Remarks of

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HISTORY OF SECURITIES ACT

At one time I assumed that the securities laws of 1933 and 1934 were a product of the New Deal era and that they reflected the political philosophy which existed at that time. This is not entirely true, however, since the drafters of our laws followed a pattern of investor protection much earlier used by the English, and for the same purpose. In both instances the purpose was to reestablish confidence in the securities markets. Although the initial impetus for legislation was for adequate disclosures in connection with the sale of securities, a necessary adjunct has been the maintenance of the integrity of the marketplace where the securities are bought and sold.

In 1720 there was widespread speculation in England, of which the shares of the South Sea Company are symbolic. This company was organized to trade with South America and the Pacific Islands, and George I was its Governor. Its shares which rose from 128 pounds in January to over 1,000 pounds in July, fell back to 125 pounds in December, but not until the directors had sold five million pounds of the stock at the ceiling.

After the "Great South Sea Bubble" had burst with its resultant ruin of thousands of investors, the Parliament passed the extremely restrictive "Bubble Act" of 1720.

Corporate enterprises continued to grow; and in 1844 a Select Committee on Joint Stock Companies made an historic report to the Parliament. Providing the facts for an investor to reach an informed investment decision was the basic recommendation. Chairmanned by Gladstone, the Committee observed:

> "Periodical accounts, if honestly made and fairly audited, cannot fail to excite attention to the real state of a company; and by means of improved remedies parties to mismanagement may be made more amenable for acts of fraud and illegality. The early publication, resulting from registration, of . . . prospectuses and circulars, will doubtless be useful in controlling . . . undertakings at their outset . . ."

The "Companies Act of 1944" adopted the recommendation of the Gladstone Committee and provided for compulsory disclosure in a prospectus.

A later committee, which gave direction to the Companies Act of 1900 and which had observed the workings of the previous Companies Acts, made the following statement:

> "It is therefore of highest importance that the prospectus upon which the public is invited to subscribe shall not only not contain any misrepresentation but shall satisfy a high standard of good faith. It may be a counsel of perfection and impossible of attainment to say that a prospectus shall disclose everything which could reasonably influence the mind of an investor of average prudence. But this in the opinion of your Committee is the ideal to be aimed at, and for this purpose to secure the utmost publicity is the end to which new legislation on the formation of companies should be directed."

One of the drafters of our 1933 Act referred to the English legislative history at length in a 1933 article. The thoughts he expressed in 1933 parallel the Committee Reports to Parliament in 1844 and 1900. They were:

> "Fair play at the start is most essential. The prospectus is the basic appeal to the investor's pocketbook. The rationale of the Securities Act is insistence on candor and completeness in making this appeal. It may be ingenious to deem truth an automatic protection against greed and credulity in investors. Much more could be done and probably will have to be done in governmental oversight of the mechanism of capital investment. But to compel the light now demanded by the Securities Act in places often consciously darkened is merely to require the elementary basis for knowledge before asking people to invest [their] savings . . ."

As I have just described, the Securities Act of 1933 affords the individual investor the opportunity to obtain meaningful disclosure concerning the financial affairs of the company in which he proposes to invest. The Securities Exchange Act of 1934 complements these disclosures and in addition provides a framework within which those persons engaged in the securities business are permitted to regulate their own affairs

subject to the continuing oversight of the SEC. I have had occasion recently to discuss the concept of self-regulation and how this may inure to the benefit of the public investor as well as those in the brokerage community. It is in this context that I would like to invite your attention to an area which has been of real concern to the Commission. Increasingly, public investors are being asked to invest in what we refer to as "shell" corporations. These companies have little or no assets, little or no management or operational capacity and, obviously, little or no future. They are marked by a lack of financial and other information and they involve extremely high investment risk.

Trading in a shell corporation usually has the following history. First of all, a promoter will purchase the outstanding sleeping shares of a publicly-owned corporation, a shell, for use as a holding company. Suppose we call this sleeping company South Sea Bubble of 1969. Since South Sea Bubble of 1969 is already incorporated and publicly owned, it affords immediate access to the public marketplace. Following the acquisition the promoter merges into the shell a private corporation, and usually one in which he has a controlling interest. As a dividend, the original shareholders in South Sea Bubble of 1969 now receive certificates representing their pro rata share in the new corporation. Shortly thereafter these same shareholders begin to receive letters, news releases and even annual or quarterly reports describing discoveries by, acquisitions of and projected sales by the formerly dormant corporation. Unfortunately it has been our experience that almost without exception these reports prove to be false.

Simultaneous with the release of this misleading information, brokers, either at the instigation of the controlling persons of the corporate shell, or unwittingly on their own volition, begin to enter quotations and make markets in the shell's stock. This is where John Q. Public enters the scene as an investor and the point where your responsibility begins so as to see to it that the public doesn't get fleeced.

At the present time, when someone seeks to insert quotations in the "pink sheets" for a security, he must provide, among other things:

1) The name, address and state of incorporation of the issuer;

2) The class of security to be quoted and the number of shares of that class outstanding;

3) The name and address of the transfer agent;

4) A yes or no answer to the questions of whether it has a copy of the issuer's balance sheet and/or profit and loss statement and whether these financial statements are certified;

5) Whether it has a copy of the issuer's annual report and, if so, for what year;

6) The current nature of the issuer's operations; and

7) The price at which the security is to be initially quoted.

Although this type of questionnaire provides a good outline of the significant questions to be raised before any further consideration is given to market-making activities, it is too often forgotten that this questionnaire is only an outline and serves only as a starting point for investigation. A situation recently came to my attention where a brokerage firm seeking to insert quotes in the "pink sheets" did not have a copy of the issuer's balance sheet, the profit and loss statement, or the annual report. In response to the question concerning the nature of the issuer's current operations, the firm stated that the issuer was a recent spin-off from another company and was presently inoperative due to lack of capital.

Despite this lack of operation, and even more importantly, the lack of information, the firm initially quoted the security at a bid of one-half and an ask of one. This particular request for insertion of a quotation in the "pink sheets" was dated July 28, 1969. Approximately two weeks later, the stock was being quoted at a bid of one and three-quarters and an ask of two and three-quarters. Based on a total of 865,875 shares outstanding, the marketplace was valuing this inoperative company at approximately one and one-half million dollars. This example is one taken at random; unfortunately there are many many others like it.

By way of illustration, between July 15, 1969, and October 10, 1969, twenty-five different advertisements appeared in the Wall Street Journal to purchase shell corporations.

During the same period, but on the other side of the market, nineteen advertisements sought to sell shell corporations.

Obviously demand exceeds supply, as few advertisements needed to appear more than twice before a taker was found. Also there appears to be a premium for clean shell corporations, as compared, I suppose, to dirty shells. Thus, on September 30 we see a nursing home seeking to buy a clean over-the-counter shell. On September 29, however, a brokerage firm advertised to buy any shell, clean or otherwise, with at least 500 shareholders. What none of these advertisements mentioned, however, is that the Commission has already developed and is continuing to develop cases involving nationwide shell distributions by hard-core criminal elements.

CONCLUSION

My message to you tonight is brief. Your association has the capacity to take an interest in matters such as this and in this regard you, as individual traders, are in a unique position. You can make a substantial contribution to the fulfillment of this responsibility. You, on a daily basis, see and participate in existing and new markets. You see markets develop, patterns emerge, volume change and markets disappear. You are the professionals and of all the people in the industry, you would be the first to recognize a phony stock or a phony price. You are also the people who have the first opportunity to see to it that neither a phony price nor a phony stock be foisted upon the public. I very much hope that you will recognize and accept your professional and legal responsibilities in this area. When trading develops in the stock of corporations for which there is not both accurate and adequate information, the duty falls upon you to recognize the situation and instigate an investigation through your firm before you continue trading. Your failure in this area may well result in financial loss to the public and it goes without saying that it also may well result in your receiving official greetings from the SEC.

Today, as before, an important responsibility of the Commission -- and one which we share with all segments of the securities industry -- is to insure for the public investor,

the integrity of the marketplace where he buys and sells. We also see that undesirable practices which are adverse to the investor's interests are restricted and channels through which corporation information flows are kept open to him. For if free and open markets are to be maintained, the interests of the public investor -- who makes it all possible -- should be paramount.