

REPORT OF CHAIRMAN OF DISTRICT #2 OF INVESTMENT BANKERS  
CONFERENCE, INC.

BEFORE THE GOVERNING COMMITTEE AT CHICAGO, MAY 6, 1937

It is a pleasure to report that considerable progress has been made by District Committee #2 toward achieving the objects and purposes of the I.B.C. Over 95% of the registered dealers in the State of California are now members of I.B.C., which is substantial evidence of recognition by the dealers that much has been done in their behalf.

A major part of the progress of District Committee #2 can be directly attributed to the fact the personnel of this Committee has functioned uninterruptedly, first as the Code Regional Committee, and then, with the passing of the NRA, as the Business Conduct Committee of the California Security Dealers Association.

The District Committee in California is made up of ten men, five of whom reside in San Francisco, the other five in Los Angeles. An inter-exchange of information and reports on every case that is handled in either locality is promptly made. The minutes of each meeting of each group are also exchanged. This tends to keep all members of the Committee completely informed and ever ready to enter into the discussion of any case which might involve the entire Committee. Throughout the entire period of this Committee's activities there has been no instance wherein all of the members of the Committee have been required to get together. The procedure under which this Committee functions is briefly described herein.

A very close contact has been established between the members of the District Committee and our Corporation Commissioner's office. The Commissioner was originally impressed with the fact that a conscientious effort was being made by the investment fraternity to rectify many of the errors of the past. He has demonstrated his cooperation by discussing with us cases which came, first of all, to his attention, and he has assisted us in cases which our Committee developed, but which we found to be too difficult to handle. Hardly a week has gone by but what the Corporation Commissioner and our Committee have exchanged information. The Commissioner has been of invaluable assistance in obtaining information for the District Committee. Where cases have been brought to our attention involving a questionable purchase or sale of securities, the Committee has never utilized its power to examine a member's books, but has asked the Corporation Commissioner to send his auditor to acquire the information needed regarding the specific securities or transaction involved.

The same close-working relationship was established with the local S.E.C. office. The personnel have assisted materially in cases which pertained to interstate matters. Close contact was also established with the Stock and Bond Fraud Department of the Police Force; two detectives detailed to that particular department were most cooperative in helping with difficult cases which bordered on criminal grounds.

At the outset many members of our Committee felt that they could not expeditiously handle cases which might be filed against non-members of either the local Association or I.B.C. It developed, however, that we were an even more potent force against non-members than we were with members because the complaints which arose against non-members were invariably placed by us with the Corporation Commissioner, the S.E.C. or the Police Department; and with the stimulus of our interest and our constant vigilance to see that these cases were concluded, these bodies did some exceptionally good work in cleaning up several bad situations in this locality. For example, complaints were received against non-members known as Standard Securities, Ackman & Company, Holland & Co., Waxman & Company. When a sufficient amount of factual information in regard to these houses had been compiled by our Committee, it was placed in the hands of the Corporation Commissioner, who required these four concerns to show cause why their annual licenses should be renewed. Careful investigation on the part of the Commissioner disclosed that these people had been violating certain Federal laws through improper handling of securities, and the State Commissioner was then instrumental in having the four cases transferred to the Federal authorities, who not only put these four concerns out of business, but sent certain of the principals of the firms to the penitentiary for periods approximating five years.

Many cases of lesser importance have been heard by the local Committee with a member of the Corporation Department sitting in with us. To bring this condition about our committee has had formal complaints addressed for the joint consideration of the I.B.C. and the Corporation Commissioner. This has had a salutary effect upon offending salesmen who have over-stepped the bounds of proper technic, but who have not definitely committed violations of law. It has caused sales agents and investment dealers to place a higher value on their licenses.

The local Committee has been particularly careful not to acquire the reputation or attitude of a police department. The emphasis rather has been placed upon advising poorly informed dealers as to correct practice and procedure. Advice given has ranged from the correct use of confirmation forms to the preparation and delivery of a lecture course on Investments. Dealers have been quick to sense that the Committee was not endeavoring in any way to embarrass them. When real information or service has been given to dealers, they have passed the word on to other dealers who have in turn called on the Committee to answer questions relative to methods, etc., which they thought might be open to criticism from State or Federal authorities.

With regard to the lecture course, the District Committee, together with an Educational Committee of the local Association, spent a great deal of time preparing an outline of subjects which should be included in a lecture course for new salesmen. With the aid of the University of California, Dr. Paul Cadman, formerly of the Economics Department, was procured as a lecturer, and through the courtesy of the Stock Exchange, whose auditorium was made available, one hundred eighty students assembled once a week to listen to the course which had been prepared for them, and sold at cost. In these lectures such subjects as the broker and dealer relationship, legal liability of salesmen, proper use of prospectuses, etc. were discussed. The Committee is indebted to both the Corporation Department and the local office of the S.E.C. for having aided Dr. Cadman in preparing technical data which was discussed in these lectures.

In the days of the Code, the Committee started out on the theory that if the public was informed through means of the press that the Committee would receive complaints against offending dealers or salesmen, that alone would be sufficient. A complete reversal of policy was shortly adopted, however, whereby members of the Committee maintained constant vigilance to hear of instances wherein the investing public may have been imposed upon. All rumors were very carefully followed through. Some dealers who had possession of pertinent information were reluctant to give it to the Committee, but as soon as it was found out that the Committee utilized the information with care, dealers were very anxious to come forward and enlighten the Committee with details which they procured from their salesmen or from offended clients. The result was that various types of cases began to pass through the Committee's hands. Brief descriptions of these cases, with names deleted, were sent to the membership each month. This information, dealing mainly with generalities and principles, served as a guide to members. Some of the following cases will illustrate the type of matters which were handled by this Committee:

1. Certain sales agents operating without a Corporation Commissioner's license were required to obtain one.
2. A salesman who was employed on a salary basis by one dealer was found to be accepting sub-rosa commissions from another dealer. Both sales agent and offending dealer were brought before the Committee and the Corporation Department.
3. Many cases developed as the result of dealers incorrectly stating their firm's position as either a broker or dealer. Salesmen represented their house to be acting as an agent working for commission, whereas they were actually functioning as principals. Many dealers were so misinformed on this point that they were actually using principal tickets and adding a commission to the net total to convey an artificial atmosphere of agency. Other cases pertained to abnormal profits, some of which ran as high as 23% gross. Still other instances of abnormal over-trading were brought to light, namely, over-paying a client for securities taken in and over-charging for securities sold, the dealer thereby becoming a party to irregular bookkeeping, which subjects him and the entire industry to criticism when the facts come to light.
4. Many cases between dealers involved misunderstandings in the delivery of various securities – certificates of deposit or actual bonds, commons or preferreds. These matters were arbitrated and adjusted.
5. One case involved a salesman absconding with securities which he should have turned in to his house. Another case involved the matter of a salesman for a small house utilizing his client's securities as collateral in his own margin account carried with another house. This matter was rectified and the Corporation Commissioner given the task of determining the man's right to retain a license.
6. One non-member dealer obtained \$7,000 worth of fairly good bonds from an elderly woman and gave her in exchange a quantity of Russian Imperial Government ruble bonds repudiated in 1917, the total value of which came to scarcely \$20. The Committee was

responsible for having this dealer arrested, divested of his license, and run out of the State. The original value of the bonds taken in trade was restored to the client.

7. Another complaint pertained to the technic of a salesman who showed an elderly woman a quotation of a security in a newspaper, and who, on receiving her order, delivered her a security carrying almost the same name as that which was quoted, but which sold for ten points less.

8. Many pieces of correspondence have come into this State descriptive of securities which are being sold from out of state points which are not "blue skyed" for sale within this State, and which have little or no merit behind them. One concern sent a considerable quantity of such mail out of Mexico. The Committee collected many pieces of such mailing matter and placed them in the hands of either the Corporation Commissioner or the S.E.C., both of which bodies issued cease and desist orders to prevent investors in this area being accosted with such mailing matter.

With the assistance of the Directors of the local Association, this Committee was recently able to develop a technic for handling when, as and if issued transactions through the use of secured receipts. Special arrangements were made with the banks in this area to hold funds pending actual delivery of securities, the investing public being protected against possible difficulty within houses during the time that they wait for when issued deliveries.

The Committee has recently prepared the way for rendering additional information to local members of the I.B.C. by preparing two pamphlets on the subject of the broker and dealer relation. This topic was recently covered by the S.E.C. in a one hundred eighty page report, but this Committee felt that great value would be derived by the industry in general if, in very simple language, the customs of the Street as applied to the broker and dealer relationship were to be set forth in a pamphlet to go to the public.

A second pamphlet was prepared for the enlightenment of licensed salesmen, informing them of the correct procedure in handling both brokerage and principal transactions. It was decided that the pamphlet to the public should be sent out by member houses to their clients, and that reprints of it would appear in the local papers. The decision was also reached to send the pamphlet for salesmen to every licensed man in the State of California.

The consummation of this plan was held up pending the promulgation of the S.E.C. Over-the-Counter Rules. Since the misunderstanding of this particular subject has been the source of so many difficulties, it is felt that the enlightenment of both the public and of licensed agents is indispensable. The idea behind the development of these pamphlets has been approved by Messrs. Landis and Saperstein of the S.E.C. and by the State Corporation Commissioner, and it is hoped that it may be of material value in clarifying for the industry and for the S.E.C. the subject which has caused no end of trouble and criticism of the business.

In summary, the experience of this District Committee points to the necessity for aggressive action on the part of Committee members, a friendly and constructive attitude rather than a policing attitude, and the creation and execution of ideas which will bring constructive

value to dealers and salesmen alike, all of which will without question prove to be of value to the members of I.B.C., and in so doing will emphasize the necessity for a united front being presented by all of the registered investment dealers of this country.

Respectfully submitted,

George W. Davis, Chairman, District #2,  
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