Presidents and Securities Regulation

by Charles D. Niemeier

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While the U.S. Securities and Exchange Commission (SEC) is an independent regulatory commission, it would be a mistake to assume that the White House does not assert influence on securities regulation. Presidents must respond to current events. Economic crises, particularly those affecting the investing public, compel the Oval Office to act. Some presidents, as part of their economic policies or philosophies, support more fundamental changes.

During this election year, we can take a look back at two presidents, Franklin D. Roosevelt and John F. Kennedy, and their roles in securities regulation: Roosevelt in response to the Great Depression, and Kennedy in inspiring a new role and impact for government.

Franklin D. Roosevelt

In a 1934 letter to Adolf Berle, author of *The Modern Corporation and Private Property*, Franklin D. Roosevelt wrote:

> The fundamental problem with the whole Stock Exchange crowd is their complete lack of elementary education. I do not mean their lack of college diplomas, etc., but just inability to understand the country or the public or their obligation to their fellow men.[1]

Roosevelt's New Deal became many things: a guarantor of labor rights, a provider of a social safety net for the poor and elderly, and a transformer of the power and nature of government. But it began as an effort to pull the nation out of the Great Depression through what the president termed "bold, persistent experimentation." With securities regulation, Roosevelt faced two tasks: reform the way securities were sold, and reform the stock exchanges themselves. With the leadership of Speaker of the House Sam Rayburn, the Securities Act of 1933—along with statutes covering banking, agriculture, and national recovery—passed during Roosevelt's vaunted first 100 days in office. By 1934, Roosevelt was ready to pursue stock exchange legislation. However, while business had been caught off guard with the 1933 Act, it now—with the New York Stock Exchange (NYSE) at the forefront—orchestrated what Rayburn later called "the biggest and boldest, the richest and most ruthless lobby Congress had ever known" to defeat or eviscerate the bill. Congress bowed to political realities to pass the Securities Exchange Act of 1934, which included a compromise backed by business interests: the new act would be enforced by a new agency, the U.S. Securities and Exchange Commission.

In a May 11, 1934, letter to Felix Frankfurter on the "Skipper's" (i.e., President Roosevelt's) plan for the first SEC commissioners, Thomas Corcoran wrote:

> The ticket for the Stock Exchange Commission on which the Skipper has secretly smiled is Jim [Landis], Democrat; Ben [Cohen], Democrat; Judge [Robert] Healy Republican; [George] Mathews, Republican; and your friend, Joe [Kennedy] in Boston, Democrat. The last is particularly "deep well," comes straight from the Skipper through Ray [Moley]. The Stock Exchange Bill with Securities Act amendments will pass the Senate tomorrow and ought to get out of conference and finally passed during the week of May 20th. The degree to which the Skipper goes through on the ticket at that time will give us a much more concrete idea than we have of just where we stand.[2]

The functions of the SEC would be many. It would regulate securities exchanges and over-the-counter markets and register the securities traded there. It would have the power to scrutinize members of exchanges and issuers of securities by demanding statements from directors, officers, and principal stockholders. The American people had the federal government's promise that it would do its best to rid the financial markets of the excesses of the 1920s and make them, if not entirely safe, at least a bit less hazardous. The Securities Exchange Act, like so much of the legislation that marked the early New Deal, was an attempt by Roosevelt at compromise—an effort to get both private enterprise and the federal government working together to create a stronger, more equitable economy.

In a Sept. 20, 1935, letter accepting the resignation of Joseph P. Kennedy as SEC chairman, Roosevelt wrote:

Sept. 23, 1935, commissioners, division heads, and assistant division heads of the Securities and Exchange Commission. Front row, center to right" Commissioner Robert Healy, Chairman Joseph Kennedy, Commissioner George Mathews, and Chairman James Landis.

Nov. 16, 1961, Securities and Exchange Commission. Standing: Commissioners Manuel F. Cohen and Jack M. Whitney II. Seated: Commissioner Byron D. Woodside, Chairman William L. Cary, and Commissioner J. Allen Frear Jr.

> You undertook a pioneer piece of administration, the successful achievement of which was as difficult as it was important for the country. Under your leadership, the Securities and Exchange Commission took two of the most important regulatory measures ever passed by Congress—the Securities Act and the Stock Exchange Act—and administered them so effectively as to win the confidence of the general investing public and of the financial community, for the protection of both of which these statutes were designed.

The SEC is one of the few New Deal agencies still functioning. The agency did precisely what Roosevelt had envisioned: create better conditions for American business and more equitable markets for American investors. On the cusp of the nation's entry into World War II, as he signed the Investment Company Act and the Investment Advisers Act, Roosevelt stated:

> These Acts give the Securities and Exchange Commission power to regulate investment trusts and investment counselors. They mark another milestone in this administration's vigorous program to protect the investor. As the pressure of international affairs increases, we are ready for the emergency because of our fight to put our domestic affairs on a true democratic basis. We are cleaning house, putting our financial machinery in good order. This program is essential, not only because it results in necessary reforms, but for the much more important reason that it will enable us to absorb the shock of any crisis.[3]

John F. Kennedy

In a March 1961 letter to President Kennedy, J. Truman Bidwell wrote:

> I would like to have you know, Mr. President, that I am an American first, and a member of the New York Stock Exchange second.[4]

The election of President John F. Kennedy in 1960 sparked a new enthusiasm for government involvement in public affairs. Kennedy, at 43, was the youngest-to-date president elected and had campaigned on the theme of attracting the "best and the brightest" public servants to his administration.

The SEC had been under increasing criticism from Congress and the press during the 1950s. A 1956 *TIME* article[5] faulted the SEC for being dominated by the financial industry that it was charged with regulating. Soon after his election, Kennedy appointed former SEC Chairman and Harvard Law School Dean James Landis to head a study of federal regulatory agencies—including the SEC—and to develop a plan of reorganization that would make the agencies more responsive to current issues.

Kennedy then appointed Columbia Law School professor William Cary as SEC chairman. One of Cary's first goals was to increase funding for the SEC by using the results of the Landis study, which described the "budget starvation" of the previous administration. Cary persuaded Congress to authorize the SEC "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" to complete what would come to be known as the Special Study of Securities Markets.

Arthur Rothkopf wrote about that time in a 2001 letter:

> The years I spent working with the dedicated lawyers, economists and accountants of the Special Study were among the most satisfying and meaningful of my professional life. We worked extraordinarily long hours and we worked collegially. Most of us were young—very young. We were brash and we thought we knew more than we did. But we were dedicated to serving the public interest and I believe that we did so in an important way.[6]

During the work of the Special Study, the NYSE, concerned about its implications for its members and the stock market in general, organized a concerted effort to react and respond to demands made by the Study staff. On May 28, 1962, in the midst of the Study's work, the market suffered a significant break when the Dow Jones Industrial Average fell 5.7 percent—the second-largest point decline since the 1929 crash. Both the SEC and the NYSE realized that the recommendations of the Special Study could significantly affect the way the exchanges did business.

The Special Study was released in stages during 1963. Historian Joel Seligman has called the Special Study "undoubtedly the single most influential document published in the history of the SEC," providing "the foundation for most of the reforms that occurred in the securities industry in the ensuing 15 years." The Special Study refocused the SEC's emphasis on fiduciary issues, those issues that had been most emphasized during the New Deal. The Securities Acts Amendments of 1964 were the most significant securities legislation passed by Congress in the aftermath of the Special Study.

Sadly, the year of the Special Study's release also witnessed the assassination of President Kennedy. Mark Kessler recalled the Commission's reaction to the news:

> From the beginning, some of those present, such as [Jack] Whitney and [Barney] Woodside, were responding with clarity of thought and purpose, whereas others, such as [William] Cary and [Manuel] Cohen (a man who wore intense emotions and loyalty on his sleeve), were so grief stricken and shocked that they had to struggle to participate meaningfully in the discussion and decisions that had to be made.… It was extremely impressionable for this young attorney to observe such an august group of men, all engaged in the same cause, reflecting the full range of human emotions in the context of an unfolding national tragedy involving our very popular president whom virtually all of them had known or to whom they were beholden for their jobs.[7]

The Next President

The next president of the United States will have an economic policy and a view of how regulatory agencies should work, and will thus impact the SEC's leadership and activism going forward. As President Roosevelt stated in his April 29, 1938, message to Congress:

> The people, in and out of the halls of government, who encourage the growing restriction of competition either by active efforts or by passive resistance to sincere attempts to change the trend, are shouldering a terrific responsibility. Consciously, or unconsciously, they are therefore either working for control of the government itself by business and finance or the other alternative—a growing concentration of public power in the government to cope with such concentration of private power. ⊙

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Endnotes

[1]Letter from President Franklin D. Roosevelt to Adolf Berle (Aug. 15, 1934).

[2]Letter to Felix Frankfurter from Thomas Corcoran (May 11, 1934).

[3]Address of SEC Chairman Jerome Frank, *The Sin of Perfectionism* (Oct. 18, 1940).

[4]Letter to President John F. Kennedy from J. Truman Bidwell (March 14, 1961).

[5]*Protection for Investors: The SEC is Unequal to the Job*, TIME (July 16, 1956).

[6]Letter from Arthur Rothkopf (Oct. 2, 2001).

[7]Mark K. Kessler in remembrance of the SEC on Nov. 22, 1963 (Dec. 17, 2003).