

TWENTY-FIVE YEARS OF SECURITIES REGULATION

Address by

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before the

**Chamber of Commerce
of
Metropolitan Saint Louis**

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It is a great pleasure for me to address the Chamber of Commerce of Metropolitan St. Louis today. Perhaps many of you in your daily life are not too directly concerned with the administration of the Federal Securities Laws by the Securities and Exchange Commission. Nevertheless, I welcome this opportunity to discuss with you a few of the problems, some of the policies and programs of the Commission, and the importance of the success of our free enterprise system through the proper functioning of the capital markets in which I am certain you all have some very direct and primary interest.

May I say, parenthetically, that besides having the honor of appearing before this meeting today, it was my pleasure to open a new St. Louis Branch Office of the Securities and Exchange Commission in this thriving city. This office will be under the direct general jurisdiction of Mr. Thomas Hart, the SEC Chicago Regional Administrator, and three of his staff who will be stationed from now on in St. Louis. It is my sincere hope that those of you who have any concern with the problems of raising capital for your corporate employers or corporate clients, or have any problems arising under the various Securities Acts administered by the SEC, will make it a point to meet these members of our staff. Needless to say, the SEC is hopeful that we can be of as much assistance as possible to the investment banking business in this area as well as being always on the alert in the interest of protecting members of the investing public.

The establishment of a branch office in St. Louis is purely a matter of economics. As activities in the capital markets increase, there is a point in which we at the SEC determine that it will cost less taxpayers money to maintain an office in any particular community than it will cost to pay travel and per diem compensation, we then open a branch office. I think it is fair for you to assume from this that activity in the securities business in St. Louis has substantially increased to the point where we can afford to serve the industry more economically, efficiently, and promptly, by having a local office here rather than through our Regional Office in Chicago. This office is located in Room 1025, Arcade Building, 812 Olive Street. Mr. William Dean Goldsberry, Trial Attorney who will be in charge of this office, will be happy to discuss any of your problems with you during the hours from 8:45 a.m. to 5:15 p.m. daily.

The establishment of this branch office will not increase the over-all personnel requirements of the Chicago Regional Office but will permit the Commission to serve the public more efficiently in its investigative activity and its broker-dealer inspection program in this area.

Some of you have asked me how large the SEC is. We are a comparatively small agency, having in our fiscal 1959 budget 916 employees with a total budget of \$7,736,600. There are nine regional offices and eight branch offices spread out over the entire country and located in the largest cities. In the Chicago Regional Office, which covers the states of Illinois, Indiana, Iowa, Kansas City, Kentucky, Michigan, Minnesota, Missouri, Ohio, and Wisconsin, there are approximately 70 employees. On the other hand, in this large regional area there were 667 registered broker-dealers as of June 30, 1958, of which approximately 90 were in the St. Louis area. In addition, I am informed that there are 40 New York Stock Exchange member firms having offices in Missouri, of which 14 are home offices. Of these 40, 18 have offices here in St. Louis, of which 11 are home offices.

I might also point out that many years ago we had a branch office here in St. Louis but we were forced to give it up because of the reductions-in-force and the then restrictions in our budget. Furthermore, in those days capital market activities were on a much smaller scale than they are today.

I thought, in discussing briefly with you a few of the problems which are facing the agency today, it might be more interesting to you in better understanding the role which the Securities and Exchange Commission plays in the capital markets if I briefly review federal regulation in the securities markets. The first federal securities statute, the Securities Act of 1933, became law on May 27, 1933. Thus the capital markets have been subjected to federal regulation for 25 years. Let us look for a moment at the situation as it existed prior to the adoption of the 1933 Act.

History indicates that long prior to black Thursday in October 1929, when the stock market crash occurred, there were a great many rumblings and danger signs pointing out unsound economic policies and procedures. These were apparent to many and reform first began with the great utility study of the Federal Trade Commission, commenced in 1928 pursuant to Senate Resolution. This study has often been referred to as the most comprehensive investigation of any industry by any Congressional committee. The published works covered 101 volumes and the disclosures made therein detailed the heart of the market weakness, the water in the securities values, and the fundamental difficulties in the entire capital market process. These included inflationary write-ups of assets, acquisition of properties at grossly inflated prices, excessive issuance of debt securities allegedly secured by such over-valued properties and assets, and the general preoccupation

of management in financial maneuvering predicated essentially on upstreaming of subsidiary earnings to the top-heavy holding company parent to support excessive dividends necessary to maintain market acceptability of the holding company's securities rather than on creating sound operating companies. In addition, there were indications that a great deal of securities trading was the result of inside information, hot tips, or purely speculative "get-rich-quick" schemes. There was little or no disclosure of the basic financial facts and figures as to the companies whose securities were traded in the capital markets.

Perhaps it would interest you to know that, as of September 1, 1929, prior to the crash, the value of all stocks listed on the New York Stock Exchange totalled \$89 billion. In the days immediately following the break in the market, this value fell \$18 billion. By 1932, or some two and a half years later, the aggregate figure was down to \$15 billion, reflecting a total loss in such value of \$74 billion in this short period. In addition, there were equally significant losses in the bond markets and American investors had suffered similar substantial losses on investments in foreign securities. These figures alone emphasized the completely demoralized capital formation process in which investor confidence in the integrity and honesty of the capital markets had all but completely been destroyed. After the depths of the depression, few persons considered that equity securities, or even debt securities, were proper mediums of investment.

Into this demoralized picture came the 1933 Act, which had as its basic Congressional purpose the requirement that corporations seeking to raise capital through the issuance of new securities in the capital markets must make certain basic disclosure of the financial background facts of the corporation. This Act has often been described as the "truth in securities" act. The theory on which it was predicated is that disclosure of the company's financial background, its aims, and the purposes for which the company proposed to use the funds which it would acquire through the sale of its securities, so that potential buyers could inform themselves of these facts prior to their investing; to put it another way-- so that investors purchasing securities would be in a position to know whether the particular securities met their own investment needs. As a result, today, some 25 years after the enactment of this first legislation, we find very different conditions existing in the capital markets. Generally speaking, the evils of overstating assets are part of the past.

There is today a vast amount of financial and factual information about corporations filed under the various securities

acts. All of this information is being constantly analyzed by independent advisory services, brokers and investment bankers, and through them investors are being afforded the opportunity of deciding for themselves on the facts whether they wish to invest in the particular type of business, be it a "blue-chip" or a speculative, newly organized venture. Securities are thus continuously being studied either individually or by comparisons with other industries, and, in connection with particular financial investments, all sorts of analytical yardsticks are being employed by the financial community with the result that the securities markets are today in most cases predicated upon relatively realistic facts, analyzed in the clear light of day.

Perhaps at this point I should say that the Congress denied to the Commission the right to make any such "value" judgments or to pass upon the merits of the securities which are being offered through the registration process. The determination of these matters was, in my opinion, wisely left where it rightfully belonged--with the investing public. It is my fervent belief that such determinations must always stay right there, for I cannot see how our capitalistic system can properly relegate this duty of value appraisal of securities to the regulator and still call itself a nation with a free market economy.

May I say to you that in my judgment the 1933 Securities Act contributed substantially to the restoration of that faith and confidence in the integrity and honesty of the capital markets and that today these markets are functioning well. The results are most apparent. And, as emphasis, let me talk for a minute about figures.

In 1957 there were securities registered with our Commission for subsequent sale to public investors in a total dollar amount of \$16,031,000,000. This was some \$2 billion greater than the hitherto record high of 1956. On January 17 of this year, the largest day in the history of the registration process occurred when \$1,350,000,000 of securities were registered for resale. To be sure, this day included the A.T.&T. issue, but that was a successful nonunderwritten rights offering to its own stockholders and was not open to the general public. Let me compare for a moment these sizeable statistics to comparable ones in the European capitalistic countries.

In 1956 in England some \$400 million of companies securities were sold to public investors, and in Germany some \$640 million. You will note that these total amounts of securities sold in both countries were substantially less than the single A.T.&T. issue.

In the ten-year period from 1948 to 1957, expenditures for new plant and equipment totalled \$270 billion. Much of this was raised through internal sources such as retained earnings and the like; but, during this ten-year period, \$89 billion of securities were purchases by public investors. I might also point out that during the same ten-year period American corporations rewarded their stockholders by paying \$97 billion of dividends. You probably know that the new plant and equipment figure is considered by economists to be the high powered dollars because they are the dollars expended by corporations in expansion and in productivity, thus they are the funds from which jobs are made and payrolls maintained.

The fact that public investors have been willing to come forward with this kind of money for industrial expansion is a great tribute to our free economic system. But, in a very real sense one must always remember that it is absolutely essential that such new capital be available if our free institutions are going to meet the unprecedented demands of the cold war which our country has been and is today facing. As you reflect upon these figures, I think you will agree with me that the 1933 Act, with its basic disclosure philosophy, caused a reappraisal and a reacceptance by the public of the function and necessity of the capital markets as a medium through which corporations could raise sufficient funds so that they could produce the goods which have made our standard of living the highest in the world.

There is no question in my mind but that the investment banking business in general maintains a very high standard of integrity, honesty, decency, and of fair play. The 1933 Act, and the other five statutes which we administer, imposes standards of financial accounting and requires of management certain responsibility towards investors as shareholders or partners of the corporate wealth, all of which has resulted in better understanding by investors of corporate operations.

I wish I could report to you that all facets of the capital markets are in fine shape. Unfortunately, there is a fringe element in the industry engaged in high-pressure fraudulent selling practices by which unsophisticated and unsuspecting public investors have lost and are losing millions of dollars of their hard-earned savings. All of us should have great concern lest such tactics inevitably cause a lessening of investor confidence in the capital markets and a withdrawing from those markets by persons whose funds would otherwise be invested in legitimate productive enterprises.

While there is no question but that prompt and vigorous

enforcement action by the SEC has a deterrent affect upon the unscrupulous securities salesman, nevertheless, all too frequently the hapless, unsophisticated and unsuspecting investor--often a poor widow with a housefull of children--becomes the victim of a smooth-talking, fraudulently scheming salesman or promoter long before the Commission has even heard of the situation.

As an example of another type of a problem, I might also say that I have been told that there is a great deal of use in the Midwest of the intrastate exemption. The Congress, in formulating the Securities Act, did not require all securities to be registered but provided for certain exemptions from the registration requirements. In this intrastate area, it is my belief that the Congress intended to exempt only local financing by local businesses. Unfortunately, here too there have been abuses where companies from outside the State have tried to come within the definition of a local company and have attempted, in order to circumvent the disclosure requirements of the 1933 Act, to do a minimal amount of business within the States so as to sell their securities to residents of Missouri predicated upon an appeal to the civic pride of the State citizens. I think it might be wise for any one of you, if approached as a prospective purchaser of such intrastate securities, to consider whether in fact the company seeking to sell its securities is essentially a local one or whether the whole deal may be one designed to avoid the disclosures to which you would be entitled if the company were registered under the Securities Act. The intrastate exemption is one of limited scope and should be available only for purely local situations.

Your group and similar groups of public-spirited citizens throughout the country can be of great help to us in stamping out these economic parasites. As a preventative measure, each and every one of you, when you hear, through hearsay or otherwise, of such diabolical promotional schemes or programs, I would suggest that you get in touch with either this newly created branch office in St. Louis or with the Regional Office in Chicago, or with the SEC in Washington, D. C. I assure you that we will do our very best to stamp out such operators wherever we can find them.

May I also say to you that ever since its formation the Securities and Exchange Commission has carried on an educational program designed to inform or acquaint the investing public not only with the functions of the SEC in the capital markets but also, and perhaps of more importance, with the dangers and pitfalls of investing in "get-rich-quick" schemes promoted by complete strangers over the long distance telephone. Some of you may have seen a poster which the Commission has disseminated entitled "Investors Beware" and which has

has been displayed for some little time on public bulletin boards and post offices throughout America.

Again, in conclusion, I would like to say to you that it has been a great pleasure for me to have been able to address you today. I hope that I have been able to give you some kind of assurance that the principal objective of the Securities and Exchange Commission is to preserve a sound capital formation process so that corporations can continue to raise the sizeable amounts of needed capital from investors possessed of continued confidence and faith in the capital markets.