THE OVER-THE-COUNTER MARKET AND NASD

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A. ORIGINS AND DEVELOPMENTS OF THE OVER-THE-COUNTER MARKET

It is a great honor to be able to participate in a program of such importance to the securities business. For this opportunity I am indebted to the Investment Bankers Association, and in particular to its Educational Committee, a member of which described the subject of the address in these words: "We would like to have you deliver a lecture on the over-the-counter market and NASD."

In thinking over the assignment, it seemed to me that perhaps the most fruitful course to pursue in handling such a broad subject would be to go back to the beginnings of the over-the-counter business in this country and see what were its early characteristics, its dominant traits, and then to chart roughly the main trends of development through the years. There is an old saying: "The child is father to the man," which modern psychiatrists tell us is profoundly true. It may be that this study of origins will show that formative influences have also left their deep imprint on the securities business. What we are looking for are permanent characteristics, basic principles, which will enable us to evaluate more accurately our present position.

In dealing with the second phase of the subject, NASD, we shall find the same method of procedure valuable. For we shall not appreciate the real significance of NASD if we consider it as a separate entity, something which began to function a few years ago in January, 1940. Like the over-the-counter business itself, of which it is part and parcel, its roots are in the past. It is one segment of the larger picture of regulation -- of the growing sense of responsibility to the public which has been developing through the years. The NASD did not create the rules of fair practice out of new cloth. The Securities and Exchange Commission did not invent those rules. Where did they come from? Who laid the foundations on which NASD is based?

Other speakers on the program of this excellent course of study for the training of investment bankers have or will discuss various important phases of the over-the-counter market, its present organization, activities and functions. In this lecture, dealing with backgrounds and trends and some of the whys and wherefores of development, I am going to paint with a very broad brush.

First of all, what do we mean by the over-the-counter market? Briefly, this market embraces all transactions in securities not made on stock exchanges. In size and diversity of issues dealt in it is far greater than all the nation's stock exchanges. The underwriting and distribution of new corporate issues are accomplished through the mechanism of the over-the-counter market. Today, practically all the buying and selling of government, state and municipal bonds and a majority of the transactions in corporate bonds is over the counter. Activity in preferred stocks and various specialized types of common shares and investment trust units is also largely over the counter. Only in the common stocks and perhaps the more speculative types of preferred stocks and bonds do stock exchange volumes exceed those off board. Although it deals in listed as well as unlisted securities, its predominant concern is with new issues, and the obtaining of capital necessary for private enterprises to develop and expand is its most important function.

The phrase "over the counter" has come down to us from an early period of the nation's history. As securities increased, commercial and private bankers began to specialize and trade in them over their counters and by personal contacts in their local communities. Today the phrase does not adequately portray the functions of this vast, nation-wide market, for modern business is more over the wire than over the counter. Another descriptive term sometimes used is the "unlisted market." This is an incorrect designation because much business in listed

securities is transacted in the over-the-counter market, and some unlisted securities still are traded on stock exchanges. Another recent coinage is “off board,” which is accurate and illuminating. But both these terms -- unlisted and off board -- describe by negative labels a market which is greater and far older than any stock exchange.

However the business is designated, there is no doubt about its antiquity. The East India Company, organized in 1602, has been called the first modern corporation. Subscription to its capital stock was open to anyone. Under its flag in 1609 Henry Hudson explored the river which bears his name. Virginia was founded in 1607 by a commercial company primarily interested in profits. In the Mayflower, each adult voyager held one share in a joint-stock enterprise, or two shares if he outfitted himself or paid for his transportation. It is not too much to say that this nation was founded by the cooperation of groups of stockholders, and these adventurers or investors or speculators -- call them what you will -- were the first to open up our frontiers.

In this country a pioneer invitation to the public to take stock in a private enterprise occurred as early as 1645 when the British proprietors of an iron-works decided to retire and the American proprietors needed capital to curry on.

As the country’s population and needs increased, it became customary to form societies for the encouragement of manufacturers, agriculture, the establishment of banks and the promotion of turnpikes and canals. The cooperation of wealthy men was enlisted, surveys of the projects were made and bills introduced in the legislature for enabling acts.

One of the earliest recorded public distributions of an issue of securities was that of the Bank of North America, chartered in 1781 in Philadelphia. By 1786 its stock was owned by citizens of at least nine states on the Atlantic seaboard.

To these beginnings of share distributions which have already been mentioned, there should be added the first two great securities speculations of this country. The first was the funding of debts incurred for the conduct of our War of Independence. Alexander Hamilton proposed to the Congress of 1790 to fund this debt at face value and interest at 6 per cent, to pay off the foreign debts and to assume full responsibility for the payment of the war obligations of the states. The total sum involved was about $75,000,000. The Continental currency was "not worth a continental," as the phrase of the day went. The domestic debt, consisting for the most part of certificates distributed throughout the country to citizens and soldiers in return for services and supplies, was in little better shape. A brisk trade developed in the securities and soon the 6 per cent "stocks" as they were called, were selling at a premium at home and abroad. This was a notable achievement for the struggling young nation and greatly enhanced its credit.

The second great financing operation of this period was the public offering in 1791 in Philadelphia of 20,000 shares of the first bank of the United States at $400 par. It was over-subscribed to the extent of 4000 shares soon after the books were opened.

During this period of the country's growth, the primary need was for better transportation facilities, and the financing of canals, turnpikes and bridges went on apace. The first canal of importance in America was authorized by the Virginia legislature in 1785, and the first turnpike by the Pennsylvania legislature in 1792. The records reveal that shares in these ventures were eagerly sought by citizens. An editorial in Dunlap's American Daily Advertiser of January 2, 1792, describes the feeling of the people toward these projects. A water communication between Susquehanna and Schuylkill had long been talked of, but wiseacres shook their heads and croaked, "Where will the money come from?" When finally the undertaking got under way and citizens were asked to subscribe, the editorial commented:

"....The four hundred thousand dollars were actually subscribed within a few hours -- and instead of any difficulty in raising the money, there is a serious contest among those who have subscribed and offered to subscribe about their right to subscribe!"

For many years, until the states passed general incorporation laws, a special act was required for each business project whose sponsors sought incorporation. These special acts are of engrossing interest in their effects upon the development of business and syndicate practice. The appointment of commissioners to take subscriptions, the public notice required, the place and manner of opening the subscription books, the number of shares to be offered and the price and terms of payment, the minimum subscription necessary to form the company, the handling of over-subscriptions, the penalty on subscribers neglecting to pay, the manner of incorporation and election of officers, the corporate powers and duties, the voting rights of shareholders -- all these and other details stud the pages of the early statute books of the original states.

The development and perfection of the corporate form of organization has been one of the most important factors in the tremendous expansion of modern business and industry, and it is a tribute to the shrewd commonsense of the business men of this early period that they recognized the advantages of incorporation. How keen was the incentive to incorporate is shown by the experience of the Bank of New York which from 1784 to 1790 had failed to obtain a charter. In its petition to the legislature the bank stated that, "standing on the footing of a private company, in which each member is supposed to be personally responsible for all the engagements entered into, it has been found that many persons who would otherwise be desirous of becoming subscribers are deterred by that circumstance from doing so; whereby the increase

of the stock of the bank is obstructed and its operations proportionately confined." The charter was obtained in March 1791 and within a few months the paid-in capital had tripled to $900,000.

It may be well to pause a moment at the milestone marked 1800 A.D. to take stock of the financial beginnings of this nation and sum up some of the main characteristics of this formative period. First of all, we note that from the day the pioneers set foot on this country it is a record of risk-taking, of venturing for a profit. All transactions were as yet without benefit of organized stock exchanges. All were new issues. There was a strong element of risk involved -- even with government financing. But these citizens were not afraid of risk. Nor were they uninformed or untutored in financial ways. On the contrary, they exhibited a decided flair for financing enterprises and early grasped the advantages of incorporation. Behind them was England's long tradition in commerce, her joint-stock companies with charters and powers obtained from the Crown. It was easy to switch those powers to state legislatures. So here we find the beginnings of state regulation of new issues. Early in the game these pioneers realized the importance of better communications, better transportation facilities. They began to finance turnpikes, canals, bridges. The great dynamic forces which were later to crisscross the continent with lines of steel were still part of tomorrow's dream -- but it is significant to note that these business men had already made a start in the right direction.

Another characteristic of this period merits attention. In financing all kinds of enterprises the custom was to offer only one class of shares -- stocks. At that time a bond was a security scarcely known in this country. Even federal and state issues were called "stocks."

In the period stretching from 1800 to the close of the Civil War, the development of the country was still local or regional in scope, with financing on a similar scale. The widest distribution of any corporate issue occurred shortly after the turn of the century with the stock of

the second United States Bank which in time came to have 4000 holders, of whom about 10 per cent were foreign. The domestic holders were scattered through 22 states and the District of Columbia and owned about $20 millions face value of the stock. Speculation was rife in these shares, as well as in federal issues and the new marine and fire insurance companies which had sprung up at the close of the War of 1812. In 1814, for example, U. S. 6 per cent "stock" sold down at 50 in specie and at 70 in New York currency.

In March 1817 the New York Stock Exchange became a definite entity upon adoption of its first constitution. Before that time during the 1790's merchants and shippers and brokers were accustomed to meet in coffee houses to exchange information and transact business. These open meetings soon led to specialization of brokers and to the establishment of informal stock boards in New York and Philadelphia. So many orders began to flow in to the Net York brokers who were buying and selling not only government issues but also the new securities of numerous corporate concerns that they decided a more coherent form of organization was necessary.

Accordingly, in 1817, as described in E. C. Stedman's "History of the New York Stock Exchange", "there took place a meeting at which 13 individual brokers and 7 firms -- through their representatives -- attended." These men resolved to start a new association, chose a committee on organization, and reported a set of rules now known as the Constitution of 1817. The rules prescribed in detail methods of transacting the business of dealing in securities. New regulations were added from time to time. "The most striking feature of the first Constitution," said Mr. Stedman, "was a rule which provided for the expulsion of any member found guilty of making a fictitious contract -- in other words, a 'wash sale.'"

This Constitution is a significant landmark, for it indicates the formal beginning of self-regulation in the securities business. From time immemorial honest and responsible men have dealt fairly and equitably with each other, building up a body of standards which later may be crystallized into law. But this Constitution is important, for here the record is written down in black and white so that the slow evolution toward higher standards and greater social responsibility to the public can be traced through the years.

Other early stock exchanges were organized in Philadelphia, Boston and Baltimore. No reliable records are available for comparing the relative volume of business done on exchanges and over the counter, but one fundamental difference between the two types of markets clearly emerges. From the beginning the stock exchanges were auction places, like the auction markets in tobacco, cotton and other commodities. In the early days the president of the New York Stock Exchange used to call the securities in rotation for auction, and between bidding there were often long intervals. The dullest day in history on the New York Stock Exchange occurred March 16, 1830 when the entire day's transactions consisted of the sale of 26 shares of the United States Bank at 119 and 5 shares of Morris Canal and Banking Co. at 75¼.

Outside the exchanges, however, dealers in the over-the-counter business carried on in a different manner. Instead of an auction transaction, it was a negotiated transaction. In their offices, in coffee houses or on the street adjacent to an exchange, men met, exchanged bids and offers, opinions and news on current values, and bargained in securities, matching prices, trying to get buyer and seller to fix on a price mutually satisfactory and profitable. The present-day trader sitting at his turret board, able to talk across the continent, quote prices or close a trade in a few seconds, may wonder how his predecessors, without benefit of telegraph or long distance wires or teletype service, got their information. The answer is: chiefly through personal

contacts and messengers. The big job of the dealers and brokers then, as it still is today, was to find as many new investors as possible and to get the best prices for them in the transactions. Channels of distribution had to be organized and constantly improved.

During this period of regional expansion money was scarce. Private banking houses which also did an investment business began to appear. These acted as agents for foreign banking houses, for now Europe was competing with America for the purchase of federal and state bonds, bank, canal and turnpike securities. Between 1818 and 1828 nearly one-half of American state bonds found their way to Europe. One reason for our favorable credit position abroad was this nation's excellent record in handling the federal debt. Another reason was the stabilizing influence of the United States Bank. England, holding the primacy in world finance, was favorably impressed by American securities, and also by their yields which were appreciably higher than those of European securities. Several large London houses bought up entire issues of state bonds for resale abroad.

The years from 1829 until the Civil War, though broken by a series of bank panics, saw a steady broadening in the field of industrial enterprise. This was the opening era not only of the Iron Horse but of the Machine Age. The early handicraft period with its laboriously made products was on its way out. The whole country was seething with activity. The young nation, no longer in leading strings, was beginning to stand on its own feet. Not government but business financing held the center of the stage. Banks were established by the hundreds. Railroads began to multiply. The first Railroad Act in America was passed by the General Assembly of Pennsylvania in 1825 and soon other states were granting railroad charters by the dozens. The funds to construct the Baltimore and Ohio Railroad were advanced by leading citizens of Baltimore, with subsequent subscriptions by 20,000 people totalling

$4,178,000. In 1828 the main line of the Pennsylvania Railroad was started. Other states followed suit with local or regional lines. All industry felt the quickening impulse of new railroads, new machinery, new inventions. In 1844 the first telegraph lines were installed -- a beginning of the mighty web of communications which became the nerve system of securities transactions. The sewing machine which was to revolutionize the clothing industry was invented in 1848 and soon afterward adapted to the shoe trade. A similar transformation was taking place in other industries, in textiles, chemistry, furniture, foods.

This was still the period of stocks. Only one class of shares -- common stocks -- was offered for the full amount required to finance any enterprise. The early railroads adhered to this practice. Until 1854 not a single railroad leading out of Boston had issued any bonds. Most of these new railroads, regional in scope, were financed by the communities they served, for Europe, still hesitant to invest capital in untested ventures, clung to federal and state issues, bank stock, and such canal and turnpike securities as had proved their financial soundness. The corporate form of organization dominated in financial institutions and internal improvement companies, but as yet it found scant foothold in manufacturing where personal ownership or private partnerships were the rule.

At this time there was little difference in the safety factor between corporate and state issues. Both types of securities were full of risk and afflicted with growing pains. Under Andrew Jackson's administration the charter of the second Bank of the United States had expired, and the banking situation throughout the country, never on a sound basis, became more critical. State banks were often organized on a shoestring under a "special" charter: they bought office furniture with the first subscription funds and began to issue bank notes which were payable in specie – "provided nobody asked for any." These "wildcat" banks flourished

especially in the South and Southwest. In the panic of 1837 many of these jerry-built institutions collapsed like punctured balloons. After the panic the New England states generally and some of the Western and Southern states overhauled their banking laws and their regulations foreshadowed our modern system of strict supervision in the public interest. The panic, however, had severe repercussions on our credit abroad. Many states, deeply involved in programs of internal improvement, could not pay the interest on their bonds. Seven states -- New York, Pennsylvania, Maryland, Indiana, Illinois, Michigan and Arkansas -- failed to meet the interest on their indebtedness. Some issued scrip. All seven inside of two years made good on their defaults. Mississippi and Florida repudiated their bonds outright. England, which had invested heavily in state bonds, was indignant. A popular ditty which went the London rounds expressed the general resentment:

> "Yankee Doodle borrows cash,
> Yankee Doodle spends it,
> And then he snaps his finger at
> The jolly flat who lends it."

For several years these defaults made European investors chary of American securities. But in time the high returns proved an irresistible temptation. Total foreign investments in 1850 were between $75 millions and $100 millions. Ten years later they were over $400 millions. Federal and state bonds, bank shares, railroad stock and even industrial issues were eagerly sought by European buyers. New York had become the financial center of the nation, with Philadelphia and Boston following close behind.

The Civil War temporarily checked the flow of foreign capital into this country. The necessity of financing the war made huge demands on domestic money markets. Capital

simply could not be found. In 1861 Salmon P. Chase, Lincoln's Secretary of the Treasury, offered $20 millions of 6 per cent 10 and 40 year government bonds. The best price he could get was $94 -- and that only for three million dollars' worth of bonds. The Secretary was at his wits' end. The Union was staggering under repeated defeats. The war seemed lost in its infancy. Then Jay Cooke, a brilliant young investment banker of Philadelphia and head of his own firm, told his brother in Washington to go to see Secretary Chase. "Tell him I hold myself at his service. I could show him a way to raise money."

The Secretary was willing to be shown. His own efforts at home and abroad had failed. So Jay Cooke took the helm. He split up government bonds to fit the ordinary man's pocket-book. In his campaign drives he used all the modern methods of publicity -- newspaper advertising, editorial cooperation, bands, open-air meetings, house-to-house canvassing and poster displays everywhere, in remote hamlets and crossroads country stores. Some of the posters read: "The Working Man's Savings Bank! Open all night! Fetch on your little sums!" And the bonds sold. Between 1862 and 1865 Jay Cooke was responsible for the sale of more than two and a half billion dollars' worth of government bonds. His achievement was lauded by the Boston Transcript which said: "The war has been won by the greatest banking firm in the world -- Jay Cooke and the American people."

It would be a mistake, however, to suppose that foreign funds were not actively employed in this country during the Civil War. Many American securities during this period of currency inflation were bought on speculation at very low prices. Joseph G. Martin, in his "Boston Stock Market -- 88 Years", published in 1886, states that in Europe, "....in 1864 the Five-Twenties of 1862 sold down to 38-3/4 per cent. Therefore $387.50 in gold could buy a $1000 6 per cent bond, interest and principal in gold, the former always promptly paid, as well as

all matured interest. Large fortunes have thus been realized by purchasers abroad in the darkest hours of the Rebellion."

Jay Cooke's brilliant financing of the Civil War taught us two great lessons. Never since that time has this nation had to solicit foreign funds in her hour of need. The young investment banker from Philadelphia revolutionized the system of distribution of securities in this country. He was the first to tap the vast sources of wealth which are the sum of the savings of all the people, and not just one class. His then novel idea of splitting up bonds into small units to make them available to the rank and file of citizens has since been applied to common stocks; and shares of $20, $10, $5, $1 or no par value have now become customary for this class of securities.

During the later years of the Civil War and after its close, foreign capital again poured into this country. The vast influx of foreign funds was due to a scarcity of money at home to finance the nation's teeming activities and to an abundance of capital abroad -- and more particularly to the discounts at which American securities could be purchased in gold and exchange. The era up to 1900 is a story of expansion on a scale unprecedented in history. After the panic of 1873 the great dynamic forces of the nation again surged forward with irresistible sweep and power. In every line of business activity -- commercial, financial, manufacturing, transportation, public utilities -- intense activity was going on. The Civil War greatly stimulated factory production and the industrial revolution gained impetus, with machinery, tools and new inventions transforming factory techniques. The most remarkable single phenomenon of this period were the great transcontinental railroad systems which pushed back frontiers and opened up vast stretches of new country to commerce and trade. This age saw the beginnings of the cattle industry and the meat-packing industry, with the opening up of the famous Chisolm Trail

over which millions of Texas longhorns streamed up to the great rail centers of Kansas. In this era mining camps dotted the Rockies and "coal oil Johnnies" flaunted their new millions on Broadway.

New trends appeared in the financing of corporate enterprises. The evolution was from small to larger units. Bonds now dominated the securities markets. Foreign financial houses participated actively in our domestic syndicates, and their preference was for fixed-interest secured bonds rather than for stocks. Railroad bonds of this era yielded from 7 to 12 per cent. Common stocks were also issued, but for years these were regarded with suspicion as vehicles of speculation. In the advertisements of financial journals of those days, all the leading financial houses referred to themselves as dealers in bonds, or dealers in "investment securities", which amounts to the same thing. It is true that members of stock exchanges carried the flag "stocks and bonds," and an occasional out-of-town dealer might mention local stocks, but the main emphasis was on bonds.

The most that can be said for bonds before the turn of the century is that they were less speculative than stocks of the same companies. They bore coupons of 6, 8, 10 and even 12 per cent, were issued copiously in boom years, with many defaults in lean years. The tendency, however, was to regard bonds as "investments" and stocks as "speculative." With seasoning down the years great areas of both stocks and bonds gravitated into investment standing and into the over-the-counter market.

In this matter of speculative trends, it is well to remember that back in 1814, U. S. 6 per cent bonds sold at 50 in specie and at 70 in New York currency; that in 1844 numerous state bonds were "quoted so low that only the most reckless speculators would touch them"; and that during the Civil War a U. S. $1000 bond sold in London for $387.50 in gold. Business on

stock exchanges has always tended to concentrate on speculative issues with a fast turnover and fluctuating prices, no matter whether these are federal, state or corporate securities.

Securities selling strictly on their investment merits have always found a larger market over the counter than on stock exchanges. The action of government bonds through the decades furnishes a reliable proof of this basic principle. When prices have declined to speculative levels below parity they are very actively traded on exchanges until they advance above parity, upon which they become inactive. State and municipal bonds follow the same pattern. In bygone days when state bonds were going through their speculative period, with rates of interest high, they were actively traded on stock exchanges. Today practically all transactions in state and municipal bonds take place over the counter. The history of corporate securities shows a similar trend. In general, it may be said that even though a listed security has a very wide distribution, unless there is an active and continuous flow of buying and selling orders, it can be more effectively marketed over the counter.

We cannot leave this much-discussed, much berated period between the Civil War and 1900, which laid the foundations of our present industrial supremacy, without speaking of the excesses of that era and also of the constructive forces at work inside the business itself which combatted those evils. This period of tremendous expansion has been aptly compared to the swift advance of a mighty army over a wide front, never pausing to consolidate gains or clean out dangerous pockets, but sweeping on with irresistible power. It was a period marked by sharp depressions and quick recoveries -- marked also by speculation, blind pools, “watered stocks”, secrecy of corporate management and battles between industrial titans whose creed was “the public be damned.”

Chief among the constructive forces inside the securities business was the New York Stock Exchange. After the adoption of its first constitution and for many years afterward, sessions were secret, names of buyers and sellers were not revealed and the public was not allowed on the premises. Secrecy in financial operations was then customary throughout the world, as it was in diplomacy and in politics. The first stock boards traded in whatever securities were available. The New York rule in 1847 was that "the stock of any regularly incorporated company having books of transfer in this city may be called at the pleasure of the members and inserted on the list." A decade later a vote of the majority of members came to be required, along with statements of the capital, number of shares, resources and so on, but any member could have any stock not on the list called by paying a fee of twenty-five cents. As the stock exchange gained prestige, it required companies whose securities were "on call" to abide by a code of rules. These rules developed gradually as the need for them became apparent. The first efforts were for protection against forgery, against over-issuance, or the secret issuance of stocks. Then came the long struggle to obtain adequate data from corporations.

In 1867 the first stock quotation ticker was installed insuring publicity of prices. The Committee on Stock List was created in 1869.

About this time occurred a dramatic incident in which the rules received an acid test. The by-laws of the Exchange required that each company whose stock was dealt in at the Board must keep with some financial institution a register of their stock at all times open to inspection, and that any new issue of securities must be preceded by thirty days' notice to the Board. Without any such notification, the Chicago, Rock Island and Pacific Railroad Company secretly got out a new issue of stocks. The president of the company was waited upon by a delegation from the Exchange and an explanation was requested. The explanation was not

satisfactory. The stocks of the company were promptly removed from the call of the Exchange. Other similar incidents, even more spectacular, met with similar fates.

In general, by a process of slow development through the years, the New York Stock Exchange, through its regulations, sought to improve its position as a free and open market; to prevent manipulation; to foster publicity and the rapid dissemination of prices; to require truthful information from companies whose securities were traded in, and to establish fair practices among its membership. The federal regulations of 1933 and 1934 and the Securities and Exchange Commission brought to fruition the work initiated and developed by the New York Stock Exchange over the years.

Around 1900 the securities business came of age. From that time down to the present, important events which had a profound impact on the over-the-counter business crowd on each others' heels so thick and fast that it is possible only to mention the highlights of the great cavalcade. Stocks vied with bonds as popular favorites and vast amounts of new industrial and public utility securities were issued. This was the age of vast consolidations, with small units merging into great industrial empires. Anti-trust legislation followed under Theodore Roosevelt with his "big stick" policy.

In the early 1900's commercial banks took an active part in capital flotations and many established securities affiliates. In 1933 the Glass-Steagall Banking Act separated the functions of commercial banking and investment banking, thus returning to brokers and dealers the business formerly done by the bank affiliates.

Investment banking matured after commercial banking. When the Investment Bankers Association was formed in 1912, 391 firms joined representing all major sections of the country. This is another notable landmark in the evolution of the over-the-counter business.

The Liberty Loan drives of the first world war repeated on a larger scale the brilliant financing operations of Jay Cooke. We emerged from the 1917-1918 conflict as the leading creditor nation of the world. The importance of this fact and its impact on the over-the-counter business can scarcely be overestimated. Hitherto, this country had depended largely on foreign capital to absorb new issues. Now all that was changed. With our primacy as a creditor nation established, we were able to finance not only our own teeming activities -- railroads, power companies, manufacturing firms, the great basic industries of steel, lumber, mining, the consumer industries, as well as the extensive programs of internal improvements initiated by states and municipalities -- but in addition, we began to lend capital abroad.

After a short postwar depression and a period of readjustment to peacetime policies, the country entered upon an era of unbounded prosperity, marked by a widely distributed improvement in the economic position of the people at large. Earnings were greater, standards of living higher than ever before. The public began to participate on a nation-wide scale in the purchase of securities. New issues which amounted to $4.3 billions in 1923 rose to $10 billions in 1929. In this tremendous expansion the investment banking business played a commanding role, for it is new investment which makes possible greater productivity. Leading corporations began to offer securities to their workers and the users of their products and to provide basic information on the ABC's of sound investment. Sales forces inside the securities business intensified their efforts to tap the vast reservoir of the people's savings. Ownership of securities, which before World War I had been largely confined to institutions and individuals of considerable wealth, broadened immeasurably. We were becoming a nation of stockholders. 1925 saw the rise of investment trusts and the development of public utility holding companies. All these developments were natural and healthy expressions of a period of enormous prosperity.

Other aspects of this period, however, were not so healthy. Some corporations seeking new capital were still chary of giving full information to the public as to their financial condition. The old tradition of secrecy died hard. In addition, the widespread interest in securities offered a rich field of exploitation to stock-swindlers who began to promote fraudulent securities of all kinds. Regulation of the investment banking business came to the fore as a vital problem. Beginning in 1911, states had enacted "blue sky" laws to curb shady practices and to regulate the issuance of new securities. Forward-looking elements inside the business had long been working toward the same goal. Chief among these constructive forces were the Investment Bankers Association and the New York Stock Exchange, both of which through their legislative committees did very effective spadework in this field.

The boom period was abruptly shattered in 1929 by the collapse of the securities markets. Followed a terrifying depression and a decade of long, lean years. During this period federal legislation was enacted regulating the securities business and NASD was born. Discussion of these developments belongs to the second part of this assignment.

The astounding feats of production during World War II disposed of the assumption that our system of private enterprise was tottering to its doom. The nation emerged from the fiery trial stronger than before. In the reconversion years the part played by the investment banking business can be epitomized by a few figures. During the year ended June 30, 1946, records of the Securities and Exchange Commission showed $5.3 billions of new securities registrations -- all of which were underwritten by members of NASD. In addition, members underwrote $1.3 billions of securities of railroads and other companies which, under the Securities Act, do not have to be registered. A comparison of the 1946 figures with those of the two preceding years is interesting. In 1946 more than six and a half billion dollars' worth of new

corporate securities were offered by members of NASD; in 1945 they underwrote three and a half billion dollars' worth, and in 1944 one billion, three hundred thousand dollars' worth. These figures highlight the power and capacity of the business to keep pace with the increasing capital needs of commerce and industry.

In noting the main trends of development of the over-the-counter business in this country, we must not overlook the profound changes which have been brought about by better communication facilities. In the pioneer days, Western trade was conveyed on the backs of pack horses walking in single file. Then came the turnpikes and the "Conestoga" wagons with their teams of six and eight horses with jingling bells. Canals followed. In those times it took days for letters between New York and Philadelphia to reach their destination. The railroads sounded the death knell of turnpike freighting and dispatch-riding by fast messengers. In 1844 the first telegraph company was organized. When Alexander Graham Bell invented the telephone in 1876, time and space began to be annihilated. Turret boards, a trade symbol of the over-the-counter dealer, appeared in 1906. The first coast-to-coast long distance telephone conversation occurred in 1915. The open-end teletype system had come into extensive use by 1935. These facilities reduced days and hours to minutes and seconds. Over-the-counter firms which before had been confined to the principal cities began to spread throughout the land, connected by a network of telephone and telegraph lines which today permit practically instantaneous contact between dealers and customers in every part of the country.

Summing up briefly some of the highlights in the evolution of this important business, certain basic traits appear, changeless through the changing years. From the very outset it is the story of new issues, of risk-taking; of independent thinking by free men; of ordinary commonsense rising to heights or genius in periods of danger when the nation's safety

was at stake. In the main it is a story of character, of stamina which imposed restraints from within before those restraints were made obligatory by law. Excesses, infractions, backslidings there have been -- and always will be. Above all, it is a story of courage in facing new conditions, new frontiers. These enduring characteristics give us reasonable grounds to hope they will still persist as we face new frontiers.

B. NASD -- ITS DEVELOPMENT AND RELATIONSHIP TO THE OVER-THE-COUNTER MARKETS.

The National Association of Securities Dealers was incorporated in 1939. It began to function officially when the first meeting of its Board of Governors was held in January, 1940. But the history of this organization, with specific powers granted by Congress to establish and maintain high standards of commercial honor in the over-the-counter securities markets and "to prevent acts and practices inconsistent with just and equitable principles of trade", reaches much farther back than 1940. The underlying constructive forces which had helped to shape state legislation and which resulted finally in the enactment of a federal law providing for self-regulation of the investment banking and securities business had, as we shall see, their origin within the industry itself.

For many decades before the Code of Fair Practice was formalized by law, the business of trading in over-the-counter securities had been carried on by voluntary observance of forms and customs that had become standard business practices over the years. Many of them had their parallels in rules and regulations by which stock exchange members were bound. These practical rules of fair play, even though unwritten, were nevertheless generally effective under the commonsense principle that anyone who failed to abide by them found himself ostracised by his own business community. They did not, of course, control the unscrupulous outer fringe of the business which followed no rules.

The era of tremendous expansion after the first world war, the increasing prosperity of the country and the widespread distribution of corporate securities among the rank and file of the people brought grave problems to the over-the-counter business in the field of

ethics and business practices. The “blue sky” laws -- so called because promoters of shady securities, in their efforts to ensnare the public, exploited schemes of every kind and description right up to the blue sky -- were enacted to curb these evils by controlling the issuance of new securities and by other legislative measures. These laws differ widely from state to state. They may be roughly classified under two types: first, the anti-fraud statutes which provide penalties after the fraudulent securities are sold; and second, laws which seek to prevent the issue of fraudulent securities by requiring that information concerning the proposed issues be filed with state commissions which have broad discretionary powers. Both of these types of state regulation have done excellent work in safeguarding investors. They are, however, limited in their powers. They cannot control the sale of securities inside their own borders by firms which operate in other states. Such interstate sales come under federal jurisdiction. This limitation in the power of states led some experts on the subject to suggest a federal law to apply to the sale of interstate securities. The idea gained impetus in 1928 when the federal government, through the agency of the Interstate Commerce Commission, took over direct supervision of security issues of all interstate railroads.

The prosperity of the 1920’s had its culminating peak in the great bull markets of 1928-1929. The catastrophic collapse in October, 1929 and the series of financial and industrial crises of the next few years, was a crucial test for the securities business and proved its ability to survive. In 1929 new corporate issues amounted to $10,026,400,000. In 1932 they had declined to $643,900,000 and in 1933 to $381,600,000.

As this brief study of the main trends of development in the securities business has shown, the history of the nation and the history of financing are closely intertwined. Many factors of national and world-wide import contributed to the debacle of the security markets and

the ensuing depression. It was inevitable in this crisis that Congress should turn its attention to the problems which confronted the country. Senate investigations in 1932 and 1933 covered the fields of money, credit, and securities, the activities of listed markets and especially those of the New York Stock Exchange. Federal legislation followed which embodied many of the unwritten standards of conduct which the securities business had practiced for years.

The Securities Act of 1933 requires, among other things, registration of new issues with the Securities and Exchange Commission. The registration statement must contain a truthful disclosure of all pertinent facts concerning the offering and the issuing company. Originally, the registration was made with the Federal Trade Commission, but an amendment to the Securities Exchange Act of 1934 transferred these duties to the SEC. In selling new issues the Act requires that a prospectus containing full and accurate information on the offering shall be furnished each buyer before the transaction can be completed. Federal, state and municipal issues are exempted under the Act, as well as railroad securities, and certain other classifications. The law provides for liability on the part of the issuer, each underwriter, many executives of the company which offers the issue, all members of the board of directors, and accountants, engineers, appraisers, etc. who may certify to any part of the registration statement. At first some of the rigorous requirements of this law alarmed the investment banking business. Compliance was costly and burdensome and it was feared that the drastic liabilities imposed would tend to check the flow of private investment capital into worthwhile issues. Amendments to the Act which lightened the burdens somewhat were made in 1934. In the main, the great advantages of the law, by eliminating questionable offerings and giving investors added confidence in the sound financing of new issues, are generally considered to outweigh the burdens which have been imposed.

The Securities Exchange Act which followed in 1934 was designed as a further protection to investors. This Act seeks to improve: the manner and extent to which credit is used in security trading; the machinery of stock exchanges; the character of corporate information which is made available to investors, and the quality of over-the-counter transactions. Under this law, all underwriters, distributors, dealers, traders and brokers who engage in over-the-counter activities -- with the exception of those who deal exclusively in tax-exempt securities or confine their business within the borders of a single state -- must register with the SEC and come under the supervision of the law.

Before this Act was passed, however, NRA, with its industrial codes, had got under way. In 1933 the investment banking business formulated its Code of Fair Practice which was approved by practically all the outstanding firms in the country. In its plan for self-regulation of the investment banking business, the Code committed every member who joined the organization "to observe and to use his best efforts to maintain high standards of commercial honor in the investment banking business and to promote just and equitable principles of trade and business." Among the important provisions were: full investigation by the originator of new issues, with regard not only to the merit and soundness of the issue but also to the proper safeguarding of investors; adequate information on all new issues to be provided the investor in prospectus form; continuing and detailed information regarding the financial condition of an issuer to be provided the investor so long as any material pert of an issue was outstanding; supervision of all correspondence and selling methods of salesmen by the employing firms.

The investment banking business had about eighteen months of experience, not altogether satisfactory, under NRA before the Supreme Court invalidated the Act. With that decision all industrial codes ceased to exist. In the period of business confusion which followed,

the Investment Banking Code Committee, feeling that some form of self-regulation was highly desirable and might still be achieved, met with the SEC and offered to cooperate with it on a voluntary, unofficial basis in the solution of problems in the over-the-counter business. Joseph P. Kennedy, first chairman of the Commission, welcomed the offer. The code committee then circularized all investment bankers, brokers and dealers registered under the code and asked whether they wished the organization to be continued, looking toward self-regulation. Over 90 per cent of those who replied voted in the affirmative and agreed to support the organization financially. The Investment Bankers Code Committee was renamed the Investment Bankers Conference Committee.

One of the first acts of the new organization was to appoint a special committee to draft a permanent plan of self-regulation for submission to the business and to the SEC. The committee met with James M. Landis, then chairman of the Commission, and the whole question of self-regulation was discussed, as well as the type of federal legislation that would be required to implement the undertaking. The result of the discussion was that Chairman Landis asked the committee to draw up "an idealistic plan, without regard to political expediency or existing legislation."

The plan which was devised incorporated major features of the investment banking code, including a provision that members who joined the organization would do business with each other on preferential terms which would not be extended to non-members. The first draft was submitted to a larger committee which made some changes. It was then sent to members of the organization and to all district committees for further constructive revisions, so that the end-product as finally evolved was not the work of a secret blue-star chamber but a plan which was thoroughly representative of every phase of the business and every section of the

country. The final draft was then submitted to the SEC. At that time, however, federal legislation to implement the project was not deemed advisable and so the informal discussions went on.

During this interlude the conference committee, though without official status, was very active, arbitrating and settling disputes within the industry. It was also called upon to consult and cooperate with the SEC in the drafting of its rules and regulations. It should be remembered that this was a period of great political tension and bitterness. Men of honest convictions in government and in business were violently opposed to each other, not only on methods but on basic principles of government. It required cooperation of the highest order to hold these warring elements together and to work out a constructive course of action. The merit of this cooperative method of solving problems was demonstrated in the over-the-counter rules. Through its consulting and technical advisers, the conference committee was very helpful in securing final adoption by the SEC of over-the-counter rules which have proved practical and workable. Among other subjects on which the conference committee gave constructive advice were the segregation of brokers and dealers, registration of securities not listed on exchanges, problems connected with trading in when-issued securities, and various phases of operation linked with the issuance of new securities. All these tasks, to which the conference members were able to bring the knowledge and experience of trained business men, reveal how profound was the influence of this organization throughout that important period when the whole concept of federal legislation providing for self-regulation of the business was still in a fluid, uncrystallized stage.

Equally important in its influence was the active participation of committees established on a community, state or regional basis. Their continuous cooperation was vital to

the success of the undertaking. The fact of the matter is that from the first day's work on the investment bankers' code back in 1933 to our present status under NASD, the essential power which has enabled us to operate has been supplied by local committees throughout the country.

In October 1937, the business learned that self-regulation under federal auspices was at length to be accomplished. Consultations with the SEC were begun toward that end. Within a relatively short time a first draft of the proposed legislation was ready for confidential discussion. Conferences on this draft and subsequent redrafts were carried on over a period of several months in late 1937 and the early days of 1938.

Finally, on January 18 of that year an amendment to the Securities Exchange Act of 1934 was introduced in the Senate by the late Senator Francis T. Maloney from Connecticut. Its title read:

"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, to prevent acts and practices inconsistent with just and equitable principles of trade, and for other purposes."

Senator Maloney, as a layman with a long acquaintance with the problems of regulation of the securities business, had this to say about the underlying purpose of the legislation:

"...There can be no large group of people engaged in any industry enjoying potentialities of profit, which does not attract the careless or the greedy few who bring discredit upon the entire group unless prevented by regulation from so doing. It is with this problem of

imposing proper standards of business conduct upon that small minority...that we have all been wrestling for years.

"The machinery of the (securities) business is delicate. It can be dislocated either by corruption from within or by unwise and burdensome regulation from without. Our task is to prevent the former without rise of the latter. The (Maloney) Act provides a formula designed to accomplish that result. This formula is predicated upon the principle that corruption from within, so far as possible, should be prevented from <u>within</u> and that external restraints should be rendered unnecessary as a result of self-restraint."

William O. Douglas, then chairman of the Securities and Exchange Commission, publicly advocating legislation of this kind, said that "the pattern is simply that provided by the Congress for the exchanges in the Securities Exchange Act of 1934. That is the type of regulation envisaged here, nothing more and nothing less. These associations (to be formed under the legislation) should have power similar to power possessed by exchanges and be subject to comparable supervision and regulation by the federal government."

The late George C. Matthews, who appeared as spokesman for the Commission on the Maloney Act in hearings before the committees of the Senate and the House, made it clear in his testimony that the choice was between cooperative self-regulation of the over-the-counter business or minute, detailed and exacting regulation by the federal government. He added that, speaking for the Commission, "such a prospect would be scarcely more agreeable to us than I imagine it would be to the brokers and dealers of the country."

While the legislation was before Congress, various meetings of representatives of the business were held throughout the country and resolutions were passed which, while unanimously approving the prime objective of the Bill, took issue with certain of its provisions

which were considered impractical. In a problem so complex, involving a pioneering experiment in the field of cooperation between business and government -- and, more concretely, cooperation between government and the securities business which is admittedly one of the most technical, complicated and important fields of effort in the whole system of American enterprise -- disagreements were inevitable. But the conference method of sitting down together around a table and talking problems over man to man, again proved its effectiveness. Differences were ironed out or submitted to arbitration. Many suggestions and revisions were taken care of in this way and the mechanism of self-regulation was appreciably improved as a flexible and practical instrument. It was the same kind of transmutation which occurs when a new appliance or mechanical device is tried out by experts in the workshop "to get the bugs out of it," as they say. In June 1938, the Maloney Act, setting forth a new concept of business-government cooperation in the public interest, was passed by Congress, signed by the President and became law.

The history of this legislation is significant because it demonstrates the gradual development of business standards which in time became codes of conduct, unwritten but commonly accepted by honest people, and are finally crystallized into law. Fortunately, this was no hasty legislation. Between 1934, when the Securities Exchange Act was passed, and 1938 when the Maloney amendment to that law was made, four years had elapsed, which allowed time and constructive vision to perform their beneficial tasks.

After passage of the Maloney Act which provided for registration of national as well as affiliate organizations formed along geographical lines, a number of exploratory discussions took place to determine what organization -- or organizations -- should be created to carry out the objectives of the law. At length the way was paved for the over-the-counter business to realize its goal. The Conference Committee was succeeded by the National

Association of Securities Dealers. Followed the arduous tasks of framing by-laws, rules of procedure and of fair practice and readying the new organization for action. It was incorporated in Delaware in 1939, registered with the SEC, and began to function in January 1940 as the sole regulatory body of the over-the-counter business.

In its organization, the Association gives free play to the natural genius and initiative of its members in handling local affairs, under the checks and balances provided by the rules and regulations. For administrative purposes, the country is divided into fourteen districts, each of which, with its on elected officers, is responsible for promoting the objectives of the organization in that area. The general management of affairs is vested in a national Board of Governors elected by the membership. All new rules, regulations and amendments must first be submitted to members and approved by a majority vote. These checks and balances are designed to prevent domination by any one special group.

In addition to the elected officers, all of whom serve without pay, the Association has an Executive Director and staff who receive compensation, and the districts have secretaries and other employees. This small group of paid personnel carries on the day-to-day operations of the organization and assures continuity. For, since the Board of Governors and district officers serve for three years, the voluntary personnel changes periodically.

Members of the Association pay the entire costs of administration. In order to make membership worthwhile and to give the organization power to function successfully, the Maloney Act contains a provision which reads:

"The rules of a registered securities association may provide that no members thereof shall deal with any non-member broker or dealer except at the same price, for the same

commission or fees and on the same terms and conditions as are by such member accorded to the general public."

This preferential treatment granted to members has always been customary on stock exchanges. On this subject William O. Douglas, at that time chairman of the SEC, stated:

"...(The legislation) should also be implemented by according members of such associations preferential business advantages not inconsistent with the public interest, in dealings among themselves which brokers and dealers who are not members would not have. Here again, the pattern is persistently that of the exchanges which grant to members certain important business preferences. Some such business preference (properly safeguarded) is as necessary here as it is in the case of stock exchanges in providing adequate incentives for permanent organizations on a voluntary basis."

What are the objectives of NASD?

As stated in its Certificate of Incorporation, these are:

"To promote through cooperative effort the investment banking and securities business, to standardize its principles and practices, to promote therein high standards of commercial honor, and to encourage and promote among members observance of federal and state securities laws;

"To provide a medium through which its membership may be enabled to confer, consult and cooperate with governmental and other agencies in the solution of problems affecting investors, the public and the investment banking and securities business;

"To adopt, administer and enforce rules of fair practice and rules to prevent fraudulent and manipulative acts and practices, and in general to promote just and equitable principles of trade for the protection of investors;

"To promote self-discipline among members, and to investigate and adjust grievances between the public and members and between members."

One of these important aims is "to standardize principles and practices." This NASD has accomplished by providing the business with a code which covers settlement of contracts and trading practices in over-the-counter transactions. The National Uniform Practice Code is administered by recognized expert technicians, on a district as well as on a national basis. It covers all phases of the technical side of trading and settling contracts. Under it provision is made for the arbitration of disputes. These, however, considering the tremendous volume of business done by members over the years, have been few and far between. Although taken pretty much for granted, which is as it should be, this code is undoubtedly one of the best examples of the contributions NASD has made toward supplying the business with practical and sound methods of procedure.

Another aim is "to encourage and promote among members observance of federal and state securities laws." In this area the Association has had no problems. Even though the securities business is probably subject to more forms and varieties of regulation than any other business or industry, it is essentially law-abiding and does not have to be encouraged to observe the statutes. This does not mean that the business is not actively interested in the rules and regulations under which it must carry on. Experience through the years has shown that clearer regulations and more practical and businesslike rules are needed. The Association believes that the public interest, protection of investors, and the welfare of the business itself would be advanced by simplification and by an enlightened, non-punitive administration of securities laws of all kinds. It is in this and related fields that the Board of Governors and special and district committees are constantly at work.

What has NASD done to promote high standards of commercial honor, "to adopt, administer and enforce rules of fair practice...and in general, to promote just and equitable principles of trade for the protection of investors"?

Here again the record reveals with what degree of success the Association has pursued these important objectives. Rules of fair practice, both of a general and specific nature, are subscribed to and become binding upon all members who join the Association. Foremost among these rules is the one which states: "A member in the conduct of his business shall observe high standards of commercial honor and just and equitable principles of trade." This rule is the keystone of the arch of the whole fair practice structure. In addition, there are 26 other rules. They cover the responsibility of a member for recommendations made to customers, require that prices and commissions charged must be fair, specify his obligations with regard to quotations, his duties as a fiduciary and in handling discretionary accounts, and prescribe what is required of him in the way of disclosure as a broker or a dealer in his transactions with customers. The rules, of course, prohibit manipulative, fraudulent or deceptive practices and improper use of a customer's securities or funds.

We come now to the enforcement program. This is the most important activity of the Association. It is a continuous process carried on every working day in every district throughout the country. Primarily it is accomplished through periodic examinations of the membership. A questionnaire is sent to every member at least once a year, and, should circumstances warrant, a special follow-up examination is made. In addition, staff examiners of the Association are continuously calling upon members, not only to review books and records but also to advise with them in a friendly and constructive manner on any problems that arise.

The Association is empowered under the Maloney Act to discipline its members for violation of rules by censure, fine, suspension or expulsion. Under our democratic form of organization -- which adheres closely to the pattern of this republic in its emphasis on local self-government -- these disciplinary actions are initiated and handled in each local area by district Business Conduct Committees which have original jurisdiction over the proceedings.

The method of procedure of a district Business Conduct Committee reveals how strictly the rules of fair practice are enforced. The periodic examination of members by means of questionnaires and personal examinations shows how a member transacts his business. Through these reports the Business Conduct Committee determines whether a member is following the rules. Every one of these questionnaires must be carefully screened and analysed for violations. The violation may be merely technical and of minor consequence. It may be more serious. If it is serious enough to warrant further investigation, an examiner is sent out to inspect the firm's books and records. His report is then analysed. If it is decided to file a complaint, notice is sent to the member and the case comes up for a hearing. Throughout these proceedings there is no publicity. The reason is obvious. A man is held innocent until he is proved guilty, and the slightest taint of suspicion from newspaper reports might damage his business reputation.

The procedure for handling complaints is carefully prescribed by the rules and regulations. The Business Conduct Committee must be actuated by good faith and fairness, free from malice or personal hostility. These proceedings are not courts of law with tugs of war between contending lawyers. The rules of fair practice are drafted by laymen; they are interpreted by laymen; the case is heard and passed upon by men engaged in the same business as the accused fellow member and familiar with local conditions. If the accused member is not satisfied with the decision of the local committee, he may appeal to the Board of Governors for a

review of the case, or the Board may call it up on their own motion; if the member is not content with that decision, he may appeal to the SEC which also may, on its own motion, call up for review any decision of the Board of Governors. If the accused member still feels aggrieved, he may apply to the courts. All his rights as a citizen are fully protected. Any investor may make a complaint, or a member against another member, or the Business Conduct Committee may initiate action.

The enforcement program does not depend on complaints from the public. Since the Association began to function in 1940, approximately 600 complaints have been filed against members, of which not more than a dozen originated with public investors. Although transactions with customers have been the bases for complaints, very few investors were ever aware that the dealer involved had been disciplined by his Association. In cases where the customer learned of the complaint, the knowledge was usually derived through restitution made by the dealer, either in repayment of charges found to be excessive or in cancellation of a contract.

It should be emphasized that examinations of members by means of questionnaires and personal examinations are not conducted solely to establish the existence or non-existence of violation of the rules. As a matter of fact, the Association is more interested in preventing and anticipating possible infractions than it is in taking disciplinary measures after the trouble has occurred. These examinations are also made to obtain vital information on current practices which may be used in fact-finding studies and the formulation of new regulations to meet changing conditions. The exploratory, fact-finding method of approach to problems by means of special study committees in the districts has been used with success by the Association in the solution of many complicated and technical problems.

The value of this research method was clearly demonstrated in the pricing policy worked out by the Association. As far back as 1944, our district committees and the Board of Governors were carefully studying the question of members' mark-ups in transactions with customers in order to determine, if possible, what was a fair mark-up commission. This was a delicate and complicated problem because what might be considered fair in one transaction would be decidedly unfair in another. The securities might differ in character. Their availability in the market might not be the same, or the cost of obtaining them might vary. The price of one security in contrast to another, the amount of money involved in the transaction, the relationship of dealer and customer -- all these varying factors enter into the problem. The question was constantly raised by our members and by Business Conduct Committees in the discharge of their duties: "What is a fair mark-up?" No arbitrary answer could be made for the simple reason that the price to the customer in any given transaction must always be considered in the light of all relevant circumstances.

However, it was recognized that the amount of mark-up was at least a starting point, and that progress might be made if the general practice throughout the business on this score could be established. To find out that the Association in 1943 made a membership-wide questionnaire examination of customer transactions. Over 60,000 principal transactions were reported. An analysis of these transactions revealed that 47 per cent were made at a mark-up or profit of 3 per cent or less, and 71 per cent at a mark-up of 5 per cent or less. These findings were reported to the members for their guidance. We were not attempting to work out any rigid and arbitrary rule but to establish a general policy or guide which members might find helpful in evaluating their many and complicated services to customers.

The effectiveness of the release of these figures to the membership, with the statement that the 5 per cent mark-up should be considered as a desirable objective, neither more nor less, was clearly reflected in the analysis of questionnaires for the following year. In 1944 our studies showed that mark-ups of 5 per cent or less accounted for 82 per cent of the transactions analysed. Seventy-one per cent in 1943; eighty-two per cent in 1944. The 5 per cent "guide" was beginning to bear fruit. In 1945 nearly 90 per cent of the transactions analysed were made at a mark-up of 5 per cent or less.

These three-year studies to determine a pricing policy covered all types of corporate securities. Every section of the country was represented and every type of dealer, from small one-man firms to large underwriting and trading organizations. The objective was to arrive at facts on which to base a pricing policy which was fair to investors and fair to the business. The steady upswing to higher standards reveals how heartily the business responded, once it clearly understood the problem and members had a guide which they could apply themselves. The studies also demonstrate that reputable dealers in securities operate at moderate profit margine. It should be added for the record that the Association does not seek to regulate profits of its members. It is devoted to the principle that members are entitled to a profit. Our interest is only with the fairness of the mark-up or commission charged.

If space permitted, studies in other fields might be mentioned, with their beneficial effects on the conduct of business. A single example must suffice. A number of valuable studies were conducted to ascertain a course of action for the proper supervision of salesmen by their employing firms. The sales force has always played a highly responsible and important role in the securities business. As the men who get the buy and sell orders, they account for the major part of securities turnover. The prosperity of the individual firm and of the

business in general depends largely on their capabilities and trustworthiness. Their practices, if unethical, reflect discredit not only on the firm which employs them but on the business as a whole. As a result of a nation-wide study of salesman-customer transactions, a rule was worked out and approved by a majority vote which makes members directly responsible for the activities and methods of salesmen in their employ. Still another study on the same subject resulted in an amendment to the rules of fair practice in 1945. By this amendment, salesmen in the securities business as well as their employers are directly charged with responsibility under the code of fair practice and are held individually answerable for violations.

The records of the districts reveal that year by year the number of formal complaints has gradually decreased. Quietly but effectively the regulation of business conduct by the members themselves goes on, lifting standards to higher professional levels. Certain types of disciplinary action have practically disappeared. Dealers who persist in flagrant violations of the rules have been expelled. The business is in a clean, sound, healthy condition, and the membership have every intention of maintaining that condition. The fiduciary relationship a dealer has with his customers has always been one of grave responsibility. Under self-regulation, with members enforcing their own rules, discussing problems of local self-government in committees and subcommittees throughout the country, that sense of responsibility to the public has deepened and quickened through the years. Day by day, progress seems imperceptible. But looking back across seven years of experience in self-regulation, it can truthfully be said that there has been general improvement all along the line. This does not mean that the battle is won, for there is still plenty of room for further improvement!

The work of the district committees, upon which the success of this whole system of self-regulation rests, is not spectacular. For the most part, this labor is hidden, anonymous,

time-consuming, and without money-rewards. Self-regulation is not a magic formula which can accomplish miracles overnight. Like democracy, it is a man-size, lifetime job which must be worked at continuously, not only by the few but by all. It is this sense of individual responsibility, this year-in-year-out reliability on the part of the many which accounts or our measure of success in the past -- and will continue to account for it in the days which lie ahead.