BAKER, HOSTETLER, SIDLO & PATTERSON

Union Trust Building

Cleveland

June 13, 1935

Honorable Joseph Kennedy, Chairman,
Securities and Exchange Commission,
Washington, D. C.

Dear Mr. Kennedy:

You and Commissioner Landis were so generous with your time on Friday morning when I was with you, that I feel guilty in imposing further upon you. However, I have a hunch that one of these days someone, somewhere, will be trying to figure out the most effective way in which a regulation of over-the-counter securities business can be had, and at that time I do not want them to overlook what we have tried to do in the last year and what I think should be continued. I have therefore dictated a memorandum which I am enclosing. It is longer than it need be, so far as you are concerned, because you understand what this is all about, but I would like it to be where it can be examined by others who may not be so well informed as to what we have been doing under the Code during the past year.

Cordially yours,

Jos. C. Hostetler

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON

June 19, 1935

Office of the Chairman

Mr. Jos. C. Hostetler,
Baker, Hostetler, Sidlo & Patterson,
Union Trust Building,
Cleveland, Ohio.

Dear Mr. Hostetler:

I beg to acknowledge with thanks your letter of June 13th and its accompanying memorandum. As you are undoubtedly aware, a skeleton organization of the Investment Bankers Code Committee is being kept together in the hope that something can be worked out to preserve the good things the Investment Bankers Code initiated.

I have taken the liberty of turning your memorandum over to Mr. Landis for his perusal. He is, I am informed, in touch with Mr. Wilbur on this general subject.

Faithfully yours,

(Signed) Joseph P. Kennedy

Joseph P. Kennedy,
Chairman

6-13-35

MEMORANDUM RELATIVE TO REGISTRATION OF INVESTMENT BANKERS

In the spring of 1934 the Rules of Fair Trade Practice, proposed by the Investment Bankers under the terms of the Code theretofore filed by them, were approved by the President under the provisions of the National Industrial Recovery Act.

When this Code was presented for approval by the President, it contained provisions for the registration of such investment bankers who were willing to agree with each other that they would be bound by the Code in its spirit rather than according to the letter. In other words, that they would obey the Code as construed by the Code Committee and in the light of the purposes for which it was written, rather than as it might be technically construed in a Criminal Court.

In order to make registration worth while and for the purpose of giving the Code Committee sufficient power to make the enforcement of the Code practically successful, we included a covenant between all registered investment bankers that they would not participate in underwritings with, nor allow dealer's discounts to unregistered investment bankers.

In presenting our Code and discussing the provisions of registration, we represented that if we were allowed the opportunity to enforce the code by the methods provided, we would undertake, to the best of our ability, to set up effective machinery by which complaints against registered investment bankers could be investigated and determined speedily and with no cost to the person making the complaint.

The industry was given the power and at great cost has been at work setting up the machinery with which to operate. I feel sure that the Code Committee may confidently invite attention to the result of the

first year's operation. It is true that perfection has not been attained. Some of the more intricate rules still need amendment, and many of them need clarification. All in all, however, it is true to say that no complaint, involving the honesty or fair dealing of an investment banker, has been made without prompt investigation and effective action.

I believe that it can be truthfully said that the Code Committee within the year has done more in a practical way to set high standards for this business, than has ever been done by any outside regulation, no matter how drastic. It would be difficult to prove this statement because much of the good that has been done is not yet apparent to casual observation. We thought that it was wise at the start to make registration available to every person engaged in the business and with no qualifying standards. Naturally, we were hopeful that if our efforts were conscientious, intelligent and reasonably effective, we would be given the opportunity to carry on and to try to demonstrate that the business within itself could properly protect the investing public.

Viewed dispassionately, the motive behind all of this was, to a degree, selfish. Rigorous enforcement of a code of fair dealing would in time be so recognized by the public that great good in a business way would result to those who had submitted to the regulation. The wisdom of this sort of regulation, as compared with public statutes, is easily seen. A statute passed even by the Congress must be so drawn as to be enforceable at the Court House. In order to do this the tendency is constantly to make the statute more drastic than it need be if it could have a practical and non-technical enforcement.

All that Congress and the President had from the investment bankers at the time of the passage of the Securities Exchange Act, was words. The Act empowered the Commission, created for its enforcement, to regulate certain

of the transactions of investment bankers. Insofar as the Commission undertakes the regulation of transactions in unlisted securities "over-the-counter," it is undertaking a task which is very difficult of performance. The practices in the security business vary in different parts of the United States. Seldom are any two transactions exactly comparable. Ordinarily, the details of each transaction, whether between investment bankers or between an investment banker and a customer, are conducted orally. For all of these reasons it seems clear to me that there is wisdom in our suggestion that the Securities and Exchange Commission allow us, under its supervision, to continue the work of regulating this business.

I realize that the present is a difficult time in which to advance the claims of any particular segment of American business for consideration. The truth is, however, that while the investment business is not to any degree spectacular, it is at the moment one of the most important from the standpoint of business revival.

Registered investment bankers did agree that in certain regards they would deal only with other registered bankers. To the extent that this constituted a violation of either the Sherman or the Clayton Act, it is submitted that such violation was only technical. The purpose of the restrictive agreement was in no wise to lessen competition or to control prices of securities to the public, but was solely for the purpose of effectively enforcing certain principles of fair dealing as to which all of the contracting parties had agreed, and which were at all times subject to the approval of governmental agencies. If Congress were to be asked, therefore, to pass legislation authorizing the formation of associations among persons in the investment banking field, and authorizing such persons to restrict their dealings with each other, there would not be involved any general

abridgment of the anti-trust laws. The Congress could protect the right of any person in the investment banking business to retain his registration and all the benefits accruing from it, until the act of the committee had been finally approved, either by the Securities and Exchange Commission and/or the United States Courts. It could be clearly provided that the rules of the association could only become effective upon the approval of the Commission and that they should cease to be effective within a given time after the Commission so ordered. In other words, this business is not asking to be relieved generally from the burden of complying with any law of the United States. It is merely asking that each person registering be allowed to restrict his dealings with other persons similarly registered, and therefore obligated to conform to the same ethical rules as himself.

This registration would not in the slightest degree interfere with the promulgation and enforcement of rules by the Commission. We would want the rules of registration to, in the first instance, be approved by the registrants. We would want the registrant to have the right to withdraw from registration if he wished. We would want the registrant to be bound contractually to the spirit of the rule construed in the light of the purpose to be accomplished, rather than technically; but all of this, so far as the registrant is concerned or so far as the Government is concerned, would be a matter of contract.

The investment bankers are willing that the decision of the Commission, insofar as it disciplines or deprives registrants of their registration, shall be reviewable, if they desire, before the Commission and/or the Courts. In other words, they are willing that the right of any honorable investment banker to remain registered shall be fully protected and that his right to retain this status shall depend upon only one thing, and that is his faithfully abiding by the rules.

I am confident that this idea of self-regulation in this particular business is sound. I am certain that it cannot be done effectively upon any other basis than we are proposing. Being confident of these two facts, I urge the consideration of the plan as soon as it is deemed practically possible.

Jos. C. Hostetler