For IMMEDIATE Release

The Structure And Works Of

The S. E. C.

Remarks Of

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THE STRUCTURE AND WORK OF THE S.E.C:

The Securities and Exchange Commission was created by Congress in 1934 with the enactment of the Securities Exchange Act. The SEC immediately took over from the Federal Trade Commission the enforcement of the Securities Act of 1933 which Congress had enacted the year before. During the next six years, Congress charged the SEC with the administration and enforcement of four additional statutes - the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, the Investment Company Act and the Investment Advisers Act in 1940. The SEC was also given advisory functions to perform under Chapter X of the Bankruptcy Act.

As you might suppose, the language of all these statutes and of the numerous rules and regulations which supplement them is very technical, for they deal with complicated segments of our national economic life. In the time at my disposal I can do no more than give you a general idea of what these seven statutes contain and of the work done by the Commission. I shall discuss each of the statutes in chronological order and give, where I can, a brief explanation of the general economic and financial reasons which led to their passage.

The Commission itself consists of 5 members, appointed by the President with the advice and consent of the Senate. It is a bi-partisan Commission, which means that not more than 3 of its members may belong to the same political party. At the present time, our principal office is in Philadelphia, where it was moved during the war. We expect to return to Washington within the next few months. There are also 10 regional offices located throughout the United States in important financial centers, and several branch offices. The office in Detroit is a branch of the Cleveland regional office. Like the other outlying offices it engages in conducting

periodic broker-dealer inspections and in investigating possible violations of the statutes. They also render interpretations and are available to assist you in any problems you may have under the statutes. You will find that you can get ready answers to any questions concerning the Securities Acts which arise in your daily business simply by calling the Detroit Office on the phone.

I.

THE SECURITIES ACT OF 1933

The basic statute administered by the Commission is the Securities Act of 1933. Those of you who lived through the period of the twenties and the market crash of 1929 should need no review of the reasons which led to the passage of the Securities Act. Let me briefly recall the period for you. The twenties were a period of unprecedented market activity. The expanding optimism which characterized those years made the market unusually receptive to demands for new capital investment. From 1920 to 1933 approximately fifty billions of dollars of new issues were sold to American investors. In a majority of cases the public purchasers were not furnished adequate information upon which to base an informed judgment to buy or not to buy. By 1933 some $25 billion or 50% of those securities had become worthless. State "blue sky" laws had proven inadequate to meet the needs of an industry which was largely interstate in character. The depression into which the securities markets had fallen made it imperative that steps be taken to restore investor confidence and once again give American industry an access to the nation's savings.

The first step taken towards restoring investor confidence was the enactment of the Securities Act of 1933. This is often referred to as the "truth in Securities Act". It was designed to provide investors with adequate information upon which to base their decisions to buy and sell securities. It was also designed to protect legitimate business seeking to obtain capital through honest presentation against competition from crooked promoters, and to prevent fraud in the sale of securities. Its basic provision is a requirement that those offering securities for sale in interstate commerce file with the Commission a registration statement containing specified information on the proposed offering. These statements are available for public inspection. They contain a full disclosure of pertinent information and financial statements regarding the securities being offered. An integral part of each registration statement is the prospectus. This prospectus must be made available to investors to whom the securities are sold.

It is important to recognize that the Act does not confer upon the Commission the power to approve or disapprove or in any way pass upon the merits of any security. The SEC merely serves as a repository for the information which must be filed, determines whether the registration statement meets the statutory requirements of full and fair disclosure, and enforces the anti-fraud provisions of the Act through court injunction or criminal proceedings.

The anti-fraud provisions of the Securities Act apply to all securities sold in interstate commerce. The registration provisions, however, have more restricted applicability. They do not apply to government securities (national, state or municipals), to securities of financial corporations such as banks and insurance companies, or to

securities of common carriers subject to the Interstate Commerce Commission, and to certain others. Certain types of transactions are also exempt from registration, such as those between an underwriter and issuer, broker transactions and certain types of exchanges. The Commission also has the power to exempt from registration issues of less than $300,000. This it has done pursuant to Regulation A, whereby issues within that amount offered within a single year may be sold in interstate commerce upon the filing of a simple form with the Commission five days in advance of the offering, together with all written advertising material. This exemption is designed to save small businesses the cost of full registration and to facilitate the raising of small amounts of capital.

II.

THE SECURITIES EXCHANGE ACT OF 1934

The second statute enacted by Congress for the purpose of restoring investor confidence in the securities markets was the Securities Exchange Act of 1934. That Act covers several phases of market and corporate activities. First of all, it provides for the registration with the SEC of all national securities exchanges. At the present time there are 19 registered exchanges, (the Detroit Stock Exchange is one of these) and 5 exempt exchanges. A registered exchange must file its constitution, rules and trading practices with the SEC and keep that information current. Second, the Act requires registration with the exchange of all securities listed on a national securities exchange and the filing of current reports. It also limits "insider trading" by directors, officers and controlling stockholders of listed companies and authorizes the Commission to promulgate proxy rules for those companies.

Third, the Act requires the registration of all brokers and dealers engaged in the purchase or sale of securities in interstate commerce (except those wholly engaged in trading in certain exempt securities, such as governments), and sets up standards of conduct which are enforced by the Commission by periodic inspection of accounts. Registration may be revoked or suspended for fraud or unprofessional conduct. Anyone so disciplined, of course, has the right to full court review. Fourth, the Act prohibits fraud or manipulative practices. Pursuant to power given it, the SEC has promulgated rules on the subject of inside trading, short selling, stabilization, etc. Fifth, the Act authorizes the Federal Reserve Board to regulate margin requirements. It regulations, known as Regulations T and U, are enforced by the SEC. Finally, the Act, through the Maloney Amendment of 1938 to Section 15, establishes a system of industry-self regulation for the over-the-counter market by means of national associations of securities dealers. This experiment in industry self-regulation is under the supervision of the SEC which reviews the rules and regulations of such associations and their disciplinary proceedings against members.

III.

THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935

In 1935 Congress enacted the Public Utility Holding Company Act. This statute was the result of an intensive study conducted by the Federal Trade Commission from 1928 to 1934 and by both houses of Congress into the operation of holding companies in the public utility field. These studies showed an excessive concentration of control in the utility industry with harmful consequences to investors and the public at large. In 1932, for example, the eight largest utility holding company systems controlled over 72 per cent of the privately produced electric power in America. The systems

were in constant competition for additional properties. This drove prices paid for utility operating companies to fantastic heights. It has been estimated that from 1924 to 1930 holding companies floated some $5 billion of securities, the great bulk of which went not to build or improve utility properties, but to purchase already outstanding securities of existing utility companies. Properties were acquired which bore no relationship to utility operations, such as amusement parks and textile mills. To sustain these highly pyramided capital structures, the holding companies frequently engaged in various unsound practices. The studies disclosed that properties were carried at inflated prices and that depreciation and retirement charges were inadequate. Operating companies were compelled to follow imprudent dividend policies and to make intrasystem loans. Excessive charges were made for services, sales and construction.

The Holding Company Act is designed to remedy these abuses and evils. The Act provides for the registration of holding companies and their operating subsidiaries, and for supervision by the SEC of security transactions and property acquisitions and sales by those companies. It also regulates dividend payments, solicitation of proxies, inter-company loans and other intra-system transactions, service, sales and construction contracts and accounting practices.

The heart of the Act is contained in Section 11. Congress took the position that it was not practicable to regulate so large a portion of the economy. Its solution to the problem was to require as soon as practicable the elimination of all unnecessary holding company entities. Only in that manner, it decided, could a recurrence of undesirable practices be

effectively prevented. Holding companies which served the useful purpose of tying together related properties into an integrated system could continue, but only with simplified corporate structures and subject to close regulation.

Initiative for compliance with Section 11 is given to the companies, who may propose voluntary plans of reorganization. Only after the companies have failed to act can the SEC, acting through a federal court, compel reorganization. The Act establishes an elaborate reorganization procedure designed to assure security holders fair and equitable treatment. It provides for court review of all Commission action.

IV.

CHAPTER X OF THE BANKRUPTCY ACT

The great number of corporate reorganizations which occurred during the last depression and the various abuses in connection therewith showed the need for providing reorganization courts with disinterested assistance in the formulation of reorganization plans. Chapter X of the Bankruptcy Act, as amended in 1938, provides that at the request or with the approval of the court having jurisdiction of the properties undergoing reorganization, the SEC shall participate in proceedings to provide independent, expert assistance on matters arising during the proceedings. The statute also requires the Commission to prepare formal advisory reports on the fairness of plans of reorganization if the indebtedness of the debtor exceeds $3 million. In smaller cases reports are prepared at the request of the court.

V.

THE TRUST INDENTURE ACT OF 1939

Corporation failures during the last depression had also revealed serious inadequacies in the protection supposedly afforded by indentures to secured debt holders. The Trust Indenture Act of 1939 is designed to strengthen the safeguards provided by indentures. It requires that bonds, notes, debentures and similar securities offered for sale in interstate commerce must be issued under an indenture duly qualified with the Commission and meeting the requirements of the statute. It applies to all issues of a million dollars or more, with certain exemptions. The Commission does not enforce the terms of the indenture. Its function is simply to see that the requirements for indentures set up in the Act are complied with. These provisions are designed to assure the independence and financial responsibility of the indenture trustee; require periodic reports by the obligor and the trustee to the security holders; and require the trustee to maintain a reasonably current list of the names and addresses of security holders available to those properly desiring to communicate with the security holders. The Act also provides that an indenture may not contain provisions which exculpate the trustee from liability for his own wrongdoing.

VI.

THE INVESTMENT COMPANY ACT OF 1940

The Commission was authorized by Congress in 1934 to investigate and study the conduct and business of so-called investment trusts and investment companies. As a result of that study and the recommendations

of the SEC, Congress enacted the Investment Company Act of 1940. The legislation, as adopted, was desired by the investment trust industry itself. Investment companies are those engaged primarily in the business of investing, reinvesting and trading in securities.

The Act requires registration of all investment companies. It also requires full disclosure of the finances and investment policies of the companies in order to give investors full information about their activities. It prohibits registered companies from changing the nature of their business or investment policies without the approval of their security holders. It bars persons guilty of security frauds from serving as officers or directors and prevents underwriters, investment bankers and brokers from dominating the boards of directors of such companies. It requires management contracts to be submitted for stockholder approval and prohibits transactions between the companies and their officers and directors and controlling stockholders without Commission approval. It also limits their ability to issue certain types of securities and prohibits pyramiding and cross-ownership. Undesirable selling practices, such as "switching" are curbed. The Commission is authorized to prepare advisory reports on reorganization plans of registered investment companies at the request of the company or of 25% of its stockholders. The Act also requires face-amount certificate companies to maintain reserves adequate to meet maturity payments upon their certificates.

VII.

THE INVESTMENT ADVISERS ACT OF 1940.

In that same year, Congress enacted the Investment Advisers Act of 1940 which requires the registration of investment advisers. These are defined as persons engaged for compensation in the business of advising others with respect to securities. The Commission is empowered to deny or revoke registration of an adviser who has been convicted or enjoined for misconduct in security transactions. The Act makes it unlawful for investment advisers to engage in conduct which constitutes fraud or deceit; requires disclosure of the nature of their interest in transactions executed for clients; prohibits profit-sharing arrangements; and prevents assignment of adviser contracts without consent of the client. The Act does not apply to banks, newspapers and publications of general circulation, brokers and security dealers whose advice is rendered incidental to their regular business and who charge no special fee, and various others.

These are the highlights of the statutes administered by the Commission. Of necessity I have had to omit reference to many provisions. Those of you who are interested in a fuller statement can secure a pamphlet which discusses "The Work of the SEC" by writing to our Bublications Division in Philadelphia. Copies of the statutes themselves, of the rules and regulations promulgated by the Commission, and the forms in general use may be obtained from our Detroit office.

Before closing I would like to outline the organizational setup of the Commission. I have already mentioned the Commission itself consisting of five commissioners. The staff is divided into three main divisions. The largest is the Corporation Finance Division which is responsible for administration of the Securities Act of 1933, the Investment Company Act of 1940, the Trust Indenture Act of 1939 and for performance of the Commission's functions under the Bankruptcy Act. The Public Utility Division is responsible for administering the Public Utility Holding Company Act. The Trading & Exchange Division administers the Securities Exchange Act of 1934 and the Investment Advisers Act of 1940. It maintains a large staff of investigators in the field and conducts constant surveillance of the market in order to guard against manipulative activities. Incidently, the Trading Division prepared the recently published report on the market break of September 3, 1946, which has attracted wide attention.

In addition to the three divisions, our operating units include the Solicitors Office which handles appellate matters in the courts and is the legal adviser to the Commission; the Opinion Writing Office which prepares written opinions in contested cases under the Commission's direct supervision; the hearing officers who preside at hearings and serve the Commission in its quasi-judicial capacity; and the Accounting Division which supervises Commission activities in the field of accounting and auditing and has been extremely active in the development of accounting principles and practices and of standards of professional conduct. We also have a statistical unit which compiles and publishes figures on corporate activity derived from statements on file with the Commission.

Mr. Edward McCormick, an Assistant Director in the Corporation Finance Division, is here with me this afternoon. He will discuss with you in greater detail the registration and prospectus provisions of the Securities Act. I know that what he has to say will be of particular interest to you.