

MEMORANDUM

RE: SELF-REGULATION

It is believed by many that the Conference has now reached a point in its development at which it is necessary to give further thought to the vitally important subject of self-regulation within the business.

On May 25, the initial Rules of Fair Practice of the Conference and the Complaint Procedure approved at the last meeting of the Governing Committee were submitted to the membership for their approval in accordance with the provisions of the By-Laws. The vote to date is almost unanimously in favor of the Rules, so they are likely to become effective as the Rules of the Conference on June 24. This, of course, is the first step in the direction of self-regulation, but it is only the first step, and it is generally believed that completely effective self-regulation cannot be achieved under these Rules alone and the powers which the Conference now has to enforce them.

In considering what, if any, further action should be taken by the Conference toward achieving effective self-regulation, it is essential first to appraise its desirability.

At this time, whether one likes it or not, it is clear that Federal regulation, or the power of a Federal agency to regulate practically all phases of the securities business, is here to stay. The Exchange Act as now drawn gives the Commission broad powers to regulate the over-the-counter business, but as yet the SEC has used only a little of this power. The Exchange Act gives the Commission vast regulatory power over the organized markets of the country, but we have seen that the Commission, rather than attempting to regulate the organized markets directly, has elected to do so

through the exchanges themselves, and the result has been that the exchanges have been permitted to continue to regulate themselves, with occasional suggestions as to rules, etc., coming from the Commission, and with the Commission, of course, retaining the power to do the job if the exchanges fail.

The present Commission fully recognizes the practical and other difficulties involved in direct Federal regulation of the so-called over-the-counter markets, and, speaking through its commissioners and other officers, it has many times expressed the hope that organizations will be formed in the over-the-counter market which will regulate their members much as the exchanges do theirs, but in lieu of such regulatory organizations the Commission has no choice under the law but to proceed with direct Federal regulation. It would seem, therefore, that the over-the-counter dealers of the country are faced with the choice of either getting together and regulating themselves or being regulated directly by a centralized Federal administrative agency. Putting it another way, it would seem clear that to the extent which the over-the-counter business can effectively regulate itself it is likely to avoid Governmental regulation. When one realizes that direct Federal regulation necessarily entails official investigations, hearings, elaborate questionnaires, expensive administrative and court proceedings, all of which is usually accompanied by publicity which is harmful, not only to the individuals involved, but to the business generally; whereas, on the other hand, much of this trouble, expense, delay, uncertainty, and publicity could be avoided if the industry really regulated itself, the desirability of an attempt by the business to do a completely effective job of self-regulation would seem obvious.

It is the hope of the Conference, of course, that it can develop into an organization which can achieve effective self-regulation. This may not be possible under its present set-up, because, as constituted, it has

jurisdiction only over its members and its present membership does not represent more than 50% of the investment bankers and security dealers at present in the business. It is believed that the present membership of the Conference represents in large part the better element in the business, but it is the dealer on the fringe and the outright crook who most need education and regulation, and many such obviously are not members of the Conference. This means, of course, that so far as rules and regulations are concerned, the members of the Conference may be placed at a competitive disadvantage to the non-members, since they agree to practices and restrictions upon their activities to which non-members are not obliged to subscribe. The problem, therefore, of devising a scheme or method for achieving more complete self-regulation would seem to be one of either forcing everyone in the business to become a member, and thus subject to the rules of the Conference, or of making membership so attractive and profitable that everyone will be willing to submit to the rules for the practical or pecuniary benefits to be derived from membership.

Up to the present time a number of suggestions have been made to this end, and a brief of the substance of each suggestion follows:

(1) The suggestion which has probably been given most consideration is the one which was incorporated in the original permanent plan of organization for the Conference. This carried over into the Conference the registration features in effect under the Code, and the Code provision that registered members could participate in syndicates and allow dealers' concessions only to similarly registered members. The difficulty with this suggestion, of course, was, and is, that it might well give rise to expensive and troublesome litigation under the anti-trust laws, and so this suggestion was supplemented by one that the Exchange Act be amended to permit the registration with the Commission of organizations similar to the

Conference, under rules and regulations similar to those having to do with the registration of stock exchanges, and that an additional provision be added that such registered organizations be exempt from the prohibitions of the anti-trust laws so long as they were registered and in good standing with the Commission. The Commission looked upon, and still looks upon, this suggestion with interest, but to date the procurement of such amendments to the law, particularly the exemption of such organizations from the prohibitions of the anti-trust laws, have not been found to be politically possible.

(2) A suggestion has been made which is something of a variation of No. 1. This contemplates an amendment to the Exchange Act which would provide for the registration of such organizations as the Conference with the SEC, but without the restrictive dealing features of No. 1, and consequently without the exemptive provisions with respect to the anti-trust laws. It is the feeling of those who make this proposal that the Commission's rules affecting over-the-counter brokers and dealers might be carried over and made a part of the rules of such an organization and that the Commission might be induced to exempt members of such a registered organization from direct application of the Commission's rules, which would mean that only non-members of such an organization would be subjected to direct Federal regulation. The advantage, therefore, of being subject to the organization's administration and enforcement of the rules rather than to a Federal Governmental agency might well induce the large majority of brokers and dealers to become members and thus give the organization the opportunity to do the necessary regulating. This proposal, like No. 1, would, of course, involve an amendment to the existing laws.

(3) It has also been proposed that an amendment might be made to the Exchange Act, providing for the registration with the Commission of over-the-counter organizations, and that the Commission, under Section 17 of the

Exchange Act, might require exceedingly burdensome reports to be made by non-member brokers and dealers to the Commission, which reports, of course, would not be required of members in good standing of such registered organizations. A memorandum prepared by the sponsor of this proposal, setting it forth in some detail, is attached hereto as Exhibit A.

(4) Still another suggestion has been made, which does not involve an amendment to existing laws. This proposal is that stock exchange commissions be increased and that members of organizations such as the Conference be given a split in the commissions on all stock exchange business originating with them. The thought here, of course, is that such a split in commission would be a pecuniary inducement to dealers becoming members of the Conference - something for which they would be willing to subject themselves to regulation by the Conference.