation of the bill. The proposal of industry representatives that the Securities Act be amended to permit pre-effective free writing was rejected. A study of the testimony given both by Chairman Demmler of our Commission and various representatives of industry groups will, I think, clearly reflect that there was no misunderstanding on the part either of the Commission or industry that pre-effective free writing was not intended to be permitted in the future any more than it has been in the past.1/

Finally, I would like to conclude on this note. The Acts of the Congress provide that the function of the Securities and Exchange Commission insofar as the securities industries is concerned is to protect the interest of the public and the investor. The work of the Commission over the past twenty years under these statutes has tremendously improved, and indeed was of enormous influence in restoring, investor confidence in the free enterprise system in America. This political and economic system is unique in the world today. It is at one pole of economic and political philosophy. I hardly need to point out that at the other pole lie the socialistic and communistic systems in which the means of production are owned and directed not by the people themselves but by an all-powerful state. The detailed work of the Commission in protecting the interest of the public and the investor in our free economic and political society takes on added importance in the background of the situation in which America stands in the world today. I ask you lawyers who represent issuers, underwriters, brokers, dealers, exchanges and other private interests in this great capital market of New York City to bear this in mind when,

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1/ Senate Hearings, pp. 8 - 31; House Hearings pp. 24, 39, 52, 117.

in your day-to-day work, you are confronted by the Securities and Exchange Commission and the mandates of the Congress which the Commission is attempting to carry out in the interests of the American public and the American investor.