JURISDICTION OF THE SEC

IN RELATION TO STATE BLUE SKY PROGRAMS

Address of

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My fellow Commissioners have asked that I convey their greetings to you. The Securities and Exchange Commission appreciates this opportunity to meet with you and to discuss some of our common problems and objectives. We wish to ask for your aid and to offer our assistance in a joint effort directed toward the prevention of fraud and the punishment of those who deal in securities in violation of Federal and State law, and toward the protection of those who wish to invest their savings in our securities markets and the encouragement of legitimate business.

There have been some suggestions recently that the Federal Government preempt the field of securities regulation. I had thought these views had long since been discarded, and it might be pertinent to review a little history to see why this is so, and why we cannot agree with these suggestions.

State blue sky laws and similar statutes designed to protect the investing public long antedate the Federal laws. I am proud to recall that Massachusetts was one of the first to adopt a form of securities regulation. It was as far back as 1852 that my home State adopted a statute designed to control stock issues of common carriers. These provisions, and similar controls adopted toward the end of the century with respect to gas and electric utilities, were originally conceived primarily as aspects of utility regulation, but they resulted in a substantial measure of indirect protection to investors. These early provisions were not essentially different from the more elaborate provisions now contained in the Interstate Commerce Act, and their extension to other utilities is found in numerous State and Federal statutes.

The first statute designed primarily to protect the investing public was enacted in Kansas in 1911, and was followed by similar legislation in other States, some twenty-three such statutes being enacted within the next two years. Today, some such statute is effective in practically every State in the Union. However, despite the enthusiastic adoption of this concept by the States, due to the inability of a state administrator or attorney general to deal effectively with a violator who operated from without the State by use of the mails or other interstate facilities, and the inability of investors, particularly those of modest means, to assert

or to enforce claims against out-of-state violators, it became apparent that it was necessary to supplement local regulation, no matter how vigorous or sophisticated, with Federal laws. And, as many of you know, some States had no special procedures or agencies set up to regulate the securities business or to deal with the difficult and frequently unique problems of enforcing general antifraud provisions. In this respect, I speak from personal experience since for nine years I had the honor to be Commissioner, Chairman and later General Counsel of the Department of Public Utilities in Massachusetts, to which agency the Great and General Court of that State for some reason delegated the responsibility to administer the local blue sky law.

As our capital markets grew, and a wide public interest in securities developed, these difficulties created problems of national importance. The market collapse of 1929 to 1932 finally demonstrated the absolute necessity of more strict control of such an important economic institution, and all that remained was to determine what form that control should take. Some urged the enactment of a national blue sky law patterned after the most sophisticated State statutes then in existence, and it was vehemently argued that Federal preemption of the field, as the Congress had done in the Transportation Act of 1920, was essential. There was a school of thought which insisted that a more thoroughgoing control over the whole corporate mechanism was necessary and that this could be achieved only by Federal incorporation. At the other end of the spectrum, it was strenuously contended that existing mail fraud and other Federal criminal provisions were adequate or could be made adequate by some rather minor amendments.

As you know, the Congress did not choose to follow any of these extreme views. While some of the later statutes which form a part of the structure of Federal securities laws took on more paternalistic connotations, the first two statutes which constitute the framework of this structure - the Securities Act of 1933 and the Securities Exchange Act of 1934 - are premised on an entirely different policy. The facets of this policy which are relevant to our discussion deserve repetition. They are: (1) not only that the Federal Government was to take no action amounting to approval or disapproval of securities offerings or their issuers, but also that its role was to be limited to securing fair disclosure of facts relevant and material to informed investment decision by investors in public offerings of securities by an issuer or some one

in a control relationship with the issuer, and with respect to securities listed on exchanges; (2) that provision was to be made for adequate private and public sanctions for failure to supply the required information, or in the case of fraud and fraudulent practices in securities transactions; (3) that controls were to be designed to promote the existence of honest, orderly and informed securities markets; (4) that those through whom the savings of the investing public were channelled into those markets were to be required by law or by rules of practice voluntarily adopted to deal honestly and fairly with their customers; (5) that an agency was to be created, to wit, the SEC, which would be vested with authority, and charged with a corresponding responsibility, to take steps necessary to the achievement of these statutory aims; and (6) that the Federal mechanism and statutory provisions were not to supplant State law and administration, but rather to supplement them and assist in making them more effective.

The last of these policy decisions explains my presence here today. It may be useful to explore its implications and the manner in which it has been implemented by the statute and Commission administration. I need not remind you that the statutes which the several States have adopted differ widely in substance and in procedure. They range from simple antifraud provisions with criminal sanctions enforceable by the Attorney General to the most sophisticated codes vesting in the state administrator wide authority and discretion. This discretion frequently extends to the right to permit or to refuse to permit flotation of a security issue within his jurisdiction based upon his view as to possible detriment to investors in his State. Such statutes reflect decisions by the State legislatures as to the degree of paternalism appropriate or necessary to protect the interests of local residents. In large measure, they have been molded by historical accident, local industrial development and many other factors which have contributed to the development of the regulatory philosophies of the particular States.

I am frequently faced with the suggestion that disclosure, no matter how complete, is not an answer to the needs of many investors, or with the argument that many investors are unable profitably to digest the information called for by a disclosure statute. These are debatable points, but of this I am sure, if there is to be experimentation with substantive control of securities which may be marketed, the States afford a more fitting crucible for such experimentation. The

State securities laws are frequently the result of development by trial and error. There have been changes, in some States, from simple to more complex codes. In others, movements have developed to relax the existing pattern of investor protection.

It is not my purpose here to analyze these statutes or to advocate one form of control or another. It is my aim, rather, to emphasize that the laws which we administer were specifically designed to permit, if not encourage, such experimentation at the State level. I think it is fair to say that the Federal statutes frequently provide the disclosures necessary to the imposition of other controls considered essential at the State level. In any event, there are some areas in which the States can, in the very nature of things, do a great deal more than we can, as, for example, in the control and regulation of securities salesmen and other employees of broker-dealers, and generally of persons engaged in giving investment advice.

It is important to note that the Congress also deliberately left to State regulation problems arising at the local level even where Federal jurisdiction might be considered to exist. Thus, the Securities Act exempts from registration (although not from the civil and criminal sanctions for fraud), issues sold within the State by local industry even if the mails and other Federal instrumentalities are employed. This reflects, in part at least, the view that these transactions, together with certain others specifically exempted by the Securities Act, might most conveniently be dealt with at the State level. So also the Investment Company Act of 1940 exempts in whole or in part from registration under that Act certain small intrastate investment companies. The Securities Exchange Act exempts from registration as broker-dealers persons engaged solely in an intrastate business. The Public Utility Holding Company Act of 1935 is designed in large measure to free local utilities from the controls and abuses resulting from ungeographic and uneconomic holding company systems in order to make regulation by State and other local authority more effective. It is clear, however, that while these statutory provisions reflect a deliberate decision by the Congress not to supersede State regulation, they are drawn effectively to deal with the problems which the local administrator is unable to meet because of jurisdictional limitations or inadequacies of local law.

In its administration of the statutes, the Commission has kept this statutory purpose in mind and has deliberately sought to implement it. The very first Chairman of the Securities and Exchange Commission wrote as follows to the Securities Commissioner of a Midwestern State:

> "I wish to assure you that the Commission has no intention of infringing upon the jurisdiction of State Commissions. We desire the greatest possible cooperation between all agencies engaged in protecting the public against fraudulent securities transactions. It is recognized that there are many types of securities violations which can be handled only by State Commissions. Furthermore, the Commission is interested in strengthening and supporting fully the state organizations for our mutual benefit.
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> "I will appreciate it if you will assure your associates in the National Association of Securities Commissions of our earnest desire to assist them with their problems and our knowledge of their importance in the field of fraud prevention."

This statement unequivocally continues to represent the position of the Commission. Through the years we have sought to make it effective in many ways. I shall leave it to Thomas G. Meeker, Esq., our learned General Counsel, and the other distinguished members of your panel to discuss with you the procedures we have devised to further our cooperation with the State authorities and other Federal agencies and to explore areas in which we may fairly expect your cooperation in our mutual interest. First, however, I would like to point out some few measures we have taken in this connection.

As a result of suggestions made by State Commissioners, we established in May 1935 our Securities Violation Section, which maintains what is probably the largest and most comprehensive clearing house of information as to convictions, indictments, injunctions, stop orders, cease and desist orders, and other actions reflecting securities violations. In addition to the material in our own files, information has been made available by State, Federal and Canadian officials,

Better Business Bureaus, investor protective committees, investment bankers and securities dealers associations and from many other sources. This cooperation has made possible the assembly of files which contain the life histories of a large segment of the world's confidence men and racketeers. They now contain data as to more than 70,000 persons. Daily inquiries are received from State, Federal, foreign and international law enforcement and other officials with regard to this information. We publish and furnish to a limited clientele, including State enforcement officers, a quarterly list of the names we have added to our list and of the actions which have been taken in previous months. These files are a never ending source of interest, revealing many tragic frauds, laced occasionally with a dash of humor and are a great tribute to the untiring genius of the get-rich-quick artists.

Some years ago, we initiated the practice of advising State agencies, on a weekly basis, of small offerings filed with the Commission under our conditional exemptions from registration and have included information as to the States within which such offerings are to be made. Such advice serves to enable the State administrators and other officials to ascertain whether the State laws have been complied with. In return, some States have undertaken to notify us of any proposed offerings in their States of which they have notice. Other States regularly bring to our attention any securities distributions which they believe may involve violation of the Federal law. These procedures are particularly important when such an offering is apparently being made in reliance upon the so-called intrastate offering exemption from registration under the Securities Act, since there are strict limitations to that exemption which may not be understood by the offeror or which he may be deliberately exceeding. And, of course, this exemption is wholly unavailable to an investment company as that term is defined in the Investment Company Act of 1940. I think that it is proper, at this point, to express our thanks for the cooperation we have received which has, in many cases, provided us with the opportunity to prevent or to minimize damage to investors. May I also take this opportunity to urge those jurisdictions which have not thus far provided us with timely information of this character to consider the adoption of procedures which may help us in reaching our common goal of investor protection.

In 1953, the Commission directed its Regional Administrators throughout the country to provide local enforcement authorities with information and other assistance in matters which appear to involve violation of State law and where local enforcement may be more readily effective. In 1957, the Commission reviewed this directive and enlarged the area of discretion of the Regional Administrators in making information, evidence and other assistance available to State enforcement authorities.

The Commission attempts in many other ways to assist and to cooperate with State authorities. Thus, the Commission and its staff participate in the annual conventions of the North American Securities Administrators, the National Association of Railroad and Utilities Commissioners and of other State and regional organizations, at which an opportunity is presented for the exchange of information and for the discussion of common problems and areas of possible coordination and further cooperation. At the request of State authorities, the Commission has made available the expertise of its staff in the drafting or redrafting of State blue sky statutes. It participated in the meetings of the Advisory Committee for the Harvard Law School Study of State Securities Regulation which culminated in the drafting of a new Uniform Securities Act. I should point out that the role played by the representative of the SEC on the Advisory Committee was not as an advocate of any particular form of statute or regulation, or even of the desirability of a uniform statute, but rather as an observer making available to the Committee the vast experience of the Commission.

I am sure that all of you are familiar with the history of the litigation initiated by the Commission which resulted in an opinion of the Supreme Court holding that variable annuity contracts are securities subject to registration under the Securities Act of 1933 and that their issuers are investment companies subject to the Investment Company Act of 1940. The Commission has recently issued extensive opinions granting to two of these companies exemptions from certain provisions of the Investment Company Act in order to permit their effective operation. In its deliberations on these exemptions, the Commission recognized and considered carefully the protections which are the result of the regulatory controls of local insurance authorities. It is probably unnecessary for me to add a caveat that the operations of these companies may present some nice interpretive problems in local laws under the VALIC case.

A problem which affects all of us, and in which each of us has suffered some measure of frustration, stems from the activities of certain promotors operating from without the United States. The Commission has brought to bear its prestige and the weight of the Federal Government towards the mitigation, if not the elimination, of fraudulent stock promotions from abroad. These efforts, designed to assist enforcement on both the Federal and State levels, have not been wholly successful. However, I can report an ever-increasing degree of cooperation from our fellow administrators and law enforcement officers in Canada and in Mexico through the development of evidence and the apprehension and conviction of violators. Certain Canadian regulatory authorities have also made arrangements to deal firmly and promptly with persons within their jurisdictions who have been found to violate the United States Federal securities laws.

The Commission has also endeavored to cooperate with State administrators by developing common forms of applications and reports to be filed by persons engaged in the securities business, by adopting procedures designed to coordinate processing of papers on a Federal and State level so as to minimize duplication and provide more comprehensive over-all control and by drafting rules which permit an effective coordination of Federal and State substantive requirements.

I have recited these actions taken by the Commission not because we feel that they have exhausted the possibilities, but rather to stimulate your suggestions for expansion of the possible areas of cooperation. We welcome suggestions from all of you with respect to further implementation of this important policy of the Commission. I hope that, in the panel discussions which follow my remarks, you will not hesitate to explore these possibilities.

Finally, I call to your attention that the Commission celebrated its 25th anniversary last year. Apart from the usual celebrations attending such an event, it may be of interest to you to know that the Commission engaged in a number of programs having a twofold purpose, first, to remind businessmen of the existence, scope and requirements of the securities laws and the importance of early recognition and compliance with such laws to avoid embarrassment, unnecessary expense and delay, and, second, to publicize as widely as possible the dangers inherent in indiscriminate purchases of securities, particularly where

such purchases are effected without adequate information and as a result of mail and telephone solicitation by persons not known to the investor. Our Silver Anniversary Report contains a good deal of information bearing on these matters and also includes an extensive section dealing with the genesis and the history of the Federal securities regulation.

In furtherance of these aims, the Commissioners and members of the staff have delivered many addresses and participated in numerous panel discussions initiated by the Commission, by the Small Business Administration or by various private organizations concerned with the public interest. The Commission last year assisted in the development and publication by the law journals of The George Washington University and The University of Virginia of special symposia on contemporary problems in securities regulation and the work of the SEC. Should any of you be interested in reviewing a wealth of information regarding Federal and State regulatory efforts, interesting discussions of difficult legal problems and useful treatises on investment banking and distribution practices as they are affected by securities regulation, I commend to you the October 1959 issues of each of these journals. We have also prepared for distribution, through our offices and the offices of the Small Business Administration, brief discussions of the jurisdiction of the Commission and the application of the statutes administered by it to small business and small business investment companies. Finally, prepared radio and television scripts were sent out which contained a simple message to investors warning them against indiscriminate investment based on telephone and mail solicitation by unknown persons and urging prospective investors to "investigate before investing." These messages together with a brief leaflet expanding upon the basic theme have received wide circulation and notice. We hope that these efforts on our part will also serve to assist the States in their own enforcement efforts.

I hope that our discussions here today will bring to our attention matters which you think may be of interest to us or in which we may be of assistance to you, and that we may continue to receive your cooperation in freeing our securities and capital markets of that racketeer element which seems to increase in size, intensity and cunning in direct proportion to increased confidence and participation of the American public.