

THE S.E.C. AND A FREE SECURITIES MARKET

ADDRESS

of

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before the

ILLINOIS SECURITIES DEALERS ASSOCIATION

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Mr. Chairman, Ladies and Gentlemen:

It is a great pleasure for me to be here with you tonight. I am glad to have an opportunity, in this congenial atmosphere, to discuss with you some of the things we at the SEC have been thinking about. They concern matters of interest to all of us.

Being a mid-westerner myself, I feel quite at home here in Chicago, and therefore, I would like to talk very frankly to you this evening. If I may say a purely personal word, I trust that I came to the SEC with an open mind and with an objective approach. At least, to the best of my ability, I attempted to do so. Being only human, I took to it my own particular philosophy. As part and parcel of my personal background I have always believed, and I believe now, that in its contacts with commercial and economic matters the role of government is that of the disinterested and impartial umpire, and that the orderly conduct of any activity, whether it be in sports or in business, depends upon having a referee to insist upon compliance with the rules and to assess the penalties for infractions. That does not mean, however, that the referee should call the plays, or should carry the ball.

You all know of the SEC and its work. I want to talk with you, however, about some things you aren't able to get from releases, opinions, orders, prospectuses and registration statements. I do not lay claim to an intimate knowledge of these matters based upon any long connection with the agency, as I have been on the Commission for only about eight months. But I have picked up some thoughts that may be of interest to you.

Even at the danger of being too elementary, I think it is not inappropriate at this particular time for us to consider briefly the background of the federal securities laws. (You know that the Congress has declared that securities transactions have to be regulated to protect our national economy and to insure the maintenance of fair and honest markets in securities. This is now an accepted axiom in our economic thinking. While we may differ as to methods, I think it is safe to say that no one with any interest in the public welfare, or the securities industry, wants to go back to the bucket shop, the boiler room or what we in Kansas used to call the "pencil bandits".

If the investor is to put his savings into securities, he must be assured that reasonable standards of honesty and disclosure will be adhered to by those who are offering securities, and by those whose business it is to sell them. He must also know that once he has bought them, his investment will not be jeopardized by fraudulent or manipulative practices in the securities markets. These are objectives of the federal securities statutes.

The purposes of the Securities Act of 1933 are to provide full disclosure of the character of securities sold in interstate commerce and through the mails, and to prevent frauds in their sale. Disclosure is obtained through filing with the Commission registration statements which contain pertinent information concerning the issuer, the securities being offered, the use of the proceeds, the financial condition of the company, and other data necessary to arrive at an informed judgment whether to buy

the securities. The Act requires the delivery of a prospectus to investors to whom the securities are offered or sold. This prospectus must contain the important facts in the registration statement, including balance sheets and earnings statements.

It was never intended that the agency which administered the Securities Act should have power to substitute its judgment for the judgment of issuers, underwriters or dealers in determining whether an issue should be offered or sold. The presidential message recommending the legislation to the Congress said that the federal government should not take any action which might be construed as approving or guaranteeing that newly-issued securities are sound in the sense that their value will be maintained or that they will earn a profit. The Commission does not approve or disapprove securities. And, let me assure you that no one at the Commission wants the power to decide what securities may be offered or sold, or at what price.

The purposes of the Securities Exchange Act of 1934 are to prevent unfair, manipulative, and fraudulent practices in connection with trading in outstanding securities, to prevent the excessive use of credit in security trading, and to provide truthful and adequate information concerning securities listed and traded on national securities exchanges. This Act fills many of the gaps left by the Securities Act, and makes it possible to control practices which, unchecked, could devastate the securities markets.

Here again, the right of supervision given to the Commission by the Securities Exchange Act does not include the power to dictate business policy. Neither the Securities Act nor the Securities Exchange Act empowers the Commission to substitute its judgment for that of the industry. No one at the Commission wants this power.

It is my hope that the maintenance of the principles of full disclosure, and the attendant duties devolving upon exchanges, brokers, and dealers, will be sufficient to keep the securities business upon the high plane where it is, where it belongs, and where it must remain. I believe that adherence to these principles will achieve this purpose. All in all, these laws make possible the fulfillment of the aims of the legitimate dealer. I am quite sure that the Securities and Exchange Commission, and the members of its staff, feel exactly as I do. None of us wants to go any further than is necessary. All of us are anxious to see the success of the present scheme of things, with such changes as are inevitably required by experience and are in keeping with its spirit and purpose.

Under the Securities Act any security can be offered for sale if it is effectively registered and the whole truth is told about it. But filing a registration statement with the Commission does not get the information to prospective investors, or even to securities dealers -- as many of you have had an opportunity to learn. Not even the provisions which require the delivery of a prospectus assure purchasers that they will get the information before they buy. As you well know, it is common practice, after a registration statement is effective, to take the order by telephone and then deliver the prospectus with the confirmation.

After a registration statement is filed under the Securities Act you know there is a "waiting" or "cooling" period before it becomes effective. It was originally twenty days. This was to allow time for public scrutiny of the information in the statement. While interested persons may come to the Commission and examine the statement, or even get copies of it at nominal cost, it is obvious that this is not the practical answer to making the information generally available. Other ways of disseminating the information during the "waiting" or "cooling" period had to be found.

Shortly after the Securities Act was passed, inquiries were made about how far underwriters could go in circulating information about a proposed offering of securities before the registration statement was effective. Before the Act had reached its first birthday, the opinion was expressed that underwriters could circulate the offering circular itself if it were clearly marked to indicate that no offers to buy would be accepted until the registration statement became effective. This marking, in red ink, across the proposed form of prospectus gave it its name of "red-herring". The practice of using red-herring prospectuses under the Act developed as a result of this opinion.

In 1940 the Act was amended to give the Commission power to accelerate the effectiveness of registration statements, after considering, among other things, the adequacy of the information respecting the issuer previously available to the public, the public interest, and the protection of investors. You all know that the Commission follows a liberal policy in accelerating the effectiveness of registration statements to permit the prompt offering of securities after omitted information has been supplied, and necessary corrections have been made in the registration statement. This policy represents a practical compromise to reconcile the interests of investors, issuing companies, and underwriters.

It came to the attention of the Commission in 1945 that, in some instances, red-herrings were being circulated which were so incomplete that the deficiencies in them rendered them misleading. To correct this evil the Commission resorted to the policy of refusing acceleration of the effectiveness of registration statements, where materially deficient and misleading red-herrings were circulated, until the Commission received satisfactory assurance that corrected information had been sent to the persons who got the red-herring. Some underwriters have blamed the dwindling distribution of red-herrings on the adoption of this policy. They say they are reluctant to circulate red-herrings because they may be considered materially misleading, and thus delay acceleration of the effectiveness of their registration statements. But in all fairness it must be remembered that underwriters would never have such a problem if they fulfilled their primary obligation and filed well considered, accurate, and complete statements in the first instance.

We at the Commission have been working to find effective methods to accomplish the dissemination of information in Securities Act registration statements during the "waiting" period. I am sure that you are familiar, at least in a general way, with this effort. Many of you have sent in your comments and suggestions on various proposals which we submitted in the last few months. I can say that we found your help very valuable.

The problem was a difficult one. An effective solution must encourage the dissemination of such information without fostering the solicitation of offers to buy the securities before the registration statement is effective. It must set a practical standard of what information can be circulated by persons interested in the eventual sale of the securities; and they must be assured that circulation of such information will not be construed as an attempt to dispose of the security before the registration statement is effective.

On December 6, 1946, after studying the problem intensively and integrating the many valuable suggestions made, the Commission adopted Rule 131. This Rule provides that sending or giving any person, before the registration statement becomes effective, a copy of the proposed form of prospectus filed as part of the registration statement, shall not in itself constitute an attempt to dispose of the security in violation of the Act, if it contains a specified red-herring legend and substantially the information required by the Act and the rules and regulations. The offering price and certain other information dependent upon the offering price may be omitted. The copies containing the legend and information necessary may be sent out as soon as the registration statement is filed.

You will remember that under Section 8 (a) of the Securities Act the Commission, in determining whether to accelerate the effectiveness of a registration statement, is required to consider whether adequate information respecting the issuer has been available to the public. In considering requests for acceleration it will consider whether adequate dissemination has been made of copies of the proposed form of prospectus as permitted by the new Rule. What constitutes adequate dissemination must remain a question of fact in each case. However, it would involve as a minimum the distribution of copies, a reasonable time in advance of the anticipated effective date, to all underwriters and dealers who may be invited to participate in the distribution of the security. Any registrant or underwriter who wants to be sure that an adequate distribution of copies will be made, may, before distributing them, obtain an opinion from the Commission's staff as to the adequacy of the proposed distribution. Of course, the granting of acceleration will not be conditioned upon the distribution of copies in violation of Blue Sky Laws.

To be sure that the prospective purchaser does not make his decision to buy on the basis of misleading information, the Commission must retain the policy of refusing acceleration of effectiveness, where materially misleading information has been circulated, until corrected information has been sent to those persons receiving the misleading information. This will be no hazard, however, to issuers and underwriters who prepare their registration statements carefully.

The Rule was adopted for a trial period of six months. During this time its operation will be closely studied to determine whether it is accomplishing its purpose. You may be sure that if practical experience indicates that changes in the Rule are necessary to make it effective, the Commission will be ready and willing to make such changes.

The Commission feels sure that dealers will welcome this attempt to see that they receive copies of a form of prospectus containing substantially complete information a reasonable period of time before they may be asked to participate in the distribution of the security.

This brings us to the very important - perhaps I should say "all-important" - point of the relationship between the dealer and his customer, the investor. All of us know that if the objective of the Securities Act is to be attained, the information in a statutory prospectus should reach the prospective purchaser so that he can make an informed judgment as to whether he wants to buy. When I say reach him I mean more, of course, than simply getting it into his hands.

The dealer is frequently his financial confidant and guide. When the investor is wondering "is this security for me?" it is the dealer to whom he often turns for help in understanding the extensive data found in all prospectuses; to precipitate, from the many statements and figures, the answers to his questions. It may mean taking the prospectus page by page and explaining and simplifying wherever possible. The information he needs is nearly always there.

Issuers and underwriters, and their counsel, should try to state the facts in a prospectus so simply, and so concisely, that everybody can read and understand it without assistance. We, at the Commission, are doing what we can to make this possible. We have undertaken a program to simplify our forms. Our staff is always available for conferences with issuers and underwriters, before and after registration statements have been filed. We have repeatedly urged the use of a concise and readable document. Unfortunately, I'm afraid our efforts in this respect have not been generally successful. In practice, as you know, the prospectus is too frequently an almost complete copy of the text of the registration statement.

In the meantime, the investor frequently relies on the dealer's assistance. It is part of the dealer's professional responsibility to bring light and understanding to his customers whenever he can. It is more than just a responsibility; it is also an opportunity which, if fulfilled, will pay dividends. The customer expects more from his securities dealer than from the corner grocer. He wants more than the merchandise. He wants to feel that his dealer has taken the time to see his problem, to understand his questions, and to show him available information which will answer these questions. He expects from his dealer those intangible but important values which together constitute the service rendered by a professional.

It would be easier to ignore the fulfillment of these expectations if the customer bought merchandise which he consumed, or if he were a transient whom the dealer rarely expected to see again. But we know that the security is not consumed. Whether it appreciates or depreciates in value the customer always remembers where he bought it.

If the dealer's business is to have that solid foundation of good will on which every successful business rests, it must be earned by patient and intelligent assistance; and the customer's trust and confidence must be justified.

You in the industry are being constantly reminded by the exigencies of day to day business, that the success of the securities industry depends, in great part, on public confidence. The minimum standards for maintaining this confidence are contained in the principles of full disclosure and honest trading embodied in the federal statutes. They make it possible for the legitimate dealer to build a successful business and at the same time render service to the investor. These are fundamental requirements. The standards embodied in the statutes are the least that any of you would want to follow.

The legislative foundation on which these standards rest cannot be whittled away if the industry is to remain firm and strong and if we are to maintain a free market in America. There must always be an effective legislative sanction to make sure that the investor and the conforming majority in the industry are protected from the renegade few.

You may be certain that we at the SEC recognize the importance of integrating our effort with yours. We have a long-established practice of consulting with those who have an interest in the effective functioning of the Acts which we administer, and we always welcome your suggestions and comments on matters related in any way to the work of the Commission. Fortunately, nearly all underwriters, dealers, and brokers, realize that cooperation is the most effective way to achieve our common goals.

In what I have said this evening, I hope that I haven't given the impression that we think that the millennium has arrived, and that there is nothing left to be done to have a Utopia in financial circles. Of course, we at the SEC have no such illusions. We recognize that there are many particulars in which rules, regulations and practices can perhaps be improved. To that end, we constantly want to work. As I have mentioned, we have made changes within the last few weeks which we believe will be helpful. Just a week ago today we took what we hope is a long step forward in simplification of registration forms.

It has been suggested that changes should be made in some of the provisions of the statutes. Some of these suggestions have come from the industry while others have originated with us at the Commission. Day to day experience has taught us all many things about dealing with the situations which arise.

This much I think I can properly say - and I want to say it with all of the sincerity and conviction I can muster. The SEC is anxious to cooperate as fully as possible with the securities industry in an honest effort to canvas the situation and to reach solutions which will more fully accomplish the laudable purposes of the Securities Act and the Securities Exchange Act, and at the same time will make compliance with them as practicable and workable as can be done. I am happy to add that we have found those of the industry from whom we have heard, evidencing a desire to cooperate in that same spirit. That certainly seems to us to be a most auspicious omen, and from it should come a real measure of progress.

A free market is one of the most important aspects of our system of economy. If it is to remain free, two indispensable conditions must exist. First, investors and those who counsel them must continue to be able to obtain sufficient information to make an adequate appraisal of securities. Second, investors must be given assurance that the securities markets will not be manipulated to the detriment of the investor and to the illegitimate profit of a few unprincipled individuals.

The job of maintaining a free and honest market, in which the investor gets all the facts, will require the best efforts of all of us. Let us all work together to perform that task.