ADDRESS

of

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It has been said that SEC is extremely difficult to describe accurately or completely. However, this is a practical audience and the facts about the SEC are relatively easy to understand when discussed with persons familiar with problems of finance. It is true that if I attempted to give you a detailed survey of the Commission's activities you would be sitting here until long after dawn while I recited the details of many pages of laws and regulations. But while SEC has authority to deal with some very complicated matters the complications are largely legal and I shall attempt to give you the factual picture without going into too many legalistic obscurities.

We administer six laws -- the Securities Act, the Securities Exchange Act, the Maloney Amendment to the Securities Exchange Act, the Public Utility Holding Company Act, the Corporate Reorganization Act, and the Trust Indenture Act. From the standpoint of the non-lawyer these can be briefly described as laws directed towards four main purposes: 1) the assurance of fair disclosure of the material facts relating to new issues of securities offered to the public including the assurance of fair provisions in trust indentures; 2) the regulation of stock exchanges and over-the-counter markets so as to prevent the manipulation of security prices and consequent fraud on investors; 3) the establishment of fair standards in corporation reorganizations; and 4) the regulation of holding companies and holding company systems in the electric light and gas business. You will note that in no SEC legislation is there any authority to interfere with the actual operations or internal management of operating businesses as distinguished from finance. SEC regulates finance in one field - public utility holding companies - and advises concerning the proper financial structures of companies emerging from reorganization. However, even in those circumstances it does not attempt to tell business men what they may or may not do in connection with the every day operations of their enterprises. We are concerned solely with those financial evils which lead to burdens which business cannot successfully carry and by reason of which investors are unfairly deprived of their savings.

The Commission's Registration Division administers the Securities Act, the registration provisions of the Securities Exchange Act, and the qualification provisions of the Trust Indenture Act of 1939. As officers associated with industrial corporations which presumably are not public utility holding companies and are not in reorganization these are the statutes with which you are most likely to be concerned. The Securities Act requires fair disclosure of material facts to investors in connection with new offerings of securities through the mails or in interstate commerce. This disclosure is effected by means of the filing of a registration statement with the Commission which registration statement must include a prospectus containing in summarized form the material information respecting the issue. Forms have been prescribed for registration statements depending on type of the security, the type of financing, for example, sale for cash or reorganization, and upon whether the company has passed the promotional stage. The Securities Exchange Act, generally speaking, requires the filing of similar information (though in much briefer form) in the case of companies whose securities are traded in on stock exchanges. The Trust Indenture Act requires in substance that when a company offers to the public a bond, debenture or note issue of over $1,000,000 the securities involved must be issued pursuant to an indenture containing various

provisions designed to protect the purchasers of the issue. A Securities Act registration statement includes material which can be grouped under four main headings: 1) a discussion of the material facts relating to the business of the company, its history, including recent general developments, material contracts and patents and the litigation, if any, to which it may be subject; 2) a statement of the persons who control the company and the profits, if any, that they are deriving by virtue of their transactions with the company; 3) a statement of the terms pursuant to which the securities will be offered to the public, including of course the underwriting contracts and the profits obtainable by the underwriter; and 4) certain specified financial information. This financial information normally consists of a balance sheet as of a date within 90 days of the time when the registration statement is filed and profit and loss statements for the last three years. This financial information must be certified by independent public accountants. I assume that you will be most interested in developments in the rules relating to financial information. While I am not qualified to discuss technical points of accounting I may say that the work of the Commission in cooperation with your Institute and with the American Institute of Accountants and the American Accounting Association in developing uniform standards for accounting treatment in particular businesses has been in the opinion of the Commission one of the most significant features of its work to date. You will appreciate that in working out standards of disclosure to investors it is necessary not only that the investor know whether the particular company is a good or poor investment taken by itself but also as to how it compares with other companies in the same industry. The development of uniform financial standards tends greatly toward the achievement of this end. Along this line, the Commission has recently adopted Regulation S-X which establishes rules for financial statements to apply uniformly to seasoned companies under the Securities Act and the Securities Exchange Act.

I think you will be interested in the method whereby Securities Act registration statements are handled by the Registration Division. As persons associated with corporate management you will understand that although corporations may have their vicissitudes, officers may be false to their trust and business may decline but if the internal organization of the company is strong it will normally survive. So also with government. SEC places great reliance upon its internal administrative strength and upon the traditions of care and efficiency which govern the work done by the staff of the Commission. Our examination process is geared to intensive work under pressure. As you may know, a Securities Act registration statement becomes effective twenty days from the date of filing. Each registration statement is assigned in the first instance to an examining group consisting of several financial examiners, one or two attorneys and one or more accountants. The group is headed by a financial analyst who may or may not be an accountant or lawyer. The accountant, the examiners and the attorney assigned to the registration statement discuss the case together and then prepare separate memoranda on those features of the case which are within their respective provinces. When the examination of the statement is completed if the registrant has failed to answer any item of the form accurately or if additional information is needed, a memorandum consolidating the separate memoranda on the case is prepared under the supervision of the financial analyst and transmitted to an assistant director who if he believes any of the defficiencies are serious transmits a so-called

memorandum of deficiencies to the company. This is normally done within ten days after the registration statement is filed and the company is then given an opportunity to correct the deficiencies so that it may begin offering its securities when the twenty days are up. We have found that this deficiency letter procedure works much better from the standpoint of companies and investors than the other legal alternative which is to institute proceedings before the Commission to determine in public or private hearings whether the registration statement was in fact materially inadequate or misleading when filed. This stop order procedure is provided for by the Act but is confined largely to the cases of failure to disclose all the material implications of promotions or serious inadequacies or misstatements in the information furnished by more seasoned companies. It is difficult to outline in detail the types of matters we correct by the deficiency letter process but it is certain that these deficiencies frequently result in substantial amendments which benefit investors. The following examples are taken from the fifth annual report of the Commission:

"(1). The total assets shown on the balance sheet of a registrant engaged in manufacturing aggregated $776,826 of which $708,589 was shown under the caption 'Intangibles' in an account titled 'Development of Aviation Devices and Licenses.' An investigation of this intangible item disclosed that approximately $425,000 only had been expended by the registrant and its predecessor on such devices and licenses and that an attempt had been made to capitalize approximately $150,000 spent by the United States Government in the late 1920's, that is, long before the formation of the registrant's predecessor. Furthermore, an attempt had been made to capitalize approximately $130,000 which represented work orders given the registrant's predecessor by the United States Government. The propriety of capitalizing expenditures by others on devices similar to those of the registrant and of capitalizing orders for products was questioned, and, as a result, the registrant reduced its assets $250,000 by reducing the intangible account by such amount and at the same time decreased the amount of capital stock issued to its predecessor from 150,000 to 100,000 shares.

"(2). The registration statement filed by an oil and gas producing company included a report by an independent oil expert in which it was stated that the depreciation provisions in respect of intangible drilling costs were inadequate to amortize such costs over the useful life of the property. The income account reflected charges of approximately $186,000, $339,000, and $329,000 during the years 1936, 1937, and 1938, respectively, relating to property dismantled and retired and against which depreciation had not been provided. In a conference with the registrant's representatives and the independent oil expert, the latter indicated the rate which he considered would be adequate for the purpose of computing depreciation. As a result of this conference, the registrant amended its balance sheet and income statements to reflect an additional provision of $825,000 for depreciation. Of this amount, approximately $424,000 was charged to earned surplus as at the beginning of the 3-year period and approximately

$116,500, $131,000, and $144,000 was provided out of income for the years 1936, 1937, and 1938, respectively.

"(3). From an examination of the registration statement filed under the Securities Act of 1933 by a utility company, it appeared that the property accounts included an amount of $1,277,083.34, representing the discount on the sale to an affiliate of certain bonds which the registrant had issued to the affiliate for certain physical properties. The bonds had been redistributed by the affiliated company at the above-mentioned discount. There appeared to be no justification for carrying this discount in the property accounts and the registrant was so advised. The registrant amended its balance sheet to eliminate the amount involved from the property accounts and to charge off against earned surplus at the beginning of the three-year period, and against income for each of the three annual periods under review, a pro rata amount of the discount in question. The unamortized portion of the discount at the balance sheet date, namely $893,958.34, was shown as a separate item and appropriately captioned and classified on the amended balance sheet."

The question is frequently asked what the Securities Act has accomplished. I assume you are as familiar as I am with the various humorous comments that have been made respecting the difficulty of reading the prospectus in detail. At the same time registration requires information about a company which may have been hidden, confused or subdued and in some instances not appreciated by its own officers. Securities Act prospectuses afford the intelligent investor an opportunity for evaluating his investment and the presence of such investors provides a powerful check upon unrestrained actions of management. If anything should be attempted that is clearly wrong the management is likely to face either stockholder criticism or in the worst cases a stockholders suit. In addition, any information about a company which is adverse eventually finds its reflection in the market price of its securities either through the operation of financial services or through the study of the information relating to the company by investment bankers and other professionals in the securities business. Moreover, a great deal of investing is done today by investment trusts, insurance companies and persons of large resources whose funds are administered by investment counsel. These persons always study the information on file with the Commission with extreme care. Finally, and perhaps most important of all, companies acting with the knowledge that the information on file is going to be carefully studied do not desire to put the worst possible face before the world. They do not want to have to use balance sheets which would upon disclosure to the public show evidence of past misdeeds. Consequently the Securities Act has led to a good deal of what we might call corporate housecleaning. As officers of corporations who are interested in keeping house in the best possible way I am sure that you are in accord with this result.

Ancillary to the Securities Act is the Trust Indenture Act which is administered by the same groups under the same time schedule. This Act is designed to achieve several major purposes. In the first instance, the corporate trustee is required to be a real trustee for the bondholder's benefit

and may not get rid of any and every possible liability through so-called exculpatory clauses which previously appeared in substandard trust indentures. In addition, the indenture may not contain misleading or deceptive provisions; finally, machinery is provided for a close check on operations under the indenture, including compliance with its conditions and in the case of a bond issue, changes in the underlying security. Provisions of the last type should be of particular interest to corporate officers; in particular, the form of indenture required by the Act must contain provisions pursuant to which corporate officers (and they may well be comptrollers) must certify to the trustee under certain conditions with respect to compliance with the conditions of the indenture, such as preservation of specified ratios, the amount of net quick assets, interest coverage, etc. Such certificates are also required in some instances with respect to the value of property released from the security of the indenture and the value of property received in substitution therefor. In addition, if the company acts as paying agent it will be the company's duty to furnish to the trustee lists of the bondholders and by whatever means are legally effective to segregate the funds to be paid from the general funds of the company. The company will also have to furnish the trustee with reports similar to those filed on Form 10-K for transmission to bondholders.

The Trust Indenture Act is closely related to the Securities Act in that it requires disclosure of the major features of the indenture in an analysis to be contained in the Securities Act prospectus. It is our hope that the analyses will eventually become brief and informative despite the complicated nature of the problem. In the event that registrants do not analyze the indenture adequately the Commission has the power to require the inclusion of a supplementary analysis. So far this power has not been used and I hope that its use will be rendered unnecessary through the maintenance of high standards in indentures and clear description of their provisions.

These are two of the SEC statutes. The spirit of administration of other laws entrusted to the Commission is similar for all our Divisions are but servants of a Commission which my observations lead me to believe is activated by a very reasonable approach to the public interest. Of course, SEC is an administrative agency and there has been a great deal of uninformed fear of so-called administrative "bureaucracy". You gentlemen know, nevertheless, that the financial field is one where fraud must be avoided if investors are to regain their confidence in industry. Improper disclosure of the effects of lax corporation laws and low ethical standards merely eliminate sources of capital. SEC's job is largely to see to it that these evils when they are present appear in the full light of day. In cases where they are not present, I know that the Commission will continue to receive the cooperation of management so that honest business will be honest with the public.

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