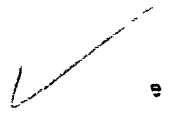


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ADDRESS
of
WILLIAM O. DOUGLAS
Chairman, Securities and Exchange Commission

AT THE DINNER
of the
ASSOCIATION OF STOCK EXCHANGE FIRMS

at the
COMMODORE HOTEL

New York, New York
May 20, 1938 -- 10:00 P. M., D.S.T.

Representatives of business and government meet tonight to hail a joint achievement and to launch a joint program.— We are proud of what we have done working together. We are confident of what we can accomplish by pooling our resources and combining our energies. What we can do, other groups can do. Working together we can overcome any problem which besets capitalism and democracy. Working together we can make this profit system work and at the same time sacrifice no whit or tittle of our government's objectives.

Greed and fraud beset all walks of life. They are immortal. You and we are not going to harness them. But you and we can deal with them effectively when we meet them. But they are not our chief problems because most people are honest. Our main efforts lie along the lines of making as certain as possible that honest business has opportunity to make honest and substantial profits. Freedom of opportunity is an essential to healthy capitalism as it is to healthy democracy. By our joint efforts we can preserve that freedom of opportunity. By doing so we will preserve capitalism and democracy. Let us not be diverted from that effort by indulging in the pastime of looking for moles in each other's eyes or in the calling of names. Only by a joint and united front can we keep from these shores the plagues that have descended elsewhere.

Fair play and simple honesty are a part of our inheritance. Individualism is our pole star. A united front on current problems has been one of our greatest assets. We know how to pool our energies in attacking a common enemy whether it be an army, a depression, or a burning issue. We need not offer each other olive branches. Unless we will it, our enemy is not ourselves but deep economic problems. This government needs you and you need this government in attacking those problems. Let us not be deluded into mistaking personalities for issues. The issues live on, though personalities change. The answer to those problems cannot be found by reliance upon dogma or smugness. They cannot all be found in laboratories. They can be found at conference tables and at forums. Free speech carries the answers on its wings.

The value of this approach is demonstrated by the joint achievement of your Exchange and my Commission. We were and are in the same boat together. We knew that all of the brains and character did not rest with one group. We knew that if we joined forces we could lick our common problem. In this manner can other groups work together, irrespective of creed or politics. We live in perilous times. We can ill afford anything but joint action. If there is failure here, we all fail. When the hearts of Americans are bound together in a common purpose, there can be no such thing as defeat. That time has come, for the common enemy of economic forces has invaded us.

But I want to speak tonight more particularly about this joint achievement and this joint program of ours.

You and we have come a long way together since last autumn. The road which we chose to travel was not the easiest. Some said it was impassable. Others said it was dead end. But you and we knew that we chose wisely. We were bent on a complete reorganization of the New York Stock Exchange. We insisted that it be a truly public institution, managed and operated so that the interest of the public be served first. Our joint acceptance of that basic principle made possible our joint achievement.

Many of you have been clamoring for these changes over a period of two decades. In your ranks there have been many who have been rebels against the smugness of those who stand resolute against any change. Out of the daily contact with Exchange problems came the realization to many of you that the public's interest was not always being well served. As early as 1914 some of you went on the line for a full time, independent, paid president of the Exchange. You felt then what subsequent events have clearly demonstrated that the private club form of government was not suited to the operation of the Exchange as a servant of the public. Some of you clamored, too long in vain, for the plan to have all stock exchange houses file with the Exchange periodic statements of their financial condition so that the public would be better protected against the risk of insolvency. Recent events have showed beyond doubt the tragic error of the long delay in accepting your proposal. Still others in your membership have been champions of similar reforms. Your capacity to agitate has been productive of many constructive changes. Dare I say, that, for that reason, a goodly number of you would qualify for admission into the ranks of the New Dealers? Tonight I salute those who have been endeavoring with heart and soul to preserve this ancient institution by remodeling and modernizing it.

A large part of your success has come as a result of the work of the Conway Committee whom we honor tonight. That Committee gave implicit recognition to the public interest as a prime motivating factor for future administration of the Exchange. It properly recognized that "the integrity of the Stock Exchange is of first importance even with a program of governmental regulation". It also set forth as basic the proposition that a huge business enterprise such as the Exchange should be run in a modern efficient way rather than in the manner of a private club. But it talked in no vague generalities. It laid down a concrete plan of action -- a new constitution, a paid president, a trained personnel, a reduction, nearly in half, of the size of the board of governors -- in short, a business-like administration of one of the most important businesses in the country; a stream-lined administrative machine geared for high speed action in the interests not only of the members but of the general investing public.

Intervening events have proved the wisdom of the principles which the Conway Committee laid down for you. And the speed and dispatch with which you adopted these proposals for reorganization are a sign of a new spirit in the Street. For that reason I congratulate you and the Conway Committee. As a result of your acceptance of its platform, you can face the future with the hope and belief that you can reclaim the public confidence in the integrity of your business.

So tonight we turn our eyes from the past to the future. And the question on all of your lips is "What next"? Last winter I told a Committee of the Congress my views as to the proper relationship of an agency of the government like the SEC to a stock Exchange. I said:

"My philosophy was and is that the national securities exchanges should be so organized as to be able to take on the job of policing their members so that it would be unnecessary for the Government to interfere with that business, and that they should demonstrate by action that they were so

organized. Now, that is something more than cooperation. That is letting the exchanges take the leadership with Government playing a residual role. Government would keep the shotgun, so to speak, behind the door, loaded, well oiled, cleaned, ready for use but with the hope it would never have to be used."

That is still my view of the matter. I do not relish governmental intrusion into your business any more than you do. And you know, as the public knows, that I am as sincere in that statement, as I am in saying that we will faithfully endeavor to do the job which is ours under the law.

We are first and last the investors' advocate. But we are also your advocate. A proprietor of a business such as yours can render a high service to his customers and to the nation. With full sincerity I can say that if we can help you render that service we will have helped you help our whole national economy. For it must be remembered that your vitality and strength are symptomatic of the health and vitality of all of our financial processes.

That is why it must not be forgotten that the way your Exchange is run is a matter of national concern and of national importance. Your Exchange is one of the greatest market places in the world -- a place where buyers and sellers throughout the world meet and do business together. It is important to those buyers and sellers (whether they be big or small) that this market place be above suspicion. To satisfy the demands of investors there must be in this great market place not only efficient service but also fair play and simple honesty. For none of us can afford to forget that this great market place can survive and flourish only by grace of investors. A man who wishes to buy or sell stocks or bonds must be convinced that this is his exchange, not an insider's exchange. He cannot be convinced by mere words. But I am sure he can be convinced by action. You have made a splendid beginning. It clears the decks for action. And if I am any judge of the attitude which prevails among the men who have been chosen to your new board, we shall have convincing action.

The course which that action should take seems clear. As I have said on other occasions, those intricate matters cannot be solved in the manner of debating societies. They are hard practical problems which can be answered only by dint of hard work and study and by an exchange of ideas between you and us. No one has a corner on truth in these matters. We must expect change and flexibility as conditions change. Our standard is and can be only the welfare of investors. Your self-interest also lies in that direction, for the welfare of investors is on the long pull your welfare.

In the first place, it should be clear to all that neither you nor we can or should endeavor to fix it so markets go up or down. And, of course, neither you nor we can be held responsible for rising or falling prices so long as those movements are not artificially generated. These markets should mirror and reflect what the world of business is doing. He who tries to interfere with those natural movements is not a true advocate of this investor. Out in the far west we used to have annually a county fair. The side shows at those fairs used to be more popular with the younger ones than the exhibits of cattle, sheep and apples. One of the most intriguing was the tent containing the magic mirrors which would make fat men out of thin ones and dwarfs out of tall ones. Too often have our exchange markets been magic mirrors, not reflecting real conditions but distorting true facts. You and we must by action eliminate so far as possible those magic mirror effects.

That means among other things a joint attack on manipulative trading. Hitherto we in Washington have carried the brunt of such policing. We have had to exercise the greatest vigilance to see to it that the law was enforced. Detection of pools is one thing; legal proof of the existence of pools is another. We operate under the law. That means full opportunity for a hearing by the accused. It also means a fair trial and a careful weighing of the evidence by us. All of that takes time. Furthermore, the doing of our job in a legal way has required collection of facts from hundreds of brokerage offices and from customers. Brokerage offices and customers naturally find us somewhat of a nuisance when we are bent on such a mission. But to enforce the law we have to have facts. We cannot manufacture them out of thin air. The only way we can get them is to go to original sources. This may be called gathering of evidence or snooping, depending on your point of view. But on that issue, here is where we stand. Congress has outlawed pools and manipulation. We intend to carry out the Congressional mandate, though some may say it took a snoop to do it. But I am convinced that through united action by the exchanges and by us we can do the job much more effectively. An exchange properly policed should seldom create such onerous tasks for the SEC policeman. I am confident that, through your activities, you can make manipulation and the manipulator as unpopular here as they are in the country at large. Hence, I look forward to the day when policing of the Exchange by you is so effective that there remains little for us to do on that score.

Secondly, there is the troublesome question of the insider on the Exchange as contrasted to the outsider. I would not be frank if I did not mention it. Some of you members and member partners have yourselves in the past complained as vigorously as members of the public about the undue advantage which the inside trader has had over others. You have also let it be known in no uncertain terms that this trading advantage has too often been used not alone for the insider's profit but to the detriment of the outsider. Due to this foment and discussion both within and without the Exchange, the popular impression has been clear and strong that some one on the inside has a mirror-- not a magic mirror this time but a clear, sharply-focused old-fashioned mirror -- behind the backs of the investors who enter this market. The feeling that one member at the table has a mirror strategically located behind the other players is not conducive to confidence here, any more than it would be in case of a game of poker, or bridge. It does not create an eager desire on the part of others to become participants. It is repellent to the American sense of fair play. It adds a casino element to what should be an old-fashioned, open auction. This is the most difficult problem confronting you and us. I do not come here this evening with a ready answer. The mechanism of the Exchange is as intricate as a Swiss watch. All of its parts properly synchronized are essential for effective operation. In a real sense, members on the floor (the so-called insiders) and the commission houses who do business with the public are dependent one on the other. There is no good reason why they should not pull together. What is good for one part is bound in the long run to be good for the other. So this problem is a joint one for solution by all of you and by us. I face this problem with confidence that working together we can solve it in a way which will be sane and sensible and at the same time protective of the best interests of the man or woman who enters this market place to buy or sell. We must soon get on with that problem for it is a constant source of irritation. If we neglect it now, it will come back to haunt us all on less favorable occasions. But over and above all else it is not fair to the investors of this country for us to neglect that problem longer, no matter how difficult its solution may be.

In the third place, there is the problem of affording the person who buys or sells securities protection against the risk of loss of the securities or cash which he has left with or delivered to his broker. Occasionally a broker has become insolvent. Still less frequently there have been misappropriations by him of his customers securities. On these scores the record of Exchange members has been exceptionally good. But these occasional cases have raised in the minds of some customers fear and suspicion. We might as well be frank about that. This condition recalls the story of the Indian out in the far west who wanted to borrow \$1000 from the local bank. The banker wanted some collateral for the loan. The Indian could not understand. The banker finally made the Indian understand that he could not have the money unless he left with the banker the Indian's twenty ponies. So the Indian brought in his ponies and got the loan. Later the Indian struck it rich. He came in with his huge bank roll, peeled off a \$1000 bill, paid the loan and retrieved his ponies. The banker, seeing the large bank roll, suggested that the Indian deposit the money in his bank.

"How many ponies you got?", asked the Indian.

Some of that Indian's blunt skepticism and simplicity crops up when one out of a thousand honest business men comes a cropper. The problem has been accentuated in periods of business recession.

In the simplest form of cash transactions, a broker often holds for his customer either cash or fully paid securities. The length of time during which cash or securities is held will vary with the details of the transaction or with the wishes of the customer. The risks inherent in this holding of cash or fully paid securities depend upon the care with which a broker's business is handled. In a situation where a broker holds cash for his customer, the customer has what is known as a "free credit balance". In effect, it is like a deposit of money in a bank. It is apparent that many customers make a practice of having cash balances with their broker for we know that those few brokerage houses alone which reported to the New York Stock Exchange by questionnaire as of March 31, 1938 had free credit balances belonging to their customers aggregating \$245,000,000.

Now a broker has his own cash funds as well as those that he holds for his customer. He may commingle his customer's funds and his own funds, or he may set the customer's funds aside in a separate account. Better run brokerage houses have taken appropriate measures to hold apart, or segregate, assets approximating the amount of the total credit balances carried by them. Just as money balances belonging to customers may be commingled by the broker with other customer's balances or with his own, similarly securities belonging to customers which are carried on margin may be in the course of the brokerage business so commingled.

In the past there has been general regard on the part of brokers for high standards in the conduct of their business and this has given protection to customers. By and large there have not been many losses to customers resulting from causes of the brokers' own making. The record of your Exchange is exceptionally good on this score. But there have been some cases where these high standards have not been followed. Over-speculation and other forms of excessive commitments in securities by a brokerage firm or its partners have involved unjustifiable risks to the customers and in some

cases actual losses. The shades of a recent example of such disregard of the customer's property still haunt financial districts. And other cases of insolvency or speculation have from time to time revealed potential weaknesses in the present system. Thus, there still remains a problem of the utmost importance to the public as a whole and we feel, as we know you do, that an attempt must be made to find the answer.

How desirable it would be to achieve a greater measure of security for the customer's property. How simple, from the brokers point of view, it would be if brokers were relieved of worry over the mechanical operations of handling securities or funds; over performing these banking functions; or over the difficulties and responsibilities of custodianship. I should like to offer a suggestion, and it is no more than that, for reaching at least a partial solution to these problems.

I may say that this suggestion is not an original one with us. It emanates from the brokerage business itself. It was suggested at least as long ago as 1932 by some of your own members. It comes down to this—the establishment of an institution in the nature of a trust company to be formed for the purpose of taking over the functions of banking, clearing of securities and the custodial duties of all members of the exchange. As I recall, this was originally suggested by some of you as an economy measure. Changing events indicate that today it has acquired additional merit by reason of the real assurance and protection which it would appear to afford customers.

The suggestion contemplates the formation of a trust institution under State law whose functions would be confined solely to acting in a fiduciary relationship as agent for both brokers and customers. It would not operate for its own account, nor would it engage in a commercial banking business. The usual functions with respect to purchases and sales of securities would be carried on by brokers just as is the case today. But brokers who had the benefit of the services of this institution would be relieved of many of their present functions. For instance, the trust company would act as cashier for brokers; receive from and make payments to customers for securities bought or sold; transfer, receive and deliver customers' securities upon instruction of the brokers; and as respects margin transactions, act for brokers not only in relation to their customers but in relation to the banks as well. Clearances could be readily and conveniently handled.

An institution along these lines would of course reduce the number of operations involved in the securities business, and should effect substantial economies for the brokers. But more important should be its service to investors and to the public generally in reducing or eliminating the risks at present involved in the performance by brokers of the quasi-banking and custodial functions which I have mentioned before—the holding and commingling of the funds and securities of their customers.

From another viewpoint such a measure should also answer many of the administrative problems of the Commission as well as of the Exchange. It would simplify the task of making inspections of the margin accounts of our far-flung brokerage community and also from many of the other details which are the necessary incidents either of enforcement or self-regulation. Certainly, when considered in this connection, this suggestion has great appeal for us.

The suggestion is, of course, only tentative and the details of the functioning of such an institution have not been thoroughly explored. We hope to explore them with you to see if practicable ways cannot be found for effecting such a measure within the near future. If, as a result, you and we agree that the idea has merit, we will be happy to cooperate in the establishment of such an institution in a form which can best serve the interests of all.

These then may be regarded as cardinal problems worthy of our joint endeavors. Their solution holds out great promise of entrenching the Exchange in public confidence and of building it up as an integral and vital cog in the financial machinery of the nation. In no sense do they constitute what might be called an official agenda. And they can be called a program only by virtue of the fact that they are a part of the unfinished business which is before you and us. Tonight we face them together and I firmly believe that we can solve them together in the near future. There are other parts of that unfinished business, though there are not many. There is the persistent question of bond trading. How can the quality and quantity of bond trading on the Exchange be improved? There is the question of the amount of commissions and other service charges which members of the Exchange should receive. There is the question of whether or not the odd lot business and procedure can be improved in the interest of the public and in the interest of the Exchange. These in main constitute our immediate unfinished business. Other problems will doubtless arise in the future. But we have in this list our chief problems. Our solution of them will switch on the green light which will open the broad and open highway which lies ahead. Let you and us see to it that that green light functions. We need not long delay. We need not await endless study. Much spade-work has been done. Common sense and informed judgments will point the way. The conference table rather than the laboratory is the place for us to do most of our joint work. We may make mistakes, as is human. But let us not permit fear of error or realization of complexity promote inaction.

Some will always look with longing backward glances to the gay days of 1929. But you and we know that as a nation we cannot and should not turn back. You and we know if we work together rather than apart, if we expend our energies on the problem rather than on each other, that we can make this segment of capitalism work. That will mean profits for your business. That will mean health for our national economy. That will mean a vivid demonstration that the aims of this government and the objectives of business are wholly compatible. So as the green light flashes, I bid you safe riding down this broad and open highway that lies ahead. I do more than that -- I offer you a police escort.