Boston University

OpenBU | http://open.bu.edu

Boston University Theses & Dissertations | Dissertations and Theses (pre-1964)

1955

Control of securities trading by the Securities Exchange Act of 1934.

https://hdl.handle.net/2144/13366

"Downloaded from OpenBU. Boston University's institutional repository."

BOSTON UNIVERSITY

College of Business Administration

THESIS

Control of Securities Trading by the Securities Exchange Act of 1934

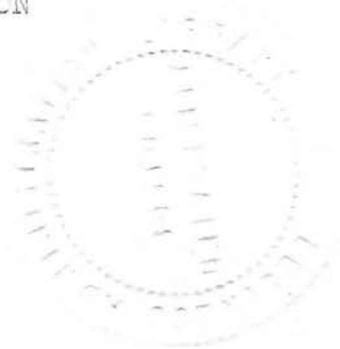
by

Edward Laurence McCormack
(B.S. in B.A. Boston College 1942)

Submitted in partial fulfillment of the requirements for the degree of

MASTER OF BUSINESS ADMINISTRATION

1955



5-23-55
46828

TABLE OF CONTENTS

I. INTRODUCTION — Page 1

II. HISTORICAL BACKGROUND OF THE SECURITIES MARKET IN THE UNITED STATES — 6

- A. Early Trading Arrangements — 6
- B. Formation of the New York Stock Exchange — 8
- C. Development of Markets and Interest in Securities — 13

III. REASONS AND NEEDS FOR REGULATIONS — 17

- A. Protection of the Public Interest — 17
- B. Manipulative Practices — 19
- C. Use of Credit — 22
- D. Financial Information — 25

IV. REGULATIONS — 27

- A. State Blue Sky Laws — 28
  1. Fraud Statutes — 28
  2. Statutes requiring registration or licensing of brokers, agents, and salesmen — 28
  3. Statutes requiring registration of securities — 28
- B. Goal of the Federal Government — 31
- C. The Securities Exchange Act of 1934 — 36
  1. Purpose — 36
  2. Securities and Exchange Commission — 37
  3. Registration of National Securities Exchanges — 37
  4. Margin Requirements — 38
  5. Restrictions on Borrowing by Members, Brokers and Dealers — 39
  6. Regulation Against Manipulation — 40
  7. Segregation and Limitation of Functions of Members, Brokers and Dealers — 42
  8. Registration Requirements for Securities — 43
  9. Periodical and Other Reports — 45
  10. Proxies — 45
  11. Over-the-Counter Markets — 46
  12. Directors, Officers and Principal Stockholders — 49
  13. Accounts, Reports and Examinations — 49
  14. Misleading Statements — 50

IV. | | Page
C.
15. Powers with Respect to Exchanges and Securities 50
16. Liabilities of Controlling Persons 51
17. Investigations, Injunctions, and Prosecutions 51
18. Information Filed with the Commission 52
19. Court Review 52
20. Unlawful Representation 52
21. Penalties 53

D. The New York Stock Exchange 54
1. Before Federal Legislation of Securities Exchanges 54
2. After Federal Legislation of Securities Exchanges 57
E. The National Association of Securities Dealers 63
1. The Over-the-Counter Market 63
2. Authority for "Over-the-Counter" Associations 66
3. Organization of the National Association of Securities Dealers 67
a) Rules of Fair Practice 68
b) Uniform Practice Code 69
c) Administration 69
d) National Quotation Bureau 70
e) Financial Strength of Members 71

V. GENERAL DISCUSSION 73

A. Effectiveness of Regulations 73
1. Manipulation 73
2. Financial Information 76
3. Protection of the Public Interest 78
a) Advertising 78
b) False and Misleading Statements 79
4. Business Ethics 80
5. Credit Regulation 81

VI. CONCLUSIONS 87

A. Benefits of Regulation 87
B. Criticism 90
C. Current Influences 95
1. Institutional Investors 95

BIBLIOGRAPHY 109

LIST OF TABLES

I. Market Value and Volume of Sales Effected on Securities Exchanges
PartI - For 12 Months Ended December 31, 1952
PartII- For 6 Months Ended June 30, 1953

II. Net Number and Amount of Securities on All Exchanges, June 30, 1953

III. Trading Investigations of Possible Manipulative Practices

IV. Comparison of Percentage Rise in Stock Prices

V. Number of Listed Issues on New York Stock Exchange

VI. Shareholding of Institutions

VII. Reported Stock Volume and Turnover of Listed Shares on New York Stock Exchange

VIII. New Securities Offered for Cash Sale in the United States

IX. Special Offerings on the New York Stock Exchange

X. Excerpt from Prospectus of Gulf Interstate Gas Company

I. INTRODUCTION

The development of the productive potential of the United States has been rapid and encompassing. It has been rapid because slightly more than three hundred years have passed since the first settlers arrived from Europe and established an economy, though elementary, based on the premises of trading. The encompassing feature of this development has been the harmonious, if turbulent, growth of all phases of the economy in the ratios necessary to produce the present day goliath of American industry. As the population increased, the farm-lands expanded and provided the food needed. The trading centers developed into industrial areas. And small banking houses merged and grew into an efficient and complex securities mart.

The securities exchanges and trading machinery of the money market act as the co-ordinators and transmitters of financial resources to the economic body of industry. They provide funds to industry seeking to sell securities. They satisfy the needs of investors by offering securities as a means of employing funds. They are a focal point for satisfying the supply and demand for capital. Except for brief periods, the industries of the nation have had a continuing need for the influx of new moneys into their

businesses. The main reason for this has been the always increasing demand for products and services. Funds are required for the establishment of new businesses to satisfy demand for present products or to keep step with technological advances. Capital funds are also sought by established firms to meet the requirements of normal expansion as the result of growth and the never-ending search for new markets and outlets. Or the funds may be needed to meet an emergency type of expenditure such as adaptation to a new process which has made the present methods obsolete. Operating funds for the financing of receivables, inventories, and corporation indebtedness are needed periodically and annually by business.

The function of the securities markets in supplying these funds through a means of offering corporate securities to the public and attracting buyers who seek the investment of their funds is vital. Any influence upon the free play of this supply and demand, even if only slight, will reflect itself upon the national industrial finances.

There have been various influences upon the securities market, some private, some governmental. The private influences have been fostered in the past by a man or group of men by means of various manipulative practices intended to adjust the price of securities for the benefit of the individuals involved directly, or for the benefit of the security itself at the time of its initial flotation.

Governmental influences have been at two levels, the state level and the federal level and have been primarily intended to reduce the effects of manipulative practices and to protect the investor. Influence at the state level is usually of the punitive type providing penalties after the wrong-doing has occurred. Some states have laws which are preventive in nature requiring registration and approval of the security to be sold and/or the dealers engaged in selling before sale or practice within the state borders.

The Federal Government's influence is both preventive and punitive in that its' regulations are intended to eliminate or reduce to a minimum the use of manipulative practices and frauds and at the same time provide penalties for violations of the regulations.

The presence of influence on the money market, either through private practices of individuals or groups, or through governmental regulation indicates indirect influence, of some degree, on the total economy because of the dependency of business on the influx of new funds. The cost to the corporations for obtaining funds will be affected by fluctuations in price which are hazardous enough in themselves without the possibility of artificial fluctuations. The ability to issue new or additional securities will be affected by regulations as to methods of offering securities. The actual movement and volume of capital in the money market may be slowed or accelerated by use of

regulations.

The Securities Exchange Act of 1934 is a sequel and natural corollary to The Securities Act of 1933 since it regulates the Exchanges, Dealers and Over-The-Counter markets and, through these elements, those securities not regulated by the Securities Act of 1933 which confines itself to regulating new issues only. These two Acts to-gether, but the Securities Exchange Act of 1934 in particular, have exercised great control and influence upon securities trading and practices.

The effects of this control and influence have been difficult to appraise in the years following their enactment because of world-wide economic and political ex-tremes. Both Acts were inaugurated during a period of financial depression when the supply and demand for invested funds was at a low ebb. The movement of capital funds was slow and conservative. This situation existed for several years and was followed by World War II which increased the need for capital funds very rapidly to keep pace with the enormously expanded productive activity for war goods. Since World War II, inflation and the Korean Crisis have served to cloud the basic effects of the regulations. But the period for 1946 to date, though of a "Boom" type of economy, serves best to indicate the influence and control exercised over the money markets by Federal Regulation.

There is no doubt of the presence of influence by these Acts. The question is whether this influence and control by governmental regulations is more beneficial than harmful, or otherwise. The purpose of this discussion is to examine the methods employed by the Federal Government in exercising control of the securities markets and evaluate the measurable effects of this regulation.

II. Historical Background of the Securities Markets in the United States

A. Early Trading Arrangements

The exact date of the birth of securities markets is clouded with uncertainty. This is attributed to the fluctuations of both the supply of stocks and bonds available for sale and the demand for investment securities.

Some dealings can be traced to as early as 1725* but "the earliest mention of any definite market for securities in the newspapers is to be found in the "Diary, or Loudon's Register," published in New York in March, 1792. A brief item on that date indicated that dealers in stocks met each noon at 22 Wall Street; sales were conducted on a joint arrangement of auctioneers and dealers."*

Up to this period financing of businesses and of governments was done by groups of wealthy men either singly or banded to-gether and the projects involved were of a size not to require the vast sums which would lead to public offerings of the type later to be introduced.

The flotation of eighty million dollars of United States Government bonds by the First Congress (1789-1791)

---

* 5, P. 77 et seq.

to consolidate and refund the Revolutionary War debts, both Federal and State, established financial confidence in the new government and also indicated the need for a securities exchange for offerings and sales. Many other government bonds (public stock) were issued and shares of bank stocks were available.

Securities brokers and commodity dealers had worked together up to this time and there was no separate securities market until speculation in government securities began in 1790. The securities brokers began trading among themselves under a buttonwood tree at 68 Wall Street. Auctioneers sold the stock. Trading in securities was active by the time of Washington's inauguration and by 1791, stock quotations were printed regularly in the New York newspapers. By 1792, the use of auctioneers to sell the stock was not satisfactory and a group of brokers joined to-gether for the first time and signed an agreement (called "The Buttonwood Tree Agreement") mutually pledging each other

> that we will not buy or sell from this day, for any person whatsoever, any kind of Public Stock, at a less rate than one quarter of one percent commission on the specie value and that we will give a preference to each other in our negotiations.#

7, P. 1 et seq.

This agreement proved practical, and sufficient order was established to operate the securities market of that day. The volume of securities available was small and public interest, as we know it to-day, was not present. The New York Commercial Advertiser on March 10, 1815 carried a complete list of twenty-four stocks, all government securities and bank issues except for one manufacturing company. The few stocks issued were to finance banks, insurance companies, canals, turnpikes, toll bridges and water companies.

An expansion of volume began after the War of 1812. New banks, new marine and fire insurance companies were formed. New York City and New York State issued bonds; and U. S. Government bonds increased from forty-five millions in 1812 to 123 millions in 1817. "The opening of the Erie Canal, whereby western trade was directed through New York City, brought about a concentration of funds in this city."*

B. Formation of the New York Stock Exchange

This increase in volume and the anticipation of even more enlarged activity emphasized the need for a formal, organized exchange with a constitution and definitive rules. And, in 1817, following the suggestions of a delegate they had sent to Philadelphia to study the workings of that city's exchange, which had been operating since 1790, the New York

---

* 7, ibid.

brokers organized themselves along the lines of the Philadelphia exchange. Their name was the "New York Stock and Exchange Board". A president and a secretary were elected whose duties were to keep a list of securities offered, bid, and sold; impose fines for non-attendance and for offenses in the mechanics of trading. Fictitious transactions (wash sales) were prohibited under penalty of expulsion from the Exchange. Commissions were established at 1/4 of 1 °/o to 1/2 of 1 °/o and fines (dues) of $10 per year were voted.

Trading became more regular; a steady market in securities was developing. The President of the Exchange called the stocks in order. There were now about 30 stocks traded regularly. As an issue was called, the bids and offers were made. Trading started about 11:30 A.M. and continued till about 1 P.M. Contracts were settled by 2:15 P.M. of the day following the date of the transaction. This particular rule was to continue for more than one hundred years.

The Stock Exchange part of the money market was the first to develop during the "heavy borrowing by the states"* in the 1820's and the successful flotation in New York of the Erie Canal bonds.* Shortly after, a money market for call loans from the funds (bankers' balances)

---

* 7, ibid.

finding their way into New York, was established and helped give New York financial leadership.

An additional rule suspending any member who became insolvent until his accounts were settled was adopted in 1820.

The average number of shares traded daily had risen to 100 by May of 1827 and the list included eight government, state and municipal bonds, twelve bank stocks and nineteen marine and fire insurance stocks. Then in 1830 the first railroad stock was introduced on the Exchange, (that of the Mohawk and Hudson). This marked a milestone for the securities market. The rise of railroads required great concentrations of capital and this, in turn, indicated the use of the corporate entity for ownership purposes. Great numbers of railroad shares were traded on the Exchange; in 1838 $175 millions of railroad securities were sold. And this activity had followed on the heels of the Panic of 1837 which resulted from inflation and wild speculation. Many states and banks had defaulted on their obligations and railroads came to be considered the sound investment of the day.

By 1848 the Exchange had 75 members, was holding morning and afternoon sessions and was trading 5000 shares daily.*

---

* 5, P. 77 et seq.

Money became plentiful in the early 1850's because speculation in California was prominent, so much so that an "outside" board was operating in quarters on the floor below the Exchange when the Exchange was closed. But the market crashed and by 1853 the Exchange almost ceased to exist. 1855 brought prosperity again but 1857 showed a sharp decline in the market. During this decline the Exchange showed "marked strength" for though the market in general declined, the listed stocks held up best. Thus giving proof of the value of an organized market and, incidentally, increasing the value of a seat on the Exchange.

The Civil War period brought speculation on a scale unknown to the market up to this time. Four different exchanges were in operation. The increased interest in securities prompted the voting by the Exchange of its first standing committee in 1861. The "Committee on Securities" had for its purpose the obtaining of financial information on the securities listed. It had little success.*

In 1863, a new name, "New York Stock Exchange" was adopted and, with the discovery of oil stocks, the public became interested and speculation was once again rife. An open-air exchange, the fore-runner of the New York Curb Exchange operated in those hours when the New York Stock Exchange was closed. "The Exchange suffered from two serious

---

* 7, ibid.

defects in the Civil War Period: (1) its failure to provide a continuous market, and (2) its lack of effective administrative organization".*

After the Civil War, the financial power passed from speculative capitalists into the hands of investment bankers. The New York Stock Exchange and the Open Board of Stock Brokers (founded in 1864) worked together to curb overissuance of stock which was common in 1868-1869. In 1869, these two organizations and the Government Bond Department (specialists in government bonds only) merged. The new organization, still known as the New York Stock Exchange, adopted many needed regulations; one of them being listing rules requiring transfer agents and registrars to avoid over-issuance of stocks. There was a total of 1060 seats and a Governing Committee with executive, legislative and judicial powers. The membership was unchanged till 1879 when it was increased to 1100 seats where it remained till 1929.

During the Panic of 1873 the Exchange was closed for twelve days. (The Exchange had been closed for one week in 1835 because of fire.) The volume of shares traded continued to increase. From 1875 to 1879 there were 51 million shares traded annually and increased to 104 millions in the next five years. By 1901 the annual stock volume was 265

---

* 5, <u>ibid.</u>

million shares and the annual bond volume was almost one billion dollars.

This expansion over a little more than twenty-five years was largely credited to the increased use of the corporate entity, the continued growth of the railroads and the emergence of manufacturing concerns in the securities markets. Assisting the mechanics of trading, the stock ticker came into use in 1867, the telephone in 1878 and the electric annunciator board in 1881.

C. Development of Markets and Interest in Securities

By the turn of the century, the securities market presented an active picture of an organized, professional business. Of the issues traded, government and state issues had faded from their early prominence, municipals had gained in stature, railroads continued strong and popular, some utility companies were available, but there were still very little business firm securities on the market. The public was becoming interested in securities investment but the market was still a professional one when World War I began. Stock ownership was not wide-spread. In 1901, American Tel. and Tel. had 8000 stockholders, U.S.Steel had 14,000. As late as 1920 Standard Oil of New Jersey had 8300 stockholders and in 1922, Du Pont had a mere 2800 stockholders.

But, interest was sufficient for the government to cast an occasional glance at the activities of the money mart. In 1909, the Hughes committee, sponsored by the State of New York, found that speculation "is a necessary incident of productive operations" and "when carried on in connection with either commodities or securities it tends to steady their prices". The questions of manipulative practices and protection of the public interest were beginning to appear. In 1910 the Stock Exchange adopted some reforms abolishing its unlisted trading department, prohibiting members from dealing with bucket shops, and authorizing the Law Committee to investigate the dealings of members. By 1913, the Pujo Committee of the Federal Government recommended that exchanges be incorporated under state law, a margin requirement of at least 20 % and the submission of full reports from corporations requesting listings on exchanges.#

By 1914 the New York Stock Exchange listed 511 stocks totaling 150 million shares and 1082 bonds; the New York Times was carrying two pages of financial news and one column of stock quotations when World War I began. "One important effect of the war was the great public participation in government bond buying."# The public became security conscious. "Before the war it was estimated that

---

7, <u>ibid.</u>
5, <u>ibid.</u>

that there were only 200,000 security owners in the country; afterward, there were 20 million, including those who owned government bonds". # The new phase of securities activity with huge volume of sales and intense public interest was beginning.

With all this expansion, the volume of trading on the Exchange grew rapidly as the public entered the market in greater and greater numbers. Never had brokers had so many customers; never had the trading floor witnessed such activity. From an annual volume of 171 million shares in 1921, trading rose to 450 million in 1925 and 1926, 920 million in 1928 and 1.1 billion in 1929. Brokers' loans were up to $8,549 million. Probably a million Americans were carrying 300 million shares on margin.

Then, out of a cloudless sky came destruction. On Wednesday, October 23, 1929, the market cracked. On a 6 million share volume the New York Times industrial average dropped 31 points. On the next day the market dropped again as the ticker ran hours behind on a record total of 12,895,000 shares. On October 28 the industrial average fell another 49 points, followed by 43 points on the 29th, when 16,400,000 shares changed hands. The New Era was over; the New Deal was four years away.

From 1929 to mid-1932, the market melted away as

5, ibid.

security values disappeared, and the country slid into its longest and worst depression. The Dow-Jones industrial average fell 89 percent. The listed value of stocks on the Exchange slumped from $89.7 to $15.6 billion. United States Steel dropped from 262 to 21; American Telephone from 310 to 70; New York Central from 256 to 9; General Motors from 92 to 7 and Radio Corporation from 115 to 3. Seldom in all its turbulent history had gloom been so impenetrable as in Wall Street. Grave troubles, however, were still ahead. The New Deal was voted into office in the fall of 1932.[77]

---

[77] 5, ibid.

III. Reasons and Needs for Regulation

A. Protection of the Public Interest

Governmental regulation of securities and securities trading has long been urged for the protection of the public's money, the obtaining of complete information on the issues offered for sale, and for the prevention of manipulative practices. But, the fear of upsetting the balance of the free play of supply and demand, and the desire of the individual (broker or buyer) to manage his own affairs unencumbered by regulations, had served to retard the enactment of legislation which is in any way confining. Action in this regard must be given impetus. And the impetus is usually provided by a financial debacle which shakes the confidence of the public in its ability to deal with its problems independent of governmental direction.

The "Bubble Act" of 1720 was enacted in England as a direct result of the financial upset caused by speculation in joint stock companies seeking to profit from trade in the South Seas.# Its provisions were very severe and virtually aimed at the suppression of all joint-stock companies. Subsequent legislation, when the exigencies of the

---

18.

moment had faded, moderated the Act and it was finally repealed in 1825. But the need for rules of organization was still recognized. In 1844, Gladstone's "Special Committee on Joint-Stock Companies" found "that adequate means for knowledge on the part of the investing public was the basic insight drawn".#

In the United States, Mr. (later Mr. Justice) Brandeis

> made an impressive analysis (in 1913) of the workings of our financial resources and of the traps and pitfalls that beset the investor. He reminded his readers of the legislative advances already made in England. (Companies Acts of 1844, 1867 and 1900) But in calling for full and complete disclosure in the intricate business of marketing securities, his was a voice in the wilderness.#

Legislation in the security field is usually sparked by two causes. The first is the lack of knowledge by the investing public. This is due in part, to the unavailability of financial data concerning the securities, and in greater measure to a void in the education of the average man in the understanding and analysis of what financial information is available. The public is not well versed in investment technology.

The other cause is the attitude and conduct of the "professionals" in the field. By its nature, the securities business, requiring a thorough-going technique

---

18.

of analysis and investigation of the issues offered for sale, is highly specialized. In such a business, the ethics of the dealers are an essential part in maintaining the confidence of the public. Their advice must be based on careful analysis of the facts and not clouded by the optimism or pessimism of the moment. After the 1929 crash, it was felt that the dealers had not husbanded this trust and confidence in the highest ethical manner. Even respectable banking houses were not too careful of the merits of the security recommended. "The unregulated practices of distributing securities led to such permeating mischief that federal legislation became inevitable."#

> The ominous history of recent years aroused strong feeling in Congress that those responsible for financial representations ought to be obliged to act at their peril, since they were in a position to verify their statements and the innocent investor was not.##

B. Manipulative Practices

Manipulation of securities prices was widespread prior to Federal regulations. And in many circles, it was recognized as acceptable business practice.

> Manipulation is an artificial control of security prices; it is an attempt to force

---

4, P.374-397.
18.

> securities to sell at prices either above or below those which would exist as a result of the normal operations of supply and demand. The manipulator hopes to profit by creating fictitious prices at the expense of the general trading public.#

The manipulator has one of three purposes: (1) to raise the price of a security and then sell, (2) to stabilize the price, which usually results in the security selling at a better price than otherwise, or (3) to force the price down with the intention of buying at the depressed price. The second purpose --stabilizing the price-- is usually practiced at the initial flotation of a new security when its true worth has not been tested in the securities market and has a certain amount of economic justification. It remains today as the one reason for price stabilization that the Securities and Exchange Commission will accept, provided the public is informed of the practice or its contemplation.

There are many means for adjusting the market price of a security. The most common general classifications are:

1) Wash sales -- where one broker sells and another buys the same security as agreed, with the purpose of establishing a fictitious price either to create a profit opportunity or to establish a loss, generally for tax purposes.

2) Corners -- "a corner is a speculative situation

#5, P.312 et seq.

in which the ownership of outstanding shares becomes so concentrated that short sellers are unable to secure stock except from this owner group."# The market price is completely in control of this group.

3) Pool operations --"a pool is a temporary association of two or more individuals to act jointly in a security operation of a manipulative character."# "In 1929, 107 stock issues of the larger exchange (New York Stock Exchange) were manipulated one or more times by pools in which members of the Exchange were interested."##

The use of publicity as a means for influencing prices was also common. Issuing "news leaks" with reference to dividend policy, new products, mergers, stock splits and other data relating to a corporation's financial policies may stimulate artificial market activity. This will result in "churning" --much buying and selling intended to step up the volume of sales.

> Especially since the War (World War I), under cloak of disinterested information, tipsters' sheets and other publications, while not purporting to offer securities for sale gave opinions that were bought and paid for. ..... Now, that gratuities for puffing publications must be disclosed, certain news items about securities may, in the future, not synchronize with the unloading maneuvers of pool managers.###

#5, *ibid.*
33, p.32.
###18.

C. Use of Credit

The use of credit in the purchase and sale of securities has contributed to the various reasons for governmental regulation. Credit is extended to investors by brokers through the employment of "margin purchasing". The purchaser pays a portion of the market price and the balance of the price is loaned to the purchaser by the brokerage house which obtains the funds usually by pledging the securities purchased with a bank for a collateral loan. The purchaser's borrowing is called "margin". The broker's borrowing is called "broker's loans". The purchaser secures his margin by pledging the security he has bought with his cash plus margin. The broker uses the same security as collateral for his broker's loan. Thus the same security is used as collateral in two different loan transactions. And any future action may ignite a chain reaction. If the bank should call the broker's loan (and it is usually callable on 24 hours notice), then the broker may in turn call the margin loan or at least, ask for additional collateral. If the margin originally granted is low (in 1929 it went as low as 25-20 percent, even 10 percent in some cases), the purchaser may find it difficult to provide the funds requested and may be forced to sell in an unfavorable market in order to cover. The relationship between margin

and broker's loans is an acknowledged fact and in the aggregate might be considered an over-extension of credit. The great advantage of margin buying is the improved position of the buyer to obtain more securities for a given sum of money and thus increase his chances for profit and investment capital. The great disadvantage of margin buying is the problem of being requested for additional margin at an inconvenient moment in the fluctuations of the market. And calls for additional margin usually occur in a period of declining markets which enhance the distress and might result in panic selling. This would contribute to the disorderliness of the market and force further decline in prices.

The use of margin in the purchase of securities has been customary in the securities market. Prior to 1914, it was probably about 10 percent on the average. It rose to about 20 percent to 25 percent of the value of the collateral by 1929 though some firms allowed trading on smaller margins. Opinion has been divided on the need for controlling margin extension. In 1909, the "Report of the Hughes Commission" on the stock market recommended 20 percent margin. But--"An insistence by the broker on a 20 percent margin would be silly and would merely drive the business elsewhere or prevent it altogether" was an opinion stated in 1914.# And the decline of the Dow-Jones

---

5, ibid.

industrial average from 381.17 in 1929 to 41.22 in 1932 is partially attributed to the calling of margin. "Unquestionably, liquidation of margin loans accentuated this decline."# Prior to the Securities Exchange Act of 1934 credit extended by a member firm of the New York Stock Exchange was regulated by (1) the minimum maintenance requirements of the New York Stock Exchange which was 30 percent of the debit balance as at the present time and (2) the policy of the particular firm (which was usually higher than the Exchange requirements). But there was no uniform policy for all firms nor was one policy maintained constantly by an individual firm. As the optimism of the moment was infectious, the margin requirements decreased. The fact that in 1929 broker's loans exceeded 8 billion dollars is an indication of the amount of margin purchases in existence at that time. Though, as a rule, brokers and dealers have attempted to maintain conservative margin requirements, the lack of uniformity in the requirements and their application, along with the tenor of the times demanding as many safeguards as possible for the investing public pointed the way to government regulation of credit in the securities market.

1, p.240 et seq.

D. Financial Information

The availability and analysis of the financial data concerning a security and the organization for which it is offered is so fundamental a requirement for intelligent investing that one wonders how a securities market could function without this knowledge. Yet, the paucity of information of a financial and statistical nature has long been a weakness in investment circles. In 1844 the "Select Committee on Joint Stock Companies" with Gladstone as chairman found that "periodical accounts honestly made and fairly audited.....The early publication, resulting from registration of...prospectuses and circulars will doubtless be useful in controlling....undertakings at their outset."#= The Companies Act of 1844 required registration of prospectuses but did not require complete disclosure of all relevant facts. Then the Companies Act of 1867 required that the prospectus had to disclose every contract made previous to the issue of the prospectus but subscribers could waive compliance. Finally the Companies Act of 1900 required thoroughgoing specific disclosures duly defined in the Act, and without the right of waiver of compliance.

In the United States, accountants were concerned

#= 18.

with the abuse of audits by promoters in selling securities through the mails in 1912.# And the scantiness of available information was cited in 1915 by the New York Public Service Commission "....In fact, it is in many cases literally impossible to secure any information whatever from the records of the corporation as to the amount of existing physical property prior to the time the filing of these reports was required."##

This lack of reliable information can be attributed to two causes: (1) The reluctance of business firms to publicize their financial status considering this information strictly private and not available to the public, and (2) The lack of any legal requirement that such information be made available to the public. At the time of the 1929 crash, few companies published annual statements or were interested in public opinion on this point. The information offered on tip-sheets and in many brokers offices was sparse, incomplete and, on occasion, misleading. Availability of information was at a minimum and that available was questionable. The New York Stock Exchange had proposed the submission of annual and periodic financial statements but with little success. It remained for the Federal Securities Acts to define and require information which could be relied upon.

20.
21.

IV. Regulations

A. State Blue Sky Laws

Regulation of securities;..their issuance and trading; and the regulation of those persons dealing in the securities..began at the state level about a century ago when the states attempted to control the stock and bond issues of common carriers. But, the regulation as we know it today, for the protection of the public by controlling fraud and manipulation was not present until# Kansas in 1911 was stirred to action after fraudulent dealings were revealed in the trading of oil stocks and leases. This was the beginning of many "Blue Sky" laws till today forty-seven states, Nevada alone excepted, have some type of law regulating securities or the persons dealing in securities. The name, "Blue Sky" springs from a judge's biting remark about "speculative schemes that have no more basis than so many feet of blue sky".##

The "Blue Sky" laws are both preventive and punitive in nature but the emphasis has usually been placed on the latter. They are of three general types, the

---

Rhode Island in 1910 enacted legislation primarily for the protection of investors.
5, Hall vs Geiger-Jones, 242 U.S. 539.

various states concentrating on one type or merging two or more types in their laws:

1. Fraud statutes..(such states as New Jersey, Delaware and New York rely entirely upon this type).. state that deceptive, fraudulent or prohibited practices may be stopped by injunction or petition for receivership, and prosecution of individuals considered to be guilty of fraudulent acts.

2. Statutes requiring registration or licensing of brokers, agents and salesmen before they may transact business within the state borders. These statutes are intended to verify the moral and ethical reputation of the men and firms involved; and also to elicit from them an intention to conduct themselves in accordance with state law and high professional ethics.

3. Statutes requiring registration of securities to be sold within the state's borders. These laws seek to obtain the filing of pertinent information concerning the securities to be traded and organizations which are issuing or have issued the securities.

Of the forty-seven states which sponsor Blue Sky laws we find various and varying types of restrictions. Five states use the anti-fraud laws and seek to prevent fraud and punish violators. They place emphasis on detection, prevention and punishment of fraudulent acts but in some

cases also require registration of brokers and dealers, and licensing of salesmen. In all, thirty-nine require registration of dealers and brokers seeking evidence of good reputation and financial responsibility. Twenty-one states also require bonding ranging from $5000 to $25,000 per man. Forty-two states require licensing of all salesman and others actively engaged in the securities business while six states require all salesmen be bonded. The qualifications for registration or licensing very but all states seek to prevent individuals with questionable or criminal records from selling securities. And forty-two states require that securities be registered before they are offered for sale. Some states require detailed applications while others are satisfied with the mere filing of intention to sell accompanied by the prospectus. Some states prohibit offerings before approval of the application is made, while others grant automatic approval with the receipt of the application.#

But state regulation of securities trading and related matters was limited in effectiveness. The most obvious limitation is that described above-- the differences in the various states' laws and consequently the relative ease of evasion. The problem of state sovereignty in administration of the laws and the ability to evade state authority by operating on a purely inter-state basis are apparent. Also, in many jurisdictions there was a sketchiness

---

1, P. 198 et seq.

or positive lack of adequate protective laws. Promoters could persuade many individuals to forego prosecution by refunding a part of the purchase price, and thus permit conditions of a questionable character to exist for lack of complainants. The generous exemptions and exceptions to regulations granted by various states further complicated the functioning of the statutes.

The glaring weakness in state legislation of securities is pointed up in the U.S. Supreme Court decision of 1917 declaring such legislation constitutional but further stating that if the mails or other instrumentalities of interstate commerce were used in selling securities from outside the states to persons within the state, such transactions could not be effectively regulated by the state. This was the loop-hole, as broad as a superhighway, through which securities and those trading in securities who sought to avoid legislation could operate with complete freedom. The Mail Fraud Act of 1909 forbade the use of the mails to defraud but was not designed specifically to regulate sales of securities and required the filing of a complaint by the defrauded victim before investigation and prosecution could be considered.

What was the glaring weakness in state regulation of securities was to become the bastion of strength in Federal Legislation; the lever which was to accomplish the effective administration of the Securities Act of 1933 and

the Securities Exchange Act of 1934.

B. Goal of the Federal Government

It was during the decade of the 20's that the need for uniformity in rules of securities trading was most greatly emphasized, not by the creation of such rules, but by the workings of the securities markets unrestrained by any regulations of an encompassing character. We have considered the temper of public opinion following the "crash" of 1929 and the desire to protect the investor through government regulation. The manipulative practices employed during that period have been examined. The use of margin as a credit instrument and the need for complete and accurate financial information about the securities on the market have been weighed. The total influence of these factors had prepared the background and on March 29, 1933 President Franklin D. Roosevelt in the following message to Congress articulated the desire and goal of the Government with reference to securities control:

> To the Congress: I recommend to the Congress legislation for Federal supervision of traffic in investment securities in interstate commerce.
>
> Of course, the Federal Government can not and should not take any action which might be construed as approving or guaranteeing the newly issued securities are sound in the sense that their value will be maintained or

that the properties which they represent will earn profit.

There is, however, an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public.

This proposal adds to the ancient rule of "caveat emptor" the further doctrine of "let the seller beware". It puts the burden of telling the whole truth on the seller. It should give impetus to honest dealing in securities and thereby bring back public confidence.

The purpose of the legislation I suggest is to protect the public with the least possible interference to honest business.

This is but one step in our broad purpose of protecting investors and depositors. It should be followed by legislation relating to the better supervision of the purchase and sale all property dealt in on exchanges, and by legislation to correct unethical and unsafe practices on the part of officers and directors of banks and other corporations.

What we seek is a return to a clearer understanding of the ancient truth that those who manage banks, corporations, and other agencies handling or using other people's money are trustees acting for others.#

In the above statement we find the goal and moving force of federal legislation in the ensuing years... "supervision of traffic investment securities in interstate commerce" to "provide full publicity and information,".... "give impetus to honest dealing"..."with the least possible

---

6, P.20-21.

interference"..."protecting investors and depositors"; legislate "better supervision of the purchase and sale of all property dealt in on exchanges"...; "correct unethical and unsafe practices" and seek "a return to a clearer understanding....that those...using other people's money are trustees....".

The aim was not only to establish the mechanics of good business through publicity, information and supervision but also to revitalize the ethical thinking of the day. "The real needs are the building up of new business habits and the generation of a new moral climate for business."#

These needs were all-inclusive and applied to all phases of economic activity, not alone to the securities market as Leffler points out so clearly:

> Let no one be too hasty in condemning the securities market and the speculators who engaged in manipulation in the market, it is well to consider that ethics in all social activities during the same period of 75 years were of an equally low state; for example the insurance scandals, bootlegging, land grabbing, timber theiving, the baseball scandals, the political spoils system, the Teapot Dome scandal, war profiteering, draft dodging, patent medicine frauds, sales of impure foods, corrupt political machines, misleading advertising, child labor exploitation, sweat shop manufacturing, unfair trade practices of the trusts, and

---

5, P.312 et seq.

bribery of legislators -- to mention only
a few examples that come readily to mind.#

And, though other phases of the national economy were to become the interest of government legislation, the securities business was the first to receive attention. The Senate Investigation of 1933-1934 under the Senate Committee on Banking and Currency made an exhaustive study which consumed seventeen months with testimony from many witnesses which filled twenty volumes. Many irregularities, questionable practices and, in some cases, fraudulent acts were unearthed by this group.

The justification for legislation of the securities business had been established and many experts in the field concurred with the committee findings. The government now passed a series of Acts intended to accomplish its goal. This control was sought through one main channel--that the securities business was, in the main, a subject of interstate commerce and so came under the jurisdiction of the Federal Government. This was the keystone upon which the Acts were based. Regulation was sought to define four elements--- persons- such as brokers, dealers, and salesmen

--- places - the exchanges

--- things - the securities themselves

--- credit - in the purchase of securities.

5, P.312 et seq.

Of the several Acts passed, two most directly accomplished the control of these four elements. The Securities Act of 1933 effectively controled the new issue of securities not presently on the market. The Securities Exchange Act of 1934 regulated the Exchanges and through the Exchanges the brokers, dealers and salesmen, and the securities traded on the exchanges in addition to authorizing the Federal Reserve Board to regulate margin requirements (credit).

C. The Securities Exchange Act of 1934

1. Purpose

The Securities Exchange Act of 1934 stated as its first purpose that it sought to regulate securities exchanges and over-the-counter markets in order to prevent inequitable and unfair practices. It also sought appropriate reports of the activities and policies of officers and directors in matters related to securities traded. Protection of interstate commerce, of the national credit, of the Federal taxing power, of the national banking system and the Federal Reserve System were included in the scope of the Act.

The Congress emphasized, as the basis for its action that securities transactions are in large part interstate transactions using the mails and instrumentalities of interstate commerce and as such cannot be properly regulated at the State level of legislation. Also the use of credit in securities transactions can have a direct effect on the finances and volume of trade, industry and transportation engaged in interstate commerce.

The susceptibility of securities prices to manipulation and control was a concern of Congress because of the possible effect which might be felt by the nation's

economy in times of unemployment and dislocations of the business community.

2. <u>Securities and Exchange Commission</u>

To implement these purposes and to administer the dicta of the Act, the Congress established the Securities and Exchange Commission consisting of five men appointed by the President by and with the advice and consent of the Senate.

3. <u>Registration of National Securities Exchanges</u>

The act forbade brokers, dealers or exchanges the use of the mails or any instrumentality of interstate commerce unless they registered with the Securities and Exchange Commission, or were exempted from registration. Exemption was granted to certain exchanges when it was shown that the volume of business they transacted was so limited as to have no appreciable or measurable effect on the national economy.

Registration by an exchange was accomplished by filing a registration application with the commission which includes the following:

1. an agreement to abide by and enforce the provisions of this Act.

2. information as to the organization, procedural rules and membership of the exchange as the Commission may

require.

3. Copies of its constitution, articles of incorporation with all amendments, and existing by-laws and an agreement to forward to the Commission copies of any future amendment that may be adopted.

The rules of the exchange must provide the exchange with power to take punitive action (expulsion, suspension or discipline) against a member whose conduct violates just and equitable principles of trade. Also, the rules of the exchange must state specifically that violations of this Act will be considered violations of exchange rules.

The exchange may regulate itself with any other rules it deems necessary which are not inconsistent with this Act or the laws of the State of its domicile.

4. Margin Requirements

The Act authorizes the Federal Reserve Board to fix the amount of credit (margin) allowed initially and subsequently to be maintained on any security registered on a national securities exchange. The Board is given broad powers in raising and lowering margin requirements under various economic and individual circumstances.

Extensions or maintaining credit or arranging for such action is unlawful for any member of a national securities exchange or anyone dealing through such a member

if the activity violates any rule of the Board. Credit arranged without collateral or with securities not registered or exempted is not allowed except for limited purposes under Board rules. These requirements are further broadened to include any extension or maintaining of credit in securities listed on a national securities exchange in contravention of such rules as may be issued by the Federal Reserve Board except those securities which are specifically exempted from these rules.

5. Restrictions on Borrowing by Members, Brokers and Dealers

Members of a national securities exchange may borrow on any registered security only from a member bank of the Federal Reserve System or from a bank which has agreed to subscribe to Federal Reserve Board rules. They may not allow their aggregate indebtedness, including customers' credit balances but excluding indebtedness secured by exempted securities to exceed that percentage of the net capital employed in the business (but not exceeding 2000 per centum) as the Commission may prescribe.

A member firm may not hypothecate a customers' securities in a way that would result in the securities being commingled with other customer's securities without written consent of the customer involved. Further, a customer's securities may not be commingled with those of

someone not in a similar status (i.e.- a partner of the firm). Nor can the customer's securities be hypothecated for a sum in excess of the customer's indebtedness to the broker in relation to the securities. And, finally, the firm may not loan out the securities without the written consent of the customer.

6. Regulations Against Manipulation

The Act declares as unlawful any attempt to use the mails or any means or instrumentality of interstate commerce for the purpose of creating a false or misleading appearance of active trading in any registered security. For a transaction to be legal there must have been a true change of beneficial ownership. Orders to purchase or to sell securities placed with the prior knowledge that corresponding orders to sell or purchase will be forthcoming are illegal since they do not represent the true picture of the supply and demand of a given security.

Pool operations of groups of individuals or firms seeking to set a price of a security are forbidden. Circulating information that a security is likely to rise or fall in price because of market operations with the intent of adjusting the price prior to buying or selling the security involved is not permitted for brokers or dealers in that security. And, of course, no broker or dealer in a

security may make a false or misleading statement concerning a material fact about the security. Nor, may anyone, for a consideration, disseminate information about the probable rise or fall of a security price due to market operations. Attempting to peg, fix, or stabilize a security price on the market through the use of a series of purchases and sales by an individual or group may not be done except within the rules of the Commission.

The Act empowers the Commission to control, by appropriate rules, transactions dealing in puts, calls, straddles, or other options to buy or to sell without binding the parties concerned to complete the transaction. Also, the endorsement or guarantee of any put, call, straddle or other option may not be made by a member of a national securities exchange in violation of any rule of the Commission. Any person violating any rules of the Commission in this regard is liable to the opposite party in the transaction for damages. But none of the above provisions apply to exempted securities.

a) Manipulative Devices. The Act specifically declares as unlawful the use of any manipulative or deceptive device which contravenes the rules of the Commission. And also declares short sales or stop-loss orders illegal if employed in contravention of Commission rules.

7. Segregation and Limitation of Functions of Members, Brokers and Dealers

In this section of the Act, the Commission receives authority to regulate trading by members of national securities exchanges for their own accounts or for discretionary accounts both on the floor and off the floor either by preventing, limiting or exempting such transactions as it deems best in the public interest. The Act also requires that members register as odd-lot dealers or as specialists if such they are. Further, disclosing information as to orders placed with a specialist is unlawful when that information is not made available to all members of the exchange. But the power to require such disclosure is reserved to the Commission. Any transaction effected by a specialist must be done on a market or limited price order. Exemption to these rules may be granted at the discretion of the Commission.

It is unlawful for a national securities exchange member to effect a transaction in which he extends credit on any security which was a part of a new issue in the distribution of which he participated as a member of a selling syndicate or group within six months prior to such transaction or to effect any transaction (other than in an exempted security) without specifying his status either as acting as a dealer for his own account, as a broker for such customer, or as a broker for some other person.

8. Registration Requirements for Securities

In order for a member to trade a security on a national securities exchange, that security must have been registered with the exchange and the Securities and Exchange Commission. This is accomplished by filing an application with the exchange which, if it approves the application, certifies this approval to the Securities and Exchange Commission along with such duplicates of the application as the Commission may require.

The application must include such information as the Commission may indicate with reference to the issuer and any person directly or indirectly in a position to be interested in a controlling manner in the security. The information must indicate the nature of the business, its organization and financial structure; the status of present securities outstanding in regard to rights and privileges; the terms on which the company has offered its securities to the public in the preceding three years and under which it plans presently to offer its securities; listings of any directors, officers, underwriters, and security holders of record holding more than 10 percentum of any class of any equity security of the issuer (other than an exempted security), their remuneration, and interests in the issuer's securities, and their material contracts with the issuer or anyone directly or indirectly connected with the issuer;

any remuneration in excess of $20,000 per year paid to others than directors and officers; bonus and profit-sharing arrangements; management and service of contracts; any existing or potential options in regard to the company's securities. The application must include balance sheets and profit and loss statements for the preceding three years certified by independent public accountants and any additional financial statements or data which the Commission may deem necessary.

The Securities and Exchange Commission may also require copies of articles of incorporation, bylaws, trust indentures, underwriting arrangements, voting trust agreements and other documents to be submitted in the public interest.

Abridgements and substitutions for the above information may be made at the discretion of the Commission.

The registration of a security becomes effective thirty days after certification by the exchange to the Securities and Exchange Commission of its acceptance of the security for listing and registration.

In addition to the registered securities which are listed on a national securities exchange, unlisted trading privileges may be extended to any security listed on another exchange for as long as the security remains listed with the other exchange; and to any security duly registered under the Securities Act of 1933; and to any

security which was in an unlisted trading status on the exchange prior to March 1, 1934. Unlisted trading privileges may be extended only after appropriate notice and opportunity for hearing when there is evidenced sufficient interest in terms of public trading and widespread public distribution of the security in the vicinity to warrant the extension of unlisted trading privileges. The responsibility and liability of officers, directors and beneficial owners will be the same for securities which are duly listed and for those traded in an unlisted status. Publication of quotations of prices must clearly indicate quotes on listed securities and on unlisted securities.

9. Periodical and Other Reports

Information on registered securities must be maintained current by the company's submission of annual reports certified by independent public accountants to the exchange with copies to the Securities and Exchange Commission. Other information and data necessary for current maintenance of the application must be submitted as the need arises.

10. Proxies

Proxies, both their solicitation and their granting, must be obtained in the manner and under the rules

of the Securities and Exchange Commission.

11. Over-the-Counter Markets

The previous sections of the Securities Exchange Act of 1934 regulated the national securities exchanges, their members and the securities traded thereon, both listed and unlisted. This section seeks the control of those securities not traded on the national securities exchanges by requiring registration of all brokers and dealers trading "over-the-counter". The application must contain such information as the Commission may indicate it needs to establish the moral and ethical reputation of the applicant and usually becomes effective within thirty days of the filing of the application unless the Commission denies registration. Registration may be denied if the Commission finds that the applicant has made any false of misleading statement in regard to any material fact in the application; has been convicted within ten years preceding the filing of the application for any felony or misdemeanor involving trading in securities, or has been permanently or temporarily enjoined by legal process from engaging in or continuing any conduct or practice in regard to trading in securities, or has wilfully violated any provision of this act or the Securities Act of 1933.

As with traders in listed securities on the

national securities exchanges, over-the-counter dealers and brokers may not engage in any manipulative, deceptive, or other fraudulent device or contrivance; or make any fictitious quotation; and the rules and regulations of the Commission must be upheld.

The applications for registration must be kept current by submission of any supplementary and periodic data as the Commission may indicate.

This section approves and endorses the establishment of national securities associations for purposes of administering their own affairs in securities trading. The registration statement must contain such information as to organization, membership, rules of procedure, copies of the constitution, charter or articles of incorporation together with bylaws as the Commission may desire.

In order to be registered as a national securities association, an organization must meet certain qualifications. It must be able to comply with the rules and regulations of this Act and to carry out its purposes. This ability must be evidenced through the manner of its organization and its general characteristics along with the number of its members, their geographical distribution and the scope of their transactions. Membership must be open to any broker or dealer, the only restrictions on membership being those dealing with geographic location and type of business, if the association so wishes. The

association may not continue a membership if the broker or dealer has been and is suspended or expelled from a registered securities association or a national securities exchange for violations of rules dealing with just and equitable trading, or whose registration with the Securities and Exchange Commission has been denied or revoked, or who, as an employee or agent for a broker or dealer, was the cause of any suspension, expulsion or disciplinary order. The association's rules must provide fair representation for members in administering its affairs, electing officers, and levying dues. The rules of the association must be so drawn as to prevent fraudulent and manipulative practices, promote just and equitable trading, safeguard against unreasonable profits and rates of commission and other charges, and provide for the protection of the investor and the public interest removing impediments and fostering a free and open market avoiding unfair discrimination. The association must provide for proper disciplinary action for violations of its rules, and a fair and orderly method in judging the acts to be disciplined. All such actions shall be subject to review by the Securities and Exchange Commission. The association may rule that non-members must be quoted the same bid and ask figures as the general public with no preferred treatment being given.

The Commission, in its turn may abrogate any rule of the association, or may suggest rules for adoption.

Suspension of an association by the Commission may result from the association not adhering to the rules of the Act or the Securities and Exchange Commission or not enforcing its own rules.

12. Directors, Officers, and Principal Stockholders

Directors, officers and holders of more than 10 percent of any class of equity in a corporation must file information as to their total holdings in the corporation and any changes as they occur. And any profit made by these people is recoverable by the issuer if the purchase and sale of the security has occured in less than a six months period. Short sales by these individuals is prohibited.

13. Accounts, Reports, and Examinations

This section requires that registrants maintain such accounts and records as the Commission may indicate as necessary; and also render such reports to the Commission as requested. Also the Commission receives the right to make any examination of records of the registrants as it considers necessary to fulfill the rules and regulations of the Act.

14. Misleading Statements

Anyone responsible for the making of false or misleading statements of material fact in any type of document submitted to the Securities and Exchange Commission or its authorized agents is liable to any person who relied upon such statements in the purchase or sale of the security involved, provided that the person considered responsible was in possession of knowledge that the statement was false or misleading at the time of its publication.

15. Powers with Respect to Exchanges and Securities

In order to implement the rules and purposes of the Act, broad punitive and regulatory powers are given the Commission. It may suspend a national securities exchange for periods up to twelve months or it may revoke the exchanges' registration; it may deny, suspend or withdraw the registration of a security; it may suspend or expel any member or officer; and it may suspend trading on any registered security or suspend all trading under various conditions. Finally, if suggestions of the Securities and Exchange Commission as to changes in rules and procedures on a national securities exchange have not been made, the Commission has the power to supplement the rules of that exchange.

16. Liabilities of Controlling Persons

This section makes those in authority and in controlling positions jointly liable with any person under their control who violates the rules of this act with the knowledge of the superior. Also it makes unlawful any violation of the Act through the use of another person and it is further unlawful to hinder, delay or obstruct the rendition of information or data to the Commission.

17. Investigations: Injunctions and Prosecution

The Commission is authorized to make such investigations as it deems necessary to determine if violation of the Act is evident, and may publish, at its discretion, information as to such violations. The Commissioners or their agents may administer oaths and affirmations, subpoena witnesses, take evidence and require such records to be produced as they may desire. The aid of any court in the United States is placed at the disposal of the Commission in the event of non-cooperation of anyone with whom the Commission may be dealing.

Further the Commission may enjoin any acts or practices believed to be in violation of the Act or its rules through the use of the appropriate district court of the United States and issue writs of mandemus as necessary.

18. Information Filed with the Commission

Trade secrets or processes cannot be required by the Commission to be revealed in any application or report filed; and written objection to public disclosure of information filed may be made stating the grounds for such objection. It is unlawful for the Commission to disclose information to other than those associated with the Securities and Exchange Commission, or to use for personal benefit any information which has not been made public.

19. Court Review of Orders

Any order of the Commission may be subject to review by a Circuit Court of Appeals as a last resort after other means of equitable settlement have been exhausted. This courts decision is final subject only to review by the United States Supreme Court if sought.

20. Unlawful Representation

This section emphasizes the neutral position of the Commission in regard to the merits of a security as an investment and declares unlawful any implication or inference as to its endorsement of a security.

21. Penalties

Violations of the Act are punishable up to $10,000 and/or two years in prison and failure to file information or reports as requested is subject to a fine of $100 per day.

D. The New York Stock Exchange

1. Before Federal Legislation of Securities Exchanges

The choice of the New York Stock Exchange for discussion with reference to the rules it sponsored for conducting trading both before and after the advent of the Securities Act of 1934 is based upon the economic pre-eminence of this exchange both in terms of volume and dollars as compared with any other single exchange, or with all other exchanges combined. In the twelve months ended December 31, 1952, the New York Stock Exchange sold four hundred thirty-two thousand (432,000) shares of stock and eight hundred sixty-eight million ($868,000,000) dollars par value of bonds for a total market value of fifteen billion, five hundred thirty one million dollars ($15,531,000,000) as compared to the total sales of all registered exchanges of six hundred twenty-seven thousand (627,000) shares of stock and eight hundred ninety-nine million dollars ($899,000,000) par value of bonds for a total market value of eighteen billion one hundred seventy-eight million dollars ($18,178,000,000).# Similar statistics for the six months ending June 3 , 1953 as shown in Table I also serve to illustrate that the major portion of securities activity on exchanges in the United States is

---

#=Table I--Market Value and Volume of Sales Effected on Securities Exchanges.

conducted through the facilities of the New York Stock Exchange.

Thus, an analysis of the method of operating as used by the New York Stock Exchange both before and after the enactment of the Securities Exchange Act of 1934 will serve to indicate the role played by the established self-governed exchanges in the regulation of the securities market.

As we have mentioned in Chapter II, the New York Stock Exchange was a child of necessity born of a growing need for an established market for trading securities. The early rules of the Exchange were mainly concerned with establishing an orderly market and limiting excess commissions. The mechanics of purchase, sale and delivery were well defined and the rules established were enforced by use of fines. The misleading effects of certain types of mechanical operations were recognized by the Exchange as early as 1817 when it instituted its rules forbidding "wash sales" and other fictitious transactions under threat of expulsion from the Exchange.

With increased volume and activity in securities, the purpose of the Exchange rules broadened from merely maintenance of an orderly market to establishing rules of ethical conduct among members to seeking detailed financial information on the securities traded. The Exchange had established listing requirements in the 1800's asking

information as to corporate structure and stability. It also sought quarterly and annual reports of financial condition from companies whose stocks were listed. Issues of limited size were not listed because the Exchange feared that their size would enhance the possibility of manipulation and "cornering" of the market in specific issues. (Since the enactment of the Securities Exchange Act of 1934, this rule has been relaxed because the Act provides so strongly against cases of manipulation.) In 1926, the Exchange decided not to list common stocks without voting power and followed a general policy that a stock must have adequate public distribution and trading interest in order to be listed. The issues of the larger and stronger domestic corporations were sought and doubtful or highly speculative issues were avoided. Since 1910, the Exchange has not permitted any stock to be traded with unlisted privileges, thus emphasizing its desire that stocks traded meet its established rules.

The ability of the Exchange to enforce the rules it defined varied in the period prior to the enactment of the Securities Exchange Act. Administering and controlling the activities of members was fairly rigid but the obtaining of financial information from listed companies was difficult and that information which was forthcoming was, in the main, too general and broad in scope to afford proper analysis of the security under examination. The presence

of these rules does serve the purpose of indicating that the exchange and its member firms did have a long-standing desire for control of the various facets of security trading both as to mechanics and financial information.

2. <u>After Federal Legislation of Securities Exchanges</u>

The stock market "crash" of 1929 has often been considered as the turning point in the American investment world. Prior to the "crash", the securities market was free of stringent government regulations and was governed only by those rules which the members of the Exchanges voted for their own compliance. The "crash" was the jagged, blinding-white lightning bolt which shoots through the sky just before a torrential rain-storm. It is the immediate percussor of things to come but by no means the first indication. The problems which the Exchange recognized and sought, through its rules, to control-- those of manipulation and fictitious transactions, of listing requirements and adequate information on companies and securities, of ethical conduct of members and responsibility to the investing public-- had been discussed, and debated with some benefit years before 1929 but it remained for the "crash" to highlight and emphasize the need for improvement. Both the public and the professional investment people were in agreement that steps should be taken to insure freedom of the securities market frommanipulation

and provide maximum information on securities. The Senate investigation of 1933-1934 contains much testimony of brokers and other professional investment people as to the state of conditions in the market which these people agreed should be corrected. It was during this year of 1933 that the New York Stock Exchange first required that an independent audit of the financial statements of all listed companies on the Exchange be performed periodically (at least once each year) by certified public accountants. The resulting compliance with this rule indicates the salutary effects of even the discussion of government regulation and the desire of the investment people to perform their own controlling functions in the market.

With the enactment of the Securities Exchange Act of 1934, the organization and functions of stock exchanges in general and the New York Stock Exchange in particular were examined by the Securities And Exchange Commission; and in 1935, the chairman of the Commission suggested to the New York Stock Exchange that a reorganization of its constitution, by-laws, rules of conduct and trading was in order. Opinion of members was divided, many agreeing that the time for reorganizing was at hand and others (called romantically, the "Old Guard") standing firmly by the present rules and methods of operation. Finally on November 23, 1937, Wm. O. Douglas, the chairman of the Securities and Exchange Commission, in a letter to

Exchanges, stated that the Commission felt that reorganization was needed regardless of majority endorsement. The implications of his statement were clear. The Exchange must reorganize; there must be full-time paid executives to administer the Exchange; there must be public representation of a disinterested and impartial nature in Exchange affairs; the club method of operation was difficult, archaic and undemocratic.

On December 10, 1937 the Exchange appointed a committee to study the reorganization proposal and the committee report of January 27, 1938 contained specific recommendations for a thorough reorganization including appointment of a full-time paid president, an entirely new Board of Governors with representation for non-member brokers and out-of-town members, public representation on the Board and a drastic revision of the committee system of operating the Exchange.

These proposals were strongly praised by Mr. Douglas and many members of the Exchange but the "Old Guard" urged delay and further study. The discussion continued until the influence and prestige of the "Old Guard" was dramatically nullified on March 8, 1938 when Richard Whitney, one of the leaders of the "Old Guard", and his company were suspended by the Exchange on grounds that their conduct was not consistent with just and equitable principles of trade. Whitney was not only bankrupt but

guilty of dishonesty; he had extensive defalcations which could not be concealed or reimbursed.

With the Whitney suspension, all opposition to the reorganization faded and the plan was overwhelmingly adopted.

Article I of the Exchange's revised constitution indicates the purposes it has established and followed. In addition to providing exchange rooms and other facilities for its members and others for the transaction of business, it also seeks to "maintain high standards of commercial honor and integrity among its members and allied members; and to promote and inculcate just and equitable principles of trade and business". The Exchange assumed greater public responsibility than at any previous time in its history. A full-time salaried president was elected and functioned as the chief administrative officer. He was not permitted to be an active member of the Exchange in order to avoid his representing any single group among the Exchange members or have any personal interests which might influence his conduct in office. The Board of Governors was vested with the legislative and judicial powers of the Exchange. It consists of twenty-five (25) members comprising ten (10) members of the Exchange, four (4) allied members or non-member partners of members, residing in New York City, two (2) members representing the general public, one (1) member to serve as chairman of the Board

and one (1) member to serve as president of the Exchange at the pleasure of the Board. The Constitution and Rules discuss ethical standards of dealing, uniformity of commissions, regulation of disputes among members, listing of securities, floor trading practices and relations with customers. Many administrative duties performed by standing committees of the Board have been transferred to departments directly responsible to the president and the duties of the Board of Governors have been limited to policy determination and judging of disciplinary cases. The Board has received broad powers for disciplining members through suspension or expulsion for violation of the Constitution orother adopted rules of the Exchange or any resolutions of the Board of Governors. Any conduct or activity of a member may be subject to review by the Board where a question of just and equitable principles of trade is involved. Expulsion for fraudulent conduct is mandatory by the Constitution. Any activity by members which tends to distort security prices on the Exchange to the extent that they do not reflect fair market values or presenting mis-statements to Exchange officials is subject to suspension or expulsion. The listing of securities on the Exchange must be done through the Department of Stock List rules as to financial information and disclosure with copies to the Securities and Exchange Commission.

Since its reorganization in 1938 the Exchange has refined and added to its rules and procedures such items as a questionaire system for regular examination of member firms' financial condition, monthly public reports on member firms' borrowings, surprise audits by independent public accountants of member firms' accounts. It has published detailed instructions for guidance of companies in listing their stock and submission of their financial statement.

In these and other rulings too numerous to mention the Exchange has indicated its willingness to control its own business and its members in order to provide the maximum information and efficiency of operation for the public interest.

E. The National Association of Securities Dealers

1. The Over-the-Counter Market

Regulation of the securities market for the protection of the investing public was attained by three means. New securities at time of issue were required to comply with the rules of the Securities Act of 1933. Securities listed on exchanges were regulated indirectly through the control exercised on the exchanges and their members by the Securities Exchange Act of 1934. The third means of control was in the form of the National Association of Securities Dealers and through this organization, the regulation of securities and dealers trading in the Over-the-Counter Market is maintained.

The Over-the-Counter Market is, perhaps, the most difficult part of the securities business to regulate since it embodies all the securities transactions which take place outside of the organized exchanges and the strictly private sales between individual buyer and seller. Unlike a national securities exchange it is not an organized body with constitution and rules; it has no trading rooms or central market place. The dealers trade directly with each other and with their customers, mainly by telephone. The market has at times been called the "telephone market". There are no statistics as to how big or what volume of trading is present. Estimates by writers place the number

of issues traded at from one hundred thousand (100,000) to one hundred thirty-five thousand (135,000). And the National Quotation Bureau has stated that houses which subscribe to its service may receive as many as five thousand (5000) stock and sixteen hundred (1600) bond quotes in a day and as many as twenty-five thousand (25,000) quotes in a year.# This compares with net number of stocks (3077) and bonds (1090) listed on all exchanges as shown in Table II,## and indicates the scope of the Over-the-Counter Market to be much wider than that of the exchanges. The securities traded in this market are much more varied than those on the exchanges. The stocks traded will range from the seasoned "tried and true" type to the new, unseasoned, weak speculations. Bonds are traded almost exclusively in the Over-the-Counter Market which sells from 90 percent to 95 percent of the total bond business and almost 100 percent of the U.S. Government bonds. It is a "negotiated" market, as opposed to the "auction" market of the exchanges. There are no sales figures released either for price or volume and the only quotes offered are bids and offers with a separate price for the dealer and the customer. No data is available on dealer commissions though it is estimated that they may go as low as the

---

5, P.442 et seq.
Table II- Net Number and Amount of Securities on All Exchanges, June 30, 1953.

minimum commission on the New York Stock Exchange and as high as one and one half to twice that figure. Its customers will range from institutions to individuals and its dealers may be very specialized as to the securities they handle or may be willing to trade in any security offered. Specialists are Municipal Bond Houses which deal only in underwriting and trading in municipal bonds; Government Bond Houses specializing in government bonds, and Dealer Banks which are commercial banks and trust companies seeking to make a market for government bonds, either federal, state or municipal. The general dealers are Investment Banks who concentrate on underwriting securities but do some general trading; Over-the-Counter Houses which are not Exchange members and trade in stocks and those bonds other than governments with very little trading in governments; and Stock Exchange Member Houses which do general trading through their Over-the-Counter Departments.

The functions of the Over-the-Counter Market are to provide a means for bringing buyer and seller together who wish to trade in a security not available on the exchanges, to distribute new securities through underwriting operations and to make a market for securities when they are offered for sale. This last function, the willingness of an over-the-counter dealer to "make a market", quote a price for a security, even if a buyer is not available, is

undoubtedly the major service performed by this market since it enhances and in some cases, creates the element of marketability in a security and thus assures the confidence of the investor in many issues which otherwise might be difficult to trade, regardless of their intrinsic worth because of being unknown and unfamiliar to the investing public.

2. Authority for Over-the-Counter Associations

To regulate the Over-the-Counter Market which is so broad in scope and with little or no organized spokesmen was a task considered practically impossible from the point of view of direct control and regulations. Section 15A of the Securities Exchange Act of 1934 was the method decided upon. This section, called the Maloney Act, provides for over-the-counter associations to organize, for purposes of self-regulation, as registered membership associations under the cognizance of the Securities and Exchange Commission. The association must establish rules intended to prevent fraudulent and manipulative acts and practices; prevent unreasonable profits and commissions and protect investors and the public interest. To enforce these rules, it may discipline its members by means of censure, fines, expulsion, or other penalties. Perhaps the most effective method of discipline is that which permits the association to rule that a member may not deal with any other non-member broker

or dealer except at the same prices or commissions and on the same terms as are accorded by the member to the general public. Thus, expulsion from the association entails a "freezing out" of the expellee by the incumbent members from ability to trade at dealers' prices.

3. Organization of the National Association of Securities Dealers

The National Association of Securities Dealers is the only association registered under Section 15A; and its existence and accomplishments are worthy of note. The purposes of this organization as listed in its certificate of incorporation are broad and encompassing. They seek to promote the well-being of the investment banking and securities business, standardize principles and practices of the business, encourage high standards of commercial honor, provide a means for consultation between its members, and governmental and other agencies for the purpose of resolving problems affecting their business and the investing public, establish and enforce rules of fair practice and for prevention of fraudulent and manipulative acts and practices and generally promote just and equitable principles of trade, and finally, to promote self-discipline among its members investigating and adjusting grievances between the public and its members and between members alone.

a) Rules of Fair Practice

The National Association of Securities Dealers has indicated by these stated purposes and its activities that it is disposed to go beyond the minimum requirements of the Maloney Act, and has expanded its interests to include the basic ethics, public responsibility and operating principles of the securities business. It has established a set of "Rules of Fair Practice" for the guidance of members in business practice. The first rule, "A member in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade" has been defined by the Board of Governors of the N.A.S.D. as limiting a member to entering into transactions with customers at prices which are reasonably related to and consistent with the current market price of the security involved. The nature of other rules of conduct is indicated by the following; Charges for services shall be reasonable and not unfairly discriminatory between customers; no quotations shall be made unless the dealer is willing to do business at such prices; no payments, other than paid advertising, will be made to anyone to influence market prices; a member must inform his customers whether he is acting as a dealer or as a broker in a transaction; members shall not use any manipulative, deceptive, or fraudulent device in order to effect a purchase or sale; members shall be ready

to disclose their financial condition to bona fide customers on request; members are held responsible for recommendations made to customers; and the fiduciary capacity in which members are sometimes placed is emphasized.

b) Uniform Practice Code

In addition to, and supplementing the "Rules of Fair Practice," the Association has compiled and issued a "Uniform Practice Code" with the purpose of eliminating disputes and misunderstandings between members. The Code contains about sixty sections which are elaborate and detailed seeking to codify and standardize practices in the trade. It discusses, among other items, the subjects of delivery, confirmation, assignment, computation of interest, transfers and reclamations sanctioning to a large extent the established practices, customs and usages of the profession in such technical matters.

c) Administration

Discipline of members is maintained by a system of investigating and rendering decisions on complaints filed with any one of the fourteen District Business Conduct Committees. A complaint or request for arbitration may be submitted either by members of N.A.S.D. or by the public. The Conduct Committee involved will investigate,

receive and hear testimony from all parties involved, and render a decision. The decision may be appealed to the Board of Governors of N.A.S.D. and to the Securities and Exchange Commission. The decisions may involve censure, fines, suspension or expulsion. The most effective disciplinary action is not that which is taken directly against a member but the ruling that members in good standing may not trade with non-members or members not in good standing at any prices except those offered to the general public, thus restricting the privileges of dealer trading to those members in good standing.

d) National Quotation Bureau

The Association has been effective in providing quotations in over-the-counter securities through the National Quotation Bureau. These quotes are listed in financial publications and over one hundred newpapers on a daily basis. This service is especially beneficial since the "negotiated" type of market which is the Over-the-Counter Market makes it difficult to establish a mechanism for accumulating and publicizing bid and asked prices. It is a valuable addition to the mechanics of securities trading.

e) Financial Strength of Members

The financial strength of its members has also been a concern of the N.A.S.D. as being necessary to protect both the investing public and security dealers. A firm's solvency or net quick assets position showing that its quick assets are sufficient to liquidate its liabilities has been the test used along with a study of the value of the business of the firm. It is of interest to note that in 1942 the Securities and Exchange Commission recommended to the N.A.S.D. that a minimum net capital of $5000 for a member doing business with the public and $2500 for a member not dealing with the public was sufficient. However, the Association preferred to retain its ruling that a ratio of net capital to total indebtedness of at least 1 to 20 should be maintained.

Besides requiring registration of many employees of investment firms as "registered representatives," the Association also requires an examination of members through a questionaire, and check-ups through accountants or examiners sent by the association.

As of June 30, 1953, the membership of N.A.S.D. was 3034 ## and the organization had firmly established itself as an effective self-regulating unit for administering

the Over-the-Counter Market with improved techniques and ethical standards which have been of benefit to both the investing public and the securities dealers.

#= 36, P.40.

V. General Discussion

A. Effectiveness of Regulations

Effectiveness of governmental regulations may be reflected in two ways; either by the strengthening of existing rules by providing legal endorsement of them, or by the establishment of rules to comply with the governmental regulations. The Securities Act of 1934 was effective in both ways. The established rules of organized exchanges were enhanced by the prestige of governmental endorsement, and uniformity of practice and conduct were assured in both the exchanges and the over-the-counter markets by the addition of new rules.

1. Manipulation

This subject was a cause for rulings by the exchanges as early as 1790 ≠ and has occupied the efforts of officials both private and public whenever the question of public interest in securities trading is considered. In the early days, the exchanges established rules prohibiting wash sales and other deceptive devices attempting to influence the prices of securities. Many State Blue Sky laws also sought to eliminate practices considered harmful to an open market.

≠ 7, P.1 et seq.

The Securities Act of 1934 added the sinew to this skeleton of rulings. The Act forbids certain types of manipulation such as wash sales, matched orders, artificial market activity, use of information concerning manipulators or making false and misleading statements about securities. Other types of practices, while not barred, may be engaged in only within the confines of rules established by the Securities and Exchange Commission. These include such actions as pegging or price stabilization, puts, calls, spreads and straddles, short sales, and stop orders. And finally the Commission has been granted broad powers to make other rules concerning manipulative or deceptive practices. The Commission maintains constant examination and analysis of the ticker tapes of the major exchanges and their quotation sheets as well as regular and financial newspapers and journals. The quotation service of the over-the-counter market is also reviewed. When price movements are thought to be unusual and do not seem to bear any relation to published news and current activity, the Commission will begin an investigation to determine the cause and possibility of manipulative practices. It will first seek its information by way of an informal "quiz" of those concerned and may follow, if the circumstances indicate, with a formal investigation. Its methods of review and analysis involve the examination of thousands of securities on either a daily or weekly basis

and include both the very actively traded issues and the less active ones. These examinations resulted in quizes and investigations which ranged in number from 105 to 135 closed or completed cases in the fiscal years of 1951, 1952 and 1953.#

Those manipulative practices which are permitted by the Securities Act of 1934 are carefully administered by the Commission. Stabilizing practices used to facilitate raising capital funds are a case in point. During the fiscal year of 1953, the Commission allowed stabilizing operations with reference to 29,340,046 shares of registered stock offerings totaling a $623,525,000 public offering price and with reference to bond issues with face value of $19,644,500 by permitting the purchase of 460,635 shares of stock at a cost of $9,429,938, and of bonds with face value of $103,500. The Commission received and examined more than 12,000 reports of stabilizing transactions during the year.###

The above represents the official action of the Securities and Exchange Commission. Both the organized stock exchanges and the National Association of Securities Dealers have established mechanisms for administering their dicta concerning manipulative practices and it may be said

---

Table III- Trading Investigations of Possible Manipulative Practices
45, P.31.

that the work of the Commission is lessened by their presence, and equally, that the presence of the Commission and the Securities Act of 1934 enhances the influence of these privately administered organizations.

2. Financial Information

Probably the most obvious benefit resulting from the legislation of securities and matters relating thereto has been the availability of financial data about the corporations issuing the securities. The investment business, through the various exchanges, has sought such information from the earliest days of organized exchanges, but until the advent of federal legislation of securities, had very little success. In one of its publications,# the New York Stock Exchange in discussing a request it had made for financial information of a well-known corporation in 1866 received the reply that the company "made no reports and published no statements and had not done anything of the kind for the last five years". The Exchange had recognized the need of investors for regular financial reports from corporations whose securities they held but the attitude of management was slow to change until popular demand and federal legislation supplied the impetus needed. The Exchange reports that, in 1953, of the companies listed,

---

39, P.A-20 et seq.

88 percent publish quarterly reports of earnings, 8 percent publish semi-annual reports and 4 percent publish only annual reports. In addition, the Exchange requires an audit of its listed companies by independent public accountants, and publication at least once a year of a balance sheet and a statement of income. Also, the listed companies agree to furnish both to the public and to the exchange, pertinent information at timely intervals, which may affect or influence security values or investment decisions in which the stockholders, the public or the Exchange may be justifiably interested.

As one writer phrased it "Some of the regulations currently embodied in law were enforced by the Exchange itself prior to 1934. For example, new non-voting common stock was not admitted to listing on the New York Stock Exchange after 1926, and corporations were requested to furnish public reports on a quarterly basis in the same year. A formal statement in law of even these principles, however, strengthened their effectiveness and created an outside authority to enforce them."≠≠

The Securities Act of 1933, requiring detailed information concerning corporations issuing new securities further enhances the wealth of financial data filed with

≠≠ 1, P.267.

the Securities and Exchange Commission; and available for analysis.

3. <u>Protection of the Public Interest</u>

The public interest is served in all the various regulations of the governmental and private bodies dealing with securities. The control of manipulation and availability of financial information have been treated separately in recognition of emphasis placed upon these two phases of regulation during the Senate Investigations of 1933-34 and in the public mind at the time of the enactment of the various securities regulations, and it is appreciated that they represent no small contribution to the protection of the public interest.

a) <u>Advertising</u>

The rules of the Exchanges, the National Association of Securities Dealers and the Securities and Exchange Commission have limited the methods of advertising securities and their sale to a bare statement of facts. Advertisements about securities are confined to stating the name of the issue, the type of security, rate of interest (if appropriate) and the sources from which prospectuses may be obtained. In fact, the paucity of information contained in financial advertisements has been the subject of criticism. The Commercial and Financial

Chronicle is of the opinion that "tombstone" advertising (brief copy) materially retarded the sale of new issues.#
However, the purpose of these limitations was to avoid the ballooning of claims as to the worth of securities offered.

Another feature mentioned in connection with manipulation, but also worthy of note as a form of indirect advertising, has been the circulation of information about securities by apparently disinterested analysts and newspaper columnists which has at times influenced the trading of securities. This type of activity is forbidden by the Securities Exchange Act of 1934.

b) False and Misleading Statements

The very strict penalties imposed for the making of false or misleading statements with reference to securities has led to the most careful preparation of reports and statistical data. The use of independent public accountants has greatly reduced the possibility of erroneous information being circulated and has increased public confidence in the information offered by corporations, exchanges and financial services.

Other following sections deal with subjects which equally protect the public interest but are considered worthy of separate treatment.

#13.

4. Business Ethics

As mentioned previously, business ethics, at the time of the enactment of federal securities legislation was not considered to be the ultimate desired. "The real needs are the building up of new business habits and the generation of a new moral climate for business."# The Senate Investigations of 1933-34 had disclosed many instances of unfair and unethical practices which were, at that time, accepted as normal business procedure. The federal securities regulations sought to emphasize the position of public responsibility which rested with those in the investment business, and private organizations of the trade concurred in this view. The requirement that dealers, brokers and certain employees of investment firms be registered and their moral and ethical reliability determined was a major factor in assuring that only those qualified to carry the responsibility of dealing with other people's money would be permitted to do so. But the rules promulgated by the government proved to be merely the framework upon which the private associations were to build their codes of ethical conduct. The New York Stock Exchange rules for members' conduct and the National Association of Securities Dealers' "Rules of Fair Practice" and "Uniform Practice

---

18.

Code" are notable contributions to the maintenance of just and equitable practices in the securities market.

5. Credit Regulation

Credit regulation dealing with securities is concerned with two subjects -- margin, and brokers' loans. They are interlocking to the extent that brokers' loans will increase or decrease as the margin requirements rise and lower. Margin is credit extended by the broker to the investor for the purchase of securities or the maintenance of a securities account which securities will be the collateral for the credit. Brokers' loans are credit extended by the bank to the broker for financing the margin extended to the investor and for maintaining a "stock" of saleable securities.

Margin is regulated both by the decisions of the Federal Reserve Board and the rules of the organized exchanges. The Securities Exchange Act of 1934 granted the Federal Reserve Board the authority to set minimum margin requirements for initial purchases. The exchanges, in their rulings, concur with the regulations of the Board and also set minimum margin requirements for the maintenance of investors' accounts with brokers.

The Federal Reserve Board has used its power to set margin requirements as a brake against possible speculation, raising and lowering the margin required as the

trend of the economy dictated. It has been set as low as forty percent in 1937 and for thirteen months beginning in January 1946 it was set at 100 percent. Until the month of January 1955 it was set at 50 percent when the rapidly rising market prompted an increase to 60 percent. Whenever the margin requirement has been changed, there has been increased activity in trading for a day or two but the market has quickly adjusted itself. This leads to the conclusion that this type of credit restriction does not affect the supply and demand ratio of the market to any appreciable degree.

The New York Stock Exchange Rule 550 requires that a margin be maintained in an investor's account with a minimum of 25 percent of the market value of all securities "long" in the account. This is the absolute minimum and brokers may and sometimes do ask for more margin.

Brokers' loans are controlled by the Federal Reserve Board by its rules as to from whom the brokers are permitted to borrow. Usually Federal Reserve Member Banks or banks which agree to abide by the rulings of the Federal Reserve System are specified. Also the collateral which the brokers may use is defined along with the margins applying to the various collateral. The rates of interest on brokers' loans has been relatively static over the years being one percent from 1936 to 1946, then being stabilized

by New York banks at one and one-half percent from 1946 to 1950 when it was raised to one and three-quarter percent.## The status of brokers' loans is subject to very rapid change and consequently they are call loans and renewable each twenty-four hours. As much as ninety-five percent of them are renewed daily. This is so because of the inter-relation of brokers' loans, margins, and stock prices. For example, in the period from March, 1943 to May, 1946 member borrowings rose from $312 million dollars to $408 million dollars or thirty percent, and the stock price rise in the same period rose thirty-one percent according to the New York Herald Tribune, and twenty-eight percent according to the New York Times.#

The relation between brokers' loans and margin was indicated in both a rising and a falling market when in the period from September 1935 to April 1937 customers' debit balances rose forty-three percent and brokers' loans went up fifty-eight percent. In the period from April 1937 to April 1938, customers' debit balances declined fifty-three percent while brokers' loans dropped sixty percent.###

This close inter-play between the stock prices, margins and brokers' loans has been attributed to changes in the number of margin buyers or in the number of shares

---

#5, P.261 et seq.
5, *ibid*.

bought on margin or a change in the average price of shares bought on margin. And it has been concluded, especially in a rising market, that the rise in brokers' loans and margins has a definite relation to speculation on the premise that the more credit which is available, the more will be used. Thus an unending cycle is produced -- rising stock prices will cause greater use of margin and brokers' loans which will bring extra money into the market which will tend to expand trading. It has been a historical fact that bull markets are usually accompanied by increases in total margin used and brokers' loans outstanding. The presence of credit in a bull market, no doubt, tends to extend the life of the up-surge.

The purpose in regulating margins and brokers' loans was to contain credit before it developed into an instrument for an extensive boom market followed by a collapse, the historic example being the $8.5 billion dollars of outstanding brokers' loans at the time of the 1929 "crash". Margin was also criticized as absorbing credit needed for business, using bank credit in excessive amounts and so endangering the banking system. Also it added nothing to making a continuous market since it was largely confined to a few stocks already enjoying continuity of sales and finally it was used by speculators with inadequate margins. In fact the Securities Exchange Act

of 1934 states that regulation is necessary "to protect and make more effective the national banking system and the Federal Reserve System". Criticism of brokers' loans were of the same type indicating that the loans absorbed more of the available credit from banks than they warranted and thus caused a dislocation of the credit available to industry and commerce. But, again, the major claim was that increased brokers' loans caused excessive speculation and inflated security markets.

The regulations being enacted, the question is whether they have influenced the securities market and alleviated some of the criticisms. An examination of today's market as compared to that of 1929 might lead to the conclusion that control of credit has restrained an extensive boom period. In October 1929 there were $8.5 billion dollars of brokers' loans outstanding, representing 8.75 percent of the total market value of the listed stocks while in March 1954 there were one billion dollars in brokers' loans representing 0.91 percent of the total value of listed stocks. In 1929 there were 87 billion dollars of stocks and in 1954 there were 137.9 billions.#
This would indicate that restraint of credit has reduced the amount of credit now in use in the market, in spite

---

24, P.21.

of the vast increase in value of stocks being traded. And if the interplay of credit and stock prices is true, the prices of stocks should tend to slow down and level off since over the entire year of 1954 the percent of brokers' loans to total value of stocks has not changed appreciably. But the bull market has continued steadily throughout the year. Though the relationship may be present, it may not be of sufficient importance at this moment to be used as a barometer of the financial economy. This seems to be the case. The place of credit buying in securities has paled in the present market to a point when credit extension can no longer be considered a threat to the national economy. To this extent, at least, the Securities Exchange Act of 1934 has seen its purpose accomplished. The relative effect of federal regulations as contrasted with changing elements in the securities market itself in producing this result is discussed in the "conclusion" of this paper.

VI. Conclusions

A. Benefits of Regulation

Protection of the public interest was the primary purpose expressed for the federal regulation of securities and activities related to them. That purpose has been accomplished in three general ways, the increase in availability of financial information, the elimination of harmful manipulative practices and the control of credit used in the securities market.

The availability of financial information, resulting from federal regulations, exchange rules and the codes of the National Association of Securities Dealers is voluminous in itself. And the analysis and uniform statistics accumulated by the various financial services has further enhanced this data. "Currently, the investor has a much better opportunity of securing accurate information concerning the corporation in which he is financially interested than he did prior to the 1930's. This is due in part to the fact that many corporations are now required by Federal Security Acts to publish complete, accurate and current financial data which is made available to investors directly, and through the secondary sources of the statistical services; and in part to a gradual improvement in the social attitude of corporate managements towards

stockholders."## This expanded information has served also to educate the general public in its attitude towards financial organizations and the securities mart reducing the wariness so evident during the 1930's and thus, indirectly, widening the potential market for sale of securities. The confidence, engendered by the insistence upon full disclosure of facts and avoidance of false and misleading statements has aided in raising the investment profession in public esteem and has produced reliance upon the information and analysis of the data. Truth in securities information is today an established fact to the credit of both the investment profession and government administrators.

Manipulative practices which are harmful to securities trading have been eliminated by two methods- prohibition and limitation upon technical features, and the general improvement and adherence to uniform codes of ethics by individuals engaged in investment work. The prohibition of certain types of manipulative practices and the limitation of others was set forth in the Securities Exchange Act of 1934 and also included in the constitutions and by-laws of the exchanges and associations. Adherence to these rules has been rigidly enforced and constant vigilance is maintained both by the bodies immediately concerned

---

##-1, Appendix, p.XIV.

and also by the public through various congressional committees. The recent bull market during 1954 has caused some concern and has resulted in an announcement by Senator Fulbright, Democrat, of Arkansas, chairman of the Senate Banking committee, that his group would hold an inquiry into the causes of the rise in securities. The inquiry is to be "friendly and informative" since they know of no instances of wrongdoing in the market but the levels "have gone up, I think, far beyond what conditions warrant...."#
This attitude of constant alertness to the possibility of manipulation has produced salutary results over the years. Today, manipulation of the market, as it was known in 1929, is not present in securities trading.

But, as stringent as the regulations may be, the successful elimination of manipulation also requires the support of the professionals, the brokers and dealers. Their support, through their exchanges and associations has been eminent both in the control of harmful practices and in the establishing of uniform accepted principles of trading and conduct. Just and equitable principles of trading are no longer a goal to be attained but a norm to be followed.

The control of credit in the purchase of secur-

11, P.22.

ities has served two purposes. The first, reduction of the possibility of speculation, has been an accepted fact for some time. The Federal Reserve Board has raised and lowered margin requirements judiciously hoping to avoid excesses of "boom or bust" and its action has been approved as a wholesome effect in this regard. "But at the present level of stock prices it was wise for the Federal Reserve authorities to discourage the increase in the use of credit for the purchase of securities."# The second purpose regulation of credit has served is the uniformity of requirements which have resulted both in banks and in brokerages with reference to percentages required and collateral used. This has aided in reducing the possibility of competition among houses for business on the basis of margin rules and has further served to raise the general trading ethics of investors.

B. Criticism

In the early days of federal legislation, dire prophecies were common predicting that the laws would stifle the national economy, produce unemployment, force the disintegration of large coporations and make the obtaining of new money very difficult. "With the purpose of

---

12, P.c-3.

the Act, (Securities Act of 1933) i.e., the protection of the public against fraudulent securities, the writer is in full sympathy but it seems hardly necessary to burn down the house to exterminate the vermin."≠ This was an extreme and was the cry before the legislation was given a fair trial. Since that time there have been many suggestions for change and improvement of the Securities Acts recommended by the Securities and Exchange Commission and by the private organizations and individuals. One of the most often repeated suggestions is that the duplication of information furnished to the Exchanges and the Securities and Exchange Commission be eliminated. Elimination of duplication in registration statements submitted under the Securities Act of 1933 and the Securities Exchange Act of 1934 has also been urged. And the reduction of information sought by the Securities and Exchange Commission in reference to stock ownership changes among "insiders" being reported on a monthly basis has been mentioned. Giving the Commission additional power to suspend the registration of a broker or dealer as well as its present power to revoke registrations has been urged; and also it has been suggested that the Commission be given power to suspend or expel from a national exchange any officer or member who violates any rule of such exchange since the power to

---

≠ 17.

suspend or expel now relates only to violations of the Securities Exchange Act of 1934 or any rule or regulation thereunder. Others have urged that the Securities and Exchange Commission be relieved of its power to prevent floor trading but allow it the power to regulate; and to remove the Commission's power to require or effect the segregation of the functions of broker or dealer. It has been suggested that the Commission be given the power to terminate or suspend a security from unlisted trading privileges, if the issuer or any of its officers or directors release materially false or misleading information about the company's affairs.

The Federal Reserve Board has, at times, been criticized that it exercises rigid control of credit but it has been suggested that the Board be permitted to regulate the extension of credit on unregistered and non-equity securities as well as those now subject to margin requirements; and that it permit one member of a national securities exchange to lend his excess capital to another member on any terms that might be arranged between the two parties.

One proposal which has been endorsed by many writers is the Frear Bill introduced in 1950 (S-2408) in the U. S. Senate which would extend the registration, reporting, proxy and insider-trading provisions of the Securities Exchange Act of 1934 to all companies with at

least $3,000,000 of assets and 300 security holders. At the present moment, these provisions apply to the voluntary act of a particular company wishing to list its securities on an exchange.

The need for the State Blue Sky Laws to be made uniform and coordinated with federal law has been emphasized if there is to be a continuance of the dual system of federal and state regulations.#

One of the major criticisms of the National Association of Securities Dealers is that it is too much in the nature of the instrument of the Securities and Exchange Commission and does not truly express the opinions of its members. This statement is difficult to discuss since the aims of the organization are so akin to those of the Commission that its actions, of necessity, will be such as those expected of the Commission. But criticism has waxed heated especially in regard to the N.A.S.D.'s attempt to limit mark-ups on sales to five percent.###

Extreme critics of government regulation have advocated the abolition of the Securities and Exchange Commission and the National Association of Securities Dealers as recently as March 1953.## They have claimed

---

16.
13.

that the effect of the laws and the method of enforcement has reduced the number of investment brokerage and banking firms as well as having adversely affected foreign trade, small business and liquidity of exchanges. Although it is stated that investment houses have decreased in number by thirty-eight percent from those operating in 1929, it is questionable that this decline can be attributed to any one factor without considering the total volume of business now handled by the present number of firms, the number of employees presently engaged in the operations, the methods of financing and trading used at this time, the type of investors now present and the kind of securities market functioning now as compared to that in existence in 1929. Such drastic action is not the opinion of the majority, either of the general public or the professional investment people themselves. "Even without any legislative changes, it seems fair to conclude that both government and industry have come a long way since the mutual suspicions of the thirties. There is every indication that the securities industry overwhelmingly approves the idea of appropriate legislation always reserving its inalienable right to recommend changes from time to time. And there is equal recognition on government's side of the vital role which the securities industry has played and must go on playing...."#

16.

Another criticism mentioned in the early days of federal regulation was that the government rules would influence business firms to try to avoid compliance by de-listing their securities on the exchanges. This prediction has not materialized as is indicated in Table V- "Number of Listed Issues on the New York Stock Exchange". The total number of issues listed has decreased over the period from January 1, 1934 to January 1, 1953 by two hundred ninety-seven. Stock issues have increased by three hundred thirteen while bond issues have decreased by six hundred ten. These figures serve to confirm the current trend in business management to seek capital through sale of equity ownership rather than using bonded indebtedness, but the net change would indicate that corporate management has not been influenced to abandon listing its securities because of an aversion to governmental regulations.

C. Current Influences

1. Institutional Investors

But one may ask how much of the present situation may be attributed to the efficacy of federal regulation and how much to changing elements in the securities mart itself.

Two events in recent months give us pause as to the total effect of federal regulations upon the investing public. The first item was the raising of margin requirement by the Federal Reserve Board from 50 percent to 60 percent in January 1955. The purpose of the increase was to restrain speculation in the booming stock market, and was consistent with the primary purpose of credit regulation. The action came after stock prices had advanced 65 percent in the current bull market from September 15, 1953. The Board's decision met mixed reaction. In general, there was approval since it was an indication of a cautious and conservative approach to the problem of possible speculation in the rising market.# The reaction of the professional investment business, as indicated by the remarks of the presidents of the New York Stock Exchange and the American Stock Exchange, was less enthusiastic. Mr. K. Funston of the New York Stock Exchange disapproved of the rise since he did not agree that margin buying was excessive. He pointed out that as of the end of November, 1954, money borrowed by individuals for margin totaled 2.2 billion dollars which was less than 1.4 percent of the market value of all stocks listed. He also compared this figure of 2.2 billion dollars credit on securities with 29 billion dollars outstanding in consumer credit. He further pointed out that the ratio of the volume of trading and the number of shares listed on the New York Stock

---

12.

Exchange was not excessive -- the turnover in 1954 being 19 percent as compared to an average 16 percent turnover for the last eight years and an average 82 percent turnover for the last 55 years.## These statistics take added weight when it is noted that the number of shares listed has more than doubled in the last eight years. Mr. E.T. McCormick of the American Stock Exchange also felt that the present use of margin was neither high nor unhealthy.

Actually, the 10 percent increase in margin was one of the smallest changes in margin since the Federal Reserve Board began regulating margin in 1934, and was probably based on a consideration of the rise in the total credit extended for margin purchases. In January, 1954, total credit extended amounted to $2,443,000,000 -- and at the end of November, 1954, the figure was $3,203,000,000; a rise of 31 percent in ten months. Of these figures, in January, 1954, $1,655,000,000 and $2,202,000,000 in late November, 1954 represented loans to customers by brokers. So sharp a rise in ten months indicated that action for slowing down this rise was necessary, though the government officials did not consider that speculation was a major factor and thought that the market rise was a reflection of general confidence by business men.#

32.
32.

The effect of the Board's action was quickly seen but not so easily understood. On January 5, 1955 stock prices began to fall and on January 6, the activity was so great that the stock ticker was thirteen minutes behind the transactions. The New York Times combined average fell 10.10 per cent the first day and 4.58 percent the second day, and its industrial average fell 10.10 percent the first day and 7.44 percent the second day. This reaction was definite and noticable, and was attributed in great part to the rise in margin requirement. But, it was pointed out that the change in margin requirements was applicable to new purchases of stock, not to margin maintenance, since the Board, though it has the power to regulate margin maintenance, has not done so to this point. Since the change did not affect margin maintenance, those people buying on margin had no necessity for obtaining cash for "covering their margin" and on this basis the change in margin requirements cannot be considered a direct influence on the market's activity during this slump. Many brokers felt that the margin change was used as an "excuse" rather than a "reason" for the increased selling and thought that the underlying reason was attributable to the reaction to a sixteen months long bull market which had increased 65 percent to November 1954 and then increased 6.7 percent from November to January 5, 1955.##

#32.

The investment business, itself, did not view the break in the market as foreboding and thought of it in terms of a technical adjustment after a long rise.# They were satisfied that stock prices were not too high and that the market was following the national economy. Also, the presence of a thick cushion brought about by institutional buying was considered a safeguard against a recurrence of the 1929 crash. Pension funds and insurance companies are almost forced to buy monthly, and also colleges and private foundations are consistent purchasers of stock. This element was not present in 1929 and is considered to be a stabilizing effect on the current market.

Following on the heels of the Federal Reserve Board's action came a survey by the New York Stock Exchange on stock transactions for two selected days, December 8, and December 15, 1954.## On these two days, margin business on the New York Stock Exchange, exclusive of dealings by brokers or members of exchange, was 52.5 percent of the total business. 76 percent of all the business was from the public (individuals and institutions) and 69 percent of this public business came from outside New York City. Purchases on margin by people in the $10,000 or better income bracket increased from 19.5 percent in 1952 to 32.7 percent

---

34.
35.

of total volume and for those in the $5000 or less income bracket, purchases on margin decreased to 2.8 percent of total volume from 3 percent in 1952. Overall, the private investor's transactions rose in the two year period from 4.3 percent to 10.3 percent of all exchange volume. His short term dealings rose from 10.8 percent to 17.3 percent and his long term dealings declined from 41.9 percent to 34.7 percent. His cash purchases declined from 65.8 percent to 47.5 percent of aggregate volume while his margin purchases increased from 34.2 percent to 52.5 percent.#

This survey when considered in the light of the market's reaction to the Federal Reserve Board's increase in margin requirements leads to the following thoughts. It seems apparent that the Board's action had a psychological effect upon that portion of the market which is the most unpredictable-- the individual investor-and the Board was correct in its assumption that the increased margin activity, though not out of proportion with increased market values, was being motivated by the individual investor seeking a quick profit through in-and-out trading (as evidenced by the short sales percentages). Since 69 per cent of all public business came from outside of New York City, a comparison with the 1929 situation, when only

---

36.

800 million dollars of the 8 billion dollar total of outstanding broker's loans were advanced by New York interests, is evident and when the slump on January 5, 1955 and the following days cannot be explained in terms of direct effect of the Federal Reserve Board's rulings, we may wonder at the adequacy of information which was considered before taking action. This seems further substantiated by the market reaction during and following the interrogations of the Senate Banking and Currency Committee during February and March, 1955. The fact that the slump in January, 1955 was so swift following the government ruling may indicate a cautious and wary public whose memory is not yet dimmed of past memories; and the fact that the speculative urge seems confined to the upper income brackets may be worthy of note. The inquiry by the Senate Banking and Currency Committee into stock market activities conducted by Senator Fulbright has produced some interesting results. Again, we find that the stock market activity during the period of the inquiry has been attributed to the effect of the inquiry on the public mind. The market dipped very sharply and experienced its worst decline in fifteen years.# The inquiry has been considered a brake on a rising market.## Information gleaned

---

37.
30.

was startling in some instances especially in the discussion of the promotion of uranium stocks. The possibility of suggestions for future legislation may be the result of this inquiry. One writer expects proposals for more complete disclosure requirements for new issues totaling less than $300,000 (which issues are now exempt from full reporting) and for more complete reporting of the affairs of companies whose issues are traded on the over-the-counter market.#

The presence of a speculative atmosphere in the present market is evident when we consider a comparison of Standard & Poor's weekly indexes of the prices of low price common stock and high-grade common stock.## It shows the low price stock rising much faster than the high-grade stock and intensifying its gains in the first weeks of 1955. Also Moody's Survey stressed this speculative trend -- "use of stocks merely as chips in a fast poker game, often with borrowed funds, has been increasing, judging from such evidence as rising brokers' loans and fast trading activity." Instances of this "fast poker game" are seen in the following. General Dynamics Corp. closed during the first week of February 1955 at 111.75 which was 53 percent above the January '55 low. On Monday, February 14, rumors of an impending

---

#38.
31.

merger sent the price up to 121.50 and closed at 119.25, a gain of $5.50 for the day. On Tuesday, February 15 the stock rose to 131, then the company denied the merger rumors and the shares lost $12 before closing. Chance Vought Aircraft, in the first week of February 1955 closed at $54.25 which was 81 percent above the January '55 low. From Monday to Wednesday (Feb. 14 to 16) it rose to 68 on the strength of rumors of merger. On Wednesday, the company denied the rumors and the stock dropped to 61 -- off 7. #

This type of speculation is recent, within the last few months of 1954 and the first quarter of 1955. In mid- 1954 investment was cautious and conservative. This is further supported by the fact that the rise in prices was localized in the "blue-chip" stocks, the tried and true investments; and the low-priced stocks were lagging behind in the rise. Table IV ## shows that in 1953-54 "blue chip" stocks rose thirty-five percent while low-priced stocks rose on twenty-four percent, a phenomenon not previously experienced in a bull market.

To offset this speculative urge in the private investor we now find in the current market a stabilizing influence not present in earlier markets. Educational institutions, pension funds, insurance companies, investment

---

31.
- Table IV - Comparison of Percentage Rise in Stock Prices.

funds, philanthropic foundations are now active traders in the market. Their investment policy is conservative with the emphasis placed on protection of capital and steady income. They seek the "blue chip" securities with occasional excursions into the "pale blue chip" field but they do not trade for appreciation of capital. Another feature of this type of investor is that he will purchase in large lots which may have a tendency to stabilize the market and may influence the need of "special offerings"# of blocks of stock on the floor of the exchange which are considered too large to be readily absorbed in the regular market. The presence of these institutional investors has become prominent in the last few years, first, because of the many new investors of this type which have been organized and second, because of the general acceptance by this group of stock ownership being preferred over the traditional bond holdings. An indication of this preference is shown by Table VI -"Share Holdings of Institutions", where in the six year period from 1948 through 1954, five groups of institutional investors increased their stock holdings from 9.7 billion dollars to 17.3 dollars. Also a recent study## found that institutions held twenty percent or more of the

---

See Table IX - Special Offerings on the New York Stock Exchange.
29, P. 98.

outstanding common stock of New York State Electric, Illinois Power, Middle South Utilities, Seaboard Airline Railroad, Amerada Petroleum, Gulf States Utilities and Wisconsin Electric Power in addition to owning fifteen percent of the shares of eighteen other corporations and at least ten percent of twenty-eight other companies. The entrance of this new type, large scale, conservative investor into the field of stock trading can produce two results. A concentration on certain issues can produce a scarcity of shares on the market in these stocks which in turn would bid up the price. This may have influenced the results indicated in Table IV-"Comparison of Percentage Rise in Stock Prices" where the rise in price in "Blue Chip" stocks exceeds the rise in low-priced stocks in a rising bull market. The second result, applying at least to the issues preferred, and perhaps to the market as a whole, is that the institutional investors may produce a sizable and relatively stable market since purchases would be large and sales would not be primarily influenced by speculative considerations.

A stabilizing influence is present in today's market which was not present twenty years ago. Table VII-"Reported Stock Volume and Turnover of Listed Shares on New York Stock Exchange" shows that for the period from 1934 to 1952 though the number of shares listed on January first has more than doubled, the annual turnover of shares has decreased from twenty-five percent to thirteen percent.

Further indication of the rising influence of the large scale corporate investor is shown in Table VIII- "New Securities Offered for Cash Sales in the United States". This table compares private placement of securities which must be made with groups of well-financed individual investors (see Excerpt from Prospectus of Gulf Interstate Gas Company#) with the total of all offerings in a given year. In 1943 private placements amounted to eight-tenths of one percent of all offerings and in 1952 they accounted for just under fifteen percent of all offerings. In 1943 private placements amounted to just under three hundred seventy-two million dollars while in 1952 they totaled a little more than four billion dollars. If large institutional investors can accomodate four billion dollars worth of offerings in a single year, their influence in the regular trading circles must be important and of growing significance in the trends of the market. The presence of these giant investors is an influence upon the markets which is recognized as presaging a change in investment operations. One writer finds the influence so strong as to note "a change from a professional to an investment market with the consequent need for concentrating on merchandising. The development of investment companies, and the siphoning of great pools of funds and securities into these companies,

---

Table X.

insurance companies, banks and pension plans has resulted in the freezing of funds and securities, the lessening of liquidity and the development of greater selectivity in the market."#

Control of securities trading by the Securities Exchange Act of 1934 has been effective and beneficial to both the investing public and the investment business with respect to the salutary effects of eliminating manipulative practices (and the corollary advantage of codification and uniformity of ethics and practices of the various parties concerned) and providing the copious financial information and resulting statistical analysis and discussion of the corporations issuing securities. The benefits of credit regulation are evident when used as a brace to restrain a rising bull market but the full effects are not clear because of the relatively small percentage of trading which is transacted on credit. Federal legislation was enacted at a time and in a period of social crisis when it was intended to cure the weaknesses of an investment market which was highly individualized and the "large" investor was, in many cases, a single man. That legislation has been administered over a period of twenty years in which the "large" individual investor has declined in importance and been replaced by the institutional investor. The volume and trading on the market has expanded in no less rapid

---

14.

a fashion than the growth of the nation's population and gross national product. The market techniques have changed just as the nation's living habits have changed in food and clothing and suburban living. American economy has expanded and increased in a manner hardly imagined when federal legislation of securities was enacted. And to the extent that this legislation has contributed to an orderly and efficient securities market assisting in the task of investment placement, it has served a purpose and filled a need which is essential to the development of the nation's economy.

BIBLIOGRAPHY

I. Books

1. Bellemore, Doublas H. Investments - Principles, Practices and Analysis. First Edition. New York, B.C.Forbes and Sons Publishing Co., Inc. 1953.
2. Boehmler, Erwin W. and others. Financial Institutions. Chicago, Richard D. Irwin, Inc., 1951.
3. Bogen, Jules I. and others. Financial Handbook. New York, The Ronald Press Company, 1950.
4. Hall, Ford P. Government and Business. Third Edition. New York, McGraw-Hill Book Company, Inc. 1949.
5. Leffler, George L. The Stock Market. New York, The Ronald Press Company, 1951.
6. McCormick, Edward T. Understanding the Securities Act and the S.E.C. New York, American Book Co., 1948.
7. Shultz, Birl E. The Securities Market and How It Works. Fifth Edition. New York, Harper & Brothers, 1946.

II. Booklets and Pamphlets

8. New York Stock Exchange Year Book, 1953.
9. Research in Securities Markets. New York, National Bureau of Economic Research, Inc., 1946.
10. The Regulation of the Securities Markets. Washington, D.C., The Brookings Institution, 1946.

III. Newpapers and Periodicals

The Boston Globe

11. "Should You Be In the Market? Or Is It Riding to A Crash?" January 24, 1955.

The Boston Sunday Globe

12. Slichter, Sumner H. "Second Half of 1955 Is Big Question." Annual Business Review, January 16, 1955.

The Commercial and Financial Chronicle

13. "Incredible- But True" Vol. 177, No. 5200, March 5, 1953.
14. McCormick, Edward T. "What Must Be Done to Save Securities Exchanges." Vol 177:101, January 8, 1953.

Financial World, Vol. 98, No. 14, October 1, 1952

15. "The New York Stock Exchange - Fifty Years Ago and Tomorrow.
16. Loss, Louis, "History of Securities Regulations."

Fortune, August, 1933, Vol. VIII, No. 2.

17. Dean, Arthur H. "Securities Act -- Legal Opinion."
18. Frankfurter, Felix. "Securities Act -- Social Consequences."

Harvard Business Review, November, 1949, Vol. XXVII, No. 6.

19. Cherrington, Homer V. "National Association of Securities Dealers."

The Journal of Accountancy, The Ronald Press Company, New York, N.Y.

20. Smith, A. "Abuse of the Audit in Selling Securities," October, 1912, Vol. 14, No. 4.
21. "Issuance of Securities in New York," March 1915, Vol. 19, No. 3.
22. "Stock Exchanges Aroused," November, 1924, Vol. 38, No. 3.
23. "Control of Listings," November, 1924, Vol. 38, No. 5.

U.S. News and World Report - Washington, D.C.

24. "What's Behind Stock-Price Trend," Vol. XXXVI, No. 10, March 5, 1954.
25. "Why Stocks Are Higher," Vol. XXXVI, No. 24, June 11, 1954.
26. "What Rise in Stock Market Means," VOl. XXXVII, No. 3 July 16, 1954.
27. "Bull Markets Everywhere," Vol. XXXVII, No. 9 August 27, 1954.
28. "Why Stock Prices Are Up," Vol. XXXVII, No. 22 November 26, 1954.
29. "Who's Buying Stocks Now," Vol. XXXVII, No. 23 December 3, 1954.

Boston Daily Globe

30. "Senate Probe Spotlights High Stock Price Level," March 13, 1955.

Business Week - New York, N.Y.

31. "Razzle-Dazzle in Stocks," No. 1329 February 19, 1955.

The New York Times

32. "U.S. Lifts Margin on Stocks 60 o/o," January 5, 1955.
33. "Stock Prices Dive on Rise in Margin," January 6, 1955.

34. "Stock Breaks Fail to Upset Wall St.," January 10, 1955.
35. "Margin Business 52.5 o/o on Big Board," February 1, 1955.
36. "Wall Street Runs Across the Land," February 3, 1955.
37. "The Financial Week," March 13, 1955
38. "Hearing on Stock Market Enlivened by Good Humor," March 13, 1955.

IV. Publications of Government Agencies, Associations, etc.

39. Company Manual, New York Stock Exchange, New York, 1953.
40. Hearing on H.R. 4314 before the House Committee on Interstate and Foreign Commerce, 73rd Congress, 1st Session (1933).
41. Securities Exchange Act of 1934 and Amendments. Public Law No. 291, 73rd Congress, Washington, D.C. U.S. Government Printing Office, 1948.
42. Stock Exchange Practices. Senate Report No. 1455, 73rd Congress, 2nd Session, Senate Committee on Banking and Currency, Washington, D.C. U.S. Government Printing Office, 1934.

U.S. Securities and Exchange Commission

43. 17th Annual Report, 1951, Washington, D.C. U.S. Govt. Printing Office, 1952.
44. 18th Annual Report, 1952, Washington, D.C. U.S. Govt. Printing Office, 1953.
45. 19th Annual Report, 1953, Washington, D.C., U.S. Govt. Printing Office, 1954.
46. General Rules and Regulations Under the Securities Exchange Act of 1934 as in effect September 1, 1952. Washington, D.C. U.S. Government Printing Office, 1952.
47. Securities Exchange Act of 1934, Release No. 4775. Amendment of Proxy Rules - December 11, 1952 Washington, D.C. (Mimeographed Release)
48. General Rules and Regulations Under the Securities Act of 1933 as in effect November 1, 1951. Washington, D.C. U.S. Government Printing Office, 1951.
49. Securities Act of 1933, Release No. 3466. Adoption of Revised Regulation A, March 6, 1953.
50. Securities Act of 1933, Release No. 3467. Adoption of Regulation D for Canadian Offerings, March 6, 1953 Washington, D.C. (Mimeographed Release)
51. The Work of the Securities and Exchange Commission August 15, 1952, Washington, D.C. U.S. Government Printing Office, 1952.

TABLE I PART I

Market Value and Volume of Sales Effected on Securities Exchanges
(amounts in thousands)
For the 12 months ended December 31, 1952

	Total	Stocks (1)		Bonds (2)		Rights and Warrants	
	Market Value (dollars)	Market Value (dollars)	Number of Shares	Market Value (dollars)	Principal Amount (dollars)	Market Value (dollars)	Number of Units
Registered exchanges	18,178,365	17,327,702	626,922	791,442	899,125	59,221	104,601
American	1,305,301	1,273,902	111,515	19,934	28,647	11,465	6,289
Boston	193,795	191,936	4,288	17	15	1,842	1,034
Chicago Board	(3)	(3)	(4)	---	---	---	---
Cincinnati	21,443	21,395	589	7	12	41	43
Detroit	75,025	74,957	3,796	---	---	68	207
Los Angeles	181,097	180,735	9,429	---	---	362	460
Midwest	464,225	462,094	14,585	413	372	1,718	3,197
New Orleans	1,822	1,774	54	48	45	---	---
New York	15,531,422	14,720,397	431,821	769,491	868,447	41,534	89,741
Philadelphia-Baltimore	166,730	165,322	4,655	420	598	988	1,325
Pittsburg	25,825	25,825	1,148	---	---	---	---
Salt Lake	2,762	2,762	21,885	---	---	---	---
San Francisco Mining	452	452	5,119	---	---	---	---
San Francisco Stock	202,043	199,912	16,017	928	810	1,203	2,305
Spokane	964	964	1,777	---	---	---	---
Washington	5,459	5,275	244	184	179	---	---
Exempted exchanges	7,626	7,472	878	154	170	---	---
Colorado Springs	73	73	131	---	---	---	---
Honolulu	6,505	6,351	720	154	170	---	---
Richmond	559	559	11	---	---	---	---
Wheeling	489	489	16	---	---	---	---

(1) "Stocks" include voting trust certificates, American depositary receipts, and certificates of deposit.
(2) "Bonds" include mortgage certificates and certificates of deposit for bonds. U.S. Government bonds not included.
(3) $500 or less.
(4) 500 shares or less.

Source: Securities and Exchange Commission
19th Annual Report, p. 143
Fiscal Year Ended June 30, 1953
U.S.Government Printing Office
Washington, D.C.

TABLE I PART II

Market Value and Volume of Sales Effected on Securities Exchanges
(amounts in thousands)
For the 6 months ended June 30, 1953

	Total Market Value (dollars)	Stocks(1)		Bonds (2)		Rights and Warrants	
		Market Value (dollars)	Number of Shares	Market Value (dollars)	Principal Amount (dollars)	Market Value (dollars)	Number of Units
Registered exchanges	9,767,721	9,323,121	352,261	425,554	496,504	19,046	56,999
American	666,130	650,141	61,094	10,279	19,659	5,710	1,895
Boston	94,510	94,455	2,120	---	-	55	411
Chicago Board	4	4	(4)	---	---	---	---
Cincinnati	11,584	11,200	346	380	650	4	14
Detroit	41,461	41,435	2,006	---	---	26	104
Los Angeles	87,616	87,538	5,500	---	---	78	242
Midwest	252,469	252,206	8.045	65	65	198	1,054
New Orleans	736	734	28	2	2	(3)	3
New York	8,396,635	7,969,676	251,628	414,171	475,463	12,788	52,424
Philadelphia-Baltimore	90,619	90,506	2,481	104	167	81	396
Pittsburg	14,388	14,388	542	---	---	---	---
Salt Lake	774	774	5,894	-	---	---	---
San Francisco Mining	202	202	2,615	---	-	---	---
San Francisco Stock	107,943	107,453	9,299	399	345	91	262
Spokane	339	339	571	---	---	---	---
Washington	2,239	2,070	92	154	153	15	194
Exempted exchanges	4,165	4,127	503	38	41	---	---
Colorado Springs	42	42	54	-	---	---	---
Honolulu	3,555	3,517	434	38	41	---	---
Richmond	264	264	5	---	---	---	---
Wheeling	304	304	10	---	---	---	---

(1) "Stocks" include voting trust certificates, American depositary receipts, and certificates of deposit.
(2) "Bonds" include mortgage certificates and certificates of deposit for bonds. U.S.Government Bonds not included.
(3) $500 or less.
(4) 500 shares or less.

Source: Securities and Exchange Commission
19th Annual Report, p.143
Fiscal Year Ended June 30, 1953
U.S.Government Printing Office
Washington, D.C.

TABLE II

Net Number and Amount of Securities on All Exchanges

June 30, 1953

	Stocks		Bonds (1)	
	Issues	Shares	Issues	Principal Amount*
Registered	2651	3,904,577,424	1002	$23,509,748,966
Temporarily Exempted from Registration	18	10,788,390	7	60,848,000
Unlisted on Registered Exchanges	301	380,775,734	63	420,430,698
Listed on Exempted Exchanges	77	35,658,052	8	22,000,000
Unlisted on Exempted Exchanges	30	3,063,584	0	0
	3077	4,334,863,184	1089	24,013,027,664

(1) Number of bonds includes 7 with an aggregate 15,650,280 pounds sterling and 1 of 24,046,600 Cuban pesos principal amount, which amounts are not shown in the dollar total.

Source: Securities and Exchange Commission
19th Annual Report, p. 144
Fiscal Year Ended June 30, 1953
U.S.Government Printing Office
Washington, D.C.

TABLE III

Trading Investigations of Possible Manipulative Practices
(Undertaken by the Securities and Exchange Commission)

	Fiscal Year 1951		Fiscal Year 1952		Fiscal Year 1953	
	"Quizzes"	Formal Investi-gations	"Quizzes"	Formal Investi-gations	"Quizzes"	Formal Investi-gations
Pending, June 30 (beginning of fiscal year)	77	11	113	10	116	10
Initialed during fiscal year	144	2	139	2	81	4
Total to be accounted for	221	13	252	12	197	14
Closed or completed during fiscal year	105	3	135	2	114	3
Changed to formal during fiscal year	3 (A)	--	1	--	4	--
Total disposed of	108	3	136	2	118	3
Pending at end of fiscal year	113	10	116	10	79	11

(A) 2 quizzes combined into 1 formal investigation

Source: Securities and Exchange Commission
17th Annual Report- Fiscal Year Ended June 30, 1951, p.40
18th Annual Report, Fiscal Year Ended June 30, 1952, p.55
19th Annual Report- Fiscal Year Ended June 30, 1953, p.31
U.S. Government Printing Office,
Washington, D.C.

TABLE IV

Comparison of Percentage Rise in Stock Prices

	"Blue Chip" Stocks* Percent Rise	Low-Priced Stocks** Percent Rise
1942-1946 rise	129	434
1949-1951 rise	71	114
1953-1954 rise	35	24

* Dow-Jones Industrials

** Standard & Poor's low-priced stocks

Source: U.S.News & World Report - August 27, 1954
Vol. XXXVII, No. 9 "Bull Markets Everywhere," p.28
Washington, D.C.

TABLE V

Number of Listed Issues on New York Stock Exchange

Year	Stocks	Bonds	Total
January 1, 1934	1209	1568	2777
January 1, 1935	1187	1540	2727
January 1, 1936	1185	1463	2648
January 1, 1937	1212	1409	2621
January 1, 1938	1259	1376	2635
January 1, 1939	1237	1393	2630
January 1, 1940	1233	1395	2628
January 1, 1941	1230	1295	2525
January 1, 1942	1232	1173	2405
January 1, 1943	1238	1136	2374
January 1, 1944	1237	1096	2333
January 1, 1945	1259	1063	2322
January 1, 1946	1269	982	2251
January 1, 1947	1334	925	2259
January 1, 1948	1379	900	2279
January 1, 1949	1419	911	2330
January 1, 1950	1457	915	2372
Janaury 1, 1951	1472	926	2398
January 1, 1952	1495	918	2413
January 1, 1953	1522	958	2480

Source: New York Stock Exchange Year Book, 1953, p. 31.

TABLE VI

Shareholdings of Institutions

(shown in billions of dollars)

At Year End	Life Insurance Companies	Other Insurance Companies	Mutual Savings Banks	Investment Trusts	Private Pension Funds	Total 5 Groups
1948	1.4	2.5	.2	4.6	1.0	9.7
1949	1.7	3.0	.2	4.8	1.1	10.8
1950	2.1	3.4	.2	4.9	1.3	11.9
1951	2.2	3.9	.2	5.2	1.6	13.1
1952	2.4	4.3	.3	5.7	1.9	14.6
1953	2.6	4.6	.4	6.0	2.2	15.8
1954 (est.)	2.9	4.9	.5	6.4	2.6	17.3

Note: Both common and preferred stocks included

Source: U.S.News and World Report - December 3, 1954
Vol. XXXVII, No. 23 "Who's Buying Stocks Now," p. 98
Washington, D.C.

TABLE VII

Reported Stock Volume and Turnover of Listed Shares on New York Stock Exchange

Year	Shares Listed as of January 1	Share Volume	Percent Turnover
1934	1,293,299,931	323,845,634	25
1935	1,305,421,004	381,635,752	29
1936	1,317,847,662	496,046,869	37
1937	1,360,349,902	409,464,570	30
1938	1,412,002,738	297,466,722	21
1939	1,424,252,369	262,029,599	18
1940	1,435,404,562	207,599,749	14
1941	1,454,761,737	170,603,671	12
1942	1,463295,021	125,685,298	9
1943	1,470,502,630	278,741,765	19
1944	1,489,367,030	263,074,018	18
1945	1,492,277,716	377,563,575	24
1946	1,592,111,825	363,709,312	22
1947	1,771,399,168	253,623,894	14
1948	1,906,512,708	302,218,965	15
1949	2,017,500,879	272,203,402	13
1950	2,165,670,128	524,799,621	23
1951	2,353,221,166	443,504,076	18
1952	2,615,904,584	337,805,179	13

Source: New York Stock Exchange Year Book, 1953, p.33.

TABLE VIII

New Securities Offered for Cash Sale in the United States

(Estimated Gross Proceeds in Thousands of dollars)

Year	All Offerings	All Private Placements	Private Placement Percentage of All Offerings
1943	44,518,166	371,861	0.8
1944	56,309,992	786,828	1.4
1945	54,711,881	1,021,690	1.9
1946	18,685,493	1,917,013	10.3
1947	19,940,927	2,235,480	11.2
1948	20,249,988	3,086,799	15.2
1949	21,110,068	2,502,296	11.9
1950	19,892,793	2,679,602	13.5
1951	21,264,507	3,414,691	16.1
1952	27,257,409	4,049,793	14.9

Source: Securities and Exchange Commission
19th Annual Report - Fiscal Year Ended June 30, 1953
p. 127 and p. 130.

TABLE IX

Special Offerings on the New York Stock Exchange

Year	Number of Offerings	Total Shares Sold	Market Value of Shares Sold
1942	73	779,776	$22,124,845
1943	69	1,017,562	29,541,245
1944	73	938,186	30,886,428
1945	70	875,264	28,358,943
1946	20	290,226	10,346,610
1947	22	298,235	8,632,879
1948	16	202,977	4,961,054
1949	25	452,485	10,282,616
1950	19	145,221	4,777,057
1951	25	299,443	10,428,874
1952	18	342,148	9,450,037

Source: New York Stock Exchange Year Book, 1953, p. 29.

TABLE X

Prospectus of: Gulf Interstate Gas Company

Excerpt: dated July 1, 1953

Bond Purchase Agreements

The Company has entered into Bond Purchase Agreements, dated February 20, 1953, as amended, with twenty-institutional investors for the purchase by them, at the principal amount plus accrued interest, of an aggregate of $96,000,000 principal amount of First Mortgage Pipe Line Bonds, 4 1/8 percent Series due October 1, 1974, as follows:

Name	Maximum Principal Amount
Metropolitan Life Insurance Company	48,000,000
New York Life Insurance Company	16,000,000
John Hancock Mutual Life Insurance Company	6,000,000
The Northwestern Mutual Life Insurance Company	5,000,000
J.P.Morgan & Co., Incorporated, Agent	3,000,000
The Lincoln National Life Insurance Company	2,500,000
Aetna Life Insurance Company	2,000,000
Provident Mutual Life Insurance Company of Philadelphia	2,000,000
Equitable Life Insurance Company of Iowa	1,500,000
The Guardian Life Insurance Company of America	1,250,000
J.P. Morgan & Co., Incorporated as Trustee of Various Pension Trusts	1,250,000
Continental Assurance Company	1,200,000
The Connecticut Mutual Life Insurance Company	1,000,000
Pacific Mutual Life Insurance Company	1,000,000
Phoenix Mutual Life Insurance Company	1,000,000
Teachers Insurance and Annuity Association of America	1,000,000
Yale University	1,000,000
The Life Insurance Company of Virginia	750,000
The United States Life Insurance Company in the City of New York	300,000
Guaranty Trust Company of New York, Agent	250,000
	96,000,000