April 12, 1939

The President
The White House

My dear Mr. President:

You recently asked that before I left my post as Chairman of the Securities and Exchange Commission I give you my views on the statutes administered by the Commission. I am very happy to do so.

First, as to the Public Utility Holding Company Act of 1938. Over the years minor amendments may be desirable in light of administrative experience. But in my opinion none is now necessary. The statute has proven to be marketable and sound. Substantial progress has already been made under it. There is still some desire in the industry to alter the provisions of the "death sentence", particularly Section 11(b)(2). Any such attempt should be vigorously opposed. That section is soundly conceived. It is practical and workable. When fully executed it will provide a large degree of decentralization in the utility industry and cause a return of that industry from Wall Street to Main Street.

Second, as to the Securities Act of 1933. The issuance of over fifteen billion in securities issues through the machinery of this statute is ample evidence that that machinery is neither inoperable nor excessively burdensome. Stoppage of at least a quarter of a billion dollars of fraudulent issues demonstrates its protection to investors. The importance of this statute in requiring the full truth about securities when they are first offered to the public is so great that changes in it along the lines proposed by Wall Street would not be constructive. Rather, they would be disastrous to investor safety and confidence. The earlier 1934 amendments, in my opinion, did more than eliminate ambiguities and uncertainties. They substantially weakened the statute. At some time in the future there doubtless are improvements which can be made in the Securities Act of 1933. But these are minor in character. Under no stretch of the imagination could they be called substantial nor placed on any list of items for a recovery program. In my opinion, representations that amendments to the Securities Act would facilitate recovery are misleading.

Third, as to the Securities Exchange Act of 1934. Section 9 of this statute has proven effective in ridding our securities markets of various forms of manipulation. It should not be altered by even a comma. The protections in Section 18 against trading by corporate insiders have likewise been effective. It should not be altered in any respect whatsoever. Although artificial stimulants to market activity have thus been eliminated, regulation has not interfered with the free play of the forces of supply and demand. Experience with this statute over a period of five years shows a combination of sufficient flexibility for the needs of finance and adequate safeguards for the protection of investors, so that there is no need for alteration of any of its provisions. Recent proposals of the Hancock Committee (attached hereto as Exhibit A) would weaken the statute beyond repair, as indicated in my statements made on March 18, 1939, which I attach as Exhibits B and C. Any such proposal having the purpose or effect of permitting the professionals or the insiders to have another "party" would be fatal from the viewpoint of investors.

On only three points would I qualify the foregoing comments. First, I believe that eventually it should be possible to merge or consolidate the various registration or reporting requirements of the three Acts to the end that information filed by a corporation under one statute would serve the purposes of all three statutes. This, however, is a technical task for legal draftsmen at some future time in a different climate of opinion.

Second, experience has shown that there is an area in stock exchange administration which can neither be effectively governed by self-discipline nor by the statute, as it now stands. I refer to matters of exchange discipline over their most powerful members. You will recall that during the course of our investigation of the failure of Richard Whitney, testimony was presented indicating that although certain members know, substantially in advance, of Richard Whitney's defalestion, they took no steps to inform either the authorities or the Exchange of the situation. The Securities Exchange Act did not give the Securities and Exchange Commission authority to discipline such members for such conduct. It was therefore determined to refer the matter to the New York Stock Exchange as had been the practice in other comparable situations. The letter of reference is attached hereto as Exhibit D. But the management of the New York Stock Exchange was unable or unwilling to take any action. Their letter is attached hereto as Exhibit E. Their failure to act resulted in the resignation of Robert E. Hutchins, one of the "public" governors of the New York Stock Exchange. His resignation was in protest against the failure of the Exchange to take any action in that case. After his resignation and on January 28, 1939, he wrote me as follows:

> "It is my considered opinion that the real reason for the inaction of the Stock Exchange was that influential and important people were involved in this case. Under the constitution as it was at the time of the incident the persons, among others, who might be disciplined were J.P. Morgan and Julius Morgan, who held the seats for J.P. Morgan and Company. No member of the Board of Governors was willing to 'lay his head on the chopping block' by raising questions about J.P. Morgan and Company and similar influences in the street. This result means to me inherent in the situation. No private voluntary organization can ever discipline the "big man" among its membership. Some outside impartial agency has to do that. The contradiction involved in the present status of the Stock Exchange is that it appears before the public as a public institution, but actually on issues like this conducts itself as a private organization, subject to all the handicaps of such an organization. In cases like the Sisto case the Exchange will be vigorous and decisive. In cases like the Whitney case it will do nothing at all."

I agree with his diagnosis. It has been verified by us from independent sources. It seems clear, therefore, that the law should be amended so as to give to the Securities and

Exchange Commission authority to act in such cases and to take off the hands of the stock exchanges cases which they have found “to hot to handle”. Otherwise, there will be no assurances that discipline will be acted out equally and fairly, regardless of the social or financial importance of the members in question.

In the third place there is the problem of margin trading. It is my opinion that regulation of margin trading should not be weakened. There are some who persist in thinking that lightening of those requirements would aid the markets. I am confident of one thing and that is that such lessening of regulation would not aid the investors. In fact it is my belief that margin trading should be abolished.

These are personal opinions of mine based on my experience with and observations of the statutes which this Commission administers. I speak only for myself, not for the Commission.

To point out the work of the Commission in the field of finance it seems to me that at least three additional measures are needed.

The first in the Trust Indenture Bill designed to eliminate material conflicts of interest from corporate trustees and to make such trustees more active in protection of the interests of security holders.

The second relates to investment trusts, reports on which have been going up to the Congress from the Commission since last fall. This has been one of the most careful and painstaking studies which the Commission has undertaken. The investment trust, at least in the form in which it is organized, has been one of the most defective and dangerous instrumentalities for investors which the 1920’s produced. Drastic legislation is needed if the investment trust is to be preserved at all.

The third involves an extension to issuers of securities traded over-the-counter of the same regulation which issuers of securities registered on stock exchanges presently enjoy. The same reason which make the stock exchange regulation necessary and desirable from the point of view of investors obtains equally in the over-the-counter field. Furthermore, such regulation would equalize the competitive conditions existing between the stock exchanges and the over-the-counter brokers and dealers. Equalization should be obtained in that way, certainly not through masculation of the Securities Exchange Act as proposed by the Hancock Committee.

This program would, as I have indicated, help to round out the work of the Commission in the field of finance and would still keep it within permissible size limits.

Along the lines of our conversation, I am sending copies of this letter to Hon. Robert F. Wagner and Hon. Sam Rayburn, in view of their deep interest in these regulatory measures.

Yours faithfully,

William G. Douglas,
Chairman

Douglas bk