

Speeches SEC staff

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ADDRESS

of

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before

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This opportunity to present some aspects of a national problem to a New England audience gives me a sense of gratification, a sense, also, of the obligation that rests upon any one who tries to view your problem in the light of the national policy that our Commission has to shape. To talk with you about your problems is to me a privilege because, though I was born far away, I claim New England as my home with the same sense of deep loyalty that is yours.

Part of the purpose of these annual meetings of the council must be to attempt to see the economic and political pressures and forces that are playing their part in New England's destiny. If we who are here, today, can see these forces clearly, perhaps they can be molded to our ends. Therefore, if I can give you a sense of the major directions of the Commission's work, it may mean a better appreciation both of its qualities and its defects.

Our business embraces the many aspects of finance. It involves, broadly speaking, a regulatory scheme directed toward making the processes of investment easier to understand and less subject to certain well recognized dangers. With that general objective, New England has an intimate concern, because as a market for securities it has unusual resources. New England funds have been accumulated through the years more often by patient industry than by speculation. As a consequence they deserve such safety as can be had in the essentially hazardous process of investment.

There are industries here, now in the process of transforming themselves, that will seek the capital market again as they have in the past, certain in the belief that the day of New England enterprise is not past. And other New England industries with a wide and national market will draw from here and abroad the capital whose flow maintains their vitality. Thus the adequate and effective functioning of the capital and securities markets both of the nation and of this region is obviously a matter of vital concern to us.

Our first consideration, perhaps, in attempting to secure the maintenance of a desirable investment market, is the elimination of certain admittedly wrongful practices. Such an objective calls for the end of those things that mean waste. And fraud means waste. It is equally true that carelessness and disrespect for the standards that should govern in the fields of investment have the same wasteful effect as fraud.

That some practices of this character existed here as well as elsewhere throughout the country is, of course commonplace. But here the very richness of the money market, the Yankee habit of saving, the high investment traditions followed by many firms, all created a condition where the unscrupulous adventurer could flourish. The very fact that good will had been established and high standards existed gave the unscrupulous adventurer endless opportunities for his activities. Fraudulent mining securities, doubtful industrial stocks, barren oil royalties, grew and prospered. Here in New England, as elsewhere, a general attack was made by state authorities against these practices and the Commission lent its

aid. This aid was necessary, for much too frequently the distributors of securities of this class sought protection against state action by operating across state lines. By a course of united action many such frauds have already been stamped out.

This problem—the policeman's task—is but one aspect of our concern. Equally, our task is the rehabilitation of a shattered financial machinery, rehabilitation along lines that will eliminate some of the causes of its breakdown. For this purpose it was necessary for government to establish standards. The honesty of our ordinary merchandise markets has been a concern of government almost from the beginning. Colonial legislation gave us inspection of them and the practices that prevailed in them. To extend these standards into the securities markets was only obvious when the elimination of undesirable practices became a vital need. That these markets are national in scope and effect, and that the continuance of these practices affected the nation as a whole, is only too apparent. The task of regulation therefore had to be assumed by the Federal Government as well as by the states.

The insistent principle that runs through this securities legislation, whether it be the Securities Act of 1933 that deals primarily with new financing, or the Securities Exchange Act of 1934, that concerns itself with trading in outstanding securities on exchanges and in the so-called over-the-counter market, is the principle that investors are entitled to knowledge of the thing that they purchase. The basic thought is identical with the concept that has for years governed the pure food and drug acts; the application, however, is infinitely more complex.

Let me illustrate this with reference to the stock exchanges. As a condition of listing, statements covering the nature of the business, its management, its control, and its financial operations must be filed by the company issuing the securities. This principle has, of course, long been in existence, but the detail of the listing statement has varied from exchange to exchange, and in some cases has been a sketchy and valueless document. Lacking adequate and centralized supervision, accounting practices have flourished whose purpose was to conceal rather than reveal. To bring the necessary degree of standardization into this picture and make it intelligible was one of the great purposes of the Federal securities legislation.

The hallmark of a listed security is now the assurance that adequate information as to the activities of the corporation is publicly on record. That this information goes far beyond the average annual report of a few years ago, and must do so, is patent to every intelligent investor. Dependable financial advice and judgment is impossible without it. The registration statement is becoming, as it should, the basis of thorough information about corporate securities.

In registering listed securities, the Commission sought to be reasonable in its requirements without sacrificing matters which are of consequence even to expert analysts. To satisfy the needs of persons thoroughly competent to analyze corporate securities must be a constant aim of the Commission. One must recognize that the majority of investors need and take advice and that, therefore, expert judgments permeate and become a part of every investment judgment. On the whole, these registration requirements that became operative last July were well received by the industries affected. Only a few industries decided that the value of an exchange market was not worth the cost of disclosure.

These enterprises which refused to continue their listings, to the Commission's regret, were chiefly businesses which had been listed on the smaller exchanges. I say to the Commission's regret because it is our wish to build up and not to weaken the smaller exchanges. But no other policy seems possible or just except the policy of requiring uniform reporting as a condition to listing on all registered exchanges. The concern of the Commission extends equally to the local exchanges and to the great exchanges of this country. A brief glance at this situation will illustrate the reason for that concern. The centralization of exchange transactions in New York is well known. To a degree, centralized trading in securities of wide national distribution finds justification in the resulting economy. But throughout the country, centering about strategic financial centers, are found securities of local enterprises with sufficient regional distribution so that they deserve an exchange market. Local stock exchanges such as the Boston Stock Exchange exist for that purpose. They also serve as a secondary market for trading in smaller lots in securities which are listed on the central market in New York but which also have a sizeable distribution in the vicinity of the local exchange.

The hesitancy of these local companies to list their securities on their local exchanges cannot be justified upon the basis that the security holders are not entitled to the information which would be required for listing. If a far-flung, complicated enterprise can, and does, assume the burden of meeting these requirements, what justification can the smaller enterprise offer for its failure to supply much simpler information?

This hesitancy, I believe, springs in part from the fact that companies often do not find the mechanism of the local exchange well attuned to what they consider a proper market for their securities. Too often the exchange has made too little effort to supply the type of market that is needed. Too often the exchange--instead of perfecting a mechanism suited to its own needs--has simply followed the pattern of the big New York exchanges, with the result that they find themselves geared to a volume of business far beyond their reach. On occasion their mechanism fails to provide for the orderliness that makes for stability, and frequently permits the introduction of the speculator who disturbs rather than stabilizes.

I feel that the exchanges--as well as our Commission--have given too little study and too little imagination to this problem. I do not, at this time, want to go into it deeply, but I do want to present it for your careful consideration. As soon as possible, I hope that the Commission, the Boston Stock Exchange and other exchanges outside New York can bend their joint energies towards its solution.

From my characterization of the nature of listing under the Exchange Act, you will see at once that the listed issue possesses from an investing standpoint a great advantage over other securities. This it will not lose where the governance of the exchange is alert to prevent manipulative practices and the undue intrusion of a purely speculative element. Under such conditions local pride as well as a true concern for a local investment market should make for the growth rather than the decadence of the exchange.

In the effort to secure adequate information for the investing public, the Commission's activities have thus far been limited to securities listed on exchanges. If the principle of adequate disclosure to stockholders is right, what justification can be urged for this limitation? And if the type of annual report formerly required by the better exchanges could be substantially improved, it is clear that great improvement can be made in the quality of information disclosed by the welter of corporations not controlled by exchanges. Of course, ways and means must be found, based upon standards of size and distribution, to limit our jurisdiction to matters that are national, as distinguished from local. But there is no need to limit the principle to those securities that should have an exchange market. Bondholders and stockholders of companies whose securities are only traded in the over-the-counter market deserve as much information as owners of listed securities.

I need not here detail the various ways and means of accomplishing this result. Its achievement is essential for the equalization of burdens and benefits between exchange securities and over-the-counter securities. The considerations that should weigh in seeking to attain such a result should naturally be those that have weighed with the Commission in pursuing its other tasks; namely, protection adequate for the end, but devised without the hurry and haste that will occasion disturbances to normal business routines which more cautious procedures could avoid.

Two methods for controlling practices in the wide unorganized over-the-counter market are now being pursued by the Commission. The first calls for the registration of brokers and dealers active in these markets, some five thousand in number, together with the imposition of a few regulations mainly confirming their fiduciary obligations. This scheme of registration should not be regarded as a guarantee that we will include only the trustworthy and exclude all the untrustworthy. In putting into effect a scheme on such a large scale, it was realized that only the most obvious of the undesirables could be winnowed from such a number. These, of course, were those with criminal records or those who had been found guilty by the courts of fraudulent practices or those who had perjured themselves upon the very record of registration. Thus we have only begun to eliminate the black sheep.

The second method of control is a present attempt to help in the organization of a self-disciplinary agency of dealers. Just as the disciplinary committees of the exchanges have been invaluable to us in our efforts to supervise the activities on the exchanges, similar machinery would seem to be of value for the over-the-counter markets. Under a self-imposed discipline it is frequently possible to lift standards of individual contact to a point beyond that possible through legislation and regulation.

Certain problems in the field of financial practices in their treatment demand more than the singling out of individual cases. They call for the kind of effort from within the industry moving upon the entire front as a whole. Such, for example, is the effort to reduce the feverish pace that still too greatly characterizes the American methods of distributing securities. Salesmen are held like horses before a barrier restlessly waiting for the starting signal. And unless sales are immediately consummated the operation is labeled a failure. Violations of the statutory requirement that a definite time shall intervene between announcement and offering result from such a system of distribution are to be expected. But merely to punish the salesman in such a situation is to touch the fringes and not reach those really responsible for the actions of mere subordinates. The investment public is entitled to a more intense and genuine effort to control this situation, and the impetus for such a movement can readily be given from within.

So far, I have spoken in a general way of a few of the many phases of the work of our Commission that seem to affect New England in particular. Our securities legislation, however, like any other legislation, reacts with a definite impact upon our national consciousness. That it must do so results from the very process of its creation. A few years ago I had the privilege of holding a chair in legislation at the Harvard Law School. One thing was impressed upon me year after year as I dealt with the subject. I learned that one of the most permeating and fundamental educational processes in a civilized society is the legislative process. The procedure preparatory to legislation, the interest aroused by it, the many persons that play a part in its administration, the public that begins to grasp the economics upon which it is based, all these are stirred by the implications and objectives of any legislation. This seems to me to be especially true of securities legislation. Its challenges for understanding and action run through the entire field of finance. Our securities legislation was regarded as radical a short time ago. But the very simple objectives of this legislation are becoming more apparent, and the tenor of every administrative act has been found to be attuned to those ends. We come to regard merely a matter-of-fact truth the principle that we as a nation must understand, must know, the directions and the implications of our corporate life. That is a task that to my mind we must assume and in which we must succeed, if those characteristics of our economic society that we care about are to endure.