

**REGULATION OF OVER-THE-COUNTER
MARKETS**

HEARINGS

BEFORE THE

**COMMITTEE ON BANKING AND CURRENCY
UNITED STATES SENATE**

SEVENTY-FIFTH CONGRESS

THIRD SESSION

ON

S. 3255

A BILL TO PROVIDE FOR THE ESTABLISHMENT OF A
MECHANISM OF REGULATION AMONG OVER-THE-COUNTER
BROKERS AND DEALERS OPERATING IN INTERSTATE
AND FOREIGN COMMERCE OR THROUGH THE MAILS,
COMPARABLE TO THAT PROVIDED BY NATIONAL SECURI-
TIES EXCHANGES UNDER THE SECURITIES EXCHANGE
ACT OF 1934, AND FOR OTHER PURPOSES

FEBRUARY 1, 2, 8, AND 9, 1938

Printed for the use of the Committee on Banking and Currency



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REGULATION OF OVER-THE-COUNTER MARKETS

TUESDAY, FEBRUARY 1, 1938

UNITED STATES SENATE,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D. C.

The committee met at 10:30 a. m. in the committee room of the Senate Committee on Banking and Currency, Senate Office Building, Senator Robert F. Wagner (chairman), presiding.

Present: Senators Wagner (chairman), Adams, Maloney, Radcliffe, Brown of Michigan, Hitchcock, Hughes, Herring, Smathers, and Townsend.

Present also: George C. Mathews, Commissioner, Securities and Exchange Commission; Milton Katz, Special Counsel, Securities and Exchange Commission; and Sherlock Davis, Assistant Director, Trading and Exchange Division, Securities and Exchange Commission.

The CHAIRMAN. The committee will be in order.

Gentlemen, this meeting today is to begin the hearings upon a bill S. 3255, introduced by Senator Maloney. A copy of the bill is to be included in the record at this point.

(The bill, S. 3255, is as follows:)

[Committee Print showing certain proposed amendments, February 1, 1938]

[S. 3255, 75th Cong., 3d sess.]

[Omit the part in black brackets and insert the part printed in italic]

A BILL To provide for the establishment of a mechanism of regulation among over-the-counter brokers and dealers operating in interstate and foreign commerce or through the mails, comparable to that provided by national securities exchanges under the Securities Exchange Act of 1934, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Securities Exchange Act of 1934, as amended, is amended by inserting after section 15 thereof the following new section:

"Sec. 15A. (a) Any association of brokers or dealers may be registered with the Commission as a national securities association pursuant to subsection (b), or as an affiliated securities association pursuant to subsection (d), under the terms and conditions hereinafter provided in this section, by filing with the Commission a registration statement in such form as the Commission may prescribe, setting forth the information, and accompanied by the documents, below specified:

"(1) Such data as to its organization, membership, and rules of procedure, and such other information as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors; and

"(2) Copies of its constitution, charter, or articles of incorporation or association, with all amendments thereto, and of its existing bylaws, [or] and of any rules or instruments corresponding to the foregoing, whatever the name, hereinafter in this title collectively referred to as the 'rules of the association.'

Such registration shall not be construed as a waiver by such association or any member thereof of any constitutional right or of any right to contest the validity of any rule or regulation of the Commission under this title.

"(b) An applicant association shall not be registered as a national securities association unless it appears to the Commission that—

"(1) by reason of the number of its members, the scope of their transactions, and the geographical distribution of its members such association will be able to comply with the provisions of this title and the rules and regulations thereunder and to carry out the purposes of this section;

"(2) such association is so organized and is of such a character as to be able to comply with the provisions of this title and the rules and regulations thereunder, and to carry out the purposes of this section;

"(3) the rules of the association provide that any broker or dealer who makes use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security otherwise than on a national securities exchange, may become a member of such association, except such as are excluded pursuant to paragraph (1) of this subsection: *Provided*, That the rules of the association may restrict membership in such association on such specified geographical basis, or on such specified basis relating to the type of business done by its members, or on such other specified and appropriate basis, as appears to the Commission to be necessary or appropriate in the public interest or for the protection of investors and to carry out the purpose of this section;

"(4) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no broker or dealer shall be admitted to or continued in membership in such association, if (1) such broker or dealer, whether prior or subsequent to becoming such, or (2) any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), or any person directly or indirectly controlling or controlled by such broker or dealer, whether prior or subsequent to becoming such, (A) has been and is suspended or expelled from a registered securities association (whether national or affiliated) or from a national securities exchange, for violation of any rule of such association or exchange which prohibits any act or transaction constituting conduct inconsistent with just and equitable principles of trade, or requires any act the omission of which constitutes conduct inconsistent with just and equitable principles of trade, or (B) is subject to an order of the Commission denying or revoking his registration pursuant to section 15 of this title, or expelling or suspending him from membership in a registered securities association or a national securities exchange, or (C) is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security];

"(5) the rules of the association assure a fair representation of [the membership] its members in the adoption of any rule of the association or amendment thereto, the selection of its officers and directors, and in all other phases of the administration of its affairs;

"(6) the rules of the association provide for the equitable allocation of dues among [the membership] its members, to defray reasonable expenses of administration;

"(7) the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market and are not designed to promote monopoly, to require or permit unfair discrimination between customers, or issuers, or brokers or dealers, nor to fix minimum profits or minimum rates of commission or other charges;

"(8) the rules of the association provide that its members shall be appropriately disciplined, by expulsion, suspension, fine, censure, or any other fitting penalty, for any violation of its rules;

"(9) the rules of the association provide a fair and orderly procedure with respect to the disciplining of members and the denial of membership to any broker or dealer seeking membership therein. In any proceeding to determine whether any member shall be disciplined, such rules shall require that specific charges be brought; that such member shall be notified of, and be given an opportunity to defend against, such charges; that a record shall be kept; and that the determination shall include (A) a statement setting forth any act or practice in which such member may be found to have engaged,

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or which such member may be found to have omitted, (B) a statement setting forth the specific rule or rules of the association of which any such act or practice, or omission to act, is deemed to be in violation, (C) a statement whether the acts or [practices] practices prohibited by such rule or rules, or the omission of an act required thereby, are deemed to constitute conduct inconsistent with just and equitable principles of trade, and (D) a statement setting forth the penalty imposed. In any proceeding to determine whether a broker or dealer shall be denied membership, such rules shall provide that the broker or dealer shall be notified of, and be given an opportunity to be heard upon, the specific grounds for denial which are under consideration; that a record shall be kept; and that the determination shall set forth the specific grounds upon which the denial is based; and

(10) the requirements of subsection (c), insofar as these may be applica- ble, are satisfied.

(c) The Commission may permit or require the rules of an association applying for registration pursuant to subsection (b), to provide for the admission of an association registered as an affiliated securities association pursuant to subsection (d), to participation in said applicant association as an affiliate thereof, under terms permitting such powers and responsibilities to such affiliate, and under such other appropriate terms and conditions, as may be provided by the rules of said applicant association, if such rules appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors and to carry out the purposes of this section. The duties and powers of the Commission with respect to any national securities association or any affiliated securities association shall in no way be limited by reason of any such affiliation.

(d) An applicant association shall not be registered as an affiliated securities association unless it appears to the Commission that—

(1) such association, notwithstanding that it does not satisfy the require- ments set forth in paragraph (1) of subsection (b), will, forthwith upon the registration thereof, be admitted to affiliation with an association registered as a national securities association pursuant to said subsection (b), in the manner and under the terms and conditions provided by the rules of said national securities association in accordance with subsection (c); and

(2) such association and its rules satisfy the requirements set forth in paragraphs (2) to (9), inclusive, of subsection (b); except that in the case of any such association any restrictions upon membership therein of the type authorized by paragraph (3) of subsection (b) shall not be less stringent than in the case of the national securities association with which such association is to be affiliated.

(e) Upon the filing of an application for registration pursuant to subsection (b) or subsection (d), the Commission shall by order grant such registration if the requirements of this section are met. If, after appropriate notice and opportunity for hearing, it appears to the Commission that any requirement of this section is not satisfied, the Commission shall by order deny such registration. If any association granted registration as an affiliated securities association pursuant to subsection (d) shall fail to be admitted promptly thereafter to affiliation with a reg- istered national securities association, the Commission shall revoke the registra- tion of such affiliated securities association.

(f) A registered securities association (whether national or affiliated) may, upon such reasonable notice and upon such terms and conditions relating to orderly liquidation as the Commission may deem necessary in the public interest or for the protection of investors, withdraw from registration by filing with the Commis- sion a written notice of withdrawal in such form as the Commission may by rules and regulations prescribe. Upon the withdrawal of a national securities associa- tion from registration, the registration of any association affiliated therewith shall automatically terminate.

(g) If any registered securities association (whether national or affiliated) shall take any disciplinary action against any member thereof, or shall deny admission to any broker or dealer seeking membership therein, such action shall be subject to review by the Commission, on its own motion, or upon application by any person aggrieved thereby filed within sixty days after such action has been taken or within such longer period as the Commission may determine. Application to the Com- mission for review, or the institution of review by the Commission on its own motion, shall not operate as a stay of such action, unless the Commission shall so order.

(h) (1) In a proceeding to review disciplinary action taken by a registered securities association against a member thereof, if the Commission, after appro-

private notice and opportunity for hearing, upon consideration of the record before the association and such other evidence as it may deem relevant, shall (A) find that such member has engaged in such acts or practices, or has omitted such act, as the association has found him to have engaged in or omitted, and (B) shall determine that such acts or practices, or omission to act, are in violation of such rules of the association as have been designated in the determination of the association, the Commission shall by order dismiss the proceeding, unless it appears to the Commission that such action should be modified in accordance with paragraph (2) of this subsection. The Commission shall likewise determine whether the acts or practices prohibited, or the omission of any act required, by any such rule constitute conduct inconsistent with just and equitable principles of trade, and shall so declare. If it appears to the Commission that the evidence does not warrant the finding required in clause (A), or if the Commission shall determine that such acts or practices as are found to have been engaged in are not prohibited by the designated rule or rules of the association, or that such act as is found to have been omitted is not required by such designated rule or rules, the Commission shall by order set aside the action of the association.

"(2) If, after appropriate notice and opportunity for hearing, the Commission finds that any penalty imposed upon a member is excessive or oppressive, having due regard to the public interest [and the established practice of such association and of other registered securities associations with respect to penalties], the Commission shall by order cancel, reduce, or require the remission of such penalty.

"(3) In any proceeding to review the denial of membership in a registered securities association, if the Commission, after appropriate notice and hearing, and upon consideration of the record before the association and such other evidence as it may deem relevant, shall determine that the specific grounds on which such denial is based exist in fact and are valid under this section, the Commission shall by order dismiss the proceeding; otherwise, the Commission shall by order set aside the action of the association and require it to admit the applicant broker or dealer to membership therein.

"(4) (1) The rules of a registered securities association may provide that no member thereof shall deal with any nonmember broker or dealer (as defined in paragraph (2) of this subsection) except at the same prices, for the same commissions or fees, and on the same terms and conditions as are by such member accorded to the general public.

"(2) For the purposes of this subsection, the term 'nonmember broker or dealer' shall include any broker or dealer who makes use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security otherwise than on a national securities exchange, who is not a member of any registered securities association, except a broker or dealer who deals exclusively in commercial paper, bankers' acceptances, or commercial bills.

"(3) Nothing in this subsection shall be so construed or applied as to prevent any member of a registered securities association from granting to any other member of any registered securities association any dealer's discount, allowance, commission, or special terms.

"(4) Every registered securities association shall file with the Commission in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors copies of any changes in or additions to the rules of the association, and such other information and documents as the Commission may require to keep current or to supplement the registration statement and documents filed pursuant to subsection (a). [No change in or addition to the rules of a registered securities association shall take effect until thirty days after the filing of a copy thereof with the Commission, or until such earlier date as the Commission may determine.] Any change in or addition to the rules of a registered securities association shall take effect upon the thirtieth day after the filing of a copy thereof with the Commission, or upon such earlier date as the Commission may determine, unless the Commission shall enter an order disapproving such change or addition; and the Commission shall enter such an order unless such change or addition appears to the Commission to be consistent with the requirements of subsection (b) and subsection (d).

"(5) (1) The Commission is authorized by order to abrogate any rule of a registered securities association, [or to prevent any rule from taking effect,] if after appropriate notice and opportunity for hearing, it appears to the Commission that such abrogation [or prevention] is necessary or appropriate to assure fair dealing by the members of such association, to assure a fair representation of [the membership] its members in the administration of its affairs or otherwise to protect investors or effectuate the purposes of this [section] title.

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eration of the record before them relevant, shall (A) find it, or has omitted such act, or omitted, and (B) shall find it, or has omitted such act, are in violation of such determination of the Commission, unless it appears in accordance with paragraph (b) that the evidence does not justify such determination. The Commission shall determine whether such act is a violation of the rules of the association.

For hearing, the Commission may, by order, suspend or revoke the registration of any member of a registered securities association who has violated any provision of this title or the rules and regulations thereunder, or has failed to enforce compliance with its own rules, or has engaged in any other activity [inconsistent with] tending to defeat the purposes of this section;

and may provide that the suspension or revocation shall apply to the member's registration for the same purposes as are for such member.

Section 15 of the Securities Exchange Act of 1934, as amended, is amended to read as follows:

(c) No broker or dealer shall make use of the mails 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:

"(2) The Commission may in writing request any registered securities association to adopt any specified alteration of or supplement to its rules with respect to any of the matters hereinafter enumerated. If such association fails to adopt such alteration or supplement within a reasonable time, the Commission is authorized by order to alter or supplement the rules of such association in the manner theretofore requested if, after appropriate notice and opportunity for hearing, it appears to the Commission that such alteration or supplement is necessary or appropriate in the public interest or for the protection of investors or to effectuate the purposes of this section, with respect to: (1) The basis for, and procedure in connection with, the denial of membership or the disciplining of members; (2) the method for adoption of any change in or addition to the rules of the association; (3) the method of choosing officers and directors; and (4) affiliation between registered securities associations; (5) the prevention of fictitious quotations; (6) the prevention of fraudulent or manipulative acts or practices; (7) safeguards against unreasonable profits or unreasonable rates of commissions or other charges; (8) safeguards against unfair discrimination between customers, or issuers, or brokers or dealers; (9) safeguards with respect to the financial responsibility of members and against the evasion of financial responsibility through the use of corporate forms, special partnerships or other devices; (10) the manner, method, and place of soliciting business; (11) the time and the method of making settlements, payments, or deliveries; (12) the collection, recording and dissemination of information relating to the over-the-counter markets; and (13) similar matters].

"(3) The Commission is authorized, if such action appears to it to be necessary or appropriate in the public interest or for the protection of investors [and] or to carry out the purposes of this section—

"(1) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to revoke the registration of a registered securities association, if the Commission finds that such association has violated any provision of this title or the rules and regulations thereunder, or has failed to enforce compliance with its own rules, or has engaged in any other activity [inconsistent with] tending to defeat the purposes of this section;

"(2) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a registered securities association any member thereof who the Commission finds has violated any provision of the Securities Act of 1933, as amended, or of this title or the rules and regulations thereunder, or has effected any transaction for any other person who, he had reason to believe, was violating in respect of such transaction any provision of the Securities Act of 1933, as amended, or of this title or the rules and regulations thereunder;

"(3) after appropriate notice and opportunity for hearing, by order to remove from office any officer or director of a registered securities association who, the Commission finds, has willfully failed to enforce the rules of the association, or has willfully abused his authority.

"(4) If any provision of this section is in conflict with any provision of any law of the United States in force on the date this section takes effect, the provision of this section shall prevail."

Sec. 2, Subsection (c) of section 15 of the Securities Exchange Act of 1934, as amended, is amended to read as follows:

"(c) No broker or dealer shall make use of the mails 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 commissions or other charges; (4) to provide safeguards against unfair discrimination between customers, or issuers, or brokers and dealers; (5) to provide safeguards with respect to the financial responsibility of members 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 settlement, payments or deliveries; (8) to provide for the collection,

recording, and dissemination of information relating to over-the-counter markets; and (2) 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 with respect to national securities exchanges."

The CHAIRMAN. We have the honor of having as the first witness Mr. George C. Mathews, one of the Commissioners of the Securities and Exchange Commission. However, before Mr. Mathews proceeds, I shall ask Senator Maloney, the author of the bill, to make a statement regarding it.

STATEMENT OF HON. FRANCIS T. MALONEY, A MEMBER OF THE UNITED STATES SENATE FROM THE STATE OF CONNECTICUT

Senator MALONEY. Perhaps it would be appropriate for me to say, Mr. Chairman, that the bill has been considerably changed, as you will note, from its original draft. When this bill was introduced on January 5 it came as the result of a long-time effort on the part of the Securities and Exchange Commission in rather close cooperation with members of the investment banking business and over-the-counter dealers and brokers.

Since the introduction of the bill I have spent considerable time with members of the investment banking business, over-the-counter dealers and brokers, and members of the Securities and Exchange Commission, and the changes that appear in the bill as it comes to us this morning are as a result of these many conferences with these people, and it is an effort to bring the bill into line with their thought insofar as it is possible.

I should also like to say for the benefit of the committee that every effort has been exerted to make this a bill that would meet with the approval of those engaged in this business, to make it, insofar as it is possible, a self-regulatory bill or, at least, a cooperative regulatory bill.

The changes are in this draft, and it is on the basis of these changes, or with these changes in mind, that I understand Commissioner Mathews is going to offer his testimony.

The CHAIRMAN. You yourself are prepared to recommend these changes in the bill itself?

Senator MALONEY. Yes. It was after a series of meetings with the over-the-counter dealers and brokers that I asked the lawyers of the Securities and Exchange Commission to draft these changes that now appear.

The CHAIRMAN. I am glad that you accepted the spirit of the times, which is that of cooperation.

Senator MALONEY. I think, Mr. Chairman, that this is a fine example of the spirit of the times—one of cooperation.

The CHAIRMAN. It is an example of what may be accomplished in that direction.

We shall now be pleased to hear from you, Mr. Mathews.

STATEMENT OF GEORGE C. MATHEWS, COMMISSIONER, SECURITIES AND EXCHANGE COMMISSION, WASHINGTON, D. C.

Commissioner MATHEWS. Mr. Chairman and Senators, I think that before I get into the detailed discussion of the bill and the more or less formal statement that I shall leave with you it might be well if I outlined generally something of the purpose and plan of this bill.

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The over-the-counter market is at present, of course, unorganized in the sense of organizations having any official recognition. We have in the exchanges given official recognition to the membership of the exchanges and their organizations, and the law also provides the basis for what Senator Maloney has referred to as a cooperative regulation of exchange practices. The exchanges may adopt rules subject to the jurisdiction of the Commission. They have certain obligations in seeing that their rules are enforced.

The Commission has certain power to impose rules on the exchanges, and it has power to adopt rules of its own which control practices on the exchanges, so the regulation of stock exchanges is rather a two-headed effort: First, the control of practices by the organizations themselves; second, the control of practices by the Commission under the law.

In the over-the-counter market at the present time we have only one wing of that structure built, and that is quite incomplete: That is, the control of practices directly by the Commission, and that control of practices, as I shall point out in more detail later, has resulted in a program of registration of brokers and dealers with the Commission, and it has resulted in the definition of certain practices as constituting manipulative practices which are forbidden in the over-the-counter market.

In a sense, the problem of direct Government regulation of the over-the-counter market is a little bit like trying to build a structure out of dry sand. There is no cohesive force to hold it together, no organization with which we can build, as authoritatively representing a substantial element in the over-the-counter business. It is true that there are organizations—highly desirable organizations—in the over-the-counter business, but they are unofficial in character, so far as the Government is concerned.

The first purpose of this bill is to make it possible to set up, with official recognition, organizations of brokers and dealers in the over-the-counter market. Right at the start I want to point out that this bill contains no element of compulsion as to setting up such organizations or as to becoming members of them; it is a purely voluntary plan of organization and registration of these over-the-counter dealers' associations.

There are certain other distinctions that should be drawn in order to understand the place into which this fits in the regulatory program as compared with the place that the exchanges occupy. The exchanges are business organizations. They have always been regarded as necessarily exclusive in character. Membership is a property right in the sense that it may be transferred when an individual drops out or is expelled. The exchanges have certain features that may be regarded as monopolistic because of their exclusive organization.

The Securities and Exchange Act, to my mind, represents an attempt to bring these monopolistic practices under Government control, to see that the acts and practices of exchanges are carried out in the public interest. Some people have likened the proper sphere of the exchanges to that of a public-service corporation, in which the monopolistic element may properly be recognized but in which the need of regulation goes hand in hand with the grant of monopolistic privileges.

In the sort of organizations that we hope will be set up under this act, I would like to call your attention to three things: First, that the organizations must be voluntary; second, that they cannot be exclusive

in membership beyond certain limits, for there are certain people, obviously, who should not be permitted to belong to any business organization; and third, that there is not a property in membership in the sense that there is something that can be transferred to a successor. There is nothing that could be sold.

Bearing in mind that these are purely voluntary associations, if a program envisaged by this bill is to be successful, the legislation must be legislation under which these people will form associations and register. If they do not register, this is a dead letter, so far as an association feature of this bill is concerned.

The first essential is that responsible organizations of sufficient standing and sufficient size be registered, so that they can play their part in this regulatory program, or else the only alternative is to drop the idea of registered associations and go to direct Government control.

Why do we regard the registration of these associations as important? Well, for two reasons. In the first place, we think it is good practice that a business of this kind, as intimately related to the economic welfare of the people of this country as this is, should take an active part in its own control. We think it is good for the business, we think it is good for the country. But aside from the question of the place that in theory it ought to occupy, there is a very practical reason, which is twofold in character, and to which I may allude later on.

If the Government is to go in and regulate practices in the over-the-counter market, with no association of people with whom it can deal, it must necessarily deal with the individual. The problem of controlling the actions of thousands of individuals engaged in the over-the-counter market would be a tremendous one if it is to be undertaken by the direct intervention of the Government in each case. It would be tremendously expensive. I hesitate to make an estimate of what it would cost, but let me touch on just one phase of it.

Suppose that it should appear desirable and necessary that the Government undertake an active program to prevent people who are insolvent from engaging in the securities business, and the Government had the positive burden of making that determination. The cost of making that determination once a year for each concern would be an enormous amount. Then, too, this business is of such a type that the condition of the people engaged in it may change so rapidly that a determination as of a given date is of little or no value as affording any real protection to the man who has a continued course of business with such people.

If I may speak of an illustration that comes to my mind, when I was connected with State administration of blue-sky laws, our legislature at one time proposed that there be placed upon our organization the burden of making an annual audit of every licensed broker in the State.

Senator TOWNSEND. What State was that?

Commissioner MATHEWS. Wisconsin, not a big State as securities matters go.

The best estimate that we could make was that at the very minimum it would cost us a half million dollars a year to make such an audit, and then there was the danger that it would be completely useless 3 months later. That is the sort of problem with which we

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may be confronted if we have to go into this thing with just the Government itself to carry out the regulatory program.

I think that associations of this sort, if they are comprehensive enough and vigorous enough, can go a long way, although I do not expect that they will reach perfection, in assuring that people who are their members, and perhaps to some extent in assuring that others in the securities business, have a proper standard of financial responsibility.

Senator TOWNSEND. Mr. Mathews, do you feel that you do not have the authority under the present S. E. C. law to set up these regulations?

Commissioner MATHEWS. I feel that for us to set up a comprehensive program of regulation of the over-the-counter market under the present law would be for us substantially to write the body of legislation, because, as I shall point out later, the grant of authority to the Commission to regulate the over-the-counter market is a grant of authority to regulate in a manner comparable to the regulation of exchanges, but the specifications of the form of that regulation are not there.

The Commission has a rule-making power and might conceivably elaborate this a great deal. Personally, I think that there might be considerable criticism, and I am inclined to think that it is poor policy for the Commission to substantially write the body of legislation, even though it has a grant of power to do it. I believe it is much better that the fundamentals of the legislation be written into the act which the Commission administers.

Senator TOWNSEND. There has been an effort, as Senator Maloney says, to bring into harmony both the S. E. C. and the over-the-counter dealers, by means of this bill, as I understand it.

Commissioner MATHEWS. That is true.

Does this bill provide the means of getting a registration of these dealers and brokers? The form for it is in the bill. Will it work? The best thing that I can say on that is that I have talked, over a period of 2 or 3 years, with men whom I have come to regard as thoroughly responsible in the securities business, and I believe that strong associations can and will be set up if this bill is enacted.

It may not be improper to say that I feel sure that these associations will be set up and will get their membership unless the people who are in a position to influence and control the economic welfare of those dealers bear down so heavily that they will be afraid to register.

Senator TOWNSEND. Can you illustrate that?

Commissioner MATHEWS. For instance, if a large underwriting house should say to me, a dealer, "If you go into this association, you are off our list," it would be very doubtful if I would go into the association.

Senator TOWNSEND. What would be their objections to his going into the association?

Commissioner MATHEWS. I am unable to answer that question, but all I can say on it is that I know that the fear—and how well grounded that fear may be, I have no basis of measuring—that that sort of pressure may be exerted exists among many of the people whom we want to see in these associations. Somebody else can tell you the ground for that fear better than I can.

The CHAIRMAN. Do you think that if there is that sort of pressure exerted it would be analogous to the pressure that was attempted to be exerted in the old days, to prevent regulatory legislation of this type from being enacted at all?

Commissioner MATHEWS. Yes, sir.

The CHAIRMAN. A sort of unwarranted fear of regulation or a desire to avoid regulation.

Commissioner MATHEWS. Personally, I think it is an unwarranted fear. I must admit, however, that my point of view with reference to that, obviously, is not the point of view necessarily of the man who is going to be regulated.

Senator TOWNSEND. You feel that there are objections to the bill which will come from the underwriters?

Commissioner MATHEWS. I believe so. I believe that there are substantial objections to this bill, and I think they will come largely from the underwriters.

Senator TOWNSEND. Not from the dealers themselves?

Commissioner MATHEWS. I cannot say that there will not be objections from dealers, but I have every reason to believe that there is a large body of responsible men in the business in this country who will welcome an opportunity to register under this bill. I do not think that is any exaggeration.

Senator RADCLIFFE. Has this opposition crystallized, so far as you know, in anything definite?

Commissioner MATHEWS. We had hoped that with the bill as reprinted, although not all interests in the securities business would welcome the bill with open arms, they would feel that they could go along with it. I believe now that there is some opposition that has crystallized to it, but others can speak better on that when the time comes.

The CHAIRMAN. Opposition now among the dealers?

Senator RADCLIFFE. Among the underwriters.

Commissioner MATHEWS. I believe it is primarily among the underwriters; but there again, not having made a comprehensive survey of opinion, I cannot say to you that there may not be dealers who object to it also.

The second thing I want to point out, that to our mind makes an association of this sort valuable, is that even if the funds were furnished for a direct government regulatory program, and even if an adequate staff were provided, and even if there were no problems of securing enforcement through the courts in any cases that you and I would agree there should be enforcement in, a great many of the abuses in the securities business are not matters of definite illegality; they are matters of ethics.

I can offer you a security for sale, and I have complied with the letter of the law or probably with the letter of most any law that can be written, and I can create a false impression, on which it would be pretty hard to convict me. There is a vast field for the control of ethical practices in this business, which is not a field which the Government can very well occupy.

Senator TOWNSEND. How does this bill attempt to remedy that?

Commissioner MATHEWS. That would be primarily the problem of the association. An association of this sort, if it is successful, must be able to control those practices of its members which, in the language

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of the stock exchange rule, are inconsistent with just and equitable principles of trading.

I think if we have any hope that the securities business generally is to be put on that high professional plane, we must look to help from within the industry and, I think, organized help. I do not mean to imply at all that there are not men in the business who have these high ethical standards. If we did not believe that there were, we would not have any hope of the success of any association. But this is the way of placing those people who have such standards effective in the position of controlling the activities of their members.

Senator RAPCLIFFE. Would each association follow a pattern, or would there be considerable leeway in each organization as regards its scope and trend of activity?

Commissioner MATHEWS. There would be leeway, and I think I can point that out later on.

The CHAIRMAN. There is just this about it: It is much more desirable to have this so-called voluntary regulation by the industry itself; but if it is for the public interest to have the regulation, a refusal of such voluntary regulation would compel Government action, would it not, if the public interest demands it?

Commissioner MATHEWS. That must be the alternative, and I should say that in the bill as reported there is one section which deals with direct control both of members of the association and of outsiders, which amplifies our direct control of the over-the-counter market. However, if there are to be no associations, I personally believe that the public will insist that there be direct Government regulation.

Senator TOWNSEND. Have you the authority set up in this bill if there should be no regulation asked for by the over-the-counter members?

Commissioner MATHEWS. We have certain authority in a revision of the present section 15 (c), which I will discuss a little later.

The CHAIRMAN. I think everyone will agree that voluntary regulation is much more desirable.

Commissioner MATHEWS. This bill affords the machinery for this voluntary and cooperative regulation, and in addition it expands somewhat the field of direct regulation by the Commission, because obviously there are going to be dealers who will not come into these associations.

One of the expressed fears of the bill as originally drawn, in which we had a more extensive power to impose rules on the association than is provided in the reprint, was that the effect of them would be to discriminate against the people who came into the associations and leave the outside free, which I think was a valid objection.

I should now like to present a little more formal statement with reference to the bill, and possibly at various points I may repeat something which I have already said, but I felt that this general background would perhaps be valuable.

In its essentials, Senate bill 3255 would set up a system of cooperative regulation of the over-the-counter markets, through the activities of voluntary associations of investment bankers, dealers, and brokers doing business in those markets, under appropriate governmental supervision. As the title of the bill indicates, this system is patterned upon the method of organization and regulation of exchange

trading under the Securities Exchange Act of 1934. The problem of adequate regulation of the over-the-counter markets seems to the Securities and Exchange Commission to be of the utmost importance, and the method of dealing with that problem contemplated by S. 3255 is, in our judgment, eminently sound. Before entering into a detailed discussion of this bill, I should like to indicate something of the size, the complexity, and the importance of the problem, as well as of the background of experience and effort which lie behind the present bill.

Under the Securities Exchange Act of 1934 the over-the-counter markets are deemed to include all transactions in securities which take place otherwise than upon a national securities exchange. I do not think it is generally realized how immense and varied these activities are. A few figures will suffice to bring this out. Currently, some 6,766 firms of brokers and dealers are registered with the Commission as transacting business in the over-the-counter markets.

Senator TOWNSEND. What percent is that of the total number?

Commissioner MATHEWS. We do not know that, Senator, for the reason that there are certain dealers and brokers who are not required to register. For example, a man whose business is conducted entirely within a single State is not required to register, and we have no survey to show how many of those there may be.

Senator TOWNSEND. Have you a general idea?

Commissioner MATHEWS. I believe the number is quite substantial. As an illustration, I was told the number of people advertising in the Chicago Telephone Directory as being engaged in the securities business, who are not registered with us. I hesitate to quote the figure, because I do not recall it exactly, but I think it was about 150.

We have been in touch with all of those people, and we are following them up from time to time. Apparently they are people who engage in business only in the State of Illinois. If that is an example, obviously the figure for the entire country is quite substantial.

For purposes of comparison, it may be pointed out that there are only 1,375 members of the New York Stock Exchange. Over-the-counter quotations for at least 60,000 separate issues of securities are published in services to which brokers and dealers subscribe, whereas only about 6,000 separate issues of stocks and bonds are admitted to trading on all the stock exchanges of the country. But these figures, impressive as they may seem, do not suggest the full story. A great deal of trading takes place over the counter even in securities which are listed upon exchanges. This is particularly true of high-grade bonds and preferred stocks.

In the bond markets large blocks of bonds that are listed on the exchanges are normally dealt in in the over-the-counter market; they do not get onto the exchanges at all. The blocks that are dealt in on the exchanges are what we might call retail transactions.

Senator TOWNSEND. Has the business of the over-the-counter market increased very materially since the passage of the S. E. C. law, or has it decreased?

Commissioner MATHEWS. I wonder if anybody could answer that with any degree of assurance. I think the best answer we could give to that is that the only statistical evidence we have on it relates to the flotation of new issues. We have no adequate statistical evidence as to the trading in issues that were outstanding.

of 1934. The problem of over-the-counter markets seems to be of the utmost importance, as contemplated by S. 3255. We are entering into a detailed study of something of the size, scope, and nature of the problem, as well as of the reasons behind the present bill.

In 1934 the over-the-counter market in securities which take place on the exchange. I do not know how varied these activities are. Currently, some work is being done with the Commission on over-the-counter markets.

What is the total number of securities that, Senator, for the purpose of those who are not required to be registered, is conducted entirely in the over-the-counter market, and we have no survey?

Is the number quite substantial? Is it people advertising in the securities business? I quote the figure, it was about 150.

Are these people, and we are following up on people who engage in that is an example, quite substantial.

It is pointed out that there are securities on the Exchange. Over-the-counter issues of securities are not registered, whereas bonds are admitted to the market. But these figures, I think, do not tell the full story. A great deal of business is done even in securities which are not registered, particularly true of high-grade securities.

Are securities that are listed on the exchange and those that are dealt in in the over-the-counter market? If the passage of the S. E. C. Act is required for the over-the-counter market, is it true that the passage of the S. E. C. Act is required for the over-the-counter market?

Who could answer that? The best answer we could give is that we have no adequate statistical data on it outstanding.

The flotation of new issues, of course, has varied with economic and business conditions. It was quite heavy in 1936, and it fell off very materially in 1937. At the present time, as judged by the volume in registration with the Commission, it is very light.

As a matter of fact, many of the higher grade bonds and preferred stocks have their only market over-the-counter. For instance, an estimate indicates that, as of last summer, insurance-company securities with an approximate market value of about \$343,000,000 were admitted to trading upon exchanges, whereas some \$1,209,000,000 of insurance-company securities—roughly four times the previous figure—were not admitted to trading upon any exchange, and thus found their only market over-the-counter.

Another striking illustration of the importance of the over-the-counter market, which I am sure you will all realize, was the flotation of and dealing in real-estate securities, which was very active about 10 years ago. Billions of dollars of real-estate securities were floated and dealt in in the over-the-counter market, and the history of the real-estate securities, considering the country as a whole is, I think, a pretty good argument for adequate control of the over-the-counter market.

Furthermore, the very great bulk of trading in obligations of the Federal Government, the States, and their local subdivisions normally takes place off the exchanges in the over-the-counter markets. Finally the primary operations of the great underwriting houses take place over-the-counter. Thus, the over-the-counter markets not only provide the medium for an immense volume of trading in a great variety of securities, but they also provide the principal channel for the flow of the savings of our people into new financing. It is scarcely necessary for me to dwell upon the importance of the process by which the financial requirements of expanding industry are met through the public sale of securities to investors. The process of distributing such securities takes place on a national scale over-the-counter.

Thus far, I have alluded only to the significance of the over-the-counter markets in and of themselves. But the imperative necessity of effective regulation of these markets springs not only from their own importance, but also from the fact that only by such a program can evasion of regulation of the exchanges under the Exchange Act be forestalled.

What I mean is this: The act is so comprehensive and so definite with reference to the regulation of exchanges that there is a danger—and in some cases there has been the actual result—that issues of securities have gone off the exchanges into the over-the-counter market.

As an illustration, an officer, director, or 10 percent holder of equity securities in a corporation whose securities are listed on an exchange has a liability to account to the corporation, within certain limits, for his trading profits in the stock of that company. There is no such liability in the over-the-counter market, so it is quite possible, if a management or those in control of a company see fit, to take their securities off the exchange and place them in the over-the-counter market.

Also, there are certain requirements for the publicity of information about securities listed on the exchanges, which do not exist in the

over-the-counter market. So, if any concern objects to furnishing to the public the information which the Securities Exchange Act contemplates the public should have if it is going to trade in those securities, all it has to do is, in accordance with the rules of the exchanges, to take its securities off those exchanges. There is no minimum requirement of information about securities in the over-the-counter market except for those which are newly floated and registered under the act of 1933.

Senator TOWNSEND. You have no authority under the present law to stop that transaction?

Commissioner MATHEWS. No.

I have been speaking of the possibility of defeating the purposes of the Securities Exchange Act by leaving the over-the-counter market unregulated. This was recognized by the Congress in enacting the Securities Exchange Act of 1934. For example, the report of the Senate Committee on Banking and Currency to accompany the bill which became the Securities Exchange Act of 1934 included the following statements:

It has been deemed advisable to authorize the Commission to subject such activities (i. e. trading in the over-the-counter markets) to regulation similar to that prescribed for transactions on organized exchanges. This power is vitally necessary to forestall the widespread evasion of stock exchange regulation by the withdrawal of securities from listing on exchanges, and by transferring trading therein to "over-the-counter" members where manipulative evils could continue to flourish, unchecked by any regulatory authority.

Now, bear in mind what I said a while ago about the grant of power in the over-the-counter market and the previous act being in very general terms. It substantially amounted to a grant of power to the commission to write rules, so far as that purpose could be accomplished by rules, to apply the type of regulation that existed on exchange markets.

In the Securities Exchange Act of 1934, as originally enacted, the over-the-counter markets were dealt with very briefly, in a single section. The brevity of this treatment did not in any sense reflect a misconception as to the importance of the problem. On the contrary, it arose from a realistic recognition of the great difficulties of working out a suitable plan of regulation, particularly in view of the fact that so little was known concerning these markets. But, though Congress was in some doubt as to the precise method, it had no doubt as to the objective of or the standards for, regulation. Section 15—that is the section dealing with the over-the-counter markets—in its original form, expressly contemplated the adoption by the Commission of rules and regulations concerning the over-the-counter markets "necessary or appropriate in the public interest and to insure to investors protection comparable to that provided by and under authority of this title in the case of national securities exchanges." To that end, the Commission was authorized to adopt rules and regulations providing "for the regulation of all transactions by brokers and dealers on any such market, for the registration with the Commission of dealers and/or brokers making or creating such a market, and for the registration of the securities for which they make or create a market."

I might say that so far we have found no practical way of securing the registration of securities, which are now outstanding and are dealt in, in the over-the-counter market. I say no practical way because if registration were required the alternative to registration would be

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to completely bar them from interstate commerce. If registration were not successfully achieved, we might freeze completely the market in the over-the-counter securities by such an action.

Pursuant to this statutory mandate, the Commission began the development of its machinery of administration. The outstanding need was obviously for facts. In retrospect, it is startling to realize that there was no reliable source of information concerning the identity or the number of investment bankers, dealers, and brokers engaged in this highly important business. Thus, at the outset, the Commission made a program for registration of these brokers and dealers the keystone of its attempts to build a system of regulation. The Commission, likewise, adopted some simple rules concerning trade practices in this field. I might add that the simplicity of these rules related to their content only, and not to the process of preparing and putting them into effect. In fact, the immense burden, at that stage, of making effective rules the content of which could not be the subject of any reasonable controversy, is itself a striking commentary upon the unexplored character of the territory which we were entering.

Section 23 (b) of the Securities Exchange Act of 1934 expressly directs the Commission from time to time to make such recommendations for further legislation as may be deemed advisable with regard to matters within its jurisdiction. We have understood this direction to apply particularly to such problems as the one now under discussion. It seemed to us to be our duty from time to time, on the basis of our accumulating experience and knowledge, to formulate and suggest to the Congress methods for effectuating the objectives which Congress clearly had in mind and clearly set forth in the original section 15.

Thus, after a year and a half of experience, the Commission made certain recommendations to the Congress which were largely embodied in section 15 as it now stands. Section 15 in its present form is much more comprehensive and specific than in its original form.

Since the amendment of section 15 in May of 1936, roughly another year and a half has passed. I am glad to be able to report that our further experience in that period has been, in our judgment, even more fruitful than in the earlier period. The Commission now feels that it has a fairly clear understanding of what must be done if the original purpose of the Congress in regard to the over-the-counter markets is to be realized.

Although we have been making steady progress, it is obvious to any student of the problem that a great deal remains to be done. The problem has these aspects: First, to protect the investor and the honest dealer alike from plainly dishonest and unfair practices by the submarginal element in the industry; second, to cope with the penumbra of inequitable and injurious methods of business which lies outside the area of definite illegality, and which can be dealt with effectively only by placing the business upon a highly professionalized basis; and third, to afford to the investor an economic service the efficiency of which will be commensurate with its economic importance, so that the machinery of our markets will operate to avoid the misdirection of our Nation's savings which contributes so powerfully toward economic depressions, and breeds disintegrating mistrust of our financial processes.

I should like briefly to illustrate the extent of the first and simplest phase of our problem—that of policing the submarginal element in

the industry. Within the last year, the Commission sank probes into three areas outside the largest financial centers—in Cleveland, Detroit, and the Pacific Northwest. A few attorneys and accountants were sent to these areas, to inquire into certain complaints, and to make a flying survey. In the space of a few months, 13 individuals were criminally convicted. Sixteen more individuals were placed under indictment, 17 corporations and 41 more individuals were enjoined, and 2 firms were expelled or obliged to withdraw from national securities exchanges, all for elementary violations of the law. The effect of these efforts has, of course, been salutary. But it would be folly to imagine that nothing remained to be done, or that the problem is less serious in other parts of the country.

The second and third phases of the problem are harder to illustrate, but are at least as significant. We are all of us familiar with methods of doing business, which while not technically illegal, are nevertheless unfair to customer and decent competitor alike, and are seriously damaging to the mechanism of the free and open market.

Now, how are we to deal with these problems? The Commission believes that there are two alternatives. The first would involve expansion in our organization; the multiplication of branch offices; a large increase in the expenditure of public funds; a distinct increase in the problem of avoiding the evils of bureaucracy; and a minute, detailed, and rigid regulation of business conduct by law. It would mean expanding our present process of registration of brokers and dealers to include the proscription not only of the dishonest, but also of those unwilling or unable to conform to rigid standards of financial responsibility, professional conduct, and technical proficiency. I speak the mind of the entire Commission when I say that such a prospect would be scarcely more agreeable to us than I imagine that it would be to the brokers and dealers of the country. We are convinced, however—and with the greatest of respect I must urge this conviction upon your committee—that this is a prospect from which we must not shrink if events should demonstrate its necessity.

But we sincerely hope that such a program will not prove necessary. There is an alternative, which is embodied in the bill now under consideration. That is the method of cooperative regulation, in which the job is largely done by representative organizations of investment bankers, dealers, and brokers, with the Government exercising appropriate supervision in the public interest, but occupying what may be termed a residual role. In the concept of a really well-organized and well-conducted stock exchange, under the supervision provided by the Securities Exchange Act of 1934, one may perceive something of the possibilities to which I am referring.

I suppose you have all seen or have been informed of the recent report of the committee which has submitted recommendations for the reorganization of the New York Stock Exchange. Those recommendations look right in this direction. The Chicago Stock Exchange has also prepared such a report, which goes very much along the same lines.

With sound organization and methods and under careful safeguards, the Commission believes that such cooperative regulation can be effective in the over-the-counter markets without being too complex and rigid, and can remain reasonably general and fluid without degenerating into petty tyranny.

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Commissioner—in Cleveland, attorneys and accountants—certain complaints, and in a few months, 13 individuals were suspended and 41 more individuals were suspended to withdraw from the industry. But it would be done, or that the industry.

It is harder to illustrate, familiar with methods of illegal, are nevertheless, and are seriously a market.

What is the Commission's first step? The Commission's first step would involve examination of branch offices; a decrease in the number; a distinct increase in the industry; and a minute, set by law. It would be the regulation of brokers and dealers, not only dishonest, but also standards of financial and technical proficiency. I think I say that such a bill is more than I imagine that the industry. We are convinced that I must urge this prospect from which its necessity.

It is not proved necessary. The bill now under consideration, in which the provisions of investment banks are exercising appropriate supervision, what may be a well-organized and provision provided by the industry to give something of the

formed of the recent recommendations for change. Those recommendations for the Chicago Stock Exchange much along the same

or careful safeguards, regulation can be effected, being too complex and and without degener-

At this point, I think it will be useful for me to review the gradual development of organizations in this industry and of their relations with the Commission during the past 3 years. I think this will help to demonstrate that the present views of the Commission on this type of cooperative regulation have not been arrived at hastily, but have been evolved carefully over a period of years.

Almost from its inception, the Commission conducted extended conferences with representatives of various associations of investment bankers, dealers, and brokers from all parts of the country. About 3 years ago, a conference committee was formed, representative of the industry, to obtain the views of investment bankers, dealers, and brokers as to the desirability of perfecting a permanent scheme of organization for the purposes which we have been discussing. As a result of the activities of the conference committee, there came into existence in 1936 an organization known as the Investment Bankers Conference, Inc. This organization has enrolled and maintained a membership, we are informed, of some 1,700 firms situated in all parts of the United States. There are likewise in existence in the country a number of other associations of brokers and dealers which have for some time exercised a degree of supervision over the conduct of their members. It is understood that plans for cooperation among many of these various associations and the conference have either been put into effect or are at the present time under negotiation.

In the early stages of our discussions with these groups it was suggested that it would eventually be necessary that their position in relation to the Commission and to others be more clearly defined as a matter of law. Almost 2 years ago we expressed the hope that, in a reasonable time, suitable organizations of over-the-counter brokers and dealers should enjoy a recognized legal position in the field of regulation, subject, of course, to appropriate governmental control. We also expressed the view that the establishment of a permanent and clearly defined relationship between any organization of the type indicated and the Commission must, in fact, as well as in law, await the completion of the organization phase of the life of such organization.

We stated that at such time as a reasonable measure of development toward realization of the objectives which I have outlined should have been achieved, the Commission would stand ready to consider reasonable proposals designed to render such organizations subject to administrative regulation by the Commission under a specific law. So far as we are concerned, that time has now arrived.

The representatives of these associations are in general agreement that little further can be done by them in the field of self-regulation or in providing a channel through which the Commission can exercise its supervisory powers without enabling legislation.

It seems to the Commission that, in its essentials, the bill under discussion is well designed to accomplish the purposes which I have attempted to outline, and takes full account of and utilizes the experience of the past 3 years which I have tried to describe.

Before going to the detailed analysis of the bill, I should like to bring you back just for a moment to this concept of it: That the bill has a twofold aspect, first, to provide for voluntary associations which, it is hoped, will largely take over the problem of regulation of the business, subject to safeguards which I shall later point out, and second,

it provides a certain amount of direct rule-making power for the Commission, which is applicable alike to members of associations and to those who stay outside, so that there will not be the opportunity to avoid the effect of these rules by refusing to join such an association or by dropping out. Of course, that involves, on the part of the Commission, a direct problem of policing, but it will be vastly less than if we had to do the entire job.

Coming now to the detailed analysis, paragraph by paragraph, of the proposed new section 15 (a) and the proposed amended subsection (c) of section 15 of the Securities Exchange Act of 1934, embodied in S. 3255, the committee print of February 1, 1938, the bill amends the Securities Exchange Act of 1934 by inserting a new section, section 15 (a) immediately following the present section 15, and by amending subsection (c) of section 15. The present section 15 deals with the regulation of over-the-counter brokers and dealers; that is, brokers and dealers who effect at least some of their transactions otherwise than on national securities exchanges.

I should say that among our registered brokers and dealers there are a great many members of stock exchanges because they also do business in the over-the-counter market.

This bill is intended to provide regulation of associations of such brokers and dealers. The plan of regulation in general is closely modeled on that which is provided under the Securities Exchange Act in the case of national securities exchanges.

Subsection (a), Registration of Associations, provides that associations of brokers and dealers may be registered with the Commission as national securities associations or as affiliated securities associations by the filing of certain information. This provision is similar to section 6 (a) of the Securities Exchange Act, which provides for the registration of national securities exchanges. The requirements for registration as a national securities association are set forth in subsection (b) and the requirements for registration as an affiliated securities association are contained in subsection (d).

Subsection (b), Standards for Registration of a National Securities Association, sets forth the standards of eligibility for registration as a national securities association. It provides that no association may be registered as a national securities association unless it meets 10 specific conditions set forth in paragraphs (1) through (10) of subsection (b). The general purpose of these requirements is to assure that the association shall be of such size and scope as to be of national concern.

Just what that size and scope should be is, of course, a matter for the future. There is strong possibility that there may be one association registered which is completely national in scope. On the other hand, there is the possibility that there may be a number of associations registered. Generally speaking, it was our thought that associations, to be sufficiently wide in the scope of their operations to justify registration here, might take in about as much territory as is taken in by the several Federal Reserve districts. That standard is not expressed here, but our thought here is that an association should be more than a purely local thing. For instance, I do not think that an association of the dealers in the largest city in the State that I come from would be of such scope that it should be registered as a national association. I doubt if an association of dealers taking in

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the entire State would be. But if you take in the Federal Reserve district of which Wisconsin is a part, I think you are getting nearer the concept of size that would justify registration as a national association.

Senator HITCHCOCK. How would this affect a local bank which handles State securities—for instance, State bonds or city or municipal bonds? They handle that business through the mails.

Commissioner MATHEWS. I always hesitate to begin to interpret the law, because I am not a lawyer. However, I will give you my understanding and then let some of the lawyers from our division correct me if I am wrong.

It is my understanding that a bank in that position is not required to register with the Commission. It is not a broker or dealer under our act. A bank is specifically excluded by definition.

Senator HITCHCOCK. But here you say:

except a broker or dealer who deals exclusively in commercial paper, bankers' acceptances, or commercial bills.

Commissioner MATHEWS. But a bank is not within the definition of "broker or dealer."

So, when we say that we except that class of brokers and dealers, banks are already excluded. There is already in the act a definition of a broker or dealer.

Do I make myself clear?

Senator HITCHCOCK. You do in a way, but I have my own doubts as to it.

Commissioner MATHEWS. Well, a broker or dealer is so defined in the act that it does not include banks. This relates only to broker-dealers, so the banks are outside of it.

Mr. Davis can show you the section there which may help to clear it up.

The CHAIRMAN. It has just been called to my attention that in section 3, subsection 4, of the Securities Exchange Act of 1934 we have defined the term "broker." This subsection reads:

(4) The term "broker" means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank.

Commissioner MATHEWS. That is it.

The CHAIRMAN. It also specifically excludes banks, so I presume there can be no question about that, Senator. However, if it has to be made any clearer, we can make it so.

Commissioner MATHEWS. I think you will find by checking back to the definition that banks are clearly outside the scope.

I have been speaking of the problem of the size of these associations, geographically. In addition, the association should be so organized as to give reasonable assurance that its operations will promote the public interest in the manner contemplated by the bill. These provisions find their counterparts as applied to exchanges in sections 6 (b) and 6 (d) of the Securities Exchange Act. Each paragraph will be discussed separately.

I have referred to the counterparts as applied to exchanges. I should now like to put this bill before you clearly as a move to accomplish that comparable regulation of the over-the-counter market, regulation comparable to the regulation of exchanges, which was the purpose set forth by the Congress in the original section 15.

As I see this bill, if it is passed, the Congress will be carrying out in legislative form the purposes which it expressed only generally in the original act, by setting up over-the-counter market regulation comparable to that regulation of the exchanges.

Paragraph (1) makes registration available only to associations of sufficient size and scope to be a proper subject of national concern. Determination of whether this condition is met involves consideration of the number of members in the association, the scope of their transactions, and the geographical distribution of the members.

Paragraph (2) requires that the association be able to carry out its avowed functions in promoting the purposes of the bill. In determining whether this condition is complied with, the Commission must consider whether the organization of the association is appropriate and adequate to carry out the purposes of the bill, and whether the character of the association is such that it may be expected to carry out those purposes.

Paragraph (3) provides that an association may be registered only if membership in the association is available to all over-the-counter brokers or dealers, except those who are required to be excluded under paragraph (4).

The importance of open membership in this association will become apparent as we get to a discussion of certain of the business rights or advantages that will accrue to members; that is, the right to refuse to deal with nonmembers on any other basis than that on which they deal with the general public, so they can refuse to give concessions to non-member dealers. It is a valuable business right, and if it is to be given to members of these associations and to the associations as such, for the guidance of members, it is important that we do not have, in the first place, a monopolistic association. The association must be open to the fellow who is willing to conduct his business decently.

The second half of paragraph (3) permits the registration of an association, the membership of which is restricted on some predetermined basis specified in the rules of the association, provided that the Commission believes such limitation on membership will serve the public interest, the interest of investors, or promote the purposes of the bill. The bill specifically mentions two types of limitations on membership which the Commission may permit, that is, limitation on a geographical basis or on a basis relating to the type of business done by members of the association. For example under this section, if the Commission deems it advisable under the prescribed standards, it would be possible to register an association of dealers from the Southeastern States, or the New England States, or some similar region, or an association of dealers dealing exclusively in oil royalties, which is a very specialized field. In all such cases, however, the particular basis of restriction of membership must be specified in the rules of the association and must be sanctioned by the Commission.

This provision is not intended as a limitation on paragraph (1) of this subsection, and the Commission could not under this clause permit registration of a purely local association of securities dealers.

Paragraph (4) provides that associations may be registered only if the rules of the association exclude from membership brokers and dealers against whom certain specified types of action have been taken because of illegal, unfair, or inequitable conduct in connection with transactions in securities. Thus, if a broker or dealer is under sus-

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pension or has been expelled from a registered securities association or from a national securities exchange, for violation of a rule of the association or exchange which forbids conduct inconsistent with just and equitable principles of trade, he must be excluded. If the Securities and Exchange Commission has denied or revoked his registration as a broker or dealer—which may be done only for specified violations of law—or has expelled or suspended him from membership in a registered securities association or a national securities exchange—which may be done only for a violation of law—he must be excluded.

As a result of this provision, a broker or dealer who falls within any of the categories specified above, may not be admitted to membership in an association of which he is not yet a member, and he must be expelled from all associations of which he is a member. In order to prevent evasion by use of corporate forms and other devices it is provided that a broker or dealer shall be ineligible for membership in any association, if any partner, officer, director, or branch manager of such broker or dealer—or any person occupying a similar status or performing similar functions—or any person controlling or controlled by such broker or dealer falls within the specified categories. Practically speaking, these are the present standards for registration under section 15. That is to say, if a branch manager had been convicted of a securities crime, that would make the firm employing him ineligible for registration, and similarly would make it ineligible for membership in this association or if a partner were in that category.

Where this general rule of exclusion may appear to be unnecessarily harsh the Commission may, in the public interest, modify it so as to permit membership in a registered association. Such action may be taken either upon the Commission's own motion or upon application either by the broker in question or by a registered association which desires to admit him to membership or to retain him as a member.

The bill originally contained an additional provision, clause (C) of subsection (b) (4), which has been eliminated. It provided that a broker or dealer who is under court injunction in connection with securities transactions was ineligible for membership in an association. It is felt, however, that the existence of such an injunction is not generally a conclusive indication that the broker or dealer is the type of unethical person who must be excluded from an association. If the case is one in which it appears that the public interest will be served by barring the broker or dealer from doing a business in securities this result may be attained by revoking his registration under subsection (b) of section 15 of the act. Revocation of the broker-dealer registration—that is, the direct registration with the Commission—would also serve to bar such a broker or dealer from membership in any association under clause (B) of subsection (b) (4).

The CHAIRMAN. Is clause (B) the one with reference to violation of the law?

Commissioner MATHEWS. That deals with registration of broker-dealers and the right to revoke their registration; and that right is generally in connection with convictions related to securities transactions or injunctions.

The CHAIRMAN. Yes; in other words, an injunction does not necessarily convict him?

Commissioner MATHEWS. That is right.

The CHAIRMAN. He may still be innocent and yet have that injunction pending; but when the court has found him guilty, then this applies?

Commissioner MATHEWS. Yes. Under the original provisions of the regulations, once an injunction was issued, he would be barred from the association.

The CHAIRMAN. I see.

Commissioner MATHEWS. Paragraph (5) requires that there shall be a fair representation of the membership in all matters concerning the government and administration of the association. I think the purpose of that will be obvious: To prevent the control of such an association falling into a limited number of hands.

The CHAIRMAN. Yes.

Commissioner MATHEWS. Paragraph (6) requires that dues imposed on members to defray expenses of administration shall be allocated equitably among the members and shall not exceed the amount necessary to defray reasonable expenses of administration.

Paragraph (7) requires that the association have rules designed:

- (1) To prevent fraudulent and manipulative acts and practices.
- (2) To promote just and equitable principles of trade; and more generally.
- (3) To protect investors and the public interest.
- (4) To remove impediments to and perfect the mechanism of a free and open market.

This paragraph also requires that the rules of the association shall not be designed to promote monopoly, to require or permit unfair discrimination between customers or issuers or brokers or dealers, nor to fix minimum profits or charges.

Paragraph (8) requires that the rules of the association shall make provision for adequate disciplining of members who violate its rules.

Paragraph (9) requires the association to have an orderly procedure for the disciplining of members and the exclusion of persons desiring to become members. This procedure must include the bringing of specific charges, the giving of an opportunity to be heard in defense, the keeping of a record, and the making of specific findings of fact by the association. In the case of an unfavorable determination against a member, such determination must include a statement of the penalty imposed and also a declaration whether the association considers that the rules violated by the member involve conduct inconsistent with just and equitable principles of trade. This last statement is important in connection with the eligibility of expelled members to admission in other registered securities associations. The determinations of an association are subject to review by the Commission, and ultimately by the courts.

Paragraph (10) provides that the association shall admit to affiliation any other association, if so required by the Commission.

Subsection (c)—affiliation of association: This section gives the Commission power, where necessary in the public interest or to carry out the purposes of the bill, to require national securities associations to admit other associations to affiliation and to prescribe the terms and conditions upon which national associations may admit other associations to affiliation.

Subsection (d)—standards for registration of an affiliated securities association: This subsection sets forth the standards of eligibility for

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and yet have that injunction laid upon him guilty, then this original provisions of the act, he would be barred

requires that there shall be no change in all matters concerning the association. I think the control of such an association shall be in the hands.

requires that dues and administration shall be fixed and shall not exceed the amount of administration. The association shall have rules designed to govern its acts and practices. The rules shall be in accordance with the laws of the land; and more

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of the association shall be such as to prevent or permit unfair practices by brokers or dealers, nor

the association shall make any rule which would prevent or hinder any person who violates its rules. The association shall have an orderly procedure for the admission of persons desiring to become members. It shall include the bringing of charges against a member, to be heard in defense, and the making of findings of fact by the association. The determination of the penalty against a member shall be in accordance with the rules of the association. The determination of the penalty shall be in accordance with the rules of the association, and the Commission, and

shall admit to affiliation with the Commission. This section gives the Commission the power to carry out its interest or to carry out its interest in securities associations and to prescribe the terms and conditions under which they may admit other asso-

in affiliated securities associations and the standards of eligibility for

registration as an affiliated securities association. It provides for the registration of associations not of themselves national in scope, provided that such associations will, upon registration, become affiliated with a registered national securities association. In all other respects the standards of eligibility for registration of an affiliated association are the same as those for a national securities association (as set forth in paragraphs (2) to (9), inclusive, of subsection (b)). In cases where a registered association has imposed restrictions upon membership of the type which is authorized by paragraph (3) of subsection (b), the affiliated association must restrict its membership at least to the same extent as the parent national association. In no case can the affiliated association admit to membership any class of persons who are not eligible to membership in the parent national association.

Subsection (e)—granting and denial of registration: This subsection provides that the Commission shall grant registration as a national securities association or as an affiliated securities association if the appropriate requirements, set forth in subsections (b) and (d), respectively, are met. If such requirements are not met the Commission must, after a hearing, deny registration to an association which has applied. This provision is similar to section 6 (c) of the Securities Exchange Act which relates to the registration of exchanges. In case an association which has been registered as an affiliated securities association is not promptly admitted to affiliation with a registered national association the registration of the affiliated association must be revoked by the Commission.

Subsection (f)—withdrawal of registration: Registered associations may withdraw from registration upon application upon such reasonable notice and under such terms and conditions as the Commission may impose to insure orderly liquidation of the affairs of the association. This provision is similar to section 6 (f) of the Securities Exchange Act in the case of exchanges. It is further provided that withdrawal of a national association from registration shall automatically terminate the registration of any association affiliated with such national association.

Subsection (g)—review of disciplinary action: This subsection gives the Commission jurisdiction to review any disciplinary action taken by an association against a member or any action by an association denying admission to any broker or dealer who desires to become a member. Such review may be initiated upon the Commission's own motion or upon application by an aggrieved party. The commencement of proceedings for review before the Commission does not stay the effectiveness of the action of the association in any case unless the Commission specifically so orders.

Subsection (h)—proceedings for review: This subsection deals with proceedings to review disciplinary action taken by registered associations against members and proceedings to review denial of membership by a registered association. The scope of review by the Commission is complete and the Commission must consider the entire record before the association. It may also take and consider such other evidence as it deems necessary.

In any case of review of disciplinary action against a member, if the Commission finds that the accused member is guilty of the acts charged and that such acts constitute a violation of the rules of the association, the Commission must permit the action of the association

to remain in effect unless it finds, under paragraph (2) of this subsection, that the penalty is excessive. If the penalty is excessive or oppressive, the Commission may cancel, reduce, or require the remission of the penalty. In all cases where the Commission finds the member to have violated a rule of the association it must declare whether the rule is one violation of which constitutes conduct inconsistent with just and equitable principles of trade.

If the Commission finds that the member has not committed the acts charged or that the acts charged do not constitute a violation of the rule of the association which is charged to have been violated, the Commission is required to set aside the action of the association.

Paragraph (3) of this subsection provides a review of denial of membership in a registered securities association. If the Commission, after hearing, finds grounds for denial of membership to exist, it must dismiss its proceedings. Where such grounds do not exist it must order the admission to membership of the broker or dealer to whom membership has been denied.

Subsection (i)—dealings of association members with nonmembers: This subsection permits registered securities associations to adopt rules requiring each member to deal with nonmembers on the terms no more favorable than the general public receives from such member. This subsection will give registered associations an effective sanction in withholding dealer's discounts, allowances, and commissions from that portion of the business which has not seen fit to submit itself to registration or which is by reason of past misconduct, not eligible to membership in registered associations. It is specifically provided that any member of a registered securities association may grant to any other member of any registered securities association any dealer's discount, allowance, commission, or special terms.

Subsection (j)—supplementary reports of associations: This subsection gives the Commission power to require registered securities associations to keep their registration statements current and to supply such additional or supplementary information as may be necessary. This provision is analogous to section 6 (a) (4) of the Securities Exchange Act. Subsection (j) also provides that a change or addition to the rules of an association shall take effect upon the thirtieth day after a copy has been filed with the Commission unless the Commission permits earlier effectiveness. The Commission must disapprove a change or alteration in the rules of an association unless the change or alteration is consistent with the standards prescribed as conditions of the registration of the association. Thus, this provision applies the same standards to amendments to rules and to new rules as are applied to the original rules at the time the association applies for registration.

Subsection (k)—Commission's power with respect to rules of registered associations: Paragraph (1) of the rules gives the Commission power to abrogate any rules of a registered securities association if, after hearing, it appears that such abrogation is necessary or appropriate to carry out the purposes of the bill. This paragraph originally contained the provisions for preventing a rule from becoming effective which are now contained in subsection (j). It was felt that the standards applied by subsection (j) are more appropriate than the standards set forth in this paragraph.

Paragraph (2) gives the Commission power affirmatively to suggest an alteration of or supplement to the rules of registered securities

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associations in certain enumerated respects. If the association fails to adopt the alteration or supplement, the Commission may itself alter or supplement rules of the association if, after hearing, it finds such action necessary and appropriate in the public interest or for the protection of investors or to effectuate the purposes of the bill. The provisions of this paragraph are modeled on the provisions of section 19 (b) of the Securities Exchange Act.

Matters in respect of which the Commission is given power to alter or supplement the rules of an association include the following: (1) The basis for, and procedure in connection with, the denial of membership or the disciplining of members; (2) the method for adoption of any change in or addition to the rules of the association; (3) the method of choosing officers and directors; and (4) affiliation between registered securities associations.

This paragraph originally empowered the Commission to alter or supplement the rules of the association with respect to the prevention of unfair trade practices and the enforcement of just and equitable principles of trade. These powers were embodied in clauses (5) through (13), which are no longer included in this subsection. The substance of these clauses has been transferred to subsection (c) of section 15, which is discussed below. The powers of the Commission to alter or supplement the rules of the association which remain in this paragraph relate only to the organization of the association as such, and not to the conduct of individual dealers and brokers.

Subsection (1)—powers of the Commission with respect to associations, and members and officers thereof: This subsection gives the Commission disciplinary power over registered associations and individual members and officers of such associations. Specifically the Commission is authorized, when it deems such action necessary or appropriate, after opportunity for hearing, (1) to suspend for a period of not exceeding 12 months or to revoke the registration of a registered securities association for violation of the Securities Exchange Act, for failure to enforce its own rules, or for activity tending to defeat the purposes of the bill; or (2) to suspend for a period not exceeding 12 months or to expel any member from a registered securities association for violation of the Securities Act of 1933 or the Securities Exchange Act of 1934 or for participation in such a violation; or (3) to remove from office any official of a registered securities association for failure to enforce the rules of the association or for abuse of his authority as an official of the association.

Similar powers in the case of exchanges are conferred by section 19 (a) of the Securities Exchange Act.

Subsection (m)—effect on existing law: This subsection provides that this section shall prevail in case of conflict with any inconsistent provisions of Federal law which may be at present in effect.

II. Subsection (c) of section 15:

As originally drafted, section (k) (2) gave the Commission power to impose rules on an association. That provision was objected to on the ground that it was unfair to ask people to come into an association when somebody else had a right to change the rules of the game, and on the further practical ground that even though there were no unfairness in that, nevertheless it would have the effect of making it difficult to get members to come in: because people out through the country may have some fear that we might proceed unfairly, even though we had no intention of doing so.

That was revised so that the power to impose rules on the association relates only to the first four items of what was originally in section (k) (2); and the rule-making power, corresponding to the other items of what was in (k) (2), is now a power for the making of rules for the guidance of individual brokers and dealers, and not to compel an association to embody those rules into its rules.

Now coming to subsection (c) of section 15: This subsection gives the commission power to adopt various types of rules and regulations designed to prevent conduct inconsistent with just and equitable principles of trade and to assure to investors in the over-the-counter markets protection comparable to that provided under the Exchange Act with respect to exchanges. Powers specifically mentioned include the power (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 commissions or other charges, but—and this is important—not the power to impose any schedule of prices, discounts, commissions, allowances, or other charges; (4) to provide safeguards against unfair discrimination between customers, or issuers, or brokers and dealers; and I want to call your attention, there, to the fact that the power is to prevent only unfair discriminations, and not all distinctions between dealers; (5) to provide safeguards with 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; and (8) to provide for the collection, recording, and dissemination of information relating to the over-the-counter markets.

These provisions, as I said, were in a large measure contained in the original subsection (k) (2) of section 15A. There was, however, considerable feeling among representatives of the industry that membership in associations might be seriously deterred if the Commission authorized to impose obligations on members of associations could not rest equally upon nonmembers. Moreover, there was a feeling that action by the Commission should be under its rule-making power, pursuant to the statute, rather than in the position of rules of conduct which, when adopted, would be rules of the association.

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in its original form was largely patterned after the Securities Exchange Act of 1934, which gives the Commission powers in regard to exchanges. We feel, however, that the proposed change is desirable. Under the new provision will be able effectually to exercise its rule-making power in two respects: First, it will be able to lay down similar requirements for exchanges in raising the standards of compliance. Second, the Commission to step into situations where exchanges are unable to do the job themselves.

I would take your time on, this morning, if you are glad to answer them if I can. I will call on Mr. Katz, if the ques-

(The letter referred to is as follows:)

SECURITY DEALERS ASSOCIATION OF NEW ENGLAND,
Boston, January 29, 1938.

Hon. FRANCIS T. MALONEY,
Senate Office Building, Washington, D. C.

DEAR SENATOR MALONEY: I am in receipt of your courteous telegram offering me an opportunity to appear before the Senate Banking and Currency Committee in the hearings on the over-the-counter bill.

Having sat on the committee which conferred with the Securities and Exchange Commission in regard to the general principles to be arrived at, which your bill pretty well covers, and with the principles of which I am in accord, I do not feel that I can further contribute material help to your committee.

However, I do feel that the mechanism for regional and national associations and their proper and adequate financing will be very difficult to establish satisfactorily. Estimates vary greatly as regards the cost. I have heard them run as high as \$5,000,000, which, I am frank to say, seems to me to be excessive, but any substantial addition to the operating cost of the investment business under a continuation of such conditions as have obtained this last year, would be an almost intolerable burden to most of the investment houses, however great was their good will.

It is an open secret that very large amounts of capital have been lost by the industry in recent months, not only by the large underwriting houses but also by the small distributing organizations. Aside from inventory losses this arises chiefly from two facts: The complete break-down of confidence on the part of the private investor, resulting in a frightfully diminished volume of business to a point that, at any fair spread of profit charged those who still have the courage to buy securities, gross income is not adequate to pay operating expenses; and, second, to the fact that there has not been issued for almost a year a type of security suitable for the small conservative private investor who needs a combination of safety and a fair rate of income, at the sacrifice of a moderate degree of marketability, to supply his daily needs.

Good quality issues have been confined almost entirely to institutional bonds. Investment houses no more than commercial businesses can exist on turning over and over securities already on the market, which their clientele has never bought and sees no particular reason for buying now. In such the spread of profit is, except in the less desirable securities, inadequate for the labor involved. Just as in the original placement of institutional bonds, the buyer is willing to pay two or three points above the cost to the bankers, but later after placement expects to buy them on the spread of one-fourth percent to one-half percent, so in the private investment business, investors are entirely willing at first to pay a wider spread than later.

The opinion is widely held by investment bankers, who have shown excellent courage and ability during the depression, that if this combination above described continues any great length of time, the investment banking machinery of the country will be threatened with an almost complete break-down on account of the almost daily diminution of capital.

This is a matter which should engage the serious attention of the Congress, and for that reason I am bringing it to the attention at this time of your committee.

Very truly yours,

WALDO KENDALL,

President, Security Dealers' Association of New England.

The CHAIRMAN. Then, if there is nothing further at this point, we shall adjourn until tomorrow morning at 10:30.

(Whereupon, at 11:50 a. m., an adjournment was taken until tomorrow, Wednesday, February 2, 1938, at 10:30 a. m.)

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ASSOCIATION OF NEW ENGLAND,
Boston, January 29, 1938.

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REGULATION OF OVER-THE-COUNTER MARKETS

WEDNESDAY, FEBRUARY 2, 1938

UNITED STATES SENATE,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D. C.

The committee met at 10:30 a. m., in the committee room of the
Senate Committee on Banking and Currency, Senate Office Building,
Senator Robert F. Wagner (chairman) presiding.

Present: Senators Wagner (chairman), Adams, Maloney, Rad-
cliffe, Brown of Michigan, and Townsend.

The CHAIRMAN. The committee will be in order.

I understand that Commissioner Mathews desires to testify briefly
this morning with reference to some newspaper account of his testi-
mony yesterday, which he feared might have created the wrong im-
pression of his testimony. Is that correct, Commissioner Mathews?

Commissioner MATHEWS. That is correct, yes.

FURTHER STATEMENT OF GEORGE C. MATHEWS, COMMISSIONER,
SECURITIES AND EXCHANGE COMMISSION, WASHINGTON,
D. C.

Commissioner MATHEWS. Judging from the newspaper accounts
this morning, I think that something that I said yesterday was mis-
understood.

The impression seems to have been gained that I estimated the
cost to one of these associations as \$5,000,000 a year. I think the
record will show that I made no estimate of the cost to one of the asso-
ciations of doing its job; that where I spoke of cost, I was speaking
of what the cost might be if the Government had to handle the entire
program directly.

I have not yet seen the transcript of the record, but my recollec-
tion of my statement is that the \$5,000,000 figure was mentioned in
connection with the complete program of direct regulation by the
Government, including the carrying out of the activities which the
Government might have to perform if it had to continually supervise
the financial responsibility and keep itself informed of the financial
condition of people in the business.

I merely want to correct any wrong impression that may have been
gained from my testimony. Thank you.

The CHAIRMAN. Thank you, Commissioner.

Our first witness this morning is Mr. Joseph C. Hostetler, a mem-
ber of the firm of Baker, Hostetler, Sidlo & Patterson, of Cleveland,
Ohio. Mr. Hostetler is counsel for the Investment Bankers Con-
ference, Inc.

We shall be glad to hear from you, Mr. Hostetler.

STATEMENT OF JOSEPH C. HOSTETLER, MEMBER OF THE FIRM OF BAKER, HOSTETLER, SIDLO & PATTERSON, CLEVELAND, OHIO, COUNSEL FOR INVESTMENT BANKERS CONFERENCE, INC.

Mr. HOSTETLER. Mr. Chairman and Senators, this bill, a copy of which as printed yesterday I saw for the first time this morning, takes care of most of the incidental matters which we have discussed with the Securities and Exchange Commission relative to this bill. There are a few items in it which I still feel we might discuss further with the Securities and Exchange Commission. Inasmuch as there are a number of witnesses here this morning, I am not going to take the time to go into them, but it is with regard to the language on page 5, section 7, dealing with minimum profits or minimum rates of commission.

The conclusion to which I come after reading this bill is that the first portion of it is workable as a basis for what we have all been calling self-regulation in the investment banking business.

I was not here yesterday, and therefore I do not know the extent to which Mr. Mathews outlined the approach of the securities group that I represent to this; but, briefly, I would like to see it. When we set about drawing a code for the investment banking business, the idea was developed that if we could create in that code a group of investment bankers who would agree to be bound by the rules in their spirit as distinguished from technically, it would be advantageous in the conduct of the business under the code. So, originally in that code it was provided that there could be a group of registered investment bankers who would agree to be bound further than the law bound all in the industry; they would be bound by the code in its spirit as construed in the light of the reforms to be accomplished.

In order to protect the men who agreed thus to be bound as distinguished from being bound by the strict construction of the law in the courthouse—

Senator TOWNSEND. By whom was the code to be set up?

Mr. HOSTETLER. By the investment bankers, under the old code authority, and with the approval of the Government.

In order to protect those who agreed thus to be bound by the spirit of the code, we provided that they might hold their operations among those who were similarly bound. I have always felt that when that code was approved it was a bold and fine thing that was given to this industry to try to do.

We then set up the registered investment bankers' group under the code and divided the country into 17 districts, with district organizations in each district, so that complaints under the code could be heard, determined, and settled with the least possible expense to the person who had the complaint. That is, a man in Denver who bought a security from a man in New York and then had a complaint could go to the Denver code authority, without needing a lawyer or anybody else. He could merely tell his story, a report would be made from his standpoint, it would be sent to New York and investigated from the dealer's standpoint, and then forwarded to Washington. In the year and a half that that group was operating it handled between 100 and 200 complaints perfectly satisfactorily, easily, and without any delay.

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When the code became inoperative, then the council was organized to try to hold the group together until such time as some basis for self-regulation or cooperative regulation—whatever you wish to call it—was developed.

The reason I am calling your attention to this language at the bottom of page 5 is that one of the things which I believe the Securities and Exchange Commission is going to want to have covered in a set of rules is some method of protecting a security during what is called the distribution period. There are, as all of you gentlemen know, two methods of distributing securities. Under the English method a security from the day it is put out, if it is registered on the exchange, is not protected in its distribution. In this country your syndicate groups agree that during the distribution period the security is to be sold at the price registered with the Securities and Exchange Commission.

The thought in my mind is whether or not this language binds the Securities and Exchange Commission so that it could not approve the language of an association which had in its rules anything with regard to the maintenance of the distribution price during that period. However, I think that is a technical question which can probably best be worked out between us and the Commission.

The CHAIRMAN. What particular language is it?

Mr. HOSTETLER. It is in lines 23 and 24 of page 5.

It would be only fair for me to say that Mr. Katz and Mr. Davis think that that language does not refer to original distribution. I think that we can straighten that out.

Senator ADAMS. Do you think that the practice of maintaining a price by agreement among distributors during the distribution period is a sound one?

Mr. HOSTETLER. I do. I think you must either do that or go to an entirely different system of distribution. We file with the Commission the price at which an issue will be bought and the price at which it will be distributed to the public. During the period of distribution in this country syndicate agreements have constantly provided that it will be sold at the issuing price.

Senator ADAMS. I am familiar with that, but my question was asked from the standpoint of the consumer or purchaser of securities. I should like to know whether or not he is receiving fair treatment. When a security is offered to him at a certain price and he inquires of this firm and finds that the price is so and so, he then inquires of another firm and the price is the same, and there is a maintenance of a level which is based upon an agreement rather than on value or market price, based upon the interchange of the opinion of the buyer and the seller, I should like to know whether or not it does not afford an opportunity for the purchaser, for his own personal investment, to be misled by these syndicate agreements.

Mr. HOSTETLER. Personally, I do not think so; and I do not think there is any doubt in the world that the group in the original distribution has the right by contract to make that agreement during the original distribution period. All I meant was that I would like to see as much leeway as is possible in the Commission, in working out the rules of these associations.

Senator ADAMS. Of course, I have naturally a very limited knowledge of it, but I had an initial prejudice against these syndicate

agreements, which goes back a good many years to the time when the stock of the Mammoth Oil Co. or the Sinclair Co. was distributed under one of those agreements. That left in my mind an initial prejudice against the practice of syndicate agreements for the maintenance of the prices of securities regardless of the value of the securities.

Mr. HOSRETLER. My understanding, Senator—and the gentlemen who are in the business know it; I really do not know it—is that the difference between the English method and our method is that where a security is not protected during distribution it leads to a much harder transaction between the distributor and the issuer as to price. In the sale of a security the issuer tries to get the money as reasonably as he can and at as high a price for the issue as he can. Where there is not any listing, the market does not control. Where you are issuing the open end of a large mortgage, where there is some on the market, dealt in day by day, you have another problem; but where you are issuing a new security, until it is listed on an exchange you have not got that problem. Where you list it immediately on the exchange and distribute it against the exchange dealings, I think you will find it makes for dearer money by subjecting it immediately to its own competition and to the competition of a person who may bid a quarter off and who is willing to sell at one-eighth off in order to make an eighth. In other words, it is dealing in quick transactions, which slows up the distribution of the whole issue.

It is a big question as to how you ought to distribute, as I understand it, but I think that the Securities and Exchange Commission ought to have the right, so far as the rules of these registered associations are concerned, to have as much leeway as possible to make the thing workable in accordance with any particular method that there may be for distribution.

There are eight or nine other witnesses here, and I realize there is a shortage of time; therefore, I shall not take more than my share of it.

I think that section 2 of the bill, which is the section with reference to the additional powers to the Commission to make rules, raises a question. I am just torn as to how I shall say this. I have a feeling that if I do not say what I want to say, I would be dishonest to you.

Senator BROWN of Michigan. Where do you find that section?

Mr. HOSRETLER. On page 16, and it goes over to page 17.

Originally those powers were put in as a right to make rules for the association. I urged that they ought to be taken out, because they ought to be applicable to the whole industry rather than to the registered dealer.

The easiest thing would be to say that the first part of this is workable and to say nothing about the last part; but I really feel that the last part is unnecessary during the period of the formation of your association. I hope you will believe me, because I am saying the truth.

It is a job to form this association. America is a very large country. In preparing the Investment Bankers' code, almost 6 months were required for its drawing. Committees from everywhere came in, because every community had its own practices, which were peculiar to that community and to their particular kinds of securities.

It is not so hard to draw rules for the large distributors and large associations, but to fit in the rules so that they are applicable in all of the districts of the United States is a job. I feel that during the

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trying to work out its own administration, with the approval of the
Commission, than it is to have it under some sort of compulsion,
carried on by the fear that someone is going to start to make the rules
if they do not.

I think that there would be plenty of time to do what is proposed
in section 2 if section 1 does not work. I think that section 1 has a
better chance of going if section 2 is not in. I realize that from the
standpoint of many people that might be difficult to understand, but
I merely know that if you had sat, as I did, with hundreds of dealers
from all over the Middle West, in Chicago, trying to explain to each
one how a given rule works in his particular instance, it is a job that
requires the highest degree of cooperation.

For instance, just let me illustrate—

Senator Brown of Michigan (interposing). What is there to induce
or to cause those who do not care to be regulated to come into the
association? It seems to me that that is the purpose of the provisions
of section 2.

Mr. HOSTETLER. Of course, the purpose of section 2, if you consider
it from that viewpoint, is that you are going to try to form this self-
regulatory body by fear. I do not think that is the basis on which
to build it. I think it is essential that this business produce, as nearly
as it can, the ethical standards of a profession. I think such standards
are too important to the prosperity and life of this country as it is
set up not to do that. I think that was the strength that did it
before; I think that is the strength that is going to do it now.

I began to illustrate. It is clear, for instance, that the person who
walks into an office of an investment banker ought to know whether
he is dealing with that man as an agent or as a broker. That is
perfectly clear. We spent weeks in trying to figure out how to give
that information to him in a way that was completely clear and at a
time when he was not yet bound to the transaction.

It is easy enough for someone to say, "Well, the way out of that
is to segregate the two." I do not think you can segregate the two
and still leave people in business in the smaller communities. When I
say "smaller communities," I do not mean towns of 10,000; I mean
cities such as I come from—cities from half a million to a million and
a half. There just is not enough underwriting business there to keep
anybody alive. There is not enough brokerage business alone; a man
has to do a general business.

We finally determined that the way to let that purchaser know
was to print it right on the face of the confirmation, which is what I
think they call it. In order to make that operative, we had to start
out and try to change the method of doing business in all shops where
the confirmation did not come at the right time in the line of procedure.
In other words, we were almost a year having committees and auditors
going to members, arranging their bookkeeping, their receipts of
orders, confirmations, and executions of orders, in accordance with
the plan which would enable that notice to be given in accordance
with the rule. It is not that those who are members do not want to
comply; it is that you have to set up, by careful preparation, the
technique of the business in order that they can comply with the rule.

I feel that in the original designation of the registered list, which
was the birth of this idea, the reason that impelled it was the conviction
on the part of this business that it was advantageous to the

business and necessary to have that type of regulation of its transactions. I think that is so. I think on that basis you can get further quicker and better than you can with any element of fear being the sole element.

Senator Brown of Michigan. From the customer's standpoint, the only knowledge that he would have that he was dealing with a regulated group rather than with a nonregulated group would come from that group itself?

Mr. Hostetler. Yes. Of course, with the power in this—

Senator Brown of Michigan (interposing). I am assuming that that section is not in the bill.

Mr. Hostetler. That is right. With the power in this bill which gives to registered associations the power to restrict their dealings to other registered associations, if there is a registered association of really representative membership throughout the United States, that will be quite enough inducement.

Senator Brown of Michigan. Do you think that people would not deal with brokers who were not members of the association?

Mr. Hostetler. I believe that brokers would have to come in and agree to be bound under the provisions of this act.

Senator Brown of Michigan. Do you think that that is sufficiently covered without section 2?

Mr. Hostetler. I certainly do. Assuming that there is a representative group that complies with the requirements of the Commission and organizes an association, and it has the right to restrict dealers' associations to participations in distributions in the registered group, I think there is quite enough incentive to make that very effective, always under the Government's supervision. We have never asked to do it otherwise. That would not be sound.

This is a very intricate business. You have to consider not only the large issues—these issues of \$50,000,000 and \$75,000,000—but you have got to consider the man who needs \$100,000 or \$200,000. His situation, I will tell you, is entirely different. Such business has got to be covered by a code that is flexible enough to allow regional operations and stiff enough to accomplish your objective. I think it can be done, but I do not think it can be done in any other way than by having this industry, as an industry, start in and make up its mind to do it. There is nothing it cannot do if it makes up its mind to do it.

There is not a business in the world that conducts as large transactions over the telephone as this business does. You know that today there will be from 10,000 to 50,000 telephone calls, and they will involve from 10,000 to 50,000 securities. Such a method must be followed in order to conduct this business.

I feel that if you offer to this business what they have wanted, which is the first portion of this bill, the next thing to do is to let them start out and try to perform. It will not be a matter of performing overnight. It cannot start that way. You have got to sell it to the man in Oskaloosa, Fla., Terre Haute, Ind., and in the cities in Idaho and in all the other States. You have got to get it agreed to. It is a job to do that. While that is going on, I really do not think it would be helpful to say to them: "If you don't do it, the bogeyman is going to get you." I think that is the wrong way to set it up.

I think that if this self-regulation does not move as the Securities and Exchange Commission thinks it ought to during this first period,

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the Securities and Exchange Commission has full right to approve or
reject the rules proposed by every association that applies for member-
ship. During that period, I do not think you need the second section
of this bill. Afterward, however, if it does not work, and if Congress
is in session, you can ask for whatever you want.

It would be easier to slough it over, but I really think it is sounder
not to have to use the force; rather let this business try to organize,
because it is the thing they ought to do.

The CHAIRMAN. Do you think they will do it?

Mr. HOSTETLER. I do. I think it would be born exactly as all
other types of professional ethics are born—out of necessity. You
are a lawyer, and you know that our legal ethics are born in such a
way. We could not practice law if we did not have rules.

If I go into a store to buy some nails, there is no particular ethics
about that. If I can get them next door for 5 cents a pound, and you
are selling them for 10 cents a pound, that is up to me.

I think the wisdom of doing this is so plain, although the experience
may not be complete. It would be a mistake for me, Senator, to
indicate that under the year and a half of the code we had all types
of markets; we did not. The code was pretty largely administered in
a very quiet market. It had not stood the test of a boiling market—
a very active market. But with a will, I think it can be done, and
I think it will be undertaken. I realize that many of them will
wonder about many of the provisions and the possibility of making
them effective. That is bound to be. You are starting something
you have never yet done. I think probably most of the doubt will
be on the part of the very best elements in the business, because you
have seen and I have seen now, if you have drastic rules which you
cannot enforce, the people who suffer are the best, because they abide
by the rules while nobody else does. But I believe even these will
undertake to utilize this opportunity. I certainly hope so.

The CHAIRMAN. You think that if they do not, the provision will
just invite drastic legislation?

Mr. HOSTETLER. I think that if in the next year, as these rules and
regulations are being submitted to the Securities and Exchange Com-
mission—I think the Commission should have complete control over
it—if the thing is not organized as the Commission thinks is proper,
then, I think, there is plenty of time to ask for the additional legisla-
tion.

The CHAIRMAN. Thank you Mr. Hostetler.

Commissioner Mathews wants to make a further statement, in
connection with the one he made earlier this morning.

**FURTHER STATEMENT OF HON. GEORGE C. MATHEWS, COMMIS-
SIONER, SECURITIES AND EXCHANGE COMMISSION, WASH-
INGTON, D. C.**

Commissioner MATHEWS. The representative of the New York
Herald Tribune calls my attention to the fact that in the article which
appeared in his paper this morning, the quotation, when the article
is more carefully read, clearly relates back to another party, rather
than to myself, as to the cost of these associations.

Unfortunately, that particular story was read hurriedly in getting
ready to come down here this morning. The fact that the quotation

was taken from another man was not understood at the time I came here. So far as that particular story goes, I would not want to leave with the committee the impression that that representative had any misunderstanding of my testimony.

The CHAIRMAN. Our next witness is Mr. B. Howell Griswold, Jr., of Baltimore, Md. Mr. Griswold is associated with Alex Brown & Sons and is chairman of the Investment Bankers Conference.

STATEMENT OF B. HOWELL GRISWOLD, JR., CHAIRMAN, INVESTMENT BANKERS CONFERENCE, BALTIMORE, MD.

The CHAIRMAN. Proceed, Mr. Griswold.

Mr. GRISWOLD. Mr. Chairman and Senators, of course, I did not have the advantage of hearing the discussions yesterday, but I have been told that as a matter of record it has not been made quite clear to all of you what the Investment Bankers Conference is and who constitute it. I am going to endeavor to do that in a very few moments. I want to make perfectly clear, if you gentlemen will permit me to do so, the distinction between the Investment Bankers Conference and the Investment Bankers Association. They are so closely related in name that a distinction has to be made. Therefore, when I speak today for the Investment Bankers Conference, I want to make it clear that in no way do I speak for the Investment Bankers Association; they doubtless will speak for themselves.

The Investment Bankers Conference is an outgrowth of the old code. The Investment Bankers Association was responsible in large measure for the drafting of the code. I had no part in the drafting of the code, although I should have been glad to be able to participate in it; in fact, I should have been rather proud to, because I think it did a fine job. I was called in at the end to serve as chairman of the code committee. Naturally, anyone is reluctant to take a job of that sort, but it did serve to give many of us a national picture of the business that I think few had had up to that time.

It was not merely the difference between the small dealer and the large dealer and the rights of the small dealer as against those of the large, and vice versa, but we endeavored also, at the same time, to understand the geographical distinctions throughout the United States. The investment business in one section of the United States is often differently conducted in many respects from the same business conducted in other sections. The habits of customers and dealers have grown up in different ways. Then, too, there are different types of dealers and investors, and if you desire to be fair to all of them you have to understand each section of the country.

As we went along it became more and more evident that the investment banking business probably did not belong under the N. R. A. The reasons were numerous.

When it comes, for example, to the making of nails, to use Mr. Hostetter's illustration, you are in competition with other nails and other nail manufacturers. Your product is a fresh product which competes with the fresh product of other manufacturers; it does not compete with old or rusty nails. But in the investment business there is not any new issue or old issue that you sell that is not in competition, theoretically at any rate, with all the issues outstanding in the financial markets. The investment business is a different kind of business.

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CHAIRMAN, INVEST-
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Therefore, it became clear at that time, I think, to Mr. Kennedy and to Mr. Landis, and to ourselves, that there was more of an alliance between the Securities and Exchange Commission and our line of business than there was between the N. R. A. and our line of business. Informal discussions had taken place, and when the act creating the N. R. A. was declared unconstitutional we were invited—I would not say invited; I would say by mutual consent—by mutual consent we sat down to see whether or not we could save some of the principles of ethical practice in our code and continue to apply them for the good of the industry itself. If you want to put it selfishly, because an enormous amount of harm is done to the decent investment banker, who really does not need a code.

Many of the things that were in the code simply expressed the customary manner of trading on the part of the better houses. And those houses never thought of doing business in any different terms. Yet in this sense, you are your brother's keeper, and you are for your own protection, for if someone who calls himself an investment banker, and perhaps has an office in Wall Street, fails, it appears that a "Wall Street firm" has gone crooked. It is a misunderstanding on the part of the public, very often, but it is sufficiently serious to invite decent people in the business to work out the suppression of people of this sort, just as they have attempted to do in a mild way in the legal and medical professions, to lead the minds of those in the business on to decent practices.

Do not think therefore that I am speaking as a missionary of lifting the ethics of individuals; I am speaking in a practical sense. You have got to have honest people in the business, whether they handle large or small transactions. If you do not have honest methods you are going to do great harm to the investment business.

Building up a system of good practices, the Investment Bankers Conference has nothing to do and never can have anything to do with the control or punishment of criminal acts. That is not within our scope at all. Further, it is clear, as you go along, that you simply do not convert people to fair practices by force of law. You find that people evade laws of this sort. I think that in working out a system of fair practices we could do very much more than the Government itself could do. I repeat, I am not talking about the enforcement of criminal law; I am speaking about fair practices. The reason for that is this: If you have the Government with the power to regulate and it puts in those regulations certain directions as to how you may act, such regulation has the force of law, and when you bring a charge against a man, you bring the charge against him as if it were a criminal indictment. He may be invited to Washington or to some other place for a hearing, or he may be called from California or any other State, with his lawyers and others, to a hearing. There is a very great disinclination on the part of people to subject people to anything of that sort for what is obviously only a violation of fair practices. Under such circumstances, you will not get the complaints. People will not make that kind of complaint—most people—if they know it is going to be a matter of a quasi-criminal indictment.

We have today about 1,700 members. There are about 6,700 people registered as investment bankers. There is a very large percentage of those who are not continuously in the investment banking business as we are accustomed to use the term—people who want

commissions, or engage in oil royalties, and various other lines. We have tried to break down the figures to determine how many there are really actively engaged in the investment banking, dealer, and broker business, and as a fair guess, not to be relied upon, but simply as a guess, I think we might say there are perhaps 3,200. There may be more or there may be less. We have 1,700 members at the present time.

One of the most encouraging things, Senator, which leads us to believe that something can be done is that these 1,700 firms have stood by and put in a contribution during all of these past years for the purpose of moving onward toward the objective of greater decency in the business. These 1,700 are large and small houses. Anybody is eligible to our particular group who is a registered banker.

With this background I shall try to give you an idea of what we, in a sense, hope to do. We, of course, have not had an opportunity to go back to the 1,700. Yet, their whole conduct and their willingness to trust the 21 governors who come from every section of the country and who know all the various features of the general investment broker's and dealer's business, indicates a most cooperative attitude. We have 21 members of the board of governors, elected from different sections of the country. We have 14 district committees, each covering a separate area of the United States, through which we attempt to carry on our plans for establishment of rules for fair practice and educating brokers and dealers, as well as the investors, as to what are rules of fair practice. We invite investors to come in and make their complaints. If a man has a wrong and you sit down and find out that there was no wrong committed, that it was simply a mistake that somebody in his office made, and that he is extremely sorry for it, an adjustment is quickly reached by the parties, unless some criminal act is involved, in which event we would refer it at once to the criminal authorities.

The thing that I believe is likely to happen to the S. E. C., as time goes by, is their effort to enforce what you might call traffic regulations will eventuate in almost complete failure. I think the history of the past has shown this. You cannot reach into the habits of the people and try to enforce, by law, certain things which are unenforceable from the standpoint of their customary habits.

I am trying to speak from the standpoint of judgment of past experience. It does seem to me that if you will think of us in the light of traffic guides, you are getting a correct idea of our purpose.

The idea of a traffic man is to keep business moving. Of course, he has got to arrest here and there, but if you find a traffic man whose mind is overcharged with the duty of criminal prosecution, he ends up by blocking traffic. The thing to do is to keep business moving if we can. It is important at the present time to keep business going. The reason is—and I will give you the figures exactly a little later on—that the amount of new reproductive capital that goes into business in this country is not what it should be at this time. Under normal conditions it is between 4 and 5 billion dollars a year. Now what we are doing is refinancing old debts. Estimates covering the years 1921 to 1930, indicate an average of \$4,500,000,000 of securities issued for new and productive purposes. Of this amount approximately \$3,000,000,000 per annum would have been registerable with the Securities and Exchange Commission. The securities registered

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and designed for new and productive purposes (notwithstanding the
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 and \$725,000,000 in 1936, against a normal per annum of \$3,000,000,000.

At the present time we turn over the same old business and reliance.
 The banks too are turning over the same old business again and again.
 We must get a reproductive atmosphere in this country, with new
 securities going out promoted by capital and new securities issues
 which will employ new labor and create, in turn, new business. It is
 important that that should be done, and I think that what we are
 discussing today moves onward toward it.

To come to the bill itself, we have had a meeting of the governors
 of the conference committee. I think there were 18 of them there.
 We had, also, men from different sections of the country who belonged
 to our regional committees. There were 38 men at the meeting. We
 went over the bill, item by item—not this one, but the one before—
 because Senator Maloney had asked us to make a study of it. We
 brought it back and presented it to Senator Maloney with changes,
 and Senator Maloney, in turn, asked us if we would present it with
 our suggestions to the Securities Exchange Commission.

The CHAIRMAN. May I interrupt you for a moment, Mr. Griswold?
 I shall soon be obliged to go to another committee to vote. I have asked
 Senator Adams to preside in my absence.

Mr. HOSTETLER. May I interpose for just a moment, Mr. Chair-
 man?

The CHAIRMAN. Yes, sir.

Mr. HOSTETLER. I referred to the necessity of discussing paragraph
 7 on page 5 with the Securities and Exchange Commission. As I
 understand it, there will be an opportunity, if the committee is still
 in session, if something of these conferences that makes us want to
 make a statement, to come before you to express our views.

The CHAIRMAN. Of course. We are acting in cooperation with all
 of the parties interested.

Mr. HOSTETLER. I just wanted to say that, because you asked me
 the question, and I answered it as seriously as I could. There are
 some provisions which I think we have got to work out in order to
 try to be sure that we have the correct authority to limit our dealings
 to registered associations.

The CHAIRMAN. I am sure that I speak the views of every member
 of the committee when I say that we want to cooperate in every way
 possible with the Securities and Exchange Commission and with those
 who are affected, so as to bring about legislation which is workable
 and in the public interest.

Mr. Griswold. Well, Senator, the result of that meeting was that
 after we had gone through every detail there were a number of minor
 objections, but one particularly serious objection, and that was to
 what was known as (k) (2). That seemed to be a unanimous objec-
 tion. The rest of it was detail work and most of those objections have
 been ironed out. We made that report to Senator Maloney.

That brings us down to what is known as section (2). The various
 extensions of power which have been granted to the Securities and
 Exchange Commission had been in the original bill, under titling
 "(k) (2)." We had stated to the Securities and Exchange Commis-
 sion that we did not believe that we could form an association which
 over its own protest could be ordered by law to enforce these additional

powers. It became a penalty upon those who joined the association, for there was no provision by which these new powers could be imposed upon those who were not members of the association. The potency of the argument was appreciated, and the provisions were removed from (k) (2). They now reappear, however, in section (2), which is designed to give these powers to the Commission itself, in which event they would formulate their own regulations and would be obliged to administer them directly and individually to all registered investment bankers.

Now, when we reach section (2), I have no right to speak for the conference. I would say that I have the right to speak for the conference about section (1) as it now stands. I would say that we have not only approved the principle of section 1, but, subject to a few other changes, the language of the bill.

I would have no right to speak about section (2) because the Investment Bankers Conference suggested that it should be removed from the bill as a whole. We should like, therefore, to make a much fuller study of the import and significance of section (2) and its relationship to the section dealing with a national institution.

I agree with Mr. Hostetler that there are certain implications and language existing at the present time which will require a great deal of study before we can speak with regard to section (2).

Senator MALONEY. The possibility of your fear with regard to section (2) would be as Mr. Hostetler explained, in connection with the organization of the dealers now under section (1)?

Mr. GRISWOLD. That is a fear that would have to be removed before I would say that we could work under section (2). We have not had time to consider the import of section (2) as now separated from the main body of the bill.

The CHAIRMAN. Thank you, sir.

STATEMENT OF FRANK DUNNE, NEW YORK CITY, PRESIDENT, NEW YORK SECURITY DEALERS ASSOCIATION

Mr. DUNNE. Senator Wagner, gentlemen of the Senate; the New York Security Dealers Association, as you probably know, is the pioneer organization for self-regulation in the over-the-counter business. The need for what is practically embodied in this bill under discussion was seen by us about 12 years ago. We, naturally, are in favor of the bill. We think that it is time that something was done to get the whole industry in line in the matter of self-regulation.

Because of the way in which we have seen our small association work out and have seen its influence throughout the Nation on the industry as a whole, we can see only benefit that would accrue as a result of self-regulation by the industry. There is just one thing which, from our experience, we cannot become optimistic about, and that is that there will be no rush for dealers to join up. It has been our experience that the dealers will set up all sorts of reasons for not joining self-regulating associations. In the first place, the majority of dealers do not like what is really self-regulation; secondly, they do not like the expense of it; third, they like to see the other fellow do the job for them.

I think the right procedure to follow is to educate the dealers and brokers of the country in the over-the-counter business as to the

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