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REMARKS

BY

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"PLAIN TALK ABOUT ON-LINE INVESTING"

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Today, you can hardly pick up a newspaper, turn on a television, overhear a conversation, or talk to a friend without mention of the Internet. It has done nothing short of change the way our world works and the way our nation invests. And overall, it has changed us for the better.

I'm here today not to extoll the Internet's virtues -- as they are self-evident -- or to raise a red flag of danger. Instead, I want to try to talk plainly and sensibly about the challenges it presents in the most practical ways.

Last week, I visited a high school in New York City to talk about the importance of financial literacy. The first question I got was from an inner-city student who asked what Internet stock she should buy. We are living in a time when the stock market is more a part of the American consciousness than ever before. After years of nothing but "up" markets and empowering technology, the investor psyche has gone through a lot of changes. Memories have shortened and important points may have gotten lost in the excitement.

We -- as a nation, as investors, as businesses and as regulators -- should not get manic about the mania. One day, a little-known company stock soars 38,000 percent after on-line investors invest using the wrong ticker symbol. Another day, someone fabricates a news story by copying a web page of a news organization and the stock in question rises 32 percent. Or, more generally, it's an investor who didn't take the time to appreciate what he was getting into and ended up losing his life savings in one fell swoop. It seems that with every passing day, we come across one story more amazing than the other.

As cliche as it may be, the fundamentals still apply. I want to review them here – whether they take the form of advice to investors, guidance to brokers, or reasoned action for regulators.

I want to discuss a number of important issues that should give all of us sufficient pause. **First** to investors, I want to talk about your responsibilities when investing over the Internet; **second**, to on-line brokerages, in the enthusiasm over on-line trading, we can never forget the fundamental obligations to customers; and **third**, I want to discuss how the SEC is responding to these rapid changes to protect investors and help maintain market integrity.

Today, more than seven million Americans trade on-line accounting for 25 percent of all trades made by individual investors. In 1994, not one person traded over the Internet. In the next few years, the number of on-line brokerage accounts will roughly equal the metropolitan populations of Seattle, San Francisco, Boston, Dallas, Denver, Miami, Atlanta and Chicago, combined.

The breadth and pace of change prompted by the Internet are phenomenal. But, while it changes the way millions of Americans invest, on-line investing doesn't alter the basic framework that has governed our markets for the past 65 years.

The laws regulating our markets are a product of the New Deal era. To me, their concepts are as immutable as the Constitution. They have weathered challenge after challenge, decade after decade, and are every bit as relevant and effective today as they were the day they were written. Companies offering their shares -- whether off a website or through a prospectus -- still have to disclose what they are selling and why. Brokers -- whether traditional or on-line -- still have the same obligations to their customers. And fraud -- whether perpetrated over the Internet, on the phone, or in-person -- is still fraud.

Consequently, I am not convinced it's necessary for the SEC to pronounce a totally new and radical scheme of regulation specifically tailored to on-line investing. I don't rule out the possibility that there may come a time when the SEC sees a need for new approaches to better meet the imperatives of the Internet. But, I don't believe we have reached that point yet.

What must occur, however, is a greater recognition by investors of their individual responsibility. I'm talking specifically about an individual investor's duty to understand and control the level of risk he or she is undertaking. That level can vary with the type of activity an investor undertakes. On one end of the spectrum lie investors who trade occasionally on-line and hold their investments for the longer term. They are basically retail investors who manage their portfolios through on-line accounts.

On the other end are so-called "day traders" whose time horizon for moving in and out of stock positions is measured by minutes, if not seconds. Day trading is really another way to say speculation. And, that's not new to our markets. Historically, however, this role has been filled by a relatively small number of professional traders.

I am concerned that more and more people may be undertaking day trading strategies without a full appreciation of the risk and difficulty involved. No one should have any illusions of what he is getting involved in. I know of one state that recently found that 67 out of 68 day traders at a firm had in fact lost money. You'd find better odds in Las Vegas.

Somewhere in the middle of this spectrum is an increasing number of Americans who use their on-line accounts both to invest longer term and to trade short term on momentum or small changes in the price of a stock. Call this mixed strategy day trading light. Quite honestly, I worry about and, at the same time, am heartened about this growing legion of investors.

I'm concerned about the great influx of new and relatively inexperienced investors who may be so seduced by the ease and speed of Internet trading that they may be trading too quickly or too often for their specific goals and risk tolerance. I also wonder about many of these investors who have never experienced a down market. On the other hand, a greater number of Americans investing for their futures and helping to create capital is, in the long-term, good for our markets and good for our country.

THE CREED OF AN ON-LINE INVESTOR SHOULD BE INDIVIDUAL RESPONSIBILITY

But, regardless of how frequently an on-line investor trades or invests, the opportunity to make trading decisions comes with the responsibility to take the time to understand the implications of those decisions. We have noticed four common misconceptions that investors have about on-line trading.

The first is that although the Internet makes it seem as if you have a direct connection to the securities markets, you don't. When you push that enter key, your order is sent to your broker, who then sends it to a market to be executed. This process is usually seamless and electronic; it is not, however, guaranteed. Lines may clog; system may break; orders may back-up.

Even when automated systems can handle a lot of investors who want to buy or sell the same stock at the same time, a line often forms. Price quotes are only for a limited number of shares; so only the first few investors will receive the currently quoted price. And, as you would expect, the price of that stock will then go up if there are more buyers and down if there are more sellers. By the time you get to the front of the line, the price of the stock could be very different. That's simply the law of supply and demand. It applies on the Internet just like everywhere else.

So, how do investors protect themselves from a rapid change in the price of a stock? The best way is to use a limit order. That's the second thing every on-line investor needs to know. A limit order buys or sells a security at a specific price. In other words, the order is executed only the market price has not moved past a certain level. Alternatively, a market order buys the stock at whatever price the security is at the time the order reaches the marker. So, if you place a market order to buy a stock at $9, you could end up paying $90 by the time your order is executed.

This isn't theoretical. More than a few investors have lost their entire savings -- thousands and thousands of dollars -- because they failed to limit their price. Now, sometimes limit orders may not get executed in a fast moving market and some firms may charge more for them. But, at the very least, I'd rather not own a stock or pay a little more upfront than be totally unprepared or incapable of paying a whole lot more later. My goals as an investor may be different than yours, but considering the costs and benefits of a limit order is part of responsible investing in today's market.

The third misconception is that an order is canceled when you hit "cancel." But, the fact is it's canceled only when the market gets the cancellation. You may receive an electronic confirmation, but that may only mean your request to cancel was received -- not that your order was actually canceled. And, orders can only be canceled if they have not already been executed. Recently, one major brokerage wasn't able to process 20 percent of the cancellation orders on a fast moving IPO. One investor placed an on-line order for 2,000 shares of the stock -- thought she canceled it -- and then placed another order for 1,000 shares.

After realizing that she had two orders outstanding, she tried to cancel both. Instead, she owed her broker over a quarter-million dollars for 3,000 shares after wanting to invest roughly $18,000. Most cases may not be this exceptional, but I urge investors to contact their firms to see how they can ensure a cancellation order actually worked.

Lastly, if you plan to borrow money to buy a stock, you also need to know the terms of the loan your broker gave you. This is called margin. In volatile markets, investors who put up an initial margin payment for a stock may find themselves required to provide additional cash if the price of the stock falls. When you buy stock on margin, you are borrowing money, and as the stock price changes, you may be required to increase the cash amount you put down against the loan.

But, some Investors have been shocked to find out that, at any time, the brokerage firm has the right to sell the securities -- without any notification and potentially at a substantial loss to the investor. Other investors have been surprised to learn that they are lending to or borrowing from other customers in their firm through excess balances in their margin accounts. It's clear that if an investor doesn't really understand the use and consequences of a margin account, he does so at his own peril.

As far as I'm concerned, for most individuals, the stock market is best used for investment not trading. And, it's important to make the distinction between trading and investing. On-line trading may be quick and easy; on-line investing -- and I emphasize investing -- requires the same old-fashioned elbow grease like researching a company or taking the time to appreciate the level of risk you are undertaking. I'm often surprised by investors who take more time deciding what movie they'll rent than on what stock to buy. These may not be popular concepts in today's markets, but they are indispensable to an investor's long-term success.

REMEMBERING THE CARDINAL RULES OF INVESTOR PROTECTION

Let me turn to some of the concerns I have about the role of on-line firms. Firms should remember that while on-line trading may place significantly more responsibility in the hands of investors, it doesn't absolve the firms of their obligations to customers. Most firms are doing a pretty good job -- especially in light of the dramatic growth they are experiencing. But as the Internet rapidly becomes more and more an integral part of investing for more and more Americas, I ask brokerage firms to help protect the integrity of this medium for the long-run.

First, firms need to ensure that their ability to provide effective customer service keeps pace with their growth. If you're marketing your firm to new customers, you better be able to provide them service when they do business with you. Firms are opening roughly 15,000 new accounts a day. That means 15,000 new potential complaints a day -- especially if a system goes down. Are investors having a hard time getting their e-mail questions answered? Are customer service 800 numbers always busy? Are complaints about failures or delays in order execution, account accessibility, and other issues overwhelming the firm's compliance department?

If the answer to any of these questions is "yes," then what are firms doing about it? It doesn't take a regulator to tell you what unhappy customers mean to a company's future, or more broadly, to the future of on-line investing.

Second, all firms -- whether on-line, discount or full service -- have an obligation to ensure the best execution of their customers' orders. That's not just good business practice; it's a legal obligation. Firms have this same duty to their customers to find the best prices -- whether they charge $10 per trade or $100 per trade.

The Commission has long stressed to firms the importance of obtaining the best possible price when they route their customers' orders. They simply can't let payment for order flow or other relationships or inducements determine where they do business. That's why I have directed our examiners to focus in on firms' order routing practices in an examination sweep. I urge all firms now to review their order routing practices to ensure they're doing right by their customers.

Third, firms need to communicate more clearly. We have reviewed the disclosure in account agreements both on paper and on web pages. Overall, we found that most firms address the different types of orders available, fewer firms discuss how market volatility and the use of margin can affect on-line investors, and almost none talk about the risks or what to do in the event of system capacity and outage problems. I know that customers' orders can be slowed down for reasons outside of a firm's control. But clearly explaining to customers rather than merely disclaiming liability through complex and legalistic language would go a long way toward reducing the complaints pouring into the SEC. Congress and your own firms.

While there's a new focus on what's on a firm's web site, we can't forget the importance of a clear and easily understandable monthly account statement. This is one document every investor reads regularly. And, there are few better opportunities in which to convey significant information to your customers.

So, to every on-line firm I challenge you to meaningfully communicate with your customers. Talk in realistic terms; let them know their options; and focus on the quality of your disclosure in your agreements and the quality of customers' account statements, instead of just the acceptability of them.

Lastly, I worry about how some on-line firms advertise. Quite frankly, they more closely resemble commercials for the lottery than anything else. When firms, again and again, tell investors on-line investing can make them rich, that creates unrealistic expectations. And, when firms sow those grandiose and unrealistic expectations, they stand a good chance of reaping the result when many of them go unmet.

Now, in fairness, there may be an increasing population of tow truck drivers who now own their own islands as a result of on-line investing of which I am not aware. Assuming there's not, there may be many investors who don't take these commercials literally -- at least I hope they don't. But I'm worried many of these commercials do represent a slippery slope and quite frankly, border on irresponsibility. Now, some may argue that we shouldn't tell firms how to sell their products as long as its lawful. I agree. But selling securities is not like selling soap. Brokers have always had duties to their customers that go beyond simply "buyer beware."

I've asked the NASD regulatory unit to hold a roundtable on advertising to add to the work they're already doing to improve fairness in advertising. I call on all of the firms to join in this effort. I've also asked the American Advertising Association to help ensure the best practices for Madison Avenue. I expect this group composed of leaders of the securities and advertising industries to report back to the SEC with specific recommendations.

WHAT THE SEC IS DOING

Today, I've talked about what investors need to be aware of if they invest over the Internet and I've also discussed some of the issues firms should be paying more attention to. As technology recasts our markets and helps attract more and more investors than ever before, the SEC's mission to protect investors and maintain market integrity remains absolute.

Financial fraud perpetrated over the Internet represents a signal challenge for the SEC. While the scams we have seen on the Internet are the same basic frauds that have always accompanied the flow of money, the Internet's speed, low cost and relative anonymity give them access to an unprecedented number of innocent investors.

Policing this marketplace will require more resources, more manpower, and more money. Nonetheless, we are prepared to do whatever is necessary to help protect investors. While we contend with the Internet's growing presence, it offers us important tools to track down and catch criminals. For example, although the individual who perpetrated last month's news hoax about a corporate takeover tried to cover up his footprints, we helped tracked him down within a week. Law enforcement will tell you that it's a lot easier to catch someone who uses the Internet than the telephone.

Last year, we created the SEC's Cyberforce -- a specifically trained nationwide corps of 125 attorneys, accountants and analysts tasked with searching for and conducting investigations of Internet fraud. This year, we're increasing that number by nearly 40 percent. Next year, the Commission is seeking an $11 million increase to expand our efforts to combat fraud -- including Internet fraud. And, with the support and insight of Congressional and Administration lenders, we will continue to step up our efforts in the future.

In the mean time, we are vigilantly pursuing those who seek to take advantage of innocent investors. In the next two weeks, the SEC's Enforcement Division will present a number of cases charging fraudulent offerings over the Internet. These cases would charge issuers with making false claims about their companies or offering investments in entirely fictitious companies.

Second, the SEC's Office of Compliance and Inspections will continue to inspect firms offering on-line trading. We've already conducted inspections of firms that represent 80 percent of the market share. Based on our initial findings, I sent a letter this morning to the largest of the on-line brokerage firms asking them improve the quality of their disclosure. I look forward to seeing their response.

The SEC and the self-regulatory agencies are also inspecting all of the brokerage firms that specialize in day trading. Clearly providing day trading opportunities is not itself against the law, but these firms should be on notice that they are still broker-dealers and must operate within the existing rules. That means they must comply with disclosure, capital, margin, and best execution requirements as well as maintain updated and comprehensive books and records. And any firm, whether day trading or on-line, that recommends a type of investment strategy needs to ensure that it is suitable for their investors.

Third, I'm announcing today the formation of a formal SEC public-private sector Advisory Committee on Technology. The Advisory Committee's mandate will be a broad one. It will encompass not only how the Commission might better leverage its resources to protect investors and safeguard market integrity, but also to examine issues specifically relating to on-line trading. I'm very pleased to announce that General Ken Minihan, former head of the National Security Agency, Charles Vest, President of MIT and Bran Ferren, a true innovator in technology, have agreed to lead this effort in lending cutting edge expertise to the SEC.

As their first priority, I have asked the Committee to convene a group of industry executives to hear their thoughts and concerns about how technology will affect our markets and its participants.

Fourth, the Commission is unveiling its new Investor Education Web Page. The Web site is ww.sec.gov. It include detailed information and tips on on-line investing, how to detect fraud both on and off the Internet and other important information on saving and investing.