

History of the Securities and Exchange Commission
Draft

Bernard Wexler
August 3, 1975

QUESTION 1

Furnish a brief history of the Commission, including specific references to organic acts and amendments. Highlight major events which have changed the Commission's interpretation of its original mandate.

TABLE OF CONTENTS

I. SUMMARY

II. LIST OF CHARTS OR TABLES.

III. LIST OF ATTACHMENTS

IV. TEXT OF RESPONSE

A. Introduction

B. The Formative Years -- 1933-1940

1. The Securities Act of 1933
2. The Securities Exchange Act of 1934
3. The Public Utility Holding Company Act of 1935
4. Chapter X of the Bankruptcy Act
5. The Trust Indenture Act of 1939
6. The "Maloney Act": Section 15A of the Exchange Act
7. The Investment Company Act of 1940
8. The Investment Advisers Act of 1940
9. Early Development

C. Twenty Years in the Shadows - The Forties and the Fifties

D. The Shadows Lift a Little -- The Late 1950s

E. Something of a Renaissance -- The 1960's

F. The Seventies So Far

G. A Concluding Note

I. SUMMARY

The following discussion describes the history of the Securities and Exchange Commission from its inception on July 2, 1934 to the present. Although all of the statutes which the Commission administers were in place within the first six years of the Agency's existence, the discussion describes significant events throughout the history of the Commission, which observed its 40th anniversary in 1974.

II. LIST OF CHARTS OR TABLES

Not Applicable.

III. LIST OF ATTACHMENTS

Not Applicable

IV. TEXT OF RESPONSE

A. Introduction

Like other human institutions, the Securities and Exchange Commission is the product of history. Such seeming anomalies as the Commission's almost obsessive concern with the flotation of new issues and its extensive involvement with electricity and gas (areas of the economy not normally thought of as primarily financial) become intelligible when viewed in their historical context. Antiquarians can trace the roots of the modern American system of securities regulation back to the common law, to the South Sea Bubble of 1720 and to certain early English statutes. To come down to more recent times, the subjects with which the Commission is preoccupied were of concern to many students and thinkers at the close of the nineteenth century and figured fairly prominently -- albeit with very little in the way of concrete results -- during the Progressive Era from the turn of the century down to the entry of the United States into the First World War.

B. The Formative Years -- 1933 to 1940

But all this is a bit remote. The Securities and Exchange Commission is really a child of the Great Depression. The Commission and the experiences that shaped it and its folkways were those of the late 1920's and the early 1930's. The buoyant securities markets of the 1920's and the free and easy standards prevalent in them engendered a flood of new stocks and bonds. Under the stresses and strains of the Great Depression many of these "securities" turned out to be "insecurities." The heavy investor losses that resulted led to a cry for action.

1. The Securities Act of 1933

That cry was answered by the Securities Act of 1933, one of the earliest New Deal statutes and the first of the federal securities laws. It was a conservative and a moderate enactment. Regulatory control over the investment process was rejected. The emphasis was on the “glaring light of publicity.” The theory of the statute was -- and is -- that wise public policy can safely leave savers and investors to make their own decisions but that it must see to it that they have the information needed for rational decision-making. The Act, which was during its first year administered by the Federal Trade Commission, is essentially a disclosure statute. Its primary effect is on the initial distribution of securities. Its purpose is to provide purchasers of securities being offered by issuers, by their controlling persons and by underwriters with information material to informed investment decisions.

To achieve that objective, it imposes the following requirements with respect to most such offerings:

1. The securities cannot be offered to the public until a registration statement has been filed with the Commission setting forth the information with respect to the issuer, the nature of the security offered, and the terms of the offering called for by the Securities Act and by the forms that the Commission is authorized to promulgate under that statute;
2. The securities cannot be sold to the public until a registration statement has become effective; and
3. A prospectus containing the basic information in the registration statement must be delivered to each purchaser.

The Securities Act’s antifraud provisions prohibit fraudulent or deceptive statements in the offer or sale of securities even if the offering is exempt from registration. Violations of the Securities Act may give rise to civil, and if willful, to criminal liabilities. The Commission may also take administrative action by suspending the effectiveness of materially deficient registration statements. An order that does that is called a “stop order.” A stop order brings offers and sales of the registered security to a halt until the filing has been amended so as to conform with the Securities Act’s disclosure requirements. At that time the stop order must be lifted and the registration statement declared effective. The key point to note is that the Commission has no power to approve or disapprove any security or to pass on its merits.

The impact of the Securities Act on most issuers of securities is irregular. They do not come into contact with the Securities Act until they wish to raise additional capital by selling new securities to the public or unless their controlling persons wish to distribute some or all of their holdings of outstanding securities to the public. Registration

statements under the Securities Act relate to specific offerings. After the offering is over, the Securities Act itself makes no provision for keeping the disclosure filing up to date.

2. The Securities Exchange Act of 1934

But most investors do not buy new issues. The traffic in already outstanding securities involves far larger amounts of money and an infinitely greater number of people than does the traffic in new issues, a commerce that had by 1933 dwindled almost to the vanishing point. It was obvious that the Securities Act's sporadic and wholly disclosure-oriented controls had to be supplemented by something more pervasive, geared to trading rather than to initial distribution. While the Securities Act was wending its way through Congress, and indeed before it had even been dreamt of, the Senate Committee on Banking and Currency was looking into malpractices in the trading markets. That investigation (commonly called the "Pecora Hearings") uncovered a wealth of material about manipulation, insider trading, breaches of fiduciary duty by the controlling persons of corporations and other strategically situated people who profited handsomely out of the financial distress of the companies that they dominated. It showed how these persons sold the stocks of their own companies short, concealed material information, and engaged in other malpractices. These hearings coupled with the legacy of ruin that the 1929-1933 collapse had left in its wake led to the enactment of the Securities Exchange Act in 1934, one year after the passage of the Securities Act.

To begin with, the Exchange Act created the Securities and Exchange Commission, took the Securities Act away from the Federal Trade Commission, and entrusted its administration to the newly-hatched SEC. But the Exchange Act did far, far more than that. It established administrative mechanisms to protect the public from dishonest or irresponsible brokers or dealers. It did that by requiring most securities brokers and dealers to register with the Commission and empowering the Commission to exclude persons and firms, subject to specified disqualifications, from most segments of the securities business and to take other remedial action against them. And it also gave the Commission broad supervisory authority over stock exchanges and over such exchange practices as short selling, the specialist system, floor trading and the use by brokers of customers' securities.

A system of continuous disclosures was also established. But that system affected only companies whose securities were listed on exchanges plus those that had sold substantial amounts of securities to the public under the Securities Act. On other issuers, the Exchange Act's continuing disclosure provisions had no direct impact.

The solicitation of proxies was also subjected to SEC control. And there were certain provisions governing trading in securities by companies' officers, directors and principal stockholders. But these controls applied only to companies with securities listed on

exchanges. Companies that had no securities listed on an exchange were not subject to either the proxy or the insider-trading provisions of the Exchange Act.

In addition, the Exchange Act:

1. Included general provisions outlawing fraud and manipulation in both the exchange and over-the-counter markets -- these ultimately proved of great import; and
2. Empowered the Board of Governors of the Federal Reserve System to limit the use of credit in security speculation and gave the SEC the task of enforcing those “margin rules.”

3. The Public Utility Holding Company Act of 1935

When the Commission was one year old, it was thrown into what later became an intimate involvement with the electric and gas utility industries. Utility companies had grown like Topsy during the 1920's. Most of the country's electric and gas utility properties had been gobbled up by holding company empires. In addition to controlling the country's supply of electrical and gas energy, these entities also lopped over into such diverse fields as coal mining, oil, foundries, textiles, agriculture, transportation, ice and cold storage, real estate, finance and credit, water, quarries, theaters, amusement parks and the New Orleans Baseball Company, Inc. Three super holding company empires, the Morgan-created United Corporation, the Electric Bond and Share Group and the Insull Interests, each of which sat atop a pyramid of subholding companies, controlled about half of the country's privately-owned electric utility industry. Twelve other large systems controlled an additional 35% of the electric utility industry. And in the gas utility industry, eleven systems controlled 80% of the total pipeline mileage.

Finance, which should be technology's servant, had become its master in this vital field where concentration of control was accompanied by the creation of unsound and top-heavy financial structures. Holding companies were pyramided on top of each other. And within each company there were pyramids of securities. These mountains of paper rested on the common stock of the operating companies. Because holding companies tended to borrow as heavily as possible, their securities were highly speculative. They were marked by “leverage,” “trading on the equity,” and “the lifting power of other people's money.” As a result of leverage, small changes in the earnings of the underlying companies had dramatically explosive effects on the earnings applicable to holding company securities. During the boom years up to 1929 book profits appeared huge.

But when the boom collapsed, leverage worked in reverse and many holding companies and their subsidiaries were forced to default on their obligations and to cease dividend payments to stockholders. The complex capital structures also afforded many opportunities for the manipulation of accounts and finances and for diverting profits or

losses through inter-company channels to the detriment of investors. Equally important was the way in which the corporate pyramids defeated or obstructed local regulation of operating companies.

The abuses resulting from the use of the holding company device in the electric power and retail gas industries led to enormous investor losses and to the neglect of consumer interests. The Public Utility Holding Company Act of 1935 sought to deal with these problems by:

1. Subjecting the holding companies to pervasive federal control;
2. Requiring each holding company to confine itself to a single integrated public utility system with provisions for the retention of additional utility systems and related incidental businesses under certain designated circumstances;
3. Providing for the simplification of holding company structures including the elimination of unnecessary holding companies and the reorganization of those that were unduly complicated and over-capitalized, and the redistribution of voting power among security holders of holding and operating companies so as to see to it that the investing public had a voice -- or at least a potential voice -- in these enterprises commensurate with its capital contributions to them; and
4. Halting the loading of excessive charges by holding companies or by their controlled service companies on the operating utility subsidiaries by requiring that all services performed by a holding company for any company in its system be rendered at cost fairly allocated.

At the time the primary tasks of holding company regulations were financial:

1. Those companies that had some real business purpose had to be rehabilitated and placed on a sound footing, and
2. The paper pyramids whose only *raison d'être* was financial manipulation and that were primarily directed toward generating securities for sale to the public rather than energy had to be dismantled and their assets distributed fairly and equitably among the parties in interest.

For that and for, other reasons, the administration of the Holding Company Act was entrusted to the SEC.

Important though the Commission's functions under that statute are, they are severely limited and do not go to what most people would consider the heart of public utility regulation. The SEC has no control over rates charged consumers. That vital sphere is left entirely to the Federal Power Commission and to the states' public service commissions.

The three statutes thus far discussed were given to the SEC to administer. And a generation later they are still there. Two of them were written before the Commission was born. Nor did the SEC have much to do with shaping the structure of the third, the Holding Company Act of 1935.

4. Chapter X of the Bankruptcy Act

In the later period to which we now come, the Commission had a most substantial impact on federal law. The first Commission-shaped statute was Chapter X of the Bankruptcy Act. That grew out of the Securities Exchange Act, which specifically directed the Commission to study the corporate reorganization process, a subject of vital public concern in the depression era. Under the direction of the future Mr. Justice Douglas, then a distinguished academic authority on insolvency law and practice, the Commission produced a massive study of the reorganization process that has come to be known as the Protective Committee Study. That 8-volume document brought to light multitudes of abuses, of which many people had been more or less aware in a general way, that were injurious to investors and incompatible with the public interest. Emphasis was placed on the fact that reorganization and protective committees, which were supposed to mobilize security holders for group action for their own best interests, were frequently formed, controlled and used by insiders to protect or further their own interests instead. These disclosures gave impetus to a reform of the National Bankruptcy Act in 1938 and to the enactment of the Trust Indenture Act in 1939. Representatives of the Commission assisted in drafting this legislation and testified before Congressional committees in its support.

The Commission's role under Chapter X is *sui generis*. Here it administers nothing. It enforces nothing. It lays down no commands.

What the Commission does under Chapter X is to act as disinterested expert adviser to the federal courts in a complex area of law and finance. In its work in this field the Commission has always paid special heed to the interests of the public investor. But the unique and demanding character of the Commission's task as adviser to the court precludes it from taking a "the public investor is always right" stance. Thus, for example, the Commission has always been a stalwart champion of the "fair and equitable" standard which requires that the contractual priorities of creditors be fully respected and that the claims of senior interests be satisfied in full before recognition is given to junior classes. That often hurts public investors who hold common stock or subordinated debt securities. But the Commission is constrained to place a higher value on fidelity to legal rules and to the standards that it deems most conducive to the healthy functioning of the enterprise system than on the interests of a specific group of investors in some concrete case -- appalling and appealing though the plight of these investors often is.

5. The Trust Indenture Act of 1939

The Trust Indenture Act of 1939, previously referred to, can be viewed as something of a companion to Chapter X, but it functions as an addendum to the Securities Act. Like Chapter X, the Trust Indenture Act grew out of the Protective Committee Study. It was designed to effectively safeguard the interests of the public investor who holds debt securities. The Act reaches that objective by requiring that most significant issues of debt securities be issued under a trust indenture that meets specific statutory standards. The Commission has no power to enforce the indenture's provisions. Its only function under this statute is to see to it that the trustee is eligible and qualified under the Act and that the provisions of each indenture filed conform to the statutory standards. The Act is based on the theory that, if the terms of the trust indenture provide adequate protection for investors, the enforcement of those terms can appropriately be left to the trustees and to the bondholders without continuing bureaucratic supervision.

6. The "Maloney Act": Section 15A of the Exchange Act

A large area in the over-the-counter segment of the securities business calls for ethical rather than legal rules. Many people in the securities business saw a need for some self-regulatory mechanism here akin to that provided by the exchanges. In the spirit of the industry codes and organizations under the National Recovery Act, that had been held unconstitutional when applied to industry at large, they thought "cooperative regulation" preferable to the bureaucratic elephantiasis that was its only conceivable alternative. The Commission agreed. Accordingly, the Congress amended the Exchange Act to authorize registration with the Commission of associations of securities dealers organized for the purpose of promoting just and equitable principles of trade. The statute that did this, having been sponsored by Senator Maloney of Connecticut, came to be known as the Maloney Act.

Only one association has ever registered under the Maloney Act. That is the National Association of Securities Dealers, Inc. ("NASD"). It is a non-profit corporation that has some of the attributes of a trade association. But the NASD is more than a mere trade association. It has crucial self-disciplinary functions of a sort normally associated with the professions rather than with business. Under pervasive Commission oversight, the NASD exercises what can be viewed as quasi-sovereign powers. Thus, to provide economic incentives for membership the Maloney Act modified the antitrust laws in various ways that make NASD membership an economic necessity for most persons who are in any way involved in the over-the-counter aspect of the securities business. Expulsion or suspension from the NASD has serious consequences. The NASD's broad powers have enabled it to do much to elevate standards in the securities business.

7. The Investment Company Act of 1940

1940 saw the enactment of two other statutes, both conceived by the Commission. The first was the Investment Company Act. That statute grew out of the Holding Company Act. Congress's consideration of financial malpractices in electricity and gas led to concern over the broader but intimately related problems presented by arrangements for pooling the resources of public investors with a view to investment in non-utility securities. Furthermore, the collapse of what we would now call highly leveraged closed-end investment companies was a particularly spectacular feature of the 1929 crash.

Accordingly, the Holding Company Act directed the Commission to make a study of the functions and activities of investment trusts and investment companies, the corporate structures and investment policies of such trusts and companies upon companies in which they are interested, and the influence exerted by interests affiliated with the management of such trusts and companies upon their investment policies, and to report the results of its study and its recommendations to the Congress.

Complying with that direction, the Commission made an exhaustive study of the then infant investment company industry. Its report, known as the "Investment Trust Study," found that to an alarming extent investment companies had been operated in the interests of their managers and to the detriment of investors. A high incidence of recklessness and improvidence was also noted. Insiders often viewed investment companies as sources of capital for business ventures of their own and as captive markets for unsalable securities that they, the insiders, wished to convert into cash. Controlling persons frequently took unfair advantage of the companies in other ways, often using broad exculpatory clauses to insulate them from liability for their wrongdoing. Outright larceny and embezzlement were not uncommon. Managers were able to buy investment company shares for less than net asset value, thus enriching themselves at the shareholders' expense.

In addition, reports to shareholders were often misleading and deceptive. Controlling positions in investment companies -- represented by special classes of stock or by advisory contracts -- were bought and sold without consent, or even the knowledge, of public shareholders. Basic investment policies were changed without shareholder approval. The advisory contracts themselves were often long-term and either noncancellable or cancellable only upon the payment of a substantial penalty by the company. Sales charges were as high as 20 percent. Management fees sometimes bore no relationship to any actual managerial services.

Because of extensive debt financing, fluctuations in the value of portfolio securities had a disproportionately severe effect on the value of investment company shares; highly leveraged capital structures made investment company shares extremely speculative and exposed those who purchased them to extraordinarily high degrees of risk.

The Investment Trust Study led Congress to conclude that the "completely liquid, mobile and readily negotiable" assets of investment companies offered unusual opportunities to

the unscrupulous, that disclosure alone was an inadequate safeguard for investment company shareholders, and that “the national public interest and the interest of investors are adversely affected . . . when investment companies are organized, operated, managed, or their portfolio securities are selected in the interest of directors, officers, investment advisers, depositors, or other affiliated persons thereof in the interest of underwriters, brokers or dealers, in the interest of special classes of their security holders, or in the interest of other investment companies or persons engaged in other lines of business, rather than in the interest of all classes of security holders.”

Although the Investment Trust Study examined every aspect of the pre-1939 investment company industry, it focused primarily on the dangers arising from: (1) outright dishonesty; (2) transactions in securities and other types of property with, and loans to, controlling persons; (3) unsound capital structures; and (4) the virtually complete immunity of many well entrenched, self-perpetuating managements from liability to the companies and from any semblance of shareholder control as well as the ease with which such controlling positions could be transferred.

These were the areas in which abuses were then most acute and the need for corrective action most pressing. Although attention was given to managerial compensation, underwriting charges, and brokerage commissions, they seemed on the whole of secondary importance in the late 1930's while the study was in progress. Since the Investment Company Act was in very large measure a product of the Investment Trust Study, its substantive provisions reflect the study's emphases. For the most part, the Act provided specific controls to eliminate or mitigate inequitable capital structures and dishonesty, loans to, and unfair property and securities transactions with, insiders. It did not impose analogous controls on compensation for services -- sales loads, managerial compensation, and brokerage commissions. In this area fund managers retained a very large measure of discretion. Their discretion was subjected to review, however, by the inclusion of certain provisions as to shareholder approval and as to the composition of investment companies' boards of directors, which would, it was thought, operate as effective checks on abuses in these areas.

The Investment Company Act adopts the registration approach employed in other Federal securities statutes. Companies that are investment companies in the statutory sense of that term (and in some situations their promoters and underwriters) are prohibited from engaging in interstate commerce and from using the mails unless the company is registered with the Commission. Willful violation of the registration provisions is a Federal crime. Registered investment companies are then subject to the substantive provisions of the Act and are required to make periodic reports to the Commission and to their stockholders.

Much of the Act was designed to protect investment companies and their shareholders from outright dishonesty on the part of the companies' managers. It barred from the investment company industry persons convicted of, or enjoined from committing, certain

types of misconduct involving security transactions, made larceny, conversion or embezzlement of investment company assets a Federal crime, and authorized the Commission to obtain injunctions against “gross misconduct or gross abuse of trust” by persons associated with registered investment companies. The Commission was authorized to prescribe accounting policies and practices to which registered investment companies must adhere.

Complex, multi-tiered capital structures characterized by thin substrata of equity beneath towers of indebtedness, which were much more common than outright dishonesty, had proven damaging to investment company shareholders. To these problems the Act provided effective solutions. Closed-end companies are generally precluded from issuing debt securities unless they have an asset coverage of 300 percent and cannot issue preferred stock unless such stock’s liquidation preference has an asset coverage of at least 200 percent. Nor can they issue more than one class of debt security or more than one class of preferred stock. Open-end companies cannot issue any long-term debt securities at all.

The Act sought to check the theretofore virtually unrestricted power of management groups by imposing specific requirements with respect to the composition of the boards of directors of investment companies.

If any director, officer, or employee of the investment company acts as, or is affiliated with, its principal underwriter, a majority of the board must consist of persons other than and unaffiliated with the principal underwriter. Similarly, if any director, officer or employee of the investment company serves as, or is affiliated with, a regular broker to the company, a majority of the board must consist of persons other than, and unaffiliated with, such regular broker.

The Act also provides that if any of the investment company’s officers, directors or employees are investment bankers or affiliated with investment brokers, a majority of the board must consist of persons who are neither investment brokers nor affiliated with an investment banker.

Additional provisions of the Act apply to transactions in which investment companies lend money to, sell property to, or buy property from, investment advisers, principal underwriters, and other affiliated persons. These transactions are prohibited unless Commission approval has first been obtained. Such approval can be granted only if the Commission finds “that the terms of the proposed transaction, including the consideration to be paid or received, are reasonable and fair and do not involve over-reaching on the part of any person concerned.” The Commission must further find that the proposed transaction is consistent with the policy of each registered investment company concerned and with the general purposes of the Act.

The Act also guards against the purchase of investment company shares by insiders on terms more favorable than those available to the general public. Options and warrants for investment company shares are permissible only when issued exclusively and ratably to all members of a class of security holders or in connection with a plan of reorganization. Insider profits from short-term trading in the securities of a closed-end investment company are recoverable by or on behalf of the Company.

Advisory contracts, underwriting agreements, and brokerage relationships are areas in which the interests of those who perform the services differ to some extent from the interests of the fund's shareholders. In the first instance, this divergence relates to the amount of the advisory fee and the services to be obtained in return for it. Second, the adviser-underwriter may wish to set the sales load at a level high enough to maximize aggregate sales by giving generous incentives to sellers of the fund's shares. Existing shareholders who wish to invest new money in the fund and who have to pay a sales load on such purchases have an interest, however, in the load being as low as possible. Third, the advisor's desire to have the size of the fund increased and thus to increase its advisory fee -- which is almost invariably based on a percentage of the fund's assets -- may not necessarily coincide with the interests of the fund's present shareholders. For example, in promoting increased fund size, the adviser may wish to use the brokerage commissions generated by the fund's portfolio transactions for the purpose of channeling additional sales compensation to retail dealers who recommend and sell the fund's shares. In that event the adviser may not be inclined to minimize brokerage costs.

(Of course, an excess of redemptions over sales may create a cash liquidity problem that would be eased by encouraging further sales. None of these matters is simple.)

The Act's controls over these relationships were, as indicated, less direct than those over other economic relationships between investment companies and their affiliated persons. In 1940, the Congress accepted the view that "a few elementary safeguards" were all that the public interest required in the areas of advisory fees, underwriting compensation and brokerage commissions. The principal "elementary safeguards" that the Act imposed in these areas were prescriptions as to the form and content of advisory and underwriting contracts and requirements with respect to their approval by unaffiliated directors and shareholders.

The Act set no express limits on the compensation paid to affiliated persons. Nor did it expressly require that such compensation be reasonable. Only when managerial emoluments were such as to make the affiliated persons "guilty" of "gross misconduct or gross abuse of trust" and to make it necessary and desirable that they be suspended or barred from being employed by investment companies in the future could the Commission take remedial action under the Act.

With respect to sales charge generally, there were no explicit provisions. But the Act expressed a policy against “unconscionable or grossly excessive” sales loads and authorized the Commission and the NASD to implement that policy by appropriate rules.

8. The Investment Advisers Act of 1940

The Investment Advisers Act, a companion to the Investment Company Act and the last of the New Deal securities statutes, regulates the activities of those who receive compensation for advising others with respect to investments in securities or are in the business of issuing analyses or reports concerning securities. Like the Exchange Act, the Advisers Act requires those subject to it to register with the Commission, prohibits fraudulent practices, and empowers the Commission to discipline violators of the statute and of its rules thereunder.

9. Early Developments

During the Commission’s first decade much of its time and energy went into defending the constitutionality of its governing statutes. But those constitutional battles of yore (the ones that raged around the validity of the Holding Company Act were especially protracted and hard-fought) are of no contemporary interest. So no time will be wasted in chronicling them.

For present purposes the significant thing about the Commission’s early years is the techniques that it then developed for doing its job. Two administrative devices that go back to the very beginning have been much commented on by students of the administrative process. One is the so-called “letter of comment.” The other is the “no-action letter.”

As soon as the Securities Act went into effect, it became apparent that formal administrative proceedings with respect to every deficient filing would be unwarranted. The Commission’s primary objective was not to bring and win cases but to do all that it could to see to it that the statutory aim of full disclosure to buyers was attained. Accordingly, the practice developed at the very beginning of communicating informally with registrants and with their counsel for the purpose of calling their attention to apparent deficiencies.

The letters by which this was done customarily began “We have the following comments . . .” So they came to be known as “letters of comment.” These letters turned out to be a potent tool for achieving compliance with the statutory aims. The letter of comment (known in early years as “the deficiency letter”) permitted the Commission to reserve the heavy artillery of formal proceedings under the Securities Act for cases of blatant insufficiency, deliberate intent to deceive, and gross carelessness. Although the

meticulous examination of Securities Act registration statements was sometimes overdone and although the letter of comment did on occasion degenerate into a pointless essay about a mass of trivia, and although serious deficiencies were sometimes missed, on balance the staff review and letter of comment procedure was a great success. And, indeed, essential to make the Act work. Furthermore, it did much to drive home the lesson that a filing under the Securities Act is an intensely serious matter that calls for painstaking care and the utmost candor. Thus disclosure standards were raised.

From time to time complaints have been raised that the letter of comment procedure, in combination with the practical necessity on the part of issuers and underwriters for a Commission order accelerating the effectiveness of the registration statement when the price of the offering has been fixed, gives the staff arbitrary power over disclosure questions which deprive registrants of due process. Due in large measure to the practical good sense that has characterized the staff's approach to these matters, the diligence and cooperation of the professionals who practice in the field, and the unattractive, if not impossible, problems presented by any other conceivable procedure, these complaints have never gained much support. Today, after many reviews of the whole process by Congressional critics, scholars and professional groups, the letter of comment and acceleration procedure is a settled part of our customary, if not strictly statutory, law.

Particular note should be made of what the letter of comment plus the Commission's early trail-blazing cases under the Securities Act achieved in the realm of accounting. Much was done to stamp out the once pervasive practice of overvaluing assets and of writing them up to arbitrary figures.¹ And though the income statement turned out to be much harder to cope with than the balance sheet, standards relating to the presentation of income were also raised to some extent. The Commission's insistence that auditors check inventories and confirm receivables (a byproduct of the 1938 McKesson & Robbins scandal) was of special significance.

The other administrative novelty, the "no-action letter," proved an effective, pragmatic tool for dealing with situations where the law was murky. Not everything under the securities laws is crystal clear. Indeed, the Commission itself has from time to time changed its view as to the thrust of a particular statutory provision. Interpretive questions abound.

To help the people affected by those questions and to assist them in avoiding unintentional violations, the first Commission instructed its legal staff to respond to requests for interpretative advice. When these responses dealt with points on which the law is obscure, they often acknowledged that this was so but concluded that under all the circumstances the writer "would not be inclined to recommend any action to the Commission" if the transaction were proceeded with. Hence the name "no-action letter."

During its early years the Commission attracted to itself and to its staff a veritable galaxy of legal and financial talent. An enviable reputation for diligence, ability, incorruptibility,

and fidelity to the highest standards of public service was earned. And in the courts, where one of its former Chairmen sat on the Supreme Court and another, the late Jerome N. Frank, on the Court of Appeals for the Second Circuit, the Commission came to be regarded as a “sacred cow.” So, at any rate, said Judge Learned Hand.²

C. Twenty Years in the Shadows -- the Forties and the Fifties

When the problems of the Depression gave way to the even more urgent ones presented by a world in flames, the SEC lost its earlier prominence. What had once been the New Deal’s glamour agency became a forgotten man. These coming events began to cast their shadows quite a bit before Pearl Harbor. Thus, for example, some of the Commission’s principal proposals for investment company reform were shelved in the Investment Company Act, a much diluted version of the Commission’s original bill and an agreed-on compromise between the Commission and the investment company industry, passed in the summer of 1940 against the giant-sized clouds of impending war by a Congress preoccupied with matters far more urgent than the long-run interests of investment company shareholders.

The SEC was a Pearl Harbor casualty. From a cosmic perspective, it was a very minor casualty. On the other hand, it was one of the first.

Moved from Washington to Philadelphia as a nonessential agency and thus deprived of its previously intimate liaison with the Congress and with the Executive, lessened in importance due to the doldrums in which the private capital markets had fallen because of the war and of the supremacy of governmental financing, and preoccupied with the onerous but wholly unglamorous and far from vital task of reorganizing the utility industry pursuant to the mandate of the Holding Company Act, the SEC was of necessity reduced to virtual invisibility during World War II and the immediate post-war period.

That obscurity did not kill the early SEC traditions of assiduity and creativity. They flourished more quietly in wartime Philadelphia than they had in New Deal Washington. But they were still there.

It was during the 1940’s and the early 1950’s that the Commission did the lion’s share of its work under the Holding Company Act. The reorganization of the electric and gas industries was a Herculean task which the Commission faced and solved with a great measure of success:

1. Many complicated problems of industrial structure akin to those that confront the courts in antitrust cases, for the Holding Company Act is in large measure a specialized antitrust statute; and

2. Intricate and novel questions of equity and corporation law engendered by the need to determine who was entitled to what in these holding company breakups.

Wartime prosperity notwithstanding, Chapter X continued to absorb much of the Commission's time and energy. Many depression-era cases were still around. In them as in the work under the Holding Company Act, the Commission made noteworthy contributions to the development of fiduciary standards appreciably higher than those deemed adequate in an earlier day.

This is not to say that the Commission's record during the forties under the Holding Company and Bankruptcy Acts was one of unalloyed perfection. Because of the need to move forward under the Holding Company Act with limited resources, some of the Act's objectives were, on occasion, subordinated or neglected in particular cases. The comprehensive study of energy economics directed by Section 30 of the Holding Company Act was never made.

And, of course, the Commission had no crystal ball. It did not anticipate either the generally widespread prosperity or the persistent inflation that were to characterize the post-1945 era. Indeed, it was far more worried about deflation and a postwar slump. Thus its reorganization work under the Bankruptcy and the Holding Company Acts was marked by what must in the light of hindsight be characterized as excessive conservatism and undue pessimism. That conservatism and that pessimism led to the virtual extinction of high amounts of junior securities whose holders would have been saved or at least given something, had perfect foresight been available.

For reasons already sketched, the problems of the security markets were not uppermost in the Commission's concerns during this period. That does not mean that those problems, which are after all the primary reason for the Commission's existence, were neglected. When wartime prosperity and the reviving prospects of once-depressed companies created a new type of investor-victim, viz., the defrauded seller overreached by insider-buyers who knew all about their companies' newly-found riches and much-enhanced prospects, the Commission arose to the occasion. There was nothing usable in the buyer-oriented Securities Act's chest of tools. But a remedy was found in the Exchange Act. Using its broad administrative powers to define fraud under that statute, the Commission late in 1942 promulgated its now famous Rule 10b-5 (known in its early days as Rule X-10b-5 because Exchange Act rules were then prefaced by the letter "X" to distinguish them from rules under the other statutes administered by the Commission), which banned fraudulent, deceptive, and manipulative acts that victimized sellers as well as those that victimized buyers. Although those who drafted it were probably unaware of the inner dynamic that would in time cause 10b-5 to overshadow the whole field of securities regulation, they made -- perhaps unwittingly -- a giant step forward in investor protection.

When the Commission returned to Washington in 1948, it did not return to the glories of its early years in that city when it had been something of a governmental child prodigy.

Starved for funds and resources, housed in grossly inadequate quarters, still immersed in what seemed to almost everybody else low-priority, largely historical, and essentially meaningless questions about the Holding Company Acts impact on the now prosperous utility industry, and about as remote as it could possibly have been from the urgencies of the Cold War and world politics -- the great concerns of those days -- the SEC dwindled to a minor bureaucratic appendage. A little statistical history shows what happened. From 1940 to 1954, Congress reduced the Commission's staff by successive budget cuts from about 1,500 to less than 700. With a staff that though still of high quality had now become comically small, the Commission's work necessarily suffered. At times it seemed to some that the Commission was confined to:

1. Nitpicking Securities Act registration statements and composing letters of comment about them;
2. Chasing the relative handful of petty crooks unfortunate enough to come to the attention of its depleted staff; and
3. Fiddling around at a much slower pace with its continuing tasks under the Holding Company Act.

Mr. J. Sinclair Armstrong, a member of the Commission from 1953 to 1957 and its chairman from 1955 to 1957 told the story of those years very well from a first-hand vantage point, when he wrote in the Virginia Law Review that:

“There is no crisis in the stock market today. . . . Stock market price averages are at all-time highs. The public, which has been fleeced in illegal or shady transactions beyond the Commission's reach, is apathetic. Congress had found, for its own reasons, that it is better to deny the Commission the necessary tools and support while loudly criticizing occasional failures of alleged slip-ups, than it is to enact the Commission's program.

“The securities industry, too, is forgetful. There is a feeling that the existing laws have worked well, but they are burdensome enough, so why have more?. . . [I]ndustry representatives have raised many technical and lawyerlike objections to the Commission's amendment programs. These objections always hark back to the shibboleth that all government agencies, particularly federal regulatory agencies, follow Parkinson's law first and are constantly trying to increase their spheres of influence and arrogate to themselves greater authority.

“Therefore, with Congress disinterested and with the securities industry's support mixed or apathetic, I do not find the auguries favorable for the Commission's future programs, legislative or administrative. Two circumstances could, however, change this. The first

would be a really bad break in the market, leading to a public realization that the protection afforded the investor today is paper-thin. The Commission would capitalize upon this to gain congressional support for its program. The second possibility would involve an aggressive effort by the Commission itself to take its story to the people, but, unfortunately, since New Deal days, this has not been in the tradition of the federal regulatory agencies, and I think it is a shame.”³

The principal legislative proposal in the securities field during this period was one that would have extended the Exchange Act’s continuing disclosure, proxy regulation, and insider trading provisions to the thousands of companies that had a substantial public investor interest even though none of their securities were listed on exchanges. That went to the heart of the federal effort to achieve some decent modicum of disclosure for and to the ordinary investor. Except at the relatively rare -- and in many cases wholly nonexistent -- moments in time when they or their controlling persons were trying to get fresh money from the public by means of a filing under the Securities Act, unlisted companies were under no legal compulsion to tell anybody anything. That absence of the most elementary disclosure was wholly antithetical to the general rhetoric of the federal securities laws. It was also a mighty engine for fraud, which always tends to flourish in the dark.

The Exchange Act’s dichotomy between listed companies, on the one hand, and unlisted ones on the other, produced an overemphasis on the Securities Act. Securities Act registration statements were the only legally required disclosure documents of high quality. Moreover, the prospectus portions of ‘33 Act registration statements had to be physically delivered to purchasers.⁴ Under the Exchange Act, on the other hand, there was no delivery mechanism -- except for proxy statements. Too often the disclosure documents elicited by the Exchange Act sat dusty and undisturbed in the Commission’s files. Not too many people knew that these things existed. And their utility to investors and those who advised them was generally considered too limited to warrant either the labor or the expense required to get hold of the stuff.

So the Commission concentrated on the Securities Act even though it knew that the prospectuses required by that statute went only to a relative handful of investors, those who purchased new issues directly from issuers, underwriters, and dealers. Under the law as it then was and under the Commission’s practices of that day, registration under the Securities Act was the only mechanism for eliciting and disseminating reasonably full disclosure. And full disclosure was the Commission’s business.

Accordingly, the Commission thought it in the public interest to maximize the number of Securities Act registration statements. Hence it tended to read the Act jealously and theologically as a sort of a sacred text mandating registration in every conceivable circumstance. Secondly, it lavished prodigious amounts of time and energy on the registration process. Skeptics wondered about how much good all of this really did. And

cynics were sure that it did no good at all. But the Commission persevered in its by now time-honored ways. It had no real choice.

Even at this low point in its history, however, the Commission had some noteworthy accomplishments to its credit. On its recommendation Congress amended the Securities Act in 1954 so as to rectify some bothersome anomalies that made that basic statute unduly cumbersome and that required resort to legal fictions. Vigorous action was taken to raise disclosure standards in the marketing of small, raw issues exempt by reason of their modest size from the Securities Act's registration and prospectus-delivery requirements. The Commission had for many years followed a hands-off policy in this field. But when fraud became rife in these offerings during the reviving markets of the '50's, the Commission acted so as to require that:

- (i) informative filings be made with it -- to avoid imposing undue burdens on issuers these filings were made with and processed by the Commission's regional offices around the country; and
- (ii) offering circulars that did not fall too far short of prospectus standards were delivered to purchasers.

It was also during the '50's that the Commission vastly upgraded proxy statement disclosure and succeeded in raising to a level approximating that attained in prospectuses.

D. The Shadows Lift a Little – The Late 1950's

As the 1950's drew to a close, the Commission began to emerge from the well-nigh total obscurity that had shrouded it for so long. Congress's appropriations became a wee bit more generous. And with the back of the gargantuan Holding Company Act task now broken at last and the Commission's utility staff reduced to a tiny band of a dozen or so, the SEC was able to pursue its investor-protection labors with somewhat greater vigor.

Those labors were now of greater public concern than they had previously been. The Depression had receded into history. Time had healed the scars that the terrible thirties had inflicted on the collective investor psyche. Economic conditions were good, by historical standards unprecedentedly good. More people had more money available for investment than ever before.

And the climate of opinion was such as to lead them to invest. Obsession with deflation had been displaced by concern over inflation. Equities were widely rewarded as an ideal hedge against that danger. And by pre-1940 standards cyclical fluctuations were delightfully mild.

So the securities industry was ideally positioned to recruit new legions of investors. It did so with great success. Wall Street seemed paved with gold.

The fact that there was an SEC had much to do with this euphoric climate. While many in the industry were dubious about or hostile to the concrete things the Commission did, it was almost universally agreed that the general idea of an SEC was a good thing. Investors and prospective investors who remembered or who had heard of the 1929-1933 debacle or of the devastating 1937-1938 market break were told that nothing of that sort could ever happen again -- not with the SEC watching things.

The influx into the markets of great masses of novice investors and of hosts of almost equally inexperienced new firms which sought to serve -- and on occasion to fleece -- them led the Commission to accelerate its antifraud enforcement activity. But the need for that activity was accelerating at an even more rapid rate. So it is rather doubtful that there was much of a net effect. Nevertheless, a brave and not altogether futile effort was made.

Perhaps the most striking aspect of the purely financial history of the fifties was the explosive growth of the mutual fund business. Between 1952 and 1958 mutual fund assets more than tripled. Investment company regulation now took a pre-eminent position among the Commission's concerns. Since the Investment Company Act authorized the Commission "at such times as it deems that any substantial further increase in size of investment companies creates any problem involving the protection of investors or the public interest and to make a study and investigation . . . and from time to time to report the results . . . and its recommendations to the Congress,"⁵ the Commission in 1958 authorized the Securities Research Unit of the Wharton School of Finance and Commerce of the University of Pennsylvania to make a study and to submit a report to the Commission. The Commission originally asked for a report concentrating on mutual funds that would "be primarily directed to the question of the effects of size on investment policies and comparative performance of investment companies and, to the extent possible, to the effects of the size of investment companies on the securities markets and on the policies of portfolio companies." It soon became clear, however, that the effects of increases in the size of investment companies could not be fully understood without a study of the relationship between mutual funds and their investment advisers, principal underwriters, and portfolio brokers. Accordingly, when the original part of the Wharton Report was nearing completion, the Commission asked that it be expanded to include an analysis of these areas.

E. Something of a Renaissance -The 1960's

In 1960 and 1961 the great postwar bull market that had begun in 1949 swung into high gear. Except for the fact that, for whatever it was worth, there was now an SEC which required prospectuses far bulkier and infinitely more detailed than those of the twenties,

the financial scene came to resemble that of 1928 and 1929.⁶ Tips abounded. Rumors spread like wildfire. And hot new issues seemed a gateway to instant riches.

Some people wondered whether “it” was about to happen all over again. And even those less pessimistic than that saw cause for serious concern about the condition of the markets and the contemporary adequacy of the investor-protection framework that had been hurriedly hammered out in the 1930’s. That concern was felt by many on Capitol Hill.

As a result Congress on September 5, 1961, added Section 19(d) to the Exchange Act authorizing and directing the Commission “to make a study and investigation of the adequacy, for the protection of investors, of the rules of national securities exchanges and national securities associations . . .” For a change, adequate funding was provided.

The report by the House Committee on Interstate and Foreign Commerce that preceded the enactment of Section 19(d) said:

“During recent months the president of the New York Stock Exchange has issued two very firm warnings against speculation in the stock market. The country’s largest brokerage firm has run a dozen newspaper ads urging investor caution, and many other brokerage houses have alerted employees to the danger of uninformed public speculation. The National Association of Securities Dealers has written to all members expressing concern over the very large total of outstanding undelivered transactions. The Chairman of the Securities and Exchange Commission has stated that there have been evidences of a substantial amount of manipulation and that they have more manipulation cases in various stages of proceedings than ever before. The Commission has initiated an investigation of the American Stock Exchange to determine whether additional rules or laws are required to insure proper operation of the exchange . . .

“Since the market collapse which led to the enactment of the Federal securities laws, there has been a rebuilding of public confidence in the securities markets as a result of both efforts at self-regulation by the industry and the enactment of the statutes and their administration by the Securities and Exchange Commission. The maintenance of this confidence is most essential. There has been a great growth and increased activity in the securities markets. It is important to be informed as to whether at this time in the light of changed market conditions the investing public is afforded the protection which was envisaged in the passage of the original legislation. What new statutes or rules are needed?. What now unregulated areas of the securities markets need regulations? What rules need changes?

“In view of the comments which recently have been made as to today’s market conditions and the testimony before the committee relating to market practices and to violations of

statutes and rules, and in view of the nearly 25 years which have elapsed since the last overall study of the operations of securities markets, it seems to this committee that it is now highly appropriate again to review the rules governing the activities of the various securities markets to see whether they are adequate to protect investors, to determine just how they are being administered by the exchanges and the over-the-counter associations, and whether changes, modifications, or expansions of the rules or statutes are desirable now in the public interest.”⁷

Pursuant to Section 19(d), the Commission made a detailed study of the securities business and the securities markets, which resulted in a report submitted to Congress in five parts during 1962 and 1963.⁸ That report has come to be known as the “Special Study.” The Special Study had much (some weary readers thought too much) to say about disclosure, fraud, manipulation -- the Commission’s traditional staples. But it also delves into the structure of the markets and their interrelationships. The Commission had for many years neglected that area. Oversight of the exchanges and of the NASD was extremely limited and viewed as a peripheral function of what was then styled the Division of Trading and Exchanges, a staff unit whose primary mission was the enforcement of the antifraud provisions.

The Special Study made a host of recommendations. Although many of them boiled down to mere exhortations for further study on a continuing basis, a goodly number were quite specific. The essential specific recommendations were that:

1. The Commission’s proposals for amending the Exchange Act so as to extend its continuing disclosure, proxy, and insider trading provisions to unlisted companies whose equity securities were held by a substantial number of public investors be adopted at long last;
2. The Exchange Act’s disciplinary provisions be amended so as to authorize the Commission and the NASD to proceed against persons -- not just firms -- so as to eliminate procedural complexities, scrap the legalistic subtleties that then surrounded this aspect of SEC practice, enhance effectiveness, and make for greater fairness;
3. The traditional structure of stock exchange minimum brokerage commission rates under which the commission for an order for 10,000 shares of a given security was exactly 100 times the commission for a 100-share order be altered by the introduction of a volume discount giving appropriate recognition to economies of size.

The Commission accepted the Special Study’s principal legislative recommendations. Accordingly it sent Congress an appropriate legislative program in June of 1963. A year-long legislative battle followed.⁹ Ultimately the Securities Exchange Acts Amendments of 1964 became law. Those amendments extended to investors in securities traded over-the-counter the disclosure and the insider trading protections that the Exchange Act had long given investors in listed securities, strengthened standards for entry into the

securities business, and made more effective the Commission's disciplinary controls and those of the industry's self-regulatory organizations.

Some might say that in the realm of securities regulation the 1960's were more notable for their numerous and voluminous studies than for concrete results.

1962 was an especially great year for studies. It saw the publication of the initial portions of the Special Study. And in August of that year the Wharton School produced the so-called Wharton Report on the mutual fund industry,¹⁰ a document that, as the preceding section noted, the Commission had ordered back in 1958. This was the most comprehensive analysis of the mutual fund industry since the Commission's Investment Trust Study, which had led to the enactment of the Investment Company Act in 1940. The Wharton Report presented much factual material about mutual funds and identified problem areas. It concluded that "the more important current problems in the mutual fund industry appear to be those which involve potential conflicts of interest between fund management and shareholders, the possible absence of arm's-length bargaining between fund management and the funds' investment advise, and the impact of fund growth and stock purchases on stock prices."¹¹ The Wharton Report's emphases coincided in large measure with those of the contemporaneous Special Study. The Special Study voiced great concern about the way in which mutual funds were sold and with, the special problems involved in the sale of so-called "contractual plans" for the acquisition of mutual fund shares on an installment plan basis. It also examined the factors influencing the way in which the brokerage commissions paid by the funds for the purchase and sale of portfolio securities were allocated and the potential conflicts of interest arising from "insider" trading in securities being bought or sold by the funds.

The Wharton Report was a report to the Commission, not by the Commission. It was an analytical study that made no recommendations for legislative or administrative action. The Special Study, on the other hand, did make recommendations; but those were the recommendations of the staff that prepared the study, not of the Commission.

It remained for the Commission to evaluate the Special Study's recommendations against the background of the basic questions posed by the Wharton Report and of its own experience in administering the federal securities statutes. When the Commission sent the Wharton Report to the Congress, it said that it would evaluate the public policy questions raised by the report "as part of a comprehensive program of study . . . with a view to determining such legislative . . . proposals . . . as may be desirable and thereafter reporting to the Congress." After 1962, and especially after 1964, that task absorbed much of the Commission's energy. At the Commission's direction, its staff made further inquiries. In these subsequent studies, the Commission's staff sought to test the conclusions of the Wharton and Special Study reports by an intensive first-hand examination of a cross section of the investment company industry.

These labors resulted in a 346-page report by the Commission to Congress on December 2, 1966. That document, entitled “Public Policy Implications of Investment Company Growth”¹² (“Public Policy”), urged that the Investment Company Act be amended so as to:

1. Expressly require that investment company managers’ compensation be limited by a statutory reasonableness test;
2. Place a 5% ceiling on mutual fund sales charges; and
3. Eliminate the so-called “front-end load” under which investors who purchased mutual fund shares on the installment plan had as much as half of their first year’s payments deducted for sales charges.

Many other legislative recommendations of a more technical character were made. Public Policy’s general theme was that mutual funds were on the whole a desirable investment medium -- but that they cost investors far too much.

After abortive negotiations with the mutual fund industry, the Commission in May of 1967 sent Congress a legislative proposal based on Public Policy. Three years and seven months of legislative battle ensued. Mutual funds were important. Everybody agreed about that. But many disagreed with the Commission’s view as to the importance of the real or alleged problems highlighted in Public Policy. At the time, mutual fund investors seemed on the whole to have done and to be doing very well indeed. The management fees and the sales charges about which the Commission was so agitated were all fully disclosed. And there was no audible investor outcry about them.

In these circumstances the Commission’s investment company reform program had little political appeal. It was as though someone had come forward with proposals for a Public Utility Holding Company Act in 1928.¹³ How many would have cared? What chance for adoption would there have been?

Prosperous periods -- and the late 1960’s were prosperous -- tend to bring to the fore the need to protect the public buyer who deals with strategically situated sellers. Many who looked at the takeovers that were so prominent a feature of the business scene in this period saw an additional need for protections here. Others disagreed. As they saw it, further regulation here would only tip the brokers in favor of incumbent management. The first view prevailed in the Congress and was embodied in the Williams Act of 1968.¹⁴ That statute, which was strengthened in 1970:

- (1) requires extensive disclosures by those making cash tender offers, exchange offers, and large-scale purchases of equity securities; and
- (2) gave the Commission broad rulemaking power in this area.

As noted earlier, it was during the nineteen-sixties that the Commission first began to address itself seriously to problems of market structure. The initial impetus for that concern, which came from the Special Study, was heightened by the Commission's intimate and extensive involvement with mutual fund problems. For it was in the mutual fund business that the deleterious consequences of the classic fixed rate system were most glaringly apparent.

That system made large orders of the sort that funds and other institutional investors often place quite lucrative. Brokers found it profitable and were eager to handle transactions for investment companies and other large institutional investors for a net return that was only a fraction of the commissions that the exchanges' minimum rate schedules required them to charge. Moreover, the exchanges' rules permitted a large customer to spread commissions among numerous brokers by directing the broker who actually handled a particular order and who therefore received the commission attributable to it to give portions of that commission to other brokers. Thus brokers could receive portions of a commission even if they had no connection with the transaction that produced it. A broker who surrendered a portion of his commission to another was said to "give up" the surrendered portion. In the typical mutual fund give-up situation the fund placed an order with a broker on condition that he would handle the entire transaction but would pay cash to another broker or brokers (who might be altogether unknown to him) and who in any event had nothing to do with the transaction. Thus the funds were able to entrust their transactions to a few selected brokers in whom they had confidence and at the same time to distribute much of the resulting commission income to the many brokers who sold their shares.

What was wrong with that?

Several things, or so the Commission thought. To begin with, the exchanges' minimum rate schedules took no account of the economies of scale. This meant that mutual fund shareholders and others who invested through institutional media were saddled with uneconomically high transaction costs. Other evils inherent in the set-up were:

1. Harmful effects on the funds and on their shareholders -- The need to allocate brokerage for sales created (or could create) pressures for "churning," i.e., frequent sales and purchases of portfolio securities unwarranted by investment considerations for the purpose of generating brokerage commissions. In addition, the pressure to allocate brokerage for sales sometimes tempted fund advisers to skimp on the allocation of brokerage for investment advice or other non-sales services of greater benefit to the funds than the accelerated sale of new shares.
2. Effect on the integrity of recommendations -- Inherent in the give-up was the danger that retail sellers would base their recommendations to customers not on the customers'

investment needs but on the additional rewards received in the form of portfolio commissions.

3. Basic unfairness to existing shareholders -- The funds' existing shareholders paid the portfolio brokerage commissions. But they got little or no benefit from the sale of new shares. Hence the use of commissions to subsidize the sale of new shares was unfair to existing shareholders.

4. Incompatibility with fundamental disclosure objectives -- One who is asked to make an investment is entitled to know what the seller will make out of the deal. That is basic to the full disclosure concept on which federal securities regulation rests. The use of investment company brokerage commissions to supply supplemental compensation to sellers of new investment company shares was altogether inconsistent with this concept. The funds' prospectuses purported to tell buyers and prospective buyers exactly what the sales charge was. But those prospectuses did not quantify the additional compensation that the seller was getting in the form of commission business awarded to him solely because of his success in selling new shares.

Accordingly, the Commission denounced the give-up as a pernicious device tempting "dealers to base their recommendations on the amount of portfolio brokerage that will be generated by selling shares of a particular fund rather than on the suitability of that fund to the investment needs of their customer."

After much persistent prodding by the Commission, the exchanges at the end of 1968 made some basic changes. They:

1. Banned customer-directed give-ups; and
2. Revised their commission rate schedule so as to introduce a volume discount on those portions of large orders in excess of 1,000 shares.

These changes which left the basic fixed rate mechanism in effect were insufficient to resolve the fundamental problems that the Commission had raised. Hence it continued to pursue its intensive inquiries into market structure. Those inquiries were supplemented by another mammoth study, the Institutional Investor Study. As in the case of the Special Study, the idea for the Institutional Investor Study came from the Congress. A joint resolution approved on July 29, 1968 (Public Law 90-438) authorized and directed the Commission to study institutional investors and their impact on the security markets. The study got under way in 1969. But it was not completed until March of 1971. Although the Commission did not deliver that report until after the close of the period with which this section deals, it seems appropriate to say something about it here. The Institutional Investor Study Report went to Congress on March 10, 1971.¹⁵

By that time the great bull market of the sixties had come to an end. And the securities business was in a fundamental crisis. Hence those concerned with securities regulation were confronted by issues far more urgent than quasi-metaphysical musings about the possible ultimate impact of institutionalization on the financial scene. So the Institutional Investor Study Report fell stillborn from the Government Printing Office's presses. The scholarly, carefully hedged character of the Institutional Study's conclusions and recommendations were not headline material.. The Study did demonstrate that thus far at least many of the vague fears that some had entertained about the allegedly devastating impact of massive institutional transactions on stock prices and about institutional investors' influence on corporate decision-making were grossly over-stated and on the whole unfounded. The Institutional Study's two most noteworthy recommendations were that:

1. Institutional investment deserves continuing study. To make that possible, the Commission should be authorized to require reports and disclosures of institutional securities' holdings and transactions; and
2. Fragmented securities markets should be replaced by a strong central market.

Still another study of the 1960's, that decade of studies, should be noted at this point. This one did not deal with the big questions of high finance. It was concerned with the humbler sphere of disclosure, the Commission's elementary and essential function:

The disclosure policy study, directed by former Commissioner Francis M. Wheat, and therefore sometimes known as the "Wheat Report," (though its formal title was "Disclosure to Investors – a Reappraisal of Federal Administrative Policies under the '33 and '34 Acts,"¹⁶) was, among other things, an essay in self-criticism. It showed that the Commission was not complacent about the manner in which it had been discharging its fundamental disclosure responsibilities and that it was painfully aware of the need for improvement. The authors of the Wheat Report tried to see what could be done within the existing statutory framework to:

1. Enhance coordination between the disclosures required under the Securities Act and those elicited by the Exchange Act;
2. Clarify the law of disclosure and make its application more certain;
3. Assure that appropriate disclosures are made prior to the creation of interstate trading markets in securities; and
4. Enhance the utility to investors and to those who advise them of the documents generated under the federal securities statutes without imposing undue burdens on those who must prepare these documents.

The Wheat Report pointed out what had long been known -- that the trading markets in outstanding securities involve much more money and far more people than does the distribution of securities being offered to the public for the first time. Hence it emphasized continuous disclosure under the Exchange Act and urged that the gap -- a wide gap indeed it then was -- between the kinds of disclosure traditionally required under the Securities Act and the much less searching sort of thing deemed satisfactory under the Exchange Act, be narrowed.

The report's other recommendations dealt with matters in which few other than securities lawyers are likely to develop a passionate interest. But they were significant. The report's view of the Securities Act registration process was a bit more skeptical and quite a bit more realistic than the approach traditional at the Commission. It pointed out that the prospectus cult had been overdone and that there was no real need for the publication of a mini-encyclopedia whenever a large well-known company that had made adequate continuing disclosures about itself happened to be confronted by a registerable event. Accordingly, far greater use of short-form prospectuses was urged.

One Wheat recommendation was of special significance. This was that a distinction be drawn between companies that filed regular, informative reports on their affairs with the Commission ("reporting companies") on the one hand, and those that do not file such reports ("non-reporting companies") on the other. That distinction would be most significant with respect to the so-called "secondary" sale, i.e., a sale by a person who is not himself the issuer of the securities in question, but who is treated as though he were the issuer for purposes of the Securities Act's registration and prospectus-delivery requirements. He may be so treated because he is a controlling person of the issuer or because he acts as a link in a chain of non-public transactions by which securities move from an issuer to the public. In the Wheat Report's view the secondary sale area was one in which the Commission had created a quagmire for itself and for others. Here the Commission's traditional reading of the statute, though subtle and ingenious, had turned out to be wildly impractical. The Commission had placed undue emphasis on the private purchaser's subjective intent and had over the years evolved a bizarre doctrinal patchwork under which:

1. People who happened to buy securities in private transactions and who often knew no more about the issuer than the general public did were subject to restrictions more rigorous than those applicable to controlling persons who could fairly be presumed to know a good deal more than the general public.
2. The cloudy rules about the circumstances under which secondary sales could be made took no account at all of the information about the company already available to the public investor.

All companies were treated alike. Thus, the Commission permitted substantial amounts of securities about which practically nothing was known to be sold to the public without

registration. On the other hand, it often insisted on registration statements for offerings of securities about which a great deal of information was available to the public -- or could easily have been made available to it had the Commission's Exchange Act reporting requirements been more thoroughgoing than they were. Such registration statements served no discernible purpose other than to supply employment to the financial printing trade. The Wheat report made detailed recommendations for the rectification of this anomaly. It also urged the Commission to stop requiring registration in every conceivable and inconceivable circumstance and to place greater emphasis on certainty, clarity and predictability in such areas as the private offering, the intrastate exemption and business combinations.

To those imbued with the traditional '33 Act mystique, all this was very radical indeed. The Wheat report laid out a program for fundamental change. No action was taken with respect to that program until the next decade.

From what has thus far been said, it may seem as though the 1960's were devoted to producing studies that sat on library shelves and to concocting recommendations that were seldom implemented. That is not the whole story of the 60's by any means. Thus, for example, it was in that decade the Commission for the first time set out to do something real about the abuse of nonpublic information for private gain by strategically situated persons.

The opening gun in this campaign was fired in Cady, Roberts & Co., 40 S.E.C. 907 (1961), one of the Commission's best known administrative decisions. The case is important enough to warrant a brief digest here. It grew out of the decision of the directors of a large, well-known company to cut the dividend. One of the directors who participated in that decision was a registered representative of a New York Stock Exchange firm. As soon as the decision had been reached and before it was publicly known, that director sent word about it to a partner in his firm. The recipient of the information proceeded to place sell orders. The Commission held that when he did so he willfully violated the antifraud provisions of the securities statutes and imposed a disciplinary sanction that it deemed appropriate.

The significant things about Cady, Roberts were these:

1. It rejected the contention that only the director himself could be an insider so that the partner was as free as a bird to do as he wished with the information that had come to his attention. For these narrow and unrealistic notions, the Commission substituted an "access test." It said in its opinion:

"Analytically, the obligation of insiders rests on two principal elements, first the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and

second, the inherent unfairness involved where a party takes advantage of such information knowing that it is unavailable to those with whom he is dealing.”¹⁷

2. To the consternation of some legal conservatives, it held basic notions of fair dealing applicable in the indirect, impersonal context of the exchanges and the over-the-counter markets. The idea that one may fleece another with impunity simply because that other person’s identity is unknown to him was rejected.

Said the Commission:

“We cannot accept respondents’ contention that an insider’s responsibility is limited to existing stockholders and that he has no special duties when sales of securities are made to non-stockholders. This approach is too narrow. It ignores the plight of the buying public -- wholly unprotected from the misuse of special information.”¹⁸

Later in the decade came the great insider trading case of S.E.C. v. Texas Gulf Sulphur Co.¹⁹ There the Commission sued a number of insiders of varying levels who had bought stock or options without disclosing a rich ore strike. The prosecution of the cause involved several years of strenuous but well worthwhile litigation effort that were ultimately crowned with success. What Cady, Roberts, Texas Gulf, and the later cases that followed the trail they blazed established was that the antifraud provisions of the securities laws were as applicable to the high and mighty who thought of themselves and were thought of by others as Pillars of Society as they were to the people of lesser eminence whom the Commission had been pursuing for years.

Perhaps less significant than the insider-trading cases, but also noteworthy was the line of administrative precedents beginning in the late fifties and running through the sixties that dealt with broker-dealer selling practices. The Commission had been instituting and deciding cases in this general area ever since the thirties. But the earlier cases tended to involve classic fiduciary situations, aged widows and people of that sort whose relationships to their brokers would have been considered “confidential” or “special” at common law. The later cases made it clear that many of the principles first developed in fiduciary or quasi-fiduciary contexts were of general applicability to the ordinary broker-customer situation because the relationship of a broker to his customers differs fundamentally from that of an ordinary merchant to those who deal with him.

As we close our account of the 1960’s, candor compels a return to a negative note. 1969 saw the peak and also the end of the great postwar bull market. Both the last stages of the rise and the early stages of the subsequent decline brought serious problems in their wake. The rapid growth in trading toward the end of the sixties caused severe operational difficulties with which the securities industry proved unable to cope. And the subsequent price declines led to a decline in trading that brought extensive losses and widespread financial distress to the broker-dealer community and to regrettably large numbers of its customer-creditors.

Unfortunately, the Commission did not foresee these developments. Perhaps it too, like society at large, succumbed to the pervasive euphoria of the Soaring Sixties. The Special Study and certain other Commission documents show what seems in retrospect an overly sanguine confidence that things would keep moving onward and upward uninterrupted, that the securities industry would keep on growing to the sky, and that there was little need for precautions against fundamental stress.²⁰

Though it cannot claim to have foreseen the storms of 1969 and later years, once they broke the Commission did all that it could to mitigate their force. The activities of firms whose operational problems were exceptionally severe were appropriately limited. Action of this character was taken against one of the world's most prominent investment banking houses. And though there was little that the Commission could do at once about the financial, as distinguished from the operational collapse, it did prod the securities industry's self-regulatory bodies for better financial reporting and for early warning systems.

F. The Seventies So Far

By 1970 the need for an insurance program to protect customers who had funds or securities on deposit with brokers had become painfully apparent. And so had the prevalence of unsafe and unsound practices in the securities business -- a generation of federal regulation notwithstanding. Accordingly, at the end of the year Congress passed the Securities Investor Protection Act, giving FDIC-type protection to brokerage customers.

That statute directed the Commission to study the unsafe and unsound practices that recent experience had shown to be rife. The Commission's report submitted to the Congress on December 28, 1971, found that the securities industry had overemphasized sales and trading activities at the expense of operational resources, that the firms' capital was often inadequate and impermanent, and that such capital as there was had often been used injudiciously. Specific reforms followed.

Capital requirements were made more stringent. Control over securities was strengthened by requiring broker-dealers to make quarterly physical examinations and counts of their securities and of those belonging to customers. New entrants into the securities business were required to disclose details concerning their personnel, facilities and financing. Measures were taken to provide the Commission and self-regulatory authorities with more effective early warning systems. The staffs of the Commission and of the self-regulatory agencies were augmented to permit more frequent and intensive inspections of broker-dealers.

It was also in this period that the Commission's intensive 1960's campaign for investment company reform, sketched in the preceding section -- which had as there noted fallen for the most part on deaf ears -- finally bore a little, long-delayed fruit. On December 14, 1970, the generation-old Investment Company Act was modified by the Investment Company Amendments Act of 1970.²¹ The final legislation fell far short of the ambitious program that the Commission had recommended in Public Policy. But the amendatory legislation did do something. Its principal features were these:

1. Investment advisory fees -- An express fiduciary duty of reasonableness with respect to the receipt of compensation for services was articulated in the statutory text.
2. Sales charges -- The Commission's proposal for a 5% ceiling on sales charges was rejected. Nor was any action taken on proposals for the repeal of the Act's resale price maintenance provisions so as to permit competitive pricing of mutual fund shares -- although the Commission was directed to study the subject.²² But 1940's "unconscionable or grossly excessive" standard was replaced by just plain "excessive," with the proviso that the sales charge "allow for reasonable compensation for sales personnel, broker-dealers, and underwriters, and for reasonable sales loads to investors." And the rules governing sales charges on so-called contractual plans were altered so as to lessen materially the front-end load's adverse impact on the installment plan buyer.²³

Except for the contractual plan buyer whose burdens were lightened, it is hard to say exactly what these amendments have done for mutual fund shareholders. Some specialized inequities of old have been eliminated or mitigated. But the general level of advisory fees and sales charges is no lower than it was. Indeed, on balance these charges are somewhat higher today than they were in 1970. Such changes as there have been in the mutual fund scene stem from economic forces rather than from legal rules. It may be, however, that in time to come the 1970 statute will reveal an as yet unrealized potential.

So far at least, the really big legislative event of the 1970's is the Securities Acts Amendments of 1975. That statute deals with a great variety of subjects. Since it is so complex an affair, since Representative Moss was one of its principal authors, and since the House and the Senate reports on it are of recent vintage and readily available to the recipients of this communication, there is no point to discoursing at length in this place on the 1975 statute.

During the first half of the 70's much of the seemingly interminable study and talk of the 60's was translated into action. That was so on the administrative as well as on the legislative front.

1. Commission rates -- Here the Commission moved with what Mr. William J. Casey, its Chairman from 1971 to 1973, styled "prudent gradualism" toward a fully competitive regime. Competitive rates on portions of orders under \$500,000 were introduced on April 5, 1971. A year later the break point was lowered to \$300,000. Finally, on May 1, 1975,

free enterprise came at last to the securities business which had for so long been preaching the blessings of competition -- for other people.

2. Structural change and greater efficiency in the securities markets -- As noted earlier the Commission has in its work under the Public Utility Holding Company Act been concerned for forty years with questions of economic structure and industrial efficiency. Until recent years, however, the Commission did not read its mandates under the Exchange Act in quite the same way. It worried to some purpose about disclosure, fraud, elementary fairness -- basic problems of the investment process that have not been and probably never will be completely solved and that call for constant vigilance. It did not worry in the same way or to the same extent about the way the securities markets were organized. There by and large it accepted as given the structure that history had shaped in pro - SEC days.

The Commission does not read its charter that way. It is concerned with efficiency as well as with venality. It wants to do what it can to see to it that the capital markets function smoothly as well as equitably. In fact this broader emphasis reflects the general societal concern of today with the capital-raising process and with the importance of assuring an adequate supply of fresh capital to industry and trade.

Of late, much labor has been expended at the Commission to fashion a modern central market system to replace the fragmented markets of old. We hope that a unified market will lead to a price-formation process that mirrors over-all supply and over-all demand better than the old system did. In a way this effort can be viewed as parallel to the Commission's disclosure effort. For years the Commission has been trying to give investors more information about the intrinsic attributes of securities. Now it is endeavoring to give them more information than they have ever had before about the markets for those securities.

3. Disclosure policy -- During the 1970's the Commission promulgated a series of rules under the 1933 Act along the lines of the Wheat proposals.

These rules sought to bring a somewhat greater measure of clarity and sense to the secondary sale, private offering, interstate exemption, and business combination areas. These fields are replete with hard questions. The Commission believes that it has made some progress in resolving them. But the ideal answers to these questions have yet to be discovered.

Continuing disclosure under the Exchange Act geared to the needs of the trading markets has been much upgraded. With respect to 1933 Act disclosure, a really serious effort was made to improve the readability and enhance the utility of the Securities Act prospectus. However, in this field, as in others, much remains to be done.

Legal rules and their vigorous enforcement can do a good deal. But they cannot banish fraud.²⁴ The experience of the past few years drives that home. Fraud and near-fraud may not have been pervasive. But there was and is a disconcertingly large amount of it. Many names could be mentioned. But Penn-Central, Four Seasons, Stirling Homex, National Student Marketing, Equity Funding and Vesco, will suffice.

(G) A Concluding Note

Human beings tend to take themselves seriously, perhaps too seriously. In that regard at least, this Commission and its staff are no different from the general run of mankind.

We think that what we do is of real social significance, that our tasks deserve every ounce of effort we can bring to them, and that our labors are not wholly pointless. And we are proud of our record. Many of us derive considerable “psychic income” from our association with this agency, which we are vain enough to regard as a unique elite corps of public servants.

Yet we entertain no delusions of grandeur about either our importance in the cosmic scheme or our collective merits.

Disclosure to investors, preventing fraud where possible and detecting it where prevention proved impossible, promoting fairness in the marketplace, seeing to it that those who handle other people’s money give accurate and adequate accounts of their stewardship, raising standards of business conduct -- we who devote our working lives to these objectives would be the last to deprecate their importance. They are important. But they are important in a marginal way.

It is foolish to expect the SEC, which neither has nor seeks any voice in basic economic policy, to take the risks out of investment. Far more important to investors than disclosure and market mechanisms are inflation, deflation, business cycles, changes in the money supply, fluctuations in interest rates, and other basic economic phenomena. To hold the Commission accountable for either the fluctuations in these crucial variables or for their sometimes devastating by-products is much like holding the agencies that deal with counterfeiting and forged checks accountable for the rate of inflation.

The SEC was not created for the purpose of making everybody rich. Nor was it brought into being to take the losses out of the profit-and-loss system. And no thoughtful person could ever have believed that the Commission could possibly eliminate bear markets. It is highly doubtful that Government is capable of doing any of these things. And if perchance some way of doing them should ultimately be discovered, securities regulation won’t have much to do with it.

When one compares the “New Era” of the late 1960’s to that of the late 1920’s, it becomes rather hard to claim that we have done a great deal to curb speculative excesses or that more disclosure necessarily makes for greater rationality. And with or without an SEC, New Eras have a disquieting habit of coming down to earth. That process is painful.

Twenty-four years ago an earlier committee of the House of Representatives asked an earlier SEC for a report on the Commission’s stewardship of the Holding Company Act. In its response the Commission said:

“It is fitting that an agency which judges others should itself be judged. It is fitting that Congress should take an accounting of our stewardship; and that, as we have undertaken to exact from others the fullest disclosures and the highest fiduciary standards, we should be measured by standards no less exacting.”²⁵

This Commission adopts that statement as its own. A special effort has been exerted to make this historical sketch objective and self-critical. Our shortcomings, our misplaced emphases, and our occasional lack of foresight have not been glossed over.

But fairness to ourselves requires that we close with the observation that our tasks are inherently difficult. Few of the questions with which we deal have simple answers. And the questions themselves are often devilishly complicated. For example:

1. In the sphere of disclosure how does one reconcile the desire of the professional analyst for a wealth of arcane financial detail with the needs of the ordinary, unsophisticated investor? And how can that balance be struck without imposing undue burdens on the issuers who have to prepare this information and excessive costs on the investors whom one is supposedly protecting? It is the investor who pays.
2. In dealing with the markets and with compensation in the securities business, when is mere disclosure sufficient and when is it appropriate to resort to regulatory controls to protect the investor from overreaching by the professionals who serve him?
3. In the realm of self-regulation how does one reconcile the demands of strict legality in disciplinary proceedings with the fact that Congress has opted for a system under which businessmen are tried informally by their peers, a system that cannot possibly work if the decision of these amateur adjudicators are to be measured by the rule of strictissimi juris?
4. The corporate reorganization process depends in large measure on proverbially fallible estimates of future earnings. How, if at all, can a greater measure of validity be given those estimates?
5. The Commission has a special responsibility for the financial soundness of the holding company sector of the utility industry. Yet it has no control over either utility rates or

utility costs. Nor does it have influence over interest rates or money market conditions. So how much can it really do about utility finance?

One could go on and on in that vein.

But the foregoing enumeration is enough to show that a large band of geniuses (and though the people at the Commission have been talented and industrious, they have been few in number, and their best friends would not claim that many of them have been touched by genius), amply financed (and the Commission has for most of its life been on a starvation diet) would inevitably have fallen some distance short of perfection in coping with these matters.

And had we been fortunate enough to come within hailing distance of perfection with respect to something or other, that happy state of affairs would not have lasted long. Economic life is dynamic. So even the best answers serve only for a season. Time makes them obsolete or inadequate.

NOTES

¹After devoting a generation to stern insistence upon depreciated cost as gospel in the carrying of assets, the ravages of inflation are now forcing the Commission and the accounting profession to consider seriously the virtues of “current value” accounting that involves the balance sheet recognition of unrealized appreciation.

²See Freeman, *A Private Practitioner’s View of the Development of the Securities and Exchange Commission*, 28 *Geo. Wash. L. Rev.* 18, 23 (1959).

³Armstrong, Congress and the Securities and Exchange Commission, 45 *Va. L. Rev.* 795, 813-814 (1960). Ex-Chairman Armstrong’s article carried a date of authorship of October 2, 1959. In that same issue of the *Virginia Law Review* Professor Louis Loss of the Harvard Law School, then as now the country’s most eminent student of securities regulation, spoke “of a Congress which has not always bothered even to hold hearings on the legislative proposals, many of them not even controversial, which the Commission has sent up over the years.” Loss, Contemporary Problems in Securities Regulation – Foreword, 45 *Va. L. Rev.* 787, 789 (1960)

⁴Of course, there was no way of seeing to it that anybody actually read them. And indeed they were sometimes unreadable. From the earliest days Commissioners and Commission officials lectured at length on the problem of the “unreadable prospectus.” But during the period here treated there was no effective action to improve the literary quality of the prospectus, which was generally written in legalistic boilerplate. Because these little

(often not so little) books were written by lawyers fearful of liability, because some of the policies of the Commission's staff were not notable for their realism, and because many of the problems of new issue disclosure are so inherently difficult that they verge on the insoluble, the prospectus came to be a kind of an art form in which lugubrious caveats fell like snowflakes but to which few (how few was a much debated question to which no one knew the answer and about which nobody had any empirical data) people other than members of the staff of the Commission's Division of Corporation Finance professionals in the securities business, and practitioners at the securities bar gave any serious attention.

⁵Section 14(b).

⁶There was one great difference of undeniable importance. Because of the Exchange Act's restrictions on the extent to which credit could be used for security speculation, most speculators now relied primarily on their own money rather than on borrowed funds. The margin hysteria of 1929 was gone forever.

⁷House Report 882, 87th Cong., 1st Sess., pp. 2-4 (1961).

⁸Report of the Special Study of the Securities Markets, H. Doc. No. 95, 88th Cong., 1st Sess. ("Special Study").

⁹That battle has been chronicled by the Commission's then-Chairman. See Cary, *Politics and the Regulatory Agencies* (1967).

¹⁰Wharton School of Finance and Commerce, A Study of Mutual Funds, H. Rept. No. 2274, 87th Cong., 2d. Sess. 1 (1962).

¹¹Wharton Report, p. X

¹²House Report No. 2337, 89th Cong., 2d Sess.

¹³The analogy is imperfect. Although holding companies seemed to be doing splendidly for investors during the 1920's, there was much concern at that time over their adverse impact on consumers. There was nothing of comparable proportions in the investment company field during the 1960's. Indignation over seemingly excessive managerial compensation and over sales charges that appeared out of line with those in other sectors of the securities business ran high in the Commission's corridors, in the groves of Academe and at the plaintiffs' bar. But investors were doing quite well. So Public Policy and the Commission's sequels to it evoked no response on Main Street.

¹⁴Although the Commission supported this legislation and participated in the drafting process, the initiative for it came from the Congress.

¹⁵H. Doc. No. 92-64, 92d Cong., 1st Sess.

¹⁶See Securities Act Release No. 4963 (April 14, 1969).

¹⁷40 S.E.C. 907, 912, quoted and followed in *S.E.C. v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 852-853 (C.A. 2, 1968).

¹⁸40 S.E.C. at 913.

¹⁹258 F. Supp. 262 (S.D.N.Y. 1966), *aff'd in part, reversed and remanded in part*, 401 F.2d 833 (C.A. 2, 1968), *cert. denied* 394 U.S. 976 (1969). For further opinions see 312 F. Supp. 77 and 446 F.2d 1301, *cert. denied* 404 U.S. 1005.

²⁰In mitigation it should be noted that the only serious market break that fell within the Special Study's purview and that it examined intensively was that of May and June 1962, a sharp but short decline of no long-run significance.

²¹Congress did not act until after the prosperity of the 60's had passed into history and until after many people had lost lots of money in mutual funds. These developments had no bearing on the intrinsic merit (or lack of merit) of the Commission's program.

²²In November of 1972 the Commission sent Congress a two-part report prepared by its staff on the potential economic impact of free market pricing in the mutual fund field. That report suggested that a free market in investment company securities might well be desirable. It also urged administrative reforms in such areas as advertising, the simplifications of mutual fund prospectuses, group sales, and volume discounts. In 1974 and 1975 the Commission acted on these matters.

²³For fuller discussion of the 1970 amendments see, 37 S.E.C. Ann. Rep. 13-21.

²⁴Laws against homicide are much older than the securities statutes. Nevertheless, people still kill other people. Or to descend to the purely financial, laws against counterfeiting are as old as the institution of money. And they are much, much simpler than the securities laws. But counterfeiting still goes on.

²⁵SEC, Report for the SEC Subcommittee of the House Committee on Interstate and Foreign Commerce on the Public Utility Holding Company Act of 1935 at page 169 (October 15, 1951).