

**The Role of the Securities and Exchange Commission  
in the Securities Markets**

**Address**

**by**

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**before**

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The year 1955 which has just ended brought with it great prosperity which has been reflected in the expansion and activity of the securities markets. The national income, number of issues and the aggregate value of corporate securities offered, the aggregate market value of securities traded on exchanges and the number of registered brokers and dealers, all reached a new high during the year. To the Securities and Exchange Commission, which is charged with responsibilities for the regulation of these securities markets in the public interest, this expansion brought both a sense of satisfaction from the public confidence in the markets which has been displayed and a sense of the responsibility which this volume of activity places upon it.

The Securities and Exchange Commission is an independent bi-partisan agency of the federal government established by the Congress in 1934 in order to require, in interstate and foreign commerce in securities, certain standards of conduct by corporations selling their securities to the public, by securities exchanges and by brokers, dealers and others trading in securities which would, speaking broadly, provide the investing public with needed information about the business and finances of corporations issuing new securities to the public or listing their securities on national securities exchanges and also protect the public against abuses and fraud. It may be said that the Commission is, in effect, the "policeman on the beat" of the securities markets. It administers a number of important statutes, including particularly the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940 and the Investment Advisers Act of 1940. Again, speaking broadly, the Securities Act of 1933 deals primarily with the initial public offering and sale of new issues

of securities and the Securities Exchange Act of 1934 deals primarily with the trading markets in outstanding securities. It is the Commission's functions under the Securities Exchange Act which I will discuss primarily this afternoon.

First, however, and by way of background, a word about the markets as they exist today.

As you all know, the securities markets can be divided into two general categories. One is the exchange market, an auction market with publicity given to transactions and prices through the ticker tape. The other is the over-the-counter market in which thousands of brokers and dealers deal in securities, generally acting as principals and upon a negotiated basis.

There are fifteen national securities exchanges registered with the Commission and in addition, four small local exchanges are exempt from registration. More than 4,000 stock and bond issues representing a large portion of the country's more important enterprises are traded on one or more of these exchanges. At the end of 1955 these issues had an estimated aggregate market value of approximately \$340 billion and are owned by almost eight million individuals directly and by many more millions indirectly through the holdings of insurance companies, pension funds, investment companies and other institutions. The aggregate volume of trading in stocks alone on registered exchanges increased to approximately \$40 billion in 1955 as compared with \$29 billion in 1954.

Traded in the over-the-counter market there are some 3,500 stock issues of corporations having in each case a sizable number of stockholders. These have an estimated aggregate market value of nearly \$40 billion. At the end of 1955, approximately 4,440 brokers and dealers were registered with the Commission.

This presents a startling contrast to the situation in the 1930's when the Commission was established. At that time both activity and public confidence in the securities markets were at a low level. For example, in all of 1935 only about \$2.8 billion of new corporate securities were marketed to the public. Today, new corporate issues are being offered and purchased at an annual rate in excess of \$10 billion. The contrast may be illustrated by the successful marketing last week of the Ford Motor Company stock. In this sale of some two-thirds of a billion dollars of stock, the greatest amount of equity financing at one time in our history, a greater amount of securities were placed in the hands of the public in one day than were invested in by individuals in new securities over a period of months during the early 1930's.

The work of the Commission over the years has contributed significantly to this restoration of public confidence in the securities markets. This in turn has been a vital factor in providing from the savings of the people the new capital which has been needed for the vast expansion in our economy. The willingness of people to invest their savings in industry depends to an important degree upon the orderly and proper functioning of the securities markets and upon the principle of fair disclosure which is a keystone of the federal securities laws.

Regulation of the securities markets under the Securities Exchange Act reflects the distinction between the exchange market and the over-the-counter market. In the exchange market, an essential feature of the statutory plan of regulation is the registration of the securities exchanges and of the securities listed on such exchanges. As I mentioned

a moment ago, there are fifteen principal exchanges which are registered with the Commission and four small exchanges which are exempted from registration but which are subject to many of the obligations placed upon registered exchanges.

To become registered an exchange must meet two broad conditions. First, it must be organized so as to be able to comply with, and enforce as to its members, the provisions of the Securities Exchange Act and the Commission's rules. Secondly, its own rules must contain provisions to insure fair dealing and to protect investors, and they must also provide for disciplining and expelling members for conduct inconsistent with just and equitable principles of trade. The Commission has authority to alter the rules of a registered exchange in many areas if the exchange does not make the revision itself after being requested to do so. In addition, the Commission can suspend or withdraw the registration of an exchange under certain specified conditions.

While under the Securities Exchange Act the Commission necessarily relies to a considerable degree upon the cooperation and self-regulation of the exchanges, the statute directly prohibits many manipulative and deceptive devices. It is unlawful for any person to create actual or apparent active trading in a security or to raise or depress the price for the purpose of inducing the purchase or sale of the security by others. Wash sales and matched orders for the purpose of creating a false or misleading appearance of active trading in any security are unlawful, as are other deceptive devices, such as the dissemination of information by persons buying or selling securities to the effect that the price of any

security is likely to fall or rise because of market operations conducted for the purpose of raising or depressing the price.

In addition to the specific prohibitions of the statute, the Commission is granted rule-making power in many important areas. For example, the Commission has in effect a rule covering the prices at which short sales may be effected on an exchange which generally prevents short sales on a declining market. This serves to discourage "bear raiding". Our rules also prevent persons engaged in the distribution of a security from paying other persons to solicit purchases of securities of the same issuer on an exchange except under specified conditions. The Commission recently adopted rules dealing with the stabilization of securities to facilitate a distribution. These requirements, like the general anti-manipulative standards of the statute, operate to prevent persons engaged in distributing a security from creating active trading or raising the price in order to facilitate a distribution except subject to requirements of disclosure and other controls which operate to prevent deceptive or unfair advantage being taken of the buying public.

The Commission carefully watches activities on the exchanges for the purpose of detecting and preventing manipulative activities. The registered exchanges are required to furnish a large amount of information to the Commission, including volume and prices of transactions, the activities of various classes of persons such as floor traders, and information with respect to margin trading, short selling, odd-lot purchases and sales, and other matters.

In addition, we maintain a "market surveillance unit" in our New York Regional Office which watches the recorded transactions on the New York exchanges as they come over the ticker, and the quotations in the over-the-counter market as they are published in the National Quotation Sheets, for the purpose of detecting activity in any security which does not appear to be based on economic factors and may indicate the presence of manipulation. When such a question arises, this "market surveillance unit" conducts a "flying quiz" with respect to the transactions in the particular security. In the "flying quiz" the identities and activities of purchasers and sellers are ascertained and reviewed. The "market surveillance unit" also investigates complaints coming to us from all sources concerning possible manipulative activity. Ordinarily none is found, but the very existence and activity of this surveillance group has a powerful deterrent effect on possible market manipulation. And on those rare occasions when a manipulation can be proved, the civil and criminal sanctions of the Exchange Act can be brought to bear. The statute provides a maximum penalty, on conviction of market manipulation, of \$10,000 fine and imprisonment for two years in a Federal penitentiary.

In addition to the registration of the exchanges, issuers of securities listed on exchanges are also required to register the securities under the Securities Exchange Act. They thus become obliged to disclose material information with respect to their business and financial condition and to supplement this information by periodic financial and other reports which are filed with the Commission and the exchanges and become a matter of public record. The Exchange Act requires that all persons soliciting proxies with respect to listed securities must conform

to the proxy regulations of the Commission. These regulations, which have been revised, effective January 30, 1956, more specifically to spell out our requirements in cases of proxy contests for control of corporate managements, contain comprehensive requirements designed to make possible for securities holders a prior and informed exercise of their voting rights. "Insiders," that is, officers, directors and 10% stockholders of listed corporations, are required to report currently to the exchanges and to the Commission changes in their ownership of the companies' securities. These changes are published in the Commission's monthly bulletin on ownership reports. These insiders may also be required by Section 16(b) of the Exchange Act to pay over to the company profits realized by them in short-swing trading in the company's stock.

To turn to the over-the-counter market, there were no such organized entities as the exchanges to furnish a focal point for regulatory activities. Brokers and dealers doing business in that market and using facilities of the mails or interstate commerce are required to register with the Commission unless their business is exclusively intrastate, or is confined to Government securities or specified types of commercial paper. The Commission may deny registration to, or revoke the registration of, any broker or dealer if he is subject to one of the disqualifications specified in the statute and if the Commission finds that it is in the public interest to do so. The disqualifications include convictions for certain types of crimes, wilful violation of the Securities Act or the Securities Exchange Act, the fact that the person is enjoined by a court from engaging in any practice in connection with the purchase or sale of securities, and false statements in documents filed with the Commission. The existence of any such disqualifications on the part of individual partners or other persons controlled by or



controlling a registered broker-dealer firm or applicant is a ground for proceedings against such firm or applicant. The statute thus gives to the Commission a degree of control over the activities not only of the firm but of individuals affiliated with them. Brokers and dealers in the over-the-counter market are subject to prohibitions on the use of manipulative or deceptive devices similar to those applicable to exchange members and are also subject to many Commission rules which are designed to protect their customers and to prevent unfair and deceptive practices. Time would prevent my enumerating all of these requirements but here are some examples:

Most members of exchanges and brokers and dealers must maintain specified books and records showing the transactions which they execute, the securities which they handle for customers; their long and short securities positions and other information with respect to their financial condition and amounts due or payable to customers. These records are subject to inspection by the Commission's staff at any time.

The Commission also has a rule which makes it unlawful for a broker or dealer to effect a securities transaction in the over-the-counter market if his "aggregate indebtedness" exceeds 20 times his "net capital" as defined in the rule. Last summer the Commission amended these definitions to afford greater protection to the customers of brokers and dealers. Before the rule was amended it provided that, in the computation of "net capital," there should be deducted 10% of the market value of securities which form a part of the broker-dealer's capital. As amended,

this percentage deduction has been increased so that it is now 30% except in the case of certain preferred stocks and defaulted debt securities. This 30% deduction was also applied to certain commodity future contracts and to positions in open contractual commitments.

The members of certain exchanges whose rules and practices were deemed to impose more comprehensive requirements are exempt from the provisions of this rule, but this exemption is being studied to determine whether these exchanges not only have net capital rules as comprehensive as those of the Commission, but also whether they have adequate inspection and other procedures to enforce those rules.

In order to afford further protection to securities carried for the account of customers, the Commission has adopted hypothecation rules applicable to members, brokers and dealers. They prohibit: the commingling of customers' securities without the written consent of each customer; the commingling the firm's and customers' securities in connection with a loan to the firm; and borrowing more on customers' securities than the customers owe on such securities.

The Commission has adopted many regulations to implement the anti-fraud and anti-manipulative provisions of the Act. A Commission rule makes it unlawful, in connection with the purchase or sale of a security, to make misstatements or misleading omissions of material facts; to employ any device, scheme or artifice to defraud; or to engage in any act, practice or course of business which operates as a fraud or

deceit. The rules prohibit broker-dealers from trading in a security over-the-counter during the period when the Commission has suspended the security from exchange trading. They require brokers and dealers to send written confirmations of transactions to their customers disclosing the capacity in which they are acting and the compensation which they have received or are to receive in connection with the transaction.

By an amendment to the Securities Exchange Act enacted in 1938, the Congress provided a mechanism by which brokers and dealers in the over-the-counter market might engage in a degree of self-regulation under the general supervision of the Commission in a manner somewhat comparable to that provided for exchanges. This was done by providing for the registration of national securities associations, which meet the requirements of the statute. While these requirements are quite comprehensive, probably the most important is the requirement that the rules of the association must be designed to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade. The only organization which has registered under this provision is the National Association of Securities Dealers, Inc. whose membership comprises most of the brokers and dealers active in the interstate over-the-counter market.

The Commission has authority over amendments to the rules of the association and over the admission or expulsion of members. Generally speaking, any registered broker and dealer can become a member of the

association unless subject to specified disqualifications provided in the statute and the rules. The statutory disqualifications relate principally to conduct which is unlawful under the federal securities laws or in violation of rules prohibiting transactions inconsistent with just and equitable principles of trade. The association has recently amended its rules effective June 1, 1956, to require that those of its members who do not have one year's experience in a specified capacity in the securities industry will have to pass an examination demonstrating their knowledge of fundamental business practices and legal requirements.

The Commission enforces the requirements of the federal securities laws in a number of ways. It has authority to make investigations in the course of which it may subpoena witnesses and take testimony. If a violation is found to exist, it can apply to a federal court for an injunction or it can refer the matter to the Department of Justice for criminal prosecution or, if the violator is a broker or dealer, it can commence administrative proceedings for the revocation of his registration or for his expulsion from any exchange of which he may be a member or from the National Association of Securities Dealers, Inc. Other administrative sanctions such as proceedings to deny or suspend the registration of securities under the Securities Act or under the Securities Exchange Act are also available.

Regular inspection of brokers and dealers is a vital part of the Commission's enforcement program for the protection of the public and public investors. Broker-dealer inspections are conducted to assure

compliance by registered brokers and dealers with the requirements of the Securities Exchange Act and to discover and prevent violations of the Federal securities laws. The inspectors check books and records to learn whether there has been compliance with Commission regulations relating to hypothecation of customers' securities, extension of credit on securities, confirmations, maintenance of books and records, and the Commission's net-capital rule. They also check for churning, switching and other fraudulent practices. These inspections frequently discover situations which, if not corrected, might result in losses to customers.

I do not mean to suggest that there are no violations of law going on or that those that do occur are all detected by the Commission. That would be too much to expect of any law enforcement agency, but I do mean to say that with the funds and personnel available to the Commission, much has been accomplished. The Commission expects to step up its broker-dealer inspection program in the immediate future.

Before closing I would like to say a word about the regulation of investment advisers. The Investment Advisers Act of 1940 provides for the registration with the Commission of persons engaged in giving investment advice for compensation with certain specific exceptions such as banks, publishers of publications of general circulation and certain professional men such as lawyers, accountants, engineers and teachers. The jurisdiction of the Commission under this statute is, however, very limited. Any investment adviser who has not been convicted of certain types of crimes, is not subject to an order enjoining him from engaging

in certain activities, and who files an accurate and complete application, is eligible to become registered as an investment adviser. While the Act prohibits fraudulent and deceptive practices it does not empower the Commission to conduct routine inspections of investment advisers or require them to maintain books and records. In fact, many of its provisions, even the anti-fraud provisions, are applicable only to investment advisers registered under the Act.

In 1945 the Commission submitted a report to Congress pointing out many deficiencies in the Federal Investment Advisers Act and recommending a number of amendments to make it more effective. Unfortunately no action has been taken on these recommendations.

On the other hand, I was pleased to learn that our Illinois legislature has recently amended the Illinois Securities Law so as to require the registration of investment advisers and also to permit more effective regulation of their activities. I am informed that under the Act the Secretary of State can adopt regulations to require investment advisers to meet certain competency standards, to comply with certain financial responsibility standards, and to maintain books and records; and that it also authorizes him to examine books, records, advertisements and sales literature of investment advisers. It is my understanding that many regulations with respect to these matters have already been adopted. It is very gratifying to us at the Securities and Exchange Commission when state administrators engaged in activities similar to our own are able to take any action which helps to maintain the confidence of investors in the securities markets.

In conclusion, let me stress the importance of the maintenance of the confidence of the American people in the securities markets. In our economy today, few citizens are unaffected by these markets. The 90 million Americans holding life insurance policies have an indirect interest in these markets through the great investment in stocks and bonds of corporations held by insurance companies. Beneficiaries under pension funds and holders of investment company shares have an indirect interest. And the 8 million citizens who directly own shares of corporations are vitally concerned. Our corporate wealth is very broadly held. The securities markets provide the mechanism by which business raises the capital required to serve the economic needs of the people. They provide a mechanism by which industry may be broadly shared by the people. Ownership of American industry has become, through the operation of the capital markets, freely transferable. Thus, investors are willing to place their savings at the disposal of industry and the capital so essential to the nation's economic progress is provided.

The Securities and Exchange Commission is not directly concerned with the economics of this process. It is not the Commission's business whether prices of securities on the markets go up or down. But we are vitally concerned that price movements result from the free judgment of buyers and sellers trading in fair, honest and orderly markets. The Commission does not, and under the statutes is not permitted to, pass on the quality or investment merits of securities registered with it for initial sale or listing on exchanges. That is not our province. But it is our

business to require, under the Securities Act and the Exchange Act, adherence to the "fair disclosure" standards of the law, the maintenance of free, fair and orderly securities markets, and the detection, prevention and punishment of fraud in the sale of securities. This is a great responsibility and requires the cooperation of analysts, securities dealers, brokers, investment bankers, the exchanges, dealers' associations, and all those who have to do with the securities markets, working together for the best interests of the investors of America and the American people.