

January 28, 1938.

MEMORANDUM TO: The President, The White House.

FROM: William O. Douglas, Chairman.

RE: S. 3255.

Next in importance to my reorganizing the stock exchanges is my desire to obtain some real regulation of over-the-counter brokers and dealers.

Several weeks ago I discussed with James Roosevelt this proposed program. Although he indicated that it was unnecessary to take the matter up with you at that time, the program has now developed to such a stage that I thought you should know more about it.

Through Senator Wagner arrangements were made to have Senator Maloney introduce a bill on the subject. That has been done and the Senate Committee on Banking and Currency has scheduled a hearing on the above-entitled bill for February 1, 1938.

We have at present limited control over the over-the-counter markets under the Securities Exchange Act of 1934. Under that Act we have adopted rules which provide for the registration of over-the-counter brokers and dealers and which prohibit the most flagrant forms of manipulation and fraud. On the basis of the experience which we have had, we believe that the time has now arrived to complete a program which will afford to investors in the over-the-counter markets protection comparable to that afforded under the Exchange Act in the case of exchanges. This need is emphasized by the fact that no program for the regulation of exchanges can be stressful so long as a ready escape from such regulation is possible into the largely unregulated over-the-counter markets.

Two alternative methods for the establishment of a suitable mechanism of regulation in this vast over-the-counter field are available. The first would be one of direct regulation by the Commission over the individual brokers and dealers. Since they are widely scattered and unorganized, this would be a stupendous task, involving substantial increases in personnel and funds. The second would consist in extending to the over-the-counter markets the technique used in the regulation of exchanges under the Exchange Act. That seemed to us by far the preferable course. In our judgment, S. 3255 satisfactorily accomplishes this result. The bill would provide a mechanism for investment bankers, dealers, and brokers in the over-the-counter markets to organize along lines patterned somewhat after exchanges, and to their business, subject to appropriate control and suspension by the Commission.

There are indications that the industry is largely in favor of such a program and is willing to undertake the burdens, financial and otherwise, incidental thereto. Naturally, to the extent that such burdens are assumed by such industry the Government will proportionately be relieved of expenses.

According to our best estimates at the present time, the Commission would be called upon to expend not more than \$50,000 for the administration of this program during the first year. The cost of administration in subsequent years would depend largely upon the success and the scope of the program. In no event, however, do we have any reason to anticipate that the cost of administration to the Commission would exceed \$100,000 a year. This is but a small fraction of the sum which would be necessary, should the alternative system of direct Commission action be adopted.

This program would, in our judgment, not only be far less expensive than the alternative course, but it would be a more effective approach. It represents the first real attempt made to clean up the conditions in the broker-dealer field. It should go far towards raise the ethical standards of that business.

At the same time it will have adequate safeguards against monopolistic practices.