

A DISCUSSION OF THE MALONEY ACT PROGRAM

by

GEORGE C. MATHEWS

Commissioner, Securities and Exchange Commission

----

Investment Bankers Association of America

White Sulphur Springs, W. Va.

October 28, 1938

----

In addressing this Convention last year on certain aspects of the work of our Commission, I urged at some length the importance to investors and to the national economy of the creation of an axis of active cooperation between those engaged in the securities business and those charged with its regulation. I attempted to point out the clear interest of the investment bankers, dealers, and brokers of the country and of the Securities and Exchange Commission in developing a plan for coordinated action which would have as its two principal objectives the enforcement of law with a minimum of interference with the normal processes of business and the establishment and maintenance of high professional standards of conduct and competence. Today I think there are few who do not recognize the essential validity of that concept. It is now very generally understood that as a matter of practical business operation, as well as of realistic Governmental administration, such cooperation is well-nigh indispensable if we are both promptly and effectively to unite the technical skill and experience of the industry with the strength and prestige of Government for the elimination of both illegal and unprofessional practices injurious alike to investors, the vast majority of brokers and dealers and the public generally. Last year I was able at best to speak in general terms of a possible method whereby such cooperation could be effectuated and could only deal abstractly with the benefits which might be conferred and the burdens eliminated through the adoption of a sound program. Since that time, as you all know, enabling legislation, in the form of the Maloney Act, has been placed upon the statute books to the end that your industry as appropriately organized may, subject to the Congressional directives, assume as important a role in the conduct of its own affairs as it has the will to undertake and as its natural genius will permit. It is the future course of action, under this legislation, of the investment bankers, the over-the-counter brokers and dealers of the country, and of our Commission which we are here to discuss today.

Misunderstanding has been so widespread with respect to the objectives and substance of the Maloney Act that I wish to review briefly certain aspects of its legislative history. You may recall that there has been continuing consultation for four years between representatives of your industry and our Commission looking toward the development of a cooperative scheme of regulation. One of the most important groups with which we conferred was the Investment Bankers Code Committee, organized under the National Industrial Recovery Act, a majority of the members of which were nominated by the then president of the Investment Bankers Association of America. With the invalidation by the Supreme Court of the National Industrial Recovery Act, this Committee voluntarily remained in existence, with the encouragement of our Commission, for purposes of continued consultation and in order to attempt to evolve some formula which would salvage what was believed by them to have been the strong and desirable features of the Investment Bankers Code. This group, as you know, inaugurated the Investment Bankers Conference, Inc., an organization which succeeded in holding an entirely voluntary membership of more than half of the firms and individuals who had been assenters to the Code. Conversations between representatives of that organization and of the Commission on many problems relating to the industry have continued down to the present time. Numerous conferences were held with them, as well as with representatives of your Association, prior to the enactment of the Maloney bill. This sequence of events has led some people to believe erroneously that the Maloney Act represents an attempt to revive the N.I.R.A. or

at least to create something founded upon the same legal concept. Nothing could be further from the fact. The Maloney Act represents a direct development of the principles embodied in the Securities Exchange Act of 1934 with reference to national securities exchanges. It, in fact, is patterned as closely after the earlier legislation as was deemed to be possible in view of the differences which exist between exchange markets and over-the-counter markets and the desire of those who framed the Act to provide for an entirely voluntary program.

Under the National Industrial Recovery Act, the Code, once it had been approved by the President, became the law of the land with respect to transactions in or affecting interstate commerce. Everyone conducting an investment banking business, as defined in the Code, was bound by its provisions, irrespective of whether he assented thereto. A non-assentor, however, was deprived of business preferences within the trade, such as syndicate participations and dealers concessions. Any violation of the provisions of the Code rendered the violator liable to injunction or prosecution. And in the case of a registered investment banker, violations were punishable by the Code Committee which was empowered to impose fines, and to suspend or cancel registration. From any such action by the Code Committee an aggrieved party might appeal to the Administrator. No machinery, however, was provided in the N.I.R.A. for judicial review of such proceedings.

In definite contrast to the N.I.R.A. and the Code is the form of organization provided for in the Maloney Act. No broker or dealer is deprived of the use of the mails or of the channels of interstate commerce should he fail to join some registered securities association. Nor is a broker or dealer bound by the rules of an association of which he is not a member. The Act provides for the punishment by associations of members who disobey their rules and for the exclusion of brokers and dealers for specified offenses. This power is, however, carefully safeguarded by provisions for review by the Commission either on application or on its own motion and under the Securities Exchange Act of 1934 appeal lies to the courts from such determination as the Commission may make. Likewise, there are provisions in the Act designed to provide safeguards against monopolies and monopolistic practices and to protect a free, open, and competitive market.

Before this audience it is obviously unnecessary to review the provisions of the Maloney Act in detail, particularly since we shall be glad at a later period in this forum to attempt to answer any questions which you may have on this subject. I, however, do wish to lay emphasis upon the flexibility of the provisions of the Act which are designed to permit forms of organization suitable to the differing needs of the financial communities throughout the country and of the various types of business being conducted within the broad framework of our over-the-counter securities markets. Likewise, it may be well to remind you that the cooperative program envisioned in the Act must of necessity be an evolutionary one. Ideally, the industry should eventually play the predominant role in its own regulation and development along sound economic and social lines. It should in the largest possible measure achieve that ideal under democratic institutions which Josiah Royce described as the forestalling of restraint by self-restraint. As spokesmen for the Commission repeatedly have said, it is sincerely to be hoped that the ultimate role of the Commission will be a residual one in which its energies may be principally directed toward dealing with that submarginal element known to all industries which in the absence of coercion refuses to abide by either moral or legal standards. Admittedly, the fulfillment of this ideal requires time. Many ancient premises must be reviewed and much of an educational nature needs to be accomplished. Mutual understanding and confidence must be cemented not only between the Government and the securities business but also among the various elements within that business. All of these things were taken

into account in the drafting of the Act. It was provided that certain definite conditions must be met in the rules and form of organization of an association before it could be registered, but ample latitude was allowed for the continuing development of such an association in the direction of the objectives sought to be achieved by the Securities Exchange Act of 1934. Furthermore, the Act is clearly predicated upon the assumption that the vast majority of individuals and firms engaged in transacting business in securities are honest and honorable. In that assumption we steadfastly believe. On any other premise a cooperative program, such as that provided for in the Act, would be absurd.

I have one other historical comment to make with respect to the Maloney Act. This concerns the discussions which took place at the hearings before the committees of Congress and in conferences between our Commission and representatives of the Investment Bankers Association and of the Investment Bankers Conference. As a result of those discussions many changes of both form and substance were made in the Act as originally drafted. I think it is safe to say that no piece of regulatory legislation in the field of securities has ever been enacted in this country with respect to which there was such substantial agreement between the Governmental authorities and the representatives of the industry to be regulated. This fact augurs well for the future success of our common project.

We now come to the questions of what sort of organizations should be created to carry out the purposes of the Act and in what manner they should be brought into existence. So far as I know, no existing organization of brokers and dealers would qualify for registration in precisely its present form. It is my understanding that your association has elected to retain its present characteristics and to continue to exercise its traditional functions. It, therefore, does not intend to apply for registration. As I indicated to you last year, there is a useful place for such an organization, one of the functions of which is in a spirit of candid advocacy to represent and make articulate the attitude and desires of a restricted membership, without pretense of impartiality, but with a firm intention to keep its partisanship intelligent and realistic, not merely blind. The Investment Bankers Conference, to which the vast majority of your members belong and which was formed in the hope and anticipation of legislation such as that which we are discussing, would be compelled substantially to alter and supplement its rules and forms of procedure before it could qualify for registration. Moreover, if a strong national association is to be formed, it is sincerely to be hoped that there will be included within its membership a far larger proportion of the brokers and dealers in the country than are at the present time enrolled in the Investment Bankers Conference, Inc. I know of no other organizations of firms of brokers and dealers within the general securities field which might be considered truly national in scope.

These facts having been recognized by the governing bodies of the Investment Bankers Association and the Investment Bankers Conference, an undertaking was launched through the agency of a Joint Committee, the purpose of which was to prepare a plan of organization for an association suitable for registration. Mr. Starkweather and Mr. Ford have already told you of the work which has been carried on by this Joint Committee. They, of course, have been performing an essential task since a great deal of initiative and effort is required on the part of the industry to produce a plan for submission to the Commission, and to the firms throughout the country, for approval. Appropriate members of the staff of the Commission have been made available to consult and cooperate with the Joint Committee and its counsel in the interest of expedition. When a draft of a plan suitable for submission to the Commission has been completed, it is anticipated that it will be circulated as widely as possible throughout the



trade in order that the Commission and the Committee may have the benefit of the criticisms and suggestions of as many brokers and dealers as possible and to the end that no individual or group within the industry need feel that an opportunity has been lacking for a full and free expression of his or its views, or for determining, alone or in concert with others in the business, which of the courses of action available under the Act he desires to follow.

Although such general national association as may become registered will in all probability be new and different from any organization presently in existence it is hoped that it will nevertheless represent a logical extension of much that has already been accomplished and that as the result of a natural evolution there will not be lost the results of the years of thought and labor which have already been expended upon this general program.

I have suggested the probability of a strong national organization becoming registered and such, we have been told today, has been the plan of the Joint Committee. This result is, I think, desirable. I have stated it freely to large numbers of people in the business with whom I have met in recent weeks. It should be made clear that this expression of a personal opinion does not reflect a desire, either of the Commission or of myself, to determine the course which the industry shall take. It is entitled only to such consideration as it may merit as an opinion. Neither the Commission nor anyone connected with it wants to direct your course except to the extent that the statute makes it our duty to do so.

The types of organization which may be adopted are provided for in the Act. If any organization meets the legal standards the Commission has no right to refuse it registration and certainly it has no wish or intention to assume any function not delegated to it by the Maloney Act.

The important thing is that the people in the industry have an opportunity to become informed prior to making a choice as to their course.

A national association, of course, need not preclude a scheme of local administration or the formation of local affiliated associations in communities in which this type of organization appears desirable or the formation of other national associations meeting the standards of the Act if people in the business decide that organization should proceed along those lines.

Through a strong national association, in my opinion, there can best be achieved substantial uniformity of rules governing business conduct and a reasonable consistency in the administration of such rules. Likewise, such an organization in all probability would provide the best vehicle for securing such degree of uniformity of technical trade practices as may be found to be desirable and the solution of those problems within our trading markets which exist on a national scale. Such an association should also be in a position to create an efficiently functioning mechanism for the arbitration of disputes and the investigation of complaints between firms and individuals in widely separated localities.

I have indicated that, in my opinion, the existence of a strong national association is not incompatible with local administration and I think that a substantial measure of local administration is not only desirable but practically indispensable. It seems only appropriate that complaints relating to the business

practices of a dealer in a given community should be heard by an appropriate committee familiar with all the circumstances surrounding the conduct of the securities business in that area, rather than by men conversant only with conditions existing elsewhere in the country. An example might be a controversy involving the reasonableness of a profit or a commission, since the rules of a registered association must provide safeguards against unreasonable charges. Clearly what is a reasonable profit or commission must be judged in the light of all the surrounding circumstances. An unfamiliarity with local conditions might well disqualify one who undertook to act as arbitrator or judge.

In conclusion, I should like to stress, first, the safeguards contained in the statute against the domination of such association or associations as may be formed by any group within the industry. No aspect of the legislation received more careful consideration at the hands of Congress or of the Securities and Exchange Commission than that relating to the firm establishment and maintenance of a truly representative form of Government and the protection of individuals and minorities. It is the clear duty of our Commission to exercise the greatest vigilance in assuring compliance with this Congressional mandate.

Finally, I wish to re-emphasize the evolutionary character of the program provided for in the Act. To be sure various fundamental standards must be met as conditions precedent to the registration of an association with the Commission. Rules of the association must contain the required safeguards. They must furthermore be designed to effectuate the purposes of the Act. Likewise, the form of organization and the character of its membership must be acceptable. It, however, is not anticipated that the great potentiality of this plan for cooperative regulation will be realized in its entirety from the outset. A firm foundation must be created upon which to build and it is our hope, as I am sure it is yours, that the work of construction will continue through the years until there shall finally have been erected a professional edifice commensurate with the importance of the investment banking and over-the-counter securities businesses in our national economy.

=====