

An Address

by

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HOW THE SEC MAKES POLICY

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In considering the policy-making activities of the SEC--and I speak only to the more conventional techniques for making policy--it is important to remember that, like some other agencies, it is responsible for many different programs. In addition to six securities acts, the Commission has important responsibilities under Chapter X of the Bankruptcy Act. Under these statutes, it regulates the securities industry and administers important disclosure requirements for larger issuers of securities.

The federal securities laws were enacted because of the failure of common law remedies and the early state blue sky laws to protect adequately members of the public in the purchase and trading of securities. It is clear that Congress intended to raise the standards of conduct of those engaged in the securities business as well as to provide a national enforcement scheme. To this end, the Commission was provided with an arsenal of techniques for the development of policy in the several areas of its jurisdiction. It has broad rule-making powers, and authority to initiate formal administrative proceedings to invoke a variety of sanctions against broker-dealers, investment advisers, investment companies, holding company systems and other issuers, and to decide other important matters. It can seek a court injunction to prevent violations of, or to compel compliance with, the statutes or recommend criminal prosecution. And, it has power to issue public statements interpreting provisions of the statutes it administers.

By far, most of the work of the Commission does not rest on formal procedures. The securities bar is aware and takes full advantage of

opportunity for the informal disposition of matters by letter, conference, and telephone. Indeed, without this flexibility we could never cope with our daily problems.

The Commission has used extensively all of the techniques available to it in the development and enunciation of policy. Many formal rules have been promulgated under each of the acts. For example, under the Securities Act of 1933 alone, there are one hundred and forty-one rules. And there are many more under the other statutes. Many of these, of course, are parts of exemptive regulations and specify the means for compliance. Others are interpretative or definitional. And, as you securities lawyers in the audience know, the pace of rule-making -- the revision of old rules and the promulgation of new ones -- has increased lately. This is in part a result of the recommendations of the Special Study of Securities Markets which are now being implemented. In addition, the Commission has promulgated many forms to assist those required to file information with the Commission. Thus, under the 1933 Act, 30 forms and schedules have been prescribed.

Many statements have been published interpreting provisions of the different statutes. Statements have also been used as warning devices and as explanations of administrative procedures. The Commission recently published a release describing a number of informal procedures which the staff follows in the processing of registration statements for the offering of securities under the Securities Act of 1933. The Commission follows the practice of elaborating in some detail on the purpose or application of a new rule in the releases proposing it and declaring it effective. In the

process of issuing or amending rules or statements the Commission necessarily re-evaluates basic policies, and where appropriate, makes the changes necessary to keep abreast of developments in the securities markets.

In certain areas of the Commission's responsibility, administrative adjudication has been an essential means of policy determination. This has been particularly true in implementing the general statutory requirements that brokers, dealers and their salesmen deal fairly with their customers. While the Commission has, in fair measure, used formal rules, public statements and adjudicative proceedings to enunciate a substantial body of policies, the standards and policies developed and announced in the course of the adjudication of cases have been of particular importance.

The Commission has relied heavily on administrative proceedings in this area of its work partly because the unlimited opportunities for unethical practice make difficult the development of comprehensive, and yet precise, rules by formal rule-making. We have been compelled to rely on the broad proscriptions of the statutes and of the general rules adopted under them. And we have received encouraging support in this effort from the courts. The emphasis on the factual context in administrative proceedings has provided a definite advantage in resolving the issues and the policy considerations present in determining whether particular conduct violates either the general or the specific anti-fraud and anti-manipulative provisions of the statutes. In early cases, the Commission may have used broader language to describe the duty required of broker-dealers toward

their customers than was necessary to dispose of the particular issue before it. These cases, however, provided the background against which the Commission developed general theories as to the duty which broker-dealers owe their customers and also formed a basis for specific rules as to particular selling practices. Perhaps of equal importance is the flexibility afforded by the case method because of the discretion it offers in terms of application of the principle announced in a particular case and the opportunity for further refinement or modification in later cases.

Adjudication also seems to provide an advantage because of the different reactions by the Bar and interested persons to a policy stated in a case and to one enunciated in a formal rule. There is a tendency by those interested to evaluate a proposed rule in terms of the maximum possible scope of its language. Objectors envision highly unusual factual situations which might conceivably fall within possible constructions of the rule. The creators of these ingenious hypothetical cases find little comfort in the obvious answer -- that no sensible administrator, and certainly no reviewing court, would interpret the rule to cover such extreme cases. By contrast, a statement in an adjudicatory opinion is evaluated against the specific factual context. There is a general understanding that the precedent value of an opinion is limited by the underlying facts. Though an opinion foreshadows future developments, and thus serves as a warning to interested persons and careful counsel, there is an awareness that its dictum will not be applied literally in every conceivable circumstance.

I should point out that adjudication has not been of equal importance in other areas of Commission responsibility. For example, the Commission has relied on detailed formal rules and informal procedures to perform its responsibilities with regard to proxy solicitation. It has utilized a similar approach in developing and announcing policies as to required disclosures in new offerings of securities under the Securities Act and in connection with registration for trading on the exchanges. Adjudication has played a role in this area, although not as significant a role as in the broker-dealer area.

Even where adjudication is not used extensively, it has greatly benefited the SEC in its regulatory activities. The consideration of, and judgments required in, formal proceedings provide a "feedback" process for evaluating previously developed policies as well as a means of providing to the Commission a live basis for deciding what new policies are required by the changes constantly taking place in the industry or to meet the latest manifestations of man's eternal ingenuity. On the other hand, the knowledge of the securities industry gained from the Commission's informal regulatory activities has induced a better understanding of the real issues involved in the formal administrative proceedings which come to the Commission for decision. In my view, external separation of adjudication from other regulatory activities, as some advocate, would result in a regulatory agency and an adjudicatory body each of which would be less knowledgeable than an agency responsible for both activities. This conclusion seems especially apt in the case of an agency, such as the SEC, which performs many of its regulatory functions on an informal basis.

The complexities involved in the tasks the SEC performs and the variety of procedures, formal and informal, it has developed to meet specific problems suggest the weakness of proposals for improving the administrative process by single concept or universal solutions such as complete external separation of functions, or "judicialization" of all procedures. These proposals fail to recognize the limits of governmental action in regulating a segment of the economy, especially when that regulation is subject to the proper limitations which are imposed on it in a constitutional democracy such as ours. The proposals, and certain of the criticism that lies behind them, ignore the basic reasons for the creation of the administrative agency; that is, the desire for expertness in the particular area to be regulated, the conviction that a specialized agency could handle better the necessarily large volume of work by giving undivided attention to the administrative details involved, and the beliefs that agencies could develop policy and help Congress construct long range programs, and, because of the circumstances of their creation, that they would enforce the policies of their enabling statutes in a vigorous manner. To achieve these goals, it was considered necessary to create organizations which, on the one hand, could keep in view the general policy of the statute and, on the other, could know what that policy meant in terms of individual application.

Proposals which would separate adjudication from other functions or impose uniform procedures on all administrative agencies and "judicialize" many types of informal proceedings ignore these reasons for the specialized

agency and the character of much of its work. I do not mean to suggest that all agencies (or any one agency) fulfill the concept in a completely satisfactory manner. Nor do I mean to imply that agency procedures need no improvement. But one does not cure a bunion by severing a leg. Agencies and administrators are not intransigent when it can be shown that changes in their procedures will result in better or fairer performance. I think the splendid action taken by most agencies to meet the recommendations of the last Administrative Conference demonstrates a willingness to accept constructive criticism. In my view single concept solutions will not produce the reform which can be achieved by studies in depth of the programs of each agency. I think it is generally conceded that a number of such studies accomplished during the last Administrative Conference have produced substantial improvements. It is for this reason that the permanent Administrative Conference offers a great potential for administrative reform. Finally, while I have taken some time to defend adjudication as a necessary policy-making tool, I agree wholeheartedly with Judge Friendly that more can and should be done in particular areas and with different emphasis for the various agencies to define better, to develop and articulate further, and to publish more extensively, standards of administrative action.