8/24/39

MEMBERSHIP IN THE

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

(Registered under the Maloney Act)

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Owing to requests received for a history of the movement which led to the creation of the National Association of Securities Dealers, Inc., its background and the probable benefits it will confer on member houses engaged in the securities business, the following is offered.

The National Association of Securities Dealers (formerly the Investment Bankers Conference) is the first national organization to register under the so-called "Maloney Act" passed in 1938. Other organizations, national in membership, may also register. The Maloney Act grants to members of registered national organizations, such as the National Association of Securities Dealers, the power of self-regulation (under the supervision of the Securities and Exchange Commission) as a substitute for direct regulation by the Securities and Exchange Commission.

At the present time, the National Association of Securities Dealers has 1451 members, distributed over 44 States of the Union, and includes almost all of the major investment bankers and over-the-counter brokers and dealers. The Association has in hand ~~115~~ 248 applications for membership.

Members of the National Association of Securities Dealers will elect their own officers, write their own fair practice regulations and administer them, under supervision of the Securities and Exchange Commission.

Origin of Federal Regulation. (1933)

Those who have stated that Federal regulation was created by the Maloney Act of 1938 have done so from sheer ignorance.

Federal regulation was created (after the post-war panic of 1929) by the Securities Act of 1933, followed by the Securities Exchange Act of 1934. The latter Act established also the machinery of control, namely the Securities and Exchange Commission.

The Securities and Exchange Commission was in some instances "directed" to formulate regulations controlling the over-the-counter markets, and in other instances it was "authorized" to do so.

The powers granted were comprehensive in the matter of regulating the security business as a whole, and minute in the power to be exercised the Securities and Exchange Commission in the conduct of their business by individual securities dealers.

Violation of law and of regulations were to be punished in some instances by criminal action, and in others by suspending or canceling the right to engage in the securities business.

Attitude of Dealers. (Origin of the Demand for Regulation.)

There were not a few investment bankers and dealers who during the 1920-1929 period apparently felt that they had been responsible for, or had greatly contributed to, the economic advances our country was evidently making. Some few sincerely believed that the money which their customers and they were making was in no small measure attributable to the personal

foresight of the advisers.

Later they found that when they claimed responsibility for a flood-tide, they had to take the responsibility for the ebb, and the recession which followed left not a few of them wreckage on the beach.

Some leaders in our business in 1932, conscious of the public antagonism to the business, wisely took the view that whoever was at fault, the greater the difficulties the greater the demand that responsible men in the business should step forward to meet squarely the difficulties facing the securities business.

Origin of the Code.

In 1933, under the guidance of the Investment Bankers Association, in order to meet requirements of law, a lengthy series of conferences was held to draft a Code of Fair Practices. Some 700 investment bankers and dealers -- some members of the Investment Bankers Association, and many non-members -- were consulted in the course of the drafting, and the firm of Baker, Hostetler, Sidlo & Patterson acted as Counsel.

This Code in its final draft set forth in broad general language the rules of fair practice which had long prevailed amongst reputable houses and should continue to prevail in the business.

On the roll of the Code Committee and the Governing Committee of the Investment Bankers Conference can be found the names of such leaders in the investment and securities business as:-

B. Howell Griswold, Jr., of Baltimore, Chairman; Francis A. Bonner and Frank McNair, of Chicago; Arthur H. Bosworth and

Donald C. Bromfield, of Denver; Sydney P. Clark, of Philadelphia; E. F. Connely and Charles B. Crouse, of Detroit; Edward J. Costigan and John R. Longmire, of St. Louis; Sherman Ellsworth, of Seattle; Harry S. Grande, of Seattle; Edward H. Hilliard, of Louisville; Joseph T. Johnson, of Milwaukee; W. Hubert Kennedy and C. A. Ashmun, of Minneapolis; Lamartine V. Lamar, of New Orleans; Robert H. Moulton and Theodore Hammond, of Los Angeles; John A. Prescott, of Kansas City; Frank Weeden, of San Francisco; Daniel W. Myers, of Cleveland; Joseph M. Scribner, of Pittsburgh; A. W. Snyder, of Houston; Geo. S. Stevenson, of Hartford; Henry B. Tompkins, of Atlanta; Orrin G. Wood and A. P. Everts, of Boston; and Robert E. Christie, Jr., George W. Bovenizer, Lawrence H. Marks, Sidney J. Weinberg, Ralph T. Crane, Joseph R. Swan, George Whitney, Oscar J. Thoster Nevil Ford, Frank Dunne, and N. Penrose Hallowell, of New York City.

We believe that without exception all of the above list have approved the registration of the Investment Bankers Conference under the Maloney Act.

Origin of the Conference Plan.

When the N.R.A. (the Code Act) was declared un-Constitutional, the provisions of the Securities Act and the Securities Exchange Act became fully operative, and the Securities and Exchange Commission, with extensive powers granted under the Acts, stepped into action.

The Securities and Exchange Commission however first invited the dealers into conference, and the dealers in turn presented

their views with relation to the threatened danger to the capital issues market of over-regulation.

It was suggested that these conferences be made continuous and at the invitation of the Securities and Exchange Commission the Investment Bankers Conference Committee was created.

At the time it was informally understood, as stated by Chairman Landis, that if the conferences appeared to be of benefit to the public as well as of the investment business, all might look forward to the day of self-regulation under supervision -- the day when the originating, drafting and administering of fair practice regulations should be performed by the dealers themselves under supervision of the Securities and Exchange Commission.

The experiment did prove a success and both parties were apparently satisfied with the result. Under the conference arrangement fair practice rules had been drafted by the Securities and Exchange Commission and after conference with technical committees of the Conference Committee and members of the Governing Committee had been approved, modified or rejected.

It is only fair to our business and to the Securities and Exchange Commission to say that so far as the over-the-counter regulations are concerned, power was exercised with caution and it would be difficult today to find any important regulation approved by the Commission which does not have its counterpart in the Code of Fair Practices drafted by the investment bankers themselves in 1933.

It was but reasonable that the Securities and Exchange Commission, having observed the successful results of these conferences, should be willing to go forward with the plan for self-regulation. This resulted in the introduction of the Maloney Act, granting to the Securities and Exchange Commission and to the securities dealers the necessary authority for self-regulation.

It is difficult to conceive under these conditions how anyone with an honest mind can find any justification for the statement that the Maloney Act was an effort on the part of the Securities and Exchange Commission to greatly extend its legislative power over the securities business.

Maloney Act. (Analysed.)

The Maloney Act passed in 1938 authorized the organization of self-regulating associations. Organization and registration is purely voluntary.

Members of the National Association of Securities Dealers will elect their own officers, write their own fair practice regulations and administer them, under supervision of the Securities and Exchange Commission.

The Maloney Act was drafted by Senator Maloney in consultation with the Securities and Exchange Commission. The original draft of the proposed Bill was widely distributed among investment bankers and dealers throughout the country for their consideration and criticism. Hearings were held before Congressional committees, at which securities dealers were asked to be present and offer

criticisms and suggestions.

The Act was a pioneering job, a venture into new fields, and was therefore in its very nature susceptible of error. Criticism was offered in full measure and before the Maloney Act was passed some 57 amendments suggested by the Investment Bankers Conference were accepted and adopted. The Investment Bankers Association added a dozen more, many of fundamental import.

After the Maloney Act was passed not only the Investment Bankers Conference, but the Investment Bankers Association, gave full approval to the Act as finally passed, and engaged at once in a study of the best method of registering under the Maloney Act.

Drafting of Registration Plan.

A committee of ten was appointed by the Chairman of the Investment Bankers Conference. These men represented every section of the United States. They were in continuous conference for nearly 6 months.

They presented their viewpoint to the Securities and Exchange Commission as to the form of registration. Agreement as to many items were readily reached, and disagreement finally narrowed down to only two points. Here again, instead of the conferences ending in dispute, an understanding was reached with the Commission whereby these two points were submitted to the dealers throughout the country for an expression of opinion.

When the large majority of opinion supported the Investment Bankers Conference committee, the Commission accepted the expression of opinion from dealers and accepted the registration application in the form presented by the organization.

To state under these circumstances that the dealers of the United States have been forced by the Securities and Exchange Commission through the use of strong-armed and dictatorial methods to accept more controls and regulations is in direct conflict with the facts.

Fair Practice Rules.

A problem so complex, venturing into a new field and requiring many months of conference, is bound to be misunderstood by a few careless readers and misread by others.

It is our desire to correct a few of these minor errors.

Contrary to the views expressed in some quarters, fair practice regulations cannot be imposed upon the Association by the Securities and Exchange Commission.

The Association drafts its own regulations and enforces them.

The Securities and Exchange Commission under authority granted in 1934 by Congress can pass certain regulations governing the whole securities business and each house engaged in it. These regulations it is expected will more or less parallel those of the Association. The Association will administer its own regulations amongst its own membership, while the Commission will administer its regulations directly amongst those whom Senator Maloney has referred to as the "fringe", namely securities dealers non-members of an association. But the Commission has no authority to order the Association to adopt or enforce any rule whatsoever.

It has been stated also in the Press that the Commission is given not only the right to reverse any decision made by the new Association, but the power to "run" the Association and its members and prescribe

their method of doing business.

The Commission has no such grant of power over the Association and asserts no such power. On the contrary, its power of "control" is limited to review of any disciplinary action taken by the Association against a member for violation of regulations. After such review, the Commission may reduce but cannot increase the penalty.

The Association furthermore elects its own directors and officers and the Commission has no power whatever over their choice, provided the method of selection provided for in the by-laws is fair. The method adopted by our Association has already been approved by the Commission.

The Commission may supervise rules for admission to and expulsion from the Association. True and right. Under the Federal law no one can engage in the securities business unless registered by the Securities and Exchange Commission, and the Commission has the power to refuse registration. If the power were taken from the Commission and granted to the Association, then an Association might well be used as a back door for registration in violation of law. All securities dealers admitted to registration by the Commission are eligible for membership in our Association. That is quite right. They can join or not, as they see fit. If they elect to become members of the Association they must obey "fair practices" of the Association; if they do not so elect, they will be regulated by the Securities and Exchange Commission.

Some criticism has been made of the "unreasonable profits" regulation in the Fair Practice Regulations of our Association. The "Code" aponsored by the Investment Bankers Association and the

"Rules of Fair Practice" adopted by the Investment Bankers Conference had long contained an "unreasonable profit" provision. What is a "fair profit" in a crowded financial section may be altogether too low for a living base in, say, a rural section. What is a reasonable profit in a sparsely settled territory may be robbery in New York.

The National Association of Securities Dealers has the authority and will permit (within proper limitations) the District Committees to determine such questions equitably.

Here again any penalty imposed by the Association can be reduced but not increased by the Securities and Exchange Commission.

The Government of course can withdraw the registration of the Association for what is regarded an unreasonable attitude. Per contra, the Association may itself resign its registration at any time if the actions of the Securities and Exchange Commission appear to it unreasonable.

We repeat, there is nothing now in the "Fair Practice" rules of the National Association of Securities Dealers that has not been the general custom of every house of integrity in the country for years past.

Furthermore, new rules and regulations can only be passed with the approval of a majority of the membership. (See Sec. of )

One proposed regulation is still under discussion, a regulation by the Act of _____ very difficult to phrase, namely a regulation which is briefly described as "price-fixing manipulation." The Association is now endeavoring to write along broad lines a regulation which will prevent fraudulent deception of investors and not interfere with legitimate market action.

Advantages of Self-Regulation.

The advantages of self-regulation are numerous. Direct Government regulation by statute should be confined to criminal or immoral acts -- acts that are crooked per se and generally recognized as such.

Self-regulation in fair practices proceeds by way of evolutionary process in education, slow advancement of standards by vote, based on experience and daily contacts with the problems of different sections before you, and with a clear intent to define and deal with unfair or what might be called unmoral acts.

Statutory regulation when aimed at these "unmoral" acts will almost always miss its objective.

Statutory penalties, often unenforceable against the crooked offender, too often create uncertainties and fears in the minds of the vast number of honest men. They greatly interfere with business and at the same time miss their aim at the crook, who escapes through the meshes of precise legal definition. Self-regulation may well prove more effective in this field.

Federal regulation and control of the over-the-counter market in all States of the Union is obviously difficult to plan and much more difficult to execute.

If this be true, and honest intent is proven, our business may wisely move onward to a more careful examination of the Securities Act and the Securities Exchange Act. Are they wise in all particulars? Have the increased fears, uncertainties and costs provided for in these laws interfered with the recovery of the capital issues market, so essential to the solution of

our unemployment problem?

Surely no one can believe that laws passed in the pioneering days of Federal regulation could possibly have proven to be 100% perfect. With the establishment of a self-regulating body, Government may well proceed to substitute, under self-regulation, broader and fairer definitions of "fair practice" which will remove the fears of decent dealers and offer under broader definitions an opportunity to expel from the business a proven crook who has heretofore crawled through the meshes of statutory technicalities.

Customs in the securities business differ widely in different sections of the United States, profits vary in different sections, the branches of the business are manifold, and an understanding of the ramifications requires broad experience and technical knowledge. Regulations designed to control larger houses, for example, may in the end destroy the smaller ones; a net spread to catch crooks may be a menace to honest dealers and at the same time offer an opportunity for the crook to crawl through the meshes of the law.

A public charge conscientiously emanating from Washington against an honorable house may well destroy that house before the evidence of innocence can be presented. Even a final acquittal seldom catches up in the public press with an indictment. The credit of the house may be ruined.

The violation of "fair practices" is quite frequently no violation of criminal laws. In most instances, violations of what seem to be fair practices are in no sense of a criminal

nature. They may occur through ignorance, or error on the part of an employee, and proper adjustment should be made.

In such instances it is clear that a voluntary association should through its District Committee call upon the supposed offender and give him full opportunity for explanation and an explanation may end the whole matter.

If the reaction is more serious and a charge is levied against a dealer, the charge if due to error or ignorance will in all likelihood be heard privately by a District Committee of security dealers familiar with the habits and customs of dealers in that locality.

Violations of Federal regulations have a smell of the criminal courts and of criminal intent. They suggest indictment, hearings and publicity of violations of the criminal law.

District Committees - Complaints of Violations.

District Committees (as they are now to be called) will serve an even more important function than they served in the I.B.C. It is these committees to which investors may make complaints against members, or one member against another. These complaints will be considered when they indicate violations of the Fair Practice Rules of the Association. The new organization is in no sense a police spying organization for the enforcement of criminal codes. The enforcement of criminal law belongs to the Federal and State courts and to them through the Securities and Exchange Commission.

It is more accurate to consider the District Committees in the nature of traffic officers, whose purpose is to keep the traffic moving, and whose very existence is a warning against violation of fair traffic rules. A violator is cautioned, warned by traffic officers, and if he is a continuous violator or does

some injury to another by a careless or ignorant violation, a hearing will be held by the District Committee to determine the rights, wrongs and penalties in the matter.

Reason why "Commissions" are allowed only between members of an organization which has pledged its members to abide by fair practice rules.

Another provision in the Maloney Act has been subjected to some misunderstanding. It is true that a registered Association may adopt a regulation by which customary dealer commissions will be allowed only between members of the same national association.

Brokers and dealers who are not members of the Association may be treated as if they were part of the general public and securities sold may be sold to them without the allowance of such a commission.

The reason for this is that the Association has its ethical rules by which every member agrees to be bound. Such pledged members may well be put to a disadvantage in competing with dealers who refuse so to be bound. As every dealer may become a member of the Association, a promise to abide by the rules and obtain the benefits of the Association is a reasonable request.

Voting in the new Association.

Following the earlier New York Stock Exchange rules of voting, the Investment Bankers Conference rules provided that changes in charter, by-laws and fair practice regulations were to be published and sent to all members, and if not voted down by a majority they automatically went into effect.