

Speeches. SEC staff

ADDRESS OF

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Before

THE BOSTON STOCK EXCHANGE

at the

Boston Stock Exchange

Boston, Mass.

March 3, 1933

7:00 P.M.

42563

There is a deep-seated impression at the Securities and Exchange Commission that nowhere in the country is there a better understanding of the basic objectives of Federal securities regulation than in Boston. I do not mean that we foolishly imagine the entire Boston financial community to be in complete agreement with every step we take. It is something broader, something deeper than that. It springs from a conviction which, I suppose, is shared rather widely that Boston is the home of truly conservative finance; that Boston is the center of the country's highest tradition of industry, of thrift, and of investment.

The relations between our Commission and your Exchange have always been, I am glad to say, most cordial. I hope that what I say tonight will only further the harmony of those relations. We are passing through a period in which effective cooperation between government and business is at a premium. Leaders in government and business alike are earnestly seeking the formula for successful cooperation. I do not know that such a formula exists, but if it does, I think you will agree that the first ingredient must be mutual understanding. Failure on either side to grasp and to understand the motives and objectives of the other immediately breeds distrust, and distrust thrives on itself. Let me give you an illustration from our own experience.

The Securities and Exchange Commission, as you know, has powers which may be of wide economic significance to the various securities markets under its jurisdiction. We are not unaware that there is concern in those markets as to the manner in which the Commission may exercise its powers. That is inevitable. Yet, I have seen worry of that type carried to extreme absurdities. Some of the rumors and reports which gain circulation could be dismissed if they were given but a moment's serious analysis. For example, the over-the-counter dealers complain that it is our sinister purpose to force trading in their securities on to the smaller exchanges. The smaller

exchanges, in turn, complain that we intend to drive trading to the big New York exchanges. And finally, the New York exchanges will tell you that it is our secret desire to drive trading into the over-the-counter markets, which is where we started. I have also heard the same rumors in reverse order and I imagine you have too.

Rumors of this type are, of course, disquieting and quite obviously they are born of a lack of understanding. My purpose tonight is not to deny or expose any false rumors, but rather I hope, by talking frankly with you about some of the things the Commission is trying to do, to contribute to the understanding that exists between us.

During the past few months there have been two matters of major concern to the Commission: The problem of stock exchange reorganization, and that of regulation for the over-the-counter markets. I know you are familiar with developments along both these lines, but I would like, if I may, to try to give you a better insight into what lies behind these efforts. And then I want to discuss in broad terms some of the problems of the stock exchange outside of New York as we see it.

It is important first to understand what role the Commission feels itself called upon to play in the regulation of the securities business.

The Commission has, since its inception, regarded itself as an impartial administrator charged with the successful economic functioning of a great and vital industry. This role of administrator is not something which is reserved for special occasions. Rather it is the daily shirt-sleeve role of the Commission, as I have seen it. Let us look for a moment at the Commission's administration of stock exchange affairs. Under the law, of course, the Commission must insist upon adherence to the standard prescribed by the Exchange Act. Yet, the actual "policing" of Exchange trading, the Commission believes,

can be done more efficiently and more effectively by the exchanges themselves than by any corps of federal investigators. It was that belief that lay behind the Commission's demand, last November, that exchanges reorganize their governing machinery. Up to that time, as you know, the Commission had not adopted a single rule or regulation of its own which related to Exchange trading. It is true that certain rules were suggested to the Exchanges for adoption by them, but the important point to remember is that those rules remained rules of the Exchange and not Federal regulations. By November, the Commission had come to the conclusion that there were too many instances in which exchanges were not being governed in the manner which faithful administration of the Securities Exchange Act would demand. Had the Commission been merely a police agency, it would simply have stepped in at that point and taken over the job of policing exchanges itself. The Commission, however, preferred at least to try another alternative. It believed that the exchanges could be shown the wisdom of so constituting themselves that truly effective self-government would become the rule rather than the exception. That these hopes may not have been too sanguine is evidenced by the forthright manner in which the New York Stock Exchange took steps to follow the Commission's recommendations. The fact that the Chicago Stock Exchange in a sense anticipated the Commission's action by having a survey made of its organization and by turning the findings of that survey into a program of action, indicates that progressive views regarding the structure of our financial system are not confined to the Commission, but are to be found as well among the guiding forces of the smaller exchanges of the country. I do not mean to imply a demand here and now for similar action on the part of the Boston Stock Exchange, but I do venture to predict that not many years will have passed before nearly all our exchanges will have found such a course both sound and profitable.

In examining the Commission's activities with respect to the over-the-counter markets, we again find evidence of the Commission's role as administrator rather than policeman. When the Securities Exchange Act was passed in 1934 very little was known about the over-the-counter securities business. Even the best estimates of the number of brokers, and dealers and the securities then traded varied widely. Since that time there has grown up within the business itself a movement having as its objective some effort at self-government. Although this movement was initiated entirely by the industry, the Commission was glad to render whatever assistance it could. After more than two years' work by over-the-counter and investment banking groups and by the Commission's staff, the time appeared to be ripe for launching a regulatory program based on cooperation between the Commission and the industry, the Government setting the standards for regulation and the industry carrying out the police work of control. Chairman Douglas himself stated publicly that the Commission preferred a program of self-regulation to the burden of direct and detailed Federal regulation.

Shortly thereafter, Senator Francis T. Maloney of Connecticut introduced his bill for regulation of the over-the-counter markets based on the principle of self-discipline. Some of the opponents of that Bill have at times indicated by their remarks that their concept of self-regulation was something quite different from the Commission's view. When the Commission speaks of self-regulation, it means not a system of private law making, but rather an organization designed to cooperate in voluntary obedience to established law.

Recently Chairman Douglas gave a definition of self-regulation. Although he was using it in connection with the over-the-counter question, the principle applies so well in any field of activity that I think it may bear repetition on this occasion. This is what he said:

"By self-regulation I do not mean private law making. By self-regulation I do not imply a private club whereby the few can control many. By self-regulation I do not mean a guild system operating above the law. By self-regulation I do not mean monopoly nor a monopolistic franchise. I do mean, first, self-discipline in conformity to law - voluntary law obedience so complete that there is nothing left for government representatives to do; - second - I mean obedience to ethical standards beyond those any law can establish. I mean a form of organization of the general kind (but with 1938 improvements) which exchanges have evolved over a long period of time. I mean groups organized under federal auspices and operated under federal supervision with ample contractual powers over members to enable them to take a hand in enforcing the law. These groups would be voluntarily organized and have only such powers as the federal government deemed it wise to give them. The government would retain such power as was necessary or appropriate to make certain that their jurisdiction was adequately delimited, their activities properly circumscribed, their powers appropriately curtailed. The pattern is simply that provided by the Congress for the exchanges in the Securities Exchange Act of 1934. That is the type of self-regulation envisaged here, nothing more and nothing less, except as the differences between exchanges and over-the-counter markets call for an adaptation in details. This type of organization must be so restricted in view of constitutional limitations. It must be remembered in the first place that this is a government of laws, not of men. In the second place, the Supreme Court has often told us that the Congress cannot delegate its law making power. Hence, such organizations must clearly conform to that pattern which constitutional law has prescribed."

The importance of the regulatory problem cannot be minimized. Yet, as I have said, the Commission's principal responsibility is the successful functioning of the nation's security markets. From that point of view, I should like to touch on the competitive position of such an Exchange as yours in its relation to other security markets. While the Commission obviously cannot allow itself to create for any one market a special competitive advantage, healthy and sound competition between markets makes for progress.

Moreover, for more fundamental reasons, the Commission is deeply interested in the development of the exchanges outside New York.

One of the principal financial problems which we as a nation face arises out of the growth of industrial bigness. So much emphasis has been placed on the development of the giant corporation in recent years that we risk slighting the smaller companies which, in truth, constitute the main body of

American industry. The emphasis on corporate bigness tends to carry over into the pattern of our financing machinery. There is the danger that with changing fashions in financing, the sources of investment funds for the less spectacular small corporation may dry up and in some cases even disappear. We cannot expect the small local company to go to the national investment market for its capital. We must, therefore, take pains to protect the health of our many local financial centers, including the stock exchanges.

Such an effort, I appreciate, requires a fairly well defined program of action. Just what might be included in such a program, I am not in a position to say; the solution of that problem must depend in large part on the particular needs of the particular locality and exchange. It does seem to me, however, that any program to build up the position of an exchange within its community must begin with an attempt to expand the number of issues traded on the exchange. This would of necessity include an active effort to induce companies, the markets for whose securities are confined to regional areas, to list these securities on the home exchange rather than elsewhere. It would also seem obvious that the rules of the local exchange must take into account the difficulties and expenses incident to the preparation by small companies of listing applications. Emphasis on the possibility of a better market existing at home where the security is known would seem essential.

An effort of this type would next involve seeking to obtain unlisted trading privileges in national issues in which there is considerable public trading activity and adequate distribution in the areas surrounding the local exchange. The philosophy underlying that section of the Securities Exchange Act of 1934 which sets up the machinery for adding to the number of securities dealt in on the smaller exchanges in this manner, rests upon the basic concept that an opportunity should be given to build up and strengthen the local exchanges and the financial resources of the communities which they serve by

permitting them to establish secondary markets for trading in smaller lots of national issues.

Your exchange, as you know, was one of the first to avail itself of this opportunity. Needless to say, you are not foreclosed from obtaining in the same manner further securities of equal rank and importance, provided sufficient distribution and public trading activity in your vicinity are established and the further extension of unlisted trading privileges is shown to be in the public interest. In fact, applications for such additional privileges have been filed with the Commission within the past few days and are now undergoing examination by the staff.

Another point in which the smaller exchange may compete with the larger market is in efforts of the former to keep at home business in securities which are traded on both types of exchanges. Statistics maintained by the Commission as to the volume of trading in securities which were granted unlisted trading privileges on application show that a substantial portion of trading formerly conducted in the over-the-counter markets has been transferred to the floors of the smaller exchanges. It may be of interest to you to know that up to the present time your exchange has been the most successful in this way in keeping securities business at home. A consideration of these facts quickly impels the conclusion that there is adequate opportunity for the smaller exchange to exert its energies for retaining more securities business. Apparently recognizing this fact, yours is the first exchange as far as I know to inaugurate an active campaign designed to keep business at home.

Another field of competitive activity exists between the smaller exchanges and the over-the-counter market in its vicinity. There are dealings in the off-board market near every small exchange in a number of securities which are suitable mediums for exchange trading. I realize that some companies may hesitate to list their securities on their local exchange. This, in part, may spring from the fact that they do not find the mechanism of the exchange well attuned

to the requisites of a proper market for their securities. Sometimes, possibly, the exchange has made too little effort to supply the type of market needed, and to provide for the orderliness that makes for stability.

This hesitancy of issuers, however, in many cases may be due to other reasons such as their unwillingness to meet the disclosure requirements of the Act. I know that some exchanges have been handicapped in their endeavors to obtain new listings by the fact that on the whole adequate information for the investing public has been required only of issuers of securities listed and registered on exchanges. But obviously there is no need to limit this disclosure principle to exchange securities, and, accordingly, this doctrine has been extended to certain over-the-counter securities as well. The Congress made use of the machinery of the Securities Act of 1933 by providing that in case of issues of substantial size registration statements filed under the 1933 Act should be kept up to date by the issuer filing periodic reports of its condition.

By way of summarizing the competitive situations which the small exchanges face, I should like to make a few general comments. It is apparent that some securities should be traded on local exchanges, others on the big New York exchanges, and still others may appropriately be dealt in on both types of exchanges. In this competition I believe that the position of the Commission should be that of an impartial arbiter, endeavoring to create a fair field for competitive activity between the exchanges and to allow them to develop in accordance with their natural genius, insofar as this development is not inconsistent with the public interest. While in some quarters it has been suggested that the Commission should actively sponsor exchange trading as against over-the-counter trading (and vice versa), there again, it seems to me that the Commission should allow each market to develop itself

on a basis of fair competition. The fact that any preference has been shown to either of these markets in our innumerable decisions relating to trading in securities does not indicate any bias in favor of one or the other market. Rather, it reveals our appraisal of the requirements of the public interest in the specific cases before us.

In conclusion, I invite your attention to certain remarks which Chairman Douglas recently made in Chicago. There, he pointed out that in many instances the financial machinery of Wall Street was not geared to supply local capital needs and that as a consequence a considerable number of worthy enterprises have suffered from lack of financing. He indicated that the problem of financing small or intermediate companies is intimately tied up with the development of regional capital and regional securities markets. In speaking of the place of the small exchange in developing local capital markets he stated "you will find those who question the economic value of the services performed by the small local exchanges. There are those who state that there is only one real security market and that there need be only one. The Congress believed, however, and we believe, that the local exchange is providing a service in the securities markets which is of value to industries and investors of the various regions".

I think it is apparent to all of us that the success of an earnest competitive effort on the part of the smaller exchanges located in cities outside of the New York metropolitan area presupposes the existence of true local control. When I say local control, I have reference to a control of the management and policies of the small exchanges in the hands of persons interested primarily in its development. I do not speak of a control by local residents whose interests are perhaps equally, if not primarily, directed toward the maintenance of a primary market in a security on the big

New York exchanges. The problem of assuring such a control to all smaller exchanges is one to which the Commission is keenly alive. Many members of your group have been giving their attention to this problem, and I know that the Commission would be more than glad to obtain the benefits of your views.

The future is indeed promising for those well-run local exchanges in regional financial centers throughout the country, which insist that their members live up to a code of just and equitable principles of trade which will inspire the confidence and respect of investors in the community.

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