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A LOOK AT SOME ASPECTS OF THE
NEGOTIATED MARKETS

Address before

NEW YORK SECURITY DEALERS ASSOCIATION

at its

27th Annual Dinner

by

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SECURITIES AND EXCHANGE COMMISSION

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I am very happy to be able to participate in the 27th annual dinner of your Association. These are always enjoyable occasions as well as extremely worthwhile. It is mutually helpful for the regulators and the regulated to get together periodically for an exchange of ideas and viewpoints. This is particularly true in the securities industry, where the regulated are also to a very real extent, regulators themselves.

Despite the remarkable development of our mid-western and far western states, and a coincident increase in the importance and responsibility of the financial communities in those areas, it is unquestionably true that New York is still the financial center of our country. The power and attendant responsibility of you who make up its financial industry are accordingly enormous.

Over the years since 1926 your Association has played a very prominent role in this industry. From that early date you have recognized the tremendous importance of both government regulation and self regulation in the securities industry. Both as a group and as individuals you strongly supported the enactment of the first Federal securities statutes. Without the benefit of your enlightened cooperation those regulatory statutes would not have been as good as I consider them to be.

And again in 1938 when it was proposed to the Congress that national security dealers associations be allowed to organize and, under the supervision of the Securities and Exchange Commission, undertake a high degree of self regulation of their memberships, your association was in the foreground of the groups lending their support. Subsequently, when the Maloney Act was passed virtually all of you became members in the National Association of Securities Dealers. Because you appreciated the importance of self regulation in your industry you have been a substantial factor in placing and maintaining the NASD in the powerful position it now occupies.

My years as a Federal regulator in the securities field have taught me the value of a substantial amount of self regulation in this industry. This experience has shown that it takes something more than government regulation to achieve an all-round regulatory job.

I suspect that very few people outside of the securities business realize that in many areas the standards of business practice and fair dealing established and enforced by industry regulatory groups are even higher than the standards imposed by Federal statute. A government necessarily deals in the enforcement of legal standards. It is inevitable that such standards far too often become maximum standards. But you are concerned with the more advanced ethical standards. And it is all to your credit and, I am convinced, to your long term advantage also, that you do endeavor to maintain these high ethical levels of fair and equitable trade principles. Indeed, without imposing a stifling rigidity, government regulation alone simply could not accomplish the objective of maintaining those high business standards in the industry which we all recognize as necessary.

It should be stressed, however, that both types of regulation are essential if the public interest is to be safeguarded. In a few days we will have a new administration take office. No one can be sure what the new administration will do in the field of securities regulation. We can only guess, and perhaps sound a note of caution.

Of one thing I am certain. Any attempt to eliminate or substantially reduce the regulatory powers of the Commission would be a serious mistake. Indeed, in my opinion, such an attempt would be unsuccessful. With the cooperation and assistance of the industry, the SEC has succeeded in substantially ridding the field of those unscrupulous operators and ruthless business practices which gave the trade such a black eye in the late twenties and early thirties. As a result public confidence has been greatly restored in our financial markets and in our securities dealers.

If the laws administered by the SEC were to be seriously tampered with, I am convinced that it would only result in permitting the lawless and ruthless operators once again to swarm into the field--to the irreparable harm of investors, the securities industry, and the country generally. It would be like deciding to eliminate crime by removing the laws defining crimes from our statute books and disbanding our police forces. This sounds ridiculous, but I believe the analogy to be apt.

While I was in England recently I heard a story which may illustrate my point. During World War II an American airman was travelling from Southampton to London on a very crowded train. After a long and fruitless search, the airman came to the last compartment in the last car. There he saw a little dog sitting beside an English lady. The soldier walked up to the lady and said, politely, "Madam, the train is full and I am very tired. Would you mind holding your dog so that I may have the seat she occupies?"

The lady looked up at the American soldier and replied, "Indeed, I would mind, young man. I procured this space for Gwendolyn and I intend that she will occupy it all the way to London." Undaunted the young soldier continued to press his point, "But, Madam, I'm very tired. Will you permit me to sit down and hold your dog on my lap?" To which the lady snapped back, "No, I will not. Now will you please go away and stop annoying me?"

With that the soldier leaned over, picked up the dog and threw it out the open window. At this point an Englishman in the compartment turned to his travelling companion and said, "Gad, these Americans are peculiar. They drive on the wrong side of the road, eat with their forks in the wrong hand, and throw the wrong bitch out the window."

Let there be no mistake about it. If the statutes administered by the SEC were eliminated, the action would be misdirected. Those we tossed out and want to be kept out are the fringe operators--the boiler

room and bucket shop operators--those who contribute nothing to our economy and merely feed like parasites on investment capital they fraudulently extract from unsuspecting investors. Legitimate broker-dealer firms have benefitted rather than been harmed by the SEC--a basic, demonstrable fact which must not be forgotten.

Because of the greater publicity given to our country's securities auction markets, few people fully appreciate the tremendous importance of our so-called over-the-counter markets. Yet, in my opinion, the gigantic industrial growth our nation has enjoyed over the past two decades would have been utterly impossible without these markets.

Through the distribution mechanism established and maintained by dealers such as you, fresh capital for existing businesses wishing to expand as well as for new businesses is obtained from the investing public. In this way two fundamental purposes of our free capitalistic economy are served. These funds are used to create new jobs and new goods. Thus they raise our standard of living; and, people throughout the country are afforded an opportunity to invest some of their savings in the future of America and add legitimate business profits to their other sources of income.

In addition, the over-the-counter market provides the public trading medium for some 5400 corporate stocks. In comparison, the stock exchanges, while dealing in stocks having a substantially larger aggregate dollar value, trade in only some 3000 such issues.

Because of the basic differences in the character and purposes of our two organized securities markets it is clear beyond doubt that they will always co-exist in America. Neither market could perform the special functions of the other. The financial facts of life require that both continue with vigor and integrity to serve the American public. Both should be preserved.

A few years ago, when Senator Frear first introduced the bill which would extend certain provisions of the Securities Exchange Act of 1934 to corporations having at least 3 million dollars in assets and 300 security holders and which do not have securities listed on national stock exchanges, many securities dealers feared for the future of the negotiated market.

I favor the Frear bill, because I believe in further curbing the opportunities for abuse of trust by corporate insiders and in making fully available to all stockholders significant financial and other information about their companies. Moreover, I am confident it need not and would not have a detrimental effect upon the over-the-counter markets. It neither requires the listing of securities on exchanges nor does it in any way change the fundamental considerations involved in determining

which market is the appropriate one on which a particular security should be traded.

However, if it can be shown that there is any real danger that the Frear bill would injure the negotiated markets, we at the Commission would very sympathetically receive constructive suggestions as to how to meet the dual problem of serving the investor on the one hand and preserving, on the other, for both the auction and negotiated markets the appropriate balance of competitive opportunities. The Frear bill in my opinion is simply another step in the right direction of making the ownership of corporate securities more attractive. If adopted, I am convinced it would encourage many potential small investors to join the ranks of share owners in America's corporate enterprises.

As we look to the future, what are some of the mutual problems faced by the Securities and Exchange Commission and securities dealers? Over the past twenty years we have witnessed, and I believe contributed to, a phenomenal growth in the American economy. We are producing goods and services today at the rate of 340 or 350 billion dollars annually. Constant expansion continues to be the order of the day. The economy is truly dynamic, and many economists predict that in a few years our gross national product will be well over 400 billion dollars a year.

Such development will demand a healthy securities industry. Today's combination of government regulation and self regulation has, in general, produced such an industry--sound, reliable and worthy of public confidence. But those conditions will not maintain themselves automatically. The high legal and ethical business standards prevailing in the securities field today can be perpetuated only by the same constant attention and vigilance that produced them. Both Government and industry regulatory bodies must remain always on the alert to prevent deterioration in these standards.

Let none of us doubt the necessity of preserving these high standards. Securities are a unique item of property. Pieces of paper with no intrinsic value, the property values they represent are at best difficult for the average person to analyze and appraise. Ordinary investors know that they must rely upon the judgment and integrity of the dealers with whom they trade. With almost every other kind of property they buy, real or personal, they can physically examine and judge the values for themselves. Such safeguards do not exist in this business. The intangible, representative character of securities makes them peculiarly susceptible to the fraudulent sales tactics in which the irresponsible are willing to indulge. We must never make it easy for them to do so. The basic philosophy which has consistently permeated the Commission's administration of its statutes is that we should do everything to facilitate the activities of honest securities dealers, and everything possible to exclude from the industry the dishonest dealers. We have always considered this course to be not only in the best interests of

public investors, but as well, for the honest dealers who make up the industry.

While we can and do rightfully pride ourselves in the general wholesomeness which pervades the securities industry now, we should not close our eyes to the fact that there is still room for improvement. There are still sharpshooters to be caught up with and we intend to be persistent. There are still some firms in the securities business who are devoted exclusively to peddling to the investing public low priced, cheap securities with the knowledge that the corporations represented have little chance of success. The line between this type of activity and outright fraud is a fine one. If anyone steps over that line and we discover it, we will take swift and effective action. We are constantly on the alert and when such firms step over the line we intend to do everything possible to put them out of business.

But we have been handicapped in this work by severe cuts in our appropriations in recent years which have resulted in serious staff reductions at the Commission. We are hopeful, however, that this situation will be soon rectified--before a serious securities fraud scandal makes its urgent necessity too painfully apparent.

I have several times this evening adverted to the importance and virtue of self regulation in the securities industry. I am a firm believer in this form of industry self-discipline. It is an excellent vehicle for the development and expression of that sense of responsibility which must be accepted by every business group. But there is one specific danger in such regulatory bodies that I should like to warn against. No securities organization should permit any one segment of its membership to dominate it and reflect only the viewpoints of that particular group. The attitudes, opinions and interests of all groups--the investment bankers, stock exchange firms, and over-the-counter dealers--should be fully represented. Unless this kind of equality prevails the organization will serve neither itself nor the public properly.

Let me mention one final problem with which we have been concerned for some time. It involves the publication of quotations for securities traded in the over-the-counter markets. In my opinion considerable improvement can be made both in the quality of these quotations and in their availability to the general public.

For many securities traded only in the negotiated market the spread between the publicly quoted bid and asked prices is much too wide to be of any real value to investors. Conceding that these prices represent merely starting points for purposes of negotiation, I do not believe that there is any justification for the range being as wide as it is. If the gap is narrowed I am convinced that increased public confidence will be highly rewarding.

Even greater public and industry benefits can result from a determined effort to extend the publicity given to the market quotations for securities traded over the counter. Probably no other single feature has done so much to popularize the nation's stock exchanges as the daily detailed newspaper reports of transactions. Obviously, the over-the-counter market cannot achieve this degree of publicity for the majority of its securities. But far short of this is still an area which would represent a great improvement.

To begin with, investors in many regions of the country have extremely limited access to current quotations. Perhaps this could be promptly remedied if the industry were to begin furnishing all banking institutions with bi-weekly or weekly quotation sheets. In many smaller communities the banks are the only source of investment information, and you would, by adopting this procedure, render a very valuable service to many public investors and undoubtedly increase your business.

In addition every effort should be made to broaden the dissemination of such quotations in newspapers. Leading papers in every community should be urged to publish quotations for the more prominent and active securities at frequent intervals. When they are made to understand the value of this public service, I feel sure you will receive their cooperation.

I am aware that there are obstacles in the path of achieving these desirable objectives. But I am also convinced that they can be readily overcome. It is certainly in the mutual interest of the public and the industry that they be overcome, and promptly. I strongly urge you to give this quotation problem your immediate and careful attention. The rewards will justify your efforts.

May I thank you most sincerely for inviting me to your dinner and giving me this opportunity to say a few words about an industry of which I am very fond. The securities industry is a good one, in many ways a great one. And it is certainly an essential one. With the constant progressive efforts of groups like this it will continue to flourish and make its important contributions to the growth and prosperity of our nation.