

**CODE OF FAIR COMPETITION
FOR INVESTMENT BANKERS**

With

**A DESCRIPTIVE ANALYSIS
OF ITS
FAIR PRACTICE PROVISIONS**

And

A HISTORY OF ITS PREPARATION

Investment Bankers Code Committee

FOREWORD

This booklet is published by the Investment Bankers Code Committee for the information of investment bankers and others who may be interested. The booklet contains the complete Code of Fair Competition for Investment Bankers, with its various amendments, including the Amendment sometimes referred to as the Fair Practice Provisions of the Code. It also includes the letters of transmittal by General Hugh S. Johnson, recommending approval of the Code and the Amendments by the President, and the executive and administrative orders pertaining thereto.

In order that the details of the Code may be more clearly understood, there is included in the booklet the essential portions of the public hearing before the NRA at which the Fair Practice Amendment of the Code was presented in detail, section by section. Both the spirit and the letter of the Code are set forth in particular clarity in the remarks on that occasion by Mr. B. Howell Griswold, Jr., Chairman of the Investment Bankers Code Committee; Mr. Robert E. Christie, Jr., President of the Investment Bankers Association of America, and Mr. Joseph C. Hostetler of the firm of Baker, Hostetler, Sidlo & Patterson of Cleveland, Ohio, counsel for the Code Committee.

It should be remarked that this Code is in no small measure owing to the untiring efforts of the Code Drafting Committee of the Investment Bankers Association of America, under the able leadership of Colonel Allan M. Pope, Chairman, and Mr. Frank L. Scheffey, Vice Chairman. In the formation of the preliminary draft of the Fair Practice Provisions this committee devoted more than three months of incessant effort in its endeavor to develop a code which would genuinely represent a new deal in the investment banking business. It is believed that a perusal of the Code itself, together with the explanations in the accompanying discussions herewith, will present convincing evidence that this Code marks a tremendous step forward in assuring sound investment conditions in the United States.

Investment Bankers Code Committee
Washington, D. C.

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Code of Fair Competition for Investment Bankers
With a Descriptive Analysis of Its Fair Practice Provisions
and
A History of Its Preparation

CONTENTS

Executive Order by the President of the United States, March 23, 1934, approving the Fair Practice Amendments. Page 1

Letter of Transmittal to the President of the United States by Hugh S. Johnson, Administrator, National Recovery Administration. Page 2

Fair Practice Amendments to the Code of Fair Competition for Investment Bankers, Approved by the President, March 23, 1934. Page 7

Statement by B. Howell Griswold, Jr., Chairman, Investment Bankers Code Committee, in Presenting the Fair Practice Amendments to the Code of Fair Competition at the Public Hearing before the National Recovery Administration, March 15, 1934. Page 37

Statement by Robert E. Christie, Jr., President, Investment Bankers Association of America, at the Public Hearing before the National Recovery Administration. Page 42

Descriptive Analysis by Joseph C. Hostetler, Counsel, Investment Bankers Code Committee, at the Public Hearing before the National Recovery Administration. Page 47

Code of Fair Competition for Investment Bankers, Approved by the President, November 27, 1933, as modified February 1, 1934, including Executive and Administrative Orders and other documents relating thereto. Page 85

NOTE: The contents hereof are taken from official records with the exception of the insertion of sub-heads and other slight editorial changes in the statements by Mr. Griswold and by Mr. Christie, and the insertion of sub-heads and clarifying passages in Mr. Hostetler's statement to facilitate convenience in reading and usefulness in reference and to give effect to changes in the subject matter subsequent to the hearing.

One copy of this booklet has been sent without charge to each employer who has assented to the Code; also to the principal newspapers, financial magazines and libraries. Additional copies may be obtained from the Code Committee at 25c each, postage prepaid.

Issued by
Investment Bankers Code Committee
April 19, 1934

(3)

visions of the Code. These deal with standards of business conduct in the underwriting and distribution of securities and in safeguarding the welfare of investors.

2. Five sections govern the issuance of new securities. In the future those issuing securities will be required to provide adequate detailed information to investors as long as a security is outstanding. This is a far reaching provision. It marks a very long step in the right direction and furnishes a new safeguard to protect investors.

3. Seventeen sections regulate the underwriting and distribution of new issues. Provisions are included which will tend to establish one price for all investors irrespective of the size of the transaction or the importance of the purchaser. Adequate time is provided for the proper study and analysis of the facts regarding new issues by all investment bankers participating in the distribution of each issue.

4. Eight sections are directed to retail sales and purchases dealing with disclosure of the adequate and the pertinent facts required to be made available to investors.

5. Four sections pertain primarily to salesmen, and stipulate the minimum qualifications of those employed in that capacity and the requirement for responsible supervision of their activities.

6. One important section relates to investment companies and places certain restrictions on investment bankers having relations or transactions with such companies.

7. Thirteen sections provide a unique opportunity for investment bankers, through registration, to agree with one another upon the expeditious enforcement of effective self discipline in the investment banking business.

It was stated in my letter of November 20, 1933, transmitting to you the Code of Fair Competition for Investment Bankers that the members of the Association proposing the Code transacted approximately 90% of the total volume of the investment banking business for the year 1932. This statement was intended to refer only to the percentage of the volume of new issues. The members of the Association did a substantial percentage of the total volume. The Investment Bankers Association of America is the single truly representative organization of this type of financial concerns, and there is no other national association.

Inasmuch as the Amendments submitted herewith involve important changes in methods now existing, I suggest a more expeditious procedure than that prescribed in the Code of Fair Competition for effectuating changes in its provisions. Especially is this necessary in view of the provisions of Section 1 of Article IV; of Sections 1 and 2 of Article V; of Section 1 of Article VI; of Article X; and of Section 11 of Article XI. I therefore recommend that you permit the Administrator, upon recommendation of the Investment Bankers Code Committee or otherwise and after such notice and hearing as he may specify, to approve such modifications or Amendments as he may deem necessary or desirable.

The Division Administrator in his final report to me on the said Amendments to said Code having found as herein set forth and on the basis of all the proceedings in this matter:

I find that:

(a) The Amendments to said Code and the Code as amended are well de-

(4)

signed to promote the policies and purposes of Title I of the National Industrial Recovery Act including the removal of obstructions to the free flow of interstate and foreign commerce which tend to diminish the amount thereof, and will provide for the general welfare by promoting the organization of industry for the purpose of cooperative action among trade groups, by inducing and maintaining united action of labor and management under adequate governmental sanction and supervision, by eliminating unfair competitive practices, by promoting the fullest possible utilization of the present productive capacity of industries, by avoiding undue restriction of production (except as may be temporarily required), by increasing the consumption of industrial and agricultural products through increasing purchasing power, by reducing and relieving unemployment, by improving standards of labor, and by otherwise rehabilitating industry.

(b) The Code as amended complies in all respects with the pertinent provisions of said Title of said Act, including without limitation subsection (a) of Section 3, subsection (a) of Section 4, subsection (a) of Section 7 and subsection (b) of Section 10 thereof.

(c) The Code empowers the Investment Bankers Code Committee to present the aforesaid amendments on behalf of the business as a whole.

(d) The Amendments and the Code as amended are not designed to and will not permit monopolies or monopolistic practices.

(e) The Amendments and the Code as amended are not designed to and will not eliminate or oppress small enterprises and will not operate to discriminate against them.

(f) Those engaged in the other steps of the economic process have not been deprived of the right to be heard prior to approval of said Amendments.

For these reasons I recommend that you approve these Amendments.

Respectfully,

HUGH S. JOHNSON
Administrator

March 23, 1934.

Contents of Fair Practice Amendments

(Not a part of the official document but published herewith for convenience)

	PAGE
Article I.	
Adoption and Interpretation.....	7
Article II.	
Definitions	7
<i>(a)</i> Code— <i>(b)</i> Rules— <i>(c)</i> investment banking business— <i>(d)</i> investment banker— <i>(e)</i> registered investment banker— <i>(f)</i> Investment Bankers Code Committee— <i>(g)</i> Regional Code Committee— <i>(h)</i> security— <i>(i)</i> new issue of securities— <i>(j)</i> new security— <i>(k)</i> public securities— <i>(l)</i> issuer— <i>(m)</i> prospectus— <i>(n)</i> originator— <i>(o)</i> selling syndicate— <i>(p)</i> selling group— <i>(q)</i> manager— <i>(r)</i> person— <i>(s)</i> salesman— <i>(t)</i> interim certificate or interim receipt	
Article III.	
General Principles	10
Sec. 1. Standard of business conduct—Sec. 2. Origination of new issues—Sec. 3. Information as to all new issues except United States Government and State issues—Sec. 4. Investment recommendations—Sec. 5. Salesmen's compensation—Sec. 6. Financial condition of issuer—Sec. 7. Written order or confirmation—Sec. 8. Charges for services—Sec. 9. Sinking fund provisions—Sec. 10. Delivery of definitive or temporary securities of issuer—Sec. 11. Duration of selling syndicates and selling groups	
Article IV.	
Rules Pertaining Primarily to Origination of Issues.....	11
Sec. 1. Agreements required of issuers— <i>(a)</i> term of agreements— <i>(b)</i> annual financial statements— <i>(c)</i> publication of annual financial statements— <i>(d)</i> stock dividends— <i>(e)</i> surplus of subsidiaries— <i>(f)</i> intercompany profits— <i>(g)</i> accounting changes— <i>(h)</i> independent registrar— <i>(i)</i> requirement of trustee and publication of substitutions in collateral—Sec. 2. Information regarding securities issued by subdivisions of States—Sec. 3. Interims—Sec. 4. Titles of new issues—Sec. 5. Interrelated directorates and managements	
Article V.	
Rules Pertaining Primarily to Selling Syndicates and Selling Groups in Connection with New Issues of Securities.....	16
Sec. 1. Statement of issue price—Sec. 2. Three-day notice of organization of selling syndicate or selling group—Sec. 3. Membership in selling syndicates and selling groups—Sec. 4. Price—Sec. 5. Pre-syndicate sales—Sec. 6. Trades in connection with new issues—Sec. 7. Requirement of down payment—Sec. 8. Requirements as to confirmations of sales—Sec. 9. Certificates to be furnished manager—Sec. 10. Extension of the original period of the selling syndicate—Sec. 11. Prohibition of participation with bank officers—Sec. 12. Disclosure of interest of directors and officers of issuer—Sec. 13.	

	PAGE
Distribution of syndicate funds; expenses—Sec. 14. Disclosure of manager's right to purchase securities—Sec. 15. Purchases of securities in open market in anticipation of public offering of new issue—Sec. 16. Disclosure of interest in distribution—Sec. 17. Copies of selling syndicate agreements and selling group agreements to be filed	
Article VI.	
Rules Pertaining Primarily to Retail Sales and Purchases.....	21
Sec. 1. "Over the counter" transactions—Sec. 2. Information to be furnished upon confirming of customer's orders—Sec. 3. Information to be given upon delivery of memorandum of transactions—Sec. 4. Brokerage transactions—Sec. 5. Guarantees—Sec. 6. Repurchase agreements—Sec. 7. Retail partial payment transactions—Sec. 8. Information received in other capacities	
Article VII.	
Rules Pertaining Primarily to Salesmen.....	23
Sec. 1. Supervision—Sec. 2. Experience and qualifications—Sec. 3. Solicitation at residences—Sec. 4. Orders taken by salesmen	
Article VIII.	
Rules Pertaining Primarily to Investment Companies.....	24
Article IX.	
Miscellaneous Rules.....	25
Sec. 1. Investment management—Sec. 2. Discretionary accounts—Sec. 3. Segregation of agency funds—Sec. 4. Quotations—Sec. 5. Offers to buy and sell—Sec. 6. Compensation and gratuities—Sec. 7. Registered investment bankers—Sec. 8. District rules	
Article X.	
Registration of Investment Bankers.....	27
Sec. 1. Registration agreement—Sec. 2. Eligibility for registration—Sec. 3. Applications for registration—Sec. 4. Supplementary statements—Sec. 5. Action on applications by Regional Code Committee—Sec. 6. Action on applications by Investment Bankers Code Committee—Sec. 7. Complaints—Sec. 8. Penalties—Sec. 9. Procedure—Sec. 10. Powers—Sec. 11. Interpretative rulings—Sec. 12. The list—Sec. 13. Expenses of committee	
Article XI.	
Administration.....	31
Sec. 1. Statistics—Sec. 2. Regional Code Committees—(a) Local districts—(b) Regional Code Committees—Sec. 3. General duties—Sec. 4. Expenses—Sec. 5. Additional local rules—Sec. 6. Modification of additional local rules—Sec. 7. Cancellation of local rules—Sec. 8. Investigations—Sec. 9. Privileged communications—Sec. 10. Waiver of rules—Sec. 11. Liability of members of Investment Bankers Code Committee and Regional Code Committees—Sec. 12. Special committees—Sec. 13. Labor complaints	
Schedule "A".....	35

**Amendment to Code of Fair Competition
for
Investment Bankers**

ARTICLE I.

ADOPTION AND INTERPRETATION.¹

The following provisions are adopted as supplementary provisions to the Code of Fair Competition for Investment Bankers, as approved November 27, 1933, by the President of the United States, and the provisions of Articles IV, V, VI, VII, VIII, and IX hereof are established as Rules of Fair Practice for Investment Bankers pursuant to the provisions of Articles IV and V of said Code.

These supplementary provisions shall become effective on the thirtieth day after approval hereof by the President of the United States: provided, that the Investment Bankers Code Committee may postpone, and from time to time further postpone, the date on which Section 7 of Article IX and Article X shall become effective so long as no such postponement is made beyond the ninetieth day after approval hereof by the President of the United States. They shall continue in effect as long as said Code shall be in effect, and shall in all respects be subject to said Code and the National Industrial Recovery Act, approved June 16, 1933. They may be amended in the same manner as is provided in said Code for amendment of said Code.

The Rules shall be interpreted in such manner as will aid in effectuating the policy of Title I of said National Industrial Recovery Act, and so as to require that all practices in connection with the investment banking business shall be just, reasonable and non-discriminatory.

The Rules are grouped for purposes of convenience under several general headings, but such grouping and headings shall not be construed as limiting the application of any Rule.

The Rules shall not apply to contracts made prior to the effective date of the Rules.

ARTICLE II.

DEFINITIONS.

As used in these supplementary provisions—

(a) The term "Code" shall mean the Code of Fair Competition for Investment Bankers, as approved November 27, 1933, by the President of the United States, under the provisions of Title I of the National Industrial Recovery Act, approved June 16, 1933.

(b) The term "Rules" shall mean the Rules of Fair Practice for Investment Bankers as established in Articles IV, V, VI, VII, VIII, and IX hereof, or as the same may be hereafter amended or supplemented.

(c) The term "investment banking business" shall mean the business of underwriting or distributing issues of securities, or of purchasing securities and offering

¹ See paragraph 3 of order approving this Code.

(8)

the same for sale as a dealer therein, or of purchasing and selling securities upon the order and for the account of others; provided, however, that the term "investment banking business" shall not include transactions on regularly organized exchanges, but such term shall include all business relating to such transactions to the extent that such business is not conducted by a member of such exchange or by any person or organization having the privilege of any such exchange for itself or any of its partners or executive officers.

(d) The term "investment banker" shall mean any person engaged in the investment banking business but shall not include an employee.

(e) The term "registered investment banker" shall mean any investment banker registered pursuant to the provisions of Article X of these supplementary provisions.

(f) The term "Investment Bankers Code Committee" shall mean the Investment Bankers Code Committee established as provided in Article III of the Code.

(g) The term "Regional Code Committee" shall mean any Regional Code Committee established as provided in Section 2 of Article XI of these supplementary provisions.

(h) The term "security" or "securities" shall mean any note, share of stock, bond, debenture, evidence of indebtedness, voting trust certificate, certificate of deposit, interim certificate or interim receipt, or, in general, any instrument commonly known as a security, or any certificate of interest or of participation in, or warrant or right to subscribe to or purchase, any of the foregoing.

(i) The term "new issue of securities" shall mean any issue of securities sold or offered for sale in one transaction or in a connected series of transactions as a result of which consideration for such securities is or is to be received directly or indirectly by the issuer thereof. As used in this paragraph (i) the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

(j) The term "new security" shall mean any security included in a new issue of securities.

(k) The term "public securities" shall mean any securities issued by the United States or by any instrumentality thereof, or by any territory or insular possession thereof, or by the District of Columbia, or by any State of the United States, or by any subdivision or instrumentality of any such State, territory or insular possession.

(l) The term "issuer" shall mean any person who issues or proposes to issue any security or who guarantees such security either as to principal or income or who assumes the obligation to pay such security either as to principal or income; except in respect to certificates of deposit, voting trust certificates, interim certificates or similar securities, the term "issuer" shall mean the person or persons issuing the securities represented by such certificates of deposit, voting trust certificates, interim certificates, or similar securities; and except that in respect to certificates of interest or shares in an unincorporated investment company (sometimes spoken of as investment trust) not having a board of directors (or persons performing similar functions) or of the fixed, restricted management, or unit type, the term "issuer"

(9)

shall mean the person performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued; and except that in respect to equipment trust certificates or similar securities, the term "issuer" shall mean the person by whom the equipment or other property is or is to be used.

(m) The term "prospectus" used in relation to any security registered under the Securities Act of 1933 shall mean the official prospectus required by said Act, and used in relation to any other security shall mean the offering or descriptive circular.

(n) The term "originator" shall mean any person who purchases from an issuer a new issue of securities of such issuer, or who contracts with the issuer to find purchasers for such securities, with a view to the public distribution of such securities, or who contracts with an issuer to act as agent for such issuer for the public distribution of such securities of such issuer.

As used in this paragraph (n) the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

(o) The term "selling syndicate" shall mean any syndicate formed in connection with a public offering, to distribute all or part of a new issue of securities by sales made directly to the public by or through participants in such syndicate under an agreement which imposes a financial commitment upon participants in such syndicate to purchase any such securities.

(p) The term "selling group" shall mean any group formed in connection with a public offering, to distribute all or part of a new issue of securities by sales made directly to the public by or through members of such selling group, under an agreement which imposes no financial commitment on the members of such group to purchase any such securities except as they may elect to do so.

(q) The term "manager" used in relation to a selling syndicate or selling group shall mean the person or persons named as manager or managers in the agreement under which such syndicate or group is formed.

(r) The term "person" shall include any natural person, copartnership, corporation, association, or other entity.

(s) The term "salesman" shall mean any officer, employee, or agent (other than another investment banker) of an investment banker, who offers securities for sale to any person other than another investment banker.

(t) The term "interim certificate" or "interim receipt" shall mean any instrument in writing delivered to a purchaser against payment in connection with the public distribution of a new issue of securities and calling for the future delivery of such securities and executed by either an originator, the issuer of the securities called for by such interim certificates or interim receipts, or a corporate trustee.

(i) The term "interim certificate" shall mean such instruments in writing when the securities called for thereby are delivered in temporary or definitive form to the person executing the interim certificate prior to or concurrently with such execution.

(ii) The term "interim receipt" shall mean such instruments in writing when the securities called for thereby are not so delivered to the person executing the interim receipt prior to or concurrently with such execution.

ARTICLE III.

GENERAL PRINCIPLES.

In addition to the Rules, the General Principles set forth in this Article III shall be a guide to the Investment Bankers Code Committee in interpreting, administering, and enforcing the provisions of the Code and Rules, as well as to the Investment Banker himself in the conduct of his business under such Code and Rules.

SEC. 1. *Standard of Business Conduct.* To observe, and to use his best efforts to maintain, high standards of commercial honor in the investment banking business, and to promote just and equitable principles of trade and business.

SEC. 2. *Origination of New Issues.* (a) If acting as an originator, to make such investigation as may be reasonably necessary to determine the merit of such issue, and to satisfy himself that the business risk of the investors who purchase such securities is reasonable and that there are appropriate provisions to safeguard the interests of such investors.

(b) If distributing a new issue of securities originated by another, to satisfy himself that the investigation required by paragraph (a) has been made.

SEC. 3. *Information as to All New Issues Except United States Government and State Issues.* Not to originate nor to participate in the public distribution of any new issue of securities, other than securities issued by the United States or by any instrumentality thereof, or by any State of the United States, unless there is available to investors, either in a prospectus or from public sources or in some other manner, adequate information with respect to the issuer, the nature of its business, its financial condition, the terms of the new security, and, in addition, all other information required by the Rules to be contained in the prospectus.

In the case of any security issued by any subdivision or instrumentality of any State of the United States, it shall be deemed a compliance with this principle if there is available to investors either in a prospectus or otherwise, adequate information with respect to the terms of the new security and all information required by the Rules, and if, in addition, where available, the record of tax collections of such issuer for the preceding three years is included in the prospectus, if any, or if there is no prospectus, is otherwise disclosed to each purchaser of such security.

In the case of securities issued by a common carrier which is subject to the provisions of Section 20a of the Interstate Commerce Act, as amended, it shall be deemed a compliance with this principle if there is available to investors, either in a prospectus or otherwise, adequate information with respect to the terms of the new security and all information required by the Rules, and a copy of the last annual balance sheet and the income and surplus accounts for the last three years of such common carrier as required to be filed with the Interstate Commerce Commission, and, if there is available, on request, to any investor a copy of all reports and orders of the Interstate Commerce Commission approving and authorizing the issue of such securities.

SEC. 4. *Investment Recommendations.* Where an investment banker recommends to an investor the purchase or exchange of any security, to have reasonable grounds for believing the security to be acquired by the investor is a suitable invest-

ment for such investor upon the basis of the facts, if any, disclosed by such investor as to his other security holdings and as to his investment situation and needs.

SEC. 5. *Salesmen's Compensation.* To compensate his salesmen in a manner consistent with the application of the principles set forth in Sections 1 and 4 of this Article.

SEC. 6. *Financial Condition of Issuer.* To keep himself reasonably informed of the financial condition of the issuer of any issue of securities of which he acted as originator, so long as any material part of such issue shall be outstanding in the hands of investors, and to endeavor to cause the issuer to meet his promises and obligations to investors.

This section is intended to apply in respect to issues of securities originated prior to the effective date of the Rules as well as to issues originated thereafter.

SEC. 7. *Written Order or Confirmation.* To require a customer, wherever practicable, to give a written order or a written confirmation of any oral order for any transaction in securities.

SEC. 8. *Charges for Services.* To make his charges for services performed, including miscellaneous services, such as collection of moneys due for principal, dividends, or interest; exchange or transfer of securities; appraisals; safe-keeping or custody of securities, and other services, reasonable and not unfairly discriminatory between customers.

SEC. 9. *Sinking Fund Provisions.* If an originator of an issue of bonds or other interest-bearing obligations for distribution to the public, to cause the issuer to make provision for the retirement of such issue in whole or in part before maturity, through a sinking fund or otherwise, where such provision is appropriate to safeguard the interest of investors who purchase such securities.

SEC. 10. *Delivery of Definitive or Temporary Securities of Issuer.* In distributing new issues of securities, to deliver as promptly as possible after the public offering date, definitive or temporary securities of the issuer.

SEC. 11. *Duration of Selling Syndicates and Selling Groups.* If the manager of a selling syndicate or selling group, to form such syndicate or selling group for the shortest period which, in the judgment of the manager, is sufficient for the purpose for which it is formed.

ARTICLE IV.

RULES PERTAINING PRIMARILY TO ORIGINATION OF ISSUES.

SEC. 1. *Agreements Required of Issuers.* No investment banker shall be the originator of any issue of securities (other than any of the classes of securities mentioned in Section 3 of the Securities Act of 1933 and other than any security issued by a foreign government or political subdivision thereof) where the aggregate amount at which such issue is to be offered to the public exceeds \$100,000, unless the issuer of such securities shall agree with the originator as follows:

(a) *Term of Agreements.* To comply with the requirements of this section so long as any part of such issue of securities shall remain outstanding.

(b) *Annual Financial Statements.* To cause for each fiscal year to be prepared by independent public or certified accountants, an Income Statement,

Surplus Statement and Summary of Changes in Reserves for such fiscal year, and a Balance Sheet as of the end of such year of the issuer as a separate corporate entity and of each corporation in which it holds, directly or indirectly, a majority of the voting stock (hereinafter in this section called a subsidiary) together with such further information as may be necessary to disclose all intercompany holdings and transactions; or, in lieu thereof, eliminating all intercompany transactions, a similar set of consolidated financial statements of the issuer and any or all of its subsidiaries accompanied by financial statements of the issuer as a separate entity and of any subsidiary not consolidated.

If any such consolidated statements exclude any subsidiary, (1) the caption shall indicate the degree of consolidation; (2) the Income Statement shall show, either in a footnote or otherwise, the issuer's proportion of the difference between current earnings or losses and the dividends of such unconsolidated subsidiary for the period accounted for in such Income Statement; and (3) the Balance Sheet shall show, in a footnote or otherwise, the extent to which the equity of the issuer in such subsidiary has been increased or diminished since the date of acquisition as a result of profits, losses, and distributions.

Such statements shall show the existence of any default in interest or in sinking fund or amortization payments and any arrears of any cumulative dividends of the issuer or of any subsidiary whether consolidated or unconsolidated.

In case there are any substantial items of profit or loss of a non-recurring nature, such as those arising from the disposal of capital assets, they shall be expressly enumerated. If, for any reason, the examination of the accounts of any subsidiary shall have been made as of a date different from that of the issuer, that fact shall be stated either in the certificate of the accountants, or otherwise, together with a statement as to the extent of their examination of the interim transactions. Insofar as practicable the examination of the accounts of each subsidiary shall be made by or under the supervision of the same accountants who examined the accounts of the issuer, but if the accounts of any subsidiary included in any consolidated statement are examined by public or certified accountants other than the accountants who examined the accounts of the issuer, such fact shall be noted in the certificate of the latter. If a consolidated balance sheet includes assets and liabilities of foreign subsidiaries, the percentage of total assets and liabilities included which represent the aggregate assets and liabilities of all such foreign subsidiaries shall be noted on the balance sheet. The accountant's certificates shall state the basis on which the accounts of foreign subsidiaries are included in the consolidation and there shall be set forth in the certificate or in an appended certificate any substantial differences in accounting practice employed by the foreign subsidiary or subsidiaries insofar as such differences shall be known to the certifying accountant.

Every balance sheet prepared in accordance with the above shall disclose the basis used to compute the figures at which the principal asset items are carried thereon. Where any liability of the issuer is secured on any assets of the issuer, the balance sheet shall show that such liability is secured, and if the security consists in whole or in part of current assets it shall show such fact and the general nature of such current assets. Any contingent liabilities, not expressly shown on the balance sheet, shall be shown in a footnote insofar as good accounting practice may require.

Loans or advances between the issuer and any subsidiary or between a subsidiary and another subsidiary, whether or not consolidated, shall be shown either as separate items on the appropriate balance sheets or as footnotes to the consolidated balance sheet.

Amounts due from directors, officers and employees (not including normal amounts arising in the ordinary course of business), and securities of the issuer (if carried as an investment) and securities of any subsidiary, shall be shown as separate items on the appropriate balance sheets.

If, for any reason, the issuer or the accountants are unable to obtain any information required for the preparation of the statements in the manner prescribed, such information need not be given, but the facts as to such inability shall be stated in the certificate of the accountants.

(c) *Publication of Annual Financial Statements.* To publish in the English language the Income Statement, Surplus Statement, Summary of Changes in Reserves, and Balance Sheet required in paragraph (b) of this section with the complete certificate of the accountants, by releasing copies thereof to the public press, in the United States of America, and to furnish copies thereof to each security holder of the issuer upon request as soon as practicable after the close of the fiscal year.

(d) *Stock Dividends.* Not itself, and not to permit any subsidiary, directly or indirectly controlled, to take up as income stock dividends received at an amount greater than that charged against earnings, earned surplus, or both of them, by the company paying such stock dividend.

(e) *Surplus of Subsidiaries.* Not to treat earned surplus of a subsidiary created prior to acquisition of such subsidiary as a part of earned consolidated surplus of the issuer and of its subsidiaries, and not to credit any dividends declared out of such surplus of the subsidiary to the income account of the issuer or of any other subsidiary.

(f) *Intercompany Profits.* To make appropriate reserves, insofar as good accounting practice may require, in respect of profits arising out of all transactions with unconsolidated subsidiaries, in either the parent company or the consolidated statements mentioned in paragraph (a).

(g) *Accounting Changes.* Not to make any material change in depreciation rates or policies or in accounting principles or in their application without describing such change in the next succeeding published balance sheet.

(h) *Independent Registrar.* To appoint a bank or trust company, or other person duly qualified to act, independent of the issuer to act as registrar in respect of the issue of stock involved in such origination and to have all certificates of that issue registered by such registrar.

(i) *Requirement of Trustee and Publication of Substitutions in Collateral.* To appoint a bank or trust company to act as trustee or co-trustee under any mortgage or trust indenture under which such securities are issued; and that the issuer shall, at least 10 days prior to any substitution or release of pledged or mortgaged property which substantially affects the character or value of the property pledged or mortgaged, publish in a daily newspaper of general circulation published in the city where the trustee has its principal place of business and also in the city where

the issuer has its principal place of business, notice that such substitution or release is proposed to be made.

SEC. 2. *Information Regarding Securities Issued by Subdivisions of States.*

(a) No investment banker shall be the originator of any new issue of securities issued by a subdivision of any State of the United States, unless the issuer of such securities shall furnish such originator with an official statement of the issuer complying with the requirements of paragraph (b) of this section, and with the data necessary for the purposes of a legal opinion complying with the requirements of paragraph (c) of this section.

(b) Such official statement of the issuer shall disclose in the case of securities payable from ad valorem taxes: (1) the assessed valuation of the property subject to the taxing power of the issuer; (2) the total bonded debt of the issuer including the amount of such issue; (3) the population of such issuer according to the most recent United States or State census, or if no United States or State census is available, an estimate of such population; and (4) the fact, if such be the fact, that the bonded debt of such issuer does not include the debt of any other subdivision having power to levy taxes upon any or all of the property subject to the taxing power of the issuer.

(c) Such originator shall, either himself procure or require the issuer to procure the opinion of an attorney, other than an officer or an employee of the issuer, who is satisfactory to such originator, approving the validity of the issue. Such legal opinion shall contain a clear warning statement in regard to any limitation on the power of the issuer to tax real estate for the payment of the securities, if there be any limitation. In the case of securities which are not payable from ad valorem taxes or which are payable solely from a special fund, such legal opinion shall state the means or methods provided for the payment of such securities and whether there are any prior claims upon such special funds.

(d) The originator of such securities shall make available to investors, either in the prospectus, if any, or, if there is no prospectus, in some other manner, (1) the facts disclosed in such official statement of the issuer; (2) the name of the attorney whose opinion will be furnished; (3) whether the securities are payable from a limited tax on real estate or whether they are payable from a special fund only; and (4) in the case of securities which are issued in anticipation of the later sale of a refunding issue or issues and where provision is not to be made for payment of such securities at maturity in any other manner, the facts in regard thereto.

(e) No other investment banker shall participate in the distribution of any such issue of securities unless the requirements of paragraphs (a), (b) and (c) of this section shall have been complied with and unless such participant shall make available to each investor to whom he offers for sale or sells any such security the information required by paragraph (d) of this section to be made available by the originator to each investor to whom such originator offers for sale or sells such security.

(f) The originator of any such new issue of securities, and any other investment banker who shall participate in the distribution of any such issue, shall, upon request of any purchaser of such security from such originator or other investment

banker, deliver to such purchaser a certified copy of the official receipt of the treasurer of the issuer in the form required by the attorney approving the validity of said issue, evidencing the payment to the issuer of the purchase price of said issue of securities and the amount thereof.

SEC. 3. Interims. (a) In all cases where interim certificates or interim receipts signed or executed by an originator are delivered, any securities or cash received by such originator upon the issuance of such interim certificates or interim receipts shall (until the securities called for by such interim certificates or interim receipts are received and held, in the manner provided in subdivision (ii) of this paragraph (a), for the account of the holders of the interim certificates or interim receipts) be held for the account of the holders of the interim certificates or interim receipts in the following manner:

(i) Any cash received upon the issuance of interim certificates or interim receipts shall be deposited in a special account with a person permitted by law to receive deposits, which person may be the signer of the interim certificates or interim receipts, if such person is so qualified.

(ii) Any securities received upon such issuance shall, pending the delivery of securities called for by the interim certificates or interim receipts to the holders thereof, be segregated from the other property of the person signing the interim certificates or interim receipts in such manner that no person other than the holders of the interim certificates or interim receipts can assert any right, title, or interest therein.

(b) In all cases where interim certificates or interim receipts signed or executed by the issuer of the securities called for by such certificates or receipts are delivered, such certificates or receipts shall require the issuer to hold any securities or cash received upon the issue thereof in the manner described in the foregoing paragraph (a); provided, however, that this sub-paragraph (b) shall not apply in the case of certificates or receipts issued by national governments.

(c) In all cases where interim certificates or interim receipts signed or executed by a corporate trustee are delivered, such certificates or receipts shall require the corporate trustee to hold any securities or cash received upon the issue thereof in the manner in the foregoing paragraph (a).

(d) All forms of interims specified in the foregoing paragraphs (a), (b) and (c) shall by their text clearly indicate their precise nature; the rights of the holders thereof; the security and the amount thereof called for; the limitation of time for delivery of securities called for, if appropriate; the redemption or repayment provisions, if appropriate; provision for payment of interest, if any; negotiability, transferability, or registration provisions, if any; assignment form, if appropriate; and the name of the person signing or executing such interim.

(e) Any investment banker who in connection with the public distribution of a new issue of securities receives any payment from any purchaser of such securities in advance of delivery of such securities in temporary or definitive form, or in advance of the delivery of interim certificates or interim receipts calling for the future delivery of such security, shall deliver to such purchaser only a receipt for the purchase price or memorandum of sale evidencing such payment; provided, however, that for purposes of economy in exchanges or shipping, there may be

delivered in advance of such delivery an instrument to be designated as a "trust receipt" calling for future delivery of the security in temporary or definitive form, which "trust receipt" shall be executed by a corporate trustee and secured by deposit of cash or collateral with such corporate trustee, who shall hold such cash or collateral for the benefit of the holders of such "trust receipts" pending delivery of the security in temporary or definitive form.

(f) No investment banker shall deliver, in connection with the public distribution of any new securities, to the purchaser of such securities, any instrument entitling the holders to the future delivery of such securities, unless such instrument complies with the appropriate provisions of this section. The titles "interim certificate" and "interim receipt" shall be used only in accordance with the definitions of paragraph (i) of Article II.

SEC. 4. *Titles of New Issues.* An investment banker shall not be the originator of any new issue of securities (except public securities) for distribution to investors, or participate in the distribution of any such new issue, which issue has a title which is misleading as to the lien, terms, or priority of such issue. If any new issue of public securities shall have a title which is misleading as to the lien, terms, or priority of such issue, the facts with regard thereto shall be stated in the prospectus, if any, or, if there is no prospectus, in some other manner disclosed to each purchaser of such security.

SEC. 5. *Interrelated Directorates and Managements.* Any investment banker who is the originator of a new issue of securities, shall, if such investment banker or any partner or principal officer thereof shall be an officer or director of the issuer company, disclose such fact in the prospectus.

ARTICLE V.

RULES PERTAINING PRIMARILY TO SELLING SYNDICATES AND SELLING GROUPS IN CONNECTION WITH NEW ISSUES OF SECURITIES.

SEC. 1. *Statement of Issue Price.* Except as to public securities where the price received by the issuer is a matter of public record, the prospectus shall state the price received by the issuer for any new issue of securities offered for sale to the public, or the formula by which such price can be ascertained, or if there is no prospectus such price or formula shall be disclosed in some other manner to each person purchasing such new security from any member of the selling syndicate or selling group.

SEC. 2. *Three-Day Notice of Organization of Selling Syndicate or Selling Group.* Any investment banker proposing to organize a selling syndicate or a selling group to distribute new securities other than those of the United States Government or any instrumentality thereof or of any State or subdivision or instrumentality thereof shall mail or deliver or telegraph a copy of the prospectus or an adequate description of the security to each investment banker who is to be offered a participation in such syndicate or a membership in such selling group, at such times that, in the usual course of delivery, such prospectus or description will be received by all such investment bankers on approximately the same day and at least three days (excluding Sundays and holidays but including the day of delivery)

before the date on which it shall be proposed to make the public offering of such securities.

SEC. 3. *Membership in Selling Syndicates and Selling Groups.* No investment banker proposing to organize a selling syndicate or a selling group shall invite or permit any person to be a participant in such selling syndicate or a member in such selling group unless such person is an investment banker actually engaged in the investment banking business.

SEC. 4. *Price.* (a) Each selling syndicate agreement and selling group agreement shall set forth the price at which the new securities are to be sold to the public or the formula by which such price can be ascertained. No participant in a selling syndicate or member of a selling group shall, during the life of such selling syndicate or selling group, offer the new securities being distributed by such syndicate or group at any price below such public offering price.

(b) It shall be deemed a reduction of the offering price mentioned in paragraph (a) of this section for a participant in a selling syndicate or a member of a selling group to allow any deduction, abatement, concession or commission whatsoever, either directly or indirectly: provided, that any investment banker may allow to another investment banker a commission or concession if and to the extent that provision is made therefor in the agreement creating the selling syndicate or the selling group.

(c) In any transaction with any investment banker located in a foreign country no commission or concession as provided in paragraph (b) of this section shall be allowed to such foreign investment banker unless he effectively agrees (1) that, in making any sales, during the life of the selling syndicate or selling group, to purchasers outside of the United States of the security in connection with which he received such commission or concession, he will conform to the provisions of paragraphs (a) and (b) of this section to the same extent as though he were subject to the selling syndicate or selling group agreement; and (2) that, in making any sales, during the life of the selling syndicate or selling group, to purchasers within the United States of the security in connection with which he received such commission or concession, he will conform to the provisions of this Section 4 and of Sections 6 and 7 of this Article V to the same extent as though he were subject to the selling syndicate or selling group agreement, and also (if he received such commission or concession from a registered investment banker) that he will conform to the provisions of Section 7 of Article IX to the same extent as though he were an investment banker registered under Article X.

(d) Any investment banker located in the United States receiving a commission or concession as provided in paragraph (b) of this section shall, in making any sale of the security in connection with which he received such commission or concession during the life of the selling syndicate or selling group, be subject to the provisions of this Section 4 and of Sections 6 and 7 of this Article to the same extent as though he were a participant in the selling syndicate or a member of the selling group distributing such security.

SEC. 5. *Pre-syndicate Sales.* No investment banker shall organize, manage, or participate in a selling syndicate or selling group to offer a new issue of securities to the public if, within thirty days prior to the formation of such syndicate or

group, he shall, at a price lower than the offering price to the public, have sold or given a right to purchase, or shall have assisted the issuer in selling or giving a right to purchase, any part of such new issue to any person other than an investment banker otherwise than as an essential step in the plan for the sale to the public of such new issue of securities.

SEC. 6. *Trades in Connection with New Issues.* No investment banker who is a participant in any selling syndicate or a member of any selling group shall enter into any agreement or arrangement with any purchaser of the new securities being distributed by such syndicate or group whereby, either directly or indirectly, as a condition of the purchase, such investment banker will accept any other securities (except securities which are being refunded or redeemed in connection with or by means of such new issue of securities, or any securities maturing within six months after the date of such transaction) in trade in payment of all or any part of the purchase price of such new securities. The foregoing provision shall not, however, prevent such investment banker from accepting such other securities as agent for sale, in which case the investment banker shall make the usual charge for such services and such investment banker may allow the purchaser of the new securities to apply towards the purchase price thereof any net proceeds realized from the sale of such other securities.

SEC. 7. *Requirement of Down Payment.* (a) Except as hereinafter provided in paragraph (c) of this section, whenever a participant in a selling syndicate, or a member of a selling group, accepts a subscription subject to allotment for the purchase of a new security to be distributed by such selling syndicate or selling group, he shall require the person making the subscription to deposit with him a down payment of not less than 5% of the public offering price on the securities subscribed for.

(b) Except as hereinafter provided in paragraph (c) of this section, whenever new securities are subscribed for subject to allotment from the manager by a participant in a selling syndicate or a member of a selling group he shall at the time of such subscription make a down payment of not less than 5% of the public offering price. Such down payments shall be deposited by the manager in a special account with one or more incorporated banks, trust companies or persons permitted to receive deposits, provided, however, that they shall in all cases be deposited with a bank, trust company or person other than the manager.

(c) No down payment as required by paragraph (a) of this section shall be required from any purchaser who may be prevented by law from making such payment in advance of the delivery of the security purchased; and the participant or member who accepted the subscription of such purchaser shall furnish the manager of the selling syndicate or selling group evidence of such fact satisfactory to the manager, and in such case such participant or member shall not be required to make the down payment as required by paragraph (b) of this section; and the fact that such down payment is not required in any such case shall not be considered as a concession under Section 4 of this Article. The requirements of paragraph (b) shall not be compulsory in the case of a selling syndicate where all the participants were parties to the purchase from the issuer of the new security to be distributed.

SEC. 8. *Requirements as to Confirmations of Sales.* No participant in a selling syndicate and no member of a selling group shall confirm a sale or a subscription from any purchaser unless

(a) Such participant or member has reasonable grounds to believe that such purchaser is bona fide and responsible;

(b) A copy of the prospectus, if any, has been delivered to such purchaser or accompanies the confirmation;

(c) Such sale does not violate or evade any provision of the selling syndicate or selling group agreement or of the Rules; and

(d) A partner, duly accredited executive or branch office manager has approved such sale as complying with paragraphs (a), (b) and (c) of this section.

Failure of a participant in a selling syndicate or a member of a selling group to comply with the provisions of the foregoing paragraphs (a), (b), (c) or (d) of this section, shall not be deemed a violation of this section if not wilful and if such participant or member gives notice, as soon as such failure is discovered, to the manager of the selling syndicate or selling group, stating the circumstances attending such failure.

SEC. 9. *Certificates to Be Furnished Manager.* Each participant in a selling syndicate and each member of a selling group shall, upon request of the manager, furnish to the manager a certificate signed by a principal officer or partner of such participant or member that he has examined the records of sales made by such participant or member, and that the provisions of Sections 7 and 8 of this Article were complied with in respect of such sales.

SEC. 10. *Extension of the Original Period of the Selling Syndicate.* If provision is made in any selling syndicate agreement for the extension of the original period of the selling syndicate, such extension shall only become effective upon the consent of participants in the selling syndicate representing 75% in interest of the selling syndicate.

SEC. 11. *Prohibition of Participation with Bank Officers.* No investment banker to his knowledge shall participate in any selling syndicate in which any officer of any bank or trust company has a participation as an individual.

SEC. 12. *Disclosure of Interest of Directors and Officers of Issuer.* No investment banker to his knowledge shall participate in any selling syndicate in which any director or any officer of the issuer of the new securities with relation to which such selling syndicate was formed has a participation, as an individual, unless he discloses such participation in the prospectus, if any, or if there is no prospectus then in some other manner, to any person purchasing the security from such investment banker.

SEC. 13. *Distribution of Syndicate Funds; Expenses.* The manager of any syndicate shall distribute the amount due to syndicate participants promptly after the close of the syndicate. Upon request of any participant, the manager shall render to him a statement of expenses, which statement shall show the aggregate amounts of: (1) payments to manager, if any; (2) legal expenses; (3) advertising expenses; (4) expenses for printing, engraving, mailing, telegrams and cables; and (5) other expenses.

SEC. 14. *Disclosure of Manager's Right to Purchase Securities.* If the manager of any selling syndicate or any selling group is given the right under the selling syndicate or selling group agreement to buy securities in the open market for account of the selling syndicate or selling group, such fact shall be disclosed in the prospectus, if any, or, if there is no prospectus, then in some other manner, by each participant in the selling syndicate or member of the selling group to any person purchasing the securities from such participant or member.

If to the knowledge of the manager of any selling syndicate or selling group the manager of any other syndicate or group formed in connection with the distribution of the securities to be distributed by such selling syndicate or selling group has the right to buy in the open market any securities of such issue for the account of such other syndicate or group, then the manager of such selling syndicate or selling group shall disclose such fact in the prospectus, or, if there is no prospectus, in some other manner, to each participant in the selling syndicate or each member of the selling group, and such fact shall be disclosed in like manner by each participant in the selling syndicate or each member of the selling group to each person purchasing such securities from such participant or member.

SEC. 15. *Purchases of Securities in Open Market in Anticipation of Public Offering of New Issue.* Except as to public securities sold by the issuer thereof at public sale, if either (1) the manager of any selling syndicate or the manager of a selling group, or (2) to the knowledge of any such manager, the issuer or originator or any other syndicate formed in connection with the distribution of any new issue of securities to be distributed by or through such selling syndicate or selling group, purchases any of the outstanding securities of the issuer in the open market within ten days prior to the date on which such securities are first offered to the public, such fact shall be disclosed by the manager to all participants in the selling syndicate or members of the selling group, and shall also be disclosed, either in the prospectus or in some other manner, by each participant in the selling syndicate or member of the selling group to any person purchasing the securities from such participant or member; provided, however, that no disclosure shall be required under this Section 15 of any purchases of outstanding securities of the issuer made for the purposes of a sinking fund.

SEC. 16. *Disclosure of Interest in Distribution.* Any participant in a selling syndicate, and any member of a selling group, who has any direct interest in the distribution of a new security other than as a member of a selling group, shall disclose such fact, either in the prospectus or in some other manner, to any person purchasing the securities from such participant or member.

SEC. 17. *Copies of Selling Syndicate Agreements and Selling Group Agreements to Be Filed.* Every manager of a selling syndicate or selling group shall, promptly after such selling syndicate or selling group is formed, file a copy of the selling syndicate agreement or the selling group agreement with the Investment Bankers Code Committee by mailing such copy, postage prepaid, to said Committee addressed to its executive office. Copies of selling syndicate agreements and selling group agreements so filed need not contain the names of any of the parties thereto, except the manager.

ARTICLE VI.

RULES PERTAINING PRIMARILY TO RETAIL SALES AND PURCHASES.

SEC. 1. *"Over the Counter" Transactions.* In view of the unusual and complicated nature of "over the counter" transactions, whether in "listed" or "un-listed" securities, it is provided that if the investment banker buys for his own account and risk from his customer, or sells for his own account and risk to his customer, he shall buy or sell at a price which is fair, taking into consideration market conditions in respect of such security at the time of the transaction, the expense of executing the order, and the fact that he is entitled to a profit; and if he acts as agent for his customer in any such transaction, he shall not charge his customer more than a fair commission or service charge, taking into consideration market conditions in respect of such security at the time of the transaction and the value of any service he may have rendered by reason of his experience in and knowledge of the market for such security.

SEC. 2. *Information to Be Furnished Upon Confirming of Customer's Orders.* Upon confirming any customer's order for the purchase or sale of any security if the investment banker (1) is to act as principal in the transaction; or (2) is controlled by, or controls, or is under common control with, the issuer, the investment banker shall inform the customer of such fact upon the written memorandum of such confirmation.

SEC. 3. *Information to Be Given Upon Delivery of Memorandum of Transactions.* Any investment banker who has a transaction with a customer involving the purchase or sale of any security shall, at or before the completion of the transaction, deliver to the customer a written memorandum of such transaction containing the following information:

(a) Whether such investment banker acted as principal or as agent for the customer;

(b) If the investment banker acted as agent for the customer, the amount of the commission or service charge charged to the customer by such investment banker, and if another broker has been used, and any part of the commission has been paid to such other broker, the amount so paid shall be stated as a separate item;

(c) If such investment banker acted as agent for the customer, the name of the person from whom the security was purchased or to whom the security was sold and the day, and the hours between which, the transaction took place, or that the information referred to in this paragraph (c) will be furnished upon written request of the customer for whom the investment banker acted as agent; and

(d) If no written confirmation of the customer's order shall have been given, the information as required by clause (2) of Section 2 of this Article.

SEC. 4. *Brokerage Transactions.* If in any transaction involving the purchase or sale of any security the investment banker purports to act as an agent to buy or sell on behalf of a customer, such investment banker shall not act as a principal in such transaction, nor, without the consent of his customer, represent any other principal in such transaction.

SEC. 5. *Guarantees.* No investment banker shall, in any transaction involv-

ing the purchase of any security for the account of the customer or involving the sale of any security to a customer, agree with the customer, either directly or indirectly, to guarantee that the market value of the security as it was at the time the security was bought for or by the customer will be maintained, or that the business of the issuer of such security will be successful in earning profits, or that the issuer will meet its promises and obligations; provided that the restrictions of this section shall not apply in respect of transactions in any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

SEC. 6. Repurchase Agreements. No investment banker shall, in any transaction involving the purchase of any security for the account of a customer or involving the sale of a security to a customer, agree with the customer, either directly or indirectly, to repurchase the security from the customer; provided that the restrictions of this section shall not apply in respect of transactions in obligations of the United States or any security guaranteed as to principal or interest by the United States, or of transactions in any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited, or to any repurchase agreement with any person whenever such repurchase agreement is limited to sixty days and is used as a substitute for borrowing.

SEC. 7. Retail Partial Payment Transactions. No investment banker shall take or carry any account or make a transaction for any customer under any arrangement which contemplates or provides for the purchase of any security for the account of the customer or for the sale of any security to the customer, where payment for the security is to be made to the investment banker by the customer over a period of time in installments or by a series of partial payments unless

(a) In the event such investment banker acts as an agent or broker in such transaction he shall, immediately, in the regular course of business, make an actual purchase of the security for the account of the customer, and shall immediately, in the regular course of business, take possession or control of such security and shall maintain possession or control thereof so long as he remains under obligation to deliver the security to the customer.

(b) In the event such investment banker acts as a principal in such transaction, he shall, at the time of such transaction, own such security and shall maintain possession or control thereof so long as he remains under obligation to deliver the security to the customer.

No investment banker, whether acting as principal or agent, shall in connection with any transaction referred to in this section make any agreement with his customer under which the investment banker shall be allowed to pledge or hypothecate any security for any amount in excess of the indebtedness of the customer to such investment banker.

SEC. 8. Information Received in Other Capacities. An investment banker who receives information as to the ownership of securities in the capacity of paying agent, transfer agent, trustee or in other similar capacity, shall under no cir-

circumstances make use of such information for the purpose of soliciting sales or exchanges except at the request and on behalf of the issuer.

ARTICLE VII.

RULES PERTAINING PRIMARILY TO SALESMEN.

SEC. 1. *Supervision.* Any investment banker who employs any salesman shall supervise the sales methods of such salesman and his correspondence in relation to offers of securities for sale to investors; and any sale made by any such salesman to any investor, other than another investment banker, shall be approved by a partner, duly accredited executive, or branch office manager of such investment banker. Such approval shall be evidenced by a written endorsement made upon a copy of the memorandum of sale mentioned in Section 3 of Article VI, and each memorandum so approved shall be made a part of the permanent records of such investment banker and retained in his files for at least three years.

SEC. 2. *Experience and Qualifications.* (a) Except as hereinafter provided in paragraphs (b) and (c) of this section, no investment banker shall employ any person to act as a salesman unless (1) such person shall have had at least two years' experience in the investment banking business or in a business a principal part of which related to securities; (2) shall be at least twenty-one years of age; and (3) shall be of good moral character; provided, however, that any person who has not had two years' experience in the investment banking business or in a business a principal part of which related to securities but who has been employed by an investment banker for a period of at least six months, and who is otherwise qualified as provided in clauses (2) and (3) above in this paragraph set forth, may be employed by any investment banker as a salesman if the compensation of the person so employed to act as salesman shall be a straight salary and shall not include, in whole or in part, commissions upon securities sold.

(b) Any investment banker desiring to employ any person to act as a salesman, may make an application to the Regional Code Committee of the district in which such person is to be employed for permission to employ such person as a salesman. If a majority of the members of such Committee shall, after due hearing and consideration of such application, be of the opinion that the person proposed to be employed as a salesman is, by reason of his age, experience, standing and reputation, fully qualified to act as a salesman, such committee may in writing advise the investment banker who made such application to that effect, in which event such investment banker may employ such person without regard to any of the requirements of paragraph (a) of this section except the requirement set forth in clause (3) thereof.

(c) Nothing contained in either paragraph (a) or (b) of this section shall be construed to prevent any investment banker from continuing to employ as a salesman any person who is so employed by such investment banker at the effective date of the Rules.

SEC. 3. *Solicitation at Residences.* No salesman shall call in person upon, or telephone to, any customer or prospective customer at his home or residence for the purpose of selling to, or offering to sell to, or soliciting an offer to buy from such customer or prospective customer, unless such customer or prospective cus-

tioner shall have previously given written permission therefor to the investment banker employing such salesman. As used in this section the term "salesman" shall include any investment banker, or any partner, officer or employee thereof who does any act or thing in this section described. This section shall not apply to the solicitation of business persons, retired or professional persons, or farmers.

SEC. 4. *Orders Taken by Salesmen.* Any investment banker who employs any salesman shall require that all orders taken by such salesman for the purchase of or subscription to any security shall be subject to acceptance and confirmation by such investment banker.

ARTICLE VIII.

RULES PERTAINING PRIMARILY TO INVESTMENT COMPANIES.

SEC. 1. If any investment banker has agreed to manage, or give investment advice to the management of an investment company (sometimes known as an "investment trust") all or part of the securities of which are held by the public, or if any partner or officer or employee of any investment banker is an officer or director of any investment company all or part of the securities of which are held by the public

(a) Such investment banker shall not for his own account sell to or purchase from such investment company any securities unless a majority of the members of the board of directors of such investment company are not such partners, officers, or employees, and unless the transaction is previously approved after full disclosure by a majority of such members of the board of directors of the investment company.

(b) Such investment banker shall use his best efforts to cause the investment company to prepare and distribute to its stockholders quarterly statements and annual financial statements, such annual statements to conform to the standards for such annual statements required by Section 1 of Article IV hereof.

(c) If such investment banker has received any compensation or commission for acting as agent for the investment company, or if such investment company has purchased from or sold to such investment banker any securities, or if the investment company has engaged in any other transaction in which the investment banker has a financial interest, the investment banker shall use his best efforts to see that full disclosure of such transactions is made by the company to the stockholders at an annual or special meeting. Where the investment banker has acted simply as broker for the execution of orders on a securities exchange it shall be sufficient disclosure if the total amount of securities dealt in and the total amount of commissions received shall be stated.

(d) Such investment banker shall not enter into any management or advisory service contract with such investment company providing for the payment to the investment banker of any fee or for any other compensation for managing or advising the management of the investment company unless the contract therefor has been submitted to and approved by the stockholders of the investment company.

(e) Such investment banker shall use his best efforts to cause the investment company not to use the term "trust" as part of the title of such investment company unless the use of the term "trust" is justified as a matter of law.

ARTICLE IX.

MISCELLANEOUS RULES.

SEC. 1. *Investment Management.* No investment banker who is receiving a fee for managing the account of any customer or for advising a customer with respect to his investments shall sell to, or buy from, such customer for his own account or as agent for any other person unless he shall have obtained the previous written or telegraphic approval of such customer to each such transaction.

SEC. 2. *Discretionary Accounts.* No investment banker who is authorized to purchase or sell securities for account of a customer in his discretion shall sell to, or buy from, such customer for his own account or as agent for any other person unless he shall have obtained the previous written or telegraphic approval of such customer to each such transaction.

SEC. 3. *Segregation of Agency Funds.* Any investment banker acting as sinking fund agent, principal or coupon paying agent, dividend paying agent or in any similar capacity, who holds any funds or securities in any such capacity shall hold such funds or securities as trust funds or trust securities unless the terms of such agency agreement expressly otherwise provide.

SEC. 4. *Quotations.* No investment banker shall publish or circulate, or cause to be published or circulated, any notice, circular, advertisement, newspaper article, investment service, or communication of any kind which purports to quote or to give a quotation of any transaction as a purchase or sale of any security unless such investment banker believes that such transaction was a bona fide purchase and sale of such security, or which purports to quote the bid price or asked price for any security, unless such investment banker believes that such quotation represents a bona fide bid for, or offer of, such security. If nominal quotations are used or given they shall be clearly stated to be only nominal quotations.

SEC. 5. *Offers to Buy and Sell.* No investment banker shall make any offer to buy or sell any security at a stated price from or to any person unless such investment banker is prepared to purchase or sell, as the case may be, at such price.

SEC. 6. *Compensation and Gratuities.* No investment banker shall, directly or indirectly, give, permit to be given, or offer to give, anything of value—

(a) To any employee, agent, or representative of another person for the purpose of influencing or rewarding the act of such employee, agent or representative in relation to the business of the employer of such employee, the principal of such agent, or the represented party, without the knowledge and consent of such employer, principal or represented party; or

(b) To any officer or employee of any bank, trust company or insurance company except for services actually rendered or to be rendered, and in no case without the knowledge and consent of such bank, trust company or insurance company; or

(c) To any person for the purpose of influencing or rewarding the action of such person in connection with the publication or circulation in any newspaper, investment service, or similar publication of any matter which has, or is intended to have, an effect upon the market price of any security, provided that this para-

graph (c) shall not be construed to apply to matter which is clearly paid advertising; or

(d) To any director, official, officer or employee of any issuer, for the purpose of influencing or rewarding the action of any such director, official, officer or employee, in connection with the issue or sale by such issuer or any person controlled by such issuer of any new securities of such issuer or of any such controlled person.

For the purposes of this section the giving of anything of value to a member of the family of any person shall be regarded as the giving of a thing of value to such person.

In order to comply with the requirements of the National Recovery Administration it is expressly stated that nothing in this Section 6 shall be construed to apply to the free and general distribution of articles commonly used for advertising.

SEC. 7. Registered Investment Bankers. (a) No registered investment banker shall, in any transaction with any investment banker not registered under Article X hereof, allow or grant to such non-registered investment banker any allowance, commission, or discount usually and customarily to be allowed to another dealer, nor shall any registered investment banker join with any investment banker not registered under Article X hereof in any syndicate or group contemplating distribution to the public of any issue of securities; nor shall any registered investment banker sell any security to or buy any security from any investment banker not registered under Article X hereof, except at the same price at which at the time of such transaction such registered investment banker would buy or sell such security, as the case may be, from or to a person who is a member of the public not engaged in the investment banking business.

(b) The provisions of paragraph (a) of this Section 7 shall not apply to an investment banker in a foreign country who is not eligible for registration under Article X hereof, but in any transaction with any such foreign investment banker where an allowance, commission, or discount is allowed, a registered investment banker shall as a condition to such transaction secure from such foreign investment banker an agreement that, in making any sales to purchasers within the United States of securities acquired as a result of such transaction, he shall conform to the provisions of this Section 7 to the same extent as though he were an investment banker registered under Article X.

(c) No investment banker who is not a registered investment banker shall represent that he is a registered investment banker, and no registered investment banker shall advertise or hold himself out to the public as a registered investment banker except as shall be permitted by regulations from time to time prescribed by the Investment Bankers Code Committee.

SEC. 8. District Rules. Every investment banker shall, with respect to any transaction in any district, comply with any additional Rule established in such district as provided in Sections 5, 6 and 7 of Article XI hereof.

ARTICLE X.

REGISTRATION OF INVESTMENT BANKERS.

SEC. 1. *Registration Agreement.* Each investment banker who registers under this Article thereby agrees with every other investment banker who registers under this Article to comply with all decisions and interpretative rulings of the Investment Bankers Code Committee under any provisions of this Article, and to comply with the Rules.

For any failure to so comply the registered investment banker who is guilty of such failure shall be subject to the penalties prescribed in Section 8 of this Article X, but such failure shall not, in itself, give rise to any civil liability to any other registered investment banker, or to any other person.

SEC. 2. *Eligibility for Registration.* Any investment banker who is actually engaged in the investment banking business in the United States shall be eligible to be registered under this Article.

If the principal office of any such person is located in a foreign country, any branch office in the United States may be designated as a principal office for the purposes of this Article.

SEC. 3. *Applications for Registration.* Any investment banker desiring to be registered, shall file with the Regional Code Committee of the district in which the principal office of the applicant is located, an application in such form as shall be prescribed by the Investment Bankers Code Committee and approved by the Administrator. Such application shall be in writing, in duplicate, stating—

(a) The name of the applicant;

(b) The address of the principal office and of all branch offices of the applicant;

(c) If the applicant be a partnership, the names, addresses, and business addresses of the partners, including special or limited partners, specifying as to each whether he is a general or limited partner;

(d) If the applicant is other than an individual or partnership, the name of the State or country where the applicant is incorporated or organized, and the names, residences and business addresses of its directors and principal officers and of each stockholder owning more than 10% of any class of the capital stock of such applicant; and

(e) The length of time the applicant or its predecessors have been engaged in the investment banking business.

SEC. 4. *Supplementary Statements.* In the event that any change shall take place in the personnel of the partners, directors, principal officers or stockholders of any registered investment banker with respect to whom information is required by the provisions of Section 3 of this Article to be given, such investment banker shall, within thirty days after such change has occurred, file with the Regional Code Committee of the district in which the principal office of such investment banker is located, a supplemental statement in writing, in duplicate, setting forth all such changes in personnel, and the information required by paragraphs (c) and (d) of Section 3 of this Article with respect to any such new partner, director or principal officer.

SEC. 5. *Action on Applications by Regional Code Committee.* Upon the receipt of any application for registration the Regional Code Committee shall cause such investigation to be made as such Committee may deem necessary and proper to determine if such applicant is actually engaged in the investment banking business, and if the facts stated in such application are true and complete; and said Committee shall, if requested by the applicant, give the applicant a hearing thereon. As soon as may be practicable thereafter, such Committee shall forward one copy of such application to the Investment Bankers Code Committee with a certificate of the action of such Regional Code Committee with relation thereto.

SEC. 6. *Action on Applications by Investment Bankers Code Committee.* Upon receipt of any application for registration by the Investment Bankers Code Committee, as provided in Section 5 of this Article, the Investment Bankers Code Committee shall, if satisfied that the applicant is eligible to be registered in accordance with the requirements of Section 2 of this Article, and that no untrue statement has been made in the application, register such applicant as a registered investment banker under this Article. The said Committee shall, at the request of the applicant, give the applicant a hearing thereon, at which hearing the applicant shall be entitled to be heard in person and by counsel, and to submit any matters which he may desire to present.

SEC. 7. *Complaints.* Every registered investment banker shall keep in each office maintained by him a copy of the Code and of the Rules and of all amendments from time to time made thereto, and of interpretative rulings made by the Investment Bankers Code Committee and approved by the Administrator, which shall be available for the examination of any customer who makes request therefor.

Any person feeling aggrieved by any act of any registered investment banker may complain in regard thereto to any Regional Code Committee. If such Regional Code Committee is in a district other than the district where the principal office of such investment banker shall be located, such Committee shall make such preliminary investigation in regard to the complaint as may be practicable and shall forward the complaint and the findings of such Committee to the Regional Code Committee of the district in which is located the principal office of the investment banker against whom the complaint is made, which latter Committee shall thereupon proceed to investigate the matter and to conduct such hearings in regard thereto as it may deem necessary and proper.

When any complaint is filed against any registered investment banker with any Regional Code Committee of the district in which the principal office of such investment banker is located, or when any complaint is forwarded to such Committee from any other Regional Code Committee, notice shall be given in writing to the investment banker complained against, specifying the nature of the charges and fixing a date for a hearing. Such Committee may make such investigations in regard to the matter as it may deem necessary and proper, provided any investment banker who is involved in such charges shall be entitled to be heard in person and by counsel, and to submit any matters which he may desire to present.

If any Regional Code Committee of the district in which the principal office of any registered investment banker complained against is located shall determine that there has been a violation of the Code or of these Rules or of any amendment

thereto, or of any interpretative ruling made by the Investment Bankers Code Committee and approved by the Administrator, such Committee shall transmit a report of its findings and the evidence adduced, together with its recommendations, to the Investment Bankers Code Committee for action by that Committee in regard to the matter.

If any registered investment banker complained against shall so request, the Investment Bankers Code Committee shall grant such investment banker a hearing, at which hearing such investment banker shall be entitled to be heard in person and by counsel, and to submit any matters which he may desire to present.

For the purpose of investigating complaints against registered investment bankers, the Investment Bankers Code Committee, and any agency authorized by it, shall have the right to require the investment banker to submit a report in writing in regard to the matter involved in the complaint, and such Committee shall have the right in the manner and to the extent provided by the by-laws of the Committee when approved by the Administrator to inspect the books, records, and accounts of such investment banker with relation to the matters involved in the complaint. Any refusal on the part of any registered investment banker to make any report as called for under this section, or to permit an inspection of books, records, and accounts, as may be validly called for under this section, shall be sufficient cause for suspending or canceling the registration of such investment banker.

SEC. 8. Penalties. (a) The Investment Bankers Code Committee, in the administration and enforcement of this Article, may prescribe penalties not in excess of \$500.00 for each violation, against any registered investment banker for any violation of the Rules or for any neglect or refusal to comply with orders, directions or decisions of the Investment Bankers Code Committee for the enforcement of the Rules, including interpretative rulings made by said Committee and approved by the Administrator, or suspend the registration of such investment banker for a definite period, or cancel the registration of such investment banker, as such Committee may, in its discretion, deem to be just.

(b) The Investment Bankers Code Committee may cancel the registration of any investment banker, for any cause for which registration could be refused as provided in Section 2 of this Article.

(c) The Investment Bankers Code Committee may impose a fine not in excess of \$500.00 for each violation against any registered investment banker, or may suspend the registration of any such investment banker for a definite period, or may cancel the registration of any such investment banker, if, in the opinion of said Committee, such investment banker has been guilty of repeated violations of the principles contained in Article III hereof. Within the meaning of this paragraph, it shall be deemed to be a repeated violation of such principles by a registered investment banker if such investment banker, having been notified by the Investment Bankers Code Committee that he is violating or has violated a principle, continues thereafter to violate such principle.

(d) In all proceedings under this section the Investment Bankers Code Committee shall grant any accused investment banker the opportunity to have a hearing, at which hearing such investment banker shall be entitled to be heard in per-

son and by counsel, and to submit any matter which he may desire to present, and a full record shall be kept of the proceedings.

(e) In any case where the Investment Bankers Code Committee shall impose any fine against any registered investment banker or shall suspend or cancel the registration of any registered investment banker, the registered investment banker against whom such fine is imposed or whose registration shall be suspended or cancelled shall have the right to appeal to the Administrator for a review of the facts upon which the action of the Investment Bankers Code Committee was based in the matter of the imposition of such fine or the suspension or cancellation of such registration, and the Administrator shall have the right, in his discretion, to stay the effect of the action of the said Committee until the further order or the final action on the matter by the Administrator, to review the facts as found by the Investment Bankers Code Committee, and to take further evidence, if he deems necessary, and the Administrator may modify, affirm or set aside the action of the Investment Bankers Code Committee in respect of such fine, suspension or cancellation of registration.

SEC. 9. Procedure. The Investment Bankers Code Committee shall determine the manner and form of its proceedings to be conducted under this Article, and may consider and take action upon any matter at any regular meeting or at any special meeting, and in holding any hearing or conducting any investigation under this Article said Committee may act by one or more duly designated members, but in such event a report of the facts as found shall be submitted to a meeting of the full Committee for its final action.

No member of any Regional Code Committee or of the Investment Bankers Code Committee shall in any manner, directly or indirectly, participate in the determination of any question affecting his personal interests, or the interest of any person in whom he is directly or indirectly interested.

SEC. 10. Powers. The Investment Bankers Code Committee shall be vested with all the powers necessary and appropriate to carry out the provisions of this Article, and it may adopt such rules, issue such orders and directions, and make such decisions as it shall deem proper and appropriate therefor.

SEC. 11. Interpretative Rulings. The Investment Bankers Code Committee may, from time to time, present to the Administrator proposed interpretative rulings based on the Rules, which rulings shall be made in the light of the general principles set out in Article III hereof, and said Committee is hereby authorized to give a liberal interpretation of the Rules, according to the spirit and intent thereof, in order to effectuate the policy and purposes of this Article. Such interpretative rulings shall, upon approval by the Administrator, become operative as part of the Rules applicable to registered investment bankers as provided in Section 1 of this Article X.

SEC. 12. The List. The Investment Bankers Code Committee shall furnish to each registered investment banker a list of all registered investment bankers and of all suspensions and cancellations of registrants.

Any registered investment banker may, at any time, withdraw from such registration and by so doing relieve himself of any further obligation as a registered

investment banker upon giving notice in writing to the Regional Code Committee of the district in which his principal office is located and to the Investment Bankers Code Committee of his desire to so withdraw and upon paying any amounts due from him.

SEC. 13. *Expenses of Committee.* Every registered investment banker agrees to make to the Investment Bankers Code Committee from time to time contributions to defray the expenses of the administration and enforcement of the Code and the Rules in the same manner provided in Section 6 of Article III of the Code.

ARTICLE XI.

ADMINISTRATION.

SEC. 1. *Statistics.* In order to provide statistical information regarding investment conditions from time to time, the Investment Bankers Code Committee is hereby authorized, within its discretion, to select a Confidential Agency to obtain from all investment bankers certified reports of such character and in such form as the Investment Bankers Code Committee may prescribe. Such Confidential Agency shall be in no way engaged in the investment banking business or interested in or connected with any investment banker. All such information so received shall be held as secret and confidential between such Confidential Agency and the reporting investment banker.

Such Confidential Agency shall analyze and digest the reports, and shall disclose to the Investment Bankers Code Committee only the general findings, which shall be available to all investment bankers who assent to the Code and to all registered investment bankers.

SEC. 2. *Regional Code Committees.*

(a) *Local Districts.* In order to facilitate the administration and enforcement of the Code and Rules, local districts are hereby established the boundaries of which districts shall be as set forth in Schedule A appended hereto. The Investment Bankers Code Committee may, from time to time, relocate such boundaries, and may increase or decrease the number of such districts.

(b) *Regional Code Committees.* In each district established as provided in paragraph (a) of this section, there shall be organized a Regional Code Committee as hereinafter provided in this paragraph. The number of members of each of said Regional Code Committees shall be either three, five, or seven persons as determined by the Investment Bankers Code Committee. Said members shall be elected by vote of investment bankers assenting to the Code and having their principal places of business within the district for which such election is being held. Nominations of persons to be elected shall be made by the Investment Bankers Code Committee, as follows: If the number to be elected is three, the nominations shall consist of five persons; if the number to be elected is five, the nominations shall consist of eight persons; and if the number to be elected is seven, the nominations shall consist of eleven persons. No person shall be nominated unless he is a person occupying an active executive office or position in the organization of an investment banker assenting to the Code and is a person having his place of business in the district for which he is nominated. The Investment Bankers Code Commit-

tee shall cause a printed ballot containing the names of all persons nominated in the manner specified to be mailed to each investment banker assenting to the Code and having his principal place of business in the district for which the election is to be held. Such ballots, in order to be counted, must be returned to such place and on or before such date as shall be fixed by the Investment Bankers Code Committee, and to be at least fourteen days after the date of the mailing of said ballots. Each investment banker entitled to vote at such election shall have the right to cast one vote for each of the number of persons who are to be elected, and the persons receiving the greatest number of votes, being that number of persons to be elected, shall thereby be elected members of said Committee. The term of office of each person so elected shall be fixed by the Investment Bankers Code Committee and specified in the nomination, and he shall serve until his successor shall be elected. Any vacancy occurring in the membership of any Regional Code Committee shall be filled by appointment made by the Investment Bankers Code Committee for the unexpired term.

The Regional Code Committees shall report all of their actions to and shall at all times and in all matters be answerable to the Investment Bankers Code Committee.

SEC. 3. *General Duties.* Such Regional Code Committees shall act as agencies of the Investment Bankers Code Committee for the administration and enforcement of the Code and the Rules in their respective districts.

SEC. 4. *Expenses.* Members of such Regional Code Committees shall serve without pay. Funds to meet the necessary and actual expenses of each such Regional Committee for administering this Code will be provided by the Investment Bankers Code Committee out of the funds collected by said Committee under the provisions of Section 6 of Article III of the Code and Section 13 of Article X hereof, but all such expenses shall be subject to approval by the Investment Bankers Code Committee. Any such Regional Code Committee may be authorized to raise additional funds for such expenses in accordance with regulations prescribed by the Investment Bankers Code Committee with the approval of the Administrator.

SEC. 5. *Additional Local Rules.* Any such Regional Code Committee may, from time to time, propose additions to the general rules of fair practice herein provided, as may be deemed desirable for such district and are not inconsistent with the provisions of the Code or of the Rules. Any such additional rules of fair practice shall be submitted to a vote of all investment bankers located in such district who have assented to the Code, and if approved by a majority of those voting, shall be submitted to the Investment Bankers Code Committee and upon approval thereof by the Investment Bankers Code Committee and by the Administrator, such additional rules shall become effective in said district.

SEC. 6. *Modification of Additional Local Rules.* Any such Regional Code Committee may, from time to time, propose a modification of any addition to the rules of fair practice for its district, or of any portion of such additional rules, and upon approval of any such proposed modification by the Investment Bankers Code Committee and by the Administrator, such modification shall become effective in said district.

SEC. 7. Cancellation of Local Rules. The Investment Bankers Code Committee, with the approval of the Administrator, may at any time, and from time to time, cancel any addition to the rules of fair practice for any district, or any portion of any such additional rule.

SEC. 8. Investigations. Each Regional Code Committee may, of its own volition, and shall, at the request of the Investment Bankers Code Committee, investigate any matter pertaining to an alleged violation of the provisions of the Code, or of any rule of fair practice effective in said district. In making any such investigation such Regional Code Committee shall act as a fact-finding body, and in any case where in the opinion of said Committee a violation has occurred, such Committee shall report its findings of fact, together with its recommendations, to the Investment Bankers Code Committee. In any instances where the Investment Bankers Code Committee shall direct any Regional Code Committee to make any investigation, as provided in this Section 8, it shall be the duty of the Investment Bankers Code Committee to provide or make provision for the expense of such investigation in accordance with the requirements of Section 4 of this Article.

SEC. 9. Privileged Communications. (a) Any communication from a customer of any investment banker addressed either to the Investment Bankers Code Committee or to any Regional Code Committee, with respect to or involving any complaint against any such investment banker, shall be deemed to be a privileged communication, and the name of the writer of such communication shall not be disclosed by any such committee: provided, however, that the name of the writer of such communication and the nature of the charges contained therein may be made known to the accused investment banker or in connection with proceedings arising out of said complaint.

(b) No communication from any investment banker addressed either to the Investment Bankers Code Committee or to any Regional Code Committee, with respect to or involving any complaint against any other investment banker, shall be deemed to be a privileged communication, and any such communication may be dealt with by said Committees, or either of them, as said Committees, or either of them, may deem just and proper in the circumstances, but in any proceeding arising out of any such complaint the accused investment banker shall enjoy the right to be informed of the name of his accuser, of the nature and cause of the accusation, and to be confronted with the investment banker making such accusation.

SEC. 10. Waiver of Rules. Any rule contained in the supplementary provisions or hereafter established pursuant to these supplementary provisions may be waived in whole or in part, in any particular case, by the Investment Bankers Code Committee, in the manner provided in this Section 10. Any investment banker desiring to secure such waiver in any particular case shall make written application therefor to the Investment Bankers Code Committee. The Committee shall consider such application at its next meeting, or the Chairman of the Committee may, by mail, or otherwise, ask each member of the Committee for his individual opinion, and if a majority of all the members of the Committee shall be of the opinion that such waiver will not permit any unfair trade practice, and will not be detrimental to the public interest, the Committee after the approval of the Adminis-

trator shall advise the applicant investment banker in writing to that effect, and upon receipt of such advice such waiver shall become effective, with respect to the particular transaction, to the extent provided therein.

SEC. 11. Liability of Members of Investment Bankers Code Committee and Regional Code Committees. No member of the Investment Bankers Code Committee or of any Regional Code Committee shall be liable, except for willful fraud, to any investment banker or to any other person for any action taken by such member in his capacity as a member of any such Committee in connection with the administration or enforcement of the Code or Rules or of any provision of these supplementary provisions.

SEC. 12. Special Committees. At any time upon there being filed with it a petition signed by not less than ten investment bankers assenting to the Code, the Investment Bankers Code Committee shall appoint a committee composed of assenting investment bankers to investigate and report upon any special problem set forth in said petition. If the question to be investigated involves any particular branch of the investment business a majority of the committee so appointed shall be members actively interested in the particular branch of the investment business involved. The committee so appointed shall report to the Investment Bankers Code Committee and the Code Committee shall give consideration to the recommendations in said report.

SEC. 13. Labor Complaints. Until such time as its organization for handling labor complaints is approved by the Administration, neither the Investment Bankers Code Committee, nor any Regional Code Committee shall attempt to investigate or adjust complaints of violations of the labor provisions of this Code, and all such complaints shall be referred to the State Director for Compliance having jurisdiction in the area where the complaint arises, or otherwise handled as The National Recovery Administration may, by rules or orders hereafter established, direct.

STATEMENT

by

B. Howell Griswold, Jr., Chairman,
Investment Bankers Code Committee

Mr. Griswold Presented the Fair Practice Amendments to the Code of Fair Competition for Investment Bankers at the Hearing before the National Recovery Administration March 15, 1934, in Washington, D. C. The Following Presents the Substance of Mr. Griswold's Statement.

We are presenting to you for your approval the proposed Supplemental Code of Fair Competition for the Investment Bankers, as finally drafted by the Investment Bankers Code Committee and approved by a large majority of those who have assented to the original Code.

We would not have you think that this is the product of a few minds, or that it has been hastily prepared, or that it has been dictated by personal interest. Many of the errors of humanity necessarily creep into constructive work that has been directed and must be approved by many minds, just as they creep into our individual lives. But, as there are men and women who struggle toward an honorable, self-disciplined and self-regulated objective, so occasionally you will find a body of men who have approached in the same manner the solution of a public problem laid before them.

I think this is true in the present instance, and I may say so without embarrassment or immodesty, as I have contributed but little to the studies which led to the original drafting of the Code, having been called but a month ago to serve as chairman of the Code Committee. I have been as much in the position of an observer, therefore, as that of a workman. But I have had full opportunity to observe and to record impressions.

My observations are certainly honestly recorded; I think, too, they are free from the bias of association or friendship, as I have had but little active association with the Investment Bankers Association, never having served as an officer or director—although my firm has long been a member of the Association.

THE SOURCE OF THE CODE

This Code, Gentlemen, has passed through the sieve of a thousand and more minds. Its original substance comes from the best and most experienced of those minds, the minds of men who were selected by those in the industry itself. The officers and directors and a special committee of the Investment Bankers Association prepared the original draft. These men were selected to leadership by the industry at a time when conditions were most menacing. Their positions evidence the approval of their associates.

When it was submitted to the Code Committee which is now before you, it was submitted under conditions which plainly stated that the obligation of the Code

Committee was to study the whole problem anew and redraft in the interest of the public and the industry. Immediately after the organization of the Code Committee the chairman sent a telegram to each member, the relevant portion of which is quoted below:

"February 15, 1934: Our Code Committee, as you are aware, was not formed for the purpose of adopting and enforcing a Code prepared by investment bankers, but to study, approve and enforce such a Code as might seem to the Committee to be in accordance with and to promote the public interest as well as the interest of the investment business. It is from this point of view I am asking each member of the Committee to review the Code thoroughly to see that the objective has been obtained * * *."

I cannot pay my fellow members a higher tribute than to say I think they have met that requirement.

I cannot pay a higher tribute to our attorneys, Mr. Joseph C. Hosterler and Mr. Paul V. Keyser than to say that they were not merely careful legal draftsmen, but as consultant and adviser, each of them took pride in his work as a contribution to the public good. Both have been engaged from its earliest inception in the drafting of the Code.

FUNDAMENTALS OF THE CODE

Back of our Code stands not only the statute creating the NRA but Federal and State statutes, to protect the investor. Our contribution is that we establish machinery for publicity; we require caution, industry and integrity—and we do it through a Code that will be policed by thousands of volunteers who believe that there is a distinct need for the investment banker and demand high standards of honesty.

In preparing the Code, the most orderly process was, of course, first, analysis, and, second, synthesis. This has been the method pursued by the drafters.

In analyzing our present difficulties they recognized the period preceding the panic one of exceptional strain and the debacle that followed was catastrophic. It gave them more concern than anyone except the speculators. They saw the rising surge of almost volcanic forces loosed by a World War which had destroyed the accumulated wealth of the world and eight and a half millions of productive youth; then they saw the panic followed by rapid subsidence and deflation. They realized that everyone who had sold a security or real estate, or any other form of property on the surge upward was rejoicing, and that those who had bought, particularly those who had speculated, followed the usual course of human nature and visualized someone else or some group as having been the cause of his error so that he personally should not be held to blame by himself or by his family.

There were vast post-war economic forces at work, and when the deflation came and smashed prices—not merely false prices, but the prices of intrinsically valuable things—in a manner few could have foreseen and none prevent, the deflation precipitated suffering and resulted in great resentment.

Notwithstanding these fundamental factors which may be offered by the thoughtless as a full justification, economic evils are always contributed to by human error. The drafters sought to find the check on the errors that accompany

prosperity. A correct analysis was necessary if we are to insert these checks in a Code for Investment Banking.

GENERAL PRINCIPLES AND RULES

We have endeavored in this Code to correct the evils of the past—fraud, ignorance, lack of frankness, haste. You will also find in the Code a distinction between General Principles and Rules. You will find, by way of analogy, General Principles embodied in the Constitution of the United States; prohibitory restrictions in the statutes. Prohibitory laws are more readily understood and more easily enforced. Consciously or unconsciously, the framers of this Code adopted this distinction. The Code is divided into General Principles and Rules.

The General Principles are to serve as a background of intent, as a pledge of good conduct in the business and as a guide to the Code Committee in interpreting the Rules.

May I now say a word about the investment banking business, the part it has played in our national development and the part it must play in national recovery.

DISTINCTION BETWEEN INVESTMENT AND COMMERCIAL BANKING

We should, at the outset, emphasize the different parts played in the economic life of the nation by investment bankers on the one hand and commercial bankers on the other. The investment banker assembles from hundreds of thousands of investors the necessary funds for the capital development of the country. He directs this flow of capital into productive enterprises and thus provides capital expenditures for construction.

Commercial banks supply facilities for carrying on the enterprises which capital funds have created. In brief, "commercial" banks provide current funds for "commerce"; that is to say, for the exchange, or buying or selling of goods, merchandise and commodities of all kinds. The investment banker originates what the commercial bank is designed to facilitate and perpetuate.

PRODUCTIVE POWER OF INVESTMENT BANKING

One of the most amazing pages in history is the story of the development within a few centuries of the continent of North America from prairies and wilderness to vast areas of cultivated lands dotted in every area with great cities harboring the most productive industries in the world.

One of the most interesting paragraphs on that page of history has been the development, within little more than a century, of the United States of America, from a population of less than 4,000,000 clinging to the Atlantic Seaboard, to a population of nearly 130,000,000 covering a territory of more than 3,000,000 square miles.

In no small measure this had been due to the individual—to the pioneer—to the courage, hardihood and genius for productive effort of our people. But it is also fair to say, when we study the contribution of organized effort to this result, that we must turn our attention to the investment banker—not to the commercial banker. As valuable as the latter's contribution, his function has been (and must be) limited to supplying the temporary demands of established enterprises. The commercial banker cannot contribute the long-term capital to create enterprises, and cannot be the leader in the development.

To assemble and to provide permanent capital remains the function of the investment banker. Through these sums so assembled, investment bankers have constructed and expanded our great railroads stretching from the Atlantic to the Pacific; from Canada to Mexico. They have made possible our vast systems of communication, the cable, telegraph and telephone. They have in no small measure been an essential part in developing our foreign commerce. They have made possible the construction of the great power plants which turn the wheels of industry and light the greatest cities and smallest hamlets of our country. They have supplied the farmers with the necessary moneys for permanent improvements to their homes and their farms. They have created our public buildings, court houses and school houses.

REPRODUCTIVE CHARACTER OF CAPITAL INVESTED

Long-term capital invested reproduces itself; for money invested in productive enterprise breeds new enterprises and new business. The commercial banker is a needed supplement to this great work, but comparatively speaking, his function is (as we have said) to supply the current credit needs of daily business.

NECESSITY OF RE-ESTABLISHING THE FLOW OF CAPITAL INTO NATIONAL DEVELOPMENT

No one then, who has read history intelligently and who has visualized a continent in process of development, can fail to realize the significance of starting again through proper channels the flow into the economic body of the life blood of investment capital. We use advisedly the term "start again" for it is estimated that the new issues (alone) of long-term capital funds supplied by investors amounted approximately to ten billion dollars in 1928 while in 1933 they amounted to less than one billion.

Quite apart from the new industries, new building and new construction that may be needed in new fields, there are a vast number of plants in this country which have been lying practically idle for four or five years. Modernization and replacement is essential.

Permanent capital cannot, should not and will not be supplied on the basis of short-term, commercial loans. Borrower industries would not be able to repay the principal as well as interest in so brief a period. A short-term loan for permanent capital purposes is not the character of loan that can be safely accepted (under the circumstances) by the industry itself.

The adoption of this Code by which the Investment Banker places his own machinery in order, is the first active step toward recovery. Other steps must yet be taken, but the discussion of these have no place in this presentation.

I now lay before you the results of our work. We have been encouraged by the kindly praise of those who believe it to be a self-disciplinary, self-regulating and self-sacrificing Code. It is not perfect; we shall learn as we go along; we shall welcome suggestions, and, in particular, constructive criticism. The Code is open to amendment. We have not been able to please all. In fact, in a sense, we have pleased none. If we had attempted to please, the Code would have been spiritless and meaningless.

Every investment banker who desires and expects to remain in the business over a long period of years, knows, or should know, that his best asset is the continued confidence of his customers, and every investment banker who studies the Code unselfishly, will realize that every effort has been made in this Code to build up this asset for him out of the wreckage of the past. Whether he retains it or not, depends upon how sincerely and honestly he adheres to the Code.

We thank you for this opportunity to be heard and we shall continue to invite criticism and suggestions.

STATEMENT

by

Robert E. Christie, Jr., President,
Investment Bankers Association of America

The Fair Practice Amendments to the Code of Fair Competition for Investment Bankers were, as Submitted to the Investment Bankers Code Committee, Sponsored by the Investment Bankers Association of America. The Following Consists of Salient Excerpts from Mr. Christie's Statement at the Hearing before the National Recovery Administration March 15, 1934, in Washington, D. C.

In accordance with the provisions of the National Industrial Recovery Act, the Investment Bankers Association of America sponsored the Code of Fair Competition for Investment Bankers and undertook the preparation of that basic Code in the summer of 1933. After a public hearing on the 6th of November the Code was signed by the President of the United States on November 27, 1933. Article IV of that Code provided that within 90 days after approval supplementary provisions relating to fair trade practices were to be submitted.

Even before the basic Code was approved, a special committee of the Investment Bankers Association was appointed to draft the fair practice provisions and began its work immediately. This committee consisting of twenty-one men represented every type of investment organization and every part of the country.

At the outset the committee undertook to obtain suggestions from every worth while source. All the dealers in the country, both non-members and members of the Association, were circularized and urged to cooperate. In many cities meetings were held to discuss the problem. Securities commissioners of every state were asked for their suggestions. Many of them responded. By the middle of December the drafting committee made a progress report to the Board of Governors of the Association. All dealers and brokers in the country were again advised on the status of the work and their further suggestions were solicited on specific problems. Again many local meetings were held, in which meetings all dealers were urged to participate. These meetings reported to the drafting committee, as did a great many dealers individually.

THE FIRST DOCUMENT SUBMITTED

The drafting committee submitted its final report to a meeting of the Board of Governors of the Association in Chicago February 10th, 11th and 12th. This meeting was also attended by twenty of the twenty-one members of the Investment Bankers Code Committee, which had been appointed in the meanwhile. Eighty-five investment bankers in all were in attendance, many of whom were not members of the Association. The group was thoroughly representative of all phases of the business, particularly a large and able representation from smaller houses.

The fair practice provisions, as approved at the meeting in Chicago, were then sent to every known dealer and broker in securities in the country and all were

urged to attend regional meetings in 26 different cities throughout the country on February 19th. Approximately 2,000 men attended. The meetings reported directly to the Investment Bankers Code Committee. The Code Committee then met in Washington and made such changes, as in their opinion, seemed desirable. The Code Committee then submitted, on February 23rd, to all dealers who had assented to the basic Code, the fair practice provisions as amended, together with ballots returnable on or before March 5th.

At the time the ballots were counted on March 5th, 1,251 employers had assented to the basic Code and were thereby entitled to vote. Of these, 1,005, or 80 per cent, voted; 888 in favor of the fair practice provisions. Of the 117 who disapproved a majority indicated either on their ballots or by correspondence that they approved the provisions in principle but took exception to specific sections. Since March 5th the number of dealers assenting to the Code has increased to over 1,500. It must be recognized that no worth while code of fair practice could be written that would be acceptable in every detail to everyone in the business. But the Code which has been developed represents as nearly as possible the best judgment of the majority in the business. Since the March 5th meeting a copy of the Code has been mailed to every known dealer and broker in the United States.

ORIGIN OF THE CODE

The duty of formulating the Code devolved upon the Investment Bankers Association directly from the National Industrial Recovery Act which stipulated that codes should be prepared by the representative trade associations of the different industries. The Association is the only national trade association of securities dealers in the United States.

The Association was organized in 1912. At present it has 443 members who have 991 offices in 118 cities throughout the United States. This membership represents every type of dealer and broker in securities and is not dominated by any one group or section.

In any event the essential interest of all reputable dealers in securities, whether or not they are members of the Investment Bankers Association, are identical.

For years the Association has been the only national bureau of standards in the business. Its work has been of immeasurable benefit to the country as well as to the business itself. The Association has, at great expense, continually maintained some 20 standing committees which are virtually expert research organizations. To these committees the Association has continually referred the financial problems of industry and government as well as the problems of the business itself. The findings of these committees, as adopted by the Association, have undoubtedly been the foremost determinant in establishing worthy investment principles and practices in this country.

COOPERATION WITH THE NRA

Prior to the creation of the NRA, however, there was no effective method of enforcing such rules and practices. The opportunity is now available to establish sound principles having the force of law. We have accordingly welcomed the cooperation of the NRA and have given of our own best efforts in response.

SCOPE OF SECURITIES TRANSACTIONS

The securities merchant is concerned with the creation and maintenance of sound credits for long periods. The extent to which his activities function for the benefit of government, industry, agriculture and labor and, at the same time, make available to investors opportunities for the profitable use of savings, justify his existence.

The result is a far-flung mechanism concerned with the issuance and the marketing of investment securities. This comprehends not only securities issued by the Federal Government, by States, by municipalities or by large corporations, but, in addition, the securities of many small industries in which investment is largely localized. Many investors prefer to place their savings in local industries with which they are familiar. It should be realized, therefore, that the problem to be dealt with in formulating this Code does not merely relate to the activities of the large issuing houses. It also concerns a multitude of security issues and the process of merchandising them in local communities throughout the United States.

No matter what laws may be enacted, no matter what stringent regulations may be enforced, there is no substitute for the fundamental fact that the investment banker who prospers must command the confidence of the investing community.

Obviously it is in the national interest that as rapidly as possible conditions shall again be created under which the capital markets can function normally. When such conditions are created, the services of the securities merchant will be indispensable. One of the purposes of the proposed Code is that in this period of recovery toward which we are looking and thereafter, these services shall be performed in a manner and upon standards higher and better than anything the country has known before.

NO MAGIC FORMULA

We do not pretend to know any formula which will guarantee that all new securities are good securities, or that all which are good when they are new will continue good. If we knew such a formula we should embody it as the alpha and the omega of the Code. Not knowing it, we have had to try to be practical and place such safeguards at the disposal of the investing public as our experience shows should be protective and constructive. All of us want to see confidence re-established, and to make our utmost contribution to its reestablishment. For this fact can never be overlooked, that all the negative regulations conceivable do not create a single new issue of securities, they do not finance a single new industry, they do not themselves create any new capital whatsoever.

In any program for reform in security transactions, the careful elaboration of safeguards relating to factual disclosures in an indispensable detail in a larger category that includes abuses of salesmanship, abuses of confidence, and abuses of competition. The safeguards must be of a kind to raise all investment practices to the level of the highest traditions in our business. It is important to bear in mind that there have been created and distributed great quantities of sound securities, measured by any standard that intelligent critics might set up. We cannot do better than to equal the best that has been done in the past.

IMPORTANCE OF CONTINUOUS INFORMATION

In the proposed Code, we have realized that facts must be current to be of value. Thus we would try to assure the continuous disclosures of indispensable data, such as many corporations have supplied in the past.

Issuing corporations, which are of course primarily responsible for the needed data, are not subject to the Investment Bankers Code. To reach them we would require all investment bankers, as a condition to issuing corporate securities, to obtain a contractual promise from the issuers that they will supply the stipulated facts as long as their securities remain outstanding. In this, we believe that the Code makes a distinct advance upon anything hitherto attempted in the effort to protect the investor.

REFORMS IN SALESMANSHIP

Certainly not less important in security dealing than the disclosure of facts is the correction of abuses in salesmanship. Under the stress of unregulated competition and under the pervasive influence of selling methods successful in other fields of American business, securities dealers in this country have allowed selling practices to grow up which have no proper place in the machinery of a capital market. The purchase of securities should not result from the mere selling ability of a salesman, but from a meeting of the minds of the investor and his investment banker, in which the investor assumes a due sense of his own responsibility.

The eradication of selling evils in the securities business is no easy task. The spirit of high pressure selling runs through most forms of American business and has naturally tended to permeate the investment mechanism. The technique of retail salesmen is not alone in question. Originating houses have too frequently appraised a new piece of business by the criterion of whether it could be sold rather than whether it should be sold.

A large number of firms now employ men as security salesmen upon a salary basis only. There is, however, a very large number of security salesmen employed throughout the United States upon a commission basis. To require, as has been suggested, that all of them should be paid fixed salaries would mean that thousands of men would be immediately thrown out of work. The wise and conservative approach to this problem is to impose conditions of employment which will exact of security salesmen a knowledge of the business in which they are engaged.

No less important than selling practices and no less difficult is the problem of conflicts of interest in the investment banking business, and the abuses to which they may give rise. We feel that every party to a security transaction is entitled to know the position or interest of every other party.

This is not the time to explain all the details of our Code. That will be done by others. I have merely attempted to indicate something of our purposes, indeed, of our ideals, as embodied in it. It is far from a perfunctory document. It upsets many of the practices of the past. It disturbs the even tenor of many who want things continued in the old way. It frankly and positively calls for a new sense of responsibility to the public on the part of everyone engaged in the investment business.

PROVISIONS FOR ADMINISTRATION

We wish now to draw particular attention to the provisions in the proposed Code for its administration and enforcement. If approved by the Administrator,

the fair trade practice provisions become an integral part of the Code of Fair Competition for Investment Bankers, and as such carry with them the enforcement sanctions of the National Industrial Recovery Act. But it has seemed to us that it is incumbent upon securities merchants to devise a procedure for enforcing the spirit of the Code to be adopted which will be far more expeditious, elastic and effective than is provided by the courts. Such a procedure we have undertaken to provide. In substance, it proposes that security merchants may register with the Investment Bankers Code Committee, and by so doing enter into a contractual engagement with all other registered investment bankers to accept the jurisdiction of the Investment Bankers Code Committee in enforcing the Code. This proposal has far-reaching implications. It is expected that this contractual relationship will supply the groundwork on which to build, for the first time, effective self-discipline in the investment banking business.

It is hoped that the Rules as prepared will mark the birth of a new epoch in American investment banking, in which the best traditions of the business will govern. Undoubtedly experience will suggest innumerable amendments, and with the passage of years the document now before us will seem but an imperfect beginning. We are convinced, however, that the principles underlying the present document are sound.

DESCRIPTIVE ANALYSIS
Of the Fair Practice Amendments as Finally Approved
By the President

by
Joseph C. Hostetler, Counsel,
Investment Bankers Code Committee

This Analysis Follows in the Main the Brief Submitted at the Public Hearing on
the Amendments to the Code of Fair Competition for Investment Bankers
Which Was Held before the National Recovery Administration March 15,
1934, in Washington, D. C.

The Code of Fair Competition for Investment Bankers was approved by the President of the United States on November 27, 1933. The Investment Bankers Association of America immediately after the approval of the basic Code set to work preparing the rules which are now being submitted, and the approval of which is asked. The men who have worked at the drafting of these rules have done so with the hope that if the job was well done they would have accomplished something of great value to the securities business, as a business, and to the country as a whole. This they intended. It must be apparent that one of the primary steps to be taken in a revival of business shall be a re-opening of the securities markets. The capital needs of American business MUST be provided for primarily by the sale of long-term securities or equities to investors rather than by Government aid or bank borrowings. The sale of securities must be preceded by confidence, and we have all learned that confidence must finally rest upon character and principle rather than upon bricks, stone, bronze and marble.

It has been the effort of the various committees who worked upon these Rules to consider all of the practices which led or contributed to the troubles which we have been through. We have examined the failures and we have honestly tried to determine wherein the practices in our business contributed to those failures. We have tried in these Rules to lay down a set of principles for the business which will, so far as is humanly possible, work against a repetition of our past mistakes, and we believe that what we are proposing today, will, if adopted go a long way toward stabilizing the business of creating and marketing securities and protecting investors. Some folks will honestly believe that we have not gone far enough. Many others will just as honestly believe that we have gone too far. Such a divergence of opinion is inevitable in the preparation of a document as novel and radical as this one is.

As we consider these supplementary provisions paragraph by paragraph there is one fundamental which must never be lost sight of—which is, that regulatory rules, in order to be effective, must first be understandable, and second, enforceable. If rules are prepared which either because of their indefiniteness cannot be understood or because of their unfairness cannot be enforced you injure the business upon which the rules are imposed. The reason why this is so is very easy to understand. The honest man engaged in the business will undertake to comply

with the Rules; the dishonest man will undertake to evade them. If the dishonest man succeeds in the evasion his advantage over the competitor is incalculable and to that degree every sound and substantial participant in the business is hurt and the business itself suffers. The fellow who evades a just Rule generally doesn't do himself any permanent good but he may do the man who is complying with it very permanent harm. When you're dead—you're dead. That goes physically and competitively.

We have therefore tried to prepare a set of Rules for this business which are sane, understandable and enforceable, and the investment banking business is today offering to the NRA in addition to this set of Rules the machinery for enforcing them which we believe can be made effective.

We have had to consider in the preparation of the Rules the Securities Act passed by the United States Congress and now in force, the rules and regulations of the various stock exchanges, and the so-called blue sky laws of the various States of the Union. It would be too much to hope that we haven't made some mistakes. We will undoubtedly have to modify some of the Rules which we have written; some will have to be strengthened, some will in all probability have to be made less drastic. The wonderful part about what we are all doing is that if we honestly apply ourselves to the task there is no mistake which we have made in the past or which we may make today which can't be tomorrow studied and modified. With this in mind we proceed to a discussion of the details of each of the provisions that are now proposed.

ARTICLE I.

Article I carries very little except references tying the Rules into the Code of Fair Competition and fixing the effective date of the Rules. It is provided that they become effective on the 30th day after approval by the President except as to the provisions in regard to registration, the effective date for which may be extended at the discretion of the Code Committee to not over 90 days. We realize that these new Rules will make necessary many changes in the operation of our business. Much study will have to be given to the Rules as they apply to each particular house engaged in the business in order to make the accounting practices fit in, but we believe that the thirty day period in the light of the three months' discussion which we have had is sufficient, with the right in the Code Committee to extend the effective date of the registration section if it is impossible to register all applicants within that time. There is stated in Article I a rule of construction to the effect that these Rules should be interpreted in such manner as will aid in effectuating the policy of the National Industrial Recovery Act.

It is also set forth for guidance in the interpretation of the Rules that while they are prepared for the purpose of convenience under general headings "such groups and headings shall not be construed as limiting the application of any Rule."

ARTICLE II.

Article II consists of definitions, and there are only a few of them which need be noted here.

The definition of the term "investment banking business" is the same as the one set forth in the Code of Fair Competition as already approved by the President.

SECURITIES

The term "securities" is defined very broadly and with the intent and in the belief that we have fairly covered everything which may be considered as a security.

NEW ISSUE OF SECURITIES

The term "new issue of securities" is defined as an issue sold or offered in one transaction or in a connected series of transactions "as a result of which consideration for such securities is or is to be received directly or indirectly by the issuer thereof."

ISSUER

We then define the word "issuer" for the purposes of this paragraph only, as including in addition to the issuing company "any person directly or indirectly controlling or controlled by the issuer or any person under direct or indirect common control with the issuer." This is done so that where there is a group of companies either commonly owned or organized as subsidiaries of one or more of the group, the sale of securities cannot be made by some one of the commonly controlled or wholly controlled subsidiaries for the benefit of some other of the corporate family and thus avoid the provisions of the rules. This definition has had given to it a great deal of attention, and it is believed that it is broad enough to make the terms of these Rules applicable to all new issues and to outstanding issues when reacquired by the issuer for redistribution to the public.

VOTING TRUST CERTIFICATES AND INTERIMS

The term "issuer" is defined for the general purposes of the Rules as the person who issues or guarantees either as to principal or income any security or who assumes the obligation to pay such securities either as to principal or income. In connection with voting trust certificates, interim certificates or other similar securities the term "issuer" is defined to mean not the person actually executing the interim certificates but the person issuing the securities represented by such certificates, and in the case of unincorporated investment companies the term "issuer" is defined to mean the person "performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued."

EQUIPMENT TRUST CERTIFICATES

With respect to equipment trust certificates and similar securities the term "issuer" is defined to mean "the person by whom the equipment or other property is or is to be used." I set forth this particular definition at length because it will present a picture as to the complicated nature of the various transactions which are lumped under the general term "securities" and so that it may be in all of our minds as we pass from rule to rule and that we may see the care which is necessary in integrating the various rules with each other and with the customs and practices of the business and the statutes governing the issuance of various securities.

PROSPECTUS

The term "prospectus" is defined as meaning the official prospectus required in the Securities Act of 1933 in cases where that Act requires an official prospectus, and in all other cases the offering or descriptive circular. At first blush it might seem that the latter part of this definition is a little incomplete, but the customs of this business have given a meaning to the words "offering or descriptive circular" which is entirely complete and well understood, and it has been deemed better to rely on the use of these well known terms instead of attempting a definition of them.

ORIGINATOR

The term "originator" is defined as meaning not only a person who purchases a new issue of securities from the issuer, but as well, one who contracts with the issuer to sell a new issue of securities with a view to a public distribution of them. This definition was written in the knowledge that the length of time required under the Securities Act for the registration of a new issue of securities is so long that it may lead to a change in what has heretofore been the American practice in the issue of securities.

Securities are purchased on a little different basis than most other things which are sold. One ordinarily buys a loaf of bread to eat it, and he buys a suit of clothes to wear it until it is worn out. He buys a security, however, to get the income from the money invested, but also with the idea that he is buying something which has ready marketability. He therefore thinks of the security not only in terms of what he is willing to pay for it, but also in terms of what others may be willing to pay for it in case he wishes to sell it. It doesn't take much room to write out this distinction, but it makes all the difference in the world between the preparation of rules governing the origination and sale of securities as against most other articles of commerce.

ASPECTS OF MARKETABILITY

The marketability of a security depends just about on every other thing in the world. Almost every major political incident in the world affects security values somewhere. Therefore in defining what is origination we must remember that the investment banker who enters into a firm contract with an issuer to purchase a specific issue is subject to market conditions from the moment that he signs his name to the paper until the time that the securities are finally sold and paid for by the individual investor. It is for this reason that the syndicating and marketing of securities is done under terrific pressure so far as time is concerned. The issuer naturally wants to be sure that he will receive the purchase price for his corporate purposes. He may want to pay off a maturing bond issue, to retire stock, or to erect buildings, but whatever he wants it for he prefers to be sure that he is going to get it.

The longer the time that intervenes between the date of outlining the terms of the security publicly and the date when they may be offered to the investor, the greater the risk to the underwriter. This definition is therefore drawn to cover origination whether it arises from firm purchase, from positive agreement to sell, or from agreement to undertake to sell.

SELLING SYNDICATE AND SELLING GROUP

In connection with the use of the terms "selling syndicate" and "selling group" just a word should be said with regard to the syndicating of securities—a practice which has been general in the United States. The originator, as we have pointed out, contracts with the issuer to take the whole block of new securities to be offered. Whether for good or ill, we in America have developed large corporate structures. The issues of new securities which are to be offered to the public therefore often run from \$50,000,000 to \$100,000,000. The originator, no matter how big he is, ordinarily does not consider it safe to carry the burden of such a commitment alone, and it is this fact that gives rise to the formation of syndicates. The originator must deal with the issuer as a principal and therefore if he desires to divide his risk he must do it among a relatively small number of very responsible persons. There ordinarily isn't time enough for him to organize a large syndicate, and therefore in the creation of large issues a supporting syndicate is often organized by the originator to help share the responsibility until the securities can be properly distributed.

In very large issues a secondary syndicate is sometimes formed, but ultimately the distribution of the issue is planned to take place through many hundreds of dealers all over the United States, and the final operation is carried forward either by "selling syndicates" or "selling groups."

SELLING SYNDICATE

"Selling syndicate" is defined as being a syndicate formed to distribute all or part of a new issue in which the participants in the syndicate have financial commitment to purchase a portion of the securities.

SELLING GROUP

The term "selling group" is defined to mean a group formed in connection with the public offering of a new issue under an agreement which imposes no financial commitment on the members to purchase any securities.

These two terms are carefully defined because there is great difference of opinion whether the dealer in securities who is selling his customers something which he has already purchased is in as good a position to advise as the dealer who has no ownership or financial commitment in connection with the security but who is operating solely for a selling commission. Many people would rather buy from a man who can truthfully say to them, "I think enough of this security which I am offering you that I bought it myself." There are many others, however, who believe that the man who owns the security is under the great pressure to sell to the customer because of his ownership. The rules, as you will see, are in some cases different for members of a selling syndicate than for members of a selling group. The main thought, however, is that the customer shall be informed clearly and unmistakably as to the dealer's position so that if in that particular customer's mind there is merit or demerit involved, he may know the facts.

SALESMAN

The definition of the term "salesman" is drawn to cover any officer, employee or agent (other than another investment banker) of any investment banker. It

will be noted that this general definition does not cover partners. It will be seen that an exception is made to this Rule when we come to the paragraph covering solicitations at homes when the word "salesman" is defined to include partners. This is for the particular reason of that section and we will comment on it then.

ARTICLE III

Article III contains the statement of eleven general principles, set forth not as rules which shall govern investment bankers and which require definite action or forbearance, but as principles to guide the Code Committee in interpreting the Rules and to guide the investment banker in making numberless decisions which will be necessary in the ordinary course of his business in connection with transactions not specifically covered by the rules and in adjusting his business practices to the rules.

Section 1 of these general principles sets forth the duty of the investment banker to observe and maintain "high standards of commercial honor in the investment banking business and to promote just and equitable principles of trade and business."

INVESTIGATION OF NEW ISSUES

Section 2 sets forth the duty of the originator of a new issue of securities to make such investigation as may be "reasonably necessary" to determine the merit of the issue, that the business risk of the investor is reasonable and that there are appropriate provisions to safeguard the investor's interests. Any investment banker, other than the originator, participating in the distribution of a new issue is enjoined to satisfy himself that the preceding investigation has been made. The degree of investigation "reasonably necessary" depends in large measure upon the issuer and the purpose of the issue. A great deal of discussion was had in the meetings of the code drafting committee as to whether or not the degree of investigation necessary to be made was susceptible of definite statement in a rule, and it was finally decided that the matter of investigation should be left to a general principle for the reason that practically every new issue has so many factors which are individual to it that any statement of a formula for the investigation would necessarily be either too extensive and too burdensome in connection with a small issue put out by an issuer of recognized responsibility, or too lenient if applied to a speculative issue or one put out by a company without established and recognized credit.

The language of the section, therefore, states the rule of reason and binds the investment banker to make his determination as to the investigation warranted or required, in the light of all the facts and in the exercise of experience which, when all is said and done, he alone has. This is a duty which, in the main, the reputable investment bankers of America have always assumed and in the performance of which they have, on the whole, made a record which is much better than would be indicated from a study of a relatively few sample transactions which in degree at least have probably been selected as "horrible examples."

INFORMATION FOR INVESTORS

Section 3, in general language, provides that there shall be made available to investors, either in a prospectus, from public sources or in some other manner ade-

quate information with respect to the issuer, the nature of its business, its financial condition, the terms of the new security, and all other information required by the Rules to be contained in the prospectus. Securities of the United States or any instrumentality of the United States or of any State are exempted. Securities issued by any subdivision or instrumentality of any State are especially provided for and it is set forth that as to such securities it shall be deemed a compliance with this section if there is available to investors adequate information with respect to the terms, all information required by the Rules and in addition where available the record of tax collections of the issuer for the preceding three years. Securities issued by a common carrier subject to the Interstate Commerce Act are also specifically covered, and with regard to such securities this section is complied with if there is available to investors in addition to adequate information with respect to terms and all information required by the Rules, a copy of the last annual balance sheet and the income and the surplus accounts for the last three years of such common carrier as required to be filed with the Interstate Commerce Commission. With regard to securities of a common carrier, it is also provided that there shall be available to any investor on request a copy of all reports and orders of the Interstate Commerce Commission.

RECOMMENDATIONS TO INVESTORS

Section 4. The investment banker in recommending an investment to an investor should have reasonable grounds for believing the security recommended to be suitable for the investor. In order to perform this function, it is, of course, necessary that the investment banker be informed as to the other security holdings of the investor and as to the investment situation and needs of that investor. It is not always possible to procure from the investor a complete list of the securities which he already holds. A great many times the investment banker has to form his own conclusions as to the actual requirements of the investor without an adequate factual basis. Not every man who has money to invest really knows either his actual worth or how careful he should be of his principal at a necessary sacrifice of his income.

One of the great stories of the investment business is of the man who applied to one of the Rothschilds for advice as to how he should invest twenty thousand pounds. Rothschilds asked him, "Do you want to eat well or sleep well? No man can do both on twenty thousand pounds." Now, of course, this is a profoundly wise observation. The income which comes from an investment made for safety, sufficient to insure sound sleep, is much less than the income derived from the same sum of money embarked in successful speculation. The trouble with most of us is that we want to eat well and sleep well upon a very limited capital investment. There is nothing unusual about this. The world is full of people who would like to have the peace and quiet of country life and yet not be over a block from the movie show. We would all of us like to have the thrills of adventure coupled with the safety of a rocking chair, but it just isn't to be had that way and, therefore, the investment banker, while he should recognize an obligation to sell to his customer only such securities as meet the customer's needs, in the light of all the facts, must, in order to perform that function, have the cooperation of the customer. The code drafting committee, therefore, has set forth this duty of

the investment banker as a general principle and not as being susceptible of statement in a definite and specific rule.

COMPENSATION OF SALESMEN

Section 5 states the general principles which should govern the dealer in determining how his salesmen shall be compensated. It is an open question as to just what effect the method of figuring the compensation of the salesmen has upon the quality of the salesman's work and his ultimate loyalty to his customer. Compensation may be figured in any variety of ways. It may be salary, commission, or a mixture of both. The commission may be a percentage of the sales price, a percentage of the profit of the concern on the distribution of that particular security, or a percentage of the monthly or annual profits. The principle here stated is that the employer shall compensate the salesman in a manner consistent with the maintenance of the business upon the basis fixed by the rules.

CONTINUING DUTIES OF ORIGINATOR

Section 6 sets forth the duty of the originator of the issue so long as any part of it is outstanding. He should keep himself reasonably informed of the financial condition of the issuer and to use his influence in endeavoring to cause the issuer to meet his obligations to the investor holding the security. In the performance of this duty, the investment banker again has to use his judgment in the light of the circumstances as he honestly understands them at the time. It is specifically provided that this duty attaches in respect to issues of securities originated prior to the effective date of the Rules as well as thereafter.

DISCRETIONARY CONFIRMATION

Section 7. It would certainly be an ideal situation if the investment banker could require from his customer a written order or a written confirmation. The code drafting committee recognized, however, that there are times when the customer's best interests require that securities be either acquired or disposed of under circumstances that make a written order, and at times even a written confirmation within a reasonable time, impossible, or, if not impossible, at least extremely disadvantageous to the customer.

SERVICE CHARGES

Section 8 provides that the charges for services should be reasonable and not unfairly discriminatory between customers. In the discussions of the code drafting committee, a great deal of time was taken in considering whether it was possible to set forth in the rules a specified enumeration of charges covering the various services performed by an investment banker. In view of the fact that the United States is a big place and that these Rules are being drawn to be applicable to investment bankers handling different classes and varying volumes of securities under circumstances that rarely duplicate, it was decided not to cover the matter of charges in detail. It is right, however, to state, as a principle of the business, that whatever charges are made should be reasonable under all of the circumstances and not discriminatory as between customers. This principle is not unusually difficult either to understand or apply.

SINKING FUNDS

Section 9 provides that where appropriate to safeguard the interests of the investors, there should be inserted a provision for the creation and administration of a sinking fund for the retirement of the issue, in whole or in part, at or before maturity. It is probably axiomatic that all debtors should, in the period which elapses between the creation of the debt and the date set for its payment, make provision for meeting the obligation when due. There will be times when the debtor is thoroughly justified in relying upon a refunding operation. As a general rule, however, it would probably be agreed that a sinking fund should be created whereby at stated intervals a proportion of the debt is either retired or provision made for a retirement. It was this fact which led the code drafting committee to insert the provision favoring the inclusion of sinking fund provisions in the indenture securing the debt.

PROMPT DELIVERY

Section 10 provides for the delivery as promptly as possible, after the public offering date, of definitive or temporary securities in the place of interims. In discussing the definitions, I have omitted the definitions of "interim certificates" and "interim receipts" which are contained in Section (1) of Article II. This was done because it was deemed better to discuss the whole question of interims in connection with Section 3 of Article IV, which provides for the safeguarding and protection of monies paid for securities before definitive certificates can be issued. It should be noted, in connection with the general principle set forth in Section 10, however, that definitive or temporary securities of the issuer should be promptly furnished. In other words, the purpose of this Rule is to discourage, so far as is possible, the use of interims.

DURATION OF SYNDICATES

Section 14 governs the matter of duration of selling syndicates. It is the unanimous opinion, so far as could be ascertained by the code drafting committee, that the duration of syndicates should be shortened. An effort was made by the committee to state a maximum length for syndicate operations. The difficulty with this comes when you consider the complications of such a restraint upon the underwriting and syndicating of an issue of securities which is subject to the preemptive rights of present stockholders. The laws of the States and local customs vary as to the length of time which shall be granted to stockholders to determine whether or not they desire to exercise their rights to purchase the securities. If you fix a period of time for the life of the syndicate long enough to be fair to the stockholders having preemptive rights under all circumstances and all State laws, it is probably a longer time than should be recognized as proper for all syndicates. Here again the period of the syndicate operation is left to the judgment of the managers, and the general principle is laid down that syndicates should continue for the shortest time that is sufficient for the purposes of the syndicate.

ARTICLE IV.

Article IV contains the rules primarily applicable to the origination of issues.

CONTINUING INFORMATION FOR INVESTORS

Section 1. It is recognized that the purchaser of securities is entitled to accurate information as to all essential facts affecting his investment. He is entitled to this information not only at the time he buys the security, but at intervals during the entire time that it is outstanding. It does not contribute either to the comfort or safety of the passengers on a boat to have a general alarm sounded every time a bucketful of water comes on the deck. Just when the alarm should be given is bound to be a question of judgment. The code drafting committee did feel, however, that it was possible to prescribe rather in detail what information should be made available to security holders, and if the committee erred at all, it is in requiring more than is necessary rather than less.

ISSUERS REQUIRED TO SUPPLY PERIODIC INFORMATION

The provisions of Section 1 provide that no investment banker shall act as the originator of any issue of securities in excess of \$100,000.00 unless the issuer agrees to have prepared, by an independent certified public accountant, four annual statements. These are to consist of an income statement, a surplus statement, a summary of changes in reserves, and a balance sheet as of the end of each fiscal year.

PARENT COMPANIES AND SUBSIDIARIES

A subsidiary is defined as a corporation of which the majority of the voting stock is held directly or indirectly by another corporation. It is provided that each of these statements shall either be made for the issuer and for each subsidiary of the issuer or a consolidated financial statement of the issuer and any or all of its subsidiaries, with the further provision that if the statements of the issuer and any subsidiaries are consolidated, there must be prepared in addition to the consolidated statement a statement of the issuer and of any subsidiary not consolidated. If a consolidated statement is published, it must eliminate all inter-company transactions between the parent and subsidiaries or between the various subsidiaries joined in the consolidated statement. It is provided that the degree of consolidation shall be clearly shown and that the parent company's proportion of the current earnings or losses and the dividends of unconsolidated subsidiaries be shown.

The balance sheet shall show the extent to which the equity of the parent company in the subsidiary or subsidiaries has been increased or diminished since the date of acquisition.

Appropriate reserves are provided for with respect to profits arising out of all transactions with unconsolidated subsidiaries, which shall be shown either in the statement of the parent company or the consolidated statement of the parent and certain subsidiaries.

DISCLOSURE OF DEFAULT

The issuer is required to set forth specifically in the statements any default in the payment of interest, sinking fund or amortization payments, and any arrears of dividends upon any security of either the parent or any of its subsidiaries.

TREATMENT OF NON-RECURRING ITEMS

It is required that non-recurring items, either of profit or loss, shall be expressly enumerated. There is no doubt that investors have been misled by profits

which were the result of transactions which in the ordinary course of operations of the business would not repeat themselves. The profit arising from the sale of a capital asset is, for instance, clearly distinguishable from a profit resulting from ordinary transactions of the business. To the extent that the value of the security reflects the profits, any such non-recurring profit should be labeled so that it will not be given undue effect.

INTERCOMPANY ACCOUNTING

There is a requirement that the statements show whether the examination of the accounts of the subsidiary is of a date different from that of the examination of the parent, and if the date does differ, the extent to which the auditors have examined the interim transactions between the parent and the subsidiary. As far back as 1908 H. G. Wells, the eminent British novelist, wrote the novel "Tono Bungay." It is hard for us to realize that twenty-one years before the crash of 1929, a novelist in Great Britain should have so clearly seen the dangers of subsidiary corporations. In the story, Mr. Ponderevo was engaged in the manufacture and sale of patent medicines. His success was great and he expanded. He organized and controlled many companies and of them Wells says, "Each of these companies ended its financial year solvent by selling great holdings of shares to one or other of its sisters, and paying dividends out of the proceeds. I sat at the table and agreed. This was our method of equilibrium at the iridescent climax of the bubble." Most of us who have now reached the age of discretion were old enough to understand this language when it was written.

The operation of business through the use of subsidiary corporate organizations presents many practical advantages, and they are most often advantages to the stockholders of the parent as well as the subsidiary. There is no doubt, however, that an incomplete picture can be created by switching profits and even assets between the parent and the subsidiary when the date of closing of the books is different for the various companies. This Rule does not require that the closing date be the same for the parent and all subsidiaries, but it does require that if they do not close on the same date, the fact be clearly stated. It requires the auditor, if the interim transactions are not examined, to set forth that fact. It would be expected that the moderately careful investor, with the fact noted that no examination of the interim transactions had been made, would rightly be inquisitive as to the result upon his security. The result of the provision as written will be that in each case an examination of interim transactions will be made and the result stated.

ACCOUNTANTS

It is not required that the examination of the accounts of the parent and each subsidiary shall be made by the same accountants, but it is provided that if the examination of the accounts of any subsidiary included in a consolidated statement is made by accountants other than those who examined the accounts of the parent, such fact must be noted. If the statements of the subsidiary and the parent are given separately and not as part of a consolidated statement, the fact that the audits were made by different auditors would, of course, be apparent on the face of the statements and in the certification.

FOREIGN SUBSIDIARIES

It is provided that if the consolidated balance sheet includes assets of foreign subsidiaries the percentage of the total assets represented by the foreign subsidiaries shall be noted, and also the basis upon which the accounts of the foreign subsidiary are included, and that any substantial differences in accounting practices employed by the foreign subsidiary, so far as known, shall be given. The mere statement of this requirement is its justification. Foreign subsidiaries are often desirable and sometimes necessary, but the holder of the securities of the parent company is entitled to know whether the accounts of the foreign subsidiary are kept in the same manner as those of the parent with which he is familiar.

PLEGDED ASSETS

It is provided that where any of the stated liabilities are secured by specific assets of the issuer, the balance sheet shall show that such liabilities are secured, and if any part of the security consists of current assets, such fact shall be shown and the general nature of the current assets comprising the security shall be given. It was not deemed feasible, and certainly not necessary, that the exact security should be shown because it would in most cases complicate the balance sheet to a far greater extent than would be warranted by any help it would give the investor.

DISCLOSURE OF CONTINGENT LIABILITY

There is a provision that contingent liability, not expressly shown on the balance sheet, shall be stated. This has always been good practice. It is hard for some people to realize that an endorsed note IS an obligation, even ahead of the time when the maker has failed or refused to pay. This weakness of human nature seems to be inherent in all of us. It is probably based upon the fact that most of us are slow to realize that the friend, for whom we have endorsed, cannot pay, that the litigation or dispute in which we are engaged can be resolved against us, or that we may come out the loser in any particular one of the contingencies outstanding.

INTERCOMPANY AND PERSONAL LOANS

The annual statement must show loans or advances to or from subsidiary companies, and amounts due from officers and employees with the exception of those arising in the ordinary course of business and normal in amount. Here again there can be no doubt as to the right of the stockholder under any circumstances to know what is due the company, either from subsidiaries, its officers, or employees. Each investor can then make up his mind as to what he thinks about it and as to whether he wants further information.

INVESTMENTS IN SUBSIDIARIES

The statement made available to the investor must show any securities of the issuer or of any subsidiary of the issuer which are carried as investments. This must be shown as a separate item on the balance sheet. There cannot be much trouble here because if the corporation has acquired and carries as an asset either its own stock or the stock of a subsidiary, the bondholders and stockholders have a right to know how much of the total assets consists of these items.

There is then a general provision that if for any reason the statement cannot show the information required in the manner set forth, the facts as to such inability shall be stated in the certificate of the accountant.

It is provided that such statements, accompanied by a complete copy of the certificate of the accountants, shall be released for general publication and that copies of them shall be furnished to each security holder upon request.

VALUATION OF STOCK DIVIDENDS

The agreement of the issuer must include a covenant that the issuer will not itself and will not permit any subsidiary to set up as income, stock dividends at an amount greater than was charged against the earnings or surplus by the company paying the dividend. At first blush, this might seem a little hard. If the subsidiary pays a stock dividend which is charged against its earnings or surplus at say twenty dollars a share, and if at the time the market for such stock is at a higher price, it is easy for the management of the parent company to justify including in its balance sheet the stock so received as a dividend at the market price. With this limitation, any such stock received must be set forth in the balance sheet at the lower price. The result of this will naturally be that the company receiving the stock and carrying it as an asset will naturally make mention of the conservative price at which it was valued and is being carried, and to that extent the owner of the security will know and appreciate that he is having presented to him a conservative statement and will be able to supply his own enthusiasm.

CHANGES IN ACCOUNTING METHODS

The issuer must agree that if any material change is made from year to year in the rates or policies of depreciation or in the accounting methods, attention will be called to this fact in the next succeeding published balance sheet. Without such notice, there can be no effective comparison of balance sheets.

The issuer shall be required also to appoint an independent agency to act as registrar, and to have all certificates of the new issue registered.

SUBSTITUTION OF COLLATERAL

Paragraph (i) of this section is one that presented a great difficulty in drafting. This paragraph treats of securities based upon collateral deposited and to be held for the benefit of security holders. It provides that a bank or trust company shall be appointed to act as trustee for holding collateral and that whenever the issuer desires to make substitution or to have released any of the pledged property, and which substitution or lease substantially affects the character or the value of the property pledged or mortgaged, he shall, at least ten days prior to the substitution, cause notice of such substitution or release of collateral to be given by publication in a newspaper of general circulation in the city where the trustee has its principal place of business as well as in the city in which the issuer has its principal place of business.

Now there is no doubt that no trustee is willing to become liable for determining the adequacy of securities offered in substitution for securities drawn down. The risk of making this determination is too great. There is also no doubt that the indenture covering a collateral issue which does not provide

a right of substitution or release of collateral is generally unfair to the issuer. On the other hand, the investor, in order to be protected, should either have some independent person pass upon the substitution or release, or, if that is not done, should have easily accessible constant information as to what substitutions are made.

There are collateral issues which have been very successful and which have been based upon a very large number of relatively small items of collateral which are changed sometimes daily. (An illustration of this is a security collateralized by automobile paper.) Here there are so many withdrawals, either caused by final payment or substitution, that publication of each item would be so burdensome as to destroy the practice of creating these issues. For that reason, this paragraph provides that only substitutions or releases which substantially affect the character or value of the property pledged or mortgaged need be published.

It may be by some objected that the words "substantially affect," by leaving a discretion in the issuer, nullify the purpose of the paragraph, but it is believed that on consideration this will be found not to be so. If publication is required of all substitutions and releases, a certain very attractive and profitable type of investment will probably be discontinued. The drafting committee has, therefore, decided that in this case four-fifths of a loaf is better than no bread, and while it has drawn a paragraph which will by many issuers be deemed unduly burdensome and oppressive, and by some investors will be thought not to go far enough, it was the committee's opinion that the paragraph as drawn accomplished a very great deal and still made possible the issuance of collateral securities based upon a great number of small items rather than a small number of important items.

AMERICAN INSTITUTE OF ACCOUNTANTS

It would not be fair to close this comment upon Section 1 of Article IV without acknowledging the value of the services which the investment bankers' code drafting committee has received from the American Institute of Accountants. There will be those who think, and probably those who will say, that the accountants were plowing the field and sowing the seed for a harvest, but the code drafting committee feels that it has had from these men a fine spirit of cooperation and most intelligent and constructive assistance.

Before I pass on from this matter of annual balance sheets, I do want to point out that there is grave doubt whether the expense of preparing the statements called for annually is not greater than is warranted in connection with all issues over \$100,000.00. It may well be that as we watch this section work out, it will be necessary to exclude from its operation issues larger than \$100,000.00 and it may be necessary to draw separate provisions requiring less detailed information for smaller issues.

INFORMATION ON MUNICIPAL BONDS

Section 2 covers information which should be made available to investors in connection with securities issued by subdivisions of States. Municipal securities are exempt from the operation of the National Securities Act of 1933. We have had as much discussion in the preparation of this Code about how far we should go in undertaking to cover the matter of municipal bonds as any other single

subject. In fairness it must be said that to a certain extent municipal bonds occupy a unique field. They are entirely the creature of statute, and the exact nature and extent of the security is at times very difficult to ascertain. As to the available data, the investment banker must very largely rely upon a compilation of public records by municipal authorities.

The important questions from the standpoint of the investor in considering a public bond are the nature of the lien and to what it attaches, the amount of taxable property in the taxing district, the record of the community for the prompt payment of its taxes, the amount of bonded debt, not only of the particular subdivision issuing the bonds in question, but the total amount of all overlapping debt, that is, the debts of other political subdivisions which are a lien upon a whole or a part of the subdivision issuing the bonds under consideration.

Public financing of the various States and political subdivisions is essential.

STATISTICS ON PUBLIC BONDS

Section 2 provides that no investment banker shall originate a new issue of any subdivision of any State unless the issuer shall furnish the originator "with an official statement" disclosing the following information, if the securities are public and to be paid from ad valorem taxes:

First. The assessed value of the property subject to the taxing power of the issuer.

Second. The total bonded debt of the issuer, including the amount of the issue.

Third. The population of the issuer.

Fourth. The fact, if it be a fact, that the bonded debt of the issuer does not include the debt of any other subdivision having power to levy taxes upon any or all of the property subject to the taxing power of the issuer.

LEGAL OPINIONS

It is provided that the originator shall make available to investors in the prospectus, or if there is no prospectus in some other manner, the facts disclosed in the official statement of the issuer; the name of the attorney whose opinion will be furnished; a statement of fact as to whether the securities are payable from a limited tax on real estate or from special funds only; and in the case of securities issued in anticipation of a later sale of a refunding issue, and where provision is not to be made for the payment of such securities in any manner other than by the sale of the refunding issue, the facts in regard thereto. It is also provided that upon the request of any purchaser there shall be delivered to him a copy of the official receipt of the treasurer of the issuer showing that the new issue has been paid for to the issuer at the time of issuance.

INTERIMS

Section 3 covers the use of interim receipts and interim certificates. It will be remembered that we omitted any discussion of their definitions in Section (1) of Article II, and only briefly referred to them in connection with Section 10 of Article III. An interim certificate or interim receipt is defined as an instrument in

writing calling for the future delivery of certificates and executed and issued by the person who has contracted with the issuer of such securities.

Section 3 provides that where the money is paid by the investor for a security before either the definitive or temporary certificate has been issued, the money shall be deposited in a special account for the benefit of holders of interim certificates and interim receipts, and with a person permitted by law to receive deposits. It is further provided that when temporary securities are issued to cover outstanding interim receipts, or interim certificates, they shall be segregated from all other property of the investment banker, and in such manner that no person other than the holders of the interims can assert any right, title or interest therein. In other words, cash held pending the delivery by the issuer of temporary certificates, and temporary certificates held pending the issue of definitive certificates which can be delivered to investors, are to be held in trust and segregated.

TITLES OF SECURITIES

Section 4. It has for a long time been recognized by thoughtful and conservative investment bankers and investors that the titles given to issues of securities are often of such a nature that, while they may perhaps be literally true, they convey a wrong impression as to the character of the security. This result occurs either by telling not quite the whole truth or by a typographical arrangement of the title, making the security look, at a casual inspection, like something other than what it is. The misleading title generally confuses the less experienced investor.

This matter of misleading titles is not a new subject either for thought or discussion. In the days when real estate securities occupied a favorable place in the minds of most investors, there was wide discussion upon the question, for instance, as to whether a bond issue based upon a leasehold should rightly be called a "First Mortgage Leasehold Gold Bond." As a matter of fact, it was just that, it was a bond secured by a first mortgage on a leasehold and payable in gold, but its real position as an investment was not much different from a second mortgage on a real estate fee. The lease demanded an annual payment of rent and taxes for the maintenance of its validity and this annual rent reserved was a claim ahead of the leasehold bond and upon the payment of which the value of the bond depended. When you add to this that an unscrupulous or careless dealer might very well print the word "leasehold" in rather submerged type face, you see the danger. The investor might read only "First Mortgage Gold Bond." You can multiply this illustration indefinitely.

It will be noted in this section that we have excepted public securities and we have provided that if any new issue of public securities has a title which is misleading as to the lien, terms, or priority, the facts in regard thereto shall be stated in the prospectus. The reason for the exclusion of public issues is that the titles of such issues are almost always fixed by the legislatures in the enactments authorizing the issuance of the bonds. It is, of course, impossible for the investment banker or the issuer, for that matter, to control this matter of titles, and as pointed out in the comments under municipal bonds (Section 2 of this Article), it is extremely difficult to know when the title of public securities is or is not misleading. This

section had to be drawn with some leeway, and as drawn gives the Code Authority, with the approval of the Administrator, broad power.

DISCLOSURE OF INTERESTED PARTIES

Section 5 covers the matter of inter-related directors and management, and provides that the originator or any partner or principal officer of an originator of a new issue of securities shall disclose in the prospectus the fact, if it be a fact, that he is an officer or director of the issuer company.

ARTICLE V.

The Rules contained in this Article pertain primarily to selling syndicates and selling groups in connection with new issues of securities.

DISCLOSURE OF PRICE

Section 1 provides that except as to public securities where the price received by the issuer is a matter of public record, the prospectus shall state the price received by the issuer for the new securities, and that if there is no prospectus, such price shall be disclosed in some other manner to each person purchasing the securities from any member of a selling syndicate or selling group. It is provided that where necessary instead of giving the purchase price the formula may be given by which such price can be ascertained. This is to cover securities bought and sold on a yield basis. If the investor knows the amount received by the issuer he knows the whole story so far as the price is concerned. The difference between the price which the investor pays and the price paid by the issuer is the total cost for the syndication and distribution. This is a short section of these Rules, but the disclosure of the price received by the issuer to the investor means more to him than many facts which will be disclosed in more elaborate language.

DEALER INFORMATION THREE DAYS BEFORE OFFERING

Section 2. This section provides that an investment banker proposing to organize a selling syndicate or selling group to distribute new securities, other than those of the United States Government or any instrumentality thereof, or of any State or political subdivision thereof, shall deliver "a copy of the prospectus or an adequate description of the security" to each investment banker who is to be offered a participation, at least three days before the date on which it is proposed or shall be proposed to make the public offering.

As I have pointed out earlier in this comment, time is literally "of the essence" in market operations of large volume. Interest is either running or commences to run from a date set. The risks of the market are ever present. The tendency all along the line, therefore, is for speed. There is no question but that this tendency had become a source of irritation, chiefly to the investment bankers themselves. Most people do not like to be rushed, and the man who is in charge of the investment of money is almost sure, in this particular, to be found among the majority. This provision, therefore, is to assure, not only the investment banker, but the investor who is his customer, that there will be a lapse of a long enough time between the receipt of the information and the public offering date to allow the investment banker who participates either in a selling syndicate or a selling group

to think it over and to "sleep on it," if he wants to, at least twice. This Rule will undoubtedly necessitate some modification of the originating contracts with issuers, but it cannot help but be more satisfactory to the distributing investment banker and of benefit to his customers.

MEMBERS OF SELLING SYNDICATES AND GROUPS

Section 3 provides that selling syndicates and selling groups shall be composed of investment bankers "actually engaged in the investment banking business."

RULES ON PRICES

Section 4. This section provides for each selling syndicate and selling group agreement to set forth the price at which the new securities are to be sold to the public or the formula by which such price can be ascertained. This last provision as to formula is inserted to cover securities having different maturities and sold on a yield basis. No participant shall, during the life of the syndicate, offer the new securities at prices below the public offering price. A concession may be allowed to another investment banker, but the investment banker receiving such concession is bound in selling the security during the life of the syndicate to observe the uniform provision of this section and also to observe the requirements of Section 6 covering trades and Section 7 providing for down payments to the same extent as though he were a participant in the syndicate or group making distribution of the security.

It is further provided that in any transaction with an investment banker located in a foreign country no commission or concession shall be allowed unless he effectively agrees that in making any sales during the life of the syndicate to any purchasers outside of the United States he will maintain the public offering price, and that in making any sales to purchasers within the United States he will maintain the public price and observe all of the provisions with regard to trades and requirement of down payments to the same extent as he would if he were a participant in the syndicate or group, and that in addition he will conform to Section 7 of Article IX of the Code which covers the participation of registered dealers in syndicate or group operations.

The fairness of all this seems clear. Securities sold under the public offering price overhang the market after the syndicate distribution. If the concession is large enough, the holder of the security has a constant temptation to make a quick sale at a small profit, and the fact of such sale discourages all men from buying securities when publicly offered and at the offering price.

Section 5. This section provides that no investment banker shall organize, manage, or participate in a selling syndicate or selling group to offer new securities to the public if, within thirty days prior to the formation of such syndicate or group, he shall have sold such securities at a price less than the public offering price or shall have assisted the issuer in selling or giving a right to purchase any part of such new issue "otherwise than as an essential step in the plan for the sale to the public of such new issue of securities."

ACCEPTING SECURITIES IN TRADES

Section 6 covers the matters of trades in connection with new issues and it is provided that no participant of a selling syndicate or member of a selling group shall enter into any arrangement with a purchaser of new securities, either directly or indirectly, whereby he will accept other securities in trade in payment of

all or any part of the purchase price. It is provided that the dealer may accept other securities as agent for the customer for sale, in which case the sale of the other securities shall be made, the usual charge for selling them shall be deducted and only the net proceeds realized from the actual sale applied toward the purchase price of the new securities.

An exception is also made to the application of this section where securities are being refunded or redeemed because in that case it is part of the operation to accept the securities being refunded or redeemed as part of the purchase price of the new securities. An exception to this trade-in provision is also made with regard to any securities maturing within six months after the date of the transaction. One method of price cutting is and always has been the taking in trade of other securities at a price higher than their fair market value. The code drafting committee at one time tried to state the obligation in trading securities to be that none should be taken at more than the "fair market value." The list of securities is so large, however, and there are so many of them unlisted and upon which it is practically impossible to fix a market value from day to day that this method was deemed impracticable. Therefore, the section was drawn requiring that no securities be taken in trade except for immediate resale and upon the basis of crediting the customer with the amount derived from the sale less a regular commission.

DOWN PAYMENT ON SUBSCRIPTIONS

Section 7. This section provides that wherever a dealer accepts a subscription "subject to allotment" he shall require the person making the subscription to make a down payment of not less than five per cent on the public offering price of the securities subscribed for. This requirement of a five per cent down payment does not apply to the purchase by an investor of securities which the dealer has the power to sell him outright and which are sold outright and not subject to allotment. If the dealer has accepted a firm allotment so that he has a power to sell the security and the investor purchases it, then the question involved is a matter of credit between the investment banker and his customer. Where however a subscription is taken to be forwarded to a syndicate manager for allotment there must be a down payment. The purpose of this section is to slow down distribution and to discourage over-subscription. Over-subscriptions lead to bad distribution and bad distribution results inevitably in a weak market until the securities find a permanent home.

Sub-section (b) of Section 7 provides that when a participant in a selling syndicate or member of a selling group forwards a subscription to the manager of a syndicate or group which is "subject to allotment" he shall accompany the subscription with a down payment of not less than five per cent. This is to discourage oversubscription on the part of the dealer just as the preceding provisions are intended to discourage it on the part of the investor.

It is further provided that the down payments made to the syndicate or group manager shall be deposited in a special account and with a person other than the manager.

EXEMPTIONS IN DOWN PAYMENTS

An exemption is made with regard to down payments from a purchaser who

is prevented by law from making such payments in advance of the delivery of the security. This exception is necessary because of the laws of some States with regard to the purchase of securities by executors, trustees, guardians and savings banks. Where the five per cent down payment is not legally possible from the investor the participant in applying for the securities from the manager is relieved from the down payment also. There is a further exemption in the case of selling syndicates where all of the participants were parties to the purchase from the issuer of the new securities. The reason for this exemption is that where the members of the selling syndicate are all parties to the originating purchase they are entirely bound by their investment.

REQUIREMENTS IN MAKING CONFIRMATIONS

Section 8 provides that no sale or subscription shall be confirmed by a participant in a selling syndicate or member of a selling group unless:

First. The participant or member has reasonable grounds to believe that the purchaser is bona fide and responsible. This is to discourage speculative buying. This provision is again to discourage over-subscription.

Second. Unless a copy of the prospectus, if any, has been delivered to the purchaser or accompanies the confirmation.

Third. Unless such sale complies with these Rules and the provisions of selling syndicate or selling group agreements.

Fourth. Unless a partner or duly accredited executive or branch office manager has approved the sale as complying with the foregoing provisions.

Section 9. This section provides that participants and members of selling syndicates and selling groups shall, upon request of the manager, certify that the records of sales have been examined and that they show compliance with Sections 7 and 8 of this Article.

EXTENSION OF SYNDICATES

Section 10 covers the matter of extension of the original period of the selling syndicate. It will be remembered that we have not fixed a minimum period for syndicate operations, but we have declared that they shall be for the shortest period which in the judgment of the manager is sufficient for the purpose for which it is formed. This section (10) provides that if it is extended it shall only be upon the consent of participants representing seventy-five per cent in interest of the selling syndicate.

Section 11 prohibits any investment banker from participating in a selling syndicate in which the officer of any bank or trust company has a participation as an individual.

ISSUER INTEREST IN SYNDICATE

Section 12 covers the participation of directors and officers of the issuer in the selling syndicate. A different set of considerations must be weighed when we consider what should be the treatment of directors and officers of the issuer participating in the selling syndicate than the participation by bank officers as covered in Section 11. In the case of many issues, and especially the smaller ones outside of the financial centers, the issue only becomes possible by officers and directors of

means underwriting and becoming responsible for a portion of the issue during the period of distribution. This participation of the officers is something which can give rise to an abuse, and therefore it was the unanimous opinion of the code drafting committee that it should be included, but that it should not be, under all circumstances, prohibited. Section 12, therefore, provides that if a director or officer of the issuer participates in a selling syndicate it shall be disclosed in the prospectus, and if there is no prospectus, in some other manner to the person purchasing the securities.

ACCOUNTING BY SYNDICATE MANAGERS

Section 13 provides that the manager of the syndicate shall make distribution to participants promptly after the close, and that upon request he shall itemize all expense for participants, breaking the expense down into five items, which separates payments to the manager, if any; legal expense, advertising expense, printing, engraving, etc., and miscellaneous.

SYNDICATE MARKET OPERATIONS

Section 14. Here we deal with the disclosure which must accompany any supporting market operation during the period of the syndicate distribution. In the consideration of this section and of the whole question of market support, we must remember the peculiar nature of the property which is being sold. As already pointed out, marketability is one of the great items of value in securities. Major issues which are to be held broadly throughout the world must, in order to be salable, be listed on one or more of the great stock exchanges. This listing on the exchange makes the matter of sales of the listed security a matter of telegraphic news throughout the world. In the syndicate distribution of a large issue of securities, more or less time must elapse and in that period there is almost certain to be some person who, having purchased the security, for some reason desires to sell it and offers it back in the market. The syndicate manager keeps a record of the numbers of all certificates going out through various distributors. Generally, any security coming back is either charged against the dealer who sold it or at least his commission is charged back against him. This gives the syndicate manager at least the leeway of commission to protect the market during distribution. It is probable that most dealers who find that they have sold a security to a man who cannot or does not want to keep it, take it back with or without an adjustment in price, and resell it without having the transaction recorded.

The quoted market price is, of course, very persuasive. Many of the abuses which have been noted in the security business arise from adroit efforts to control the quotations. The burden of doing this is constantly upon the shoulders of the governing boards of the various exchanges. The benefit to be derived from protecting the market during a syndicate operation against fractional losses due to the sale of a very few securities, is positive.

PREPARATION OF A MARKET

Section 15 covers purchases in the open market in anticipation of the public offering. We have seen that Section 14 covers market operations during syndica-

tion. We now come to a consideration of what should be the treatment if there is any effort made to make the market ready. If the new issue of securities which is to be offered is, let us say, a new series of bonds to be issued under an open end mortgage, then the securities may be identically like a large amount of the securities that are already on the market. The security is the same, the rate may be the same, the issuer is the same. Naturally, an investor would just as leave buy one of the bonds that has been out for a period of time as a bond exactly like it which is just coming out. In this type of distribution the competition is the keenest between the new security and the old. But in every type of distribution where securities of the same issuer are being sold in the market or where securities of the new issue are very like other securities on the market the question of the condition of the market especially affects the sale of the new issue.

Now, financing costs must be borne finally by the issuer or by the industry, utility or government issuing the securities, and it must be passed on by the industry or utility to the consumer, and by the government to the taxpayer. It is therefore extremely important that the new issue be sold in a market which fairly represents as nearly as possible the value of the thing sold. Again we seek the remedy for our evil in full disclosure. What is publicly and openly done is seldom done meanly or dishonestly. We provide that if either the manager of a selling syndicate or a selling group, or, if to the knowledge of any such manager, the issuer, originator or any other syndicate purchases any of the outstanding securities of the issuer in the open market within ten (10) days prior to the date on which the securities are first offered to the public, such facts shall be disclosed to all participants and shall also be by them disclosed in the prospectus or otherwise, to any person purchasing the security.

SINKING FUND PURCHASES EXEMPT

The paragraph exempts from this disclosure purchases of outstanding securities made for the purpose of a sinking fund. Purchases for the purpose of a sinking fund are made by the issuer or a trustee, in compliance with contract in connection with such issue of securities. Sinking fund provisions vary greatly and they run all the way from retiring the security to be purchased at a given price and determining which security shall be retired by public drawing, to sending out offers to all holders and buying the required amount from the purchasers offering the security at the lowest price. In any event, much of it is done by trustees and it was not deemed feasible to require publication because it would be in many cases in effect the publication of the operation of the trust fund. Public securities sold by the issuer thereof at public sale are exempted from the provisions of this section.

Section 16. We here provide that any distributor of securities who has any direct interest in the distribution other than as a member of the selling group, shall disclose the fact in the prospectus or otherwise to purchasers. The object here, as elsewhere, is that the purchaser of the security may know exactly what incentive urges the man from whom he is buying it.

Section 17 provides that every manager of syndicates or groups shall file a copy of the selling syndicate agreement or selling group agreement with the Investment Bankers Code Committee. These copies, however, may be filed without the names of the parties to the agreement, except the manager.

ARTICLE VI.

This article contains the rules particularly applicable to retail sales and purchases. We have been up to now, talking almost wholly about the activity of the investment banker as originator, syndicate participant and distributor of new issues of securities. We now come to consider the portion of the business which has to do with the purchase and sale of securities in the hands of the general public.

In the business of originating and distributing new issues, the investment banker has handled most of the securities that are outstanding. In connection with the sale of securities already out, he divides the field with the stock exchange member. This Code does not cover stock exchange transactions, and practically the only place where we touch them is where the investment banker sells for his customer a security which must be sold over a public board and where he does it through a member of the stock exchange.

OVER-THE-COUNTER TRANSACTIONS

Section 1. This section covers what is technically known as "over-the-counter" transactions, that term designating the purchase or sale of listed or unlisted securities off an organized exchange. We provide at the outset that in any such transaction, whether the security be listed or unlisted, if the investment banker purchases or sells for his own account, he must purchase at a price which is fair. If he acts as agent for his customer he shall charge no more than a fair commission, taking into consideration the condition of the market and the value of the service he may have rendered by reason of his experience and knowledge of the market for that security. In other words, his transaction with his customer must basically be fair. Here again we have spoken in simple language, but with wide implication.

This section is drawn in language which can be applied to any situation, and while cases may be imagined which will be very difficult to decide, the great bulk of transactions will, when considered by persons trained in the business, fall clearly either on the fair or the unfair side if examined. Upon this basic requirement of fairness we built up the balance of the sections treating with this type of business and providing clear notice of the relationship between the dealer and the customer.

PRINCIPAL OR AGENT

Section 2. Upon confirmation of the customer's order for the purchase or sale of any security the investment banker, if he acts as a principal in the transaction, or is controlled by, controls or is under common control with the issuer, must inform the customer of such fact upon the written memorandum of confirmation.

It must be clear that the written confirmation is the time when the duty should be imposed. A very large majority of security transactions are conducted over the telephone. It is difficult enough to interpret written language, it is almost impossible to prove satisfactorily at a remote date just what was said orally.

The importance of this Rule is very easily understood, directly one appreciates the ordinary method of investment transactions. The duties of an agent who acts on behalf of his principal are well known. He owes a primary duty of allegiance to the interests of the principal and cannot have any adverse interest without the principal's approval. His duties are entirely different from those which one principal owes in dealing with another. It is very easy in a telephone conversation for

a customer to use language by which he intends to impose upon the investment banker the obligations of an agent but which, as construed by the investment banker, gives him full latitude to offer the customer securities which he then owns or thereafter acquires. In other words, what I am trying to say is that it is very easy, when one is dealing informally and over the telephone, not to have clearly understood whether the customer is relying upon the advice of the investment banker as his agent or whether he is dealing with him as a principal.

This Rule makes it incumbent upon the investment banker, unless he is acting as agent and assuming all the legal duties incurred from that relationship, to spell out to the customer when he confirms the order that he is not so acting. We believe that generally this information has been given and understood. The importance and advantage of this Rule, from the standpoint of the investment banking business, is that it gives a nationally uniform Code and that over the years a customer—those with much experience as well as those with little—will come to know exactly where to look for the thing which he wants to know in any particular transaction.

When the customer receives the confirmation, if he sets forth the status of the dealer as different than he understood it when he talked over the telephone yesterday, he can raise the point immediately while it is clear in the minds of both himself and the dealer and any misunderstanding can be settled immediately, which is generally the best time to settle misunderstandings.

DISCLOSURE OF CAPACITY

Section 3 covers the memorandum of the transaction to be delivered at or before the completion of the transaction. The language of Section 3 provides that any investment banker who has a transaction with a customer shall "at or before the completion of the transaction" deliver to the customer a written memorandum containing the following information:

- (a) Whether the investment banker acted as principal or agent.
- (b) If he acted as agent, the amount of the commission or service charge and if another broker has been used and any part of the commission paid to such other broker, the amount so paid to be stated as a separate item.
- (c) If the dealer acted as agent, the name of the person from whom the security was purchased or to whom it was sold and the day and hours between which the transaction took place or a statement that the information referred to in this paragraph (c) will be furnished upon his request.
- (d) If there has not been a written confirmation of the customer's order, as provided in Section 2, then the information as therein provided.

I have outlined this section fully because, if fully stated, it is self-explanatory.

Section 4 is merely declaratory of the common law. It provides definitely that a dealer who purports to act as an agent shall not act as a principal in the same transaction and shall not, without the consent of the customer, represent any other principal in the same transaction.

RESTRICTIONS ON GUARANTEES

Section 5 forbids an investment banker, in any transaction, from guaranteeing that the market value of the security will be maintained or that the business of the issuer will be successful, or that the issuer will meet its promises.

There is excepted from the operation of this provision transactions in notes, drafts, bills of exchange or bankers' acceptances which have a maturity at the time of issuance of not exceeding nine months. The reason for this is perfectly clear because these instruments are often sold with endorsement.

REPURCHASE AGREEMENTS

Section 6 forbids the sale of securities upon agreement to repurchase. The exception is made in respect to transactions in Government, State and municipal bonds, bankers' acceptances, or transactions with any bank, trust company, insurance company, or investment company; or any repurchase agreement when such agreement is limited to sixty days and is used as a substitute for borrowing. The exceptions are inserted because this form of contract is often used instead of the hypothecation of the security for a debt. As a general proposition, however, the investment banker clearly should not promise his customer that he will repurchase the security.

PARTIAL PAYMENTS

Section 7. This section places certain rather drastic restrictions upon handling the sale of securities under partial payment plans. Prior to the market crash in 1929, certain security dealers in the United States were developing quite broadly the business of selling securities in relatively small amounts to people who undertook to pay for them on the partial payment plan, with a small sum down and the balance payable in weekly or monthly installments over a long period of time. Where the actual security contracted to be delivered to the installment purchaser at the completion of the payment of his installments is purchased and held safeguarded for delivery to him under the contract, there can, of course, be no fault to find with this transaction. This, however, was seldom done because the down payment was not large enough to justify the security dealer in the risk involved in purchasing and holding securities of fluctuating value. It has been argued by persons engaged in this business that the purchaser is sufficiently protected if the monies paid by him are kept segregated, so that he can at least have his money returned to him. This is, of course, not quite so if the security which he purchased has, in the meantime, risen in value beyond the purchase price.

COMMINGLING OF FUNDS

The real abuse in this type of business, however, results from the dealer mingling the installment payments with his own funds and using all this money in the conduct of his own business, treating the installment purchaser as a general unsecured creditor and relying very often upon his ability (that is, the dealer's) to purchase the stock, which must be delivered to the installment buyer, in the market at some time between the inception of the contract and the date when delivery becomes due, and at a price lower than the price which the installment purchaser agrees to pay. The transaction when conducted in this last described way is nothing more or less than "bucketing."

Dealers who commingle the installment funds ordinarily sell to the installment buyer a security which, as nearly as they can judge, is high in price. It is, indeed, easier to sell to the inexperienced buyer a stock or bond which is "up" in the market as compared to one which is "down," and the chances of "bucketing" the trans-

action at a profit are much greater in a security, the price of which is relatively high, than in one which is cheap. It was the view of the code drafting committee that while this business properly conducted can offer to an investor means of accumulating capital which might in certain instances be advantageous, the need for such transactions for the benefit of investors who lack the capital to buy a few shares outright is not sufficient to allow the practice to go without strict regulation.

It is, therefore, provided in Section 7 that where the investor purchases securities to be paid for in installments, the investment banker shall, if he acts as agent, immediately make an actual purchase of the security for the account of the customer and shall take and maintain possession or control of the security so long as he remains under obligation to deliver the security to the customer; in other words, until the security is either delivered to the customer upon the final payment of the purchase price or until the customer by breach of the contract has lost his right to performance. If the investment banker making such a transaction acts as principal, he must at the time of the transaction own the security and must maintain possession or control thereof so long as he remains under obligation to deliver.

It is further provided that no investment banker in connection with such a transaction shall make any agreement with the customer under which the investment banker shall be authorized to hypothecate the security for any amount in excess of the indebtedness of the customer to the investment banker. In other words, the intention is to regulate this type of business so that the security is always ready to deliver to the customer upon the payment by him of the balance of his installment contract price.

Section 8 provides that the investment banker who receives information as to the ownership of securities while acting in the capacity of paying agent, transfer agent, trustee or otherwise shall under no circumstances make use of the information for soliciting sales or exchanges except at the request and on behalf of the issuer. It does not need much argument to justify this Rule. Perhaps a word of explanation would be well with regard to the exception. This exception is made because if the issuer desires either to refund or propose an exchange to the security holder, he certainly has the right to demand from his transfer agent or trustee the list of security holders and the issuer thus being in a position to address them directly, the investment banker should be able to address them on his behalf.

ARTICLE VII

The Rules set forth in Article VII pertain primarily to salesmen. There is no portion of these Rules that has had as much discussion as the general question of salesmen. I believe it may be truthfully said that any one who has the permanent welfare of the investment business at heart will admit that "high pressure" selling methods must be discouraged and as far as possible eliminated. The blame for over-enthusiasm in the sale of stocks seldom belongs upon the shoulders of the salesman only. I recognize that. There are those who say it never belongs there primarily, but whatever the fact we have tried to meet it in three separate and distinct ways.

SUPERVISION OF SALESMEN

Section 1 places upon the investment banker employing salesmen the duty of supervising the sales methods and correspondence of the salesmen to the end that he may know exactly how the salesmen are operating and for the purpose of discouraging unwarranted representations or high pressure selling. It is also provided that every sale made by any salesman to an investor other than another investment banker shall be approved by a "partner, duly accredited executive or branch office manager" of the investment banker employing the salesman. Such approval is to be by written endorsement upon a copy of the memorandum of sale mentioned in Section 3 of Article VI and each memorandum so approved shall be kept as part of the permanent records for at least three years. Here again the language is simple, the compliance relatively easy, but the written endorsement fixes the responsibility with the house and no matter where it has been in the past that is where it should be.

QUALIFICATIONS FOR SALESMEN

Section 2. Whether salesmen should be paid upon a salary basis or commission basis or a mixed basis and whether the method of compensation has anything to do with the activities of the salesman in the performance of his job have been debated in the various meetings until everything on both sides has been said many times. As to whether there should be an age requirement and an experience requirement and what should be the exceptions, if any, has also been discussed.

As a result of all the discussion it was decided to leave the question of compensation governed by general principle No. 5 which provides that it must be in the manner consistent with the principle set forth in the Rules and to confine the requirements of this Rule to one of experience.

The Rule provides that no investment banker shall employ a person to act as salesman unless such person has had at least six months experience in the investment banking business or in a business a principal part of which related to securities; shall be at least 21 years of age; and shall be of good moral character. If the person hired as a salesman has less than two years experience the basis for his compensation must be a straight salary and shall not include in whole or in part commissions upon securities sold. If the salesman hired has had two years or more experience at the time he is hired or after he has worked on a straight salary a period of time which gives him two years experience, he may sell securities on commission. To cover exceptional cases of men who are clearly competent to sell securities while lacking the required experience it is provided that any investment banker may make application to the Regional Code Committee for the right to employ a salesman who lacks either the experience or age qualification, and the Regional Code Committee by a majority vote after hearing and consideration shall give the permission if they are of opinion that the person proposed to be employed is fully qualified. The approval of the Regional Code Committee however waives only the provisions as to experience and age and not the requirement of good moral character. It is specifically provided that this section shall not be construed to prevent any investment banker from continuing to employ as a salesman any person who is so employed by such investment banker at the effective date of the Rules. This last exception was inserted because it was deemed only fair to leave undisturbed the employments in existence.

SOLICITATION AT HOMES

Section 3 provides that no salesman shall call in person upon or solicit by telephone any investor at his home unless he has received a written permission from the investor to make the call. It is specifically provided that these limitations shall not apply to the solicitation at their homes of "business persons, retired or professional persons, or farmers." The purpose of this section is to discourage house to house selling and high pressure solicitation of persons who are seldom competent judges of the values of securities. Generally the security buyer either calls at the office of his investment banker or has a place of business at which he can be seen. There are cases in which the salesman rightly calls on the investor at his home, but in those cases it is believed that where it is the desire of the investor that the salesman make such a call, the written permission could be very easily gotten.

There has been a great deal of adverse comment from certain dealers in securities as to this paragraph. The criticism has been pitched, as one would expect, not upon the real objection to it but upon the argument that the paragraph as drawn is to the advantage of the so-called "big houses" and upon the theory that the small dealer must, in the conduct of his business solicit persons at their homes and must build his business by selling securities to people who have no place of business at which they can be met.

It will be noted that in this connection a new definition of the term "salesman" is made. This definition includes "any partner, officer or employee" of any investment banker and in addition of course the class covered by the general definition of the word "salesman." The reason for this broadening of the definition is that many of the unreliable solicitors are individual partners and therefore would not be reached by the general definition.

It may take a little time and some rulings of the Code Authority to clarify who are "business persons." In the main the intention is that the investment banker may have complete right to call upon persons of some experience at their home but shall not do indiscriminate solicitation by going from house to house.

CONFIRMATION OF ORDERS

Section 4 provides that all orders taken by salesmen shall be subject to acceptance and confirmation. This ties into the requirement of supervision and approval in Section 1 and under its terms the sale is not complete until accepted and confirmed by the employer.

ARTICLE VIII

INVESTMENT COMPANIES

Article VIII has to do with the relation of the investment banker to investment companies, sometimes called investment trusts. It comprises but one section and it should probably be first noted that we have required of the investment banker, operating in conjunction with an investment company, that he use his best efforts to the end that the word "trust" be not used as part of the title unless the investment company is as a matter of law a "trust." The word "trust" both technically and in the popular mind has, rightly, certain fine implications. It

should not be abused and we, therefore, purpose to require those engaged in our business to do all they can to avoid the abuse. The Rules in this Article apply to investment bankers who have agreed to manage or give investment advice to an investment company or trust, all or a part of the securities of which are held by the public or to an investment banker any of whose partners, officers or employees are officers or directors of any such investment company. In these cases stated the Rules are as follows:

(a) The investment banker shall not sell to or purchase from the investment company for his own account unless a majority of the members of the board of directors of the investment company are not partners, officers or employees of the investment banker and unless the transaction is "previously approved after full disclosure" by a majority of the members of the board of directors who are not affiliated with the investment banker.

REPORTS BY INVESTMENT COMPANIES

(b) He shall use his best efforts to cause the investment company to prepare and distribute to its stockholders quarterly statements which conform to the standards of the annual statements required by Section 1 of Article IV hereof. These are the annual statements to be required of the issuer in connection with the distribution of a new issue of securities.

DISCLOSURES

(c) If the investment banker has received any compensation or commission for acting as agent of the investment company or if the company has purchased from or sold to the investment banker any securities or if the company has engaged in any other transaction in which the investment banker has a financial interest he shall use his best efforts to see that a full disclosure of the transaction is made to the stockholders of the investment company. The provision is added that where the investment banker has acted simply as broker the disclosure shall be sufficient if the total amount of securities dealt in and the total amount of commissions shall be stated without itemizing the transactions.

(d) The investment banker shall not enter into any management or advisory contract providing for the payment of a fee to him unless the contract has been submitted to and approved by the stockholders of the investment company.

The basic idea behind the organization of investment trusts is sound. In theory they provide a vehicle by which the small investor can secure expert management and diversification. The investment trust is no better than its management.

ARTICLE IX

DISCLOSURE IN MANAGEMENT SERVICES

Miscellaneous. Section 1 provides that no investment banker who is receiving a fee for managing the account of a customer or for advising a customer in respect to his investments shall sell to or buy from the customer for his own account or as agent for any other person unless he receives the written approval of the customer to the transaction. In this case it is clear that the investment banker who receives a management fee owes his first duty to his principal. The provision is made, there-

fore, that, before he shall deal with the customer as a principal, the customer must not only know that the banker is a principal but must give written approval.

DISCRETIONARY ACCOUNTS

Section 2 covers discretionary accounts; that is, accounts where funds are left with the investment banker to be invested at his discretion and the duty is here laid down towards such accounts the same as in the preceding section toward cases where a management fee is paid.

RESPONSIBILITY FOR FUNDS

Section 3 provides that any investment banker who acts as a sinking fund agent, principal or coupon paying agent or dividend paying agent or in any similar capacity and who holds funds or securities in such capacity shall hold them in trust unless the terms of the agency expressly otherwise provide.

QUOTATIONS

Section 4 covers the matter of quotations and provides that no circular, advertisement, newspaper article, investment service, or communication of any kind which purports to quote or which does give a quotation of any transaction shall be published or circulated by any investment banker, nor shall he cause such a statement to be published or circulated unless he believes that such transaction so quoted was a bona fide purchase and sale and if such communication or service purports to quote a bid price or an asked price for any security he must believe that the quotation represents a bona fide bid or offer for such security. If the quotation is a nominal quotation, that is, the quotation of a price which he believes can be received it must be clearly stated that such quotation is nominal.

FICTITIOUS BIDS AND OFFERS

Section 5 forbids an investment banker from making any offer to buy or sell at a stated price unless he is prepared to purchase or sell, as the case may be, at the price given.

RESTRICTIONS ON GRATUITIES

Section 6. Here we have gathered in one place provisions as to compensation and gratuities and it is provided that no investment banker shall give, permit to be given, or offer to give anything of value: First, to any employee, agent or representative of another person for the purpose of influencing or rewarding the act of such agent in relation to the business of his employer unless the employer has knowledge and has given consent. This restates the law of commercial bribery.

Second: To any officer or employee of a bank, trust company or insurance company for services rendered or to be rendered without the knowledge and consent of the bank, trust company or insurance company whose officer or employee is so compensated.

Third: To any person for the purpose of influencing or rewarding the action of such person in connection with the publication or circulation in any newspaper, investment service or similar publication of any matter "which has or is intended to have an effect upon the market price of any security." An exception is made in

this case to clearly paid advertising matter. This section is broad and it is deliberately so written because the investment banking business wishes to cooperate with the publishers of newspapers and investment services in their effort to keep their news columns free from matter directly or indirectly paid for.

Fourth: To any officer, official, director or employee of any issuer for the purpose of rewarding such person in connection with the issue or sale of any new issue of securities.

It is generally provided that for the purpose of this section the giving of anything of value to a member of the family of any person shall be regarded as the giving of the thing to such person. In order to comply with the requirements of the NRA it is expressly stated that nothing in this section shall be construed to limit the distribution of articles "commonly used for advertising."

Section 7 should be discussed and considered in connection with the provisions of Article X relating to the registration of investment bankers and we will, therefore, reserve it for a few moments.

Section 8 provides that every investment banker shall with respect to any transaction in any district comply with any additional rules established for such district as provided in Sections 5, 6 and 7 of Article XI hereof.

ARTICLE X REGISTRATION

Article X sets up the machinery for the registration of investment bankers. The purpose of including registration in these Rules is to secure a quicker enforcement of the Rules and to enforce a liberal interpretation of the Rules in the light of the purposes to be accomplished.

In order to understand the theory upon which the registration is provided for in these Rules, there must be a brief statement as to, first, the operation of the Rules upon all investment bankers, and, second, the enforcement provided in the event there is a breach of a Rule. These Rules, when approved by the President of the United States, will become binding on all persons engaged in the investment banking business and a breach of the Rules may be punished as provided in Section 3(f) of the National Industrial Recovery Act.

CODE ENFORCEMENT

Punishment for breach of Rules must be preceded by a criminal action. In a criminal action the statute being enforced is construed strictly against the sovereign and in favor of the accused. That may be all right sometimes, but the court house is a poor place to regulate a legitimate business and the criminal court is one of the worst places in the court house to do it. When punishment is necessary it is essential and of course all of the rules of N.I.R.A. would at all times govern both registered and non-registered dealers, but regulation in order to be helpful to a business must be available and exercised long before the punishment of any one is desirable, much less warranted. The idea of the code drafting committee in providing for a registered list of investment bankers is that each member joining such registered list would agree contractually with each other registered investment banker to comply with the Rules, not as they will be interpreted in a criminal court, but as they will be liberally construed by the Code Enforcement Author-

ity for the purpose of maintaining high standards of commercial honor in the investment banking business and for the purpose of accomplishing the other objects for which these Rules are drawn.

It is provided that every bona fide investment banker in the United States can be registered upon agreeing to abide by this liberal construction of the Rules.

DUTIES OF REGIONAL COMMITTEES

It is further provided that any person who feels that there has been a breach of the Rules by an investment banker may lodge a complaint with the Regional Committee of the region in which he resides. An investigation of the complaint will be made by that Regional Committee, and a report forwarded to the Regional Committee of the region in which is located the principal office of the investment banker involved. The customer, therefore, is greatly facilitated in making his complaint and is absolutely relieved from cost in having his complaint investigated. It makes no difference where the investment banker is located against whom he has lodged a complaint. The customer can go to the Regional Committee nearest to him. The reports of the Regional Committees are forwarded to the Code Committee with recommendations and the Code Committee with approval of the Administrator has power either to discipline or strike from the registered list, the investment banker complained against.

SIGNIFICANCE OF REGISTRATION

Now, it is quite clear that enforcement of the rules by the Code Authority will be effective exactly in proportion as the investment bankers desire to remain on the registered list, and for that reason Section 7 of Article IX is drawn providing that no investment banker shall participate in any syndicate operation in which any participant is a non-registered investment banker. In other words, the investment banker who loses his registered status cannot participate in syndicates with other registered bankers. He may organize syndicates of his own, and he may participate in syndicates with unregistered investment bankers, but he is deprived, having violated the Rules or having refused to abide by a liberal interpretation of the Rules, from the right to participate in syndicates with other registered investment bankers.

Section 7 of Article IX also provides that registered investment bankers will not allow the customary dealer's discount to unregistered investment bankers. If the purpose of registration were to control the price, there might be doubt as to the validity of this provision, but the only thing which is required of the registered investment banker is a compliance with the Rules which have been approved by the President and as they have been interpreted by the Code Authority, appointed by the governmental agencies and the President.

It is the hope that over a period of time, by strict enforcement of the Rules that are here set up, there can be built up a confidence of the investing public in registered investment bankers which will make registration a desirable thing from the standpoint of every investment banker and which will give to the investor all of the safeguards which can be given him.

PRACTICABILITY OF INFORMATION

The keynote of these Rules is that the investor should be given the fullest information. It must be assumed that the man who is competent to handle funds for investment is competent to understand the facts if they are given to him. Whether the individual investor can or cannot, in all cases, adequately interpret the information which is made available to him by these Rules, this one fact is certain—the financial writers of the public press, the various statistical services, and investment bankers and advisers generally WILL, be able to understand the facts made public and their conclusions cannot escape the attention of the individual investor.

FOREIGN INVESTMENT BANKERS

Section 7 of Article IX provides in addition to limiting the dealings of registered investment bankers with non-registered that these provisions shall not apply to an investment banker in a foreign country who is not eligible for registration but that in any transaction with such foreign investment banker a registered investment banker shall, as a condition of the transaction, secure an agreement that in making any sales to purchasers within the United States of the securities acquired the foreign dealer shall conform with the provisions of Section 7 to the same extent as though he were a registered investment banker.

REGISTRATION REQUIREMENTS

It is further provided that no investment banker who is not registered shall represent that he is and no registered investment banker shall hold himself out to the public as such unless he be permitted so to do by regulations prescribed by the Code Committee. This last provision is included to guard against harm being done due to the ease with which registration is at the outset granted. We are providing that any bona fide investment banker may register. We make no capital requirement of him nor any other requirement except that in his dealings he comply with the Rules. We feel that those investment bankers who are willing to comply with the Rules in letter and spirit as they may be enforced by the Code Authority with the approval of the Administrator are entitled to the greatest protection; that the persons they are dealing with are likewise bound to comply in the same high degree.

It is provided in the registration article that a statement shall be filed with the application for registration giving certain facts with regard to the investment banker applying. These are simple and include only the title under which he does business, the address of his principal and branch offices; if he is a partnership, the names and private and business addresses of the partners and specifying as to whether each partner is general or limited and, if he is other than an individual or partnership, the name of the State or country where he is incorporated and a list of his directors and principal officers and the name of each stockholder owning in excess of ten per cent of his capital stock, also the length of time that he has been engaged in the investment banking business. We for a long time considered whether we should not go further in providing restrictions upon registration. It was seriously considered adding a provision that no investment banker should be eligible for registration who had in the past been convicted of violation of any

provision of any State securities act, but it was finally decided that we ought to go to the utmost limit in making it clear that there was no intention to monopolize or restrict this business. What we are asking from now on is that we be allowed to separate the sheep from the goats.

EFFECTIVE REGULATION

If our Code is adopted with the registration section in it and if the Administration of the NRA will sit with us as we iron out the many mistakes which will be discovered and make it less drastic where it is unduly hampering honest business and more drastic where it is allowing dishonest evasion we will jointly with the NRA do more to stabilize and regulate this business and will do more to protect security buyers and we will do it quicker than can be done by any other means. We know this business. It is a highly technical and complicated business. It is a business which must be done by using every implement of modern science because the business always has been and always will be one of the fastest. The application of the law of interest is one of the most inexorable and wherever it is involved time becomes valuable especially when you are dealing in large amounts of money. We offer to the Administration our cooperation and our knowledge to the ends set up in these Rules.

PROCEDURE BEFORE COMMITTEES

It is provided for in the registration article that applications for registration shall be acted upon by the Regional Committees and finally by the Code Committee with the approval of the Administrator. The applicant is given the right to a hearing and representation by counsel if he wishes, both in connection with his application and complaints.

It is provided that where any complaint is filed against a registered investment banker the Code Committee and any agency authorized by it shall have the right to require the investment banker complained against to submit a report in writing and shall have the right to inspect books, records and accounts with relation to the matters involved in the complaint and that the failure to produce for inspection such records shall be sufficient cause for suspending or cancelling registration.

Every registered investment banker must keep in his office a copy of the Code and Rules and of all amendments and interpretative rulings made by the Code Committee and approved by the Administrator which shall be available for examination by any customer who requests it.

PENALTIES

The Investment Bankers Code Committee in the administration and enforcement of the registration section is given the power to prescribe penalties not in excess of \$500.00 or to suspend or cancel registration for each violation of the Rules or for neglect or refusal to comply with orders, directions or decisions made by the Code Committee and approved by the Administrator. The Code Committee is also given the right to impose a fine or suspend or cancel registration of any investment banker if in the opinion of the Committee he has been guilty of repeated violations of the principles contained in Article III, and it is particularly set forth that it shall be deemed a repeated violation if any invest-

ment banker having been notified by the Code Committee that he is violating or has violated a principle, continues thereafter to violate it.

In any case where the Code Committee shall impose any fine or suspend or cancel registration the person against whom such award is made is provided with the right of appeal to the Administrator for review of the facts upon which the Code Committee based its action. The Administrator is allowed to take further evidence and to modify, affirm or set aside the action of the Code Committee. It is provided that upon appeal of an investment banker to the NRA against a decision of the Code Committee the NRA shall have the right in its discretion to stay the effect of the order of the Committee until there has been a review. The Code Committee may determine the manner and form of its proceedings and no member of a Regional Code Committee or the main Committee shall in any manner directly or indirectly participate in the determination of any question affecting his personal interests or the interests of any person in whom he is directly or indirectly interested.

INTERPRETATIVE RULINGS

The Investment Bankers Code Committee is given the right to from time to time present to the Administrator proposed interpretative rulings based on the Rules, which rulings shall be made in the light of the general principles set out in Article III hereof and the Code Committee is authorized to give a liberal interpretation to the Rules according to the spirit and intent and in order to effectuate their policy and purposes. These interpretative rulings upon approval by the Administrator shall become operative and applicable to registered investment bankers.

Withdrawal from registration can be had at any time, which withdrawal leaves the investment banker still bound by the Code as construed and interpreted in the courts but frees him from the contract obligation to abide by a liberal construction and by the interpretative rulings but at the same time, as we have drawn it, deprives him of the privileges which he gets by reason of registration.

A registration list shall be furnished to each registered investment banker.

ARTICLE XI

This Article covers the matter of administration of the Code.

RESEARCH AND STATISTICS

Section 1. In order to provide statistical information regarding investment conditions, the Code Committee is authorized to select a Confidential Agency to obtain from all investment bankers certified reports of such character and in such form as may be prescribed. Such Confidential Agency shall not be engaged in the business or interested in or connected with any investment banker and all information so received shall be held as secret and confidential by the agency. The agency may analyze and digest the reports and shall disclose to the Code Committee only the general findings which shall be available to all investment bankers who assent to the Code and who are registered investment bankers.

REGIONAL DISTRICTS DEFINED

Section 2 provides for the establishment of local districts as set up in Schedule A attached to the Rules. It will be seen by consulting Schedule A that there are sixteen regional or local districts provided for. This division of the country into local districts follows the division made by the Investment Bankers Association of America. The districts were set up after careful study and in order to join in each district the dealers who naturally cooperate and center their activities in the same financial centers. The Code Committee is given the power to, from time to time, re-locate boundaries and to increase or decrease the number of districts.

FORMATION OF REGIONAL COMMITTEES

It is provided that in each district there shall be organized a Regional Code Committee to consist of either three, five or seven persons as determined by the Code Committee. The members are to be elected by a vote of the investment bankers assenting to the Code and having their principal place of business within the region. Nominations are to be made by the Investment Bankers Code Committee. If the number of the Regional Code Committee is three, five persons shall be nominated to be voted upon; if the number to be elected is five, eight persons shall be nominated, and if the number to be elected is seven, eleven persons shall be nominated. No person shall be nominated unless he is actively engaged as an investment banker and has his place of business in the district for which he is nominated. The voting shall be by printed ballot and under regulations established by the Code Committee. The Regional Code Committees shall report all of their actions to and shall at all times and in all matters be answerable to the Investment Bankers Code Committee.

FUNCTIONS OF REGIONAL COMMITTEES

Regional Code Committees shall act as agencies of the Central Code Authority for the administration and enforcement of the Code and Rules in their respective districts.

Members of Regional Code Committees shall serve without pay and funds to meet the necessary and actual expenses of the Regional Code Committees will be provided by the Central Code Authority out of the funds collected by it under the provisions of Section 6 of Article III of the Code and Section 13 of Article XI (the registration section).

Any Regional Code Committee may be authorized to raise additional funds in accordance with regulations prescribed by the Investment Bankers Code Committee with the approval of the Administrator.

ADMINISTRATION

Section 5 of this Article XI on administration provides that any Regional Code Committee may from time to time propose additions to the Rules of Fair Practice, as may be deemed desirable for their district and which are not inconsistent with the provisions of the Code and Rules. Any such additional Rules so proposed shall be submitted to a vote of all investment bankers located in the district who have assented to the Code and if approved by a majority of those

voting shall be submitted to the Code Committee and upon approval by the Code Committee and the Administrator they shall become effective in that district.

Section 6 provides that any Regional Code Committee may, from time to time, propose modifications or additions of any district Rules and upon approval by the Code Committee and the Administrator, such modification shall become effective.

Section 7 gives the Code Committee, with the approval of the Administrator, the right to cancel any addition to the Rules or any portion of such addition as applicable to a particular district. It will be remembered that in Section 8 of Article IX it is provided that all investment bankers shall comply with the additional rulings established for particular districts as provided in these Sections 5, 6 and 7 of Article XI.

Section 8 provides that each Regional Code Committee may of its own volition and shall, at the request of the Code Committee, investigate any matter pertaining to the alleged violation of the provisions of the Code or of any Rule. In making such investigations, the Regional Committee shall act as a fact-finding body and if in their opinion a violation has occurred shall report the findings, together with its recommendations, to the Code Committee.

PRIVILEGED COMMUNICATIONS

Section 9 is one about which there has been a great deal of comment and discussion. Complaints filed either with the Investment Bankers Code Committee or any Regional Code Committee by a customer of an investment banker shall be deemed to be privileged communications. The name of the writer of the communication and the nature of the charges made may be known to the accused investment banker in connection with proceedings arising out of the complaint, otherwise the privilege is absolute. Where the complaint against an investment banker is made by another investment banker no privilege is to exist and in any proceedings taken in connection with such a complaint the accused investment banker is to enjoy the right to be informed of the name of his accuser and the nature of the accusation and the cause thereof, and to be confronted by the person making the charge. No one has much use for anonymous complaints and yet it was deemed wise to make a distinction in connection with complaints filed by customers.

WAIVER OF RULES

Section 10 is an insurance which we put into the Code against damage resulting from our inability to foresee consequences. We want this Code to be workable and we, therefore, propose that any Rule may be waived in whole or in part in any particular case. The investment bankers desiring to secure the waiver shall make written application which the Code Committee shall consider and if a majority of all of the members of the Committee shall determine that such waiver will not permit any unfair trade practice and will not be detrimental to the public interest, the Committee, with the approval of the Administrator, shall advise the applicant investment banker in writing to that effect and upon receipt of such advice, the waiver shall become effective "with respect to the particular transaction to the extent provided therein."

Section 11 provides a limitation upon the liability of members of the Code Committee and the Regional Committees. It is provided that in any action taken by a member of either the Code Committee or any of the Regional Committees in

his capacity as a member of the Committee, and in connection with the administration or enforcement of the Rules, he shall be liable only in case of willful fraud.

CONCLUSION

I don't like to repeat myself but I do want to say in closing: We have tried to keep the faith. We may have made mistakes. We probably have. We have tried to provide for their speedy rectification as soon as they are discovered. We want to do our bit in restoring to this country and to its industries a normal, active and conservatively regulated investment market. We ask the approval of the Administrator for these Rules and if approved and we are allowed to aid in their enforcement, we pledge to you unstinted and honest cooperation.

THE PRESIDENT,
The White House.

SIR: This is a report on a modification of the Code of Fair Competition for Investment Bankers, increasing the membership of the Investment Bankers Code Committee from five members representing Investment Bankers to twenty-one such members.

The Assistant Deputy Administrator in his final report to me on said modification of said Code, having found as herein set forth and on the basis of all the proceedings in this matter:

I find that:

(a) The modification of said Code and the Code as modified are well designed to promote the policies and purposes of Title I of the National Industrial Recovery Act including the removal of obstructions to the free flow of interstate and foreign commerce which tend to diminish the amount thereof, and will provide for the general welfare by promoting the organization of industry for the purpose of cooperative action among trade groups, by inducing and maintaining united action of labor and management under adequate governmental sanction and supervision, by eliminating unfair competitive practices, by promoting the fullest possible utilization of the present productive capacity of industries, by avoiding undue restriction of production (except as may be temporarily required), by increasing the consumption of industrial and agricultural products through increasing purchasing power, by reducing and relieving unemployment, by improving standards of labor, and by otherwise rehabilitating industry.

(b) The Code as modified complies in all respects with the pertinent provisions of said Title and said Act, including without limitation subsection (a) of Section 3, subsection (a) of Section 7, and subsection (b) of Section 10 thereof.

(c) The Investment Bankers Association of America was and is truly representative of the Investment Bankers and that said Association imposed and imposes no inequitable restrictions on admission to membership therein and has applied for or consents to this modification.

(d) The modification and the Code as modified are not designed to and will not permit monopolies or monopolistic practices.

(e) The modification and the Code as modified are not designed to and will not eliminate or oppress small enterprises and will not operate to discriminate against them.

(f) Those engaged in other steps of the economic process have not been deprived of the right to be heard prior to approval of said modification.

(g) The enlargement of membership on the Investment Bankers Code Committee is desirable and will result in the Committee being more representative of Investment Bankers, as a whole, by making it possible to have representatives thereon from all parts of the country.

For these reasons this modification has been approved.

Respectfully,

HUGH S. JOHNSON
Administrator

February 1, 1934

**Code of Fair Competition
for
Investment Bankers**

(As modified by Administrative Order, February 1, 1934)

PREAMBLE

To effectuate the policy of Title I of the National Industrial Recovery Act, the following provisions are established as a Code of Fair Competition for Investment Bankers.

ARTICLE I
DEFINITIONS

(1) The term "investment banking business" as used herein shall mean the business of underwriting or distributing issues of bonds, stocks, or other securities, or of purchasing such securities and offering the same for sale as a dealer therein, or of purchasing and selling such securities upon the order and for the account of others; provided, however, that the term "investment banking business" shall not include transactions on regularly organized exchanges, but such term shall include all business relating to such transactions to the extent that such business is not conducted by a member of such exchange or by any person or organization having the privilege of any such exchange for itself or any of its partners or executive officers.

(2) The term "employer" as used herein shall include every natural person, co-partnership, corporation, association or other entity that is engaged in doing any investment banking business. If the major part of the business of any employer consists of any business other than investment banking business which other business is governed by any other code or codes, such employer shall not be bound as to his investment banking business by the wage and hour provisions of this Code, but shall be governed as to his investment banking business by the wage and hour provisions of such other code or codes; but all other provisions of this Code shall apply to such employer as to his investment banking business.

(3) The term "employee" as used herein shall mean any one employed by any employer, regardless of the nature or method of payment of his compensation.

(4) The term "Administrator" as used herein shall mean the Administrator appointed by the President of the United States under the National Industrial Recovery Act.

(5) Population for the purposes of this Code shall be determined by reference to the 1930 Federal Census.

ARTICLE II
LABOR PROVISIONS

(1) (a) Employees shall have the right to organize and bargain collectively through representatives of their own choosing, and shall be free from the interference, restraint, or coercion of employers of labor, or their agents, in the desig-

nation of such representatives or in self-organization or in other concerted activities for the purpose of collective bargaining or other mutual aid or protection.

(b) No employee and no one seeking employment shall be required as a condition of employment to join any company union or to refrain from joining, organizing, or assisting a labor organization of his own choosing.

(c) Employers shall comply with the maximum hours of labor, minimum rates of pay, and other conditions of employment, approved or prescribed by the President of the United States.

(2) No person under sixteen years of age shall be employed by any employer; provided, however, where a State law requires higher minimum age, no person below the age so specified shall be employed within that State.

(3) (a) No employer shall employ any person for more than 40 hours in any one week, provided, however, that in order to meet contingencies which cannot be anticipated and over which the employers have no control, the said hours of employment may be increased to meet such contingencies, but in no event shall such employees work more than a total of 44 hours per week averaged over a period of four (4) months without the payment of overtime.

(b) The maximum hours fixed in the foregoing paragraph (a) shall not apply (1) to guards and watchmen employed at night to safeguard securities or assets (provided such guards and watchmen do not work more than six (6) days each week), or (2) to partners in any co-partnership, or (3) to outside salesmen, or (4) to employees in a managerial or executive capacity or in any other capacity of distinction or sole responsibility who receive more than \$35 per week.

(c) No employee, except outside salesmen working solely on a commission basis, shall be paid (1) less than \$16 per week in any city of over 2,000,000 population; (2) less than \$15 per week in any city between 500,000 and 2,000,000 population; (3) less than \$14.50 per week in any city between 250,000 and 500,000 population; (4) less than \$14 per week in any city between 2,500 and 250,000 population; and (5) in any town of less than 2,500 population all wages of employees shall be increased by not less than 20% provided that this shall not require the payment of wages in excess of \$12 per week; provided, however, that where a State law provides a higher minimum wage than is provided in this Code, no person employed within that State shall be paid a wage below that required by such State law.

(d) All employees, except employees mentioned in paragraph (b) above, if employed for more than a total of 44 hours per week averaged over a period of four (4) months, shall be paid for all such excess time of employment at the rate of 133 $\frac{1}{3}$ % of the regular hourly rate at which such persons shall then be employed; but regardless of the calculation of such overtime averaged over a four months' period, all such employees if employed for more than 48 hours in any one week shall be paid for such time in excess of 48 hours at the rate of 133 $\frac{1}{3}$ % of the said regular rate. The amount paid for overtime for any weekly period shall be credited on the amount of overtime paid at the end of any four months' period, and in computing the amount of overtime to be paid as herein provided the regular hourly rate at which any person shall be employed shall be determined by dividing the amount per week which he shall regularly be paid by 40.

(e) The wages of employees (except employees mentioned in the foregoing subdivisions (2), (3), and (4) of paragraph (b)) being paid on September 1, 1933, in excess of the established minimum shall not be decreased, notwithstanding that the hours worked in such employment may be hereby reduced.

ARTICLE III ADMINISTRATION

(1) To cooperate with the Administrator in the administration of this Code there is hereby constituted an Investment Bankers Code Committee. Such Committee shall consist of fifteen members appointed by the President of the Investment Bankers Association of America; six members chosen by a fair method approved by the Administrator to represent employers not members of the Investment Bankers Association of America; and a representative or representatives without vote appointed by the Administrator. The twenty-one voting members of the said Committee shall be appointed or chosen from assenting employers.¹

(2) The Investment Bankers Code Committee herein provided for shall be the representative body from the employers subject to this Code, to act on their behalf in the administration and enforcement of this Code, and shall have, in addition to the specific powers herein provided for, all general powers necessary for such administration and enforcement; such general and specific powers shall be at all times subject to the right of the Administrator to veto or modify any action taken by such Committee.

(3) The Investment Bankers Code Committee may from time to time appoint such committee or committees as it may deem necessary or proper to carry out its powers and duties under the Code and may delegate to any such committee such of its powers and duties as it may deem necessary and proper to effectuate such purposes. The representative or representatives appointed by the President of the United States shall be given notice of all meetings of any committee or committees appointed by the Investment Bankers Code Committee and shall have the right to participate without vote in the activities of such committee or committees.

(4) The Investment Bankers Code Committee may from time to time present to the Administrator recommendations which will tend to effectuate the administration of the provisions of this Code and the policies of the National Industrial Recovery Act.

(5) In order to keep the President of the United States and the Administrator informed as to the observance or non-observance of this Code, each employer shall prepare and file with the Investment Bankers Code Committee, at such time and in such manner as said Committee may prescribe, statistics covering the number of persons employed, wage rates, hours of working, and such other data or information as the Investment Bankers Code Committee may require, provided such other data or information shall also be required by the Administrator. All information so furnished shall be treated as confidential and used only for the sole purpose herein set forth.

(6) The expenses of administering this Code shall from time to time be equitably assessed and collected by the Investment Bankers Code Committee from

¹As modified by Administrative Order, February 1, 1934.

employers assenting to this Code in accordance with a plan to be approved by the Administrator; but no such employer shall be liable for any payment in excess of said assessment.

(7) Any employer may voluntarily assent to this Code by signing and filing his assent with the Investment Bankers Code Committee, No. 33 South Clark Street, Chicago, Illinois.

ARTICLE IV FAIR TRADE PRACTICES

Within 90 days after the approval of this Code, the Investment Bankers Code Committee shall submit, in accordance with the procedure set forth in paragraph (1) of Article V, supplementary provisions relating to fair trade practices.

ARTICLE V AMENDMENTS AND TERMINATION

(1) Any employer assenting to this Code that may hereafter desire to have the Code amended or any supplementary provisions added shall take the following procedure: Propose the amendment to the Investment Bankers Code Committee which shall, if a majority of the Committee shall approve the proposed amendment, submit it to a meeting of the employers assenting to this Code especially called for that purpose upon due notice; and if at any such meeting a majority of such employers shall be present or represented and if a majority of such employers as are present or represented at said meeting shall vote in favor of the adoption of such proposed amendment, such amendment shall be submitted by the Investment Bankers Code Committee to the President of the United States for approval, and such proposed amendment shall take effect as a part of this Code upon such approval thereof by the President of the United States. Employers voting on such amendments as above provided may vote in person, by proxy in writing, or may vote in writing without being personally present.

(2) This Code shall continue in effect as long as the National Industrial Recovery Act shall be in effect, but in no event after June 16, 1935, and shall in all respects be subject to the provisions and conditions of the National Industrial Recovery Act.

(3) This Code and all the provisions thereof are expressly made subject to the right of the President of the United States, in accordance with the provisions of subsection (b) of Section 10 of the National Industrial Recovery Act, from time to time to cancel or modify any order, approval, license, rule, or regulation issued under Title I of the National Industrial Recovery Act, and specifically, but without limitation, to the right of the President of the United States to cancel or modify his approval of this Code or any conditions imposed by him upon his approval thereof.

ARTICLE VI EFFECTIVE DATE

This Code shall become effective on the second Monday after its approval by the President of the United States.

Firma
Box 256870