

THE WORK OF THE  
SECURITIES AND EXCHANGE COMMISSION

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before the

DALLAS SECURITY DEALERS ASSOCIATION

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It is a great pleasure for me to speak before the Security Dealers Association of Dallas. This is the first opportunity I have had since I became a member of the Securities and Exchange Commission in 1953 to visit Texas. I am sure you can realize what a pleasant and interesting thing it is for me to be in your State.

You Texans have a reputation in the country that is almost legendary. I don't know whether that is because of your past history or your present enormous agricultural, industrial and cultural development, or a combination of many factors of contemporary life.

The securities industry and the Securities and Exchange Commission have come a long way since the dark days of 1933 and 1934 when the Federal securities laws were enacted. Let me take you back for a few moments to some of the conditions then in order to contrast the responsibility of the Commission in the middle 1950's with the job which confronted it in the middle 1930's.

The capital markets in the early 1930's had lived through a period of disaster. Securities sold to the public in many billions of dollars had depreciated to little or no value. The people had lost confidence in the capital markets as a place in which to invest their savings. New issues of corporate securities were being placed in amounts that today seem almost nominal. Trading on the organized exchanges was at a low ebb.

For example, in 1934 new issues of corporate securities offered for sale were only \$400 million. Even in 1939, ten years after the famous stock market crash, only \$2.2 billion of new issues of corporate securities were sold. In 1934, 325 million shares were traded on the New York Stock Exchange, and in 1939 only 260 million shares were traded. In 1934 the value of all shares listed on the New York Stock Exchange was only \$34 billion, in 1939 only \$47 billion.

Into this corporate capital market struggling for survival came the Securities and Exchange Commission to attempt, under strict Congressional mandate, to restore confidence in the capital formation process and the capital markets. The Securities Act, enacted in 1933, was designed to make available to investors the business and financial facts they should have in order to make informed decisions as to whether to buy securities that were being offered to them, particularly new issues being sold to the public for the first time.

The Securities Exchange Act, enacted in 1934, provided for the registration and regulation by the Federal Government, acting

through the Securities and Exchange Commission, of national securities exchanges, that is the stock exchanges, and of the companies whose securities were listed on exchanges. This law also provided for the filing by listed companies of periodic financial reports. It provided for regulation by the Commission of the solicitation by listed companies of proxies from their stockholders. It requires brokers and dealers to register with the Commission and comply with statutory standards and Commission rules. It imposed restrictions on officers, directors and large stockholders -- that is holders of 10% or more of the equity securities -- of listed companies from "profiteering" by the use of "inside information" in short-swing trading in the company's securities. It gave the Commission powers to review the rules and regulations of the stock exchanges or to impose rules upon them. Manipulation of the securities markets was prohibited, and criminal as well as civil sanctions were provided in these laws against misrepresentation and fraud in the sale of securities in interstate commerce.

In 1938, the Exchange Act was amended to add to the Commission's jurisdiction regulatory authority over securities dealers' associations, together with limited supervision over the unlisted market. It is under this amendment that the National Association of Securities Dealers, Inc. is registered with the Commission.

The impact of these laws and the Commission's administration of them in the 1930's was on an economy in which the formation of new capital and securities trading was almost dormant. Nevertheless, the procedures which the Commission established under these laws, by which a large body of comprehensive and accurate financial information has been made available to the investing public with respect to listed companies, and by which exchanges, securities dealers, brokers and others have been required to conform to legal standards of good conduct protective of the public interest and the public investor, have contributed toward the confidence which the public has shown in the past few years in the capital markets. In my opinion, this confidence in the capital markets, which are required under the laws administered by the Securities and Exchange Commission to adhere to standards of fair and honest dealings in transactions with the public, has been one of the factors at work in the past several years leading to the highest rates of capital investment, employment, national income and gross national product in our country's history.

To complete the contrast I began a few minutes ago between the capital markets today and those of the 1930's, and to emphasize the increased responsibility of the Commission and the enormous

importance to our economic system of investor confidence in these markets, let me again cite a few figures. In the single year 1954, \$9 1/2 billion of new issues of corporate securities were sold to the public. In the present year 1955, up to September 30, new issues of corporate securities aggregated almost \$7 1/2 billion. The number of shares traded on the New York Stock Exchange in 1954 was 573 million shares, and in the first nine months of 1955 510 million shares. This is roughly twice as much as in the 1930's. The aggregate market value of all shares listed on the New York Stock Exchange at the end of 1954 was \$169 billion. During the course of the present year there was a considerable increase and the figure at the highest point of the market was approximately \$205 billion on September 23. Of course, as you are all aware, there was a retreat from this on September 26 when the news of the unfortunate illness of the President hit the people. There was a continuing decline, or a see-saw, for a period so that the current market value of all shares listed on the New York Stock Exchange is approximately \$198 billion. But whatever the figure is on a particular month or day of 1955, the significant contrast with the times when the Securities and Exchange Commission first began the Federal regulation of the securities markets is very marked.

Now what does this difference in the condition of the capital markets mean to the securities industry and to a regulatory agency such as the Securities and Exchange Commission?

In the first place, as to attitudes, the Commission does not regard itself as having a mandate from the Congress as would make it difficult for legitimate business to raise capital or for the securities markets effectively to function -- just the opposite. We are trying to assure, in line with the statute's specific provisions, that the securities markets function effectively, but with fairness, honesty and integrity toward the public investor. We believe the public can be protected in the manner specified in the laws we administer, and the capital markets function properly and serve their purpose in our economic life, all at the same time.

Second, as to procedures, the financial reporting requirements for companies registering securities for sale to the public for the first time, and for companies whose securities are listed on exchanges have been well defined and standardized over the years. Parenthetically, I might say that our Commission has avoided the adoption of rigid accounting procedures. Rather, we have permitted accounting practices under "generally accepted accounting principles," leaving room for flexibility and growth under standards recognized by the accounting profession.

However, at the Commission in the past few years, there has been a program of revision and simplification of forms and requirements to ease the burden on reporting companies, to make the Commission's operations more effective and efficient, but not to diminish the investor protections provided by our rules and regulations under the Acts.

Just to give you an example, let me mention the completion in the past few weeks of the revision of the basic form for registration of new issues under the Securities Act. 1/ This has brought into conformity for the first time in the history of the Commission important disclosure requirements which are common to the basic reporting form for new issues, the basic reporting forms for companies soliciting proxies 2/, the basic form for listing new issues on the stock exchanges 3/, and the annual financial reporting requirements of listed companies 4/ -- all of which revisions have been accomplished in the last several years. This is but a typical example of the recent efforts of the Commission toward efficiency, both for our agency and for the companies we regulate.

Third, we do not regard our regulation of those areas of the securities business in which the public is most likely to be hurt as static or frozen. In other words, even though the Commission has for a number of years kept its regulatory hand off certain practices in the industry, we are constantly at work seeking to determine how the public can be better protected.

For example, acting under a recommendation made by a Congressional Committee in 1952 5/, the Commission after long study recently promulgated rules under the Exchange Act providing for permitted practices in regard to stabilization in connection with the distribution of securities. The rule is designed to permit, in connection with flotation of new issues, transactions which stabilize prices during the offering, that is prevent or retard a decline. This is regarded as a necessary and highly proper aid to the raising of new capital by corporations. But the rule does not permit transactions that would result in underwriters running up the price during distribution or other manipulative practices. 6/

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1/ Securities Act Release No. 3584.

2/ Securities Exchange Act Release No. 4979.

3/ Securities Exchange Act Release No. 5243.

4/ Securities Exchange Act Release No. 4991.

5/ House Report No. 2568, 82d Congress., 2d Session (1952), p. 3.

6/ Securities Exchange Act Release No. 5194.

For another example, the Commission recently revised the "net capital" rules applicable to brokers and dealers so as to provide more stringent standards in valuing the broker's assets for purposes of complying with the capital ratios specified in the statute. 1/ These are the so-called "haircut" provisions, which now call for a 30% deduction from market value of common stock commitments or inventory in computing the broker-dealer's net capital. We have also amended the "net capital" rule so that it will shortly apply to brokers and dealers regardless of whether they carry customers' balances or securities. 2/

For another example, we are in the process of revising our rules pertaining to securities which, because the amount offered in any one year does not exceed \$300,000, fall under the conditional exemption provided by the Securities Act. 3/ Our proposed revision pertains to "promotional" companies.

We are aware that our regulation of the offering of these promotional issues should take into consideration the exemption which the Congress specified should be available. We recognize the necessity and desirability of not interfering with the raising of capital for speculative exploratory purposes in the extractive industries, such as oil and mining. But we also recognize that the exemption provided by the Congress was conditioned and was not intended to free issuers and underwriters of such securities of all regulation whatsoever.

The statutory wording is important enough for me to read the two bases on which the exemption from the registration provisions of the Act may be granted. Section 3(b) of the Securities Act provides:

"The Commission may from time to time by its rules and regulations and subject to such terms and conditions as may be prescribed therein, add any class of securities to the securities exempted as provided in this section, if it finds that the enforcement of this title with respect to such securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering; but no issue of securities shall be exempted under this subsection where the aggregate amount at which such issue is offered to the public exceeds \$300,000."

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1/ Securities Exchange Act Release No. 5156.

2/ Securities Exchange Act Release No. 5244.

3/ Securities Act Release No. 3555.

There are difficult questions of judgment to be decided in acting upon our pending revisions of Regulations A and D. The Commission has been greatly aided in its consideration over the past few months of this difficult problem by the work of the Subcommittee on Commerce and Finance of the Interstate and Foreign Commerce Committee of the House of Representatives. The Subcommittee has been considering a bill introduced by Representative John Bennett of Michigan to repeal Section 3(b). 1/ The Subcommittee has held hearings on the problem in Washington, Denver and Salt Lake City and is holding hearings this week in New York. There is certainly a great deal to be said in favor of requiring issuers and underwriters of speculative promotional issues to comply with the registration provisions of the Securities Act. One particular advantage of requiring registration, rather than continuing the conditional exemption techniques which the Commission has permitted under present regulations, is that the issuer and underwriter would be subject to the civil liability provisions of Section 11 of the Act for misstatements and omissions of material facts required to be set forth in the registration statement.

We are determined that our revision of these regulations shall reflect the Commission's best judgment as to how investors in new issues of securities of the speculative promotional type can be given a fair disclosure of the pertinent business and financial information in accordance with statutory standards without strangling the capital markets for such issues. But I for one have never been aware that the registration requirements of the Act strangled legitimate capital formation, even for speculative purposes.

Finally, because of the active market movements of the month since President Eisenhower's illness, you may be interested in learning something of the Commission's regular market surveillance work. The Commission observes market conditions so as to carry out the Congressional mandate against the types of abuses -- manipulation, rigging, pools and the like -- that were typical in the stock market before the Commission was created.

The Commission has in effect various rules directly regulating trading on exchanges, and the exchanges themselves have many more self-policing rules and procedures.

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1/ H. R. 5701, 84th Congress, 1st Session (April 20, 1955).

For example, the Commission has in effect a rule covering the prices at which short sales may be effected on an exchange which generally prevents short sales on a declining market. 1/ This serves to discourage "bear raiding." Our rules also prevent persons engaged in the distribution of a security from paying other persons to solicit purchases of securities of the same issuer on an exchange except under specified conditions. 2/ As I mentioned a moment ago, the Commission recently adopted rules dealing with the stabilization of securities to facilitate distribution. These requirements, like the general anti-manipulative standards of the statute 3/, operate to prevent persons engaged in distributing a security from creating active trading or raising the price in order to facilitate a distribution except subject to requirements of disclosure and other controls which operate to prevent deception or unfair advantage being taken of the buying public.

In addition to these specific controls the statute and the Commission's rules prohibit the use of manipulative or deceptive devices and contrivances in connection with the purchase or sale of securities. 4/ Under these requirements it is unlawful for any person to effect a series of transactions in any security creating actual or apparent active trading in the security or raising or depressing the price for the purpose of inducing the purchase or sale of the security by others.

The Commission enforces this prohibition of manipulative and deceptive practices in a variety of ways. We inspect the books and records of brokers and dealers and our inspectors, among other things, review transactions recorded in such books in the light of anti-manipulative standards. We investigate complaints coming to us from the public, from customers and from brokers and dealers.

In addition to this, we carefully watch activities on the exchanges themselves. A considerable volume of reports and statistical material comes to us regularly from the exchanges, covering short selling, the activities of floor traders, and similar matters. These are published in the Commission's Monthly Statistical Bulletin. Beyond this we maintain a "market surveillance unit" in our New York Regional Office which watches the recorded transactions on the New York exchanges as they come over the ticker, and the quotations in the over-the-counter market as they are published in the National Quotation Sheets, for the purpose

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1/ Rule X-10A-1.

2/ Rule X-10B-2.

3/ Securities Exchange Act, Sections 10(b) and 15(c)

4/ Rule X-10B-5.

of detecting activity in any security which does not appear to be based on economic factors and may indicate the presence of manipulation. When such a question arises, this "market surveillance unit" conducts a "flying quiz" with respect to the transactions in the particular security. In the "flying quiz" the identities and activities of purchasers and sellers are ascertained and reviewed. The market surveillance unit also investigates complaints coming to us from all sources concerning possible manipulative activity. Ordinarily none is found. But we feel that the very existence and activity of this surveillance group has a powerful deterrent effect on possible market manipulation. And on those rare occasions when a manipulation can be proved, the civil and criminal sanctions of the Exchange Act can be brought to bear. The statute provides a maximum penalty of \$10,000 fine and imprisonment for two years in a Federal penitentiary on conviction of manipulating the market, which is perhaps one reason why there are so few manipulation cases nowadays.

In addition to these direct controls, the light of full disclosure is brought to bear on many market activities where formerly inequitable practices flourished under the cover of darkness. As I mentioned earlier, issuers of securities listed on national securities exchanges file with us and make available to the exchanges and thus to the investing public comprehensive reports of their financial condition as well as of events of major significance to investors. "Insiders" -- that is officers, directors and 10% stockholders -- report currently to the Commission and the exchanges changes in their ownership of their company's securities, which are published in the Commission's monthly bulletin on Ownership Reports, and "insiders" are required by Section 16(b) of the Exchange Act to pay over to the company profits realized by them on short-swing trading.

We feel that by all these methods the Commission, working in collaboration with the securities exchanges and the securities industry, has come a long way toward providing for investors an orderly market, free of manipulation, deception and other unfair practices. Public confidence in the integrity of the securities markets is high and sustained and these markets are in a better position than ever before to perform their important function of channeling the savings of the public into productive corporate enterprises.

I do not mean to suggest that there are no violations of law going on, or that those that do occur are all detected by the Commission. That would be too much to expect of any law enforcement agency, particularly one cooperating in the national policy of reducing the

expenses of the Government. But I do mean to say that with the limited funds and personnel available to the Commission much has been accomplished.

In conclusion, let me stress the importance of the maintenance of the confidence of the American people in the securities markets. In our economy today, few citizens are unaffected by these markets. The 90 million Americans holding life insurance policies have an indirect interest in these markets through the great investment in stocks and bonds of corporations held by insurance companies. Beneficiaries under pension funds and holders of investment company shares have an indirect interest. And the 8.5 million citizens who directly own shares of corporations are vitally concerned. Our corporate wealth is very broadly held. The securities markets provide the mechanism by which business raises the capital required to serve the economic needs of the people. They provide a mechanism by which industry may be broadly shared by the people. Ownership of American industry has become, through the operation of the capital markets, freely transferable. Thus, investors are willing to place their savings at the disposal of industry and the capital so essential to the nation's economic progress is provided.

The Securities and Exchange Commission is not directly concerned with the economics of this process. It is not the Commission's business whether prices of securities on the markets go up or down. But we are vitally concerned that price movements result from the free judgment of buyers and sellers trading in fair, honest and orderly markets. The Commission does not, and under the statutes is not permitted to, pass on the quality or investment merits of securities registered with it for initial sale or listing on exchanges. That is not our province. But it is our business to require, under the Securities Act and the Exchange Act, adherence to the "fair disclosure" standards of the law, the maintenance of free, fair and orderly securities markets, and the detection, prevention and punishment of fraud in the sale of securities. This is a great responsibility and requires the cooperation of securities dealers, brokers, investment bankers, the exchanges, dealers' associations, such as yours, and all those who have to do with the securities markets, working together for the best interests of the investors of America and the American people.