

THE LAWYER'S ROLE  
IN SECURITIES REGULATION

An Address by  
The Honorable Manuel F. Cohen  
Chairman, Securities and Exchange Commission

Before the ALI-ABA Conference on  
Current Problems of Broker-Dealer Regulation

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It is always a pleasure for me to attend one of the meetings of the Securities Law Establishment, particularly one devoted to increasing the depth and breadth of understanding of lawyers who must deal with the daily flow of problems that constitute the substance of securities regulation.

My talk tonight is directed primarily to lawyers, since the sponsorship of the Conference by a Committee on Continuing Legal Education implied that those in attendance would have received some legal education before getting here. However, it appears from the registration for the Conference that a large number of those in attendance are clients. In a way, this adds further meaning to my remarks, as I think you will realize shortly. Any appeal I may make for more involvement of lawyers in certain problems is really an appeal to their clients to get them involved. In any event, I want to make clear that we welcome the interest of broker-dealers, insurance company officials and others. My remarks should not be interpreted as indicating a desire to exclude nonlawyers from consideration of the urgent problems facing us.

I am also pleased to attend a securities law conference which is not devoted exclusively to further exploration of the Securities Act of 1933. I hope you will not misunderstand that statement.

I grew up (professionally, at least) with the Securities Act of 1933, and I have a particular fondness for the many decorative curlicues and imaginative interpretations with which it has been embellished over the years. This, of course, may be due to the fact that, in all due modesty, I had some part in designing some of them.

Also, I do not mean to depreciate the importance of the private securities bar in developing the doctrines and practices under the 1933 Act that have caused it to be admired as one of the outstanding achievements of the administrative process. The securities bar has done well by the Securities Act of 1933, and, I might add, has done well at it. It has been a mutually profitable relationship for the bar and the Commission.

Of course, despite all the imagination and effort put in by so many on 1933 Act registration statements, we still have a long way to go. I do not intend to discuss the recent opinion of Judge McLean in the Bar Chris case except to suggest that it does provide a timely reminder that, in periods of infatuation with "hot issues", any temptation to cut corners should be firmly resisted. Moreover, although review of registration statements by the Commission's staff is helpful, it is, of course, no substitute for diligent investigation. The greatly increased work-load of an already overworked staff, as a practical matter increases the responsibility of all concerned with the preparation of registration statements to minimize the risk that seasoned or unseasoned issues will be sold to the public without the disclosures the 1933 Act was designed to elicit. We are in the middle of a "hot issue" period now. I know that you gentlemen recognize the dangers, and will do your best to deal with them. Just as you are deemed to be officers of the courts in assisting them to enforce the laws, I believe that the privilege of appearing and practicing before the Commission imposes on you a corresponding obligation to assist in achieving the protection of investors and the public interest that the securities laws are designed to bring about.

I said at the start that I was particularly pleased that you were not concentrating on the 1933 Act at this meeting, and I certainly do not intend to devote my remarks tonight to that subject. My primary purpose in referring to the 1933 Act was to contrast the very important contributions made by private lawyers in that area with the very limited impact they have had in certain other areas which are of very great current concern to your clients, to the public and to us. I am thinking particularly in this connection of the responsibility of the Commission and of others with respect to many procedures and practices in the exchange and over-the-counter markets and to persons and institutions involved in those markets.

You are of course discussing at these meetings many facets of the obligations of broker-dealers to their clients and to others, and that is a subject concerning which some members of the Bar have made important contributions. I would like to devote a few minutes to one particular aspect of that

subject. As you know, the Commission has brought a number of proceedings against investment advisers for improper advertising practices. You also know that we have rules laying down specific standards for investment advisers to follow in their advertising. Our decisions in the Spear & Staff and Market Lines cases, and in the more recent Dow Theory Forecast case have, I hope, made clear that the Commission will not tolerate failure to adhere to the required standards.

Despite these actions, the business section of nearly any major newspaper contains advertisements which, I am told, are not unlike comments found in a horse racing tout sheet. These advertisements use the "come on," the scare technique, the rhetorical question suggesting imminent sure fire gains, promises of riches and of protection against market reversals. They sometimes intimate if they do not represent, that the advisor has inside or other unique sources of information. Such advertising plainly does not meet the spirit of the requirements of our rule. Advertising which may or may not be suitable for products which are subject to actual inspection and testing in use by nearly everyone clearly have no place when one considers the intricate complicated, and intangible merchandise we call securities. It is important to state that this kind of advertising is not limited to the investment adviser community. We find broker-dealer firms engaging in similar practices. There is, in short, a need for the development of proper industry codes and standards.

From time to time, the Commission has been asked for more specific rules or guidelines on advertising. We have wherever possible attempted to do just that. It is impossible, however, to attempt to cover by rule the myriad techniques and nuances that imaginative copywriters can devise. Frequently, it is difficult to assign a single factor as the basis for a finding that the standards have not been met, since it is the overall impression created by the advertisement that is the controlling factor. Nevertheless, I will make several suggestions. Advertisements should be factual, in good taste, and not flamboyant. They should not make or suggest promises which are incapable of fulfillment. When read as a whole the advertisement should present a fair description of the services offered. It should be free of the deceit contained

in subtle appeals to the desire of some for instant riches or their fear of impoverishment. It is no excuse that each statement may be literally true or that the advertisement is interspersed with hedge clauses which may be designed to provide insulation to the advertiser but which may be meaningful only to the most sophisticated reader of the fine print. In any event, such devices will not cure advertisements which do not meet the standards of our rule.

We can and will bring more proceedings when necessary. More important, however, in my opinion, is the urgent need for more discipline and self-restraint. Here, as elsewhere, members of the Bar can assist their clients best -- and at the same time serve the public interest -- by advising clients how they should behave, not simply what they can get away with. My own experience suggests that the securities bar does recognize an obligation in advising on these matters, to take into account the interests of the investing public, as well as the interests of the client. While I have been talking about the importance of the attorney's role, I must emphasize that in the end it is the client who is responsible for complying with the law. I should also emphasize that neither the courts nor the Commission accept reliance upon legal advice as an excuse for violative conduct.

But we are not only concerned with the practices of individual broker-dealers, with trying to separate right from wrong and with the elimination of other kinds of fraudulent or manipulative practice. Your clients and we are also concerned and the Commission has a statutory responsibility with respect to other aspects of the securities markets -- rate structures and levels, the competitive situation within and among markets, the efficiency and vitality of the securities industry as a catalyst for the allocation of public savings to those markets, and the effects and implications of the development of new investment media and techniques.

You are of course aware that we are supporting resolutions in the Congress which would authorize us to conduct a study of the growing institutionalization of these markets. You also know that we announced last week a public investigatory hearing with respect to the rules and practices of the national securities

exchanges concerning commission rates and related matters. These are areas of great importance and concern, in which excessive costs, and therefore potential savings, to investors may substantially exceed the amounts lost annually through inaccurate prospectuses or fraudulent or manipulative practices of individual broker-dealers. Yet this is an area in which the securities bar, I regret to say, has thus far made a relatively limited contribution.

In considering proposals concerning commission structures and rates and competition within and among markets, for example, one of the greatest difficulties we have faced has been the inability or unwillingness of many members of the industry to recognize fully the implications of the practices in which they engage in the contexts of the various national policies, such as those embodied within the antitrust laws as well as those in the securities laws, which must be taken into consideration.

The history of the 1933 Act provides much evidence of the noteworthy role lawyers have played in bringing their clients to relatively comfortable terms with what seemed at one time to so many of them to be a totally unwarranted incursion into the area of free enterprise and one which would ultimately cause grass to grow in Wall Street.

We have met with many delegations of brokers and dealers and with representatives of self-regulatory and trade organizations over the past few months and years to discuss some of the difficult problems of market structure and practices. I have wished, on more than one occasion, that these groups had involved their independent counsel more fully in the formulation of their positions. I cannot help but think that the active participation of lawyers with extensive experience not only in other aspects of securities law, but also in dealing with problems of competition and regulation in other contexts, would have helped to produce a greater flexibility and a greater awareness of the need for constructive changes.

I do not mean to say that greater involvement of lawyers is the answer to every problem. There are occasions when that cure may be worse than the illness. But lawyers are useful because, and to the extent that, they are trained to look for real solutions to real problems, rather than to seek theoretical absolutes or glib solutions that mask the symptoms without reaching the underlying causes. I must admit, however, that in many cases, legal reasoning alone, no matter how hard-headed, will not provide the answers, particularly where the problem can only be fully understood in the context of the economic and political structure of the industry in which it arises. In the proposed study of institutional investors, for example, we hope to utilize the services of outstanding economists who have developed a facility for dealing with large aggregates of data and industry-wide phenomena which I hope will complement constructively the facility of lawyers for dealing with more specific situations.

There is no shortage of novel and difficult problems facing the securities business today, and I do not believe there are any in which informed and intelligent lawyers cannot play a constructive role. One of the most shocking -- and most disturbing and potentially dangerous to the public -- is the current inability of broker-dealers to process physically the vast bulk of transactions with which the energy and imagination of their salesmen have flooded them. In the over-the-counter market, I understand it has reached the point where brokers, in many cases, find it difficult to execute a transaction, let alone clear it. While some firms in the securities business have been working diligently on the development of automated procedures and the training of adequate staff to deal with back-office problems, other firms seem to have been concerned solely with increasing their sales without regard to how they were going to handle the business that was brought in. The exchanges and the NASD have taken a number of stop-gap measures to meet this crisis. The Commission and the self-regulatory organizations may be called upon to take more drastic action. Unfortunately, the burden of the measures that have been taken or proposed may fall as heavily on the firms that have improved and modernized their procedures as on the firms that have not. Nevertheless, I believe we agree that emergency measures are required.

I regret the need to advise you, however, that at least one leading spokesman for the securities industry has laid part of the blame at the feet of lawyers for interposing what he considers to be rather technical legal objections to the development of simplified techniques for the handling of securities. It has been my own experience that when a lawyer is obstructing something, it is usually because he is being paid by his client to do so, but that is not always the case. Lawyers are human, and like everyone else they tend to resist changes in established procedures which will require them to relearn their trade or abandon satisfying routines or relationships.

This is a danger we must all guard against. The problems we are facing now are not only difficult -- they are different. Lawyers must constantly develop their talents and learn new ones if they are to continue to play an effective and relevant role in our economy and our society. The problem, of course, far transcends the field of securities regulation. Lawyers have played a uniquely broad role in American life, in business, government and other areas. Lawyers in some other parts of the Western world have generally been satisfied with a more limited role, but I think that in many countries they are beginning to see the potential benefits to the public and to themselves from a broadening of their role, in the securities field and elsewhere. I think one important reason for the ubiquity of American lawyers is that, from the moment they enter law school, they are taught, as I said a moment ago, to think in terms of specific solutions to specific problems in specific contexts. It is not surprising that they continue to analyze problems in those terms even when they actually involve more complex relationships, such as those between an individual on one side and a large complex institution on the other, or among institutions with different kinds of managers, beneficiaries and orientation.

Even within the comparatively more modern field of securities regulation, lawyers who learned their techniques in the context of organized public offerings of industrial securities through professional broker-dealers must adjust their thinking to deal with the sale of new specialized



investment media. Thus certain kinds of investment company shares, variable annuities, as well as many somewhat more esoteric securities, sometimes sold on a door-to-door basis, create special problems and give rise to new and complex relationships. But the degree of imagination and flexibility which lawyers should bring to these problems will not provide the talents required to analyze the public obligations of broker-dealers, and the market institutions through which they operate, in terms of competition and market structure rather than in terms of manipulation or fraudulent conduct. Nevertheless, lawyers must rise to this challenge if they are to remain relevant to the solution of current problems of great significance to our economy. Programs such as you are conducting here are important in developing and maintaining that relevance.