

REPORT TO
INVESTMENT BANKERS CODE COMMITTEE
ON CODE ENFORCEMENT

Pursuant to instructions from the Executive Committee at its meeting in New York, October 16, 1934, the undersigned group has given careful study to the subject of Code Enforcement and presents herewith its conclusions and recommendations:

It is self-evident, in our opinion, that the all-important question facing the investment banking business today is this: whether the business can effectively regulate itself with a minimum of governmental supervision, or whether, failing in this, it is to be confronted with further intimate and drastic governmental regulation. The crucial test of this question lies in the administration and enforcement of the Fair Practice Provisions of the Investment Bankers Code.

The Regional Code Committees, with the support of the Code Committee, are charged with the duty of seeing that compliance with the Code be maintained at the highest possible standard. Upon the efficiency with which this duty is performed depends the success of the Code.

It is essential that the administration of the Code be such as to demonstrate clearly that the Code is not an idle gesture. There must be fostered and maintained a definite appreciation that the Code embodies the accepted and approved trade practices of the business, that it is thereby the trade law of the business, and that as such it merits in and of itself a full measure of support. To those who would disregard or willfully violate the Code, it must be as clearly demonstrated that compliance is obligatory. Enforcement is necessary, not only as a deterrent to those who might be willing violators, but as a needed encouragement to those whose will is to abide by and support the Code.

LIMITATIONS

Enforcement limitations are well known. The profoundly depressed conditions of the investment banking business necessitates keeping all expenses at the absolute minimum consistent with satisfactory administration. Limitation of funds results necessarily in limitation of personnel, and we face the fact that, in very large part, enforcement work must be carried on by the voluntary services of the National and Regional Code Committeemen, serving without compensation.

Careful consideration has been given to a report based upon a special study of the problem of creating an independent enforcement staff. That report sets forth a detailed estimate of initial necessary personnel and cost. In our opinion it is quite impractical to undertake this step now, both because of the difficulty of getting and organizing properly trained personnel, and more especially because of the expense, which has been estimated at a minimum of about \$75,000 per annum.

We therefore turned our consideration to such other avenues as may be open for assistance in Code enforcement. There are important agencies available. Such agencies include the National and State organizations of the NRA; the Securities and Exchange Commission, including district and local representatives; the Securities Commissioners of the various states; Federal, State and County prosecuting and law enforcement authorities; United States postal authorities; Stock Exchanges; and Better Business Bureaus, Chambers of Commerce, or similar local organizations. In these recommendations we have attempted to outline the manner in which each of these may be utilized to the best advantage.

Primarily, the enforcement of the Code must rest upon the Regional Committees. These Committees must receive adequate support and help from the Code Committee, but in seeking the assistance of such outside agencies, the contact must remain primarily between Regional Committees and such local agencies within their own territory.

The Investment Bankers Association of America assumed the original responsibility for drafting and establishing the Code and is vitally interested in its success. I.B.A. members and their many salesmen can be of inestimable value in all phases of Code activities. We therefore recommend that immediate steps be taken toward developing a specific program for continuing the closest cooperation with the Association itself and its various groups. In various sections of the country there are other associations of dealers or traders in securities and all such associations should be invited to cooperate to the fullest extent in developing the program outlined below.

OBJECTIVES

Any plan for obtaining maximum compliance with the Code must take into consideration the two important classes of persons subject to the Code, namely, those disposed to observe ethical principles and rules of fair practice voluntarily, and those not so disposed. Violations of the Code by the former may be expected to be inadvertent, through oversight or lack of accurate knowledge. Violations by the latter may be expected to be willful. The two types of violations must be handled differently. Those who are disposed to comply voluntarily as a matter of business principle will need only encouragement and education. Willful violators must be dealt with as the circumstances require.

In general, the problem of Code enforcement falls into three main divisions. First, and most important, Encouragement of Compliance; second, Origination of Complaints; third, the Handling of Complaints. In the following recommendations we have endeavored to approach the problems under each of these main headings.

I

ENCOURAGEMENT OF COMPLIANCE

Encouragement of compliance is the most important phase of Code Enforcement because far more efficient results can be effected by stimulation of moral support and good will on the part of dealers, than can be accomplished by inquisition, the right of visitation, or stringent punitive action. To this end, we feel that the primary effort of all Committees should be toward fostering and maintaining an active good-will attitude toward the Code, with a resultant voluntary compliance on the basis of sound ethics and fair play.

Encouragement of compliance may be approached from several angles:

1. Maintenance of good-will for the Code.

(a) We recommend that the Code Committee at once designate a member of the headquarters staff whose primary duty shall be, under the direction of the Managing Director, to act as liaison officer between the Code Committee and Regional Committees. The lack of activity by several Regional Committees has been ascribed directly to failure to receive information, instructions, and assistance from the Code Committee or an adequate dissemination of experiences and methods of other Regional Committees.

(b) All Committees must give prompt and continued evidence that they are serious and efficiently on the job. This, we believe, more than any other single factor is necessary for the maintenance of good-will.

(c) Waivers of rules must be limited to clearly exceptional, meritorious cases.

(d) Committee members, national or regional, should keep inviolate deliberations when in executive session and should appreciate that a decision of the majority is the decision of the Committee. No individual opinions with respect to Committee decisions should be indulged in. This to avoid dissension and confusion.

(e) An adequate program of publicity must be adopted. This, in turn, has two phases:

First, publicity within the Code organization through dissemination and exchange of news items of general interest among parties to the Code. To this end the Code Committee should send out as frequently as possible a bulletin or general letter of information containing pertinent items of Code Committee and Regional Committee activities.

Secondly, publicity outside the Code Organization by means of news releases to the press where circumstances warrant a national or local news story of public interest and appeal, or by special articles for magazines or public addresses. There should be a definite organization for this purpose. We recommend that a publicity organization be set up.

All publicity, whether within or outside, should stress so far as possible the ethical aspects of the Code, appealing to the sense of fair play and legitimate self-interest of dealers, and be of a character understood by the public and attracting its approval.

(f) Occasional regional meetings should be held, called by or under the auspices of Regional Committees, to get dealers together for discussion and elucidation of the Code and stimulation of their interest. Such meetings should be designed to include non-registered as well as registered dealers. Such meetings should be called in all regions now.

2. Education Regarding the Provisions of the Code.

(a) The Code Committee should send frequent communications to Regional Committees regarding interpretations or explanations. The Code Committee, likewise, when it seems desirable, should send such communications direct to dealers.

(b) Regional Committees from time to time should send questionnaires to dealers in their district, calling attention to specific provisions of the Code. We commend the procedure adopted in California, which serves the double purpose of acquainting dealers with particular points in the Code and of discussing infractions thereof.

(c) Regional Committees, in preparing such communications to dealers, should send copies to the Managing Director's office, where they should be examined and those which seem of general interest should be circularized by the liaison officer to other Regional Committees.

3. Friendly Adjustments.

The Code Committee and Regional Committees should avoid the appearance of policing the industry or of using the "Big Stick". Instead they should adopt, so far as possible, a policy of friendly explanations and friendly adjustments of misunderstandings. This, we believe, will tend to foster good-will and a spirit of willing compliance.

4. Encouragement of Registration.

Publicity, whether internal or external, should endeavor, whenever possible, to emphasize the privileges and benefits of registration. Committeemen should take every opportunity of explaining the same to non-registered dealers.

5. Cooperation of State Securities Commissions

(a) Some states have already adopted the policy of encouraging registration by including in their questionnaires to dealers applying for state license or state registration, questions as to whether or not the dealer has registered under the Code (deeming this a measure of moral fitness) or questions tending to bring out the dealer's familiarity with the Code.

(b) Some states have announced that the Fair Practice Provisions of the Code have been adopted as regulations under their State securities laws and that infractions thereof will be deemed infractions of the State law.

(c) Some states, pursuant to the adoption of the Code as a state regulation, have sent questionnaires to their dealers, raising questions as to possible violations of the Code.

Such steps on the part of State Commissioners present one of the most effective possible means of encouraging Code compliance or registration under the Code. It is important also to note that such action by the states reaches as effectively the non-registered as the registered dealer.

II

ORIGINATION OF COMPLAINTS

In our study, reports have been received from twelve of the seventeen Regional Committees, in response to a request from the Managing Director, presenting suggestions or experiences which they have encountered in connection with Code enforcement. In several instances, Regional Committees express gratification over

the fact that no complaints have been received. This, we believe, is evidence of misunderstanding on the part of such Regional Committees.

The duty of encouraging justifiable complaints should be pointed out by the Code Committee to Regional Committees.

Complaints may be originated through a number of sources:

1. Registered dealers.

(a) Regional Committees should be instructed to address a letter to all registered dealers in their respective districts requesting that information obtained by them of non-compliance be brought to the attention of the appropriate Regional Committee, and emphasizing to dealers their duty to do so.

2. Regional Committee Members and Secretaries.

(a) Regional Committees should be instructed to make immediate contact with existing agencies herein mentioned, in order to establish friendly and cooperative relationships with them.

(b) Regional Committee members and secretaries should be alert to evidence and rumors of Code infractions.

(c) Where such evidence is not specific but is a matter of common knowledge, Regional Committees should be instructed to investigate to determine the facts. Such investigation possibly may be carried out best by a general questionnaire to registered dealers within the region or in a given community, as the circumstances may dictate.

3. The Public.

(a) With adequate publicity and dissemination of information as to the existence of Regional Committees and their location, the public may be expected to make inquiries and to lodge complaints. Publicity, however, need not and should not in any sense take the form of encouraging a multiplicity of miscellaneous complaints of unimportant character.

4. Securities Commissioners and State or County Prosecuting Officers.

(a) Such agencies should be encouraged at once to report to the appropriate Regional Committee code violations coming to their attention which may or not be violations of State laws. We have evidence of a sincere desire of cooperation by the states in this respect.

(b) Regional Committees should be instructed to contact such state agencies at once.

5. Better Business Bureaus.

(a) Better Business Bureaus, Chambers of Commerce, and other similar bodies should be encouraged to report to appropriate Regional Committees violations of the Code or evidences of fraud.

(b) Regional Committees should be instructed to make contact with Better Business Bureaus or similar agencies within their territories.

6. Securities and Exchange Commission.

(a) The Washington or local offices of the Securities and Exchange Commission should be invited to give to the appropriate Regional Committee evidences of Code violations which may come to their attention.

(b) Regional Committees should be instructed to ascertain the location of such local Securities and Exchange Commission offices and to make contact with them.

7. National Recovery Administration.

(a) The Washington or local compliance offices of the NRA should be invited to report cases of Code violations to appropriate committees.

(b) Regional Committees should be instructed to ascertain the location of local NRA Compliance offices in their region and to make contact with them.

8. Postal Authorities.

(a) Postal authorities should be invited to cooperate through the exchange of information with the Code Committee.

It is the duty of the Code Committee to be alert for evidence of negligence or indifference on the part of Regional Committees. Upon indication of any such condition, the Code Committee should instruct such Regional Code Committees to report as to the reasons therefor and to investigate any matter as may seem proper pertaining to violation of the provisions of the Code.

It is the duty of the Code Committee to maintain direct and intimate contact at Washington with the NRA; the Securities and Exchange Commission, and the Post Office Department, for the purpose of mutual cooperation.

In any of the above recommendations wherein Regional Committees are instructed to invite information from other agencies it is important to remember that such relationship should be mutual. Information and cooperation should, in turn, be given to such agencies in return for such help as they may give. This should be pointed out to Regional Committees.

III

HANDLING OF COMPLAINTS

1. Procedure for Handling Trade Practice Complaints.

(a) This procedure has now been completed and approved by the NRA, and must serve as the basis for all formal complaint procedure.

(b) Copies of this procedure have been sent to all Regional Committeemen, who should be instructed to study it and follow carefully its requirements.

(c) Release of "Procedure for Handling Trade Practice Complaints" should be made the basis of a national news story.

2. The general principle in handling of complaints should be that outlined in the letter of the Managing Director to all Regional Code Committees, dated September 24, 1934, namely, that non-compliance resulting from a lack of proper understanding of the Code with no willful intent to violate, should be dealt with in a corrective and helpful manner rather than in a punitive spirit; while cases of willful disregard of Code provisions should be made the subject of punitive action.

Complaints, whether involving registered or non-registered dealers, should be handled, so far as possible, on an informal basis and settled whenever possible upon an adjustment of the complaint and a written assurance from the respondent of future compliance, except when such complaints involve violations of federal or state laws.

Where violation is due to lack of understanding with no apparent willful intent, the process should be corrective and helpful, rather than punitive.

Where violation is willful, Regional Committees should proceed to establish facts under which punitive or disciplinary action may be taken by the Code Committee or by the NRA, following the procedure set up in "Procedure for Handling Trade Practice Complaints".

3. Under such procedure all complaints shall be investigated and if possible adjusted by the Regional Committee. In this process of investigation by the Regional Committees, where there is evidence of violation of federal or state laws this should be called promptly to the attention of the proper authorities.

4. Where no disposition as above can be effected, proceedings should be followed through formally as provided in "Procedure for Handling Trade Practice Complaints".

5. Where circumstances necessitate and where available, Better Business Bureaus, Chambers of Commerce, or other similar agencies, may be called upon for purposes of investigation.

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Nothing herein recommended incurs additional expense **except** the last item, namely, expense of investigations. Some of these independent agencies provide effective media for investigation when necessity therefor arises. The extent to which their services may be utilized must largely depend upon the amount which it may be possible to contribute toward their support.

It has been our effort to suggest the employment only of existing agencies to the utmost of their efficiency and availability. Many of them are supported by us as taxpayers. All of the cooperation herein suggested is in line with the normal functions of these agencies, and carries out our duty to take into consideration the item of expense in these trying times.

Respectfully submitted,

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