# "New U. S. Securities Law"

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## Speech

*of*

## Hon. Garland S. Ferguson, Jr.

*Federal Trade Commissioner*

*Hon. Garland S. Ferguson, Jr.*



THE WASHINGTON STAR

*And Broadcast Over a Nation-Wide Network of*

THE NATIONAL BROADCASTING COMPANY

Tuesday Night, Sept. 12, 1933

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The Evening Star
The Sunday Star
WASHINGTON, D. C.

Some part of the general public may be under the impression that the "securities act of 1933" is a sudden and hasty creature of Congress, passed only to meet an emergency and intended as temporary legislation. If so, this is an erroneous impression. While it was the collapse of unsound financial structures under the stress of the depression of the last few years that brought home to the people the necessity for such legislation, that necessity had existed for a long time.

Since the days of John Law and the "Mississippi Bubble," since the days of the "South Sea island speculation," the people of France, England, the United States and other countries have had their savings swept away by investment in worthless and fraudulent securities. Those who are most frugal and conservative are often the most easily induced to buy "wildcat" stocks and bonds—are most easily misled by a rose-colored prospectus, and deceived by an inaccurate financial statement. Long ago the principal foreign countries passed laws regulating the issuance and marketing of securities, and have from time to time made them more stringent.

For many years the States, through their "blue-sky" laws, have been endeavoring to protect their citizens from those who would prey upon their savings. These laws have served a good purpose and have afforded protection from those who would sell within the State. Those from without, however, have been little impeded. During the boom period preceding 1930 the interstate sales of unsound securities grew to such proportions that billions of dollars were lost to the people of this country.

Realizing the necessity of national legislation, President Roosevelt, in a message to Congress, recommended the passage of a law that would put a stop to this evil. After many days of public hearings, in which the committee heard the testimony of able, thoughtful and experienced men, and weeks of consideration, Congress passed the act. Its administration and enforcement were intrusted to the Federal Trade Commission.

The success of the act will depend, not only on the ability and fidelity of the commission, but in a large, if not a greater measure, on the support of the public.

If there is any one thing that has grown out of the times of adversity in which we have been recently living it is the desire to make common cause against the problems that confront us. There is now a singleness of purpose in our united efforts such as we could not have hoped for in the days of easy prosperity. And beyond the accomplishment of our immediate purposes there is, I sincerely believe, a hope and

determination that we learn how to build more soundly in the future; that we shall profit by our experience. Of major importance in this concerted drive is the securities act, approved by the President on the 27th of last May.

This legislation aims definitely to shut the door for all time upon those financial methods of the past that brought disaster to thousands of investors and, to a great extent, destroyed the broad base of public confidence upon which our economic structure depends. As a program for the future it opens the way to a rebuilding of public confidence along new lines, along lines that promise untold benefit, not only to the great number of people who have their savings to invest in industry and in business, but also to those business and industrial organizations which merit that confidence, and stand ready to deal wth their investors as co-partners in a common enterprise. To those who hold that the requirements of this act stand in the way of financial recovery, I reply that recovery is impossible unless confidence in financial institutions is first restored to the great number of large and small investors whose savings make possible the very existence of those institutions. And once that confidence has been restored it is unthinkable that the irresponsible financial practices of the earlier era shall again be allowed to lead us blindly to the same tragic outcome.

The outstanding purpose, I might say the principal purpose, of the securiites act, is that full disclosure shall be made of all material facts concerning an issue of securities that is offered for sale to the public. It stands squarely upon the principle that an investor whose savings are solicited for the uses and purposes of a corporation is entitled to be told the truth, the whole truth, and nothing but the truth. It proceeds upon the assumption that those who accept the trust of employing the money of other people in the conduct of business must let those people know the purposes for which their money is to be employed, and facts upon which they can exercise their own judgment as to the wisdom of their venture. Surely there is no element of startling radicalism in this requirement. It is the simplest requirement of common honesty. Common honesty which consists of telling all the truth and not merely the savory part of it, is the legal standard to which those who offer securities for public investment must conform. The only wonder is that the enactment of this standard of fair dealing has brought forth from some quarters the cry that it is dangerous and destructive and will unduly hamper legitimate enterprise. This, I am happy to believe, is a cry which comes only from those whose hold upon the

standards of the past gives way reluctantly before the more candid and more forthright standards of the present.

To accomplish this purpose the act provides that an issuer of securities shall, before offering them for sale to the public, make disclosure of all the material and significant facts concerning it. Twenty days before the issue is to be offered for sale, the issuer must file with the Federal Trade Commission a registration statement contianing all the material facts in regard to the issue, such as are necessary to even an elementary judgment upon the value of the security, and a copy of the prospectus by which the issuer proposes to lay those facts before the public. During those 20 days the commission examines the documents for omissions, inaccuracies or untruths. Such of these as it finds the issuer must correct. Until correction is made the commission may delay, by a stop order, the date when the security may be offered for sale.

Should the issuer proceed to sell the security without having filed the required statement, the Federal Trade Commission may apply to the courts for an injunction restraining such selling, and the Attorney General may seek to enforce the criminal penalties provided in the act.

But neither the commission nor the Attorney General is empowered by the law to pass upon the quality or the investment value of any security. Neither the issuer's right to offer nor the public's right to buy a security may be limited under this act on account of its speculative, unsound or hazardous character. The securities act differs in concept and in plan from the so-called "blue-sky" laws of many of the States. While certain of the State commissions pass upon the quality of a security to determine whether or not it may be offered for sale within their jurisdiction, the Federal act, as proposed by the President and enacted by the Congress, adheres to the principle which I have already stated, namely, that investors shall be told the truth, and all of it, concerning securities publicly offered for sale.

Obviously, then, it was the intention of Congress that the corrective power with respect to unsound financial and investment practices be placed largely in the hands of the investing public. This, to my mind, is an outstanding virtue in the Federal act. It has been most wisely fortified in its provisions. The lack of power in the commission to supervise or control the decisions of investors is supplemented by a grant of relief to investors by suit for recovery of money paid for a security falsely or inadequately described in the statements made concerning it. This liability is imposed by the act upon the issuer or issuing company,

upon is directors, principal officers and underwriters, and upon such experts as are quoted, with their consent, in the statements made by the issuer. They are held responsible, however, only for the use of reasonable diligence, such as is required of any fiduciary who undertakes to manage the property of others in their behalf. Any of them except the issuer itself may escape this liability if they can prove that they exercised such diligence in determining the accuracy of their statements to the investor.

I do not wish to convey the impression, however, that in granting these rights to investors and in leaving them free, as before, to make their own decisions on investments, the securities act has imposed no important duties upon the commission. This is far from the case. The right of investors to be told the truth on security issues, and their right to recover their money upon proving a falsehood, would turn out to have little practical value if there were not also the provision for requiring issuers to make a definite commitment on the material facts of their securities. This requirement appears in the provision for filing a registration statement and a prospectus. The enforcement of this provision is the most important function of the commission under this act. Broad powers are given to it to prescribe the form and, in large part, the content of the facts that shall be stated in registration and prospectuses.

The most important requirements in this respect are statements of the purposes to which the money raised by the new issue is to be put, and statements showing the financial condition of the company at or shortly before the date of issue, and its operations during the last three years. In connection with the purposes of new financing, the forms prescribed by the commission require adequate descriptions of the property to be acquired, how much is to be paid for it and to whom, and complete revelation of any interest in such property owned by promoters, officers or directors of the issuing company. In the matter of financial statements, the commission is given authority to prescribe not only the forms in which statements shall be rendered, but also by what terms the various items of assets, liabilities, profit and loss, shall be designated. This feature of the act will undoubtedly contribute in large measure to the furnishing of more uniform and more informative financial reports to the investing public. That such an outcome is very much to be desired is surely not open to question if we have learned anything at all from the unhappy experiences of the last few years.

Up until September 1 the commis-

sion had received for filing 191 registration statements involving securities amounting to $211,900,000. The task of examining these statements as they come in will provide us with what I might call a running comment on the response of corporate and other issuers to the public demands which are made upon them by the requirements of this act. Will there be frank acceptance of the principle that a business which solicits investment by the public is bound to render fair account of itself and of what it proposes to do with the money? Or will there be an effort to defeat those requirements and to refuse that responsibility? Our brief experience with these statements has shown on the whole a very definite intention on the part of issuing corporations to meet the requirements of registration, not merely in a technical sense, but fully and generally in compliance with its intent and purposes.

Of particular interest to us in this connection is the co-operation of those professional groups that are, and necessarily will be, called upon to render services in the preparation of registration statements. The public accounting profession, for example, is called upon by the terms of the act to audit the financial statements which must be furnished by the issuer. The accountant who does this work is required to be independent. He renders his services on behalf of the issuer, but in doing so he has a very definite obligation to the investing public.

To the legal profession also is given a vital opportunity to serve not only the clients who, as issuers of securities, seek its advice, but also the investors to whom those securities are to be sold. Sound legal advice in this matter will proceed, in my opinion, upon the theory that the act quite properly requires a full, frank and unstinted disclosure of the facts which a prospective investor needs to know. The securities act is, and I trust it may remain, dangerous to those who seek to evade the responsibility of telling prospective investors the whole truth. Let me urge upon the legal profession a recognition of the fact that the liability created by this act is a contingent liability. It is contingent upon a lack of good faith, or a want of reasonable care, or dishonesty. In the absence of these there is nothing any reasonable man need fear. However, one result may be that there will be more directors who direct and fewer directors who are directed.

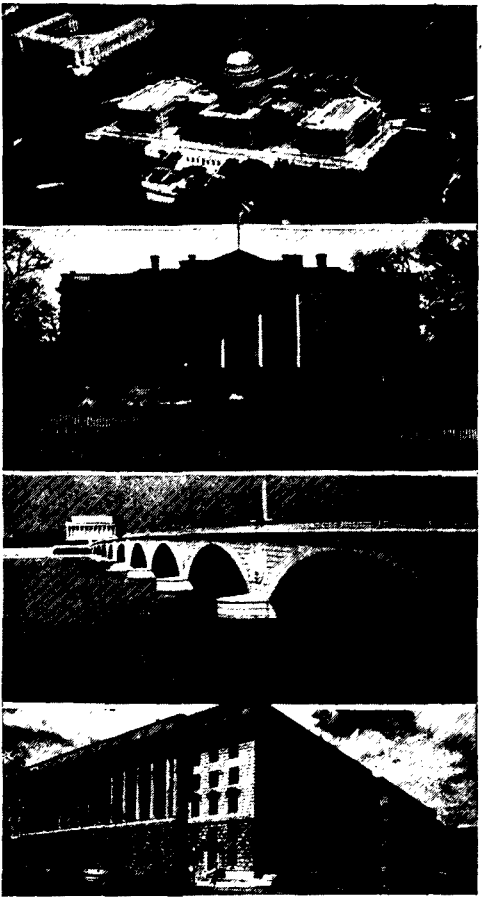
While it has been correctly said of the act that it substitutes a doctrine of caveat venditor for caveat emptor, the fact remains that by the exercise of good faith and reasonable diligence in the rendering of statements the caveat may in practice be dispensed with entirely, so that neither the buyer

nor the seller shall have reason to beware of the other.

The securities act is not predicated, as I view it, upon the theory that the interests of investors are in conflict with the interests of the issuers. On the contrary, it embodies the most practical recognition ever put into Federal law of the fact that the investor and the corporation are mutually dependent. Neither can continue to prosper at the expense of the other, nor can either fail in the sharing of responsibilities without bringing failure to both. A law which is founded upon this view and which seeks to give a new and practical meaning to the interdependence of these two interests assuredly is a law that will work to the benefit of those corporations which, by telling their story to the public, can prove that they merit public confidence. Directly it will benefit them through helping to restore the confidence to their investors; indirectly also it will help them by making the distinction more clear between those concerns that do and those that do not deserve the continued support of the investing public.

If, out of the opportunity that this law creates, we cannot restore the public credit of private corporations, and if, out of the standards that this law makes mandatory, we cannot make progress toward a more enduring financial and economic structure, then indeed we have learned nothing from the tragic mistakes of the recent past. But I will not accept that outlook. I am not ready to believe that the letters which the commission receives daily from persons who invested and lost all they had saved are letters that must be written over and over again indefinitely in the future. Restitution of their losses cannot now be made to them; but that they and those who follow them shall not again be betrayed by the false promises, the glittering half truths and all the paraphernalia of arrogant financial practices is the purposes for which the securities act was written. It will be administered to that end.

# Washington



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