United States Senate

COMMITTEE ON APPROPRIATIONS

December 20, 1943

Mr. Wallace Fulton
National Association of Security Dealers
Philadelphia, Pennsylvania

My dear Mr. Fulton:

I am taking the liberty of sending you herewith (unsigned) a copy of an interesting letter which I have received from a member of your Association.

I thought that you might like to comment upon it - and give me the benefit of your views, and any suggestions that you might have. Quite frankly, I am not sufficiently "up to date" to be able to comment intelligently upon this letter.

My best wishes.

Sincerely yours,

Francis Maloney

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Senator Francis Maloney
United States Senate
Washington, D. C.

Dear Senator Maloney:

not a rule not a limitation on profit

Knowing that you must follow current events regarding the Maloney Act, I am taking the liberty of expressing my opinion of the profit limitation rule recently approved by the Board of Governors of the NASD. This particular rule will affect our firm very little. We are in the institutional bond business and our audited reports indicate our gross margin of profit has averaged under 1% for over ten years. I am, however, very much concerned with the way this particular Association may affect the status of the independent firm in the security business if this development is a sample of their policy.

not true

The NASD has one important weakness from the standpoint of public policy. The large underwriting firms pay the most substantial membership fee. As a matter of self protection they play an important part in the politics of the Association. In order to safeguard their own selling organizations out in the territory and the firms included in their selling groups they must be represented directly and indirectly throughout the set up of the Association. The independent dealer has little voice in the policies of the Association. Regardless of what the set up may look like there is a community of interest built up by certain large underwriting firms within the Association, in such a manner, that they hold the balance of power. The smaller dealer is subject to their policies.

not so

The present rule was passed without previous notice to the membership, without submitting useful information to the members, and without explanation. Apparently no effort was made to determine the cost of doing business in the case of different sized firms. There is no evidence any effort was made to try and understand the problems of the local security dealer, or smaller firms. There is no information whether salesmen for the smaller firms can make a living on certain classes of securities under this rule. The rule is arbitrary. It may allow too substantial a margin of profit on transactions in high priced securities, and not enough to pay the cost of doing business for many firms on lower priced securities. This class of firms has no underwriting profits. Their costs are higher. The conduct of their business more difficult. Their volume less. No mention is made of underwriting spreads of the large houses, which in many cases substantially exceed the gross margin of profit to be applied to the small firm. Two issues underwritten this month priced around 15 carried a gross underwriting spread of 14 to 16%, three times the yardstick to be applied to the small firm on similar transaction.

apparently doesn't understand the letter

Confuses disclosure of spread on registered securities with markup policy.

I can't help but wonder whether this community of interest within the Association representing the large firms is not too smart to set faction against faction in the security business without definite benefits

in mind for their own interest. This rule leaves the public impression that only the large firms have the public interest at heart. It implies the small firm is the principal offender. It diverts attention from underwriting spreads and underwriting practices. Most important, it tends to drive the business of the local dealer to the large wire firms, and their representatives in the territory. The biggest underwriting firms are incorporated and cannot join the Stock Exchange. They fear the "full disclosure rule" requested by the SEC because it would intensify competition among themselves, principally on institutional business, and drive business to Stock Exchange members, who as commission brokers can handle many transactions for a smaller commission than these other firms can charge, and still satisfy their salesmen. This move may also be an effort to forestall the "full disclosure rule", which it is doubtful is practical.

This constant pressure from the SEC in connection with the gross margin of profit is unwittingly tending towards fostering a monopoly in the security business. The problem is a difficult one from the standpoint of the public interest, but unless somebody in Congress understands at a reasonable early date that the general effect of too much regulation to reduce the gross margin of profit will destroy the independent dealer, many of us won't be around long enough to worry about eventualities. Neither the Association, nor the SEC, so far as I know have ever taken a constructive attitude on the problem of the little dealer. Nobody seems to care about his cost of doing business, what margin of profit is essential to pay salesmen a living, or about the problems of dealing in local securities, or his problems of competing with the big outfits. It should not be overlooked these firms have no underwriting profits. Serving a very personal clientele these little firms are the only fellow who stands between the big trading houses of issue, and John Q. Public. From my experience as a bank examiner I know that it would be against the public interest to slowly destroy the independent dealer. My principle reason in writing this letter is to call your attention to the fact that we need somebody in Washington who can help the independent dealer stay in business, and avoid this growing concentration of power in the security business.

The Maloney Act gave the security business a wonderful opportunity. I don't believe you ever intended this legislation should entrench the influence of the larger firms, and foster a tighter monopoly in the security business. Most of the smaller dealers are afraid to express their opinions to the Association for fear of reprisal. They are afraid to drop out of the Association for fear of SEC reprisal. That sort of a situation is a sad commentary on any trade Association.

If an Association formed under the Maloney Act limited the influence of the large underwriting houses to a minimum, and was actually governed by the independent dealers, it wouldn't take long to correct the problems of this industry. The average fellow has no objection of being subject to any rule proposed by other average firms, who understand his problems. Such Association would study the problems

of the independent firm. Such Association could do a great deal as a group to correct certain underwriting practices still not in the public interest.

If the proper officials in the Association heard from your office, the Maloney Act contemplated, that any Association formed thereunder would be run in a democratic manner, and that it would seem particularly advisable not to destroy or damage the competitive position of the small independent dealer, and that this problem meritied gathering cost information and further study, I believe it might keep us all. Eventually this problem of the big firms controlling the Association thru their community of influence within the business must be settled. If you have any suggestions I would appreciate them.