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FRANK L. SCHEFFEY, *Director*

June 24, 1936.

Re: *Segregation in The Over-The-Counter Markets.*

TO ASSENTING MEMBERS OF THE CONFERENCE PLAN:

On the reverse side of this letter there is printed that part of the Securities and Exchange Commission report on "Segregation of the Functions of Dealer and Broker" which gives the Commission's conclusions and recommendations insofar as over-the-counter markets are concerned.

It is to be noted that the Commission does not recommend segregation of the broker-dealer functions in over-the-counter markets at this time and also that the Commission is of the opinion that security dealers can be of real service by assisting in the continued study of the questions affecting these markets.

Very truly yours,

FRANK L. SCHEFFEY,

Director.

Investment Bankers Conference Committee

**Excerpt from the Securities and Exchange Commission Report
on "The Feasibility and Advisability of the Complete
Segregation of the Functions of Dealer and Broker"
Dated—June 20, 1936**

THE OVER-THE-COUNTER MARKETS

In the light of available evidence it is not possible to forecast with sufficient degree of accuracy the consequences of complete segregation in the over-the-counter markets. The Commission consequently does not feel justified in recommending at this time the inauguration of a program whose effects upon the over-the-counter markets and upon investors in securities traded in those markets would be too largely conjectural. Equally important is the fact that such evidence as does exist suggests that segregation might seriously hinder the development and extension of the brokerage function.

It does not follow from this that the existing combination of the brokerage and dealer functions in these markets is regarded as free from criticism. Here again, there are present the conflict of interests between the broker-dealer and his customer and the attending opportunities provocative of abuse of the fiduciary relationship. Consideration of means for reducing that conflict must therefore be regarded by the Commission as a continuing duty. As such, they must be part of the greater duty of developing a well-rounded program for the sound growth and development of the over-the-counter markets, a program upon which the Commission embarked this year and which it is pressing forward.

It is important at the present time to encourage continued exploration of the questions affecting these markets, not only by government, both federal and state, but by persons in the securities business and others. Organizations that would consider the problems of the business from an imaginative standpoint, and would think ahead as to the directions of possible and desirable development, could perform a true service. To do so, they must view the problems from the broad viewpoint of public interest, and must not, because of possible implications affecting the revenues immediately derivable from their business, resist the logic or the consequences of their own clear thinking. Too often, arguments advanced to justify the existence of the dual function show merely the sum total of the services rendered by the exercise independently of broker and dealer functions, and do not show advantages or disadvantages to the investor inherent in the combination of those functions.

The immediate program in regard to the over-the-counter markets envisaged by the Commission as being practical and fruitful in results, is a continued elaboration and enforcement of prohibitions against deceptive and fraudulent trade practices, with an insistence upon clear and unequivocal disclosure to customers of the capacity in which broker-dealers are acting. Should it be established that too many abuses arise from the combination of the broker and dealer functions in the over-the-counter markets, that such abuses are too costly to the nation, or that, because of the combination of such functions, these markets require constant policing of an expensive and irritating nature, the course of wisdom might well be to segregate the two functions.