FOR RELEASE UPON DELIVERY OF THE SPEECH

ADDRESS

of

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Commissioner, Securities and Exchange Commission

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at

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I presume that most of you gentlemen are brokers and dealers, as defined in the Securities Exchange Act. In fact, I presume that most of you are *registered* brokers and dealers *under* the Securities Exchange Act. So I want to talk to you about the over-the-counter markets and the proposed new amendment to the over-the-counter section of the Act which we have submitted to Congress and which is now under consideration by the Senate Banking and Currency Committee, and to explore with you some of the principles underlying that proposal.

First, however, I think I should tell you something about the way in which that proposal came to be made at this time. It grows out of the problem of unlisted trading of securities on exchanges. As you know, when the Securities Exchange Act was passed in 1934, Congress found itself with insufficient evidence on which to base a final disposition of that problem. It set a tentative date, May 31st this year, on which this type of trading was to cease, but it ordered the Commission to make a study as to the advisability of extending this dead-line.

The Commission made this study and submitted its recommendations. Our report showed approximately 2,000 stock and bond issues--more than one and three-quarter billion shares of stock--now enjoying unlisted trading privileges. Sixteen of the twenty-three registered stock exchanges permit this type of trading--with the New York Curb Exchange by far the largest in this group. How many stock and bondholders hold interest in these 2,000 issues of stocks and bonds we do not know, but the total is in the millions.

In view of these facts, the Commission was not prepared to recommend doing away entirely with this type of trading. It took the practical viewpoint that to throw all these issues back into the over-the-counter markets would certainly not be a constructive step, and might in some instances be very harmful to present and prospective security holders. Most of you are probably familiar with the proposals of the Commission, but for those of you who may not be, I shall recite them briefly. First, that unlisted trading privileges for securities traded on that basis before March 1, 1934, be continued subject to controlled discretion of the Commission; second, that securities listed upon one exchange shall be eligible for unlisted trading on other exchanges under certain conditions; third, that if a company has one or more securities listed on an exchange, others of its securities may be traded unlisted on that or any other exchange under certain conditions. Then we have a fourth proposal that securities of any company registered and filing periodic reports under the Securities Act of 1933, as amended as well as data equivalent to that supplied by issuers under the Securities Exchange Act shall be eligible for unlisted trading privileges on exchanges.

This fourth proposal--that periodic reports under the Securities Act shall serve as a basis for permitting unlisted trading of securities on exchanges--gives the clue to the philosophy of the Commission in approaching this problem. One of the most vital principles of the Securities Exchange Act is that the investor shall be able to obtain the material facts about a corporation essential to guide him in buying, selling or retaining a security. This principle is in full force with respect to fully listed securities, but, aside from such registration statement as may be in effect under the Securities Act of 1933, as amended, it has no force at all with respect to securities now traded on an unlisted basis on exchanges or to over-the-counter stocks and bonds. It seems obvious, therefore, that little if anything could be gained for the investor merely by saying, "There shall be no more unlisted trading privileges. Either list your shares or go into the over-the-counter markets." The best solution, it seemed to us, was a program which would gradually but surely broaden the range of securities publicly dealt in about which there would be reliable current information. Therefore, the Commission formulated its recommendations with these two primary objectives in mind: first, to obtain from the issuers of securities traded over-the-counter or traded unlisted on exchanges corporate information equivalent--both as to content and to reliability--to the information

now required by law from issuers of listed securities; second, to evolve a long range program which will permit both the exchange markets and the over-the-counter markets to grow naturally and consistently with the public interest.

You are all aware that the issuers of listed securities must agree to submit a substantial amount of pertinent information periodically--at present annually--for the benefit of investors. That, in a sense, is the price they pay for exchange privileges. As to unlisted securities and securities traded over-the-counter, the issuing company has made no such agreement. The trading has arisen because of the interest of brokers, dealers and security holders. Section 15--the over-the-counter section--of the Exchange Act requires the Commission to adopt rules and regulations designed to insure investors protection comparable to that in the case of listed securities. Section 15, therefore, would seem to indicate that trading by brokers and dealers must be restricted to registered securities. But who is to take the initiative in registering all these unlisted and over-the-counter securities? And if nobody takes it, are security holders to be deprived of a market for their holdings, and investors of a means of investing their funds in these enterprises?

The Commission might have chosen to attempt to carry out the apparent mandate of this Section by ordering that after a certain date all trading in unregistered securities must cease. Such a program would have placed a tremendous burden directly on the brokers, dealers and security holders who want a market for the securities. Obviously, the issuers themselves would be the only ones who could supply the required information authoritatively and they would be reached only indirectly. The Commission felt there were serious practical objections to such a course. If the issuer were obdurate it might destroy almost all market for its existing securities and thus drastically penalize its security holders for a course of conduct over which they, in most cases, would have little or no control. Bondholders, for example, and holders of non-voting stock would have no means of making their wishes respected by the management of their corporations. Similarly, in cases where only a minority of the voting securities are traded--no matter how large a minority--the security holders would have little or no recourse; furthermore, this program would present brokers and dealers with the relatively futile task of attempting to compel issuers over whom they have little or no control to register their securities. Such a measure might create so many temptations and opportunities for evasion by brokers and dealers that it might lead to a bootleg securities trade. In consequence we have sought for many months to evolve a program which would bear directly upon the issuing corporation. And as a result of this study we have submitted to Congress a proposal to amend the over-the-counter section of the Act. The proposed amendment would not provide any drastic over-night change in the present state of trading but rather it contemplates proceeding slowly through the medium of registration under the Securities Act of 1933. This Act, also, as you know, administered by the Commission, requires that all issues of new securities must be registered with the Commission. The proposed amendment would provide that in the case of issues of substantial size these registration statements be kept up-to-date by having the issuer file periodic reports. The securities of these companies would then be considered registered for the purpose of trading in over-the-counter markets under the Exchange Act so long as the periodic reports continued to be filed.

I desire to emphasize the fact that this program would apply only to issuers of very substantial size; specifically it would apply only in cases of issues, the aggregate amount of which, together with the aggregate of all other securities of the same class of the same issuer, outstanding, computed on the basis of the offering price, came to $2,000,000 or more. And it would continue in force so long as the aggregate amount of these securities outstanding was $1,000,000 or more. It is extremely difficult to form any accurate estimate of the number of corporations which would ultimately be affected. Inasmuch as the program would affect only securities hereafter registered under the Securities Act the number would grow slowly and it is estimated that it might ultimately reach a total of 2500 corporations in addition to those already having securities listed.

Limitations of this method of control are obvious enough. There are many corporations which, having raised their capital requirements prior to the passage of this amendment, would not market any more securities. These corporations would not be reached by the proposed amendment. A substantial number of other corporations might not raise any more capital for many years, and these, too, would not be reached by the proposed legislation. However, we are convinced that the approach to this highly difficult problem must be evolutionary. Any course of action adopted now must be recognized to be no more than a beginning to be perfected during the years to come.

In reviewing this problem with you there is one point in common misunderstanding which I would like to clarify. It has been suggested that the Commission should actively sponsor exchange trading as against over-the-counter trading. In fact we have even been accused of sponsoring such an idea. It has likewise been suggested that the Commission should advocate the termination of all unlisted trading privileges, leaving the issuers to take their choice between listed exchange markets and the over-the-counter markets. The fact is that any preference which either the exchange markets or the over-the-counter markets may have obtained from any of our innumerable decisions during the last eighteen months stemmed not from any bias which we had in favor of one market rather than the other but resulted from our appraisal of the requirements of the public interest in the specific issues before us. Our attempt has been solely to create a fair field of competition between exchanges and the over-the-counter markets. There is, of course, no fixed and easy formula by which the choice between an exchange market and an over-the-counter market can be made for all securities. But there are certain minimum conditions more or less applicable. Thus, if no information is available concerning a security admitted to unlisted trading privileges upon an exchange, or if the distribution of that security is inadequate, or if trading activity in that security is inadequate, or if the character of trading in that security is vicious, the situation may be regarded as involving both harm to the general public and unfair competition against over-the-counter dealers in the same security. It would be the clear duty

of the Commission in such a case to intervene to correct the situation. If, however, full and periodic information filed with the Commission under the law, is available concerning a security; if that security enjoys adequate public distribution and active trading; if the obligations as to proxies and the trading of corporate insiders are satisfied; and if an exchange undertakes to conduct an honestly administered market in that security, the development of an exchange market in that security normally would involve neither harm to the public nor unfair competition against over-the-counter dealers. In such a case, we do not believe that the issuer alone should be permitted to prevent the creation of an exchange market. The wish of the management must be given due weight, but it should not be controlling. If all of the minimum conditions just described are met, the determination of which is the best market should be left to the buyers and sellers of the security--that is, to selection by the forces of the market place. This principle is so important that we have urged its incorporation into law, although we are well aware of the very small number of securities that will pass the rigid tests prescribed by the suggested amendment. We feel the number will be very small because this privilege of unlisted trading is not to be obtained merely for the asking. The burden of proof is on the exchange, which seeks that privilege for a security, to prove that the minimum conditions of the kind just described are met. That will be a heavy burden to sustain for it must be remembered that the requirements of the public interest and protection of investors are not lightly met.

In this connection it would be difficult to over-emphasize the functions which over-the-counter groups on the one hand and exchange groups on the other could perform in aid of the administration of these proposed amendments. It is the easy course to assume that any Commission can, in the solitude of its conference room, gaze into the crystal glass and discern what the components of the public interest are in a given situation. That course, though easy, is not a wise one. For that reason, among others, the burden of proof is on the applicant that unlisted trading privileges should be accorded a particular security. For the same reason, one of the healthiest aids to effective administration of such provisions would be an articulate over-the-counter group moving in opposition to encroachment by organized exchanges on their legitimate domain. Unless an administrative agency continuously receives the viewpoints of the organized cons, as well as of the organized pros, it cannot but fail to meet the highest requirements of the public interest, no matter how meticulous are the administrative standards prescribed by the Congress; no matter how high minded the aims and objectives. The practical limits of omniscience are soon reached.

The Chairman and other members of the Commission have emphasized that we do not wish to discriminate in favor of either exchange or over-the-counter trading. You all realize, however, that a large portion of the public has definite preference for securities listed on exchanges. We can do relatively little now to influence this preference, but there is a great deal that can be done by sponsors of securities which are traded in over-the-counter. There is also much that can be done by over-the-counter brokers and dealers to win public favor not only in policing these markets but also in establishing in communities throughout this land unimpeachable

records for fiduciaries and security merchants. There is also the important function of making articulate not only the self-interest of the over-the-counter group, but, more important, the public interest and the cause of investors which is actually, not apparently, served by this group.

They tell the story of the student who took a course in investment banking in business school and passed the examination at the end of the year. Thereupon he became an investment banker. After ten years of experience in investment banking, he was given the same examination and passed it once more with the identical grade he had received when a student of the subject. Aesop - not an investment banker and therefore entitled to philosophize - would conclude that investment banking experience at least does not impair the knowledge and insight of the student of the subject. Let us, however, hope that in the troublesome - though perhaps exciting - days which lie ahead, there will emerge a statesmanship in this banking field which, responsive to experience and sensitive to the insistent demands of the public interest, will set high and enduring standards for the trade. That group which excels in such statesmanship will be deserving of all the encouragement which any protagonist of the public interest - such as this Commission - can give it consistently with that public interest and with the protection of investors.