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REMARKS BY CHAIRMAN COOK TO FORDHAM LAW REVIEW

ALUMNI ASSOCIATION ANNUAL MEETING

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My appearance before the annual dinner of the Fordham Law Review Alumni Association tonight is a particularly pleasant assignment because the winner of your 1973 award is a close friend and former professional associate, Judge Kevin Thomas Duffy of the Southern District Court of New York.

Actually, appearing before legal groups today is generally a pleasant experience. When I address lawyers these days, I can't help but note the general tone of optimism and well-being around me. I find this a rather sharp contrast to people on Wall Street, who are living through one of the toughest profit squeezes in the history of the securities industry. Perhaps the contrast between these feelings of well-being on the one hand and depression on the other can be explained by the fact that we are living in an era of litigation. Today, it seems that everybody is suing everybody else and lawyers are busier than ever before. I noted in a speech recently that the April issue of Fortune Magazine, in the article titled "The Legal Explosion Has Left Business Shell-Shocked" reports that the annual bill for legal departments and outside counsel for American companies may run to something to the tune of \$3 billion. So it would seem that law is the real growth industry. Perhaps the law firms should incorporate themselves rather than their clients and let everyone share in the litigation boom.

Before I get into the heavy stuff of my remarks, I would like to comment briefly on the distinguished alumnus of the Securities and Exchange Commission being honored

here tonight. Judge Duffy was on the Fordham Law Review, as was his wife Irene. After graduating from Fordham he clerked for the Chief Judge of the Second Circuit Court and later moved to the Office of the U. S. Attorney as Assistant Chief of the Criminal Division. I'm told he had a lot of appeals in those days. Following this, he entered private practice and later joined the Securities and Exchange Commission as Regional Administrator in the Commission's New York Office. Since the New York Office is in the heart of things, perhaps as no other Office in the Commission, Judge Duffy as Regional Administrator had his hands full with a number of the major cases brought before the Commission. In fact the case load at one time was so heavy that a New York newspaper reporter used to call Regional Administrator Duffy the "ghetto priest". That remark made me think of some of the B movies now on television where the young District attorney tells the criminal to "Come quietly son. Just hand over the gun." I can imagine Kevin in the starring role. I can also imagine Regional Administrator Duffy and his companion, Bill Moran, now the new Regional Administrator, double-teaming a suspect. "Let me at him," says Mr. Moran, restrained by Mr. Duffy. "I can't hold him much longer," Kevin explains to the suspect, "you'd better come clean."

Last November, the President appointed our Regional Administrator to the bench as a Judge in the Southern District Court of New York, one of the youngest men to hold that honor. His has been a career of extraordinary experience and achievement. The Commission, knowing a good thing when it sees it, does not want to let the Duffys go entirely. Kevin's wife, Irene, will shortly be joining the staff of the Commission in the New York Regional Office. So we are delighted to continue to have the services of the Duffys.

Tonight I want to briefly tell you about some of the concerns that we have at the Commission, to inform you of some of the problems that affect all of us concerned with the economy, and outline briefly what we are doing about them. I should add here that my trip to New York is not entirely social, that the Commission is on the alert for legal talent. We are now developing an SECC Attorney Fellow Program which will bring experienced attorneys from corporate and securities law to the Commission for a specified period. We will get the benefit from the infusion of new legal approaches. And the participating attorneys will find themselves involved in the substantive legal problems confronting us-- and there are plenty of these to go around.

We at the Commission are concerned about the capital markets. I think most of you know that the securities markets in this country are an important national asset-- one that remains as a distinct advantage for this nation in the increasingly competitive economic race it finds itself running with the rest of the world. Two hundred million Americans depend on the ability of our securities markets to direct and propel our economic progress. About one hundred million Americans through various indirect investment have a fairly direct stake in the values established by our securities markets. Thirty-one million of these Americans own stocks or mutual funds directly. By contrast, the Commission has a population of about 1,500 people and a budget of \$29 million. So we are a comparatively small band to protect the vast interests of these many millions of Americans.

The challenge grows increasingly more difficult. Today, for example, we probably have more major enforcement cases going at the same time than at any other time in the Commission's history. There is the Equity Funding scandal, involving

millions of dollars in bogus insurance policies. There is the Vesco-International Controls Corporation case involving what the Commission alleges was the looting of one of the largest mutual fund complexes, Investors Overseas Services, to the tune of \$224 million. We at the Commission are still active in the National Student Marketing case, the Dare to be Great promotional complex, and a number of other cases of extraordinary dimension. Personally, I believe the scope of a number of these cases, which really involve vast amounts of people's savings, are contributing to a crisis of confidence in the securities markets. The visible evidences of fraud involving large pools of capital not only are a contributing factor to this problem but they add to the more basic problems surrounding a growing institutionalization of the securities markets. Certainly it is no revelation to say that the fraud in these cases has become more impersonal, more distant, because the companies have grown so large-- as have the pools of capital and savings, so that the institutions can no longer know the individuals whose savings they are representing as they once did decades ago. The Equity Funding case raises particular problems for the market, since this was a stock which for a long time enjoyed large institutional buying interest and had a very active following. Then it was developed that most of the company's insurance in force was represented by non-existent policies. The direct effect to investors who were relying on the information coming from the company can only be described as devastating. The ripples that continue to fan out from this monumental fraud can only damage public confidence in the securities markets.

Coincidentally with the huge dimension of these enforcement cases before the Commission, we are seeing a sharp decline in the role of the individual in the securities markets. In a recent address to the Economic Club of Chicago, I looked at this problem

in some detail and I won't develop it to any great extent tonight. However, we are convinced that the vacuum being created by the growing absence of the individual investor in the markets already is having a strong visible and adverse effect on the liquidity and the pricing mechanism for hundreds of stocks. And there are strong indications that the unique ability of this country's capital market system to raise new money for many thousands of small young corporations throughout the country is beginning to be affected as well.

Many of you have probably observed in your own investment experience that the securities markets today appear to be really made up of two distinct and divergent markets. The first is the world of the major stocks with large pension fund and other institutional followings, and their course is usually developed by the Dow Jones Industrial Average and other popular averages. The other market consists of the smaller less established companies with little institutional following or sponsorship. It is interesting to note that while the Dow Jones Industrial Average dropped from over 955 in November 1968 to below 700 in 1970 and then recovered to break 1,000 in November, by contrast an unweighted index of 1400 stocks is still languishing almost 50 per cent below its peak in 1968. It is clear that one of the causes for these separate and distinct markets lies in the relative absence of the individual from the market. That is because the large financial institutions generally concentrate their activity in a narrow range of stocks. It is the activity of the individual which brings trading interest and liquidity to the broad range of other stocks, principally the smaller companies. Today, we are increasingly seeing what happens-- in the form of abrupt price swings and widening spreads between the bids and offers for many securities-- when the flow of individual orders begins to dry

up. And it is this problem probably more than any other-- because it has such a fundamental interest to the welfare of the economy and the future of the capital raising mechanism in this country--that occupies the great general concern of the Commission.

We have a number of major projects which we believe will move to rejuvenate investor interest and confidence in the securities markets. Many of you are familiar with some of them. We recently developed in detail our thinking for a new central market system which would tie together the great market making capability of the New York and other exchanges, as well as the activities of market makers off the exchanges, in a huge communications network for listed securities. What this will do is assure the individual investor of the best possible price for a listed security at any given point in time--no matter whether he is a buyer or seller. It will give the broker both the means and impose on him the obligation to direct the customer's order to the best market--no matter whether that market is in New York, Chicago, Los Angeles, or in the office of a broker-dealer off the exchanges. In this way, the individual investor will know that his order is receiving the kind of execution that a large institution could expect. In addition, the new market system will allow customers to participate in some of the potential bargains that exist in dealings between institutions at prices away from the current market price. We think that the central market system, which we are seeking to have implemented within two years, will prove to be a major incentive for the return of the individual investor to the market.

The Commission is attacking the problem on a number of other fronts as well. The quality of disclosure is a matter that has always concerned us. It is particularly important today since many individual investors feel that financial institutions get all the best information, the best advice, and even inside information. We are moving to clarify

the rules on inside information and to bring tougher enforcement procedures, including possible jail terms for securities fraud involving inside information. We will move to develop more disclosure on what institutions do in the market and their stockholdings. This will be the thrust of our Institutional Disclosure Act, which will give the Commission power to require all types of institutions--banks, insurance companies, pension funds, and the like--to disclose holdings and transactions in securities over which they have investment authority. Among other things, the collection and analysis of this information should provide investors with a glimpse of how much of a stock is in institutional hands.

Our concern with disclosure doesn't stop with requirements for more information. We are increasingly developing rules and guidelines to improve the clarity of information that corporations issue the public. This involves prospectuses on new offerings, the way companies explain their accounting practices to investors, the scope of what is provided in corporate annual reports, and many other disclosure documents.

We have moved additionally to limit institutional membership on exchanges to entities which are primarily on the exchanges to do a public brokerage business. We believe that the closeness to the market and the many other advantages that accrue with an institution being a member of the exchange require that the institution not be a part of the exchange mechanism merely to do its own business or that of affiliates. I think this equalization and responsibility that will come with exchange memberships will also assure the individual that he is on comparable footing in the marketplace with other investors. And, the Commission has already moved in substantial ways to clear up the problems of the past in the brokerage industry--the paperwork crunch and the financial

crisis that gripped the industry in 1969 and 1970. We have today new rules that effectively bring about a separation of the customers' cash and securities from the risk business of the brokerage firm so that the broker is never using public funds to finance underwriting in other risk activities. We have a whole network of regulation on the movement of securities and both financial responsibility and financial reporting of broker-dealers. This year again we will support in the Congress a bill to establish a nation wide system for the processing of securities transactions and the transfer of ownership. This comprehensive scheme will involve not only the brokerage firms but the banks and other entities involved in the movement and processing of securities.

Obviously, we have our work cut out for us as we seek to lay the groundwork for the return of the individual investor--which is a vital economic concern to the country. And we will be increasingly working with the Congress and the securities industry to develop a rate system in the industry that is more effective and offers more of an inducement by way of services to the individual investor. We are also encouraging Congress to take a look at the effect on the market of inflation, high interest rates, and tax policies involving capital gains, treatment of pension funds and many other related matters.

I think you can see that the scope of what the Commission is doing grows increasingly complex and important. It is a growing challenge. We believe the future of the money-raising mechanism is among the most important confronting the economy today. We hope to make a substantial contribution to the continuation and strengthening of this unique national resource.