Speeches SEC Staff

*CAUTION - FOR RELEASE UPON DELIVERY*

# THE OVER-THE-COUNTER MARKET AND THE MALONEY ACT

by

**FRANCIS A. BONNER**

before the

Annual Convention of the

INVESTMENT BANKERS ASSOCIATION OF AMERICA

at

Greenbrier Hotel
White Sulphur Springs, W. Va.

10:30 A.M., October 28, 1938

42399

It is nothing new to be here with you today. Some of the pleasantest memories of my life are centered in this spot, at gatherings such as this. It is a new experience, however, to be here as your guest, and I wish to express to all of you my sincere thanks.

Things have changed somewhat, perhaps, when (if I may appropriate the title for a moment) a government official appears before you wearing a gold button. Whether this sets a record I do not know. So far as I am concerned it sets a record. This being in the securities business and in the government at one and the same time is likewise a novel experience; one that I can assure you is not without its worries. In the work which lies ahead, there must be reconciliation of many points of view within the industry and the plan that is evolved may not completely satisfy everyone. My share in the task of reconciliation may put me in the middle, and the fellow in the middle is often the target for both sides. It is worth whatever risk there is, if such effort is of help in finding a solution.

Though sitting for the time being on the government side of the table, I ask you to believe that in the little I have to say here I am trying to look at this from the business side, as one among you, still trying to cope with the problems of the securities business.

The subject before us today is the oldest in the history of this Association. It is in fact the corner-stone. Permit me to read to you the first paragraph of the first page of the first Annual Report covering the first convention of the I.B.A.:

> "Six months ago the Investment Bankers Association of America was in an embryonic state, conceived only in the minds of a few investment bankers in this country. The conception of the organizers was given nation-wide publicity on August 8, 1912, when in New York City a meeting of investment bankers was held for the purpose of organization. This gathering was significant for the diversity of its make-up, including representatives from investment houses in all parts of America; it gave to the public its first assurance of an association, constituted purely of investment bankers, *organized primarily to improve the standard of those engaged in investment banking and for the general protection of the investing public.*"

The very history of securities legislation in this country is written by the Legislation Committee reports of this Association year by year since 1912. It is a history of which this Association can well be proud. It is a history which, I believe, is unexcelled by that of any other business. In that same first Year Book, in the section on "Legislative Action" this appears:

> "The need of legislative action to correct existing ills in the investment field was given particular emphasis throughout the convention."

Throughout its history the Association's policy in meeting this need has been consistently one and the same. As early as 1913, its second year, that policy was announced, as follows:

> "The Committee is in sympathy with any fair and practical statute . . . which will protect investors against fraud" . . . but "against the enactment of such laws, the enforcement of which would practically destroy the legitimate business of responsible investment bankers. . ."

and hamper the flow of capital to industry.

The method of effectuating that policy underwent radical change as time went on. The early Blue Sky Laws were crude. They were written without adequate study of all the problems involved. It was decided that they should be directly and vigorously opposed, and injunctions were obtained. In 1913 the Committee stated:

> "Your counsel and committee believe that these laws are unconstitutional and that these injunctions will be made permanent."

The fight was pressed through the courts and by 1916 six Federal decisions, rendered by fourteen Federal judges, had held typical Blue Sky Acts invalid.

Early in 1917, however, the Supreme Court of the United States held the laws of Michigan, South Dakota, and Ohio to be constitutional. At once the Association's report called on members to cooperate with State officials, to make the growing array of laws and regulations more workable. But it was not until 1922 that the new philosophy became clearly defined. The Denison Bill had been introduced in Congress, with drastic provisions which in effect enacted into Federal law the myriad and conflicting details of all the State laws. Conferences were undertaken with the State commissioners to try to bring order out of such chaos. In reporting on one phase of that work a member of the Special Committee states:

> "I think that in those four days there was more accomplished in bringing to the Securities Commissioners the viewpoint of the Investment Bankers Association of America and bringing to the members of the Investment Bankers Association of America the view point of the Commissioners than has been accomplished in the fight we have had with them covering a period of ten years to my knowledge."

Successive reports refer to the growing friendly relationship with the States, until in 1926 the Committee's chairman says:

> "There has been enough continuity both in personnel and thought of our Committees having to deal with this subject to gain a considerable amount of *understanding* of the position in which the commissioners of the various states are placed and a great amount of *sympathy* with their point of view. It is believed also that contact with the Commissioners has given them for the most part an *understanding* of our problems."

The round table method was here, the only satisfactory method of settling the common problems of government and business. It has been marked by great accomplishments on the part of the Association toward improvement in laws and business practices. To cite only one example, by 1929 the legislation committee reported that "today 16 states have (blue sky) laws representing approximate uniformity of one type or another, a vast advance over the seemingly hopeless confusion which existed a few years ago." The round table method has persisted since, with one lamented exception, in the early 30's.

But the round table method is back again. I have often wished since I have been in Washington that every dealer in the country could have the same opportunity to see from the inside how earnestly those charged with the administration and enforcement of the Federal securities laws, which so vitally affect our business, are approaching a multitude of problems and seeking practical advice in finding the right answers. After some years of experience looking at government from the standpoint of our business I have recently had a chance to look at our business from the standpoint of government, and the guide posts do not seem greatly shifted. The same kind of topic lies on the centre of the table, and it seems to make not much difference which chair one happens to be sitting in.

The question often is asked: "What is the drift in Washington?" For answer, need we go further than the subject of today's forum? I ask you to imagine Congress, three or four years ago, passing an Act designed to enable the investment banking business to cooperate with government in the management of its own affairs. It is an expression of confidence which has few, if any, precedents in legislative history. It is a confidence which was not easily won, but which has been and I hope and believe will be well deserved. The investment banking business can well be proud of the way in which, under the leadership of this Association, it united to produce its code. It was a purely ethical code, concerned principally with questions of sound and decent practices, and as such, differed from many others. The NRA looked upon it as one of the best, if not *the* best, of all the codes. The business stood behind it and during its short life, though far from perfect, it worked well.

But after all, there was some legal compulsion in the code. It may be said we *had* to have one. At least as great a tribute to our business has been the way in which, with only a thread of morality to hold them together, so large a part of it has carried on since the death of the code, to preserve the progress which they believed had been made in the improvement of business practices, and to work out some means of perpetuating it. One cannot pick up an underwriting or syndicate agreement today that does not contain important features brought in by the code and never abandoned.

Recently some of us have had the privilege of meeting with dealers in a number of cities, to discuss this new legislation. The spirit is still the same. It has been inspiring to see the wholehearted response of dealers everywhere as soon as they have better understood what it is all about.

What we are here today to discuss is thus the fruit of 26 years of gradual progress. More directly it is the outcome of a steady, consistent chain of events over the past three or four years. One need but cite the almost unanimous vote of registered dealers under the code, after the Supreme Court acted, in favor of holding together to work out a permanent plan, and agreeing to pay assessments to make it possible. The 1938 amendments to the Securities Exchange Act did not just pop out of a hat, but were the outcome of three or four years of concentrated study and effort on the part of our business.

It has been a hard won road and is far from finished. It is not the time, perhaps, to indulge in visions, but one cannot refrain. What we are facing here is no Sunday school picnic, with a set of papers to pack in our basket and go about our play. Nor is it an old ladies' sewing circle, to adopt a set of rules, gossip about our neighbors, and catch them in the act. The fundamental purpose of this effort must and should always be to make our business better and cleaner and keep it so. But if we go no further than that we have not fully realized our opportunity and there may be doubt whether the project will endure. A feeling of righteousness alone, however important, is not enough. There must be more concrete results, yielding measurable value to membership.

Unless out of this is forged a sounder, healthier, more virile over-the-counter market, enabling all of us better to provide a fundamental service to the national economy, on a lasting basis, we have failed in our full opportunity. The whole history of the investment banking business, since the beginnings of this Association, has been building up to what is before us today. That is a commanding fact which we must not overlook. It means the chance for us now to carry further that growth in popular esteem which has marked our business over the past five years, and to build and keep for the over-the-counter market a place commensurate with its importance in our economy. This is the market which not only provides new capital for our industry, but also in very great part cares for the securities representing that capital afterward. There is no reason why with organization, standardization of general principles, efficiency, the over-the-counter market should not be in every sense as well established a market as that of the exchanges. Securities of some types, to my mind, belong to one market; those of other types belong to the other; and if we get our house in order and keep it so, there is infinitely more promise that we may the better care for, even retain, those which belong to ours.

Improvement of practices, establishment of the over-the-counter market on a firmer basis, increase in public confidence, alone are worth to all of us, in assurance of a more stable and lasting business, more than this effort will ever cost. Is there any reason why with adequate, reliable quotations, an over-the-counter security should not be as welcome collateral at the bank as one listed? Is there not opportunity for substantial savings to all of us in shipping, insurance, and other expenses through establishment of clearing houses? Cost, of course, must be always a vital factor, but could not some of these efforts in fact be self-sustaining? One can imagine many other possibilities, working to the benefit of both the public and ourselves in the daily conduct of our business. But much of this is for the future, as we go carefully along and gain in experience.

We stand at the threshold of a great opportunity. To succeed in achieving it calls for statesmanship. Statesmanship on the part of government, in understanding and appreciation of the size, nature, and difficulty of the task before us. What in effect we are trying to do is to set up an organization which it has taken the stock exchanges 146 years to achieve. The task is to set up for the over-the-counter market an orderly, well organized exchange, for we may call it that, with a floor 3,000 miles long and almost as wide, with a membership (and I speak advisedly) in part untutored in even the rudiments of age-old common law or the primer of sound practice in the conduct of their own daily business. In large part our initial task is educational.

To succeed there must be appreciation that an infant must creep before it walks and walk before it runs. I am hopeful therefore that on the part of government there may be patience and adequate time to attack a ponderous job, and no expectation that a warrior shall spring full grown from the brow of Zeus.

Statesmanship on the part of ourselves, in realization of the necessity of give and take. No problem of such complexity can be worked out entirely as any *one* of us may wish it. We must remember the vital fact that Congress has done perhaps an unprecedented thing in removing restrictions of the anti-trust laws from this effort. Safeguards therefore have had to be erected. We must remember that what we tackle is a national industry problem and not that of any group large or small within it. In this there must be no east versus west, or north versus south. Those of us who are large must remember the fears of the small, that they may be dominated by those who do not understand and appreciate their problems. Those of us who are small must remember that there are similar fears on the part of the large, that they may be dominated by the numerically greater small, who do not understand and appreciate *their* problems. There must be give and take, checks and balances, unity of purpose, for the sake of the whole.

Some have criticised, perhaps some still do, the kind of regulation envisioned here, in view of the Commission's supervisory powers. Yet they could hardly have expected repeal of the Securities Exchange Act as it relates to our business, and that is what an unsupervised form would have represented. Let us be realistic. We have an opportunity here to set up our rules of business conduct under a system of business penalties -- far preferable, is it not, to Commission regulations covering the same field, enforceable through criminal penalties. The process, I think you will find, is parallel to the governmental supervision now existing over the stock exchanges. Governmental controls, moreover, must provide the essential safeguards to prevent discriminatory, monopolistic, or other unfair tendencies.

Let us not be over-optimistic. We have a real task before us. It will not be easy sailing. There may be breakers ahead. But if we appreciate our job and do it well, we shall have accomplished something and set up an example of cooperation between government and business, the consequence of which for the good of ourselves, the benefit of our national economy, and the welfare of the public, may well be great.

---oOo---