C A U T I O N - HOLD FOR DELIVERY

Address by

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at the

Twenty-second Annual Convention
of the
NATIONAL SECURITY TRADERS ASSOCIATION, INC.

Mackinac Island, Michigan
Luncheon Meeting
September 12, 1955

Gentlemen:

I am honored to be the guest of your fine organization today and to deliver my maiden speech after three months as a member of the Securities and Exchange Commission at your Twenty-second Annual Convention. Over the years your organization has graciously invited the Commissioners and members of its staff to attend your annual conventions, and last year, I understand, the entire Commission and several staff members conducted a forum on SEC problems before your group at Atlantic City. It was impossible, however, for all of the Commissioners to be present today.

I am pleased to attend your convention this year, not only because it has afforded an occasion to meet so many outstanding members of the securities industry who are represented in this Association, but also because it has provided an opportunity to discuss with you some of the problems confronting security traders in this provocative period which is characterized by a record volume of new financings and increased market activity. The novelty and complexity of many conditions affecting the securities industry arise out of this unprecedented interest in corporate investment and securities trading. During the past three years the volume of new corporate financings averaged nearly 9½ billion dollars each year as compared with less than 7 billion dollars a year in the immediately preceding post-war period and about 2 billion dollars a year during the depressed period of the 1930's. The volume of trading on national securities exchanges during the past year was almost as much as the aggregate volume of trading during the preceding two years.

It is appropriate that a member of the Commission again attend your convention this year, because during the past few months the Commission has acquired not only a new chairman - J. Sinclair Armstrong of Illinois - but also two new members - Harold C. Patterson of Virginia and myself from California. Since all of you have considerable interest in the manner in which the securities acts are administered, I believe that the Commissioners should appear before your Association, and similar organizations in the securities industry, for the purpose of keeping you informed of the program and objectives of the Commission and of its views on proposed legislation that affects the securities markets. The present Commission is confronted with many pressing problems arising in this strenuous financial period, and its members, individually and collectively, are vitally interested in administering the securities acts enacted by the Congress thoroughly, effectively and fairly, in the public interest and for the protection of investors.

At the outset, before discussing an important legislative proposal affecting the securities markets, I shall review briefly some of the significant problems in the enforcement field that the Commission has faced in the past few months and what has been done to solve them:

Since June 1955, the Commission has commenced stop order proceedings against the registration statements of six companies in which it appeared that there was a wilful, deliberate attempt to mislead or conceal material information, and it has suspended 22 offerings under Regulation A in which the companies did not make adequate disclosure of material facts or failed to file the necessary reports. The Commission believes that prompt action should be taken to prevent or suspend public offerings in cases where a company has wilfully or negligently failed to comply with the disclosure standards of the law. The use of its stop order and suspension powers by the Commission not only protects the public by preventing the distribution of securities where the disclosure standards of the Securities Act have not been met, but it also has the effect of discouraging the filing of material with the Commission which is either fraudulent or grossly inadequate.

The distribution of and trading in mining stocks - especially uranium issues in the Colorado Plateau area, has created a major enforcement problem for the Commission. In order to supervise more adequately these activities in speculative mining stocks, the Commission recently dispatched to Denver and Salt Lake City a special task force, composed of accountants and lawyers, for the purpose of inspecting the brokers and dealers registered in that region, to determine whether they are fully complying with the securities acts.

In order to provide further protection to investors purchasing the securities of small uranium companies, the Commission recently circulated for comment a proposal to revise Regulation A (which is applicable to issues under $300,000) which, among other provisions designed to prevent abuses in small speculative offerings by promotional companies, would require the issuer to escrow a portion of the funds obtained from the sale of its stock. These proposed revisions are presently the subject of intense discussions in the Commission and by the State Securities Administrators, the mining industry and other interested parties. The Commission would, of course, also welcome your comments and those of your Association on the subject. Parenthetically, it might be mentioned that a bill has been introduced into the House of Representatives by Congressman John Bennett of Michigan to eliminate entirely the provision exempting small issues from the registration requirements of the Securities Act. Hearings on the Bennett bill have been conducted both in Washington and, more recently, in Denver and Salt Lake City.

The Commission is also actively working on the continuing problem imposed by the illegal distribution throughout the United States of speculative uranium and oil securities issued by Canadian companies. The proposed revision of Regulation A, which is applicable to small offerings by Canadian companies, would afford an additional measure of protection to investors in the United States in Canadian companies. The Commission anticipates that a satisfactory solution to the problem of boiler shops operated by unscrupulous promoters located in Canada may also be achieved in the near future.

The Commission has distributed for comment a more detailed and exacting set of rules, which codify the present practices and procedures of the Commission in processing proxy material. Designed to prevent abuses that have recently been encountered in the solicitation of proxies in contests for corporate control, the rules require, among other matters, that the solicitation material of both sides reveal the essential facts concerning the participants and their interests. Unsupportable predictions of future financial results and attempts to discredit the character, reputation and integrity of the opposition, unless based on provable facts, and similar unfair and misleading representations are prohibited. Both the Commission and some members of the Congress are considering, furthermore, whether the Commission should not be granted additional administrative power, similar to the procedure of issuing stop orders with respect to registration statements, to prohibit the use of misleading proxy soliciting material. The only legal remedy presently available to the Commission under the statute to enforce its proxy rules is to commence an action in a Federal District Court seeking to enjoin the use of misleading proxy soliciting material.

Let me now direct your attention to a consideration of the Fulbright bill. During the early part of this year the Senate Committee on Banking and Currency began its extensive and much publicized study of the stock market. In its majority report the Committee recognized the basic soundness of the securities acts and expressed its general satisfaction with the contributions that these laws have been and are making toward the maintenance of fair and honest securities markets. However, the Committee expressed its belief that additional legislation might be necessary to preserve a healthy, growing economy. The majority report pointed out that an issuer of securities registered on a national securities exchange is subject to one set of regulations whereas another issuer in the same industry, and with the same degree of public interest, whose securities are traded in the over-the-counter market, is subject to entirely different regulations. The majority report concluded:

"The Committee is of the view that as a general policy, it is in the public interest that companies whose stocks are traded over the counter be required to comply with the same statutory provisions and the same rules and regulations as companies whose stocks are listed on national securities exchanges."

On May 24, 1955, Senator J. William Fulbright of Arkansas introduced a bill into the Senate to implement these findings of the Committee. The general purpose of the bill is to extend the provisions of the Securities Exchange Act with respect to furnishing adequate, accurate and periodic reports to stockholders, making fair disclosure to security holders in proxy solicitations, reporting transactions by insiders, and preventing unfair use of inside information by insiders, which are now operative only to listed securities - to securities not listed or registered on national securities exchanges. It also makes the provisions relating to extension of credit applicable to unlisted securities.

Over the years the Securities and Exchange Commission has been cognizant of the problems raised by the absence of legislation which would make the principles of fair, adequate and accurate financial reporting and disclosures of the Exchange Act applicable for the protection of investors in the important over-the-counter market. The present Commission, like its predecessors, is fully aware of this situation. In his testimony before the Subcommittee on Securities of the Senate Banking and Currency Committee on the Fulbright bill, Chairman Armstrong stated that "the Commission believes that the broad principles and objectives of the bill are sound and the Commission supports them." The basic principle incorporated in the bill - namely, that a stockholder is entitled to complete information about his company, whether or not the securities of the company are listed - is generally accepted as fair and reasonable. The opposition that has been expressed to the Fulbright bill appears to be grounded on the hypothesis that material information about unlisted companies is presently being furnished voluntarily and is readily available to public investors.

The bill, as originally introduced, contained, in the opinion of the Commission, a number of technical deficiencies which the Commission brought to the attention of the Committee. At the request of Senator Fulbright the Commission prepared appropriate amendments to the bill, and a revised bill, which included many of the changes proposed by the Commission, was introduced into the Senate in the closing days of the last session of the Congress. Very significantly, a companion bill, containing some but not all of the provisions of the Fulbright bill, was also introduced into the House of Representatives by Congressman Arthur G. Klein of New York. It can reasonably be assumed, therefore,

that the 84th Congress, upon reconvening in January 1956, will give serious and early consideration to this legislation.

As originally introduced, the bill would have required the registration with the Commission of all securities (with certain specified exemptions) of any company if the company's total assets amounted to 5 million dollars or more and if all of the company's securities are held by 500 or more persons. The Commission recommended that the asset test for registration be entirely eliminated, for the reason that the Commission believes that it does not provide a satisfactory standard to measure the significance of an issuer, either in terms of earning power or public interest, and is unsatisfactory from the standpoint of administration and enforcement. The Commission also recommended that the sole statutory standard for registration of equity securities should be whether the security holders of a particular class number 750 or more persons. Our studies have indicated that there is limited public trading interest in over-the-counter issues of securities whose holders number less than 750 persons. For example, certain studies have shown that 27% of the value of transactions in unlisted industrial common stocks occurred in issues where the number of holders were less than 1,000, but that only 4.6% of the value of transactions in the same class of securities occurred in issues of which there were less than 500 holders. On the basis of available information, the Commission believes that the selection of 750 record holders is a reasonable standard by which to measure public interest in the trading of over-the-counter securities for the purpose of the proposed legislation.

The revised bill adopted as the standard for registration of equity securities under the Securities Exchange Act, the provision for 750 security holders, but it also imposed a total asset test of $2,000,000. Thus, the bill would make the reporting, proxy solicitation, insider trading and margin requirements contained in the Exchange Act for securities registered on national security exchanges applicable to every unlisted issuer whose total assets exceed $2,000,000 (provided the issuer is engaged in interstate commerce or its securities are traded by use of the mails or any means of interstate commerce) with respect to each class of its equity securities held of record by more than 750 persons. The bill would also apply these requirements to debt securities which have been registered under the Securities Act of 1933 where the principal amount of the class exceeds $1,000,000.

Registration of unlisted securities would automatically terminate 90 days after the issuer certifies to the Commission that 1) the total assets of the issuer have been reduced to less than $1,000,000, or 2) the holders of the class of equity securities number less than 500 persons, or 3) the outstanding principal amount of the class of debt securities has been reduced to less than $1,000,000. The Commission is

also given authority to enter an order terminating the registration of any security, either upon application or upon its own motion, after notice and hearing, if it finds that continued registration is not necessary in the public interest or for the protection of investors, by reason of the small number of public investors, lack of trading interest, inactivity of the issuer or the small amount of the public investment as measured by the market value of the security.

The statutory test for inclusion of equity securities under the bill is 750 record holders. This is a simple, certain and easily applied standard, and in order to avoid the possibility of confusion where the number of record holders might fluctuate above and below 750, the bill provides for continued registration until the number of record holders drops to less than 500 persons.

In addition to the three standards for exemption - the $2,000,000 total asset test, the $1,000,000 principal amount of any class of debt securities test, and 750 equity security holders test - the bill also exempts from its purview the securities of certain specific types of companies, such as registered investment companies, banks, insurance companies, charitable organizations, savings and loan associations and similar institutions.

In view of the purpose of the Fulbright bill to require registration of unlisted securities in which there is substantial public interest, certain provisions of the Exchange Act dealing with unlisted trading privileges on the exchanges are revised, for the reason that most of the issues now admitted to unlisted trading privileges would be required to register under the bill. The extension of unlisted trading privileges is limited to those securities which are duly listed and registered on another national securities exchange and unlisted trading privileges shall continue only so long as the security remains listed on another exchange. Unlisted trading privileges of securities which had been admitted to exchanges prior to the effective date of the act may continue. The Commission is authorized to terminate or to suspend unlisted privileges, after notice and hearing, where it finds that termination or suspension is necessary in the public interest or for the protection of investors by reason of inadequate public distribution of such security in the vicinity of the exchange or inadequate public trading activity or the character of the trading.

The bill would also make the provisions of the Exchange Act relating to margin requirements and restrictions on borrowings and extensions of credit applicable to the unlisted securities covered by the bill. The anomalous situation that is created by different credit regulations for listed and unlisted securities whereby an investor may

not borrow any funds on unlisted securities from a broker or dealer but may borrow on unlisted securities from a bank would be eliminated.

Finally, the bill authorizes the Commission to suspend trading in any security covered by its registration provisions if the Commission finds, after notice and hearing, that the issuer of such security has failed to comply with the provisions of the Exchange Act or the rules of the Commission. In the event that trading is suspended, the bill specifically makes it unlawful for brokers or dealers to effect transactions in such securities.

The Commission estimates that approximately 1500 to 2000 companies will be affected if the bill is enacted in its present form. It is unnecessary to tell you, who make your livelihood as traders in securities and who, therefore, have an informed opinion on the impact which this legislation might have on the companies and the capital and trading markets affected, that the problems raised by this legislation are complex. The following are some of the problems that have been discussed in this connection:

1) It has been suggested that if small businesses are required to publish and circulate financial reports periodically and to disclose the internal aspects of their operations - such as their current inventories - their competitive positions would be undermined.

2) It has been claimed that an additional and onerous financial burden on small companies, in the form of increased costs for accounting and legal services and record keeping, would be imposed.

3) The bill also raises intricate problems respecting its effect on the sponsorship by dealers of locally traded issues. Such dealers may not only have participated in the original distribution of an issue and be active as broker or principal in making or creating a market in the securities, but they may also be represented on the board of directors of the issuer. If the restrictions against short swing trading in such securities were imposed on these dealers, the maintenance of an orderly market in the securities might be adversely affected to the detriment of the public stockholders.

4) A substantial increase in the annual appropriation for the Securities and Exchange Commission would be

required to administer the bill. The Commission has conservatively estimated that the cost would amount to at least $500,000 annually.

The soundness of the basic principle of requiring companies in which there exists substantial public investor interest to disclose fully, fairly and accurately the material facts about its activities cannot reasonably be disputed. However, the Commission believes that before the Congress decides whether to extend the jurisdiction of the Commission over the vast and important area represented by the over-the-counter market, an objective factual study of the unlisted companies to be affected by the bill should first be made. The Commission is presently conducting such a survey, which it plans to complete before the Congress reconvenes in January 1956, to determine, among other things:

1) The identity of the companies that would be required to register;

2) The type of financial reports which these companies make public or furnish to their security holders;

3) The type of proxy materials employed, and soliciting procedures followed, by such companies;

4) The extent and nature of insider trading in the securities of such companies;

5) The effect of sponsorship of the securities of such companies by brokers and dealers who are also directors of such companies; and

6) The effect of periodic, financial reporting and disclosure requirements on the competitive position of small businesses.

A reliable and informed judgment on the merits of the bill and whether it constitutes necessary curative legislation to close the existing gap between the type of protection that the Securities Exchange Act affords the stockholders in listed and unlisted securities, is predicated upon the collection and evaluation of this type of information. In this strenuous market period, when trading activity is so high and the volume of new financings is so large, the utmost vigilance of the Commission to protect the public investors by requiring full, fair and adequate disclosure is expected by the public, and the Commission is determined to enforce strictly and aggressively, all of the laws under its jurisdiction.

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