

COORDINATION OF WORK OF STATE AND
FEDERAL SECURITIES DEPARTMENTS

ADDRESS

of

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Member Securities and Exchange Commission

before the

NATIONAL ASSOCIATION OF SECURITIES COMMISSIONERS

at

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Mr. President, Ladies and Gentlemen:

I bring you the greetings of the Securities and Exchange Commission, of all the members of its staff, but more particularly of the Commissioners themselves.

I appreciate the opportunity of meeting with you and of talking with you, whose problems are 'so similar to those we wrestle with at the Securities and Exchange Commission. We are jointly charged with the duty of protecting the public from unscrupulous promoters and fraudulent securities. Our methods of procedure vary according to the provisions of the acts under which we function. However, we have a common goal, - the prevention of fraud, the punishment of habitual violators of Federal and State security laws, and the protection and encouragement of those who sell honest securities by legitimate methods.

The Securities Act of 1933 and the Securities Exchange Act of 1934 were not created to eliminate or supersede the several State Acts, but to supplement them and to make them more effective. They have added much to the force of state legislation and with proper coordination this force will be felt more and more.

I need not tell you that limited jurisdiction has long been a major problem of State Act enforcement. Most of the older officials here, in point of service, have had numerous unsatisfactory experiences in their efforts to reach some securities' racketeer taking refuge behind State lines, confident in the knowledge that he was beyond the reach of the State into which he was making sales. Experiences of this kind were discouraging to State officials and costly to the public. Cooperation between State officials, often enthusiastically undertaken, was handicapped by differences in legal powers and procedure.

This situation was fully recognized by the men who participated in framing the Federal Acts. It was my privilege to appear before the Committee on Interstate and Foreign Commerce of the House of Representatives during the hearing on the Securities Act. At that time I gave the following illustrations:

A state official in New England having to do with the enforcement of the blue sky law of his state, in answer to some inquiries addressed to him by the Federal Trade Commission, said that his only difficulty resulted from the selling in his state of unapproved securities through the medium of interstate agencies.

An official of a Mid-Atlantic State, charged with enforcement of blue sky laws, wrote to the Commission that at least ninety per cent of the fraudulent securities sold in his state at the time were sold through the mails.

A West Coast official, dealing with blue sky laws, said that many, or a majority of the most injurious securities frauds perpetrated in his state, had been those in which promoters had availed themselves of the protection of state boundaries.

Comments from an official of a Rocky Mountain state are in the same tenor.

To these conditions can be traced the rapid growth of the tipster sheet, the boiler room and the questionable practices that accompanied them. No fair minded person could charge state officials with responsibility for the situation. They lacked the tools and they frankly said so. We feel that we now have the tools. We must make effective use of them to protect the purchasing power and the savings of the Nation. The financial health of a nation deserves as much protection and care as physical health.

At this point I wish to quote from a letter written in June, 1935, to the Securities Commissioner of a Mid-Western State, by our former chairman, Joseph P. Kennedy, to whom S.E.C. and U.S.A. are so greatly indebted. Mr. Kennedy said:

"I wish to assure you that the Commission has no intention of infringing upon the jurisdiction of State Commissions. We desire the greatest possible cooperation between all agencies engaged in protecting the public against fraudulent securities transactions. It is recognized that there are many types of securities violations which can be handled only by State Commissions. Furthermore, the Commission is interested in strengthening and supporting fully the state organizations for our mutual benefit.

"I will appreciate it if you will assure your associates in the National Association of Securities Commissions of our earnest desire to assist them with their problem and of our knowledge of their importance in the field of fraud prevention."

This statement unequivocally states the position of the Commission.

Last May the Securities and Exchange Commission established the Securities Violations Section which maintains a sort of clearing house through which State Commissioners and State Officials give us information about bad practices going on in their states. They also send to us records of all official actions undertaken by them. This bureau was set up along the lines suggested by your association in a resolution on the subject passed at your New Orleans meeting on November 14, 1934. Mr. Baldwin Bane has explained the mechanics of the Securities Violations Section.

Thirty-one State Commissioners have furnished the Securities Violations Section with data covering their activities for the past ten years. To this has been added information received from States Attorneys' offices, United States District Attorneys, city and county prosecuting officials, as well as records prepared by the voluntary agencies.

We are pleased with the exceptionally fine response from State Securities Commissioners. Pledges of support have also been received from all but one of the Canadian Provincial Securities Commissioners who have expressed themselves as favoring close cooperation. We are also receiving data periodically from the Post Office Department and to a lesser extent the Department of Justice. At least one State Commissioner has checked his entire registration against the file. The Securities Violations Section is your section - make use of it.

Daily, new data regarding convictions, indictments, injunctions, stop, cease and desist orders, flow into the file. This information is furnished by State and Federal officials, Better Business Bureaus, Investors Protective Committees, the Investment Bankers Associations, and various associations and individuals. We, of course, furnish the Section with all the pertinent material on file with the Commission. Daily inquiries are received from State officials requesting information from the files, which now contain data upon more than 20,000 individuals. Cooperation has made it possible to assemble the life histories of a large portion of the country's most dangerous promoters. To me these files are a never-ending source of interest. They reveal much of tragedy and of humor; much of fraud and cases of rather pathetic self deception.

One of them reminds me of the anecdote about the efforts of an oil stock salesman to get into heaven. When he knocked at the pearly gates, St. Peter said, "I am sorry, we have too many oil men here now." "May I come in", asked the applicant, "if some of the others leave?" "Yes" answered St. Peter. Whereupon the oil man shouted, "Oil discovered in hell!" He was nearly crushed in the rush. "You may now enter", said the holy man. "No", said the oil man, "I guess I'll run down to hell. There may be some truth in that report."

Then there is the story of the promoter of a perpetual motion machine. On the trial of an injunction action he spent two hours with chalk and black-board demonstrating the mathematical soundness of his device before a none too impressed judge, who finally courteously inquired, "If this is a perpetual motion machine, Mr. X, and you have spent \$30,000 on this ten ton gadget, why, may I ask, is it not running?" Whereupon the defendant with great dignity replied, "Your honor, the only reason we have not started it is because we haven't figured out a way to stop it."

The Securities Violations files built by us with your assistance, reveal to an astonishing degree the short-comings of law enforcement in the past, - not due to lack of efficiency or application on the part of State Commissioners but because, as I have already indicated, of lack of jurisdiction which no amount of cooperation could overcome. There are actually hundreds of fraudulent promoters, vendors of worthless securities, and bucket shop operators, who have been constantly changing their scenes of operation to escape the punishment they so richly deserved. In the past this may have been due in part also to the fact that the several State Commissioners have not been adequately advised of one another's activities. There is increased confidence and faith when we are all working as a team in the service of a Nation rather than as scattered individuals. At the present time the monthly bulletin of the Securities Violations Section keeps State Commissioners advised not only of what we are doing but of the activities of their colleagues in the same work. The effectiveness of the bulletin will be limited only by the degree of cooperation in the furnishing of data.

On three occasions the bulletin has been instrumental in locating missing individuals for whom warrants or indictments had been held by State Authorities for months.

We came across one man who had been convicted on security violations no less than eight times in five states during the past ten years. This information had never before been assembled at one point. As it happened he was about to be sentenced in an Eastern State at the time. We placed his record in the hands of the official of the State, charged with enforcing the Securities Act, and it helped in securing a long sentence for the defendant.

In seeking their cooperation it is far from the Commission's intention to embarrass any State body. Sometimes honest differences of opinion may arise. Your suggestions and advice are always welcome. Likewise we desire to assist you with your problems. If we compete in any sense it should be a race of diligence.

There is another matter I wish to speak about in connection with cooperation between State and Federal Commissions. It is this: The recent formation of the Investment Bankers Conference Committee has furnished concrete evidence of a desire on the part of a substantial number of investment bankers and dealers in securities to cooperate with the work of the Commission. We have been gratified to learn that over 1,700 of the investment houses are perfecting an organization, the purpose of which is to cooperate with the Commission for the suppression of fraud and the promotion of fair practices and to assist the Commission by being a medium for the presentation of the views of the investment bankers and dealers in securities on problems of mutual concern. The investment bankers have already formed a national committee to cooperate directly with the Securities and Exchange Commission and also regional committees functioning in the various sections of the United States. May I express the hope that these committees of the Investment Bankers Conference Committee will cooperate with you and you with them. It is believed that the permanent organization will be properly representative of the industry and will have as its leaders men in whom the members of the industry and the public repose confidence. Pending the completion of the permanent organization, the Commission has been pleased to recognize the Investment Bankers Conference Committee as a cooperating agency for the purposes already mentioned.

The Committee possesses no governmental or quasi-governmental authority whatsoever.

In a recent release the Commission has said:

"The new Committee will be requested by the Securities and Exchange Commission to conduct preliminary hearings (through subcommittees or otherwise) of certain complaints of unfair practices between and against consenting investment bankers who accept the supervision of the Committee. It is hoped that these committees will exercise functions akin to those exercised by business committees of exchanges. In cases of complaints which do not require direct reference to either state or federal authorities an investment banker will have the opportunity to have a preliminary hearing in his own locality before men familiar with the customs and practices of investment banking and competent to make recommendations to the Commission.

The Securities and Exchange Commission will also confer with the new Committee upon the desirability of developing plans for a permanent organization of a self-regulatory, self-disciplining body of investment bankers with a view to cooperation with the Government for the elimination of fraud and the promotion of fair practices."

The Commission has not and will not surrender or assign any part of its power or duty to prevent or punish violations of the law. Of course we cannot do so, but it is believed that the formation of this new organization of investment bankers and of dealers in securities will, in cooperation with the Federal Commissions and the State Commissions, become a powerful influence in the enforcement of law and the elimination of undesirable practices from the securities business of the country.

Many complaints involving the sale of worthless or fraudulent securities cannot be handled by the Commission. These cases involve not only the question of jurisdiction but in many instances are concerned with alleged violations which antedate the Federal Act, although still actionable under State Statutes. It is equally clear that on many occasions the Commission needs the active cooperation of the State Commissions.

Plans for coordinating future Federal and State activities in fraud prevention work are now under consideration. In one state frequent conferences are held between representatives of the Commission and of the state, so that each party may be kept informed regarding the other's activities, thus preventing needless duplication of effort. The aim of these conferences is not to see which Commission can handle the most cases, but to ascertain which body can secure the quickest, most effective remedy for the situation - the real ideal of good law enforcement.

Just as State Commissions refer cases to us, we do not hesitate to send cases to them, feeling certain that they desire this type of cooperation.

The Commission's Regional Administrators and field representatives have repeatedly reported examples of outstanding assistance given them by state officials. Such cooperation very often serves the double purpose of making it possible for the Commission to secure valuable evidence, at the same time solving a problem which has been embarrassing to local authorities.

One of the most important factors in security laws enforcement is found in contacts with the public. It has long been evident that an individual, who feels that he has been defrauded, much prefers to relate his misfortunes verbally to a sympathetic listener rather than to put them in writing for consideration of a reader whom he never sees. At the present time the Commission maintains eight regional offices in addition to the Washington headquarters making nine offices at which members of the public can call personally. The State Commissions, many of which maintain a number of sub-offices, provide locations in nearly seventy cities to which the public may come. To these official listening posts may be added about sixty voluntary agencies which entertain complaints from investors. In addition, under our clearing bureau plan, more than one hundred twenty-five Chambers of Commerce, not actively engaged in investors protective work, have agreed to notify the Commission of bad practices coming to their attention. They also are forwarding data on official actions involving indictments and injunctions, for inclusion in the Violations file.

The value of these listening posts in fraud prevention work cannot be over-estimated. Time should increase their usefulness.

One of our mutual problems is the disgruntled investor who, having applied to us or to one of you, finds that for one reason or another he is unable to secure what he considers proper redress. Whether he be guided by civic duty or by the desire for the return of his money, he feels that he is entitled to full details as to why the State or Federal Government cannot satisfy his demands. It is much easier to explain such situations

to interested parties in interviews than to attempt the difficult task of appeasing them by mail. A plan whereby such individuals may be referred, when it seems advisable, to the nearest cooperating agency for a detailed explanation of the case, should prove a mutual benefit. The voluntary agencies are already doing much to protect the authorities from unjust criticism by informing investors that governmental agencies are not collection agencies.

I can not pass by this opportunity of saying to you what all of us from the Commission say every time we get a chance, and that is to emphasize an important fact, which is that the Securities and Exchange Commission has no power to pass on the merits of securities registered with it, either under that Act of 1933 or the Stock Exchange Act. We are constantly running across men even in important business circles who do not understand this situation. Our duty is to see that the registration statements are complete and truthful, so that the investor may be fully informed before he parts with his money, but we are not empowered to pass on the merits of securities. Whether the security he buys is an investment security of a speculative or outright gamble, the investor can decide for himself from the information we make available to him.

I feel that at every opportunity we should all advise the public of the scope and limitations of our respective laws. It will do much to lighten our labors and aid the investor to help himself.

There have been a few reports current that the setting up of the Securities and Exchange Commission has done away with the need for the several state bodies.

Statements that State Securities Commissions are no longer essential are in my opinion based upon hope rather than fact.

Reduction in appropriations for Securities Commissions by State Legislatures will prove a serious error, - fatal, perhaps, to the chance of winning the fight we have jointly undertaken. Such proposals, and I am glad to report that to date I have heard of only one, will, if carried out, having damaging effects upon the citizens of those states denied the protection which they have the right to expect. It is needless for me to say that the Securities and Exchange Commission cannot assume the full burden of protecting the citizens of any state from the ravages of all types of security frauds and illegal financial operations. Laying aside the question of our inability to regulate purely intra-state transactions, our facilities as limited by our own budget will not admit of unlimited expansion. We have no doubt of the need for and value of vigilant, effective State Commissions.

The dropping out of even a few State Commissions will materially increase the burden for the rest of us. Now that we are winning the fight against financial charlatans, there must be no breaks in a united front.

We of the Securities and Exchange Commission have issued a goodly number of stop orders against fraudulent or defective registrations and with a frequency that is increasing, as our staff is better organized; we are in the courts seeking injunctions against those who are using the mails and instrumentalities of interstate commerce to sell securities by fraud or misrepresentation.

The State Commissions as revealed by reports to the Securities Violations Section, are equally active in their respective fields. Different conditions demand different remedies, but the fact is that never before have vendors of questionable stocks and bonds found the going so hard or punishment so certain. The tipster sheet and the boiler room have been practically eliminated. Bucket shops, despite statements to the contrary, are fewer in number. But it would be unwise to think that fraudulent agencies have been done away with. They cannot, as a rule, flourish in this type of a capital market when only the highest grade securities are salable. They do, however, appear in legions in a later phase when low-grade securities become possible.

With current improvement in business we may expect renewed activity on the part of questionable promoters and their associates. We are prepared. We have their records. We know of their past activities, and we now have the facilities to check them.

Let us agree that we shall all continue to work together to protect the investing public and the honest sale of stocks and bonds - that we shall do our utmost to reach the goal which at last seems to be in sight - the complete elimination of fraudulent securities sales.

This goal will not be reached, however, if you do not cooperate among yourselves, you with us and we with you. That is really what I came down here to say and now I have said it, and I thank you for the opportunity.