SOME SEC PROBLEMS

Address by

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When I sat down to work on this speech I had before me the schedule of events which notes this occasion as a men's luncheon. The same schedule indicates that there is simultaneously in progress a ladies' luncheon and hat show. I am in position to make a firm representation that each of you will find both the ladies and the hats vastly more entertaining than the shop-talk in which I am going to indulge. Consequently, if any of you leave now to join your wives or sweethearts, I will take it as an indication not that you love the SEC less but that you love the ladies more.

Perhaps I should apologize for indulging in shop-talk, particularly when your Association has been gracious enough to set aside a whole afternoon for an SEC round table discussion. But your industry and our Commission have so many problems of mutual interest that we should not neglect any opportunity to discuss them with one another. It is far more than a cliche when I say that it is a great help for you and for us to understand our common problems.

Moreover, I am not indulging in platitudes when I suggest that round-the-table discussion -- even discussion at which voices are occasionally raised -- usually results in reducing areas of disagreement. I hope that this afternoon's meeting will achieve that result.

The year and three months during which I have been Chairman of the Commission have encompassed a very rich experience, and the richest part of that experience has been working toward solution of problems by conferences among fair minded people sitting around a table. That method has been used among the Commissioners themselves, between the Commission and the staff, between the Commission and representatives of the industry, and between the Commission and the public, organized and unorganized. For example, discussions of the Commission with Senators Capehart and Bush and with members of the staff of the Senate Banking and Currency Committee, with Congressman Wolverton of New Jersey and with members of the staff of the House Interstate and Foreign Commerce Committee, with

representatives of the securities business, and with representatives of the Executive Office of the President and the Council of Economic Advisers resulted in the formulation of legislation which was approved unanimously by both Houses of the Congress and signed into law by the President.

Figuratively speaking, each of us is working toward the same general goal, namely, that of making the American system of free enterprise work. Naturally, the regulator and the regulated are going to have their battles occasionally, just as the credit department and the sales department of a mercantile business have their disagreements. But most personal disagreements are resolved without fisticuffs and most legal disagreements are resolved without law suits or punishment. The reason for that is that intelligent human beings, when possessed of a normal amount of good will, have learned to reach mutual understanding on most issues.

Let me therefore make the point that at the Commission we do try hard to work out solutions by mutual agreement. I don't mean, however, that the Commissioners have dedicated themselves to a career of being agreeable good fellows. We must bear in mind constantly the fact that in dealing with organized associations of the securities business or any other business, we must be hard bargainers. In such dealings we are, after all, the representatives of the otherwise unrepresented public. Each of us is under a sworn duty to administer a group of laws which are both strict and technical. Moreover, we are vested by the law with the power and duty in many situations to prescribe such rules and regulations as are required in the public interest and for the protection of investors.

Just stop and think about that responsibility for a moment. The rules which the Commission makes have the force of law, and the only guide furnished to the Commission by the Congress is "the public interest and the protection of investors." That represents a broad charter of power and a serious responsibility. Consequently when the Commission on its own motion proposes a rule change or when it considers a suggestion for such a change made by representatives of the business community, each Commissioner must employ all the resources of his intellect and his conscience in answering the question: "Is it in the public interest and for the protection of investors?"

When you analyze this legislative power delegated to the Commission and realize that each time we make a rule we are in effect passing a law, you will understand why proposals for rule changes are processed with a degree of deliberation which may well irritate the sponsors of the proposal.

You gentlemen in your day to day work are more concerned with the Securities Exchange Act than with any of the other Acts administered by the Commission. Therefore, I would like to indicate by way of example a few problems, particularly those involving Commission-made rules, which concern us -- and therefore you -- under that Act.

As you know, the Commission is charged not only with the duty of enforcing statutory prohibitions against manipulations and fraud but is also empowered to make rules and regulations with respect to manipulative and deceptive devises and stabilization or price pegging. In addition to that it has certain jurisdiction over rules of the several exchanges and of the National Association of Securities Dealers, Inc. It has power under Section 16(b) of the Exchange Act to make rules exempting certain transactions from liability imposed on insiders for short-swing profits.

You can see from that limited list of subjects that the Commission is given a job the wise performance of which cannot necessarily be taken for granted. There will always be some element of trial and error.

The market place for securities, like all market places, is one in which trading instincts are sharpened and ingenuity is developed and rewarded. In regulating the market place we are dealing with innumerable variables. Consequently legislation and regulation standing by themselves can never provide a wholly clean market place. Put another way, regulatory legislation is no substitute for self-control.

The securities laws and the regulations made thereunder, plus the rules of the exchanges and of the NASD, can provide guide posts: They can have the effect of discouraging cupidity and they can have the effect of encouraging each man to be fair because his competitor is subject to the same rules as he is.

To the extent that regulation and self-control may fail to maintain a clean market place, both the industry and the Commission suffer. The Commission would receive some public opprobrium, and the industry would receive that, plus a regulatory system more severe than that which now prevails.

The whole scheme of vesting in the Commission the power to make rules and regulations had its origin in the undeniable fact that it is almost impossible without an oppressive amount of rigidity for the Congress to frame an act prescribing detailed rules for a market place. The Commission, therefore, is under a mandate to move with changing trends and new problems and to keep its rules constantly abreast of developments. To illustrate the kind of problems we encounter in meeting that responsibility, I would like to give just a few examples.

As you know we have circulated for comment and have had a public hearing on rules relating to stabilization. It is highly desirable that the principles governing stabilization should be publicly known. This subject of stabilization is highly technical and always has been. The Securities Exchange Act makes it unlawful to stabilize "in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." For many years, in fact even now pending the adoption of rules, any proposed stabilizing activity is cleared by telephone on a case by case basis. I understand that this has worked out reasonably well in practice because those who direct our Trading and Exchanges Division operate on principles which are becoming generally well known.

However, when the statute tells the Commission to make rules I submit that we are under a duty to make rules. That is one reason why we have proposed formal stabilizing regulations. The other is that to the extent that we perpetuate present practice we tend to act like a government of men rather than a government of laws. We think that people should know without guessing, what is permitted and what is prohibited.

The proposed rules have been criticized by some as prohibiting some activities which are permitted under present practice. That criticism is being carefully examined and I believe that our staff questions the validity of some of the criticism. The fact that such a disagreement can arise, however, is a good reason for having

a rule. We are working hard to come up with a set of rules on stabilization which does in fact codify existing permissible practice. We are discussing the proposed rules with technically competent people in our own staff and in the industry so that the rules will be formulated with an awareness of practical consequences. We hope that the rules, when finally adopted, will prove to be a workmanlike job in the public interest.

Another type of problem is provided by Section 16(b) of the Securities Exchange Act which imposes on certain insiders (officers, directors, 10% stockholders) a liability for short-swing profits realized from trading of listed securities. This section was put in the law to prevent the unfair use of inside information. The Commission is empowered to exempt by rules and regulations transactions which it deems not comprehended within the purpose of the Section. The rules on this subject have been made and remade from time to time. They seem to grow more complex as time goes on. The Commission as a matter of fact has many times been in the position of intervening in private litigation to interpret to the courts the meaning of the Commission's rules. We think this is unfortunate. Rules should be clear enough that the persons bound by them and certainly their lawyers are able to understand them. After all they govern the rights and liabilities of many thousands of people all over the country. Yet the differences between transactions which afford opportunity to use inside information unfairly and transactions which do not afford that opportunity are technical differences.

All kinds of problems arise in connection with options, mergers, sales of assets, liquidations, underwritings of primary distributions, underwritings of secondary distributions and the like. Here again, remember that our rules have the force of law and in the case of this Section, the rules result in the imposition or exemption from civil liability. The rules must be complete in order that they may be fair and treat alike all situations which should be treated alike. At the same time the rules should not be so complex that no one will understand them.

The public and the bar -- not to mention you traders -- should be given understandable rules to live by. Much work has been done at the Commission over the last year in endeavoring to clarify rules under Section 16(b), but we do not wish to propose any revisions without having given them very thorough study. The Commission considers

that Congressional policy has been categorically expressed in favor of corporate recovery of short-swing trading profits by insiders. Exemptions from the statutory liability should be granted only in cases where there is no opportunity for unfair use of information. We want to do a workmanlike job of describing the limited area in which such cases fall.

To my regret my remarks have turned out to be pretty technical but they developed that way for a reason. I want to impress upon you the fact that anything we do under any section of any statute administered by us presents a multiplicity of problems. Moreover, wrong decisions might have serious consequences. From the illustrations I have given you can see some of the opposing considerations which we are required to weigh:

(1) The need for certainty against the danger of too much rigidity;

(2) The need for administrative flexibility against the danger of purely personal government;

(3) The need for completeness of description against the danger of too much complexity;

(4) The danger of taking action on the basis of reasonably available information against the danger from delay while more exhaustive information is developed.

While I want to impress upon you the fact that the job we are doing is not an easy one, I don't want you to get for one moment the idea that we take ourselves too seriously. We realize, as I am sure you do, that the strength of the American economy is not something which is a creature of government. In a sense, you and we are only part of the mechanical operation of the economy. To be sure, we like to think of ourselves as being reasonably important parts. The fact of the matter, however, is that the creative genius of our scientists, our farmers, our labor, our management, and the constitutional system which gives that genius free play are the real reasons why you have a market to trade in and why we have one to regulate.

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