

INVESTOR CONFIDENCE IN THE SECURITIES MARKET

Address
of

EDMOND M. HANRAHAN
COMMISSIONER, SECURITIES AND EXCHANGE COMMISSION

before the

NATIONAL SECURITY TRADERS ASSOCIATION, INC.

HOTEL STATLER
BOSTON, MASSACHUSETTS

THURSDAY, AUGUST 14, 1947

The hospitality which you have extended to me fully justifies the great New England traditions. Not only am I gratified personally but I see it as a sign of the time that you and I can get together in a spirit of friendship and understanding to discuss our common problems. There is every indication that the old ringside atmosphere that clouded our relations is disappearing and that the spirit of the conference table is taking its place. On our part I think we have made it clear that we don't regard every securities salesman as guilty of violations of our Acts until he is proved innocent. And on your part, it is becoming increasingly more evident that you no longer believe the Commission to be an officially constituted star-chamber or heartless board of inquisitors, enforcing and administering its Acts unmindful of your particular business problems.

We have done away with some of those old notions because over the past fourteen years we have come to know a great deal about each other. You have learned that the Commission has earnestly tried to administer and enforce the laws within its jurisdiction with an understanding of the practical problems which have to be faced in your industry and with an eye toward the practical effect of its actions upon your business. We have learned that we can more efficiently accomplish the objectives outlined for us by the Congress by making every effort to understand your problems.

Associations such as this one have gone a long way toward making the Commission's position understood among members of the industry and making the industry's position known and understood by the Commission. In this spirit

of hand in hand cooperation, I feel that we will finally achieve what is desired by us all, namely, a fair market in which customers have complete confidence, a market in which the public interest and the interest of investors rather than immediate profits is the primary aim of those concerned.

Your association has recognized for a long time, I am sure, that people in general will not invest in a dishonest market. They will not enter the securities field unless the rules of the game are fair and above board. They want to know what they are buying and they want no part of tailor-made markets. They want a security whose price is fixed by the untampered influence of the law of supply and demand. Above all, they want fair play in the securities field. They are entitled to it. No one can deny that and, of course, it is our job as referee to see that they get it.

Like any referee we recognize that it is extremely unpopular and unnecessary to blow the whistle too frequently for minor inadvertent violations of rules. We don't like to do it. You know how sparingly we call a "foul" and impose a penalty. It's true that this is accounted for chiefly by the general improvement in the game since 1933. The violations are not nearly so flagrant as formerly. The rough and tumble era appears to have passed. The players are now more sophisticated -- more cognizant of their fellow players' rights and of the interests of the bystanders. Violations of the rules still occur to be sure but they have the air of refinement about them. They are a bit more difficult for us to uncover. And it is much less seldom than of old that the referee's whistle is heard. Let no one be deluded into

believing that this results from any lack of proper supervision on our part. We have been on the job, I can assure you, and we propose to stay there to see to it that those few of you who cannot play fair and square are removed from the game.

I think it is a common belief among members of the Commission that the years have brought about a steady rise in the internal standards and morale of the securities business. The thief, the deliberate sharper, are now by far the exception. They come, of course, with every new generation and, like taxes, we know they will always be with us, but as time goes on they find life harder and their professional environment less congenial. I believe that associations like your own have assisted and will continue to assist in large measure in their removal from the field.

We can never afford to relax our diligence in investigating violations and enjoining them or bringing them to prosecution. That function is important to us in our sworn duty to administer the law. It is an important bulwark of public confidence in the securities profession that the public be assured that any wilful violation will be punished.

Of course, we do not measure our progress in terms of the number of prosecutions or injunctions we obtain. It is measured by a more subtle, but more pervasive and significant factor, the growth of ethical standards and ideals of customer service within the securities business itself. As a public body charged with the protection of investors we justify ourselves more by our constant effort to have the standards of the law become innate rules of behavior than by alleging them in bills for injunctions or in indictments. To us these injunctions and indictments obtained against members of the

industry are considered not so much evidences of work done as they are indications that our main objective has not been accomplished; they are glaring signs that members of the industry are as yet unable to abide by the rules of the game and are incapable of exercising a directing, restraining, and governing influence over their own personnel.

If they have not already attained it, persons engaged in the securities business approach professional standards, and as professionals or quasi-professionals must be judged by standards worthy of that status. It is not consistent with the public interest to judge them by any other standard. They must not take advantage of the customer's lack of knowledge and thereby obtain profits for themselves in the market. They are, of course, entitled to a profit by being fairly compensated for their services. But that compensation should not come from excessive charges made possible by concealment of material facts and unfair dealing with customers.

In my opinion one of the greatest challenges now facing professional organizations such as yours is to educate its members in the principles of fair trading and have such principles become part of their business alphabet. Yours is but one such association among several in a great business, a business which I believe to be essential to the existence of our present economy. Your business has played an extremely vital part in the growth and development of this nation. It affords a ready medium whereby investor capital can be placed behind production in growing industrial and other types of corporation and business enterprises. It has also afforded an ever present mart where security holders may dispose of their securities as needs be.

Members of your business are not "hucksters," they are the persons upon whom the public relies for market information and advice. They are the persons to whom the bulk of investors goes for guidance. This reliance of individual investors upon the professionals in your field is the natural result of public bewilderment in the field of finance, a bewilderment which was born of a recognition that the choice of proper investments from the thousands of securities now outstanding is one which can best be made by experts in the securities markets. Since your business has throughout the years successfully sought to foster this dependence of public customers upon the professionals with whom they deal, you must give recognition to the responsibilities which spring from that dependence. This can best be done by keeping the securities market orderly and clean and by maintaining high standards of professional conduct in your customer relations. Give the customers the information they need to have when buying and selling securities. Buy from or sell to them, and purchase or sell for them at the fairest price possible. Put yourself in the customer's shoes. Deal with him as you would have others deal with you under the same circumstances, and you won't go far wrong.

You, securities traders, perform an important function, at least so far as maintaining an orderly market is concerned. You are the men who know the market from day to day, yes, from minute to minute in many cases. Your bids can maintain an orderly market or make it chaotic. You are the heart of the over-the-counter market. Yours is a great responsibility not only to the investing public but to the economic welfare of the country. In your dealings with others you should also bear in mind your responsibility to your firm and the fact that your authorized acts are the acts of the firm, which will be held responsible by the Commission and the courts for any violations of law of which you are guilty.

On the point of customer confidence I believe that in addition to advising a customer properly concerning the merits and demerits of a particular security as an investment and, in addition to effecting transactions at a fair price, you should make it a fundamental precept of your business practice that the customer be advised of and made to understand, the basis of his legal relationship with your firm and of the legal rights and duties flowing from that relationship. In our review of records at the Commission involving over-the-counter broker and dealer proceedings, we face with distressing frequency the fact that customers simply do not know the basis of their relationships with many securities firms. Physicians, school-teachers and others, possessing some intelligence and familiarity with the English language, are found not to understand that they have been buying securities from the firm rather than through the firm, and that they have been paying profits rather than commissions.

I have heard people in the securities business give the standard explanation for this. First, they say that many customers don't have sufficient intelligence to comprehend even the simplest explanations of technical matters. This is open to some question. There is no misconception in the real estate field, for example, of the functions of an agent. No one who buys a house using the services of a real estate broker has any doubt that he bought the house through the broker and not from him. It should be no more difficult to make your customers aware of the difference between the securities broker and dealer than it has been for others to train them concerning the real estate agent's functions. A brief oral discussion with the customer in each transaction, explaining to him exactly the relationship in which the firm proposes to act, should impose no impediment to and, in fact, should greatly benefit your business and increase the customer's confidence.

On the other hand, a slurring over of the disclosure of the firm's status in over-the-counter transactions has been found to be the first step in many of the serious violations with which we have dealt: such as excessive markups, churning, misrepresentation and others. In doubtful cases, where the Commission is appraising the wilfulness of violations and the public interest in fixing a penalty, it is likely to put a good deal of weight on the fact that the customers, in their testimony, have not been informed of and have not understood the nature of the transactions and their relationship with the firm.

So far as prices charged to customers are concerned, it has been and will continue to be Commission policy to interdict transactions effected with customers at prices which bear no reasonable relationship to the current market price. I need not enlarge upon this point. But in this connection let me point out that the Commission has never adopted a rule requiring firms conducting a fair dealer business to disclose the actual market price of the securities which they buy or sell: nor does it have the adoption of any such rule in contemplation at this time. Notwithstanding this fact, you must never forget, at any time that you have a duty to perform to deal fairly with your customers. Unless this obligation is complied with, this Commission or some future Commission may be driven by public clamor to adopt a market disclosure rule.

On the general subject of investor confidence, I should like to add one last thought. It is a matter of concern to those of us who represent agencies of the government that the minimum protections afforded by the registration requirements of the Securities Exchange Act of 1934 are not available to all investors. This ought to be of even greater concern to those of you whose responsibility it is to supervise investments of your clients. In my mind public confidence in the securities markets cannot long continue if certain

issuers of securities continue to pursue a policy of withholding material facts from their public security holders. It is difficult for me to understand how a broker or dealer can advise his customer to buy the securities of an issuer which does not give recognition to its obligations to its security holders by keeping them fairly informed at reasonable intervals concerning the progress of the enterprise. In my mind an issuer which goes to the public to finance its enterprise has a moral obligation to keep the public informed of the progress of its business. This existing lack of information has a two-fold defect for it is bound not only to lessen public confidence in the issuer but also in the firm which encourages its customers to invest their funds blindly. When you push an investment you have not and cannot fully investigate, the customer buying without full information will certainly remember that fact when the market drops. In times of stress the investor will lay the acts of the issuer at the door of the firm which sponsored an interest in such securities.

You will recall that in June, 1946 the Commission proposed to the Congress the adoption of legislation to apply to unlisted securities of large issuers some of the protections surrounding listed and registered securities, including the filing of corporate information. The Commission has not pressed the proposal recently -- not because it has been abandoned by any means -- but because we undertook a broad program of statutory revision based on cooperative review of the legislative problem with representatives of the securities industry. To carry out the spirit of that cooperative program we have determined to have the 1946 proposal jointly considered along with other recommendations.

We have gone forward in our consideration of that proposal and have talked it over with many people in the industry. I am glad to say that much of the opposition to it tends to disappear when the problems are talked out rationally and calmly.

The important fact to remember in all this is that we all work toward the same general objectives toward removal of sharpers and swindlers from the securities business, and toward a market which is honest and orderly, a market in which investors may be encouraged to place their savings with greater safety, -- a market in which they may have confidence.

You will remember that because of sharp practices customer confidence in the market was once lost. Let's not lose it again.