

WHAT'S NEW AT THE SEC

Address by

ANDREW DOWNEY ORRICK

Commissioner
Securities and Exchange Commission

Before the

Los Angeles and San Francisco Regional Groups
of the
AMERICAN SOCIETY OF CORPORATE SECRETARIES

Pebble Beach, California
December 3, 1955

WHAT'S NEW AT THE SEC

A discussion of the work of the Securities and Exchange Commission must be considered in the context of the current unprecedented economic activity in this country, which is reflected in an annual gross national product of nearly 400 billion dollars. The vigor of our economy has generated many complex and novel problems for the Commission in carrying out its statutory responsibilities to protect the interest of public investors. The avalanche of penny stock promotions, the bitterly-fought proxy contests for corporate control, the vastly increased volume of new corporate financings and securities trading are factors which have compelled the Commission to adopt some new administrative techniques.

The current strength of our economy has been created by the initiative and ingenuity of American industry - labor and management, scientists and farmers - working in a favorable climate for economic progress that has been conditioned by the policies of the present administration. Other federal agencies, such as the Treasury Department, the Federal Reserve Board and the Council of Economic Advisers, are directly concerned with determining economic policies, including the control of credit in the securities markets. The Securities and Exchange Commission, which was established by the Congress in 1934, is vested with the responsibility for protecting the public in the sale and trading of corporate securities in interstate commerce. In administering the securities laws, the Commission requires certain standards of conduct by corporations and their controlling stockholders, to provide for full and fair disclosure of the character of securities sold to the public and to prevent fraud, and by brokers and dealers, to prevent inequitable and unfair trading practices.

The Commission is a relatively small agency, operating at a net cost to the taxpayers of only 4 million dollars a year, with approximately 700 employees. Its influence, however, in maintaining the confidence of business and the investing public in the securities markets and in the American system of free enterprise, is great. The enormous economic expansion of the past few years could not have occurred unless the public had continued to show its confidence in the processes of capital formation and in the existence of free and open markets by investing in corporate securities. Today over 8½ million citizens directly own shares in corporations and more than 90 million Americans holding life insurance policies have an indirect interest in the securities markets through the great investment in corporate stocks and bonds held by insurance companies. Beneficiaries under pension funds and holders of investment company shares also have a large interest in the securities markets.

The task of the Commission in carrying out its Congressional mandate to protect the interest of public investors has become increasingly important and has been complicated by the vigor of the current economic activities. The amount of corporate securities registered with the Commission for sale to the public during the first nine months of this year has aggregated over 10 billion dollars. In the calendar year 1954, 9.6 billion dollars of securities were registered and in 1953, 9.2 billion dollars. The significance of this intense public interest in corporate investment is brought into vivid focus when compared with only 2.8 billion registered in 1935, 1.8 billion in 1939 and 800 million in 1942.

The amount of trading in corporate securities has also shown a startling growth. In 1935 the market value and volume of all shares traded on the national securities exchanges amounted to 15.3 billion dollars and 600 million shares. These figures decreased to 11.4 billion dollars and 460 million shares in 1939, and 4.3 billion dollars and 220 million shares in 1942. Contrast these statistics with the trend during the past few years. In 1953 the market value and volume of shares traded on exchanges was 16.6 billion dollars and 630 million shares; in 1954, 28.1 billion dollars and 990 million shares; and during the first nine months of this year, 29.3 billion dollars and 940 million shares.

Under the Securities Exchange Act of 1934 the Commission has the responsibility for regulating the practices of the stock exchanges and of brokers and dealers. The statute makes it unlawful for any person to create false or misleading appearances of active trading or to use any manipulative or deceptive device in connection with the purchase or sale of any security. Severe sanctions are imposed on conviction of market manipulation - a maximum fine of \$10,000, and, or, two years imprisonment. The Commission has always carefully observed stock market activities in order to prevent such manipulative abuses as market rigging and pools that existed before the Commission was created.

The sharp market breaks this fall accompanied by the pronounced fluctuations in both trading volume and prices, caused the Commission to intensify its market surveillance work. The recorded transactions on the various stock exchanges as they come over the ticker and the quotations in the over-the-counter market as they are published in the National Quotation Sheets are carefully scrutinized to detect trading activities which do not appear to be based on economic factors and which may indicate the presence of manipulation. When market rigging or the use of manipulative devices is suspected, flying quiz investigations are immediately instituted to ascertain the identities and the nature of the activities of the purchasers and sellers. The Commission also keeps itself informed of any unusual market movements, including such information as the size of transactions, whether large buy or sell orders dominate, the extent of foreign investor participation, and the market activities of institutions and pension funds.

Our analysis of the stock market decline on September 26, indicated that there was widespread public selling not in large blocks. There was, however, only a limited amount of forced margin account selling and stop-loss orders were not an important factor in the market break. It is also significant that on September 26 there was no substantial trading, either on the buy or sell side, by pension funds, investment trusts or other institutional investors, and that on the subsequent Mondays when further declines were registered, institutions were buying on balance. On September 26, foreigners appear to have been buyers, but a week later, sentiment had changed and they became heavy sellers of American securities.

The statutory proscriptions against the evils of manipulative practices have also been implemented by various Commission rules. One rule, which prevents short sales on a declining market, effectively discourages "bear raiding." Our stabilization rules prevent deception of the public investor by prohibiting persons engaged in distributing a security from creating active trading or raising the price in order to facilitate a distribution. These statutory and regulatory safeguards have, in our opinion, worked well in protecting the public from manipulative practices, even during the active market of this fall.

The high volume of corporate financing and increased securities trading has attracted into the broker-dealer ranks many persons who are untrained in financial affairs and who have had limited, if any, experience in handling the securities or funds of other persons. Many of the new registrants contribute insufficient capital to their businesses, and some are not imbued with the sense of professional calling that is generally characteristic of the investment banking and securities industry today. The number of broker-dealers registered with the Commission during the past fiscal year amounted to 4,334, which is a net increase of 202 over the number registered during the previous fiscal year.

In order to provide additional protection to the public against the danger of broker-dealer insolvencies, the Commission has recently amended various rules designed to establish more stringent standards for broker-dealer financial responsibility. The tempo of our broker-dealer inspection program has also been increased. In these inspections the books and records of the registrant are reviewed to determine if they are being properly kept and are current; the capital condition of the firm is analyzed. Our inspectors also look for evidence of unlawful practices, such as transactions in unregistered securities, gun-jumping, churning accounts and violation of the margin requirements.

Favorable market conditions have encouraged the flotation of many unseasoned, speculative issues by inexperienced promoters and underwriters. Due to the intensity of the public speculative interest in uranium, the evils of high-pressure salesmanship have sometimes occurred in the distribution of the stock of small mining companies. In some instances, offerings have been discontinued as soon as sufficient securities have been sold to pay the claims of promoters and the commissions and expenses of underwriters. The insiders walk away from the deal and the public investor is left with a worthless equity in a company without operating funds. Other promotional issues have been heavily weighted against the public investor, who has furnished all the cash capital, through the issuance of warrants and options to promoters and underwriters. Sometimes, the underwriters have received more than one-third of the total gross proceeds from the public distribution in payment of commissions and expenses.

The Commission has attempted to protect the public from front-money rackets and stock-jobbing activities in various ways, such as requiring adequate disclosure by the issuers of securities, denying or suspending offerings, investigating and prosecuting fraud, and regulating the practices of broker-dealers. Since June 1955, the Commission has issued 7 stop-orders suspending the effectiveness of registration statements and ordered the denial or suspension of the effectiveness of 33 filings made under Regulation A - the rules which cover offerings of securities issues under \$300,000.

The authority of the Commission to regulate the solicitation of proxies has become increasingly important in recent years due to several highly-publicized contests for control of large corporations. Where opposing factions hurl charges and counter-charges in an effort to obtain stockholder support, special need arises for protecting the property interests of individual stockholders by requiring the dissemination of fair and accurate information by both management and opposing groups. Last August the Commission circularized for comment its proposed amendments to the proxy rules. The principal purposes of these proposals are to codify many long-standing administrative practices and to clarify the applicability of the rules to proxy contests. In addition to numerous constructive comments received from the public, which the Commission is carefully studying, considerable interest in the subject of proxies has also been shown by the Congress. One of the principal provisions of the Fulbright bill would extend the coverage of the Commission's proxy rules to certain companies whose securities are not listed on a national securities exchange.

Some comments on the proposed new proxy rules have pointed out that an attempt to regulate the communications of participants in proxy contests, which are announced to the general public and not distributed directly to security holders, would be administratively

ineffective. Other comments raised the issue of possible infringement on the freedom of the press. However, neither the Securities Exchange Act of 1934 nor the present nor the proposed proxy rules gives the Commission the power to restrict the freedom of newspaper reporters at press conferences or in private interviews or to control editorial comment with respect to proxy contests. The newspaper which publishes a story or editorial or advertisement on a proxy contest is not, by definition, a participant subject to the proxy rules. The impact of the rules is only on persons who are participants in a solicitation for proxies.

The Fulbright bill, which was introduced during the last session of Congress, has created intense interest and partisanship in financial circles. The bill would extend the regulatory power of the Commission by making the reporting, proxy and insider trading provisions of the Securities Exchange Act of 1934 applicable to many companies whose securities are not listed on national securities exchanges. It would apply to unlisted companies having total assets of more than two million dollars if the number of holders of equity securities exceeds 750 or the total amount of debt securities exceeds one million dollars.

The Commission has not endorsed this bill although it recognizes the soundness of its broad principles and objectives. The Commission believes that a thorough, objective study of the legislation should first be made in order to determine the factual need for such a vast extension of its regulatory jurisdiction. This study is now being made and upon its completion in a few weeks, it should disclose whether, in fact, serious abuses exist that should be rectified by the proposed legislation.

The Commission is continuing its program to simplify and clarify its forms and rules. With the recent adoption of major revisions to Form S-1, the principal registration form under the Securities Act of 1933, and to Form 10, the principal registration form under the Securities Exchange Act of 1934, the corresponding items have, for the first time in the history of the Commission, been conformed with each other and with the requirements of the proxy rules. The preparation of new rules to prescribe the contents of summary prospectuses, which may be used in offering securities for sale, is being vigorously pressed.

In conclusion, the present Commission is determined to use its vast regulatory powers to protect the public investors through aggressive and strict enforcement of the disclosure and anti-fraud provisions of the statutes without stifling or strangling the economic development of legitimate enterprises by unnecessary or burdensome regulations. We intend to conserve vigorously the tested virtues of the full disclosure theory. We intend to strengthen energetically our enforcement activities against unlawful practices in the purchase and sale of securities, and by regulating wisely, to continue to maintain favorable conditions for economic growth.