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Speeches SEC Staff

"REGULATION OF THE OVER-THE-COUNTER
SECURITY MARKETS"

ADDRESS

by

SENATOR FRANCIS T. MALONEY

At a Luncheon Meeting of

California Security Dealers Association

Investment Bankers Association

National Association of Securities Dealers

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Opportunities to make an address which is neither a Congressional debate nor a political speech are fairly rare in the life of a Senator. I am therefore particularly pleased to take advantage of the opportunity which you are affording me today to discuss a subject which, in the ordinary sense of the word, is completely non-political. I refer to the 1938 amendment to the Securities Exchange Act of 1934.

As you all know, the first national securities dealers association to be formed under that amendment has just been registered by the Securities and Exchange Commission. It therefore seems appropriate at this time that I, as the individual who must accept responsibility for the introduction of the measure, should review before an audience of this character something of the historical background of what is sometimes called the Maloney Act and the promise which it holds for the future. It is not my purpose and it would not be appropriate for me to discuss the mechanics or the administration of the Act. Those are matters within the jurisdiction of the Securities and Exchange Commission, which I know constitute the subject matter of numerous round table conferences between the representatives of the securities business and those of the Commission. It is rather my intention to take advantage of this occasion, so soon after the registration of the National Association of Securities Dealers, to discuss the philosophy underlying the Act and its connotations for the future.

I have said that this subject is non-political. That statement is true. No individual or small group of individuals may justly claim the complete authorship of this measure. It represents a joint enterprise and a protracted effort by the government and the investment bankers and security dealers of the country to accomplish a result earnestly sought after by each. The statute as finally enacted, while perhaps perfect in the eyes of no one, since perfection is at best rare, undoubtedly represents a far greater degree of unanimity of opinion on the parts of both government and business than does any other law regulating the securities business which has ever been enacted. That such is the case is the result of the spirit of close cooperation and of compromise which characterized the representatives of the Securities and Exchange Commission and of the securities business in their negotiations and in their appearances before the committees of Congress. No one achieved everything that he desired, but the net result has received the blessing of all parties concerned. This fact alone would make the 1938 amendment a landmark in the relations between the brokers and dealers of the country and the government.

But perhaps of even greater significance is the underlying purpose of the Act itself. For this legislation represents what is actually a two way street in the field of cooperation between government and business. In the vast and highly ramified business in securities transacted otherwise than on exchanges, this Act is designed to effectuate a system of regulation, the need for which is recognized on all sides, in which the members of the industry will themselves exercise as large a measure of authority as their natural genius will permit.

And here let me say that no one is more familiar than I with the very high quality of intelligence and character of the men engaged in your business. My native State of Connecticut was one of the early cradles of banking and finance in this country. The finest traditions of public responsibility

and honor are deeply embedded in our financial community. So far as I am qualified to judge, and I think I am fairly well qualified, what I say of the bankers and securities dealers of Connecticut is generally true throughout the country. First as a member of the Committee on Interstate and Foreign Commerce of the House of Representatives and then as a member of the Banking and Currency Committee of the Senate, it has been my privilege to meet personally a very large cross-section of your profession from all parts of the United States and to discuss with them the legislative problems which have been our common concern. Though, unfortunately, I cannot lay claim to the same intimate acquaintanceships and years of experience in California which have been mine in New England, I have good reason to know that the same high standards of financial integrity maintain among you as do in my native State. Furthermore, the importance of your profession in all parts of the country is unquestioned. Without it, the economy of this country could never have been built up as it has been.

Unfortunately, however, there can be no large group of people engaged in any industry or enterprise which enjoys potentialities for profit which does not attract the careless or the greedy few who bring discredit upon the entire group unless prevented by regulation from so doing. It is with this problem of imposing proper standards of business conduct upon that small minority who are unable to function properly without external restraints that we have all been wrestling for years. The machinery of your business is delicate. It can be dislocated either by corruption from within or by unwise and burdensome regulation from without. Our task is to prevent the former without risk of the latter. The statute we are discussing today provides a formula designed to accomplish this result. This formula is predicated upon the principle that corruption from within, so far as possible, should be prevented from within, and that external restraints should be rendered unnecessary as a result of the exercise of self-restraint.

It was the purpose of Congress to provide the broadest practicable opportunity for the knowledge and experience of the members of this highly technical calling to be employed in the elimination of undesirable practices and in the promotion of truly professional standards of character and competence. Subject only to such governmental controls as are believed to be necessary to safeguard minorities and individuals and to prevent the growth of monopolistic or similar abuses, Congress has undertaken to provide a mechanism whereby the securities business of the country may deal with all problems of technical regulation, leaving to the Securities and Exchange Commission what it is hoped will be the residual position of policing the submarginal fringe which recognizes no sanctions save those of the criminal law and of dealing with those problems of regulation with which the industry, as organized under the Act, finds itself unsuited or unable to deal.

That this legislation will be administered in the light of this Congressional intention seems amply clear from the statements which have been made by the Commissioners and officials of the SEC. These gentlemen have stated repeatedly that, insofar as the business can and will take the initiative under the Act, the Commission will be more than happy to play the residual role which I have described. Sight must not be lost, however, of the fact that the Commission, under the various Acts which it administers, is charged with a Congressional mandate with respect to the securities markets of the country. This mandate must be carried out and it is hoped that it will be, so far as possible, by the voluntary action of the brokers and

dealers themselves. The Commission, however, still retains jurisdiction to supplement such voluntary action by direct regulation where such is found to be necessary. Thus there has been established the program for what I think has quite properly been called truly cooperative regulation. So far as I know this is a pioneering effort in the field of cooperation between business and government, though a natural development of the program for the regulation of exchanges contained in the original Securities Exchange Act of 1934. One of the best indications of the probable success of this undertaking seems to me to be furnished by the degree of cooperation achieved in the production of the legislation of 1938.

Unfortunately, your business has been passing through one of those quiet periods which from time to time occur in our economy. There are many indications, I am happy to say, that this period of dullness is drawing to a close. In my own industrial State, with the conditions of which I am most familiar, I can definitely state that business is much improved. Nevertheless, it is clear that a special effort is required in times such as these, to bring to complete fruition an enterprise of the magnitude and importance of that which is now being launched within your business. It is primarily for the purpose of urging upon you, who are the leaders in this great enterprise, the exercise of an intensified energy and a magnified enthusiasm that I appear before you today. I do not ask or suggest that you undertake this special effort because I want some special credit from an Act which bears my name. I can assure you that I have no pride of authorship or of sponsorship of that Act except so far as it or I can be a little helpful in promoting your great business and through it the general business welfare of the country. There exists no compensation for a conscientious legislator other than such satisfaction as may result from witnessing betterment of the conditions under which men must live and work as the result of wise legislation. The ultimate sound prosperity of your business is as close to my heart as it is to yours because, insofar as you prosper soundly, an important contribution is made to the entire business life of the nation.

We are all at times critical of government and of legislative policy. It is only human to find it easier to condemn than to construct. Most of us, however, have sufficient experience and maturity to realize that little is accomplished by purely negative criticism; and in this realization can only fairly ask, in those phases of our lives which are to us most important, a fair opportunity to bend our energies in the direction of constructive effort. In your business such an opportunity is afforded you in the 1938 amendment to the Exchange Act. Here is provided your chance as an industry to take the initiative and make an important and permanent contribution to good government. As Americans we all naturally abhor regulation. Both you and I would like, so far as possible, to live without rules of conduct being imposed upon us. We are, however, old enough to know that, in a civilization as complicated as ours, it is essential to the public welfare that there be a very large amount of regulation. When traffic lights first made their appearance among us, I dare say we all grumbled about what today we recognize as a public necessity. We all can multiply this simple illustration manyfold. However, a mere recognition of the need does not necessarily make the process of regulation more palatable. We all desire to confine it to its essential minimum. Nevertheless, we all recognize that it must not be permitted to fall below that minimum lest the healthy flow of commerce be rendered as chaotic as undirected traffic on the streets of a great city.

The form of regulation, however, may well be as important as its substance. The regulation within a highly professionalized business such as yours should not only be very much more acceptable but also more effective than the imposition of legal sanctions. The very form of rules and the procedure for their adoption and enforcement with an association organized under the Act, can be infinitely more simple, exact, comprehensive, and understandable than those of a public administrative body required to act under rigid legal formula. Moreover, while it is possible for public authority to undertake to stamp out abuses and to eradicate demonstrated evils, there is little of an idealistic nature which can be accomplished by criminal law and administrative rule-making. An important part of our problem, it seems to me, is the promotion of the vitality and well-being of your great business. How much more competent you are to play the dominant role in this undertaking than can be any group of public officials, no matter how wise or how devoted! That the forward-looking brokers and dealers throughout the country are well aware of these considerations is demonstrated by the fact that the challenge has been accepted. A national securities dealers association has been formed and registered with the Commission, but the important work lies ahead. Let us all hope that the energy and enthusiasm which has brought this association into being will carry it forward to a future of accomplishment as brilliant as its opportunities are challenging. Is it visionary to suggest that we may be attending the preview of a drama in which not only in the securities business but all branches of American industry may some day play a part?

As I have already indicated, it is almost necessarily the case in cooperative enterprise that no one is able to effectuate all of his views. Differences of opinion are, of course, inevitable when engaged in pioneering. Even when there is substantial agreement as to objectives, reasonable and honest men can differ very widely on questions of method. It is therefore not surprising, as I read the opinion of the Securities and Exchange Commission granting registration to the National Association of Securities Dealers, that there should be a few reservations in the mind of the Commission with respect to some of the provisions of the constitution and rules of the association. Experience and a common will to make this effort a success should in due time correct such mistakes as may be found to have been made. In any event, a very substantial beginning has been made and I find it a source of gratification that it has been found possible substantially to reconcile the views of the many elements in the over-the-counter securities business throughout the country and to coordinate the efforts, not only of the established groups within the business such as the Investment Bankers Conference, the Investment Bankers Association, the California Security Dealers Association and the others, but also of a vast number of individual houses both large and small.

The precise form of the organization and rules of the new association which has just become registered in all probability are not entirely to the satisfaction of anyone. Many of us had hoped and continue to hope that it would be able to assume an even larger measure of responsibility over the business than is provided for in the present rules. Nevertheless, the program has always been recognized as essentially evolutionary and a long step forward already has been taken. Here, in a most important field, active cooperation between government and business is at last a reality. In what has heretofore been a heterogeneous and almost entirely unorganized group of firms dealing in securities over the counter, there has come into being

a mechanism whereby the government, through the SEC, and the brokers and dealers throughout the country can combine their energies for the protection of the public and of the securities business against the depredations of the few. Clearly such protection is the first and most important element in securing the confidence of the public, without which there can never be a healthy and prosperous securities business. Now, as in the case of a properly organized and administered securities exchange, there is a medium within the business itself through which the investing public can undertake to obtain redress where there has been unfair dealing and preventive measures to eliminate improper practices without being forced to invoke the necessarily somewhat cumbersome processes of law. All of this I conceive to be a great achievement, not in the field of politics as the word is often used, but in that of democratic government.

I am exceedingly grateful to you for inviting me to meet with you and to speak to you briefly on a subject of such importance to you and to all of us. The future of your business is in your hands. I think the prospects are brightened and your business immeasurably strengthened because you now are members of a partnership with government. This partnership is in a sense unique in the field of American business. It affords brilliant possibilities in the achievement of which your fraternity should be immeasurably assisted because there has been made available to it the talents, experience, noble purposes, and energy of that skillful body of men in Washington who compose the Securities and Exchange Commission and its staff. Their task is at least as difficult as yours, and believe me when I tell you that they can have no real reward without your success in achieving the major objectives. Because I know the men of that Commission and because I am well aware that your fraternity is composed of people of patriotism, courage, vision, and firm faith, I look forward with confidence to the future of this partnership which has been formed between government and business. Benefits which should flow to the public from such an alliance are incalculable and, likewise, the upward and forward movement of your business and of business generally should be definitely stimulated.

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