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Department of Justice

"CRIME AND THE INVESTOR"

AN ADDRESS OF

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TRUST DIVISION, AMERICAN BANKERS ASSOCIATION

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It was Montesquieu who wrote, "Peace is the natural effect of trade." His point was that "two nations who traffic with each other become reciprocally dependant" and develop a vested interest in maintaining peace.

This may be true, but we tend to overlook the corollary to this proposition, that "trade is the natural effect of peace." This is valid not only between nations but within a nation. That is, business depends upon venture capital; venture capital depends upon confidence; and confidence depends upon maintaining the public peace and safety.

This proposition, which is the basis of my remarks on "Crime and the Investor", would seem obvious enough, but let's look at the record.

You will, of course, recall how Americans were alarmed at the wave of crime mounting in the 1960's. From 1960 to 1968 serious crime increased by more than 120 percent, and it grew by 17 percent in the peak year of 1968. Mob violence also rose to a serious level, with 83 persons dying as a result of civil disorders in 1968 alone.

The impact of this orgy of lawlessness on the American people can well be remembered, and it is still with us. In 1967 the President's Crime

Commission reported that one-third of Americans were afraid to walk alone at night in their neighborhoods, and more than one-third kept firearms in the house for protection.

In 1968 a Gallup Poll showed that Americans considered lawlessness to be the top domestic problem facing the nation. A Harris Poll showed that 81 percent of Americans believed that "law and order has broken down in this country."

In that same year, at a conference of the National District Attorneys' Association, Professor G. Robert Blakey of the University of Notre Dame Law School declared that "The law enforcement system has collapsed in this country," and the 300 District Attorneys in the audience showed their agreement by thunderous cheers and applause.

In fact, the fear of a breakdown in the public order in the United States was not confined to America. The European press was full of editorials viewing with alarm the rate of crime, riot, and assassination in this country. The Prime Minister of Canada expressed the fear that in the future, the beginnings of civil war in the United States might overflow across the border. "Civilization and culture in North America," he said, "are more menaced by internal disorder than by external pressures."

Now, from our vantage point five years later we may not believe that the United States appeared to be approaching a civil upheaval. Yet, as I recited, a great many Americans thought so at the time. And in my opinion it would not have been surprising if the investors in this country had reacted by pulling in their capital. As we have noted, investment is an act of faith. One's confidence in the marketplace is hardly enhanced if the pillars are trembling.

But what did the stock market do in 1968? It went up to reach a new high at the end of the year--a new high that was not surpassed for nearly four more years. In fact, the main market reaction to the 1960's crime wave--so far as I can make out--was a boom in the stock of companies making police equipment.

So it would appear from this record that crime has very little to do with the investor, and that the title of my address is an anomaly.

But the truth is just the opposite. Lawlessness is anathema to economic progress. I want to devote my remarks to this proposition, and to convince you that investors have an absolute interest in maintaining the public peace.

The truth is that what the Prime Minister of Canada referred to as "civilization and culture" depend completely on the stability that comes with the rule of law. And no aspect of civilization is more dependent upon law than business.

Law provides the basis for contracts and for the courts through which contracts can be enforced. It provides the currency and the rules by which the credit system operates. It provides the standards of weights, measures, and quality by which prices take on meaning. It provides the basis for patents, for licenses and franchises, and most important, for the legitimacy of corporations as business entities.

In short, law provides an enforceable framework of rules within which business can feel free to risk capital.

This is readily demonstrated by the rise of banking in the late Middle Ages as soon as legal support was given to the lending of money and the collecting of debts. It comes through clearly when we recall the tremendous impetus given to oceanic trade when the entrepreneurs could get insurance against the loss of ships and cargo, and could be confident of collecting on that insurance if necessary through courts of law.

But the law does much more than this in the cause of commerce. It provides a climate of public safety which assures not only the free flow of trade, but the confidence that trade is safe enough to be worth the risk.

This benefit is intrinsic in the political philosophy on which our nation was founded. John Locke wrote that since the state of nature "is full of fears and continual dangers," men are willing to join together in a Social Contract "for the mutual preservation of their lives, liberty, and estates..." And Jean-Jacques Rousseau added that this Social Contract into which men enter to govern themselves "far from despoiling them, only assures them legitimate possession."

So it was that the rise of commerce in Western Europe followed hand-in-hand with the rise of viable governments that could assure the peace. As historian William McNeill has put it in his Rise of the West, "The secret of the new strength of the French and English monarchs lay largely in their informal alliances with townsmen of the realm, who agreed to contribute tax monies to the royal exchequer in return for guaranties of their corporate liberties and protection against local feudal lords."

As we know, this arrangement did far more than guarantee the possession of property. In proportion as the rule of law increased in Western countries, commerce expanded. And it is in the strength of the government's promise to maintain the public peace that business enterprises have dared to build the vast and sophisticated structure of financial capital that has made ours the most bountiful economy in the world.

To prove this we need only look at those lands where this guarantee does not exist. What company will invest its funds to develop the resources in a country where bandits rule the highways, or for that matter, where they rule the government itself? And the ultimate tragedy has occurred where weak governments have permitted such civil disorder that the economy itself was threatened, and the only means of restoring stability appeared to be a Mussolini or a Hitler.

These historic references might seem superfluous to many, but the trouble is that we take for granted the edifice of stability which has stood in this country almost unbroken for two centuries. As investors, no less than as citizens, you and your clients have an infinite stake in the rule of law. A crime, whether a street mugging or a white-collar fraud, is a mini-revolt against that rule of law, and it is your concern and your business.

Now, my purpose in all this is to elicit your interest, but not your alarm. As you remember, Richard Nixon expressed the nation's feelings on the subject of crime in his campaign for the Presidency in 1968. He pointed out that crime was increasing "almost nine times as rapidly as the population." He outlined a strong program to block this trend.

"We can not accept a wave of crime," he said, "as the wave of the future."

When John Mitchell and the others who were to lead the Justice Department gathered in Washington early in 1969, our thinking was dominated by this injunction from President Nixon. We mounted a war on crime at the Federal level, and in the next four years we allocated to the States $1.5 billion in Federal aid to help them fight crime at their level.

Through this combined Federal, State, and local offensive, the tide of crime was turned. Today, though we still agree that it is too high, serious crime in this country is increasing no faster than the population. It has been 13 years since it was possible to make that statement. In many of our largest cities, including New York and Washington, the volume of crime has been turned downward. Americans continue to be concerned about crime, but fewer are saying any more that "law and order has broken down in this country."

Yet in at least one respect, crime continues to be a direct threat to the investor. I refer to the high incidence of theft and forgery of stocks and bond certificates which is, in effect, jimmying the machinery of the securities business. We are, of course, cracking down on such crime, and the amount of stolen securities dropped from an estimated $675 million in 1971 to approximately $270 million in 1972.

But this is still a very sizable volume of theft. According to our present information, about $2 billion worth of stolen and counterfeit securities are currently outstanding--that is, unrecovered. Our Criminal Division believes that if truly effective means of reporting such thefts and forgeries were established, we might find that the truly outstanding loss would be as much as 10 times bigger--that is, $20 billion.

Who steals these securities? Our files show that much of it is done by burglary, but much more is done by insiders, and even some of the burglary is accomplished with the conivery of insiders. It is stolen out of the vaults of banks and brokerage houses, and it is stolen out of the mail and express pouches at airports.

One confessed thief told a Senate subcommittee how he and his colleagues stole $100 million in stocks, bonds, and other valuables over a four-year period at airports across the country.

Another estimated that in a five-year period he had been involved in or was aware of thefts of up to $50 million in securities.

In 1969 one bank alone lost more than $13 million in Treasury bills. Most of the bills have been recovered and more than 40 persons have been arrested in this case in the United States and Europe.

How are all these stolen securities used? Mostly they are sold at huge discounts to organized crime syndicates. They, in turn, use them as collateral to get loans, which they then default, or for other nefarious purposes. Recent hearings before a Senate subcommittee showed the underworld to be involved in a very large part of securities thefts, and also showed how it used these assets to infiltrate legitimate business. Many if not most of these securities are fully negotiable, and are often sold on the stock exchange through a broker who does not realize that his client's certificates are stolen.

I cite all of this not to alarm American investors, but to promote among them and their agents some healthy and legitimate concern. These thefts and forgeries of securities have reached the point where they are injecting a new element of risk into the securities business. One insurance company official has testified that his firm is suing five different financial institutions because they accepted securities which had been stolen and which had been paid for as a loss by the insurance company. His firm is so wary of securities thefts from the vaults of brokerage firms that he requires his clients to discontinue the practice of holding securities for their customers.

From this kind of testimony it is clear that such thievery is, in fact, a serious disruption to the securities business, comparable perhaps to sky-jacking in the airline business. Conceivably it could reach the point where some traders will be deterred from doing business as usual, the same as some potential passengers may have been deterred from flying on the airlines. This is why I firmly believe that restoration of security in the securities market is your business as well as mine.

How can private business help? The consensus among professionals in this field is that the theft of securities is still far too easy. Many banks and brokerage houses maintain securities controls that are too little and too late. Negotiable securities are among the easiest loot to carry away and dispose of on the market. Once they are gone it is far more difficult for us to recover them than it is for you to prevent their theft in the first place. So may I suggest: know your employees; maintain limited access to your safes and vaults; invest in some modern electronic equipment that helps control even this legitimate access to them; keep serial number records of certificates where this is possible; and take inventory frequently and at unannounced times.

You can also maintain a willingness to get involved in our enforcement efforts, and this leads me to a story illustrating my point.

Our Strike Force in Newark, New Jersey, composed of investigators from various Federal agencies, was tipped off to an impending theft of bonds from a large brokerage house in New York. When alerted, the officials of this company agreed to leave the bonds in place in order to catch the thief. Soon the officials were able to watch through closed-circuit television cameras while one of their employees stole the bonds from the vault and passed them to an outside accomplice. One of the three suspects arrested in this case is said to have strong connections with an organized crime syndicate in New York, and the three are now being prosecuted.

Besides this kind of helpful cooperation, you can strike still another blow for the integrity of the securities business. You can make yourself acquainted with the proposals that have been made for a comprehensive system of recording and controlling securities transactions. One of these would provide a central depository where records of ownership are kept constantly updated by computer, so that your ownership of a security can be confirmed even if the certificate is stolen. Certificates there would be kept only in very large denominations. Another would put all the emphasis on the central bookkeeping system as the record of ownership, eliminating certificates entirely.

These proposals deserve the serious consideration of trust officers and their clients, not only to help solve Wall Street's paperwork problem, but to help safeguard your securities.

In fact, a comprehensive solution to this problem will almost certainly require an Act of Congress, and last year the Senate passed a bill to establish a national commission that would, among other things, work toward eliminating negotiable stock certificates. Bills along this line will undoubtedly be re-submitted in both houses this year, and Administration spokesmen have given support to the principle of central securities record-keeping.

In my opinion this is a new example of the role of law in facilitating business. Here the government is not getting into the securities business, in any sense. But it does provide the legal framework by which the securities business can strengthen itself.

In the days of John Locke the pioneer investor found he could afford to risk more capital because of the stable society created by law. Today the investor may find he can give up personal possession of a stock certificate in return for a government-sponsored system that protects his ownership.

Providing this legal basis for progress is, in my opinion, one of the true roles of government. It is surely in the tradition of John Locke and his Social Contract, of which our Constitution is the American embodyment. And it enables us to say once again to Montesquieu, "Yes, peace is the natural effect of trade, but trade is also the natural effect of peace."