Address of

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at the

Annual Dinner

of the

NEW YORK SECURITY DEALERS ASSOCIATION

The Biltmore

New York City

March 11, 1955

It is a stimulating and somewhat frightening experience for a lawyer turned government administrator to speak to an assembly of securities dealers in the City of New York. Nobody loves a lawyer and there are many categories of the human species vastly more popular than government administrators. In addition, there is always the problem of what to talk about. The banquet room isn't the proper setting for a technical dissertation, and yet, because you are dealers in securities and I hold a responsible post in the regulation of your business, both you and I by this time probably suspect that I will say something on the subject of our common interest.

To talk about the capital markets in general terms involves a risk of indulging in a recital of platitudes. To talk in any detail about the regulation of capital markets involves the risk of boring one's audience with technicalities interesting only to the speaker. Tonight I hope to steer a middle ground between the philosophical and the technical. I don't want to scare you away by my announcement of the subject but this speech could be entitled "Basic Concepts of Federal Securities Regulation." It might be given a more amiable sounding title, but I may as well prepare you for the worst.

You who are in the securities business in New York or in any large center work under great pressure most of the time. In one capacity or another you are playing a part in the energetic, fast-moving, exciting, dynamic drama of capital formation. Your immediate tasks are always interesting. Your problems are challenging. They must be solved quickly and before one immediate problem is solved, another one comes along. You work hard. You probably play hard.

At the Commission we have a multiplicity of statutes to administer and a multiplicity of powers and duties under each statute. We have big problems and little problems every day. The time pressures are such that we always seem to be trying to bring two trains in on the same track simultaneously. We work hard too. It is only natural, therefore, that neither you nor we have or take the opportunity to do enough fundamental thinking about how our day-to-day activity and the exercise of our day-to-day responsibilities fit into the general pattern of things. We don't have or we don't take the time off to climb a mountain and look down on the scene of our activities.

I remind you that the part of the human race which happened to be engaged in the processes of issuing, selling and trading in securities in the 1920's was basically neither much better nor much worse than the part of the human race which today is engaged in the same processes. There did occur then, however, a gradual intensification of the zeal with which more and more people devised more and more means to turn some dollars into more dollars. The community lost its perspective. I don't need to recount what followed. It was a period of chastisement -- economic chastisement, legal chastisement. In addition to the self-examination conducted during the leisure time for introspective and retrospective thinking -- leisure afforded by the inactivity of the depression -- there was the examination conducted on behalf of the Government. That examination, conducted against an historic background of economic disaster, had elements of angry emotion in it. Many headaches would have been avoided had more sober thought been taken while the party was going on.

Today the capital markets are prosperous; the economy is prosperous. We are not looking back on a debacle. We are busy doing our respective parts in the conduct of a process of capital formation which is maintaining American economic life in a style to which it would like to become accustomed. I suggest that an objective analysis of your work and our work makes good sense. In other words, some precautionary measure, if one is required, taken after a physical check-up is always better than a successful major operation.

In spite of the fact that I said a little while ago that we don't get enough time for objective thinking, all of us do snatch a moment now and then and perhaps subconsciously our philosophy on a particular subject takes some definite shape. I would like to pass on to you tonight the results of some of my own thinking on the general scheme of securities regulation and to phrase those thoughts, not in terms of statutes, regulations, or details, but in terms of allocations of responsibility, allocation to the investing and trading public, allocation to securities dealers, brokers and underwriters, allocation to stock exchanges and associations of securities dealers, allocation to the Securities and Exchange Commission and allocation to the courts.

A lot of people have the idea that the Securities and Exchange Commission is a kind of guarantor that all is well in the operation of markets for securities. Not only that, I think there is a kind of unadmitted subconscious feeling, even on the part of those familiar with the business, that if the SEC does not move in to thwart a particular practice of doubtful integrity, the practice becomes ipso facto validated.

Put another way, there may be somewhat of a feeling in the business that the disciplinary power of the SEC is a substitute for self-control. There is a feeling on the part of some members of the investing public that the Commission's processing of a registration statement or the Commission's registration of a broker or dealer eliminates the necessity of the investor's exercising intelligent standards of selection in the choice of his investments or his broker. The atrophy of a dealer's sense of responsibility for business conduct or the atrophy of an investor's appreciation of the necessity of exercising intelligent judgment in his investment decisions would be as disastrous to the American economy as an atrophy of the initiative which characterizes the nation's development.

In spite of the fact that there are elements of paternalism in the securities laws and in their administration -- just as there are elements of paternalism in any other function of government -- the securities laws themselves impose ultimate responsibility on both the organizations and individuals regulated by those laws and on the members of the public whom the laws seek to protect.

Let us examine more closely into this. Take first the subject of disclosure. Disclosure is perhaps the most fundamental obligation imposed by the various laws administered by the Commission. Who has the responsibility to make the disclosure and who has the responsibility to see that the investor benefits from it? To be sure the Commission examines statements of fact made in material filed with it but it does not and cannot vouch for the accuracy of that material. Administratively it calls attention to apparent misstatements or half-truths. Its staff suggests the subject matter of corrections, but the responsibility for the statements is that of the party making them. That is clear in the law and it is clear as a matter of common sense. Without an Army-sized division of traveling auditors, the Commission could not truly verify the accuracy of the material filed with it. And what about the benefits from the disclosure? Disclosure is for the investor's benefit. Unless the investor or his adviser takes the trouble to read and understand the information made available to him, the disclosure is sweetness wasted on the desert air. In other words, the benefit of the law is realized to the full extent only by those who use the energy and wisdom to take advantage of those benefits. The Commission's function is to formulate standards for disclosure, to activate the disciplinary powers of the law against those who fail or refuse to make adequate disclosure, but the efficacy of the disclosure provisions of the law depends basically on the integrity of those who supply the information and the energy and enlightened self-interest of the investors for whom the information is supplied.

I mentioned that a basic concept in the securities laws is disclosure. Another basic concept is the old familiar one found in every legal code since those of the predecessors of Hammurabi, namely, outright prohibitions of illegal acts. The duty to avoid breaking the law is no different in the case of securities laws than in the case of any other kind of law. The prohibitions are different, of course, prohibitions of fraud, prohibitions of certain manipulative activities, prohibitions in the case of investment companies and holding company systems of certain types of transactions among affiliates and the like. But fundamentally the prohibitory provisions of the securities laws are like any other criminal law. Those who disobey them are subject to criminal penalties of fine or imprisonment. While the Commission has investigative powers and can impose certain limited disciplines, or more importantly refer the matter to the Department of Justice for prosecution, the general efficacy of these prohibitions depends upon the fact that generally speaking people do not break the criminal law. Upon a nation's respect for the law depends its national integrity.

There are also found in the securities laws provisions for civil liability. Most of these provisions are fixed by the terms of the statutes themselves -- for example, the liability for misrepresentation in a registration statement or the liability for misstatements in an annual report filed by a listed company. Other liability provisions are found in Commission rules adopted under authority given in the statute.

Issuers and underwriters have been known to be impatient with their lawyers from time to time. Be tolerant of your legal adviser, gentlemen. He usually knows what he's talking about. He knows that getting a filing with the Commission made effective does not create any exemption from the civil liability imposed by the securities laws. That is a responsibility remaining on the party filing the document. It is a legal obligation, enforceable in the courts just like the obligation to respond in damages for negligence in an automobile smash-up.

These civil liabilities are enforceable in private litigation in the courts, not by the Commission. The Commission's intervention in such litigation is only in the exceptional case where a basic principle of statutory construction -- important to the Commission's administration of the statutes -- is involved.

The next concept in the securities laws is that involved in the Commission's rule-making power. The Commission has broad power to fill in details on many matters treated generally in the statutes. It can prescribe standards for disclosure, make regulations as to forms and procedures. It has powers under the Public Utility Holding Company Act and the Investment Company Act to pass upon many types of specific transactions. Most important perhaps are the Commission's powers to make rules and regulations which have the force of law. In other words, some of these prohibitions and some of the civil liabilities I spoke about a moment ago are imposed under rules which the Commission makes. For example, the Commission can prescribe by rule the types of manipulative practices which are criminal; it can prescribe rules to separate prohibited from permitted practices in stabilization; indirectly it can prescribe rules for the exchanges themselves and these rules can in turn provide what activities are permitted and what are prohibited for floor traders and specialists. Since rules relating to practices in the trading markets necessarily deal with many transactions and since they deal in that area where the line between what is unethical and what is illegal is sometimes indistinct, the securities business has a responsibility for compliance and enforcement. The discharge of this responsibility transcends in practical importance anything that could be accomplished by a regiment of Commission investigators.

That last observation brings me to another concept found in the securities laws, namely, that of according legal status to self-regulation. I am not going to talk about the NASD and its rules and its disciplinary proceedings and its inspections. Neither am I going to talk about the stock exchanges and their rules and their examinations and their disciplinary proceedings. What I am going to mention is the fact that the Congress in the Securities Exchange Act of 1934, as amended in 1938, recognized that in the securities business, self-regulation was of such importance that it should be given statutory recognition. Through that recognition vast power and responsibility were imposed on the exchanges and on the NASD. The Commission has reviewing functions, to be sure, but the basic responsibility is on the self-regulating private agencies whose peculiar status the Congress has recognized.

I hope that this analysis of the securities laws in terms of allocations of responsibility has perhaps stimulated some thinking on your part as to the nature of your own individual responsibilities both legal and moral. I come back to the point from which I started, namely,

that we become too much absorbed in our day-to-day tasks. We need to think, we need to gain and regain and gain again our perspective.

An inquiry into our trading markets is now in progress before the Senate Banking and Currency Committee. That inquiry will doubtless result in an appraisal of how you and how our Commission are meeting their respective responsibilities. It will doubtless result in an appraisal of the efficacy of the present Federal securities laws. In order to answer to your own satisfaction and to that of the Committee and of the people as to the discharge of our respective responsibilities, you should do, and we should do and even investors should do, some pretty sound thinking about what those responsibilities are. Only by clear, conscientious thinking, continuously done, can we have reasonable assurance that the capital markets will continue to serve, as they are serving, the American economy which, thank God, is still the greatest material human force in the world.

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