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ADDRESS

of

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before the

BOSTON SECURITIES TRADERS ASSOCIATION

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I welcome this opportunity to discuss with you some of the problems which we have in common. Although this is my first visit to Boston in many years, I do not feel like a stranger in your midst. The reason, I suspect, is that the flavor and the accent of Boston are by no means unfamiliar in the corridors of the SEC building. In fact, it would be impossible to drop a brick out of any window in my office without killing at least three Boston lawyers.

I understand that your association is comprised principally of brokers and dealers transacting business in the over-the-counter market. Individually and as a group, therefore, your interest in the work of the Commission is undoubtedly focussed upon the steps which have been taken in connection with the regulation of the over-the-counter market. Perhaps a few moments may be profitably devoted to a discussion of those steps, the circumstances which made them necessary and their underlying objectives.

The Securities Exchange Act of 1934 empowered the Commission to formulate a program which would insure to investors in the over-the-counter market protection comparable to that provided by the Act in the case of organized exchanges. The magnitude of the project intrigues the imagination. Before the enactment of the statute, the over-the-counter market was one of the economic enigmas of our financial system. Authentic data were lacking with respect to its nature, its functions, its size, and the technique of its operations. The number of over-the-counter brokers and dealers was in serious dispute, estimates ranging between 5700 and 16,000. Only the most adventurous of economists would have endeavored to compute or catalogue the securities which were the subject of over-the-counter trading. Except in professional quarters, an aura of mystery hovered around methods of origination, syndication and distribution. Even the Investment Bankers Code

in one of its sections referred to the "unusual and complicated nature of over-the-counter transactions, whether in listed or unlisted securities."

One point, however, was altogether free from doubt. The economic cost to the American public of maintaining the securities markets had been too great. The excessive, uninformed and unrestrained speculation which dominated those markets during the turgid twenties had contributed in full measure to the disruption of the nation's credit mechanism, the impairment of its purchasing power, the dislocation of industry and commerce, and the propagation of unemployment, poverty and distress.

The retrospect of the average securities dealer at that moment was a sad one; but the prospect for the future was even worse. The tide of public confidence was out -- so far out that many believed it would never return. With the possible exception of commercial banking, no business is less likely to thrive without public confidence than that of marketing securities. Hence, the forward-looking persons in the business were fully cognizant of the urgent need for organic changes. In public or private they agreed that it was time to abnegate accepted dogmas, to lay aside traditional concepts and to approach the task of reconstruction with a new blueprint of the rights of the investor.

Under these circumstances, it seems strange that there should have been any serious opposition to the passage of the Securities Act or the Securities Exchange Act. The events leading up to and following the convulsion of 1929 demanded this legislation with a relentless and irresistible logic. Yet, as we know, there was opposition in some quarters - opposition motivated largely by fear. Fear was expressed that the regulatory body entrusted with the administration of the Acts might adopt unduly harsh and repressive measures, that it might even pursue a policy of exterminating legitimate

business enterprise. The fanciful nature of these fears has long since been demonstrated.

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Let us examine now the steps which the Commission has thus far taken to protect investors in the over-the-counter market. These may be divided generally into three classes; those designed to eliminate the unfit from the securities business; those designed to vitalize certain principles of fair practice; and those designed to encourage the formation of self-governing associations of security dealers.

Many if not all of you are registered with the Commission as over-the-counter brokers and dealers. As of April 15, 1936, the Commission had permitted the registration statements of 5,677 brokers and dealers to become effective. Included among these were 329 statements filed by brokers and dealers who maintain their principal offices in Massachusetts.

The process of registration was simple enough -- for those whose business record was honorable. It consisted merely of answering several questions on a form provided by the Commission. Despite its simplicity, however, the program was fraught with significance. It constituted the first attempt on a national scale to identify the persons transacting business over the counter. Much of the information contained in the registration statements had never before been compiled. It is not generally realized how much basic data was made available through the medium of those statements. We know now the persons who act as brokers, those who act as dealers and those who combine both functions; we know their forms of organization, the location of their main and branch offices, the names and previous connections of their officers, directors, partners and branch-office managers and the number of their employees; we know the identity of persons

controlling them; we know the names under which they operated in the past; we know the exchanges of which they are members, the associations to which they belong and the states in which they are registered or licensed to deal in securities; we know those who carry margin accounts, sell securities on a partial payment plan or extend credit in any other form; we know those who have been blackballed, suspended or expelled from membership on exchanges and those who have been denied the privilege of selling securities by state authorities.

In addition to the names and numbers of the players we know something of their batting averages in the courts. If an applicant or a key person in his organization had been convicted during the preceding ten years of a crime involving the purchase or sale of a security or arising out of the conduct of the business of a broker or dealer, he was required to disclose that fact. Similarly he was required to give the details of any injunction entered against him during the preceding ten years by virtue of which he was restrained from any practice in connection with the purchase or sale of a security.

I do not recall a single criticism with respect to the form of the registration statement or the relevance or value of the information requested. As I have indicated, the individual or firm whose business record was above reproach had a minimum of difficulty in supplying the required information. This is evidenced by the fact that some of the largest firms in the business were among the first to file their registration statements.

On the other hand, the necessity for filing a statement was a prolific source of difficulty and embarrassment to a certain type of person. I refer to the broker or dealer whose previous record branded him as unfit to remain in the securities business. Some of these when applying for

registration performed prodigious feats of forgetfulness. Only chronic amnesia could have accounted for their failure to mention such incidents in their careers as a stretch in the penitentiary, an elopement with customers' funds or a well-timed retreat from a warrant. The decay of memory had so far progressed in some that they omitted to furnish their correct names or addresses.

Hearings have been held by the Commission in more than two hundred cases to determine whether grounds exist for denying or revoking registration. To date registration has been denied or revoked in nineteen cases and thirty-three applications have been withdrawn "under the gun", that is, after proceedings had been instituted to investigate them. Those excluded from registration were persons who by any standard of fair and honest business dealing should not be in the securities business. We have combed the registration statements to prevent such persons from slipping through. There is, of course, no assurance that we have been altogether successful in this regard. The combing process must perforce be a continuing one.

A few illustrations selected at random will suffice to indicate the ramifications of this aspect of the Commission's work. In one case our investigation disclosed that the applicant firm had previously decamped from a state where it had run afoul of the law under a different name. Two principals in the firm, it developed, had criminal records. The failure to disclose these facts resulted in the denial of registration.

Another case involved an outfit which, if coming events truly cast their shadows before, was preparing to launch a sell-and-switch racket. Two agencies were to be used under separate names. These, we discovered, were located in post office boxes at which mail could be picked up by messengers and forwarded to the home office where the switching operations

were to be conducted. This scheme was nipped in the bud by our investigation.

In several cases we had nothing to start with except the fact that the applicant could not be found at the address shown in his registration statement. Investigation usually turned up unsavory records in such cases. For instance, after refusing registration to one applicant for furnishing a false address, we discovered that he was wanted in a Western state on criminal charges growing out of a securities fraud.

Other applicants who vainly applied for registration included a firm suspected of aiding in the disposition of stolen securities, a fugitive from justice wanted on a charge of forgery, a notorious swindler and an embezzler.

There is no way of determining the number of racketeers, high-powered salesmen, bucket shop operators, sell-and-switch peddlers, boiler room technicians, purveyors of fake securities, ex-convicts and other gentlemen of similar stripe, who retired from the field rather than come to grips with a Federal agency. I venture to say there were many; but I fear that many others still lurk in the shadows watching for opportunities to bludgeon the unwary out of their savings with the weapons of misrepresentation and concealment. The campaign against this group, who dare not seek registration, can be waged successfully but it will exact the most unrelenting efforts on your part and on ours.

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The second phase of the Commission's work in connection with the over-the-counter markets is the establishment of certain standards of fair practice to be observed by registered brokers and dealers. The rules heretofore adopted relate chiefly to the fiduciary obligation which a broker owes to his customer. A broker who acts as the agent of both buyer and seller is required either to procure the written or telegraphic consent of both parties at or before the completion of the transaction or to make written disclosure to both before its completion that he is so acting. Neither a broker nor a dealer may effect any transaction for or with a customer unless at or before the completion of the transaction he informs the customer in writing whether he is acting as dealer for his own account, as broker for the customer or as broker for some other person. If he acts as broker for the customer he is under a duty to disclose or offer to disclose the name of the other party and the time of the transaction. He is further required to reveal the amount of his commission or service fee and the amount paid by him to any sub-broker in the transaction. If he is controlled by or controls or is under common control with the issuer of a security involved in the transaction that fact must be stated. A broker or dealer who furnishes investment advice for a consideration or has discretionary powers over a customer's account may not effect any transaction in a security for or with his customer unless he discloses any position, interest or option he may have in such security and obtains the written or telegraphic consent of the customer. Neither may such a broker or dealer trade with his customer for an account in which he or any principal for whom he is acting is interested without obtaining the customer's written or telegraphic consent.

I need not pause to discuss the rationale of these rules. Generally speaking, they were familiar to the law prior to their codification by the Commission. Reputable firms have long regarded them as fundamental tenets of a sound and honest business. Their promulgation by the Commission, however, with the additional sanctions thereby entailed, should result in their more universal application and observance.

These rules constitute a beginning in the task of creating standards of just and equitable principles of trade in the over-the-counter markets. A great deal of patient study has been devoted to the problem of safeguarding the investing public from the ravaging effects of unfair practices in those markets as well as on exchanges. A well-rounded program in this regard is in process of completion.

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The third aspect of the Commission's work bearing upon the over-the-counter problem is its effort to quicken the urge for self discipline. We have long felt that associations of security dealers formed for the purpose of improving the standards of conduct prevailing among their members were deserving of support and encouragement. Such associations have potentialities for elevating those standards beyond the point which legislation unaided can achieve.

An organization like yours can occupy a significant place in the financial life of its community. Its development along sound lines can be of incalculable benefit to the investing public and, as a corollary, to its members. By a wise and proper policy of self discipline it can inspire in its members an abiding recognition of the grave responsibilities which are imposed by their important vocation. By lending its cooperation in the detection of persons engaged in fraudulent and manipulative practices it can assist in the removal of impediments to a free and open

market and can materially facilitate the competitive process. Finally, it can provide a channel for the frank and frequent exchange of views between the Commission and responsible persons in the securities business.

I have a feeling that you would not expect me to conclude these remarks without adverting to the amendatory legislation now pending before the Congress. I confess to some astonishment at the pronounced views which are apparently held in a few quarters that the Securities Acts could not be improved by amendments -- particularly insofar as unlisted trading is concerned. It seems fairly certain that those views are based upon a misconception of the Commission's attitude toward trading in the over-the-counter markets.

The proposals, in brief are as follows:

(1) That unlisted trading privileges to which a security had been admitted on an exchange prior to March 1, 1934, be permitted to continue until it appears that there is inadequate public distribution in the vicinity of the exchange or inadequate public trading on the exchange or an unsatisfactory character of trading on the exchange and that as a consequence the termination of such privileges is in the public interest;

(2) That unlisted trading privileges may be granted on one exchange to any security which is listed and registered on another; and

(3) That unlisted trading privileges may be granted to any security with respect to which there is available from a registration statement and periodic reports filed pursuant to the Commission's rules under either Act information substantially equivalent to that required in the case of a fully-listed and registered security.

As a necessary concomitant to these proposals an amendment to the Securities Act is suggested which would require any issuer seeking new capital to agree in its registration statement to furnish periodically

the same information as may be required under Section 13 of the Exchange Act in respect of a security listed and registered on an exchange. The agreement would become operative only if the aggregate offering price of the issue plus the aggregate value of all other securities of the same class amounted to at least $2,000,000.

No security would be admitted to unlisted trading privileges de novo unless the Commission were satisfied that investors would have complete and current information regarding the issuer; that wide spread distribution and public trading existed in the vicinity of the exchange; that the issuer or its officers, directors or stockholders were not endeavoring to acquire the benefits of an exchange market without assuming its obligations; and that in all other respects unlisted trading was in the public interest. Moreover, after a security had been admitted to unlisted trading privileges such privileges would be terminated if the public interest so required, either because the minimum requisites were no longer present or because the character of the exchange trading was unsatisfactory. Trading under such circumstances would be "unlisted" only in a purely technical sense, i.e. in the sense that the issuer had not applied for listing. While the wishes of the issuer are entitled to consideration, they are not controlling. Only the public interest and the interest of all investors should be controlling.

It is difficult to see how a program of this kind can be regarded as favoring one type of trading over another. These amendments represent a sincere and thoughtful attempt on the part of the Commission to create a fair field of competition between exchanges and over-the-counter markets. They were not conceived in any spirit of discrimination against over-the-counter trading. We feel that there is ample room for both types of trading in this country.

Perhaps it may be urged that the amendments are not discriminatory but that their administration may result in hardship to the over-the-counter markets. This, I pause to remind you, was precisely the kind of argument which was made when the original legislation was being considered. It is just as devoid of substance now as it was then.

I have endeavored to convey to you some idea of the scope and magnitude of our task in the over-the-counter field. We are moving simultaneously on many other fronts. We are faced with a divergent host of problems, each demanding its full share of painstaking effort. But we have never ceased to regard as one of our major objectives the progressive improvement of practices in the over-the-counter markets. We welcome so robust and promising an ally as your organization in the advance toward that objective.

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