REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES.

SECURITIES AND EXCHANGE COMMISSION

Part VI, Section IV:

CONCLUSIONS AND RECOMMENDATIONS

We conclude that it is necessary in the public interest and for the protection of investors (1) that the trustees under these indentures be disqualified from acting or serving if they have or acquire conflicts of interest incompatible or inconsistent with their fiduciary obligations; and (2) that they be transformed into active trustees with the obligation to exercise that degree of care and diligence which the law attaches to such high fiduciary position.

This Commission is at present vested only with limited powers which can be exercised to the end of reaching these desired objectives. By virtue of the powers vested in it under Section 19 of the Securities Exchange Act of 1934, it can by appropriate rules and regulations change the listing requirements for securities on national securities exchanges or by order alter or supplement the listing rules of such exchanges, on determination by the Commission that such changes are necessary or appropriate for the protection of investors. In light of the conditions which our study has revealed, we propose to determine the extent to which listing requirements along the lines of the foregoing recommendations can be developed. There are, however, two practical limitations of such a program. In the first place, such listing requirements would reach only the rather limited classes of securities dealt in on such exchanges. In the second place, the Commission cannot in justice to exchange trading set up such strict standards for the indentures and the trustees acting thereunder as to make it more attractive for issuers to stay off the exchanges and thus to be able to use any form of trust indenture and any trustee desired. Hence, although the Commission can move towards the objectives of the proposed reforms by exercise of its powers under Section 19 of the Securities Exchange Act of 1934, that power and method are inadequate for effectuation of the proposed reforms.[356] Uniform legislation by Congress is accordingly necessary.

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[356] Under Section 7 of the Public Utility Holding Company Act, however, this Commission has broader powers over the terms and conditions of the issuance or sale of securities of registered holding companies and subsidiaries. We propose to determine how far it is practicable to go in adopting rules and regulations under that Act embodying the foregoing standards in advance of uniform legislation applicable to all types of issuers. Sec. 7 is applicable to the issuance or sale of securities by a registered holding company or subsidiary company. It provides for filing by such companies with the Commission of a declaration concerning such issuance or sale and prescribes conditions precedent to such declaration becoming effective. In subsection (d) it provides that if such conditions precedent are satisfied the Commission shall permit the declaration "to become effective unless the Commission finds that * * * (6) the terms and conditions of the issue or sale of the security are detrimental to the public interest or the interests of investors or consumers."

Such legislation should be part of an integrated legislative program dealing with all phases of the reorganization problem. It should be aimed at refashioning the trust indenture in light of the objectives which have been discussed.

As in case of the Securities Act of 1933, the point of control should be the public offering of securities. Such legislation should provide for the setting of minimum standards for indentures under which securities are issued and publicly offered and qualifications for those undertaking to act as trustees for such security issues. It should forbid the use of the mails or any means or instruments of transportation or communication in interstate commerce for the sale of securities issued under indentures, unless these indentures and the trustees thereunder meet the prescribed standards. The protection of investors will require not only that conflicts of interest of trustees be eliminated but also that some safeguards against impecunious and irresponsible trustees be established. This is essential lest the safety of funds be jeopardized and the administration of these vast trusteeships fall into irresponsible hands. Towards that end provisions should be made that the trustee should be a bank or trust company, organized under state or federal laws, with resources commensurate with the responsibilities of the proposed trusteeship.

Furthermore, such standards should be sufficiently broad as to prescribe the requirements for the fiscal or paying agent under these indentures. We have pointed out in our report on Committees for the Holders of Real Estate Bonds certain critical conditions arising out of these fiscal or paying agencies. We noted there the reckless manner in which the funds were used or invested; the way in which control of the fiscal or paying agency by mortgagor and house of issue led to concealment of defaults; the method by which the earnings from these funds were retained by the fiscal or paying agent rather than credited to the bondholders or the mortgagor, as the case might be. Consequently we conclude that the fiscal or paying agency should be divorced from the mortgagor and house of issue and either be placed under the control of the trustee or in the hands of a wholly independent and responsible bank which is under a duty to notify the trustee of defaults. Furthermore, the fiscal or paying agency funds should be guarded with the same care as trust funds and be invested pursuant to the same standards. Earnings from these funds should not accrue to the fiscal or paying agent; his compensation should be fixed pursuant to the worth of his services.

Certain exemptions from such regulation doubtless can be provided where the character or amount of such security issues are not of true national concern. Further, it may be advisable to vest in the Commission power to provide for exemption of other classes of securities where in light of the small amount of the holdings, the absence of broad distribution, or the short maturity of the obligation it would not be necessary in the public interest or for the protection of investors to require these higher standards of trusteeship.

Other parts of the integrated legislative program in the reorganization field which we will submit can be made to buttress such legislation. Thus, Federal courts or administrative agencies in passing on the fairness of the plans of reorganization can be required to examine the indentures under which any new securities are to be issued to ascertain that they comply with these new standards.

Such measures would go far towards curbing the exploitation of investors which has occurred either at the hands of the trustee itself or at the hands of the reorganization and management groups with the knowledge, consent, or acquiescence of a complacent and inactive trustee. The result would be that investors would have an active guardian of their interests throughout the entire life of the security. There would be carried over into the corporate field the standards of fiduciary relationships which have long obtained in personal trusts and with which these professional trustees have had a long and rich experience. In view of the history of exploitation of investors under present trust indentures any less rigid requirement would be inadequate. There can be no permanency of integrity and confidence in this field unless those in control of other people's investments are held to high fiduciary standards of conduct.

(From General Hugh S. Johnson's column, "One Man's Opinion.")

"'We believe in a balanced budget at any cost except the cost of widespread human misery. As recovery creates employment in private business the relief cost will lighten, revenue will increase, the budget will move into balance and taxes and debt can be reduced. We will not abandon necessary farm and unemployment relief to hasten this process. On the other hand, we will not continue any relief expenditures which are not indispensable to preserve the health and self-respect of the sufferers and casualities of the depression.

"'No past or probable future spending threatens the credit or soundness of the money of the United States, now on a firmer basis than that of any country in the world--amply backed by gold, and well supported by the resources and income of the country, by a favorable balance of trade and by a strong creditor position among the nations. We purpose to keep them safe and firm by reducing expenditures as promptly as our relief obligations will permit, and by providing by taxation for expenditures or for the prudent amortization of unavoidable debt. We shall continue to oppose any resort to the printing presses to finance expenditures.

"'We propose stabilization of the dollar on foreign exchanges as soon as that can be done without exposing our foreign trade to the money maneuvers of other nations.'"