

Address of Manuel F. Cohen, Chairman
Securities and Exchange Commission
before
The Business Council
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1964 marks the thirtieth birthday of the Securities and Exchange Commission, and it is difficult in this anniversary year to resist some retrospective comparison with the past as we look ahead to determine our future direction. 1964 is also the year in which the Securities Acts Amendments were adopted, representing the most important piece of securities legislation in more than 20 years. As we embark on the program of implementing the new legislation, it may be helpful to look briefly at where the Commission started when the original securities acts were passed.

We started, of course, in the depths of the depression. The dramatic difference in the national economic vitality of today, as compared with those dismal days thirty years ago, may tend to obscure the equally dramatic differences in the securities markets. We have gone from depression to sustained recovery, from stock market crash to the highest stock averages in our history. And we have also undergone startling changes in the securities markets themselves.

The easiest way of measuring those changes is to compare two studies of the securities markets: The Pecora Investigation of the early 30's, which led to the SEC, and the Special Study of Securities Markets concluded last year. It is surely unnecessary to do more than merely refer to these two investigations to make my point: Gone today are the gross, cynical abuses of the pre-SEC period in which the law of the jungle prevailed in the financial markets. The Special Study showed that problems still exist in those markets, but of a far different scale and scope.

This has been an astounding transformation. For one thing, it occurred within the span of a single generation. For another, it occurred during a time of wide-spread expansion of public participation in the securities markets. Lack of restraint or failure of self-control could have been disastrous. But moderation has largely replaced excess, and today, in retrospect, the reasons seem quite clear: first, the establishment in 1933 and 1934 of new ground rules in the securities markets and, since then, the development of a new, different morality in the market place.

Surely this has been the significant accomplishment of the federal securities laws. For the first time in the history of our stock markets, the dominant principles have become disclosure and fair dealing. For the first time government and industry have joined in a cooperative effort to clear the markets of abuse. For the first time corporate issuers, insiders, and securities professionals have accepted responsibility to investors and to the public generally. As a result of this acceptance of the principles of the securities laws, public confidence in the securities markets was re-established. Viable markets were available to serve the dynamic economy of the post-war period. The high standards of investor protection achieved in our securities markets have made them a model for other nations throughout the free world.

My purpose in reviewing these basic accomplishments of the last thirty years is to emphasize that the great progress made in the past three decades proves -- if proof be necessary -- our capacity to cope with the problems which confront us today.

And let there be no question about it: problems there are, and substantial ones, too. The Commission and industry are now in a period of momentous change, as new methods of doing business develop to meet new economic needs, and as the governmental and private regulatory agencies adjust to a changing securities industry. These fundamental questions now before the Commission and the industry are not matters to be resolved in any short period of time or by any simple rule or equivalent single action. They are matters likely to command the attention of the Commission and the industry for a long time to come.

It is important to note the difference in these problems from those that have[†]preoccupied our attention until recently. Today's problems are as fundamental as those of yesteryear; but the solutions seem much less obvious. The technical skills required to cope with them are perhaps more demanding. The challenges before us are not as much those of the obvious market manipulations; instead, we are more and more concerned with the essentials of the system itself, as it changes to meet the demands of an expanding and imaginative economy.

What are some of the challenges? A high place on any list must, of course, be given to those presented by the availability of increasingly more sophisticated electronic data processing equipment. Many securities firms are today utilizing the best of the technology to perform backoffice and bookkeeping operations. The Midwest Exchange's Centralized Bookkeeping Service, and EDP service corporations, have brought the benefits of this technology within the reach of firms which might not otherwise be able to utilize it.

But EDP equipment has an equally great potential for the securities markets. It is a potential that is only now beginning to be tapped. The new methods permit vast improvement in the reporting of transactions and quotations, in surveillance, in the analysis and understanding of market processes, and possibly even in the execution of transactions.

We must evaluate the meaning of the new technology and plan for its utilization in a sound and responsible way: Surely the customers of the securities markets,

the nation's investors -- individual and institutional -- are entitled to the benefits of that technology to the extent that it can be properly assimilated into the industry's operation. Even short of its application in the markets, there are broad areas to be cultivated in coordinating, planning, and programming the use of this equipment.

Another of today's challenges is to achieve a real understanding of the interrelationships among the several securities markets, including the off-board market in listed stocks -- the so-called "third market." The third market, viewed in its proper perspective, is only one side of a many-faceted problem that reaches into every aspect of the trading markets for securities. Basically, the question becomes one of the manner in which action by the Commission, or the exchanges, or the NASD, or any other element in our pluralistic securities industry, operates to channel trading to competing markets. There is a compelling need for better understanding of the characteristics of the various markets, and as a first step we have this week

adopted a rule which, through reports by participating broker-dealers, will give us some information about the third market and its place in the overall trading system.

It is also apparent that the commission rate structure of the New York Stock Exchange is one of the underlying factors which determines the market in which securities transactions are executed and by whom they are executed. For this reason, as well as a clear statutory obligation under the Exchange Act of 1934, the Commission has a legitimate interest in the New York Stock Exchange's current review of commission rates. The last commission increase was in 1958, and according to news accounts, rising costs and declining profits are combining to create pressure for higher commissions or mandatory service charges to customers. Additional pressure from the third market has prompted consideration of some kind of volume discount for large transactions. These suggested changes in the Commission rate structure cannot be considered as within the exclusive domain

of the business section of the industry. They are matters of vast public interest, and the Commission must satisfy its statutory responsibility to see that any changes in the structure or level of rates or charges have a rational basis and are consistent with the needs of the public.

Without attempting to compile a complete catalog of other large items on our agenda, I shall list a few beyond those I have already mentioned:

For example, there has been a substantial growth in institutional investors, active participants in the third market and prime candidates for the volume discounts I mentioned earlier. According to the New York Stock Exchange, institutions now own 20% of the market value of all shares listed on that exchange, and it is projected that by 1980 they will own a full 30%. These investment companies, pension funds, banks, insurance companies and similar institutions certainly have the power to affect the securities markets. I am not sure that we know, in any meaningful detail, how pervasive their influence is at the moment, and whether this influence,

actual or potential, should be the occasion for action by the industry, by its self-regulatory agencies, or by the Commission.

I should refer also to the increasing extent to which some of these institutions -- particularly the banks and insurance companies -- are competing for investment business of a kind traditionally reserved for broker-dealers. We will have to accommodate this competition within the framework of the securities laws, and with minimum conflict at other governmental levels.

Then there is the recent increase in private placements -- up 6% in 1963 and 1964, measured as a percentage of total corporate debt issuance. We will have to find whether this indicates any deep-rooted problems of the distribution process or of the regulatory pattern, and decide whether we can or should, as an administrative matter, encourage or discourage the trend.

One of the most significant of recent changes has been in the investment company industry, which has grown from about \$2 billion, when the Investment Company Act

was passed in 1940, to its present almost \$42 billion. Clearly, this reflects more than a difference in degree. The effects of reciprocal business and commission give-ups, for example, now multiplied twenty-fold, cut through the entire securities industry, and have an inevitable effect on the rate structure and the economics of the broker-dealer business, as well as on the mutual funds themselves. And the continued growth of sales organizations not dependent on conventional broker-dealer distribution presents problems in economics as well as regulation. In partial recognition of the growth in size and complexity of investment companies, we have recently reorganized our Division of Corporate Regulation, and added additional manpower to it. Administrative responsibility for substantially all phases of investment company work is now centralized in that one Division. This reorganization will, at the same time, make it easier for the industry in dealing with the Commission. Equally important, we are studying in considerable detail the effects of this growth in the investment company industry and its changing methods of doing business, and our report should be completed before long.


Then there are the many problems others have raised in the application of the anti-trust laws to the securities industry. You may remember last year's Silver case, in which the Supreme Court of the United States held that some practices of the New York Stock Exchange were subject to those laws. Another case, now pending, is attacking, as a violation of the anti-trust laws, the New York Stock Exchange requirement that members charge a minimum commission to all non-members of that institution. And one byproduct of the discussions relating to listing on the New York Stock Exchange of securities of banks has been the suggestion that Rule 394 of the Exchange is invalid, in that its restriction against members dealing off-board in listed securities is a restraint of trade. And last, there is, of course, the recent trend toward horizontal mergers among broker-dealer firms, some of them involving substantial firms as well as smaller ones.

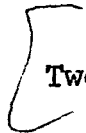
Some or all of these developments I have mentioned may turn out not to be problems at all, in that they are not threats to the public interest. But each represents

an area of change, where thoughtful evaluation is required, where ultimate conclusions may come only after a period of introspective examination of the industry as a whole. Significantly, most seem to be developments of prosperity and active economic life, as compared with the developments based on despair of thirty years ago.

Securities regulation, as it has developed over the years, has been a cooperative process, in which the regulated have themselves participated in the regulatory process. Without industry acceptance of the goals of regulation, our task would have been immeasurably more difficult. The need for cooperation is a continuing one, and there are any number of ways in which industry groups can assist in this self-regulatory process. One that comes readily to mind relates to financial statements, in which most of you have a more than academic interest. I suppose we can assume that you have a natural bias for reports which show at least a steady, if not phenomenal, improvement in operations. This would be the picture of a healthy

business -- one that would attract investors to securities offerings, and keep existing shareholders happy. It is up to the business community, however, to keep up its guard against over-optimistic financial reporting, and to help the accounting profession as it develops standards on which we all rely.

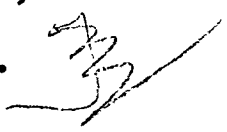
 The securities acts recognize the valuable contributions of the independent public accountant, in fact the Securities Act of 1933 requires that most of the financial statements used in a public offering shall be certified. The Commission's accounting regulations prescribe the form and content of the financial statements but for the most part the Commission has, in the past, relied upon and supported the accounting profession in defining the generally accepted accounting principles and auditing standards to which the accountants refer in their certificates.

 Two months ago in Florida the Council of the American Institute of Certified Public Accountants "unanimously adopted recommendations that members should see to it that departures from Opinions of the Accounting

Principles Board (as well as effective Accounting Research Bulletins issued by the former Committee on Accounting Procedure) are disclosed, either in footnotes to financial statements or in the audit reports of members in their capacity as independent auditors."

Adoption of this policy should assist in eliminating differences in reporting rather than perpetuating them.

Robert E. Witschey, a past president of the Institute, in an address before the Annual Meeting of the Financial Executives Institute in Dallas in October, summed up the demands of the day in the observation that "The increasing tempo of change in our time requires a speeding up of the profession's work" in the search for better accounting principles. We agree also with Clifford V. Heimbucher, ^{the} immediate past president of the Institute, ^{has stated} that an immediate and pressing objective is to eliminate the use of alternative accounting principles underlying financial statements not justified by differing circumstances. The business community should have the same objective, and we enlist your support in working to achieve it.



Finally, I should remark the last thirty years are telling evidence that the administrative process is appropriate to our purposes. This was not a foregone conclusion when the Commission was established. All the flexibility and breadth of the independent regulatory agency has been needed to bring us to our present stage, and will be needed as we move forward. With the help of a willing industry, we can use these powers to accomplish as much in the next thirty years as we have in the past.