REMARKS OF RICHARD B. SMITH, COMMISSIONER,
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"Developments and Problems in Securities Regulation"

At the outset I thank the Education Committee for letting me join you here. The Institute, like the B School or the War College or the ALI, was never a place I could have imagined myself attaining. That, I suppose, is my own kind of tribute to the Institute's reputation. In any case, I truly compliment you for having been selected to attend on the basis of your own past achievements and potential for future leadership.

Need for Generalists

Clearly, the continued development of professional skills and management leadership in the securities business is necessary for our system of public capitalism. Fortunately, the industry has been graced with an increasing number of capable, vigorous men who see the changes occurring in our economy and in our society and in their own world of finance. They are seeking ways to channel those changes on to the most constructive course for the country.

Unfortunately, and perhaps this is inevitable, there are nevertheless still some who would prefer to keep a key-hole view of their role. This attitude can be expressed in a variety of ways:

-- as a registered representative with a lack of concern or interest in the necessary mechanics for the timely consummation of the whole transaction.

-- as a firm manager who can somehow adopt, and adapt to, the most modern systems for making securities sales. At the same time he accepts antiquated procedures for securities processing, somehow feeling it is really not his problem and only a bookkeeper's job at best.

-- as a principal in the securities business who looks at the capital requirements of other industries in terms of years, and demands of issuers long-range budgeting and capital planning, but still sees his own business and industry in terms of short-term horizons and capital.

-- as a market maker who enters the sheets on securities of a company where there is no public information on its business, income, assets or management, without considering how this compromises the quality of all the markets.

-- as an underwriter who can create the most imaginative financings for businesses in the mainstream of our economy, and not feel in himself the relevance and need for uses of private capital in the inner cities where it is in all our interest to rebuild and bring employment.

As I look at the curriculum here it seems to me that the Institute's effort is to lead the coming leaders of the securities industry away from the excuses of specialization to a more comprehensive understanding and involvement. That is certainly to the good. I applaud it and earnestly hope that you will take the message of generalization to heart -- not the easy generalizations that come from only half-thinking and unconcern, but a developed generalized perspective based on a thoughtful awareness of our whole economy and society that leads to constructive actions. For if we all keep on our particular blinders, we shall not be able to see any problem, even in the industry, in its totality and consequently will not be able to develop a meaningful response. We shall be like the blind men and the elephant in the famous old Indian legend:

It was six men of Indostan
to learning much inclined,
Who went to see the Elephant
(though all of them were blind),
That each by observation
might satisfy his mind.

The First approached the Elephant,
and happening to fall
against his broad and sturdy side,
at once began to bawl:
"Bless me! but the Elephant
is very like a wall!"

The Second feeling of the tusk,
   cried, "Ho! what have we here,
So very round and smooth and sharp?
   "To me 'tis might clear
this wonder of an Elephant
   is very like a spear!"

The Third approached the animal,
   and happening to take
the squirming trunk within his hands,
   thus boldly up and spake:
"I see," quoth he, "the Elephant
   is very like a snake!"

The Fourth reached out his eager hand,
   and felt about the knee.
"What most this wondrous beast is like
   is mighty plain," quoth he;
"'Tis clear enough the Elephant
   is very like a tree!"

The Fifth who chanced to touch the ear,
   said, "E'en the blindest man
can tell what this resembles most;
   deny the fact who can,
"This marvel of an Elephant
   is very like a fan!"

The Sixth no sooner had begun
   about the beast to grope,
Than, seizing on the swinging tail
   that fell within his scope,
"I see," quoth he, "the Elephant
   is very like a rope!"

And so these men of Indostan
   disputed loud and long,
Each in his own opinion
   exceeding stiff and strong,
Though each was partly in the right,
   and all were in the wrong!

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Now this must seem like a very curious exercise to you, for an SEC Commissioner to come up to Philadelphia and recite a doggerel, particularly when he was asked to speak to you about "Developments and Problems in Securities Regulation." Well, I have taken this tack for a reason.

New Order of Problem

Significant developments and problems in the securities field over the last couple of years, it seems to me, are of a markedly different order from those with which we have traditionally been confronted. I think we must look at them with a realization that a broad range of new factors are at work that may call for new approaches and new preparation. I say "we" to mean both we at the Commission and you in the industry, because your problems, such as paperwork, seem inexorably to become our problems, just as ours, such as citizen complaints, tend to become yours.

It is true that a number of problems and developments today are not of a different order. Our concerns about the spate of excessive speculation and hot issues, about a possible pattern of manipulative distributions of securities of corporate shells, about recent unregistered distributions into the United States of Canadian mining companies, about going into the sheets and trading by the numbers, about improving and expediting our registration procedures and seeking better dissemination of corporate information filed with us, about interpositioning activities -- these are not essentially new phenomena. Even the widely heralded cases on insider trading, while undoubtedly important and marking further developments in the law, do not represent a different order of problem from those with which we have customarily had to deal. In any case I shall leave that subject to former Commissioner Whitney who will be addressing at least some of you on Friday.

But perhaps the deepest sounding developments in the securities markets today cut across our traditional legal niches, just as they cut across (or around or under) your traditional ways of handling matters. That is the different order I am talking about:

-- the pressure of market volume on the accepted system, or lack of system, for evidencing, transferring and recording ownership and transactions in securities.

-- the pressure of investment institutionalization on the structure of the securities business, the distribution of securities, the centralized auction markets and the historic commission rate structure.

-- the pressure of conglomerating takeovers on the structure of American industry, on the established companies you finance and the investors you advise.

-- the combined and related pressures of minority groups for access into the mainstream of the American economy and of inner cities for access to private capital investment.

These are developments that are unprecedented in their magnitude and for which you, we and the country have not in many respects been prepared. This is a time for meaningful dialogue between the financial community and the government as we consider the new phenomena and what it means to the country. It is a time for careful and candid thought, and not a time for a closed or narrow mind on anyone's part.

"Back-Office" Operations

Knowing that most of you are "production" men, nevertheless let me turn now to the pressure that market volume has brought on the industry, causing the net of difficulties that have been lumped together under the word "back-office" and have tended to be measured under the word "fails."

It is hardly necessary for me, with a group such as this, to dwell on the existence of the volume (despite the fall-off in recent weeks). Nevertheless, it might be worthwhile to recall a few of the statistics to your mind. It is estimated that there are now well more than 24 million individual investors who own corporate securities directly, compared with only about 6 million at the beginning of the 1950's. It is estimated that another

100 million today have an indirect ownership in such securities through financial intermediaries such as insurance companies, pension funds, bank-administered trusts and mutual funds. The securities markets thus have assumed a more formidable role in the husbanding of national savings than ever before.

The rising demand for securities on the part of both institutions and individuals has had its impact on the markets. Between 1963 and the end of 1967 the dollar value of securities listed on stock exchanges increased from $442 billion to $653 billion -- an increase of $211 billion in four years. At the same time share volume more than doubled -- from 1.9 billion in 1963 to 4.7 billion at the end of 1967, and the average daily volume has jumped from 4.6 million shares in 1963 to 10 million in 1967, and last year 13 million. The unanticipated nature of this increase may be seen from the fact that in 1962 the New York Stock Exchange estimated that volume approximating 8 million shares a day would not be reached until 1980. As you know, the Exchange had several days over 20 million shares during 1968. Increases on the American Stock Exchange and the over-the-counter markets have been at least comparable. As to new offerings, in the four fiscal years from 1964 to 1968, the number of registration statements made effective increased from 1100 to 2400 and the dollar volume of new offerings for cash rose from $15 billion to $37 billion.

Thus, the input has been enormous. But every system has to have its output and in the securities business the output for this purpose is the delivery of stock or bond certificates. Those deliveries must be preceded, accompanied and followed by an enormous amount of paper work, very little of which is standardized, that includes instructions to the broker or bank, stock powers and assignments, evidences of authority to sell, signatures of transfer agents and registrars, entries on blotters and ledgers, and recordings to customer accounts. And then there is the shuffling of papers from broker to broker, from broker to bank, from bank to bank, and then to the customer. And for the roughly one-third of transactions that are on margin, additional steps are required.

To a twentieth century systems engineer, all of this must seem incredible, particularly when he looks at the highly

automated devices that report the market, retrieve relevant financial information and transmit orders instantaneously. While I concede I am oversimplifying, it may not be unfair to characterize it as a twentieth century input system superimposed on an essentially eighteenth century tradition for evidencing and transferring ownership of securities and in many cases a nineteenth century method for keeping records.

The result should have been obvious, had the volume been anticipated. Corporate deliveries fell behind, stretching from the then four-day settlement date to five days, a month, three months, six months, and sometimes over a year for the more complicated items. Fails to deliver to brokers became a serious problem more than a year ago. Since that time it has remained in excess of $3 billion with a high of over $4 billion last December. Unacknowledged trades, or DK's, soared, and the books and records of some brokers fell behind in their posting, and account discrepancies developed between brokers and within firms. Transfer agents and registrars fell behind in processing certificates submitted to them. At the end of the pipeline, customers' accounts showed mistakes and they received certificates for securities they purchased months after the trade. It was grim.

The problem is still serious and still requires an enormous amount of determined effort. Suddenly, the back-office doesn't seem to be back-office anymore, but is emerging as the highly vital and important operation in the securities business that it must be. Much still remains to be done, but at least the problems are now breaking down to what appear to be manageable components. There are still some tender spots, and certainly the situation cannot be permitted to continue long.

The first problem of course was the volume of input. Control of this was sought by shortening trading hours and this undoubtedly served as a lid on what might have been runaway volume. It also gave more time for back offices to keep from falling further behind. Individual firms that were experiencing severe difficulties in processing their transactions were put on restriction by the NYSE or the Commission. Restrictions related to the number of trades they could execute, not opening any branch office or hiring new registered representatives, cutting off advertising, and the like. To get at the fails problem, net capital penalties and mandatory

buy-ins were imposed on aged fails. A nationwide broker-dealer inspection program by the Commission and stepped up inspections by the Exchanges and NASD were effected. Where net capital requirements were not being met, these were acted on promptly. An ad hoc committee was formed in New York, composed of representatives of the exchanges, brokers, market-makers and banks, to focus on quick-fixes on the mechanics of transfers. With respect to NYSE listed securities, the Central Certificate Service was hastened along; by this date substantially all the list is included. Shortly it is hoped CCS will begin including Amex securities and in time it will be extended to national over-the-counter securities. Other steps are being taken. An important one is the development of a uniform, computer-usable identification system for securities, and brokers and banks. The securities identification system, known as CUSIP, is now substantially completed. Hopefully a uniform numbering system for brokers, banks and transfer agents will follow. Work on a machine-processable stock certificate is proceeding, but here we are getting to the longer-range solutions.

One of the basic problems has been the absence of any clearing system for over-the-counter securities, where the principal fails problem lies. At the end of February the Commission sponsored a two-day meeting devoted to this problem. The NASD is now firmly committed to sponsor and develop such a clearing system. On the immediate level, Amex will be substantially expanding its clearing, through the National Over-the-Counter Clearing Corporation, of securities in the New York area trading market, to include both additional securities and non-member market makers. An inter-regional clearing, or at least comparing, arrangement for over-the-counter securities will be established between the Amex, Pacific Coast and Midwest Stock Exchanges. Ultimately, a national over-the-counter compared clearing system must be established, and probably one that will operate on a net-by-net basis, that is it will deal as principal with clearing house members netting all transactions daily and marking securities on which delivery is owed to the market.

For the long-term, the New York and American Stock Exchanges announced recently a broad, multi-level program looking toward fundamental changes in the way securities and related paper work are processed. They have commissioned the Rand Corporation, which specializes in long-range research on major

problems affecting the public interest, to conduct a feasibility study for the securities industry to determine how Rand can use its systems analysts and broad research capability to develop programs to improve the operations aspects of the securities business. The program would be aimed at restructuring the system by which securities transactions are processed and ownership is transferred. Depending upon Rand's initial findings the study is likely to take upwards of one year.

In addition, the Amex, with the cooperation of the NYSE, retained the North American Rockwell Corporation to analyze present operational systems and methods in order to implement more immediate changes which would be of a shorter range than those encompassed in the Rand study. Other projects of the Exchanges and the Association of Stock Exchange Firms are also under way.

These are all extremely important efforts which have the encouragement of the Commission. In the meantime of course we are required to keep a close watch on the situation, which remains serious. We are concerned not only with the level of fails but also with the apparent level of differences. Nevertheless, as Chairman Budge said in testimony before Congress, we "have great faith in the ability of the industry to solve its problems." That requires the full attention and focus of everyone in the industry, no matter how specialized his function.

Institutionalization

Let me turn now to another pressure, one that is a basic development in the securities markets and, for all appearances, is an irreversible one. That is the pressure of institutionalization of investment.

Over just the last decade, institutional participation in the ownership and trading in securities -- I emphasize both ownership and trading -- has grown enormously. The initially gradual and then increasing pace of institutionalization in the securities market is clearly the most significant development in the securities markets during this period.

Just to give you some sense of the enormity of this growth:

As recently as the end of 1957, private non-insured pension funds, the bulk bank administered, held approximately $7.5 billion in equity securities; in June 1968 they held $54 billion.

Mutual funds at the end of 1957 held a little less than $8 billion in equity securities; at the end of June 1968 they held approximately $46 billion.

Insurance companies (both life and casualty) held approximately $8.5 billion in equities at the end of 1957 and by June 1968, despite state laws limiting their ownership of equities, they had grown to about $25.5 billion.

Foundations and endowment funds held approximately $7.5 billion in equities at the end of 1957; by the end of June 1968 they held about $23.5 billion.

While the value of stocks outstanding increased from about $285 billion at the end of 1957 to about $730 billion at the end of June 1968, this is only about a 2-1/2 times increase. Pension funds increased in the same ten years about seven-fold, mutual funds six-fold, and the rest more than tripled. And the pace is accelerating -- insurance companies, for instance are now moving into the sale of variable annuities and mutual funds in a substantial way. That is potentially an additional 200,000 institutional securities salesmen; already there are about 20,000 life insurance salesmen registered or in the process of being registered as securities salesmen.

Rough calculations would indicate that today about one-third of the ownership of equities is in the hands of financial institutions. For a number of years now, individuals have been net sellers and institutions net buyers of equity securities. At the same time that this has been occurring, there has been a dwindling of new common stock issues from the financial programs of large American industrial companies. This has seemed to produce an apparently growing imbalance between institutionally created savings and appetites for equities, and the available supply of portfolio securities.

At the same time that institutional ownership has been increasing, it is apparent that institutional trading has been increasing even more -- at least in the last several years. It has been, again roughly, estimated that about fifty percent of the trading on the New York Stock Exchange is now done by institutions of various kinds.

The growing strength of the institutions, of course, is due to a number of developments. Many institutions, out of concern for inflation and for improving their comparative performance, have shifted from debt securities of various kinds, including mortgages, to investment in equities. Collective bargaining, and governmental as well as union and employer concern for treatment of those retired from our working population, have vastly increased the pay-ins to pension funds. State laws limiting fiduciary investment have been liberalized in recent years throughout the country. Because of the increasing complexity in making investment decisions in our technological economy, many individuals prefer to leave their investment decisions in the hands of professional managers who can both diversify risk and concentrate on the investment. So the causes of institutional growth appear to be many and varied. I am sure there are a number of factors I have not averted to.

The result in the marketplace from institutional investment has been a happy one in the sense that the massive demand has increased the general price level of equity securities substantially, but it has also produced some troublesome, or potentially troublesome, features.

Institutions are competing more aggressively with each other and competition often is in terms of performance. Some have felt this to mean short-term performance. The resulting high turnover ratios have contributed materially to keeping the securities markets boiling. The real significance or impact remains to be seen of large pools of capital engaged in essentially trading operations, and sometimes using highly speculative techniques.

The purchase or sale by one or more large institutions of a security of a company with a relatively small public float can dramatically and abruptly move the price of that security.

While the proportion of individual investors in the markets is diminishing, they are still numerous, and in absolute numbers have grown. What effect such large movements of capital into and out of particular securities has on the smaller individual investors who have been schooled to look for a "fair and orderly market" is a question of some moment.

As savings are collectivized (if you will forgive the word) into large funds, the number of investment decision makers with respect to the primary securities diminishes. And, since many of the large investment managers have equivalent access to information and expert analysis -- or should have, that is another timely subject not unrelated to institutionalization -- it is possible that investment decision making will become, or is becoming, more homogeneous and simultaneous. There are some, of course, who believe that institutions will protect themselves against this kind of a development by delegating investment management decisions to sub-units.

But the questions go beyond the impact on securities prices. The growing orientation towards equity or equity equivalent securities means that the savings have been diverted from some other channel such as investment in land, mortgages, insurance, government bonds, industrial debentures, savings accounts and so forth. The resultant reallocation of the nation's capital resources, and its effects, requires better understanding.

The impact of institutional investors has been felt on the organized securities auction markets. The enormous economic leverage which the institutions brought to bear on brokers enabled them partially to break down the exchange commission structure which had prevailed for some fifty years or more. By this time I am sure most of you are familiar with the now-banned practice of give-ups that had developed in the securities industry.

The pressure of the institutions on the use of commission dollars and on the level of commission rates for their large orders has also been accompanied by the efforts of some institutions to become direct members of the exchanges themselves. This, of course, would work a radical transformation

of the organization of the securities markets as we know them. The institutions have also to some extent sought executions off the exchanges on either a net basis with third market makers or directly among themselves.

There is another impact which institutionalization has produced which is indirect as to the markets but direct as to the corporate issuers of securities. That is the relationship between corporate managements and the institutional investors. The latter act as financial intermediaries to their ultimate shareholders or pension holders or whatever. Should the institutions be passive investors, in the sense that if they are dissatisfied with management they will simply sell securities or not buy securities of that particular issuer? For one thing, because of the increasing size of the positions being taken by the large institutions, the decision to sell may not be a simple one. Or should institutional investors be active shareholders and attempt to influence or control corporate managements? The role of institutions in certain takeover bids has to some extent already posed these questions.

The Commission, and the Congress, have reacted to these developments in three ways:

The mutual fund legislation introduced in early 1967 and reintroduced this year, was aimed at certain aspects of the developments. That legislation is still pending.

It was recognized that institutionalization implications went beyond and beneath the matters dealt with in the mutual fund bill. This led to the Congressional resolution introduced at the end of 1967 and adopted unanimously last July authorizing the Commission to conduct a study of institutional investors and their impact on the securities markets. Initial funding was appropriated later in the year and the Study is now being organized.

In mid-1968, largely because of apparent distortions resulting from the large institutional orders, the Commission instituted an investigatory hearing to consider brokerage commission rate structure problems. The hearings are continuing and in the meantime the exchanges have adopted an interim reduction in brokerage charges on the larger transactions and banned give-up practices.

And so institutionalization requires broad spectrum thinking by all of us because of its manifold effects in altering the patterns of investments and the markets.

Conglomerates and Takeovers

A third development of a different order is literally that -- a different order in our economy is being brought about through the process of conglomerate mergers and acquisitions. Some have claimed that this trend toward economic centralization could proceed so far as to place the production machinery of the country in the hands of a few hundred super-corporations. The Congress, the Justice Department, the Federal Trade Commission and other agencies are studying this matter in depth. At least until all the evidence is in, it would seem premature, to me, to lump all conglomerates together and say bad.

There is at least an analogy, and perhaps a correlation, between the institutionalization of investors and the conglomeration of corporations. There is certainly a time span coincidence between the concentration of investment decision-making into the hands of managers of larger and larger capital funds, and the concentration of capital allocation decision-making into the hands of managers of larger and larger conglomerates. At the same time that individual investors were purchasing diversification in mutual funds, they and the institutional investors were voting their approval of or accepting tender offers for diversification in conglomerates. During the period from 1960 to 1968 investment company assets grew by $46 billion and the assets of conglomerate companies grew by about $30 billion. The simultaneity of the developments is some indication that there may be underlying motivations in our society that have produced them both.

It may also be that the existence of large portfolio positions in institutional hands has facilitated the ability of conglomerates to acquire companies held in those portfolios. The current emphasis by institutions on short-term performance results probably does lead to a special receptivity on their part to the instant capital appreciation that the public tender offer techniques produce. But, while one observer described the conglomerate as a "mutual fund with smokestacks," I do not want to carry the analogy or correlation too far.

There is even an interesting definitional question with which we have been increasingly confronted. If a corporation falls within one of the technical definitions of an investment company in the 1940 Act it becomes subject to all the requirements of the 1940 Act, including its detailed provisions regulating capital structure. Where any corporation owns or proposes to acquire investment securities having a value exceeding forty percent of the value of its total assets, it may fall within the definitions. Particularly when a smaller company acquires securities of a larger company and is not controlling and directing the affairs of the target company, we are faced with the question whether this aspiring conglomerate has become an investment company. The question might be framed as whether the conglomerate has lost its smokestacks.

There is another statute administered by the Commission that can be kept in the back of your mind, and that is the most drastic financial legislation ever passed by the Congress -- the Public Utility Holding Company Act of 1935. The administration of that statute was the principal area of the Commission's work during the late 1930's and the 1940's. It involved simplification of the complex, watered and highly leveraged capital structures of public utility holding companies and integration of the public utility systems. The integration requirements led to the divestment of both geographically dispersed utility properties and of non-utility businesses that were not reasonably incidental or economically necessary or appropriate to the operations of the integrated utility system. I do not mean to suggest that contemporary conglomerates have brought us near this point, but only to indicate that if things do go far enough, the legislative remedy can be pretty drastic.

The Commission's contact with the current conglomerate phenomenon occurs today principally at three junctures.

The first occurs when a tender or exchange offer is made. If securities are being offered in exchange for those of a target company, the tenderor must file a registration statement under the Securities Act of 1933 which provides information not only about the tendering company but also the target company. Tenders may not be accepted until the Commission declares the registration statement effective. When only cash is being offered, the tendering company must immediately upon

announcing the tender offer file with the Commission an information statement under the 1968 takeover legislation. Under either procedure the news and detail of the impending takeover bid is likely to be sprung on the stockholders of the target company and the markets with trip-hammer suddenness. If one of the purposes of the securities legislation is to make the investment decision as rational a one as possible, it is difficult to imagine an atmosphere less conducive to rational thinking than the heat and haste generated by tender offers. Particularly where complex securities packages are being offered, the time generally provided for investors to reach a decision hardly seems sufficient. To cite an example of the sort of analytical problem facing the investor, a prospectus filed with the Commission by one conglomerate company contains a five page capitalization table, including detailed footnotes.

The Commission's second contact occurs during the period of a tender offer. Here we may, depending on the facts, become concerned about activities in the market, particularly if the tender is accompanied or preceded by market purchases of the securities of the target company by the tendering company or its associates.

The third occurs in the resulting financial statements of a conglomerate company, both in the accounting treatment given to the acquisition or merger and in the disclosure of income information with respect to the acquired business after the acquisition is consummated.

The accounting treatment problem relates to whether the companies are combined for accounting purposes through the "pooling-of-interests" method or the "purchase" method. If the former method is used, the financial statements of the two companies are, in substance, added together with no reflection in the accounts of any cost of acquisition, even where one of the pooled corporations is nine or ten times the size of the others. If the acquiring company has a higher price earnings ratio than the acquired company, the mathematical result is that the combined enterprise will show an increase in earnings per share. Unfortunately, the purchase method is not without its problems either. The amount paid for the target company is nearly always greater than the book value of its assets. The difference is treated in the accounts as goodwill,

and the problem becomes what to do with the often large intangible item. Accountants argue over whether goodwill can be left on the books forever, must be written off immediately against surplus, or must be amortized over some period of time. Some resolution of the accounting problems must be reached promptly, and resolved, I would hope, so not to give an artificial incentive to acquisitions.

The problem with regard to future disclosure of information about the acquired business is the subject of the Commission's proposed amendments to Forms S-1, S-7 and 10. The revised forms would provide investors with useful financial information about the important components of a conglomerate enterprise. Briefly stated, the proposed amended Forms would require diversified companies to disclose for each of a maximum of five fiscal years ending subsequent to December 31, 1966, the approximate amount or percentage of total sales and of contribution to operating income attributable to each line of business which contributed, during either of the last two fiscal years, ten percent or more to either sales or operating income. Similar disclosure is also required with respect to any line of business which resulted in a loss of ten percent or more of such income before deduction of losses. Where the number of lines of business exceeds ten, the disclosure may be limited to the ten most important lines.

The amended forms when adopted will thus provide investors with information about conglomerates needed to test the validity of an often cited reason for their creation, the theory of synergism. In its corporate context this theory implies that the total capabilities of a conglomerate exceed those of the sum of its constituent parts. The proposed forms are a step in the direction of providing information about the parts.

These accounting, disclosure and takeover impact questions, in which the Commission has a direct concern, are only a portion of the net of issues raised by the conglomerate phenomenon. Tax policy questions are also clearly involved, as well as antitrust, and there may even be broader questions of the ultimate direction of our society. But since the action is occurring now in the financial arena, it is a development in which you must realize your role and appreciate where it is leading, and ask yourselves is that the direction in which we want to go, or are these the means by which we want to get there.

Inner Cities and Private Capital

Now let me turn to another pressure of today on us, one that perhaps we still feel only obliquely, without relating what is to be read daily in the press to our own functions. It is one in which I hasten to point out the Commission has no direct regulatory role or authority. I speak to it here only as a citizen interested in the future of our country.

That is the need to involve minority groups more meaningfully in the processes of the private sector of our economy. And because minority groups are the principal inhabitants of our decaying inner cities and that decay affects all of us, it involves the need to bring private capital to bear massively on the massive job of rebuilding our cities and creating jobs for people living there. Public housing and permanent relief rolls certainly cannot be an acceptable answer. Disregarding the problem or refusing to face up to it is no answer at all. Yet we all are involved.

The bare facts are staggering. It is estimated that in 1970 ten percent, or 6.9 million housing units, will be substandard -- that is physically dilapidated -- and this does not reflect the overcrowding that exists in many such units. The national housing goal of a decent home and suitable living environment for every American family was reaffirmed in the Housing and Urban Development Act of 1968 with strong bi-partisan support. That Act measured our current housing needs as the construction and rehabilitation of 26 million housing units, six million of these for low and moderate income families. To create a "suitable living environment" also requires the provision of many ancillary services and facilities related to housing.

It is unquestioned that vastly more private capital must be attracted into residential investment and that any rebuilding of our cities will be a very long-term effort. Because the housing need is so great, the opportunity for imaginative financing should be equally great. I understand the 1968 Act, for example, allows investors to gain sizeable tax-shelter cash flows, which may suggest syndicating individuals in high brackets.

While the national unemployment rate is under four percent, this does not reflect the degree of unemployment in the urban ghettos where non-whites have the highest unemployment rates in the labor force. In 1967, nationwide more than 26 percent of non-white teenagers, more than double the white teenager rate, were recorded as unemployed. In particular ghettos the unemployment rates are considerably higher. The need for employment is so great, the imaginative private employer can surely find ways to utilize it. Experience has shown that the most efficient employer is, and the most efficient way to provide job training for the unemployed is through, private business.

Of course, providing private housing and jobs from outside the community is not the only way to get the job done. Helping private enterprises within the community to become organized, financed and managed is another and perhaps a more productive means. Indeed this is the route being urged, albeit not to the exclusion of others, by the newly created Office of Minority Enterprise in the Commerce Department. President Nixon and Secretary Stans in announcing the creation of this office said it would attempt to draw upon the resources of private industry, voluntary organizations and foundations to help minority group members become businessmen, "to foster the economic status and the pride of members of our minority groups", "to involve them more fully in our private enterprise system." The important new office will perform a coordinating function, to bring together the resources of those willing to assist, and an identification function, to locate the groups in need of development help.

The Investment Bankers Association some time ago formed an Inner City Business Committee. The purpose is to seek ways to bring financing expertise and funds to minority enterprises in the inner city. I hope all of you here will take an active interest and utilize the services of this existing committee of your association. If you, who are so equipped to understand the problem realistically and to help with it practically, do not, who will? Training and encouraging members of minority groups to become more involved in our private capital system can be done in many ways. As you know, a number of individual securities firms and banks have taken various steps of their own to promote housing, jobs and entrepreneurship in ghetto areas. Perhaps it is time for a more coordinated and larger effort.

I have no doubt that we at the Commission can do more than we have to help in this effort, and I hope that we shall

do so. We have amended our Conduct Regulations to permit our professional employees to participate in voluntary legal programs for the poor. We have proposed the adoption of a rule granting a conditional exemption to securities issued by local Washington, D.C. development companies from the registration requirements of the Securities Act of 1933. The purpose is to make more practicable the solicitation of equity participation by ghetto residents themselves in such companies. Our Washington Regional Office has been engaging in pre-filing conferences on Regulation A filings by local minority owned businesses. It is apparent from these and other contacts that competent financial advice is desperately needed to provide assistance and encouragment to such highly motivated people.

The kind of assistance that persons such as you can give to such an effort would serve to minimize risks to the investing public as well as to contribute to the accomplishment of a national objective. This is certainly one area where all our interests and faith in our capitalist ways can coincide.

Conclusion

Well, these seem to me to be some of the different order of developments today. Even the language is different: systems automation, institutionalization, conglomeration, inner cities. While they are highly significant developments in the industry the Commission regulates, the developments are difficult to fit within the frameworks of registration processing and antifraud enforcement, and in many respects do not fit at all.

Nevertheless, they require the thought of the best minds of all of us. It is difficult for me to see how one can become professional in your business without being able to take account of the significance of these broader developments. None of us can afford to be men from Indostan who choose to be blind to the world of change.

You're in a great business. Not because you make money at it, but because it has integrity and is essential to our country. I am asking you today to help make your business work well, professionally, and to help make it work for everyone -- everyone -- in the country.

Thank you.