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ADDRESS

of

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BEFORE

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My spirits are always lifted by this great Pacific Northwest. Perhaps that is due to the fact that, based on twenty years residence here, it still feels like home. Perhaps it is the very sight of the glories of Nature which Providence has so bountifully bestowed upon you. But I think it goes deeper than that. It is something in the air. It is the climate of opinion; the mental attitude which prevails. It is evidenced by the directness, and forthrightness; the boundless energies; the contagious enthusiasms of the West. It is also evidenced by an absence of smugness and stodgy conservatism. The pioneer still dominates the character of this region; individualism is still the pole star here. And the combination of these qualities has produced a social consciousness and a constructive liberalism which are par excellence. They not only lift the spirits of those who visit here; they are a leavening influence throughout the land.

The nation sorely needs these qualities which have made the Pacific Northwest great. And they need their application to a host of specific problems. All of us in this country - whatever our work, our business, or our profession - are in the same boat together. Unless we will it, our enemies are not ourselves but our common problems. Many of these problems are man-made. Since they are man-made, men can solve them. The stakes are high. Those stakes are capitalism and democracy. Your government in Washington is intent on saving those stakes. You are intent on saving them. Your government is your partner in that endeavor. This must be a joint venture by all of us. We cannot solve these problems working separately. We cannot conquer our difficulties by endeavoring to castigate each other. Let us expend our energies on the problems rather than on each other. Let us pool our resources. Let us have a united front. Working together we can overcome any problem which besets capitalism and democracy. Give us that combination and we can, with full confidence, defy any foe from within and without. Our inheritance is too precious to be risked on any other course - either by placing class against class; or by placing special vested interests against humanity. That inheritance is freedom of opportunity - the freedom which is as basically necessary for the preservation of capitalism as it is for the preservation of democracy. That is the course on which your government is actually launched.

This is not mere sentimentality; it is plain common sense. Let me be more specific by drawing from recent experiences in my own bailiwick. As you know, the S. E. C. has entrusted to it certain types of supervision over national securities exchanges. These exchanges constitute an extremely vital cog in the machinery of our securities and capital markets. Their strength and vitality are matters of national interest, for their condition is symptomatic of our economic well being. Furthermore, they are the great auction markets where buyers and sellers of securities the world over expect and need to be serviced. But for too long did our stock exchanges remain institutions for the easy perquisites of their members and the precarious satisfaction of a speculative urge. The position of the investor who owned securities which were traded on the stock exchanges was too often a secondary consideration. The exchanges were wont to operate as private clubs. As such they regarded themselves as beyond regulation. Under the leadership of Richard Whitney, regulation was bitterly fought. Though his cause was defeated in Congress, Richard Whitney did not accept

defeat. He exerted a powerful influence. At times that influence was positive; at other times, negative. But it was in totality a negation of the will of Congress.

After three years under the Exchange Act we were making slow progress. Matters were in process of being stalemated. Lip service was rendered to cooperation; but little action was evident. That was not a sudden development; it was a growth. In September, 1937, we decided it was time to take action - drastic action, if necessary, to protect investors and business in this country. Our efforts to obtain an undertaking from the Exchange to reorganize are familiar to you. You are likewise familiar with our inability to obtain it. And you know what our decision was - to make the issue a public one, since the public interest was involved. On November twenty-third when we brought the issue out in the open, we did not know that Richard Whitney had misappropriated securities of the Gratuity Fund and had engaged in other defalcations. We did not have even an inkling of those facts until a brief fourteen hours before the public knew them in March of this year. And this leads to the crux of the whole problem of regulation. Governmental regulation at its best should be residual. We should not have to be in a position of watching the details of operation. Those are for the exchanges themselves. If we carried regulation to the extent of knowing what the status of each customer's account was, we would be not only a blight and a burden to the industry; we would be an enormous burden on the national treasury. Supervision of the accounts of members to the degree necessary to detect misuse of customers' funds properly lies in the realm of self-regulation. Liberals in the exchange had been urging such quality of self-regulation for years. That problem was typical of the issue between the S.E.C. and the Exchange in November, 1937. We had arrived at a point where, unless the exchange really undertook adequate self-regulation, we ourselves had to move in with detailed regulation, as distasteful to us as it would be onerous to the Exchange.

We were not playing a lone hand. The liberals in the Exchange brought the issue directly to me in October, 1937, with a plea that the Exchange be reorganized. So when the negotiations broke down in November, these liberals carried on the fight from within. You know the consequences, viz: the appointment of the Conway Committee. And you are acquainted with its distinguished report (which came out some weeks before the Whitney scandal broke) and which had immediate and wide support among all ranks of Exchange members. I review these matters solely to illustrate what business working with government can accomplish. The achievement was not just an S.E.C. achievement. It was a joint achievement between the Exchange and the S.E.C., an achievement which gave voice to a long slumbering urge for change, both from within and without.

That joint achievement, however, was merely chapter one. Chapter two is now being written. And it should constitute an interesting and important page in the history of government and business. Reorganization of the Exchange made possible the doing of the basic jobs - (1) an appraisal of the existing Exchange mechanism in light of the philosophy of the Exchange Act; and (2) a cooperative undertaking by the S.E.C. and the Exchange in enforcement of its provisions. This joint program has been launched, and is progressing splendidly.

Prominent among the items of unfinished business is the proposal to establish a brokers' and dealers' trust institution which would perform the custodial, safekeeping and quasi-banking functions presently performed by the members. This trust institution would not engage in any commercial banking business nor operate for its own account. It would, as a trust institution, be under state supervision. Securities and free credit balances of customers would rest at all times in its hands rather than in the hands of the brokers. A broker would thus not be in a position to ease the strain of his own commitments by dipping into his customers' securities or funds. But the idea is not born just as a result of the Whitney episode. Those are the rare exceptions. The business is an honorable one, engaged in by men of integrity and character. We all know this from our own experiences. Furthermore, we know on the basis of performance over the years that the record of stock exchange houses has been exceptionally high on this score. A compelling reason for endeavoring to establish such an institution is one of economy to the brokers. This was a paramount consideration which led to its advocacy by a group of members as early as 1932. What the details and mechanics of such an institution will be is a matter for round table determination. As I have said, our discussions have started. I am hopeful not only of speed but of permanent, constructive achievement.

The progress which has been made is the reason why a new spirit is abroad in the street; where once there was discouragement, there is now hope. Once it seemed to some that there could be no basis of sympathetic, mutual understanding between government and the street. That has been dispelled. Under the able leadership of Mr. Martin, the new Exchange management is well under way. We have pledged our unstinting support to that program, and to Mr. Martin and his new regime.

Our attack on these problems is through the medium of the round table, not the debating society. We have had several of those round table conferences since the new management took office. They will go on continuously until the agenda is disposed of. To that round table, we bring our respective experts. To that round table we also expect to bring representatives of business and finance who have a contribution to make to our specialized subjects. Thus last week Mr. Martin and I requested the institutional buyers of bonds - the banks and the insurance companies - to appoint a committee to consult and advise with us on the problem of the quality and quantity of the bond market on the Exchange. They readily accepted. So we have brought to our round table an outside group of experts to aid and assist us.

I give you this in detail because I know you want facts not theory. This is a current picture of a united front by government and business. It is not government's job to run the Exchange. But government can be helpful by assisting the Exchange in making its adjustment to the new era envisaged by the Securities Exchange Act of 1934. Government and the Exchange working together can reconstitute or restore the Exchange as the greatest market place in the world, commanding the confidence and respect of investors. That's typical of what government and business working together in any sector of our broad national front can do.

This is not an isolated example. There are others. Currently our progress under the Public Utility Holding Company Act is, I believe, significant. You will recall the intense opposition which was generated in 1935 when the bill was before Congress. That Act, like most other liberal measures, was forged in a furnace brought to an intense heat by a convergence of the forces of advocacy. That opposition did not cease when the bill became law. It was carried on for two and a half years in the courts. During that period our administration of the Act was, of practical necessity, drastically curtailed. But when the Supreme Court in March of this year upheld the constitutionality of the registration provisions of that Act, the ice jam went out. The holding companies registered in mass. And a new climate of opinion was created in this twelve billion dollar industry. Once more did we adopt the round table method. Singly and in groups leaders of the industry came to Washington, not just to talk but to make specific plans for adapting their companies to the standards of the Act. A committee of certain groups in the industry was organized to consult and advise with the S.E.C. on practical problems under the Act. Substantial groups in the industry are satisfied with the soundness of the statute. Others are less enthusiastic but are eager to comply with the law of the land. The leaders are indulging not in mere talk but in action. Much of this action is still inchoate. But development of concrete plans are under way in many utility offices today. This work should bear fruit soon.

I have said on other occasions that the initiative, the resources, the technical skills and the energies which created the fantastic holding company structures and which conceived the holding company practices which brought disrepute to the industry, can be employed constructively to accomplish the objectives of the Act. Two of the chief problems of the Act flow out of the so-called (but misnamed) "death sentence" provisions. One involves the requirement of corporate simplification; the other geographical integration. In the past the sprawling systems of the gigantic public utility holding companies shifted endlessly. Fantastic corporate structures grew with abandon. In the past these developments were often without direction, without relation to the broader purposes of sound finance. In the future, under our supervision, but still energized by the boundless initiative and ingenuity of the men of the industry, they will have direction and they will create form and pattern. Capital structures will assume greater simplicity and conservatism. Investors will be sufficiently close to the real values so as not to require the services of a magician to conjure them up, or a higher mathematician to compute them. And as a result of geographical integration, the red and blue spots of systems which are now scattered amorously over the nation's map will tend to draw themselves together into a solid mass - a symbol of economic and geographic integration for the better service of consumers and the greater security of invested capital. Upon the S.E.C. and the industry rests the responsibility for the final accomplishment of this gigantic financial and engineering task. It cannot be done overnight; my estimate is that its back can be broken in five years.

Such a program of complying with the standards of the statute and living under the law of the land will bring strength and vitality to the industry. It should also bring peace. And if we can only by diligence

and continued cooperation make up for the two and a half years of time lost through litigation, we can, through the utility industry, make an important contribution to our national economy. For, as you know, one of the chief problems of the nation is a revival of our capital markets. The private utility industry has a contribution to make there, though it is commonly over-advertised. Through cooperation our objective is to put the utility house in order and thus enable it to contribute to our national economy.

There are other examples in the S.E.C. workshop of the round table technique between government and business. The two I have just mentioned are not unique; they merely are the most conspicuous. This round table method is the sane and sound course. What the Exchange and we have done, and what the utilities and we are launching, can be done by other groups. Debating societies are excellent media for talk. The round table is unequalled for action. What we need now is action - action by all groups on their common problems. Action in specific terms, not generalities. Action which will permit energies to be expended on the constructive side. When business forsakes its basic skills and resorts to the political technique, it heads for the trackless desert. When business uses its basic skills in the round table method, it charts the broad and open highway to honest and substantial profits.

I have given you what I think is the trend of the time. And I have indicated what to me seems to be the best technique for coordination of our efforts in a common cause. And I hope that the newly authorized monopoly investigation will afford unusual opportunity for action in this same direction. I have but a modest part to play in that undertaking and I do not speak for anyone but myself. But it seems to me that here is a signal opportunity for the constructive elements in business and finance (of which there are plenty) to make a significant contribution to the future of America.

Again let me give you a specific illustration. One of the pressing current problems is small business. In the preservation of the profit system, there are few matters of greater significance than efficient functioning of the machinery by which industry obtains its capital, directly or indirectly, from the savings of the public. The public, if it makes its investment directly, must have confidence that its investment will have a reasonable chance of success and that opportunities for fraud and deception are reduced to a minimum. If the public's savings are to be invested indirectly, there must be some residual control or supervision e.g. to prevent oppressive practices, as among many investment trusts. In all of this we must avoid making restrictions (whether under our banking laws, our securities laws, or otherwise) so severe as to hamper legitimate, small business, and to put a premium upon the blue chips of big business. Now there has been a growing recognition of the fact that small business, due to a myriad of circumstances, has been having an increasingly difficult time in getting money for capital expenditures, such as plant, machinery, and for production. That condition may seriously jeopardize our national welfare. That is a basic economic fact. It is also in my opinion a basic economic fact that the answers to some (but by no means all) problems of monopoly are to be found in facilitating the opportunities of small business. These problems of small business are

basic economic ones. We see them constantly under the Securities Act of 1933. Recently we took several steps to cut down the paper work and the expenses of small business, and to give it further assistance in registering its securities with us. But while we hope that such administrative procedure may help or assist, we know that the real problem strikes much deeper. What the answers may be, I do not purport to say. But I am convinced that groups like yours, working in a round table manner with your government, can find answers which are sane and practicable and which will help remove the heavy hand of monopoly from some parts of our economic body.

I want to mention in the second place a related problem - the problem of development of regional strength and vitality in this country. Investment in this country has undergone a shift in the past twenty years, from a few but very rich private families and individuals to the masses. The complexion of institutional investments has likewise changed. The banks are larger investors in corporate securities, particularly bonds, than they were at the turn of the century. Life insurance companies are still the largest single factor in the bond market and have become more so in the last few years. The advent of the investment trust and the investment company, and the spread of stock investing among insurance companies, has made the institutional buyer of stock a greater factor than it was two decades ago. But the most pronounced change has been the spread of corporate securities among small income people. The spread of investment in bonds and stocks among the masses has moved steadily ahead. At the same time, there has been another shift - an increasing flow to the East of the local investment funds from communities throughout the land. Too often these local savings have been attracted to the great national corporations at the expense of small local enterprise. The East, as a national clearing house for investment funds, supplied capital to the larger local enterprises all over the country. Still you know and I know there were many instances where worthy local enterprises suffered from lack of financing. The reason is clear. An eastern banking house could hardly be expected to service all the needs of local enterprises. There is, furthermore, the size of the issue. Wall Street, as a general rule, is not geared up for small local issues. The local job cannot be done there. Yet the backbone of this country's progress has been the small companies. The giants of today started under humble auspices but a generation or so ago. The problem of financing small or intermediate companies is primarily the problem of local companies which do not yet enjoy national credit (or which may never enjoy such credit because of size) no matter how good the risk; no matter how good the prospects. The problem, as I have said on other occasions, is intimately tied up with the development of regional capital and securities markets. It is a problem of how to develop, with the help of local financial machinery, regional capital centers so as to keep local capital for local needs.

This problem of the small local enterprise is a major national problem which presses for local solution in almost every community. You here in the Great Northwest know your problems of this kind better than I. But on the basis of my own observation I would say that if the Pacific Northwest is to come into its own with full and sound industrial development, more adequate credit and capital facilities for Pacific Northwest industries must be found. Small business has almost invariably been financed by plowing earnings back

into the business, by commercial bank credit, and occasionally by private financing. The very high percentage of risk which is involved in any of the offerings of small and unseasoned companies poses the question as to whether the public, especially the small investor, should be urged to invest savings in this type of security. Naturally, commercial banks, whatever their attitude may be toward established companies, cannot be expected to extend credit to a new and unseasoned business. But though the small company is seasoned, it may still experience great difficulty in reaching the capital markets. There is thus a void in our capital machinery.

There are throughout the country old well-established companies which have given work to citizens of their communities for years. Some of them have found that in order to keep up in competition they must undertake extensive modernization. Others need capital to take advantage of new markets which lie at their door. You must know of such companies in the Pacific Northwest. Yet investment funds are likely to go to the East and into our national industries. This means, in effect, that while our national economic welfare rests on the welfare of small business, our national financial machinery is geared almost exclusively to large industries. A cartoonist once likened the situation to the cow who, though doing much of her grazing in the Pacific Northwest, had her udders most of the time in the East.

This condition is not just one relating to small business. There are seasoned local industries of a larger size in your region which are constantly in need of adequate and healthy securities and capital markets, and which frequently can be well served locally. But there is the tendency even here to go into the Eastern market when new money is needed. I realize the predicament of your industries in this connection, for the local capital machinery is at times inadequate. In many instances in the past the Eastern market because of its great financial and technical sources has been able to render the required service on terms at which local financial machinery could not compete.

When I urge that adequate regional facilities be made available for the needs of the Pacific Northwest I do not speak with any desire or hope that the Eastern markets will be weakened. The advantages to the East in such development are equally obvious. What is good for the financial health and vitality of the various regions of the country is also good for the East. Tangible and intangible values to the East and to the nation at large are obvious if we can perfect sound regional development. Nor do I mean to imply that arbitrary areas of business relationship should be erected nor that we should engage in a program of economic planning. I merely say this: that if local enterprises could patronize their local financial centers more extensively, those financial centers could develop into healthy resorts for both large and small companies in need of financial assistance.

I appeal to the ample supply of brains, imagination, and courage to be found in the Pacific Northwest to help solve this problem. This is a great opportunity on which local banks, insurance companies, dealers, brokers, investment advisers, and business men should be able to capitalize.



Leadership to do it is here. It is not solely an affair of government; it is an affair of business. Industrial banks have been suggested as the solution. Some bills have even been introduced in Congress to that end. What the precise solution should be, I do not know. But can we not place it on this new round table for discussion?

You will find in us a strong ally if you will help lead the way. The trend of the times is for increasing opportunity for local interests to assert themselves so as to be rid of absentee management and remote financial control. Your past record in pioneering gives strong assurance that you can, by working with your government on this problem, bring renewed strength and hope to this great industrial area.

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