

H.S.

Address

of

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before the

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The S. E. C. workshop has no ceiling on hours. And my staff often feels that their modest rate of pay is the sub-basement rather than the floor for wages. I fear we do violate all known union rules and principles, as our over-time reaches astronomical proportions. The other day a group in my office (some of whom had worked until three o'clock that morning) worked with me incessantly, past luncheon and past dinner - without interruption until nine o'clock at night. I pronounced it a job well done. One spoke up and said, "We will substitute flattery for food any day; but our wives have reached the point of rebellion."

But we are young; and there is adventure in our workshop. We have not settled down to the routine of action by tradition. No one has built us a magnificent building - we are in an office building, an apartment house, and an hotel. And we ride in elevators that some museum will soon discover (and we hope, bid for) with glee. All parts of us have not yet been declared either constitutional or unconstitutional. Each Congress has added materially to our powers until now we are almost at the peak of our growth. But we are manned with youth - youth intensely loyal to the objectives of the four statutes under which we operate; youth sobered with heavy responsibility; youth filled with the desire to make the teachings of simple honesty, of fair play, of conservative finance realities in American business and finance.

Our mandates from Congress are conservative ones - conservative in the best New England sense of the word. That is clearly true in case of the Securities Act of 1933, which merely requires that those who want to sell securities to the public must tell the simple truth and make disclosure of all material facts. That is also true of the Securities Exchange Act of 1934 which is designed to eliminate many of the artificial elements which have impaired the quality of securities markets from the viewpoint of investors and business. Recognition of the conservative standards of that Act has received a tremendous impetus as a result of well-known events on the New York Stock Exchange during the last year. During the heat of battle over the Public Utility Holding Company Act of 1935 the picture was frequently drawn of its destructive qualities. But during the last year there has been greater and greater recognition that that Act calls only for conservative practices - for practices and standards designed to protect the industry itself and the investors and consumers against financial wizardry, indiscretion, and excesses. This has come about as a result of the fact that emotionalism has been on the wane and business judgment and technical considerations have been on the ascendency. Let me give you a few examples of what I mean.

We need not have elaborate statistical or financial studies to know that write-ups of property accounts or of investments have been the sand upon which some holding company structures have been built. We know that in times of stress and strain some of those structures have collapsed or have become dangerously top heavy as a result of such practices. Under the Act the matter of write-ups is hereafter our concern. It comes to us in several ways. Thus on the issuance of securities by registered holding companies or their subsidiaries we must satisfy ourselves that the security is reasonably adapted to the earning power of the issuer. It is also our duty to prevent the payment of dividends out of capital; to prevent the payment of dividends which will impair the financial integrity of companies in the holding company system. As a result of these and other provisions of the Act the detection of write-ups is a continuous necessity; the elimination of write-ups is frequently essential. The work which we and the industry have been doing on this problem has led to extremely significant results. The elimination of write-ups by

voluntary act of the industry has become truly fashionable. Published results to date tell only a fraction of the story. In many utility offices today elaborate plans are under way to restate these accounts along conservative lines. This will entail the elimination of many millions of dollars of water from utility structures. Many of these efforts will bear fruit soon; others will take longer, since in some cases delicate operations are necessary. But greater progress is being made. And one utility executive recently told me, "Give me time, and the elimination of write-ups is not only theoretically sound, it is desirable as a cold practical proposition." And another company official called us up on the telephone and said, "We want to eliminate some write-ups in our system. Will you show us how to do it under the Act." So when the elimination of write-ups becomes, as it has, the "fashionable thing to do", we can rest assured that the practical men in the industry have found in the letter and spirit of the Act provisions which appeal to the judgment and instincts of conservative financial men.

Another example of conservative practices instilled through the Act relates to the creation of debt by holding companies. Under the Act holding companies can issue bonds only under exceptional circumstances. The purpose of the restrictions is clear. They were partially designed to eliminate unsecured bonds which had behind them only a portfolio of common stock or other securities and hence by conservative standards did not warrant the normal connotation of that term. Furthermore, they were designed to protect the holding company itself from unsound capital structures; they had as their purpose creation of capital structures of holding companies composed essentially of stock, preferably common stock so that the ups and downs of cyclical trends could be more readily weathered. The other day a prominent holding company executive was in my office. He had caused his holding company many years back to issue debentures. He was relating to me the headaches which those debentures had caused him. In times of great prosperity, he said, the enormous leverage in the stock which was in the holding company portfolio, made those debentures seem as strong as Gibraltar. But when markets declined and earnings fell, those debentures with their promise to pay and with their heavy interest requirements became the bane of his existence. Only by Herculean efforts could he save his entire holding company structure from complete collapse. On the basis of that experience he vehemently pounded my desk saying, "Never let any holding company issue any debt." Like the Hungarians, his motto was not just "No"; it was "No, no, never". Here was an executive of broad experience adopting on the basis of his own experience a conservative standard of finance - a conservative standard which the Congress wrote into the Act in modified form in 1935.

That Act is replete with similar examples. Thus there is the provision which makes it possible for a holding company to have children and grandchildren but not relatives of a more distant relationship. Men of the world of finance approve that general standard. They approve (at least all to whom I have talked do) because they know on the basis of experience that once a top-heavy holding company structure is created, with tier upon tier of companies, it takes not only a higher mathematician but a magician as well to figure out what the third preferred stock (not to mention the fourth preferred or the common) in the top company really is worth. The technical men and the policy men in the industry silently approve in practice as well as in theory such examples of conservative financial practices.

And aside from the normal conservative practice which the Act instills there are other provisions which reduce the risks of extravagant practices in

which the occasional financial genius has revelled. Two of these are noteworthy of comment. One was presented to me impressively by an operating company only a few weeks ago. This operating company had had a good record. It operated exclusively in one state. It was proud of its intra-state character. Its securities were largely held locally. Years ago it suddenly awoke to the fact that a far-distant and foreign holding company was silently acquiring its stock for purposes of control. The management was startled at the prospect and saw happening to them, if the foreign raider was successful, what had happened to other local companies, viz., a siphoning off of their assets to some distant financial center. Working feverishly, it and its lawyers worked out an elaborate scheme to prevent such control from being acquired. Without going into details, suffice it to say that they created a holding company of their own with an elaborate voting trust as well; and sought deposit of the outstanding voting securities. With that legal paraphernalia (too elaborate to discuss here in detail) the contest was on. The local company moved with sufficient dispatch substantially to thwart the plans of the foreign holding company raider. But the complicated holding company structure which was created to accomplish that result remained, piled on top of this operating company and making cumbersome its every act. In fact that top structure was viewed by the company itself as somewhat of a monstrosity. To those who are proud of their local companies, who desire to keep them local, who desire to prevent them from becoming overnight a mere pocket in a foreign holding company system, the Act is a great comfort. For the Act places great restrictions on such acquisitions. They can be made only after public hearing before us with opportunity for interested parties to be heard and then only on our approval.

From the viewpoint of those who desire to keep their utility industry at home, or in many cases to bring it back home, the Act holds great promise of comfort in other respects. As you know, the Act contains standards for geographical integration of holding company systems. As a general rule (there are exceptions) it provides that a holding company must confine itself to a single, geographically integrated system. The Congress discarded the "scattering" theory which would permit far-flung scattered properties to be pulled together into one huge utility empire. The Congress decided in favor of integrated local or regional systems, closely knit, compact, and confined geographically. I personally think Congress decided wisely. But whatever may be any one person's view as to the soundness of that decision, that mandate is the law of the land. And it is gaining enormous practical appeal to numerous local or regional interests or groups. Local leaders (including investment bankers) are fast awakening to the realization that here is a grand and superb opportunity to free their home or regional enterprises from remote control. Responsible citizens from a number of states have conferred in my office during the last few months on their paper plans to reconstruct various utility properties along state or regional lines. Many who have been seriously intent on bringing control of home industry closer to home now see a way of doing it. How these tentative plans will work out, is too early to predict. Certainly, we are going to give a right-of-way to the plans, desires, and programs of the industry, so far as reasonably consistent with the standards of the Act. I merely emphasize at this point the opportunity, now being realized for the first time, for those who desire to keep their basic industries at home.

These matters are, as I have said, illustrative of the conservative business and financial standards which pervade our statutes. They point up and illustrate one of the real reasons why a genuine business and financial

leadership is guilty not of supine submission to "crack-pot" theory but of conservative stewardship of old-fashioned standards, when it puts its shoulder to the wheel with us to make these statutes living realities.

And that leadership exists. It is fast emerging. That leadership is accepting the principle of the supremacy of the law as evidenced by the mandates of Congress. That leadership has abandoned the use of political techniques which too often were employed in an endeavor to win in newspapers victories denied them in the legislature. It is a leadership tackling in a sane, hard-headed, practical way the problems of reconstruction.

The President of the New York Stock Exchange, William McC. Martin, Jr., recently has stated the philosophy of that type of leadership as follows:

"The Stock Exchange welcomes government regulation and supervision. This does not mean that we have surrendered any of our independence. It does not mean that we have subordinated our own judgment or that we have relinquished our administrative control. It does not imply supine submission. It means simply that we recognize that our government, with full authority from Congress, has set up regulation in our interest and in the public's interest.

"We have a joint responsibility with the government to see that the people of this country have as sane, as honest and as efficient a market as it is humanly possible to provide. The old maxim, 'To govern well, govern little,' will not be applied by thinking people today to our problem. We do not regard government as a necessary evil. Our government should be our greatest pride and a part of the very fabric of our lives."

The rank and file of business and finance will follow such leadership. When those in our foremost exchange set that pace and adopt that policy, they established the standards for our smaller exchanges. By their words and deeds they have pointed the way for enlightened business leadership in other circles. Such leadership is contagious. The New York Stock Exchange having pointed the way, others follow. I need only cite the case of the New York Curb Exchange which, on no prompting from Washington, recently has voluntarily undertaken to reorganize itself along modern, progressive lines - in light of the too long forgotten standard that stock exchanges are public institutions, not private clubs; public markets, not casinos.

That climate of opinion, by virtue of the acts of a few, is today pervading all of our securities markets. It is not restricted to the stock exchanges. It is spreading fast throughout the sprawling, unorganized over-the-counter markets. There has been a growing realization of the desirability for and need of constructive leadership there. That such leadership in the over-the-counter markets is fast emerging is evidenced by the fact that investment bankers, brokers, and dealers (many from this city) joined forces with the S. E. C. at the last Congress to duplicate in the over-the-counter field the type of regulation which the Congress imposed upon the stock exchanges. It is evidenced by the fact that those groups are now working with us to establish a patrol and supervision over those markets comparable to that which exists today over the exchange markets.

That kind of leadership is now asserting itself in the private utility field. Utility executives are taking the mandates of Congress under the Hold-Company Act both seriously and constructively. I have seen (in confidence)

many of their far-flung but tentative plans to put their utility houses in order. I have listened, in private conferences, to their ambitious programs to comply with the letter and the spirit of that Act. I have heard the voices of some of them ring with conviction, as they vowed that they would emerge from the so-called "death" sentence (which the President properly called the "health" sentence) with sounder and better systems than they had when they entered. I have seen them slowly bringing their technical men and their investment bankers into the picture to devise ways and means of doing the technical, practical job of reconstruction. Concrete, tangible evidence of this is contained in the news which we released today. You will recall that on Aug. 3, 1938, we wrote the registered holding companies to submit to us not later than December 1, 1938, their plans and programs, though tentative, for compliance with the provisions of Section 11 relating to geographical integration and corporate simplification. By November 1, 1938, North American (a \$900,000,000 holding company system), United Light and Power (a \$600,000,000 holding company system) as well as two small holding companies had submitted informally and confidentially their plans for compliance. When companies are coming in, a month in advance of the schedule, I can most assuredly say that progress is being made.

These men in these various fields are creating a new climate of opinion - a climate of opinion of confidence in their own enterprises; of respect for the law; of an honest, intelligent working relationship with their government; of confidence in themselves to meet the demands of the new order. The leadership which a few have been providing in these fields can be provided by the few in other fields. The brains, the courage, and the imagination are there to do it. It needs only the will to do it and the modus operandi.

First, as to the will to do it. In speaking of the will on the part of business and finance to assume a position of leadership I need not rest on any sentimental reason - on any renaissance of social consciousness; on any discard of one political and social philosophy for another. Such factors may or may not be present. I do not deprecate them. But I think that the results we have been obtaining may be appraised at quite different levels. From the point of view of getting the job done, of adopting conservative standards for financial practices, of realizing the benefits of a sound reconstruction, the factor of sound business judgment itself is of sufficient impelling importance.

Under our administrative form of government, the preservation for business of the principle of self-determination is not only possible; it is practicable. Such an administrative agency as the Securities and Exchange Commission has certain flexibility and certain discretion in dealing with the problems assigned to it by Congress. That flexibility and discretion are provided in the law itself and are circumscribed by the law. The objectives are prescribed by Congress as are the standards to be applied in reaching those objectives. We can change neither. At times, the Congress has given such an agency little or no discretion except as to method. In many cases such discretion takes the form of a choice between direct action by the government or joint cooperative action between government and the particular industry being regulated. Some have regarded the very existence of such alternatives as alarming examples of government by discretion. But those are prone to overlook a very fundamental consideration, namely, that Congress by that method has preserved for business a great deal of the democratic principle of self-determination.

That principle has been recognized throughout the entire history of the Securities and Exchange Commission. The Commission under its first Chairman,

Ambassador Joseph P. Kennedy, gave it ready recognition by calling in at our conference tables many leaders from industry, together with outstanding accountants and financial experts to help us translate the requirements of the Securities Act of 1933 and the Securities Exchange Act of 1934 into registration procedures which would provide the desired information with minimum inconvenience to business. This pattern was followed and further applied in a similar manner by the Commission under its next Chairman, Dean James M. Landis. And we are still moving forward in that strong tradition.

I have already referred to the stock exchange problems. I doubt if anyone would have predicted five years ago the changes that have been accomplished in the New York Stock Exchange. Yet such changes took place within less than the period of a single year. A year ago at this time that Exchange seemed destined to a period of strict prescription by the government. Today it is outstanding as an institution which has firmly taken its destiny into its own hands. For our part, we are only too glad to be able to assume an increasingly residual role. At the same time, there has been an increasing awareness in financial circles that the stock exchange's path to better business lay in taking advantage of opportunities, which administrative law offered, to work out with government the methods of reaching objectives embodied in the law.

Those men about whom you have been reading lately in connection with public utility cooperation with government are also realistic business men. As I have already indicated, the Holding Company Act gives us two choices as to how we shall proceed toward the objectives of geographical integration and corporate simplification. That Act in effect says that we may propose plans and work out ourselves the blue prints for the reorganization of America's holding company system. We may ourselves tell the various systems which properties they may hold and which ones they must sell. On the other hand, we may consider plans voluntarily submitted by those systems. So long as it seems likely to work and to produce results; so long as there is real progress, we are going to pursue the latter course. If I were a business man, I would prefer that the S. E. C. do precisely that. I would want to make the original suggestions as to how my company could and should be reorganized, how my system could and should meet the requirements of the Act. I would want to try to work out my own views for the trading of properties with other systems in conformity with the requirements of geographical integration. Furthermore, I would get the benefit of having matters of policy decided on the facts of my case and with the benefit of my advocacy. I would thus minimize the risk of precedents based on the facts of somebody else's company and after the inferior advocacy of somebody else's lawyer. I would realize that while I might not in the end get everything I wanted, I would if I participated actively in the development of the program, at least minimize the chance of my hopes or desire being overlooked or inadequately considered, or of getting something wholly unacceptable. And that, I believe, is precisely what is happening. There has been all along the line a renaissance of good business judgment.

And I might add, parenthetically, that the realization on the part of investment bankers of the enormous underwriting and distribution job involved in all of these programs is beginning to provide something of a profit-motive spark plug in the whole process. At least wherever that has appeared, the wheels have begun to turn.

There, it seems to me, is the real story behind this encouraging improvement in the relations between government and business.

So much for the will on the part of business and finance to assume a position of leadership. Now as to modus operandi. Perhaps after the comments which follow, I should make a slight apology, in private if not in public, to my lawyer friends. For my formula on modus operandi is to leave the lawyers out of it. At one of our hearings a few years ago, the late Grayson M.-P. Murphy with his usual sparkling humor commented from the witness stand that the surest way of producing a real case of the jitters was to give a high powered New York lawyer a few minutes to work on a high powered New York banker. However that may be, I can state the following undisputable facts of record. In the first place the progressive program worked out between the New York Stock Exchange and the S. E. C. and now in process of being consummated was done without benefit of counsel. In the second place, the rapid strides being made by the utility industry to work constructively with the S. E. C. in developing a holding company act program was likewise accomplished without any intermediary in the form of lawyer or otherwise. That is fact number one. Fact number two is this. Once the lawyers disappeared from the holding company scene and the executives of those companies sat down for direct conversation with me and my colleagues, peace and harmony began gently to settle over the entire scene. That in turn may be nothing but a coincidence. But to those who are thinking in terms of modus operandi, I do not think it is entirely irrelevant.

These experiences with the stock exchanges, the over-the-counter markets, and the utilities have made a deep impression on me. They have convinced me that at least a semblance of that quality of solidarity which is obtained in times of war is not impossible in times of peace. And they have convinced me that that type of solidarity in times of peace, unlike solidarity in times of war, may even be of a more enduring quality especially where it is founded not merely upon sentiment but upon hard-headed, practical considerations.

And I recently had another experience which made a similar deep impression on me in terms of the relationship between business and government. The National Emergency Power Committee (of which Assistant Secretary of War Johnson is Chairman, and of which I am a member) has been studying in the last few months the power requirements of this country in the event of war. Some weeks ago we completed our preliminary survey and had estimated the amount of shortage and the industrial centers where such shortage existed. Thereupon we called into our executive session the executives of the various utility companies whose capacities would have to be increased in order to meet these emergency requirements. The meeting was devoted to a discussion of the amount of power required in fifteen industrial cities. The method of obtaining that additional power had not at that time been developed; nor was there any reference to methods of financing the increase, to costs of financing, or to the allocation of such costs among the various private companies. In other words, no one company could tell, on the basis of the data discussed, how much it would cost that company, whether the additional investment would or would not be profitable, whether the end result would be a burden or loss to the several companies involved. Those phases of the matter were necessarily conjectural not only because of the lack of details, but also because the whole program was to take care of the eventuality of war - a condition which might or might not arise.

But at the end of the conference a poll of the several utility executives was taken. One by one they were asked if they would support this war program; if each would pledge his share of this new construction. And one by one they replied - each stating without hesitation or condition that he would carry his

portion of the burden; each pledging his cooperation, not to the War Department but to the Administration and the various agencies and departments represented on the Committee, in furtherance of this program. And as the meeting broke up and we walked down the hall, I turned to the Chairman and I said, "Mr. Secretary, that was a most significant performance. Against the background of years of litigation on various fronts, it was especially impressive. For here were men willing to make sacrifices, if necessary, for furtherance of a national program. Here were men not asking how. Here were men not saying 'Yes, but'. Here were men not hesitating a single second to pledge their support. By what method, by what magic, can we obtain in the atmosphere of peace and for the broad objectives of peace such wholehearted response and cooperation as we have just obtained for the objectives of war?"

And there came to my mind the portrait of the ancient Chinese physician of the 5th Century B. C., who was the great healer of his day. The portrait shows him girt with ropes of herbs and minerals which he had collected from various parts of the earth for their medicinal qualities. But they had failed him. And deep in thought he walks beside a placid lake upon whose unruffled surface the moon's reflection rests. He reaches out his hands towards the mirrored image and exclaims, "Ah, if only I could gather up the healing properties in the moon as well, I would cure all of man's ills." 1/

Wherever the search for those qualities, which will fuse the energies of government and business, may lead, I am convinced that their discovery will be a positive force for democracy and capitalism. For by their discovery, we will have placed deep in the national consciousness a philosophy whose curative qualities may have almost mystic effects. That is why this new enlightened business leadership, accepting the philosophy of the new legislative program, holds such great promise.