

TWENTY-FIVE YEARS OF SEC SECURITIES REGULATION

Address of

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Commissioner
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Washington, D. C.**

**before the
HOUSTON DOWNTOWN ROTARY CLUB
Houston, Texas**

March 5, 1959

It is a high privilege and a great pleasure for me to address the Rotary Club here in Houston today, and I am particularly happy to be accompanied by Judge O. H. Allred, the Regional Administrator of the Securities and Exchange Commission's Fort Worth Regional Office, and by Frank Pinedo, the Attorney-in-Charge of our Branch Office here in Houston.

It is of special significance that I have this opportunity today, at a time when investor confidence in the capital markets seems to be soaring. The value of securities listed on the New York Stock Exchange is at an all-time high of \$280.8 billion as of January 31, 1959, up from \$276.7 billion as of December 31, 1958, as is the number and dollar amount of new issues registered with our Commission amounting to 970 and over \$17.3 billion in 1958. The Dow Jones Industrial Average has recently passed the 600 mark and the volume of trading continues to exceed all expectations with numerous of those 4,000,000 share days which so warm the stock broker's heart.

This is a far cry from the dark days and years following that black Thursday in 1929 when the stock market crash occurred. It might be of interest to you to return with me for a moment to 1929. The value of all stocks listed on the New York Stock Exchange on September 1 of that year totalled \$89 billion; in the days immediately following black Thursday in September of 1929 when the break in the market occurred, this value fell \$18 billion. By 1932 the aggregate figure was down to \$15 billion, reflecting a total loss in such value of \$74 billion in two and one-half years.

The recovery has been remarkable. Investor confidence, which reached its nadir in the early 1930's, has been largely restored. This restoration, in my opinion, has been in a great measure due to the securities legislation enacted in 1933 and 1934 and its administration by the SEC. Basically, this legislation was designed to supply investor protection through disclosure of the basic facts, financial and otherwise, of corporations seeking to raise capital from the public so that potential buyers could be informed investors prior to making their purchases. As a result, today, slightly over 25 years since the enactment of this first legislation, we find very different conditions. The evils of overstating assets are a part of the past. The vast volumes of information which are filed under the various securities acts are constantly being analyzed by independent financial advisory services, brokers and investment bankers, thus affording investors the opportunity of deciding for themselves whether they wish to invest in any particular type of business, be it a "blue chip" or a highly speculative, newly organized venture. Securities are continuously being studied individually, or by comparison within industries, and in connection with particular financial investments all sorts of analytical comparisons are employed by the financial community, with the result that the securities markets are today in most cases based upon relatively realistic values. As you know, the Commission was denied by the Congress the right to make any "value" judgments or to pass upon the merits of any security, such determination being left where it, in my opinion, rightfully belonged--with the investing public.

I realize that most investors do not read and analyze the information contained in a prospectus which is given to each purchaser of a security that is registered with the SEC. This is unfortunate, for the spirit behind the Federal securities acts is one of self-help wherein all of the pertinent facts regarding a security are laid before the purchaser for his scrutiny and edification. Nevertheless, the fact remains that thousands of investment banking firms, brokerage houses, trust companies, insurance firms, institutional investors, investment companies, investment advisors and statistical services do read the prospectuses from cover to cover so as to advise their customers, on the basis of adequate information, whether to buy or not. This in itself has the salutary effect intended by the Congress.

This October the Securities and Exchange Commission will celebrate the Twenty-Fifth Anniversary of its creation to act as a watchdog over the capital markets. As the confidence of investors has returned and the markets have continued to grow, we have been faced with new and different problems, two of which I believe are of particular current significance to those of you assembled here today. During a period of prosperity and increasing values of securities, the investor tends to fall victim to his own apathy and gullibility. He becomes the perfect mark for the con man or the fringe operator who sells securities either through fraud or by evasion of the securities laws or both.

I have been told that there is a great deal of use in the southwest of the intrastate exemption, particularly in the sale of securities of newly formed insurance companies. The Congress, in formulating the Securities Act, did not require all securities to be registered, but provided for certain exemptions from the registration requirements. In the area of the intrastate exemption, it is apparent that the Congress was intending to provide an exemption only for local financing by local business. Unfortunately, there have been numerous abuses where companies from outside the State have tried to come within the definition of a local company and have attempted, in order to circumvent the disclosure requirements of the Federal Securities Act, to do a minimal amount of business within the State so as to sell their securities to residents of Texas predicated upon an appeal to the civic pride, i.e., sold only in Texas to Texans. I think it might be wise for anyone of you, if approached as a prospective purchaser of such intrastate offerings, to consider whether in fact the company seeking to sell its securities is essentially a local one or whether the whole deal may be designed to avoid making the disclosures to which you would be entitled if the company were registered under the Securities Act. Additionally, I should throw out this caveat: the intrastate exemption is limited in scope and should only be available for local companies seeking to raise money from local citizens for purely local situations.

You the residents of Texas are very fortunate in having a strict State regulation of the sale of securities ably administered by Mr. William N. King. If any questions should ever arise as to the legitimacy of securities offerings, I urge you to check with Mr. King's office, Frank Pinedo, or with your own broker or investment banker. This suggestion applies equally to the scheme to defraud which I would now like to discuss.

Within the past few years the Commission has been confronted with "boiler rooms" which have caused us great concern. Most of the larger boiler rooms have disappeared due to our vigorous enforcement campaign. However, in their stead have sprung up a group of small firms which sell one or two spurious issues of securities and then move on. Essentially, a "boiler room" is an organization which sells worthless, or almost worthless, stock to the public via the long distance telephone. We have used these words to describe an office where the salesmen indulge in high-pressure sales talk to such an extent as to cause a din and uproar like unto that which occurs in a steam boiler room. These unscrupulous operators assemble a group of salesmen in a large room, each with his own telephone and out of town "sucker list" or telephone book (it may have included Houston), who proceed to sell these securities over the phone by means of the grossest of misrepresentations as to the worth of the stock--that the price will double or triple in a matter of weeks--etc. These fraud artists prey upon the small unknowing investor, the widow, the housewife, etc.

These "boiler rooms" have caused great concern because they are weakening investor confidence and bringing into the capital markets a feeling of disfavor by the American investing public. Public confidence brought about by painstaking work in the securities markets in recent years can quickly be forfeited once an investor is burned by a complete stranger who sells him on some participation in a fraudulently conceived "get-rich-quick" scheme over the long distance telephone.

These frauds present difficult enforcement problems because there may be little or nothing to arouse the suspicion of an investor at first glance. Upon being first informed of the misrepresentation and fraud, we are compelled to undertake an extensive and thorough investigation because our only resort is through courts and we must prepare our cases accordingly. Investor protection, therefore, sometimes cannot come quickly enough to preclude damage to members of the public.

But, in order to help public investors help themselves, the Commission has engaged for the past few years in a broad program of public information warning the public of the dangers. The Commission has recently adopted--in cooperation with the New York Attorney General, now United States Senator Jacob K. Javits of New York--a ten-point guide, urging the public to be cautious in purchasing securities as a result of long distance telephone solicitations by persons of whom they have had no prior knowledge, and suggesting that public investors consider these ten points as guides before purchasing securities:

1. Think before buying.
2. Deal only with a securities firm which you know.
3. Be skeptical of securities offered on the telephone from any firm or salesman you do not know.
4. Guard against all high-pressure sales.

5. Beware of promises of quick spectacular price rises.
6. Be sure you understand the risk of loss as well as prospect of gain.
7. Get the facts -- do not buy on tips or rumors.
8. Request the person offering securities over the phone to mail you written information about the corporation, its operations, net profit, management, financial position and future prospects. Save all such information for future reference.
9. If you do not understand the written information, consult a person who does.
10. Give at least as much thought when purchasing securities as you would when acquiring any valuable property.

In the dissemination of this information, and in assisting the public, no organization in this country is better suited than yours to complement and assist this Commission in achieving these ten safeguards. The Commission stands ready to cooperate and assist in any way it can to maintain investor confidence. Our objective is to preclude any vital damage to American investor confidence. The best way to do this is through "prevention" and not "cure." We must prevent the damage before it occurs. It is difficult to cure in this area because once "burned" a public investor may never return again to the capital markets. The American public investor must continue to have the confidence of our capital formation process. We at the Commission, therefore, ask your assistance in "passing the word" to the American public.

By way of conclusion I would like to express to you my fundamental belief that if the confidence and faith of the American investing public in the capital formation process are to be maintained so that the enormous amounts of needed capital can be continued to be raised at the high rate of demand anticipated by present estimates of industrial expansion and production with the resultant high standard of living for the American people, it is essential that this Commission continue its close supervision of the capital markets in accordance with the Congressional mandate expressed in the securities laws. Only by such means can there be any assurance of integrity and fair dealings throughout the securities markets and can there be any real measure of success for our free enterprise system and/or the welfare of the American people as a whole.