

Address of

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at the

**BUSINESS MANAGEMENT INSTITUTE**

of

**COLBY COLLEGE**

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It is much more than a formal pleasantry to say how happy I am to have the privilege to meet with this distinguished group of State of Maine people. I also appreciate this opportunity to get my perspective readjusted by a trip away from Washington. There are no "Potomac Fever" germs in Waterville.

Although I have heard of the absence of honor to a prophet in his own country, we in Washington feel that you should be proud of your Maine Senators, Margaret Chase Smith and Frederick G. Payne, and of your Congressmen. I have had some opportunity to confer with Senator Payne, who is a member of the Senate Banking and Currency Committee, and with Congressman Hale, who is a member of the House Interstate and Foreign Commerce Committee. These two Committees have charge of legislation affecting the Securities and Exchange Commission. It is a pleasure to work with them. I am sorry not to be acquainted personally with Senator Smith or with Congressman Nelson whom I understand was born here in Waterville and was graduated from Colby College in 1928.

I know that an after dinner speech is not a place for a lecture. On the other hand, we are meeting at a college, a distinguished institution which recognizes its responsibility not only for the education of youth but for providing stimulation and focus to the adult thinking of your whole region. Consequently, I am not going to apologize to you for talking in a serious vein about the federal scheme for surveillance of capital markets.

The current inquiry being conducted by the Senate Banking and Currency Committee into the securities markets has naturally turned the attention of the public to these markets. Public education and understanding of this complicated process of capital formation is in the public interest. You in New England are perhaps ahead of the rest of the country in that respect, since the assembly of capital for manufacturing had its origins here in considerable measure.

The growing public interest in our capital markets is inevitable because more and more people have direct or indirect interest in investments. Look at the growth of investments by union welfare and pension funds and life insurance companies, not to mention the mutual funds. For example, it is estimated that 90 million individuals hold life insurance policies and 53 million hold

savings accounts. Also, 14.5 million hold some form of annuities or pension plans -- all of which are, to a considerable extent, invested in corporate securities. These indirect holdings are in addition, of course, to almost 8 million individuals who own stocks.

The interest of direct and indirect investors, however, is only a part of the great public interest in the field of raising and administering capital. The securities markets provide the medium by which the savings of the people are turned into productive facilities.

One characteristic of the American economy which has helped produce the standard of living which our people enjoy (and I apologize for over-simplifying) is constantly improving methods of production based on research and replacement of obsolescent equipment. This makes for mass production for a mass market so that the luxuries of one generation become necessities for the next. To keep our capital plant growing and improving, to maintain the expanding economy we now enjoy, there must be a continuous flow of new investment capital into our economy.

While retained earnings and reserves for depreciation provide more than 70% of the funds to build and replace plants and equipment, continued new investments of capital are necessary for the economic bloodstream.

In the six years, 1934 through 1939, the amount of money devoted by corporations to plant and capital expenditures aggregated 25 billion dollars. In 1953 alone American industry placed over 28 billion dollars into new plants and facilities, for 1954 almost 27 billion dollars and business is planning slightly more for 1955. The use of depreciation reserves and retained earnings accounted for approximately 19 1/2 billion dollars of the plant and facilities expenditures in 1953 and about the same in 1954. In 1934 offerings, public and private, of corporate securities came to about 4 hundred million dollars. In 1939 the corresponding figure was about 2 billion 200 million dollars. In 1953 the amount was almost 9 billion dollars and for 1954 about 9 billion 600 million dollars.

I use these few statistics to indicate the enormity of expenditures required to keep American private enterprise growing as well as to point out the enormity of the increase in such expenditures over what they were twenty years ago. But more than that, these statistics are indicative of the importance of maintaining public confidence both in the integrity of our capital markets and the integrity of the management of American private enterprise.

Basically, continued investment requires continued public confidence in our economic processes.

Confidence in our economic processes means a lot of things. It means confidence that the government has a sound fiscal policy. Sound fiscal policy includes the control of government expenditures consistent with the requirements of national defense. It includes a tax policy that encourages investment in new facilities to make more jobs and better products. It includes a willingness to stand up against superficially appealing expedients which lead to inflation and a budget out of control. These things I think we have. The cost of living has been almost constant during a period of readjustment. The purchasing power of the dollar is being held steady. That makes people willing to make commitments for the future. Confidence in our economic processes also means confidence in our system of capital formation -- that is, investment. Confidence in the processes of capital formation is not synonymous with an uninterrupted rise in security prices. The basic confidence must be a confidence in the integrity of the system for raising capital and in the administration of corporate enterprise. We have capital markets because we have savings. This country has generated surplus wealth available for investment.

In the operation of these markets we might depend entirely on an automatic system of self-adjustment. Investors could learn by bitter experience; the buyer could beware; businesses which forfeited public confidence would fail; the strong would survive; there would be no restriction in gathering capital into enterprise. Any such concept involves an inexcusably naive confidence that good always will triumph over evil. Tom Paine once said in effect that government is necessary because moral principles don't operate without assistance.

It is inherent in the nature of things that there must be some legal controls imposed on one man who gathers together and administers capital furnished others. That is true of trust funds. It is true of bank deposits and in its own way it must be true of corporate capital.

When we look at the function of the modern corporation in gathering and administering capital, what ends do we desire? What abuses do we seek to prevent?

(1) We want to encourage investment -- money in the mattress, jewelry in a vault are static wealth.

(2) We want no foolish, meaningless obstacles to the accumulation of capital.

(3) We want opportunity for initiative and imagination to develop the full economic potential of an enterprise. But there are a few other things that we want also. Let me enumerate a few of these and indicate what the securities laws do to attain them.

(4) The investor should know what he is getting into when he buys securities. The Securities Act of 1933, the so-called "truth-in-securities law", required the disclosure of information in the sale of securities and prescribes standards for such information. The Securities Exchange of 1934 provides for periodic reports by companies listed on national securities exchanges and for companies which have offered securities to the public by registration with the Commission under the Securities Act.

(5) The owners of an enterprise are entitled to current information. The reports under the Securities Exchange Act of 1934 provide this in the case of listed companies. Some state corporation laws, of course, also provide for the furnishing of information to shareholders.

(6) Financial information should be presented to investors with reasonable completeness and in accordance with generally accepted accounting principles. Under each Act administered by the Securities and Exchange Commission the Commission is given power to prescribe accounting rules.

(7) The investor should have a remedy against someone who deceived him by misrepresentation or concealment. The Securities Act of 1933 and the Securities Exchange Act of 1934 in the aggregate provide for civil remedies against a number of types of fraud and concealment in the sale and purchase of securities.

(8) A stockholder should have a chance to vote intelligently at corporate meetings -- not blindly. The Securities Exchange Act and the proxy rules thereunder provide, in the case of listed companies, for information as to management's stewardship and for an explanation of matters to be acted upon at corporate meetings of listed companies.

(9) The markets for securities should be free of manipulation. The Securities Exchange Act provides for the regulation of national

securities exchanges. It provides penalties for manipulative activity and provides for some controls of the over-the-counter market.

(10) People with inside information should not be allowed to make use of such inside information to the disadvantage of their fellow security holders, and transactions between such persons and the corporation should be subjected to careful scrutiny.

The Securities Exchange Act provides that a listed company may recapture short-swing trading profits made by its officers, directors, and 10% stockholders.

(11) People engaged in businesses involving recommendation of investments, sale of securities, handling of other people's money and securities, should be registered and should be required to file publicly available information about themselves. These things are required of broker-dealers and investment advisers by the Securities Exchange Act and the Investment Advisers Act.

The securities laws impose ultimate responsibility on both the organizations and individuals regulated by those laws and on the members of the public whom the laws seek to protect.

Let us examine more closely into this. Take first the subject of disclosure of information. Disclosure is perhaps the most fundamental obligation imposed by the various laws administered by the Commission. Who has the responsibility to make the disclosure and who has the responsibility to see that the investor benefits from it? To be sure the Commission examines statements of fact made in material filed with it, but it does not and cannot vouch for the accuracy of that material. Administratively it calls attention to apparent misstatements or half-truths. Its staff suggests the subject matter of corrections, but the responsibility for the statements is that of the party making them. That is clear in the law and it is clear as a matter of common sense. Without an Army-sized division of traveling auditors, the Commission could not truly verify the accuracy of the material filed with it. And what about the benefits from the disclosure? Disclosure is for the investor's benefit. Unless the investor or his adviser takes the trouble to read and understand the information made available to him, the disclosure is sweetness wasted on the desert air. In other words, the benefit of the law is realized to the full extent only by

those who use the energy and wisdom to take advantage of those benefits. The basic doctrine of the securities laws is that the role of the Federal government in policing the public offering of securities is to require issuers of securities to give the investor the facts. The Commission's function is to formulate standards for disclosure, to activate the disciplinary powers of the law against those who fail or refuse to make adequate disclosure, but the efficacy of the disclosure provisions of the law depends basically on the integrity of those who supply the information and the energy and enlightened self-interest of the investors for whom the information is supplied.

If someone violates the securities laws, he is responsible criminally or, in the case of a broker or dealer, he may have his registration revoked and be put out of business. A failure to observe the laws administered by the Commission may also lead to civil liability. What I am trying to emphasize is the personal responsibility for observing the securities laws just like any other laws.

The complexity of the capital markets is such that the Congress recognized the necessity of not attempting to cover the whole subject by federal regulation. It recognizes that there is a very vital role played by self-regulation. The stock exchanges and the National Association of Securities Dealers, Inc., (we call it the NASD), have strong disciplinary and investigating powers over their members. This self-regulating responsibility is recognized by the securities laws. The Commission has, to be sure, certain supervisory powers over the exchanges and the NASD, but the day-to-day self-regulation is on these organizations. On the adequate discharge of the responsibilities imposed on the exchanges and on the NASD depends in very considerable measure the integrity of our capital markets and the public confidence in those markets.

What I have done up to now is, first, to summarize in a general way what the securities laws are designed to accomplish and the results they try to produce; second, I have indicated that the legislative principles by which they try to accomplish that result are (a) disclosure, (b) imposition of civil and criminal liability, and (c) self-regulation by the securities business itself. I have also indicated in a very general way where the Commission fits into the application of these principles.

You can see that the picture that I have painted is not simple. We're dealing with a complex system. But we must guard against that complexity stifling growth of the American economy because that complexity enters not only into the organization of the system but into the rules which operate it. I quote and requote to people on our staff the Ninth Verse of the Fourteenth Chapter of First Corinthians, "So likewise ye, except ye utter by the tongue words easy to be understood, how shall it be known what is spoken ? for ye shall speak into the air. "

This problem of complexity is important because it must never be permitted to stem the flow of needed capital into small business. Capital required for the growth of the American economy must flow not only into big business but into smaller business. If the various elements of the economy grow too unevenly, we get into the numerous problems and controversies created by concentration of economic power.

Big business knows its way to the capital markets. Smaller business ( I am speaking relatively: I don't know where to draw the line between "big" and "small") is not quite so sophisticated on the subject. For example, the Federal Small Business Administration gets many applications for loans from businesses which should be seeking equity capital from public investors. Too many people lack competent advice on the subject and conclude mistakenly that compliance with the securities laws presents an impossible hurdle.

Our Commission is trying to achieve greater public knowledge of its requirements. We are getting into the hands of all offices of the Small Business Administration around the country copies of our releases and forms relating to the more usual financing. We are preparing a memorandum on equity financing under the Federal securities laws for use by the Small Business Administration personnel. Copies of the SEC releases on private offerings and the intra-state exemption are being made available. It is contemplated that the Small Business Administration will include a publication on the work of the SEC in its Management Aid Series. Furthermore, our staff will be available to participate in Small Business Administration's business clinics.

You may think that more widely disseminated know-how about compliance with securities laws is a microscopic stimulant to the economy. If that is what you do think, I respectfully disagree.

The securities laws are here to stay. As knowledge of the requirements of those laws becomes more widespread; as the techniques of compliance become more generally known, more businesses in need of capital will resort to the public capital markets. The first registration statement is a hard job. The first public disclosure of corporate affairs involves a break in habit patterns, but thousands have survived the experience.

If our major premise is correct -- that the savings of the people reinvested in the economy keep the economy growing and continuously raise the general standard of living -- then it is obvious that we need in all parts of the country people familiar with the processes of capital formation and the laws which regulate those processes. American business and American industry are scattered all over the country. American national wealth is broadly diffused. We need mechanics where the machines are located.

The wide dissemination among literally millions of Americans of skill and knowledge in fields of science and technology doubtlessly accounts for much of the progress which this nation has made. It is accountable in considerable measure not only for our defensive strength but for the character of our economy and our national standard of living. Our rivals on the other side of the iron curtain and the bamboo curtain are building up great bodies of people trained in engineering and technical skills.

I think, in terms of importance to our economy, there is a fair analogy between technical competence in scientific matters and technical competence in the processes of financing our business enterprises, large and small.

To the extent that real competence in the field of capital formation -- as distinguished from competence in investment analysis or salesmanship -- is confined to too few people, it tends to become a kind of black magic. Management today has a duty to keep informed of the growing list of alternative methods to provide capital and the problems and requirements which they involve.

Government becomes a supplier of capital to private business to finance great defense programs, or to fill needs which arise when private enterprise fails either through lack of confidence or inertia. Financing defense production is a case by itself which I shall not discuss. To the extent that public financing of private business is

brought about by the inertia of any segment of our private economic organization, private enterprise must assume its share of the blame.

Here in New England you have a history of adaptability to change. Toynbee's Study of History points out that the challenge of a threat evokes in a vigorous people a response which results in an increase rather than a decrease of strength. You have seen farming give way -- fortunately it has not given way so much in Maine -- to manufacturing. You have seen some manufacturing move away, but your talents and your skills and your imagination have created new industries. You have seen the fortunes of shipbuilding wax and wane and wax again. But New England remains a bastion of strength in our national economy.

That strength -- the aggregate strength of many individuals -- manifests itself in many ways -- in production skills, in business acumen, in perseverance and common sense. What I have said tonight is related to the husbanding of that strength in this way. We live in an age in which we must move forward even to stay where we are -- relatively. That means an ability to organize and build up our enterprises to keep pace with the times. To do that involves the intelligent introduction of new capital.

To carry on that process soundly and safely we need the protection of legal safeguards -- and I've dwelt on them at considerable length tonight. But we also need what only the people themselves can supply -- the will and the wisdom to move forward. Your attendance at these forums manifests your earnestness in attacking your problems intelligently and analytically. Problems are not solved by simple slogans but by constructive action after study of the facts. What you are doing here at Colby this week end exemplifies the genius of American enterprise. Our system has had its ups and downs but it has put us into a position of world leadership. The responsibility of that position is a challenge to which all of us must respond, each in his own way. Your meeting is a part of your response.

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