

ADDRESS

of

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before

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For me, this is no ordinary occasion. It marks the last formal statement which I will make as an official of the Securities and Exchange Commission. Upon returning to the practice of law on December first, I shall have rounded out five years in the government service.

During those years, a great many changes have occurred in our financial system. Perhaps it is too early to gauge with complete accuracy the effects and the incidents of these changes. But on the backlook it is abundantly clear that they have grown out of the struggle of a maladjusted society to integrate more effectively and to distribute more equitably the rights and responsibilities of its component groups. Because these changes have their roots in the elemental need for a stable economy, and not in the exigencies of the moment, they are of more than passing significance and will endure.

It has been an absorbing spectacle to watch the awakening of a great nation to the deficiencies in its economic structure. From our present point of vantage we can trace that awakening from the period of investigation when the betrayal of the investor by many of his financial leaders was first laid bare for all the world to see; through the period of legislation when a new code was written around the central doctrine that the interests of the investor are of paramount importance not only to himself but to the society which needs him so badly; to the period of regulation when the Securities and Exchange Commission entered upon the task of translating that doctrine into reality.

The magnitude of the projects which confronted the Commission intrigues the imagination. In some quarters the opinion was held that many of them were impossible of accomplishment and that the obstacles were unsurmountable. Yet, during the relatively brief period of its existence the Commission has compiled a record of achievement which is genuinely impressive. In our constant absorption with the problems of today we are prone to forget the progress thus far made. I think it peculiarly appropriate, therefore, that I recapitulate some of the results of the Commission's labors during the past three years.

Every securities exchange in the country has either been registered as a national securities exchange or exempted from registration. The process of registration entailed a far-flung investigation to determine whether the exchange was so organized as to be able to comply with the Securities Exchange Act of 1934 and whether its rules were adequate to insure fair dealing to investors. The exchanges applying for exemption were likewise investigated. Where, by reason of the limited volume of trading on an exchange, the public interest did not require registration, exemption was granted upon such conditions as would protect investors. The rules and practices of each exchange have been the subject of constant scrutiny by the Commission and recommendations for their progressive improvement have been made.

The 1934 Act requires that trading on national securities exchanges be confined to securities which are registered or exempted from registration. Registration for exchange trading is accomplished by the issuer filing an application with the Commission and the exchange and submitting data which will inform investors of the essential facts concerning the issuer. Every registration application is carefully examined by the Commission to ascertain whether it

conforms with the prescribed standards. As of June 30, 1937 permanent registrations were in effect covering 4,368 securities of 2,489 issuers. These registrations related to more than two and one-half billion shares of stock and to more than twenty-four billion dollars in principal amount of bonds. Issuers are also required to submit for the benefit of investors periodic reports of their current situation and these reports likewise demand careful inspection. Hundreds of requests for confidential treatment of applications, reports or documents filed by issuers were received and, after consideration, either granted or denied.

The Commission made a thorough study of the vexatious subject of unlisted trading on exchanges and reported its findings to the Congress. As a result of its recommendations the 1934 Act was amended to provide for the continuance of unlisted trading on exchanges under a system of regulation which has already done much to solve the most controversial aspects of the problem.

Trading activities on exchanges have been kept under close observation. Persons engaging in manipulative practices such as wash sales, matched orders, pool operations, the dissemination of false or misleading information and other deceptive devices have been relentlessly pursued and effectively prosecuted by the Commission. Excessive trading by exchange members tending to accentuate price trends has been discouraged. Exhaustive studies have been made of pegging, fixing and stabilizing operations and of the use of puts, calls and similar options in connection with transactions on exchanges.

Many other advances have been made in the Commission's work of supervising the exchanges. Among these I need only mention the formulation of

rules governing "when-issued" trading; the formulation of rules governing the solicitation of proxies with respect to registered securities; the preparation of forms for the reporting of changes in the holdings of insiders and the establishment of a system for making publicly available the contents of such reports; and a study of appropriate regulations governing the borrowings of brokers and the hypothecation, commingling and lending of their customers' securities.

Some idea of the size and ramifications of the Commission's task in regulating the exchanges may be derived from a consideration of the vast extent of the business conducted thereon. For the year ending June 30, 1937 the total market value of all sales on registered exchanges amounted to \$28,052,500,834. The volume of stock trading during the period was 94,164,509 shares; and the principal amount of bond sales was \$4,307,104,255.

Thus far, I have adverted only to those phases of the Commission's activities which relate to exchanges. On the over-the-counter side, the Commission has evolved a program of registering brokers and dealers transacting business in the over-the-counter markets, which, I venture to say, is as comprehensive as any ever attempted in this field by a regulatory body. Every broker or dealer in the United States who uses the mails or the channels of interstate commerce to effect or induce transactions over the counter is required to be registered with the Commission. Only those whose business is exclusively intrastate or who deal exclusively in exempted securities are free from the necessity of registration. As of October 31, 1937 the Commission had permitted the registration statements of 6,869 brokers and dealers to become effective.

The Commission is required to deny or revoke the registration of any broker or dealer, if the public interest so demands and the registrant or a key person in his organization has wilfully made a false statement in connection with his registration; or has been convicted within ten years of a crime connected with a securities transaction or the securities business; or is enjoined from any conduct connected with the purchase or sale of a security; or has wilfully violated the Securities Act of 1933 or the Securities Exchange Act of 1934 or a rule or regulation thereunder. Proceedings have been brought in 114 cases to determine whether registration shall be refused or revoked.

Comprehensive standards of fair practice in the over-the-counter markets were embodied in rules which became effective on October 1, 1937. The practices defined in the rules as manipulative, deceptive or fraudulent are prohibited by the Act as amended upon recommendation of the Commission.

Another aspect of the Commission's activities in the over-the-counter field is its effort to quicken the urge for self-discipline. In this connection, it has consistently encouraged the formation and development of associations of security dealers whose purpose is to improve the standards of conduct prevailing among their members.

In addition to its achievements in the administration of the 1934 Act, the Commission has made considerable progress in carrying out the purposes of the Securities Act of 1933. Under this Act it is unlawful to publicly offer for sale or sell a security, except an exempted security, in interstate commerce or through the mails, unless the security is registered. Registration is accomplished by the issuer filing with the Commission

a statement containing information adequate to assist investors in appraising the value of the security. A prospectus setting forth the salient facts appearing in the registration statement must also be filed with the Commission and delivered to every prospective purchaser. Each statement and prospectus is examined for the purpose of determining whether any information contained therein is misleading, inaccurate, or incomplete. The Commission is required to decide whether stop order proceedings should be instituted or registration refused or suspended in appropriate cases. It also has the duty of enforcing those provisions of the Act which prohibit the sale of securities through the use of any device, scheme or artifice to defraud. Its activities in this connection, it is safe to say, have resulted in a saving to investors of millions of dollars which might otherwise have been expended in the purchase of fraudulent or worthless securities.

The Commission has pursued the policy of furnishing advisory and interpretative assistance to the public whenever possible. Every effort has been made to clarify promptly the problems raised, to the end that sound financing may not be impeded by doubt or delay.

I have endeavored to give you some idea of the area of the Commission's work and the extent of its accomplishments. Even a summary confined to the salient features is bound, as you have seen, to be of impressive length.

Many of you have undoubtedly given serious thought recently to the question of what the future holds for the securities business. Being dynamic in nature, the business has changed materially during the past five years and will probably continue to change. Not being endowed with

the gift of prophecy, I cannot predict the nature or extent of the changes to come. I can, however, give you my view as to the factors which will play a part in shaping the future of the business, and of the relative importance of those factors.

The first of these is government. The Commission will, of course, continue to enforce to the full extent of its powers the provisions of the Acts which it administers while at the same time exerting every effort to avoid interfering to any degree with legitimate investment enterprise. But it is easy to over-emphasize the importance of the Commission's part in the picture. Its activities, as I see them, are addressed primarily to the rules under which the business is or should be conducted. These activities are bound, in a measure, to affect subsequent developments in the industry.

But there is a second and more fundamental influence at work--the inexorable law of economics which moves, as a stream moves through grass, sometimes hidden, its direction often obscure, but always there. This is the law which beyond all others will determine the future of your business. It is essential, therefore, to distinguish between the factors which relate merely to the rules of the game and the economic forces which in the long run will prevail.

Let me emphasize this point by referring to certain familiar principles respecting the securities legislation. No power is vested in the Commission to interfere with the normal functioning of the law of supply and demand as it affects the prices of securities. It is not authorized to evaluate securities or to determine whether their price level is too high or too low. Its function is not to advise whether securities shall be bought or sold.

The responsibility for appraising the value of a security and for judging whether its market price truly reflects that value devolves on the investor. He has the burden and the privilege of deciding whether to buy it or sell it or leave it alone. He is the focal point of the entire investment system. His judgment may be sound or it may be unsound; but in a democratic society it is a final judgment.

The task of government is to protect the investor from forces which tend to distort or confuse his judgment. This is not accomplished by substituting the judgment of an administrative agency for his own. The approach is rather to make available to him accurate and comprehensive information from which he may, if he chooses, reach an enlightened conclusion; and to banish from the market place such factors as fraud, manipulation and excessive speculation which serve to corrupt his judgment or to subordinate it to unwholesome influences of false hope, despair, rashness and panic.

Against this background, the various steps taken by the Commission in the fulfillment of its functions appear in proper perspective. Its continuing endeavor to make more complete, candid and comprehensible the information available to investors; its close surveillance of the practices prevailing in the securities markets; its efforts to check the type of speculation which performs no sound economic function; all these are readily understood. They are seen as part of a program to repair, improve and lubricate the investment machinery of the nation.

It is not my intention to discuss the extent to which these steps have succeeded in their purpose or to speculate on whether more regulation or less would have succeeded better. My desire is to focus your attention upon these facts: that it is not the Commission's function to interfere with or

control economic laws; and that the steps taken in the administration of the securities legislation have had no such design or effect. It seems to me important that these points should be thoroughly comprehended because the failure to grasp them is provocative of fruitless debate and the dissemination of many curious notions.

These observations have an important bearing on your appraisal of the future of the securities business. Your compliance with the rules and standards of the Commission is, of course, essential, if you are to remain in this field. Your cooperation in the task of ridding the industry of those who, by their conduct, tend to bring it into disrepute is likewise essential. It is of the utmost moment to your welfare as well as to that of investors that the securities markets be swept clean of unwholesome and wasteful practices. But whether the business is to expand or contract, whether it faces prosperity or adversity, whether it is to occupy a position of major or minor significance in our economy -- these are questions to which the answers cannot be found in the statutes or the rules of the Commission. They are to be found rather in the condition of industry, commerce and agriculture, in developments affecting foreign trade, in the unemployment situation and in the myriad other factors which determine whether the securities markets shall flourish or languish. I happen to be among those who believe that the current situation is devoid of many of the elements conducive to a major recession, that the prospect for the near future is far from hopeless and that the securities business has sufficient virility and resiliency to adjust itself to whatever conditions the future has in store.

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I would like to turn now to a consideration of a few of the problems affecting the activities of securities salesmen. I am glad of this opportunity to do so because, while much thought has been devoted to these problems by the Commission, the opportunities to discuss them with organizations such as this have been relatively rare.

We have long recognized that the salesman, as the point of contact between the securities house and the public, may exert a tremendous influence for good or evil. He may be the agent of a reputable house dealing only in honest securities; or he may be the instrumentality through which the victimized investor is induced to part with money or valuable securities in exchange for shares which prove to be worthless. He may employ the methods of fair and open dealing; or he may resort to the weapons of fraud, misrepresentation and concealment. He may have a genuine desire to build up a permanent clientele whose good will he has deservedly won by his concern with their individual investment requirements; or he may be intent only upon exploiting a constantly-changing "sucker" list.

While the requirements for the registration of brokers and dealers are not applicable to salesmen, this is not to be construed as an indication that the salesman is exempt from regulation. On the contrary, he may subject himself to serious liability if he fails to recognize his obligations to his customers. It is essential, therefore, that he be thoroughly familiar with the legislation and the rules of the Commission.

A salesman who aids his employer in effecting illegal transactions is not relieved of responsibility because he acted under instructions from his firm. In a recent case it was brought to our attention that the salesmen of a registered broker-dealer had been instructed by their employer to

procure from each customer a receipt for a prospectus but not to deliver the prospectus to the customer. Under the Securities Act it is unlawful for any person to use the mails or the channels of interstate commerce to send any security for the purpose of sale unless a prospectus is also delivered. A salesman who obtains a receipt for a prospectus, but wilfully fails to deliver the prescribed prospectus to the customer, is subject to the criminal penalties of the Act along with his employer.

Hence, it is well that the salesman be as selective in his choice of employer as the firm is in its choice of salesmen. Participation in a violation of the law may not only involve him in immediate difficulties but may also jeopardize his chance of being permitted to register as a broker-dealer, should he later decide to engage in business for himself.

Because of his intimate relation to the customer, the salesman can perform a great service in rendering effective the principles embodied in the over-the-counter rules. The burden of making the disclosures required by the rules falls largely upon him. For example, the rules require that at or before the completion of each transaction involving a customer, the latter be notified in writing of the capacity in which the firm is acting in the transaction. Although the time fixed for this disclosure is "at or before the completion of the transaction" it has always been in accord with sound practice and with fundamental concepts of law that the customer and the broker-dealer have a clear understanding at the earliest possible moment as to whether their relation is that of principal and agent or otherwise. The salesman is in a position to satisfy the spirit as well as the letter of the rule by informing the customer of the

capacity in which the firm will act, if possible, before a contract is made. Moreover, by explaining in simple, unequivocal terms which the customer will understand the firm's capacity in advance of the transaction, the salesman precludes the danger of subsequent dispute.

In like manner the salesman can bring home to the customer more directly and comprehensibly the other matters required to be disclosed by the rules. These include the fact that his firm controls, is controlled by or is under common control with the issuer whose securities are being offered and the fact that the firm is participating or otherwise financially interested in the primary or secondary distribution of the security.

Where a broker or dealer is financially interested in the distribution of an unlisted security, he may not represent that the security is being offered "at the market" or at a price related to the market price unless he knows there is a market other than that made or controlled by the distributors. Here again the salesman has a serious burden of responsibility to avoid misleading the customer into a belief that a free market exists when in fact it is controlled by those engaged in the distribution.

Of special interest to salesmen is the rule prohibiting a participant in the distribution of a security from paying any other person for soliciting purchases on an exchange of that or any other security of the same issuer or from paying another person for effecting purchases of any such security on an exchange except for the account of the participant himself. If any such payment is made in connection with the distribution, subsequent sales or deliveries of the security by the participant are prohibited. This rule is intended to purge the market of the practice of "painting a picture on the tape" by the subsidization of customers' men, salesmen and others.

It seems to me patent that reputable salesmen are profoundly interested in the objectives of the securities legislation. They are perhaps the most direct and immediate victims of unfair competition on the part of those who will not comply with the standards of fair practice. It is to their interest as well as to the interest of the customers, without whose good will they cannot subsist, that they exert every effort to cooperate with the Commission in the achievement of those objectives.

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