

INVESTMENT BANKERS ASSOCIATION OF AMERICA

- President -

Francis E. Frothingham Boston

OFFICE OF THE PRESIDENT

60 State Street

Boston

New York, N. Y.  
February 1, 1938.

Memorandum to  
GOVERNORS, OFFICERS AND GROUP CHAIRMEN:

At the meeting of the Board of Governors of the Investment Bankers Association just held at Absecon, N. J., you will recall that there was a prolonged discussion of the Bill S.3255, copies of which are being sent to you under separate cover, an act "to provide for the establishment of a mechanism of regulation among over-the-counter brokers and dealers", etc., commonly thought of as a Bill providing for self-regulation. A report was made to the meeting by the following Special Committee that had been appointed by the President of this Association to give the Bill preliminary consideration. That Committee having reported was then discharged.

SPECIAL COMMITTEE

John K. Starkweather, Chairman,  
Starkweather & Co.,  
New York, N. Y.

T. Weller Kimball  
Glore, Forgan & Co.,  
Chicago, Ill.

Albert T. Armitage  
Coffin & Burr, Inc.,  
Boston, Mass.

John C. Montgomery  
First Boston Corporation,  
New York, N. Y.

F. Malbourne Blodget  
Spencer Trask & Co.,  
New York, N. Y.

Francis F. Patton  
A. G. Becker & Co.,  
Chicago, Ill.

Robert Dillon  
Dean Witter & Co.,  
New York, N. Y.

Joseph M. Scribner  
Singer, Dean & Scribner,  
Pittsburgh, Pa.

N. Penrose Hallowell  
Lee Higginson Corporation  
New York, N. Y.

Albert R. Thayer  
Thayer, Baker & Co.,  
Philadelphia, Pa.

John D. Harrison  
Lazard Freres & Co.  
New York, N. Y.

Max O. Whiting  
Whiting, Weeks & Knowles, Inc.  
Boston, Mass.

The report was as follows:

To the Board of Governors:

The Special Committee on Federal Unlisted Trading Legislation has held two meetings in New York to consider the preliminary draft prepared by the S. E. C. and the Bill presented in the Senate by Senator Maloney of Connecticut. The Chairman has also conferred in Washington with Senator Maloney and William O. Douglas, of the S. E. C. Our conclusions, in which the undersigned members of the Committee present in New York on January 18, 1938, are unanimous, are as follows:

We believe that the principle of self-regulation in the unlisted markets is a desirable one and in line with the thought and efforts of many of our members for several years past.

The Bill under consideration was presented to Congress without sufficient time for careful consideration by the I. B. A. which it should have had, and against our strong protest. As written, it lacks the essential elements of self-regulation in that the S. E. C. have power to alter rules and make new rules without the consent of the business, and to define rules for the selection of officers and to remove officers, also without such consent, and in other ways.

It also carries the danger of becoming a heavy burden on such elements of the business as are least in need of regulation for the policing of a small minority through placing the cost of the organization entirely

on the shoulders of its members. In other words, it places on our shoulders heavy cost for carrying out certain provisions of the Securities Act which it would normally be the duty of the Government to assume.

It outlines a program which, in the discretion of the S. E. C., might become and probably will become highly complex and widespread in its activities and its effects, with no limitation on cost or expense.

It is the opinion of the Committee that the I. B. A. should inform the Senate and the S. E. C. that, while we approve the general principle of self-regulation, we cannot approve the Bill as now written unless amendments are added or changes made which will:

(1) Limit the power of the S. E. C. to alter or impose rules without the approval of the registered Association;

(2) Limit specifically the amounts which shall be assessed against the business to such sums as the Association in its own discretion decides can be raised without undue burden on the business, and

(3) Limit in some reasonable degree the extent of the activities to be undertaken. With these general limitations we are in accord with the underlying principles of the Bill.

We recommend that, in the event the Board of Governors approve the foregoing, the Bill be immediately turned over to the attorneys for the Association for their careful consideration on these points and minor technicalities on which the Committee is not prepared to pass, and that steps be taken at once to present our view formally to the Senate and the S. E. C.

Respectfully submitted,

Special Committee on  
Unlisted Trading Legislation

This report was signed by all members of the Committee except Mr. Scribner who presented a dissenting statement favoring acceptance of the Bill.

Thirty-one of the thirty-eight Governors and Officers were present, also twelve Committee Chairmen and past presidents. Widely scattered territories were represented. After extended discussion the following resolution was unanimously adopted. It was promptly reported to Senator Francis T. Maloney of Connecticut, sponsor of the Bill, and to William O. Douglas, Chairman of the S. E. C.

#### RESOLUTION

The Board of Governors of the Investment Bankers Association of America at its meeting at Absecon, N.J., Jan. 21 and 22, 1938, gave extended consideration to the Bill introduced on Jan. 17, last, by Senator Francis T. Maloney of Connecticut to provide for the establishment of a mechanism of regulation among over-the-counter brokers and dealers.

After discussion, the Board authorized the appointment of a Special Committee to confer with Senator Maloney and his sub-committee, with the Securities and Exchange Commission, and with other organizations, and to cooperate in an endeavor to find a workable method of regulating over-the-counter transactions.

The Board of Governors registered its approval of the principle of regulation among over-the-counter brokers and dealers, but it was the opinion of the Board that in order to provide effective regulation, the present Bill as introduced requires modification.

This Committee will make a report to the Board of Governors after the above-mentioned conferences.

#### COMMITTEE

John K. Starkweather, Chairman  
Starkweather & Co.  
New York, N. Y.

James J. Minot, Jr.  
Jackson & Curtis  
Boston, Mass.

Perry E. Hall  
Morgan, Stanley & Co., Inc.  
New York, N. Y.

Devereux C. Josephs  
Graham, Parsons & Co.  
Philadelphia, Pa.

Edward B. Hall  
Harris, Hall & Co.  
Chicago, Ill

Jean C. Witter  
Dean Witter & Co.  
San Francisco, Calif.

F. E. Frothingham, ex-officio  
Coffin & Burr, Inc.  
Boston, Mass.

This Committee, having been advised by the Commission that the opening of hearings on the Bill had been set for Tuesday, February 1, and that Senator Maloney and some of the Commissioners would be glad to confer with the Committee on the morning of Thursday, the 27th, in Washington, a special meeting of the Committee was called for Tuesday afternoon, January 25th. At this meeting, Messrs. Starkweather, Minot, Josephs, Hall and Frothingham were present. The same members of the Committee conferred with Senator Maloney, Commissioner Mathews of the S. E. C., and Mr. Davis and Mr. Katz of the Commission's staff during the entire morning of January 27th.

Mr. Starkweather stated the feeling of the Committee, expressing the belief that it was also the viewpoint of the recent meeting of the Board of Governors. He pointed out that the I. B. A. was in fullest sympathy, and always had been, with the principle of self-regulation, and was not only ready but anxious to cooperate to that end. The Committee, however, felt that the Bill as written did not in fact provide for self-regulation, but rather gave to the S. E. C. such powers of supervision, of control over the organization and executive officers of any voluntary association formed under the Bill as to deprive it of real self-regulation, reducing it to little more than an agency of the S. E. C. operating under its instructions. If this were true, Mr. Starkweather pointed out that the Committee doubted if the plan would be accepted by the investment banking industry. He presented the committee's idea of what would be a genuinely self-regulatory Bill that would be considered workable by brokers and dealers, — calling attention to the fact, nevertheless, that progress in self-regulation would of necessity be slow

at first, and that costs of administration would be indeterminate and probably heavy, -- as involving the elimination from the Bill of Section (k) (2) on Page 15; also as providing for some reasonable qualifications for membership, in order to insure responsibility of membership, such, for instance, as a moderate capital requirement, experience in the business, permanence of residence; and finally the S. E. C. to have only the right to veto rules or regulations, and to dissolve the Voluntary Association if, in the judgment of the Commission, the Association was not functioning adequately or properly. This, it was pointed out, would be true self-regulation whereas the Bill as introduced, contemplated quite a different thing. The gentlemen before whom the Committee appeared, discussed the aspects and implications of the Bill as written and the suggestions of the Committee with the utmost goodwill and cordialty, in an effort to explore the subject exhaustively. Everyone present took part in the discussion. It was, however, apparent that though Commissioner Mathews might be disposed to meet the Committee on minor points, he expressed himself as unwilling to abandon the basic principle around which the Bill was built, i.e., that of complete regulatory control of the Voluntary Associations, as to their constitutions and by-laws, their executive personnel, the orders they might promulgate, the discipline to be meted out to members. This difference in point of view is, of course, fundamental, and goes to the core of the whole proposition of self-regulation.

It should be pointed out that the Investment Bankers Conference has also been giving its time and attention to these matters, and that we have been in close contact with it. The "Conference" has also had meetings with the S. E. C. in Washington, and on the afternoon of January 27th, a Special Committee appointed by it had also a conference at Senator Maloney's office. The ideas of the two groups apparently run along similar lines.

We have just learned that the S. E. C. now plans to present, at the hearing before the Senate Committee on Banking and Currency, a Bill in two interdependent parts. Part One is the Bill as previously introduced with the omission of items (5) to (13) inclusive of section (k) (2); while Part Two substitutes for these omitted items an amendment to section 15(c) of the Securities and Exchange Act of 1934 including and extending the powers enumerated in the omitted items, as direct powers of the S. E. C. applying to all the business, including both those who are members and those who are non-members of any registered voluntary associations, without power of the Commission apparently to direct the Voluntary Associations to enforce regulations directly issued by the Commission. As submitted to us the form of Part Two includes the following.

Section 2, Subsection C of Section 15 of the Securities Act of 1934 amended to read as follows:

C. No broker or dealer shall make use of the mail or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of any security (other than commercial paper, bankers acceptances, or commercial bills), otherwise than on a National Securities Exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

1. To prevent fraudulent or manipulative acts or practices;
2. To prevent fictitious quotations;
3. To provide safeguards against unreasonable profits or unreasonable rates of commission or other charges; provided that nothing herein shall authorize the imposition of any schedule of prices, discounts, commission, allowances or other charges;
4. To provide safeguards against unfair discrimination between customers or issuers or brokers and dealers;
5. To provide safeguards in respect to the financial responsibility of brokers and dealers and against the evasion of financial responsibility through the use of corporate forms, special partnerships or other devices;

6. To regulate the manner, method and place of soliciting business;
7. To regulate the time and method of making settlements, payments or deliveries;
8. To provide for the collection, recording and dissemination of information relating to the over-the-counter markets;
9. Otherwise to prevent acts or practices inconsistent with just and equitable principles of trade and to insure to investors protection comparable to that provided under this title in the case of national securities exchanges.

I have just wired the Commission, in behalf of the Special Committee, saying that while we feel the eliminations proposed in the Bill are all to the good and make the Bill one under which we believe the industry would endeavor to form and administer a self-regulatory association, we feel that the implications of Part Two as proposed are so newly before us as a direct regulatory measure and may have such a serious effect on self-regulation that there has been altogether inadequate opportunity to weigh its provisions, and for that reason we would like opportunity to consider it further and at a later date present any suggestions, modifications or objections to this part of the Bill that may seem appropriate.

Our Association cannot be unmindful of the gravity of its responsibilities in these matters. The issue is not single to those engaged in over-the-counter trading, but involves as well a relation to the government on the part of activities generally, which means that our thought of the subject must be thoroughly objective and genuinely concerned with what we conceive to be a principle in itself sound, and so ultimately most likely to operate in the public interest, as well as in the specific case, in the interest of investors. These are the issues involved and should guide our thought. The Investment Bankers Association must accept responsibility for the position it finally takes in the matter.

The resolution of the Governors, above quoted, calls for a report back to the Board of Governors. In view of the unexpectedly early date set

for the hearing, the Special Committee has thought it well that the President of the Association send this communication at once to each Governor and Officer of the Association, and to each Group Chairman, so that the Bill may be studied and the matter fully discussed, to the end that carefully considered replies be sent at the earliest date to the Chairman of the Committee, Mr. Starkweather (with copies to the Executive Vice President and to the President). Unfortunately very few in the industry have yet had an opportunity to see and study the Bill. The further steps taken by this Special Committee will be taken in the light of the replies received. The need for haste is as initially stated, that the hearings begin on February 1, and we should desire to be responsive without unnecessary delay. We feel that the Investment Bankers Association should take an official position in the matter, but this thought should not in any way limit individual members of the Association from making any appearance before the Committee for the expression of independent views.

Finally, it is perhaps a fair statement to make, that this Bill reaches to the very heart of our business. No one can be more anxious than we to aid in the recovery of the capital markets, on the highest basis of sound ethics and business probity.

FRANCIS E. FROTHINGHAM

President

Investment Bankers Association of America.

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