# STOCK EXCHANGE PRACTICES

**TUESDAY, FEBRUARY 27, 1934**

UNITED STATES SENATE,
COMMITTEE ON BANKING AND CURRENCY,
*Washington, D.C*

The committee met at 10 a.m., pursuant to adjournment on yesterday, in room 301 of the Senate Office Building, Senator Duncan U. Fletcher presiding.

Present: Senators Fletcher (chairman), Barkley, Bulkley, Gore, Reynolds, Byrnes, McAdoo, Goldsborough, Carey, and Kean

Present also: Ferdinand Pecora, counsel to the committee; Julius Silver and David Saperstein, associate counsel to the committee, and Frank J. Meehan, chief statistician to the committee; also Roland L. Redmond, counsel to the New York Stock Exchange.

The CHAIRMAN. The committee will come to order. Now, Mr. Corcoran, will you please state your name, place of residence, and occupation.

## STATEMENT OF THOMAS GARDINER CORCORAN, IN THE OFFICE OF COUNSEL FOR THE RECONSTRUCTION FINANCE CORPORATION, WASHINGTON, D.C.

Mr. CORCORAN. My name is Thomas Gardiner Corcoran. I am in the office of counsel for the Reconstruction Finance Corporation here in Washington, but I want it fully understood that I do not speak for the Reconstruction Finance Corporation.

The CHAIRMAN. We understand that. Are you familiar with the bill the committee has under consideration, S. 2693?

Mr. CORCORAN. Yes; Senator Fletcher. I am one of the persons whom Mr. Landis called in to help on the drafting of the bill after you requested of him that, in cooperation with Mr. Pecora and members of his staff, a bill be prepared for you.

Mr. PECORA. Mr. Chairman, might I interrupt Mr. Corcoran for just a moment?

The CHAIRMAN. Certainly.

Mr. PECORA. Mr. Redmond, can you have available for us here in the next day or two the minute books of the committee on business conduct the conference committee, the governing committee, and the law committee of the New York Stock Exchange?

Mr. REDMOND. We will produce them here if you wish?

Mr. PECORA. All right, please do so. And the balance sheets and operating statements of the New York Stock Exchange for the last 3 years.

Mr. REDMOND. For what term?

Mr. PECORA. For the last 3 years, of the New York Stock Exchange and its affiliated and associated corporations.

Mr. REDMOND. I do not know whether such balance sheets exist.

Mr. PECORA. How about the treasurer's reports of such corporations?

Mr. REDMOND. Yes, they exist.

Mr. PECORA. But there is no consolidated balance sheet for the associated and affiliated corporations?

Mr. REDMOND. There may be, but only as filed with the Federal income tax authorities, and that, of course, is a privileged document.

Mr. PECORA. Well, whatever the treasurer's reports are, that those associated and affiliated corporations made, we should like to have.

Mr. REDMOND. We will produce those, of course, before the committee. We feel that they are confidential papers and should be produced, if required by the committee, in open hearing.

Mr. PECORA. That is what we want them for, for the committee in open hearing.

Mr. REDMOND. All right.

Mr. PECORA. And then there is a special report of the secretary of the committee on publicity of the New York Stock Exchange, which was acted upon at a meeting of that committee held on April 21, 1931.

Mr. REDMOND. Suppose I make a note of these things?

Mr. PECORA. All right. Please do so.

Mr. REDMOND. April 21, 1931, did you say?

Mr. PECORA. Yes.

Mr. REDMOND. All right. And now you say you want the minutes of the business conduct committee, the conference committee, the governing committee, and what else was it?

Mr. PECORA. The law committee.

Mr. REDMOND. There are no minutes of the law committee.

Mr. PECORA. Then, of course, they cannot be reproduced.

Mr. REDMOND. I think I now have a memorandum of what you request.

Mr. PECORA. And the operating statements or balance sheets of the New York Stock Exchange and its affiliated or associated corporations.

Mr. REDMOND. All right. I have a memorandum.

The CHAIRMAN. Mr. Whitney, do you desire to have Mr. Redmond appear as counsel for the New York Stock Exchange at these hearings and to take such part as he may see fit to take in the hearings?

Mr. WHITNEY. If you please, Senator Fletcher.

The CHAIRMAN. Without objection, that will be agreed to. So, Mr. Redmond, you may be here at the table.

Mr. REDMOND. I will take a seat down here beyond the person appearing, if I may.

The CHAIRMAN. Yes; as the representative of the New York Stock Exchange.

Mr. REDMOND. All right. I thank you.

The CHAIRMAN. Now, Mr. Corcoran, you may proceed. Please take up the bill and explain it to us, and let us see if the members of the committee understand its provisions. It has been published,

but we would like to have it explained, and how we may expect it to accomplish the results aimed at.

Mr. CORCORAN. I understood, Senator Fletcher, that that was what you wanted me to do, to explain the bill, the ideas behind the bill, and to try to illuminate some of the objections that have been made to the bill.

Senator BARKLEY. May I ask you whether you assisted in the preparation of the bill?

Mr. CORCORAN. Yes; I did, Senator Barkley. This bill was prepared at Senator Fletcher's request by the cooperation of two groups: Mr. Pecora's group, who have been carrying on the investigation before this committee, and Mr. Landis' group. Mr. Landis is one of the commissioners of the Federal Trade Commission. Senator Fletcher asked Mr. Landis to prepare a bill in combination with Mr. Pecora's group, and Mr. Landis asked me, along with some others, to help him on the bill. One of us is at the House this morning, and Senator Fletcher has asked that I come over and simply try to explain what the bill is about.

Senator BARKLEY. I just wanted to get your connection with the bill, so that I might understand the situation and, so to speak, qualify you as an expert witness on it.

Mr. CORCORAN. I do not think anyone is an expert on stock exchanges.

Senator BARKLEY. I know a lot of people who wished they were or that they had been.

Mr. CORCORAN. Perhaps so.

Mr. PECORA. And there are people who thought they were experts but who now wish they had not thought so.

Mr. CORCORAN. I once thought so, but I no longer do.

Senator BARKLEY. All right.

Mr. CORCORAN. There are 49 pages of this bill, and there is a great deal of technical language in it relating to stock-exchange practices and to corporate practices, as there must be on any subject of this kind. There is, however, a very definite structure in the bill in the shape of provisions aimed at four general fields of operation which you must regulate if you are going to do a thorough job of regulating stock exchanges.

There are, first of all, provisions relating to the control of the credit that gets into the stock market, to the field which Dr. Goldenweiser and Mr. Thomas discussed with you yesterday. In this connection there are provisions relating to borrowing by brokers to finance their own operations and to finance their customers' operations. Then the bill tries to get at the same problem, of borrowed money in the stock market, by regulating the loans which individuals may obtain from brokers or from banks to carry securities.

A second group of provisions in the bill relates to the protection of investors from evils in the stock market machinery as presently set up, from manipulations, and from what is considered to be the evil of the combination of the functions of the broker who executes orders on commission for customers, and of the dealer who is trading in securities for his own account and has something of his own to sell to the same man from whom he is taking an order as a broker.

The problem of the specialist comes under that general category, that is the group of provisions designed to protect investors from existing evils of the market machinery; and, likewise, under that heading fall the provisions for control by a Government commission over the actual practices of stock exchanges.

Then there is a third group of provisions, designed to protect investors in the market from ignorance and from exploitation by corporate insiders. Lack of information on the part of investors and ignorance of what they are buying is one of the real factors in connection with that speculation the President talked about in his message.

And then there is a fourth group of provisions, designed to regulate the over-the-counter market in unlisted securities, to protect listed securities from having the provisions of this law so burdensome on them that a corporation with unlisted securities will be in a preferable position.

Now, these provisions have been worked out with the best advice we have been able to obtain here in Washington. The provisions with reference to control of credit were worked out in consultation with the best men we could find to work on that matter in the Federal Reserve System. The provisions for the protection of investors from evils in market machinery were worked out largely by Mr. Pecora's staff, who are probably the best-informed men in the United States on that subject at the present time.

The provisions for the protection of investors in the market from corporate insiders, particularly insofar as corporate publicity is concerned, were worked out with the help of the manager of one of the biggest investment trusts in New York City, a professional investor who invests for 20,000 stockholders, and who testified before the House committee.

Senator BARKLEY. Who was that?

Mr. CORCORAN. A man named Presley. I have a newspaper release of his which I will try to read into the record a little later on. The probley of handling the over-the-counter market is one on which we consulted many brokers in New York. Likewise the problem of regulating the stock exchange machinery.

Within the limitations as to the time that could be put on a bill like this, I really think the field has been fairly well covered. Of course, in any bill produced to order there will be some errors in language that need to be corrected. And I, no more than anyone else who worked on the drafting of the bill, am here to say that this is something perfect in the last detail.

Now, there has been a great deal of criticism of the bill that it is too drastic, that it goes surprisingly far; but you must remember that if you are going to tackle the problem of regulating stock exchanges, and all the implications of stock exchange operations, and of the flow of credit from the savings of the average investor into corporate financing, and the problem of handling decent publicity for the investor in connection with all the intricacies of corporation finance, you have a job which is so big that unless you do it right you might just as well not attempt to do it at all.

The criticism which has been made of the bill, that it gives too great powers to an administrative commission, does not take into consideration the fact that the commisison which is given this job

is given a job of regulating the most powerful single institution in the United States, an institution which with all its connections cannot be expected tamely to submit to regulation when you pass this bill or any other bill, that you will have constant pressure on any organization set up to regulate an institution as powerful as the Stock Exchange and and the roots of invested interests in which run as deep as in the case of the Stock Exchange; that you are always going to have pressure on any administrative commission in such a case.

Really, to say that the Congress should put a commission without very large powers in charge of the regulation of stock exchanges, would be like advising that one put a baby into a cage with a tiger to regulate the tiger. For a commission must have full powers or the stock exchanges and the forces allied with the stock exchanges, which are supposedly being regulated, will actually regulate the regulators.

There is one other matter which I think we ought to discuss before we get into a detailed report on the bill. This bill is in a sense the third report on this subject that has come out within the year. There was an earlier report of a committee headed by the Secretary of Commerce, known as the "Dickinson report", which the President sent to both Houses of Congress without comment. Then there is another report that was worked out by a staff of 30 market specialists and investigators, under the auspices of the Twentieth Century Fund, which, I understand, will be released in full in the papers tomorrow morning, and which has been released piecemeal in newspaper reports since about the 9th of February. The Twentieth Century Fund is governed by a board of trustees that includes men you certainly would not call radical. Newton D. Baker is a member of the board, as well as Owen Young of the General Electric Co., Henry Bruere of the Bowery Savings Bank, John Fahey, chairman of the Home Loan Bank System, Henry Dennison of the Industrial Advisory Board of the N.R.A., and several others. The director of the investigation resulting in this particular set of reports is Evans Clark. Some of the ideas of that committee were used in the preparation of this bill, and you will find that on many of the very controversial points this supposedly impartial expert committee, who have made the most thorough investigation made this year of market operations, agree with this bill, contrary to the arguments of the stock exchange.

There is one other thing we ought to remember before we go into a detailed discussion of the bill. Normally when you think of a stock exchange you think of the New York Stock Exchange. Just remember that there are many other stock exchanges beside the New York Stock Exchange. I do not know how many there are, but there is a stock exchange in practically every important city in the United States. The New York Stock Exchange is so far ahead of these other stock exchanges, in its rules and regulations, with few exceptions, that there is almost no comparison, and many of the provisions of this bill that might not seem absolutely necessary if you were dealing only with the New York Stock Exchange, and if you were sure that the reform of the New York Stock Exchange would go on at a sufficiently accelerated pace, become absolutely necessary

when you are dealing with the standards of the smaller stock exchanges in other cities of the country. Now, if we may go on——

Senator BARKLEY (interposing). Let me ask you a question right there. These local stock exchanges that you are speaking of deal very largely in local stocks, don't they?

Mr. CORCORAN. Yes.

Senator BARKLEY. And there is not usually that feverish enthusiasm and impatience and expectation and deferred hope in connection with such local exchanges because of their limitations and the limited number of stocks listed, that pertain to the New York Stock Exchange.

Mr. CORCORAN. That is true. Of course, one difficulty with the small exchanges is that they were used unfairly as a method of qualifying securities under blue-sky laws. Blue-sky laws in some States regulating the distribution of securities were rather onerous. You really had to do something in order to qualify before the State blue-sky commission, and under the pressure that was always present in the distribution of a big issue of securities, there was neither the inclination nor the time to satisfy the blue-sky commissioner of some of these marketing States on some of these matters. They really wanted to know something about the securities before they would permit them to be sold within the State. The favorite device was, therefore, for some second-rate stock exchange, within the borders of the State, to go to the legislature of the State and obtain an exemption from the blue-sky laws of the State for issues listed on that stock exchange. Then the issue could, by listing the stock with the second-rate stock exchange, duck the blue-sky law of the State. Small exchanges were also, unfortunately, used merely as a place, although there was practically no trading, on which a quotation could be established in order to help the salesmen of securities, which could not be listed on the big stock exchanges, so that they could go to their customers and say: "See. This is a listed stock. There is a quotation."

Senator BARKLEY. To what extent are the local stock exchanges regulated by the laws of the States in which they are located, if at all?

Mr. CORCORAN. Not very much.

Senator BARKLEY. Is there any law in any of them which provides that no stock shall be listed unless it passes through the blue-sky process?

Mr. CORCORAN. No.

Senator BARKLEY. They can list any stock, whether it has been approved by the State authority or not?

Mr. CORCORAN. It is very difficult for the States to regulate stock exchanges. You cannot very well regulate the home team, you know.

The CHAIRMAN. They claim that they do an intrastate business and not an interstate business.

Mr. CORCORAN. Well, sir, even before the Congress acts, of course any attempt by a State to regulate a stock exchange finds itself subject to a certain degree of political pressure, brought on State legislatures, through local interests. You cannot expect effective legislation of stock exchanges from within the State itself.

The CHAIRMAN. They are almost obliged to do an interstate business, aren't they?

Mr. CORCORAN. Yes, sir.

The CHAIRMAN. And they cannot succeed in the conduct of interstate business without the postal regulations being involved.

Mr. CORCORAN. That is true of the very large exchanges, although it would not be true in the case of the small exchanges, such as Senator Barkley spoke about a moment ago, because in the case of the small exchanges they do a great proportion of their business in local securities.

Senator BARKLEY. To what extent does the New York Legislature attempt to regulate the New York Stock Exchange?

Mr. CORCORAN. Very little; there is regulation which has been incorporated in this bill and to which Mr. Whitney makes no objection, concerning the hypothecation of stocks of customers. But there is very little regulation, or at least I think this is right, of the New York Stock Exchange under the New York law.

Mr. PECORA. There is none at all of the exchange. There are various laws in regard to practices.

Senator BARKLEY. Of course, there is a sort of twilight zone, legally speaking, between the power of a State to regulate an exchange that transacts its business within the borders of the State, and the power of the Congress to regulate that same exchange insofar as its transactions cross State lines.

Mr. CORCORAN. That is true.

Senator BARKLEY. All right.

Mr. CORCORAN. Now, if we may go on and discuss, first of all, the provisions of the bill relating to control of credit. Those provisions are set forth in section 6 (a) and in section 7 of the bill, beginning on page 12 and extending over on page 13; and I suggest that inasmuch as we probably shall not have as much time as would be necessary to read the bill word for word from the beginning, I be permitted to work on the sections which are the most important.

As Mr. Goldenweiser and Mr. Thomas stated to you yesterday, there is a direct relationship between the amount of credit that gets into the stock market and speculation on the stock market on the one hand and the fluctuations that result from speculation on the other hand.

That, first of all, has a very definite effect upon business and, secondly, a very definite effect upon the pocketbook of the average small investor who goes in on too small a margin.

This bill tries to hit the problem of control of credit from two angles. On page 12, section 6 (a) it tries to hit the problem from the angle of the amount that a customer can borrow to buy securities in the market; and in section 7 it tries to hit the problem from the angle of the amount and the manner in which a broker can borrow to finance those same customers or to finance himself.

If we may just go through this section 6 (a):

It shall be unlawful for any member of a national securities exchange—

That is, for an exchange that will be licensed under the provisions of this act—

or any person who transacts a business in securities through the medium of any such member, directly or indirectly, to extend or maintain credit or

arrange for the extension or maintenance of credit to or for any customer on any securities not registered upon a national securities exchange

The purpose of that provision is to prevent a broker engaged in the brokerage business from lending on anything but securities listed on a national securities exchange, and therefore subject to regulations to be prescribed for national securities exchanges.

Senator CAREY. Does that mean that a customer could not borrow on a perfectly good security if it did not happen to be so listed?

Mr. CORCORAN. He could not borrow from a broker on unlisted securities.

Senator CAREY. Suppose he had some good securities that were not listed on an exchange, and there are a good many good issues that are not so listed, does that mean that he could not use that security to borrow money to buy other securities?

Mr. CORCORAN. That is true.

Senator CAREY Even though a perfectly good security?

Mr. CORCORAN. Yes.

The CHAIRMAN But how about banks?

Mr. CORCORAN. Will you let me come to that, which is a very important point?

The CHAIRMAN Yes.

Mr. CORCORAN. You will notice that in paragraph (b) it provides:

It shall be unlawful for any member of a national securities exchange or—

And this is important language, gentlemen of the committee—

any person who transacts a business in securities through the medium of any such member, directly, or indirectly—

That language was not intended to catch banks And I do not believe it does catch banks It was intended to bring within the limitation that loans can be made only on listed securities, not only the broker who is actually a member of an exchange, but a great class of brokers who are not members of exchanges but who receive orders from customers for securities listed on exchanges and then execute those orders through a broker on the exchange.

Of course under the Glass-Steagall bill a bank can no longer peddle securities at retail. It can do two things: it can buy securities for its own account, for its own investment; and it can act as agent to transmit to a broker an order to purchase or sell securities, given to it by one of the bank's customers.

Certainly we had no conception when we drafted the language of this bill that it would be said that if a bank bought securities for its bond account, or merely transmitted, for a service charge, an order from a customer to a broker (because very often customers of banks do not know whom to go to for brokerage service), that operations of that kind on the part of a bank constituted transacting a business in securities.

And I might say that if there is any difficulty with that language, or any conception that it does cover a bank, acting as banks may act under the Glass-Steagall Act, then the language should be changed so that banks so acting are not within the scope of the language; but that brokers who are not members of an exchange but who clear through or operate through a broker who is a member of an exchange, or a dealer who operates through a broker who is a member of an exchange, will be within the scope of that language.

Now, objection has been made that it is not fair to deny to holders of unlisted securities the privilege of putting them up with a broker and having the broker make a loan on those unlisted securities as a part of a mixed margin account.

Senator GOLDSBOROUGH. Do I understand that they are ineligible for credit? I mean, such securities as municipal bonds, or the stocks of national banks, insurance companies, and public utilities, that they will be ineligible under section 6 of this bill?

Mr. CORCORAN. No. They will be eligible for a loan by a bank, but not for a loan by a broker. If you wanted to carry such securities on margin you would have to carry them at your bank.

Senator GOLDSBOROUGH. But section 6 of this bill so far as brokers are concerned would not make eligible even the type of securities I have asked you about.

Mr. CORCORAN. No.

Senator CAREY. As this reads now, I would think a bank which made a loan of money on securities that were not listed on an exchange would be violating the law. How about that?

Mr. CORCORAN. No; I do not think so, because the business that a bank can do in securities now, as the statutes have been changed, would not be what you could fairly call business coming within that language: "Who transacts business in securities."

Senator CAREY. It says:

or any person who transacts a business in securities through the medium of any such member, directly, or directly—

Let us presume that a bank has securities and was selling them through such member, that bank would be precluded from lending on unlisted securities, wouldn't it?

Mr. CORCORAN. Well, Senator, I have just said if that interpretation can be given to that language, you are quite right that the language should be changed.

Senator CAREY. Then you will agree with me that it should be changed?

Mr. CORCORAN. Oh, yes. I do not believe that is the correct interpretation of the language, but no chance should be taken upon it and the language should be changed if there is any doubt about it.

Now, if I may answer your question, Senator Goldsborough, about unlisted securities, I think I can better do that a little further along.

Senator GOLDSBOROUGH. All right.

Mr. CORCORAN. Section 6 (b) provides that—

It shall be unlawful for any member of a national securities exchange or any person who transacts a business in securities through the medium of any such member—

That is the same language and would be subject to the same change.

directly or indirectly, to extend or maintain credit or arrange for the extension or maintenance of credit to or for any customer on any securities registered on a national securities exchange in an amount exceeding at any time whichever is the higher of (1) 80 per centum of the lowest price at which such security has sold during the preceding 3 years, or (2) 40 per centum of the current market price The Commission may, by rules and regulations, prescribe lower loan values as may be deemed appropriate in the public interest or for the protection of investors during any stated period of time or in respect of any specified class of securities

You will notice that as the language is now written it gives the commission discretion only to lower the loan value. That is, taking the correlative of that, to raise the margin requirement. There is no provision in here, as the bill is now written, permitting the commission to lessen the margin requirement beyond the alternative of the 80 percent of the lowest price the security has sold for during the preceding 3 years, or 40 percent of the current market price, whichever is the higher.

These margin requirements were worked out, in collaboration with individuals in the Federal Reserve System, to try to put a premium for margin purposes on comparatively stable securities, like bonds, municipals, governments—and governments are exempt from this bill, anyway—bank stocks, or other stocks that keep comparatively stable over a period of time.

Senator GOLDSBOROUGH. And insurance company stocks?

Mr. CORCORAN. And insurance company stocks, and all that sort of thing.

Senator GOLDSBOROUGH. And public utilities?

Mr. CORCORAN. Yes, sir; although a lot of them dropped pretty badly during the period. It would make for a much higher loan value on a bond that sold very little below par during the last 3 years.

Now, if we may go on and finish this section before we discuss the interrelations of it as a whole.

The CHAIRMAN. May I ask you right there: A great many letters have come in complaining about that. They claim that it is too high, that the margin ought to be 40 percent instead of 60 percent.

Mr CORCORAN. Senator Fletcher, I am coming to that. But I want to take it up in connection with this paper I have distributed to the members of the committee. And may I just finish this section and then go back to that and discuss the inter-relations as a whole?

The CHAIRMAN. The reason I asked the question was that I thought you were finishing that section right now

Mr. CORCORAN. No; I have not finished that section.

The CHAIRMAN. You may proceed.

Mr. CORCORAN. I want to go back over this whole section in detail after reading it entire to get the feel of the inter-relations of the paragraph.

The CHAIRMAN. All right.

Mr. CORCORAN. I will now read paragraph (c):

It shall be unlawful for any person to extend or maintain credit or arrange for the extension or maintenance of credit to any person (other than to a dealer to aid in the financing of the distribution of securities to customers not through the medium of an exchange)—

That is, a loan to an underwriter—

upon any security registered on a national securities exchange—

It is limited to listed securities, mind you—

in an amount exceeding the amount which it is lawful for a member of a national securities exchange to lend to any customer on such security, unless the application for the loan is accompanied by a statement by the borrower that such security has been acquired by the borrower and paid for in full more than 30 days prior to the making of the loan

The exception in there for securities that have been owned outright for 30 days was to provide a convenient way by which it might be determined that the borrowing on the security was not made for the purpose of carrying the security so that the limitations here on securities loans would not apply in cases when a person wanted to raise some money to pay a bill, to arrange a loan at a bank and put up securities owned outright as collateral; or when a manufacturer raising a loan for inventory purposes was asked by the bank to put up, in addition to his note and in addition to his commercial paper, some collateral security.

Any person who, for the purpose of obtaining a loan, makes such a statement which is false in any material respect, shall be deemed guilty of a violation of this subsection

I will go to section (d)

The Commission shall by rules and regulations prescribe the times at and the specific methods by which values shall be calculated for the purposes of this section, the time within which initial and subsequent payments shall be made by the customer, and the notice to be given and the method to be followed in closing out accounts, and no person who shall comply with such rules and regulations shall be deemed to have violated any provision of this section

Now, let us discuss this section as a whole What the section tries to do is this: It tries to fix a certain margin requirement on securities that is very much higher, yes, very much higher, than the margin requirements in vogue at the present time. It fixes those margin requirements on listed securities for brokers. It must, or there will be evasion by brokers, prevent brokers from lending on unlisted securities where one really never does know what the market value of the security is.

That comment is not correct for certain categories of unlisted securities, such as New York bank stocks, and stocks of certain big insurance companies, of certain big public utility companies; but you must remember and when you are dealing with unlisted securities that the number of unlisted securities you can think of as having a well-organized over-the-counter market is very small in proportion to the number that you have never heard about; and a broker could, if he were permitted to lend upon unlisted securities, where the value is indifferently known, completely evade the margin requirements for listed securities by taking into an account and putting a value upon unlisted securities which would enable him to balance up for the difference in the margin requirement provided by this act on listed securities as distinguished from the margin requirements we now have.

There are other reasons for pushing unlisted securities into banks. One is to give listed securities a frank premium for the purpose of brokers' loans, as another inducement to keep listed securities on the exchanges. Another reason is that it is not sound national economics to have excessive loans made on securities. The value of an unlisted security for the purpose of a loan is not a market proposition, as is the case with a listed security. It is essentially a commercial proposition. Remember, again, that only a few unlisted securities have the certain market value you can attribute to New York bank stocks, stocks of large insurance companies, and so on. It is much

better to put loans on unlisted securities in the banks, which will deal with them as a commercial proposition, and where you have the further check of the examinations of bank examiners.

## MARGINS

### (1) MARGIN RULES

NOTE—All the following rules relate to *minimum* margins, the broker as a matter of his private relations with his customers can always require *more* on particular securities

(a) Present New York Stock Exchange rules
maintain margin of 50% of debit balance—equivalent of permitting broker to lend 66⅔% of value of securities, applies to all accounts where customer "puts up" less than $2,500

(y) On accounts with debit balance of more than $5,000, customer must maintain margin of 30% of debit balance—equivalent of permitting broker to lend 77% of value of securities; applies to all accounts where customer puts "up" $2,500 or more.

(b) Rule proposed by Fletcher-Rayburn bill
The broker may not lend *more* than whichever is the higher of—

(a) 40% of the current value of securities—equivalent to the customer's putting up 60% of the market value of securities purchased or 150% of the debit balance (i e, the broker's loan of 40% of the market value), or

(b) 80% of lowest price within three years—equivalent to customer putting up 20% of the market value of the securities purchased or 25% of the debit balance (i e, the broker's loan of 80% of the market value).

### (2) COMPARATIVE TABLE ILLUSTRATING OPERATION OF MARGIN RULES

| | Maximum % of value of securities broker may lend | Minimum % of value of securities customer must put up as margin | Maximum number of times his deposit customer can buy in market value of securities | Minimum % of debit balance customer must put up as margin |
|---|---|---|---|---|
| N Y Stock Exchange—debit of less than $5,000 | 66⅔ | 33⅓ | 3 | 50 |
| N Y Stock Exchange—debit of more than $5,000 | 77 | 23 | 4⅓ | 33⅓ |
| Fletcher-Rayburn—40% loan value on speculative securities | 40 | 60 | 1⅔ | 150 |
| Fletcher-Rayburn—80% loan value on stable securities | 80 | 20 | 5 | 25 |

### (3) HOW MUCH STOCK CAN A CUSTOMER BUY WITH A GIVEN DEPOSIT?

With a $2,500 deposit a customer can buy the following values of securities:
(a) $7,500—under present New York Stock Exchange rule
(b) $4,100—under Fletcher-Rayburn 40% speculative loan rule
(c) $12,500—under Fletcher-Rayburn 80% stable loan value rule

With a $10,000 deposit
(a) $43,333—under present New York Stock Exchange rule
(b) $16,666—under Fletcher-Rayburn 40% speculative loan rule.
(c) $50,000—Fletcher-Rayburn 80% stable loan value rule

### (4) PROTECTION AFFORDED MARGIN TRADER BY LARGER MARGIN

(a) Suppose a trader without resources to meet additional margin calls buys 100 shares X stock at 100 on New York Stock Exchange margin—putting up $2,300 on $10,000 market value of securities
Account reads Market value long position, $10,000, debit, $7,700.
If stock drops suddenly to 77 where market value equals debit customer's margin is wiped out.

(b) Suppose the trader buys the same 100 shares of X's stock at $100 on the Fletcher-Rayburn 40-percent loan-value margin. He will have to deposit $6,000 on $10,000 market value of securities and his account will stand:

Market value long position, $10 000; debit, $4,000

If the stock drops to 77 the trader can still readjust the account to the required margin on a smaller number of shares without additional cash By selling 20 shares at 77 for $1,540 and applying the proceeds to the debit balance, the trader can reestablish his account on the following basis:

Market value long position, $6,160, debit, $2,460

By the drop in the market the trader will have lost part of his investment, but not all

(c) Suppose that with the same down payment of $2,300 referred to in the first case above, the trader buys the maximum number of shares of the same stock at the same price which the broker will be permitted to carry for him under the Fletcher-Rayburn 40% loan-value margin rule He will be able to buy 38 shares of a market value of $3,800 and his account will stand

Market value long position, $3,800, debit, $1,500

If the stock drops to 77, the trader can still readjust the account to the required margin on a smaller number of shares without additional cash By selling 8 shares at 77 for $616 and applying the proceeds to the debit balance, the trader can reestablish his account on the following basis:

Market value long position, $2,310, debit, $884

By the drop in the market the trader will have lost approximately ⅓ of his original investment but he will still have an equity in an account and may be able to recoup with a rise in the market.

Now, let us go to the matter of the amount of this margin. I have distributed figures you will want to have so that you will not have to figure too much with pencil and paper. The computation that has been distributed to you, shows just what the margins provided for in this bill are in comparison with the margins provided for by the New York Stock Exchange rules at the present time.

The New York Stock Exchange has margin rules at the present time. They are not inflexible. Mr. Whitney testified the other day before the House committee, as I understand, that the New York Stock Exchange had had percentage margin rules since about 1921 or 1922. But Mr. Pierce testified before the House committee the other day that those margin rules were very flexible, and that he was not sure that any objection was raised to trading on much smaller margins for big operators, of whose ultimate solvency the broker was sure. That is, the margin rules had been put into effect for the protection of the broker on his loans to the customer, and not to dissuade customers from going into the market on too small a margin. I think he said he was not sure but thought the account of one big operator must have been carried on something like a 10-percent margin. I do not know whether there are any margin requirements expressed in percentages, or in any different percentages, on other stock exchanges at the present time.

So I must deal, for the purpose of comparison, with the margin requirements of this bill and the similar requirements of the New York Stock Exchange rules. Now, this bill expresses margins in the way in which the average layman thinks of margins. The layman thinks of a margin in terms of how much he has to put up to buy 100 shares of such and such stock.

The broker and the banker do not think of a margin in that way. They think in terms of the amount that the customer owes them on debit account, and the percentage of security they have up

for that account in terms of the ratio between the value of that security and the value of the loan outstanding on the security.

The bill has expressed the margin requirements in the way the average investor thinks of margin. This little table we have here is a translator's table for turning margins, computed on the basis which the bill adopts, into margins computed on the basis that the New York Stock Exchange adopts.

One other thing while we are talking about margins: Mr. Whitney the other day in his testimony before the House committee intimated that one of the difficulties arising in connection with an inflexible margin was that some securities needed more margin than others. That argument is not applicable to the bill, however, because the provision, stated in section 6 (b) of the bill, relates to minimum margins. A broker may, of course, have an arrangement with his customer to refuse to carry the account unless securities are more heavily margined. All the matters we will talk about from now on relate to minimum margins.

Present New York Stock Exchange rules, as we present them on page 1 of the paper which you have, say that on accounts with a debit balance of less than $5,000 the customer must maintain a margin of 50 percent of that debit balance. That is equivalent to permitting the broker to lend 66⅔ percent of the value of the securities as contrasted with the 40 percent which the broker is permitted to lend under the terms of section 6 (b) of this section 6.

That rule, which is a different rule from that applying to the bigger traders, applies to all accounts where the customer's initial risk, in the sense of the initial deposit that he puts up, is $2,500 or less.

For the larger accounts, the accounts with a debit balance of more than $5,000, the New York Stock Exchange rules require the customer to maintain a margin of 30 percent of the debit balance, which is the equivalent of permitting the broker to lend 77 percent of the value of the securities purchased or carried, as compared with 40 percent under section 6 (b) of this bill.

And then the rule proposed by this bill is the alternative of permitting a broker to lend 40 percent of the current value of the security, or 80 percent of the lowest value to which the security has fallen within 3 years, whichever is the higher.

Now, on page 2 there is a comparative table illustrating the operation of these margin rules.

Senator GORE. What are you reading from, Mr. Corcoran?

Mr. CORCORAN. I am reading, Senator, from a tabulation which I have made up for the convenience of the committee on the comparative operation of the margin rules prescribed by the New York Stock Exchange and those embodied in the bill

Senator GORE. Has it been distributed?

Mr. CORCORAN. It has been distributed, Senator. I will see that you get a copy.

You will notice in here, so that we think all around this subject, that we have shown in these comparative tables the maximum percentage of the value of the securities the broker may lend under all four rules; the minimum percentage of the value of the securities which a customer must put up as margin; the maximum number of

times his deposit a customer can buy in market value of securities, which is a very important calculation of a customer, particularly as we stand on the threshold of a bull market.

Senator GORE. State that again.

Mr. CORCORAN. The maximum number of times his deposit a customer can buy in market value of securities.

Senator GORE. You mean deposit with the broker?

Mr. CORCORAN. Yes. Suppose a customer has a thousand dollars and he wants to buy as much as he possibly can with his thousand dollars, the largest possible market value of securities. He could buy three times his thousand dollars if he were operating under the New York Stock Exchange rule relating to accounts with a debit of $5,000 or less. He could buy four and a third times his thousand dollars in market value of securities if he were operating under the New York Stock Exchange rule relating to accounts with a debit of more than $5,000 He could buy only one and two thirds times his thousand dollars in market value of securities operating under the 40 percent rule laid down in section (b) of this act, or he could buy five times his thousand dollars in the market value of stable bonds under the 80-percent rule laid down in section (b) of this act.

Then there is another column, the fourth column to the right, showing margin percentages computed in the way a broker computes a percentage. Under the New York Stock Exchange rules on accounts with a debit of less than $5,000 there has to be a margin of 50 percent of the debit balance. Under the New York Stock Exchange rules on an account with a debit of more than $5,000 there has to be 33⅓ percent of the debit balance. Under the Fletcher-Rayburn bill, with a 40 percent loan value on the securities, since the broker can only lend two thirds as much as the customer puts up, the margin expressed in the way brokers express margins is 150 percent, and under the Fletcher-Rayburn 80 percent rule, if you are dealing with securities that come under that rule, the margin is 25 percent of the amount of loan that the broker puts up. You can buy five times as much in securities as you put up, and the amount that you put up is one quarter of the remainder of the price of the securities which the broker lends you.

At the bottom of this page we can see some more tangible illustrations. How much stock can a customer buy with a given deposit under these margin rules? With a $2,500 deposit—that has been taken because it is the limit under the New York Stock Exchange rule—the customer can buy the following amounts of securities. Under the New York Stock Exchange rule $7,500 market value, you put up $2,500 and the broker will carry you for a market value of $7,500 worth of securities. Under the Fletcher-Rayburn 40 percent rule——

Senator GORE (interposing). In that case your deposit is half?

Mr. CORCORAN. Your deposit, sir, is $2,500. You owe $5,000, and your deposit, therefore, is 50 percent of what you owe. That is the way a broker computes his margins. You could buy $7,500 worth of securities under the present New York Stock Exchange rule. You could buy only $4,100 worth of securities under the Fletcher-Rayburn 40 percent rule. You could buy $12,500 worth of very stable securities if the Fletcher-Rayburn 80 percent rule were applicable.

Senator BULKLEY. That would only be in case you were buying at the lowest price it sold in 3 years?

Mr. CORCORAN. Yes; your margin is computed at the lowest price. That is true.

Senator BULKLEY. Then you could only buy this amount if you were actually buying it at the lowest price within 3 years?

Mr. CORCORAN. Yes.

Senator BULKLEY. So that if you happened to buy it at the lowest price that it got in 3 years, then you could buy it for this amount?

Mr. CORCORAN. Yes.

Senator BULKLEY. But if you bought it at a higher price than that——

Mr. CORCORAN. There would be some other scale. You cannot work it out for the purposes of a comparative tabulation until you know what price you buy at.

Now, with a $10,000 deposit—and I take a second figure because the New York Stock Exchange rules are different for small accounts and for big accounts—with a $10,000 deposit a customer could buy under the present New York Stock Exchange rules $43,333 worth of securities. Under the Fletcher-Rayburn 40 percent rule he could buy $16,666 worth, which you see is less than half, considerably less than half. And buying at the bottom under the 80 percent rule he could buy $50,000 worth of securities.

Senator KEAN Why not take a case like this: Suppose Industrial Alcohol, that we had here the other day; that price was something like 7. It is now—what is it now?

Mr. CORCORAN. It went to 80, and it went down again to under 30. I don't know where it is now.

Senator KEAN. Well, say, 40.

Mr. PECORA. The last time I looked it was around 49, but that was only a week ago.

Mr. CORCORAN. You want to know how the margins work out?

Senator KEAN. Yes.

Mr. CORCORAN. Well, it all depends. How much do you want to put up, sir?

Senator KEAN. $10,000.

Mr. CORCORAN. Well, under the Fletcher-Rayburn rule you get 80 percent of 7 or 40 percent of 40, whichever is the higher. Obviously, you would take the 40 percent of the 40. So that you could lend on that $1,600; a broker could lend $16 a share. That means that the customer would have to put up the difference between $16 a share and $40 a share—$24 a share. Approximately $25 a share. For $10,000, therefore, you could buy 400 shares.

Senator KEAN. That is all?

Mr. CORCORAN. That is all.

Mr. PECORA. Mr. Corcoran, I think perhaps there is a misconception about the answer you made to Senator Bulkley's question, and if there is, perhaps it would be clarified if you answer this question· When does the 80-percent rule apply under the Fletcher-Rayburn bill?

Mr. CORCORAN. When it is the higher, sir; when the computation on that basis is higher than the 40-percent computation on the current basis.

Mr. PECORA. And does that mean that the purchase must be made at the time when the security is selling for its lowest price within 3 years?

Mr. CORCORAN. No. The computation of margin is made on that basis.

Senator BULKLEY. Yes; but if the computation of margin is made at the lowest price, then it would be a different percentage if you paid any higher price. So unless you buy within that lowest price, you cannot get the benefit of the 20 percent margin.

Mr. CORCORAN. No. Let us take, for instance, the case of a bond that has a par of a thousand dollars, sir, and suppose during the break that bond went down to $80.

Senator KEAN. Suppose it went to 30?

Mr. CORCORAN. I will work out several sets of illustrations. If it went down to 80, then the rule will not work—it is not that it will not work, but the computation on current value yields you a greater loan value. Suppose the bond went down to 800. Suppose the bond is now selling at par. If we could lend 80 percent on 800, it would be $640 on the lowest price. You could lend only $400 on the current price.

Senator BULKLEY. Yes; but you could still lend the 640, but it would be 64 percent instead of 80 percent.

Mr. CORCORAN. That is true, because you lend 80 percent of whatever——

Senator BULKLEY (interposing). You only get the benefit of the 80 percent loan if you happen to buy at the very lowest price in 3 years?

Mr. CORCORAN. Yes; that is true. What you mean is that the amount that is lent on a security computed on this 80 percent basis will not be 80 percent of current market value.

Senator BULKLEY. That is it exactly.

Mr. CORCORAN. But it will be 80 percent of the lowest value within the 3 years and in the case of a stable security the percentage of current market price which you reach on the 80 percent computation will be higher for a stable security than 40 percent of current market value.

Senator BULKLEY. Yes, it might be, but it would be very seldom as high as 80 percent?

Mr. CORCORAN. That is true.

Senator GORE. It could work out in that case. It looks to me like it would have to be lower than the lowest in order to function under that.

Mr. CORCORAN. No, Senator. Take the thousand dollar par bond case that we have had just a minute ago. I can illustrate Senator Bulkley's point by that. You have a bond that has a par of $1,000. During the deepest of the dark days that bond sold for $800, and that is the lowest price within 3 years. The bond is presumably back to par at $1,000.

Now, if you take 80 percent of the low, it will be 80 percent of $800, which is $640. That does not represent 80 percent of present current market value; it really means 64 percent of current market value.

But the alternative rule based on current market value would give you only a $400 loan value. So that, although the larger loan value permitted by the 80 percent rule is not 80 percent of current market price but is 64 percent, it is nevertheless higher than the current loan value.

Senator KEAN. Yes, but suppose you take the instance that I quoted a minute ago, when the bond went down to 35, somewhere around there?

Mr. CORCORAN. Which computation gives you the higher margin, sir, depends upon the particular set of figures that you use. But there is a very definite premium placed upon the securities that have had the slightest drop within the last 3 years, which normally will be the securities that you think of as falling into stable categories. Good municipal bonds, good underlying bonds of railroads, stocks of good insurance companies, and that sort of thing.

Senator GORE. In that case the broker could carry the customer for $640?

Mr. CORCORAN. Yes.

Senator GORE. Instead of $400.

Senator KEAN. Now, take municipal bonds—why, lots of them went down to 50-odd.

Mr. CORCORAN. That is true, sir. Lots of municipal bonds deserved to go further than down to $50.

Mr. REDMOND. Mr. Chairman, may I ask a question?

The CHAIRMAN. Yes.

Mr. REDMOND. Mr. Corcoran, isn't it equally true that this 80 percent provision will apply to a declining security irrespective of its quality?

Mr. CORCORAN. Once you get, sir, below the lowest price which the security has reached in 3 years.

Mr. REDMOND. So that, throughout, let us say, 1930 and 1931——

Mr. CORCORAN (interposing). It would have allowed you much more liberal margins.

Mr. REDMOND. Even the most speculative securities could have been carried on a more liberal margin?

Mr. CORCORAN. That is true, sir, but, of course, the answer to that is, as we have said before, that this applies only to the minimum which the broker can exact, and you and I know perfectly well that in a declining market, although that is a time when you like to have by law the most liberal computation for margins, a broker would superimpose upon the minimum margin requirement we required an additional amount for his own protection. Always trust the broker to take care of himself on the way down, sir.

Mr. REDMOND. Mr. Corcoran, my point is not that, but you described this 80-percent provision as applying to stable securities.

Mr. CORCORAN. Yes.

Mr. REDMOND. That is actually a misnomer, isn't it, because it applies to stable or declining securities?

Mr. CORCORAN. It applies to stable securities in its normal application. There is a possibility that in a declining market, after once in the course of the decline the price gets below the lowest price to which the security has gone during the preceding 3 years, it will apply to speculative as well as to stable securities. But that op-

eration is insignificant, because, as you and I know, in a situation like that the broker will take care of himself.

Mr. REDMOND. Might I ask you simply this, As I read this provision the prohibition is not only against the extension but also the maintenance of credit. Therefore, as securities decline——

Mr. CORCORAN. Yes.

Mr. REDMOND (continuing). This 80 percent provision, which might have applied, let us say, to a stable security initially——

Mr. CORCORAN. Yes.

Mr. REDMOND (continuing). Goes down with the decline in the market.

Mr. CORCORAN. Yes.

Mr. REDMOND. Isn't that going to be a factor which will tend to force liquidation?

Mr. CORCORAN. No; because, sir, again remember it is expressed as a percentage of loan value, and in this case is a maximum percentage of loan value, so that it does not put the broker in a position where he has to liquidate as the stocks go down. That is up to the broker. This provides for more liberal margins by reason of law when stocks are going down.

That is why I cannot understand in your own brief, sir, why you object to this. "In periods of necessity or of decreasing prices it will permit over-liberal margins." As to that the broker can take care of himself. The law should be in such shape that in periods of declining prices if a broker wants to take the chance, he can give what from a business point of view is a more liberal margin, and that in periods of rising prices it will fix prohibitively high margins, which is again just exactly the correct result if you want to keep the market from running away on the upside.

Mr. REDMOND. I am addressing myself now, Mr. Corcoran, to a different point, if I may, and that is that it seems to me that this requirement governs not only the extension but also the maintenance of credit.

Mr. CORCORAN. Yes.

Mr. REDMOND. And that it is going to mean that in a loan, let us say, made on stable securities, where your 80 percent clause applied, and the loan was made on that basis, a perfectly conservative loan, let us say on municipal bonds.

Mr. CORCORAN. Yes.

Mr. REDMOND. If you should get a decline in the market from par to 80, as you used yourself——

Mr. CORCORAN. Yes.

Mr. REDMOND (continuing). Automatically the loan value of those so-called "stable securities" gets fixed at 64 for at least 3 years to come.

Mr. CORCORAN Are you talking about an immediately undesirable effect in driving the market down?

Mr. REDMOND. True, because it is going to force loans which are otherwise well margined to be liquidated, because you go over from your 80 percent to your 40 percent category.

Mr. CORCORAN. No. What you are saying to me, Mr. Redmond, is this, that a broker may lend 80 percent on the value of securities. If the security is at 1,000 the broker may lend $800. If the security

falls from a thousand to 800 the broker can lend only $640. Well, of course, the broker lends a less aggregate amount as the security goes down.

As far as the drop in the particular market is concerned, you will agree with me that of course if you are lending 80 percent you are lending up to about the limit anyway, and if the value of the security goes down of course the aggregate amount that may be lent against it on an 80 percent basis also goes down.

Is this what you are worried about: We will say it goes down to 640 and then comes back to 1000. The benefit that is given to stable securities through this 80 percent loan value will always be fixed until you get another year rolling by at 64 percent rather than at 80 percent after the market comes back.

Mr. REDMOND. No, I was not concerned with that. But remember that as soon as you reach the limit of the loans that can be made——

Mr. CORCORAN. Yes.

Mr. REDMOND. Because this bill imposes criminal penalties, the loan will have to be liquidated.

Mr. CORCORAN. Well, you mean when the loan gets below 80 percent loan value?

Mr. REDMOND. Yes.

Mr. CORCORAN. Certainly. That is true.

Mr. REDMOND. In the slightest degree?

Mr. CORCORAN. Yes; that is true, except that the commission is given power in here to determine the time at which you can close out the account. But it is absolutely true that when a security drops in value that is what happens. You cannot have a loan higher than 80 percent loan value, no matter what value the security has.

Mr. REDMOND. That is true.

Mr. CORCORAN. Well, I did not understand that a broker objected to marking down the margins as the securities went down, sir.

Mr. REDMOND. They do not, Mr. Corcoran, but I think you are increasing the complexity of the problem. Very few brokerage accounts consist, or even bank loans, of a single security.

Mr. CORCORAN. No. On some you would loan 80 and some you would loan 40.

Mr. REDMOND. And there, when you once get a decline which carries you down below, then on that security, taking the example that you yourself used a minute ago, that bond is then marked at 64 for all purposes, even if it recovers, while other securities in the loan may decline.

Mr. CORCORAN. That is true.

Mr. REDMOND. So that you permanently write down the so-called "stable security."

Mr. CORCORAN. You write down the security, sir, for 3 years; that is true.

Mr. REDMOND. For 3 years?

Mr. CORCORAN. And that is an inevitability of this way of working out a more flexible margin.

Mr. REDMOND. I agree.

Mr. CORCORAN. Of course, you realize that this 80-percent rule is lagniappe as far as the general margin provisions of this bill are concerned.

Senator GORE. Do I understand that that fixes that value for a period of 3 years?

Mr. CORCORAN. It fixes the low. Of course, the 80-percent calculation is based upon the lowest price within 3 years. Mr. Whitney says you should not talk too much about the advantage that is given stable securities by the 80-percent margin rule, because the 80 percent is based of course upon the lowest price within 3 years, and you may have a situation in a catastrophic market where the value of a stable security will drop very, very low and then that very, very low price is the basis on which your 80-percent calculation is made for the next 3 years. That is very true.

The CHAIRMAN. Mr. Corcoran, what effect will this have on the volume of business?

Mr. CORCORAN. That is what I wanted to come to next. If you look at paragraph three in this computation and see how much stock the customer can buy with a given deposit—and you realize that brokers collect a commission on the market value of securities purchased, irrespective of the margin requirements—you can readily see from those figures why brokers are howling about the bill.

This bill will cut the margin business at least in half, and the brokers will lose that half of the commissions they would collect under the present margins. It is easy to understand for that reason why the brokers do not like the bill.

Senator GOLDSBOROUGH. That is the "flight of commissions"?

Mr. CORCORAN. That is the flight of commissions, sir.

Senator KEAN. It would cut it more than half.

Mr. CORCORAN. I don't know, sir. It all depends on how much of your accounts are big accounts and how much are small accounts. You see, the comparative figures are $7,500 and $4,100 that may be bought with a $2,500 deposit for small accounts. There the proportion is about 7½ to 4 So, that it does not quite cut it in half.

But when you get into the bigger accounts you more than cut it in half. The proportions are 43 to 16. So, that you really appreciably cut into the margin business.

Senator BULKLEY. What do you conceive to be the advantages of having margin trading?

Mr. CORCORAN. Sir, you heard yesterday—I don't remember whether you were present, but I think you were——

Senator BULKLEY. Not all day. No; I was on the floor.

Mr. CORCORAN. You heard yesterday the argument of Dr. Goldenweiser and of Mr. Woodlief Thomas about margin trading. From the social point of view there are two justifications for margin trading. I do not think they are very good myself, but I will give them to you, state them fairly for what I think they are worth.

The first is that you should permit a man when a stock is down, as stocks now are down, and when there is a prospect that those stocks are going to get out of sight, to buy on a down payment and then pay in as he goes along. You buy a stock now at 50. If you wait 2 months for it, it might be 100. The market on many stocks is already, sir, 100 percent of what it was last March, when we were in the depths. The argument is that a man who is acquiring for investment may very well want to buy at 50 more stock than he can presently pay for, and then, just as he buys an automo-

bile on the installment plan, he will pay for it out of future earnings until he owns the stock outright.

The difficulty with that situation is that in a rising market human nature is such that the man never pays for the stock as it goes up. He just pyramids his margin and buys some more.

The second justification is one that is of a piece with the arguments of the economists of the stock exchange in favor of speculation generally; that if you are going to have a liquid market you must have a very active market. To have a very active market you must have a speculative market, because a market of investors is not active enough. To have a speculative market you must have a market into which borrowed money can enter, and to have a borrowed money market you must have a margin market.

Now, the nub of that argument goes back to the purely pragmatic question of how valuable speculation is in the market. You have seen the report on that of the Twentieth Century Fund, the group of experts I have just been talking about. There is no question as to the position Mr. Meeker and all the rest of the stock exchange people take on the value of a speculative market. It is very significant that the Twentieth Century Fund, which has been looking into this proposition and examining on a completely independent basis the premises of that argument in favor of a speculative market reported the other day—I have to read from a report in the Herald Tribune.

> All the conclusions we have reached on the basis of our factual studies converge at one point Speculation, especially when accompanied by manipulation, should be drastically curbed, not only because it actively interferes with the proper evaluating functions of the market, but also because it does not exert the beneficial effects which it has been commonly supposed to produce

Senator BULKLEY. Would it not be a good idea to confine speculation to a man speculating with his own funds instead of being encouraged to borrow?

Mr. CORCORAN. Well, sir, I think so, because I am not so sure that the prospective value of having a liquid market is worth what it has cost society to have the debacle we have had in the last few years. There is not any way, however, of finally determining it. I mean it is a matter of judgment.

When we sat down to draw this bill there was a very strong element that believed in cutting out margin trading altogether. This bill is a compromise between those who believe that you should eliminate margin trading altogether and those who are willing to go along with the stock exchange for a time in its thesis that a liquid market made liquid with borrowed funds is worth enough so that some margin money should be left in it, though not much. The particularly drastic cut in margins that has been made in this bill is based on a theory that if any bill is going to have any effect by cutting down the amount of borrowed money in the market it has got to go a long way; that cutting margins 5 percent won't make any difference at all.

Senator BULKLEY. Of course, my criticism of your theory is that you do not really go the whole way and take the broker out of the banking business.

Mr. CORCORAN. The difficulty with that, sir, is the necessity of compromising. You will find a great many people who think there

should be no margin business at all; but at least, although you do not go the whole way, if you moderate the amount of borrowed money in the market you may help the situation considerably, providing you moderate enough. If you cut these margins 5 percent, you may just as well not legislate on margins. If you cut the amount of borrowed money that gets in the market by a half, you may have done something toward attaining the social benefits that are urged by those that think there should be no margin trading at all.

Mr. PECORA. In other words, Mr. Corcoran, it is not deemed that we should go to either one extreme or the other?

Mr. CORCORAN. That is true, sir.

Mr. PECORA. We wanted a middle ground that was sought to be found in the provision that is now in the bill.

Mr. CORCORAN. That is true, sir.

Mr. REDMOND. Mr. Corcoran, is that based upon your conclusion that there is too much borrowed money in the market today?

Mr. CORCORAN. Well, of course, today—you provided some figures the other day about the amount of brokers' loans in the market.

Mr. REDMOND. The borrowed money has been published right straight along for years, Mr. Corcoran.

Mr. CORCORAN. Yes; that is true.

Mr. REDMOND. What we provided the other day were the figures of the brokers' debit balances.

Mr. CORCORAN. The brokers' debit balances showed how much of the borrowed money in the market was represented by borrowed money in brokerage accounts as distinguished from borrowed money in bank accounts.

To answer the question somebody asked me just a minute ago, whether I thought there was too much borrowed money in the market, I do not pretend to be an economist, sir; but Dr. Goldenweiser of the Federal Reserve told you yesterday that he felt there was entirely too much money in the market.

Mr. REDMOND. I do not remember his making that statement as of the present time

Mr. CORCORAN. That was the aggregate. And of course what we are doing is sitting down at the bottom of the market, even with prices at a hundred percent above last March, and legislating with respect to what we all expect is going to be a rise in the stock market. If you take hold of the situation now you may prevent the market from running away, with the inevitable repercussions on business you get from a run-away market, and with the repercussions you had in the business situation last year.

Senator BULKLEY. Are you giving us a reliable tip that the market is going to rise?

Mr. CORCORAN. No, sir.

Mr. REDMOND. Mr. Corcoran, on that very point, though, I suppose you appreciate that the adoption of these margin requirements means necessarily an immediate liquidation of part of the brokers' debit balances held today?

Mr. CORCORAN. Let us talk about that right now. When this section was drawn, perhaps in a little overexpectancy of how fast the market was going to move, it was thought that by putting the date

at which these margin provisions would become applicable over to October 1, after the expected spring and expected fall rise in the market, and by confining these margin requirements to listed securities, which in the case of the best securities are well above the lows of last fall, at which level present brokerage accounts are being held, there would be plenty of time for the market to rise to a point by that date where most brokerage accounts that could get out of the red would be out of the red on the standards of these particular margins.

There has been a great deal of factual criticism to the effect that that judgment is wrong, and that by next October 1 there will still be many brokerage accounts and many bank accounts carrying securities that will be under water on the present margin requirements.

Therefore, the other day before the House, talking for those who drafted the bill, and very humbly as such, we suggested that this section should be modified so that the new margin requirements would not apply to accounts that were presently existent; that they could be carried indefinitely if in the judgment of Congress it were wise to carry them indefinitely; but that the new margin requirements, to prevent evasion, should apply if any substitutions were made in those accounts after the 1st of October.

Senator KEAN. What do you mean by "substitutions"?

Mr. CORCORAN. Suppose, sir, you have an account now that is under water; but suppose you have an account with stock X in it that has a market value of $1,000. The account is under water on October 1. You think that the X stock won't go up as fast as Y stock now selling at a thousand dollars. You say to the broker "Sell out the thousand dollars worth of X stock and buy me a thousand dollars worth of Y stock." So long as you carry the X stock which you have held in that account prior to the time when the new margins went into effect, it will be carried for you at whatever margin rate the bank is carrying it. But the minute you transfer to a new stock, then the new margin requirements apply.

Clamping down on substitutions is an absolute necessity. If you are going to permit the leniency of carrying present accounts indefinitely, then you must prevent the certain evasion that would come about by customers rushing into the market now to buy lots of stock at the present low margins, and then want to carry their accounts through after October 1 indefinitely.

Senator GORE. If he substituted in the case you supposed there, it would require a larger margin to carry Y stock than X?

Mr. CORCORAN. Yes, that is true.

Senator GORE. Is that on the general assumption that it is not wise to shift from a more sluggish stock to a stock that is presumed to be more active?

Mr. CORCORAN. No. It is a rule of necessity to prevent evasion of the new margin rules by the device of carrying through securities under the old margin rules and then being allowed to switch indefinitely within the accounts. Otherwise, you could rush into the market right now, anticipating a change in margin rules by October 1, and load up on a 10-percent margin, if the stock exchange would permit you to do so. Then after October 1 you could trade indiscriminately on the theory that you were substituting so long as you provided the fiction that you were dealing with the same account.

Senator BARKLEY. Is there any real difference between the man who in the last year or two or during this crisis was either sold out or had to sell out voluntarily, so as to put him under water, although his account may not be under water he is very much under water, and the man who has been able to hang on all this time with his stock, though it is under water, and would run into the 1st of October and be able to carry that stock on indefinitely, as against the man I referred to first who might now get hold of some money and buy a little stock and want to carry it in the hope that he might recoup the losses that he sustained in his former transactions?

Mr. CORCORAN. Sir, what you are really talking about is the difference between the fellow who carried his margin account with a broker who sold him out and the fellow who carried his margin account with his home-town bank, which, because of its customer relationship to him, carried him through.

Senator BARKLEY. That is by and large.

Mr. CORCORAN. Yes; that is a rough classification. I am not passing on the morals involved in it, sir. I just don't know. I am simply concerned that because of its deflationary effect there should not be any forced liquidation of present underwater accounts between now and October 1.

Senator BARKLEY. You mean by present accounts stocks held at this time?

Mr. CORCORAN. Stocks held at this time in banks.

Senator BARKLEY. You do not mean accounts that fluctuate from day to day, that you can buy today and sell next week?

Mr. CORCORAN. They can fluctuate from day to day, sir, up to October 1. It would be impractical to work a rule that said that all accounts had to be frozen with their present long commitments until October 1.

Senator BARKLEY. Is it your theory that anybody who buys stock now and carries it up till October should then be subject to the new margin requirements?

Mr. CORCORAN. In any changes made after October.

Senator BARKLEY. If he bought stocks now and carried the same stocks on the books up till the first of October he would not thereafter be required to put up more margin?

Mr. CORCORAN. That is true, sir. If there is any seeming inequity in that situation, it is because you just cannot put the law into effect right away, anyway. You have to give a date somewhere in the future to which the market can be adjusted and before which machinery can be set up for the enforcement of the act.

Senator BARKLEY. As to all such accounts the status quo would be maintained?

Mr. CORCORAN. Right, sir.

Senator BULKLEY. If you are going to allow existing accounts to be carried through, would it not be better to make the effective date a good deal earlier than October 1?

Mr. CORCORAN. We all—all who are interested in the recovery effort—do not want to put any damper on the beginnings of an upturn, and we wanted to put the date ahead as far as we could consistently with the act getting into operation.

Senator BARKLEY. If that is your viewpoint about it, is October late enough? The fall has just begun in October.

Mr. CORCORAN. Sir, you have to stop somewhere. You can jiggle this date, October 1, to any date that your good judgment dictates, but sometime there comes a time in the history of every book when it has to be written, and there comes a time in the history of every statute when it goes into effect.

Senator GORE. Senator Barkley wants to be sure the recovery has started.

Mr. PECORA. Mr. Corcoran, you are not using the term "jiggle" in street parlance, are you?

Mr. CORCORAN. Oh, no, sir; I am careful.

Mr. REDMOND. You have talked about this thing as affecting only brokerage accounts in stocks, but of course it would also affect, would it not, loans in banks?

Mr. CORCORAN. Yes.

Mr. REDMOND. So as to prevent substitutions?

Mr. CORCORAN. On the same basis. You could not substitute except pursuant to the new margin requirements after the 1st of October.

Mr. REDMOND. So that if a person who had borrowed money against good bonds thought that it would be advisable, because of developments in a particular industry, to sell some of those bonds and buy other equally good bonds, he would find that that would be impossible unless he put up additional margin?

Mr. CORCORAN. He could not buy as much.

Mr. REDMOND. He would have to pay his loan off?

Mr. CORCORAN. He would have to pay his loan off.

Mr. REDMOND. It would be impossible unless he put up more margin?

Mr. CORCORAN. It would be impossible with the same market value.

Mr. REDMOND. That means payment of part of the loan?

Mr. CORCORAN. Yes, sir; that means payment of part of the loan.

Senator GORE. You apply these same requirements to the banks as well as to the brokers?

Mr. CORCORAN. Yes; you have to apply them to the banks, Senator, for the reason that a great, great part of the margin accounts, that is, the securities carried on borrowed money, are carried through the banks, a much larger proportion right now than are carried through the brokers, and if you are trying to reach the general evil of too much borrowed money in the market, both from the effect upon the general economy and the effect upon individuals you have to reach those accounts in the banks as well as in the brokerage houses.

Another reason why you must reach the banks is that if you did not regulate the amount of margins required on securities accounts in banks, brokers who wanted to evade the requirements that you put upon them would simply arrange for their customers, and you would never be able to catch the practice, loans from the banks on small margin requirements.

Senator GORE. I was asking the question yesterday and the gentleman said somebody else knew more about it. That was on that very point, as to whether or not, if you impose this regulation of higher margin requirements—now I am speaking in the light of our experience under the eighteenth amendment—would there not be some

bootleg broker around the corner who would sell it and buy it, dealing with Tom, Dick, and Harry on a low margin?

Mr. CORCORAN. Well, sir, you always hear the possibility of the bootlegger. But, by and large, the bulk of the business will not be done by the bootlegger. You will not be able to stop all bootlegging. You will be able to stop enough of it so that the purpose that you are trying to reach by cutting down the aggregate amount of borrowed money will be achieved. You will always have some bootleggers, sir.

Senator GORE. What I have in mind, though, is the people that I assume you are trying to protect, Tom, Dick, and Harry, that do not know anything about stocks, do not know anything about the earning capacity or the capital investment or the character of the management of anything else. They buy because stocks have been going up, and they guess they will continue to go up.

Mr. CORCORAN. Sir, you can stop the bootlegger just as much as you stopped the bucket shop. The stock exchange will say you are pushing us back into the era of the bucket shop, which is the form that bootlegging would normally take.

Senator GORE. Yes.

Mr. CORCORAN. That depends upon the extent to which you can enforce the law. The problem of breaking up the bucket shop is no more difficult under this statute than it has ever been under any other statute. You have successfully handled the bucket shop You have not completely eliminated it, but you have to a great degree reduced the bucket-shop problem. Mr. Pecora himself chased the bucket shops out of New York. You can keep the bucket shops down by effective prosecution under this law, just as you kept them down by effective prosecution under the existing law.

Senator BARKLEY. What effect would this margin requirement have upon people of small means who are not speculators, but who desire to accumulate stocks and pay for them outright upon the installment plan?

Mr. CORCORAN. It would make the amount of stocks which persons of small means could accumulate in that way very much smaller. But the trouble is, Senator Barkley, even if it sounds, as the fixed investment trusts would say, like "permitting the small man to buy an interest in America should be discouraged", that very few of the people who started in buying on margin as a method of buying stocks on the installment plan ever completed the installment. As the stock went up they pyramided or they bought more. The very optimism that led them to think that it was a good time to accumulate stocks because they were cheap led them to try to accumulate more and more and more on margin as the price went up; and the man who started out with the best intentions in the world of paying a quarter down while stocks were low—the man who started out with that very good intention found himself playing a speculative account within 2 or 3 months afterward.

The CHAIRMAN. And about 7 out of 10 lost?

Mr. CORCORAN. More than that I think lost.

Senator BARKLEY. I am speaking more particularly of those who intended to accumulate for investment.

Senator GORE. I have seen the figures that 97 percent lose, 2 percent win, and 1 percent come out even.

Senator BARKLEY. I am speaking of those who deal with banks, who in good faith go to a bank and say, "I would like to have a hundred shares of Steel or American Telephone or L. & N. Railroad, anything, to lay aside", without any education and who never do get into the speculative fever.

Mr. CORCORAN. Very few of those people, sir, really exist. A lot of good intentions start out, but the good intention gets completely wrapped up in the speculative fever as the rise in the stock in anticipation of which the installment movement was made comes about.

Mr. REDMOND. Might I ask Mr. Corcoran: Those last statements of yours are very sweeping in their nature. Might I ask on what authority they are made?

Mr. CORCORAN. You mean that most people lose?

Mr. REDMOND. No; you stated that they practically all lost; that they practically all when they once bought on margin ended up by having nothing but a speculative account in which they never completed their purchase.

Mr. CORCORAN. Mr. Redmond, I haven't the statistics to prove that the majority of people who go into a rising market buying securities on installments end up by running a speculative account on margin. I do not think there are any statistics on that.

Mr. REDMOND. I think there are some, Mr. Corcoran.

Mr. CORCORAN. I simply know that everybody I know who started that way ended up just as I have stated.

Senator GORE. I was looking at an analysis of 500 accounts in the Board of Trade, I believe at Chicago, and 414, I believe, lost, 72 won, and 16 came out even. Now, if that works out, it is approximately that. That was based on an actual analysis, and there were 500 stock accounts dealt with in the same statement. I didn't go through that. Someone told me Henry Clews said—and he was in the market 50 years—he never knew of anybody who dealt on margin and stuck to it but what came out broke, and I think he was pretty conservative.

At the same time, I do not think you can stand between the fool and his folly. I think he is intelligent enough to beat you to it. If you do that, I am for you.

Mr. CORCORAN. You can stand part of the way, Senator.

Senator GORE. Yes.

Mr. CORCORAN. There is one more provision——

The CHAIRMAN (interposing). Before you pass from that, what specific provision and what change would be made in the bill so as to prevent this forced liquidation?

Mr. CORCORAN. Something would have to be added to the bill.

The CHAIRMAN. Section 6?

Mr. CORCORAN. There would have to be a new section. It is the cleanest way to draft the change.

Mr. PECORA. Or a subdivision of 6?

Mr. CORCORAN. Or a subdivision of 6. It might be done by inserting a few words, but it is probably a matter of considerable redrafting.

The CHAIRMAN. Very well. Now, passing on, Mr. Corcoran, to page 14—

To borrow on any security registered on a national securities exchange from any person other than a member bank of the Federal Reserve System

Mr. CORCORAN. Could I come to that in just a minute, sir?

The CHAIRMAN. Yes.

Mr. CORCORAN. I am going to come to that. I would rather handle that together with the other.

The CHAIRMAN. Very well.

Mr. CORCORAN. There are two other things we ought to talk about before we leave this section on margins. One is the answer to a question which Senator Kean asked yesterday: What difference does it make whether a fellow puts up 60 percent margin or 20 percent margin? In any case, when the margin is reached he has lost his money.

The answer is attempted to be given on pages 3 and 4 of this analysis. It is true that as soon as the debit balance—what a trader owes the broker—corresponds with the value of the securities the trader is wiped out; but the deeper the margin the longer it takes for the trader to reach that unfortunate stage, and on the way down he has time to readjust the account by selling a certain number of shares without putting up additional cash, so that he can maintain the margin much further down.

This computation on page 3 shows three cases: One where a trader buys 100 shares of stock at $100 under the New York Stock Exchange rules and the stock drops to 77 and wipes him out. That is, we are taking the New York Stock Exchange case as the normal.

Then we show two other situations: One where the trader buys the same amount of stock on the Fletcher-Rayburn margin; and one where he buys not the same amount of stock but puts up the same amount of money as margin, and in each case his 60 percent margin gives him time to readjust his account on the way down without putting up more money. So that if the stock drops to the same 77 he is not wiped out. He has lost part of his money, but he still has an account; he still has a chance to come back if there is any come-back, and he still has an equity.

I will not go through that in detail.

Senator KEAN. I would like to point out to you there that if the market goes down so that his margin is impaired by 1, 2, 3 percent at once, why, the broker must notify him either to put up more margin or else he will be wiped out.

Mr. CORCORAN. That is true; but, sir, after that notification comes he has a chance to readjust the account if his margin is wide enough. I am supposing the case of a man who has put up all he has and has no cash left in his pocket when a margin call comes. When the margin call comes if his margin is wide enough he still has a chance by selling a part of the securities to readjust the account without putting up more money.

Senator KEAN. If his margin is 30 percent or 35 percent he still has the same opportunity?

Mr. CORCORAN. No; because, sir, a smaller drop in the market will wipe him out.

Senator KEAN. A smaller drop in the market, of course, will wipe him out.

Mr. CORCORAN. That is what we are talking about.

Senator KEAN. But he still has to liquidate a large part of his stock in order to make his margin good; is that right?

Mr. CORCORAN. Yes.
Senator KEAN. He does not have to liquidate quite so much?
Mr. CORCORAN. That is true.
Senator KEAN. That is true?
Mr. CORCORAN. That is true.
Senator KEAN. And it would be less if he had 75 percent margin?
Mr. CORCORAN. That is true.
Senator KEAN. Or if he had a hundred percent margin?
Mr. CORCORAN. Yes, sir.
Senator KEAN. He would not have to liquidate at all?
Mr. CORCORAN. That is right.
Senator KEAN. But as soon as his margin goes below the point that you are allowed by law to carry you are going to make him either sell out or else put up more margin?
Mr. CORCORAN. That is right. But the point I am trying to make, Senator, is that there is a real protection to the investor in requiring him to put up a bigger margin.
Senator KEAN. It would be better to make it 75?
Mr. CORCORAN. That is true.
Senator KEAN. It would be better at a hundred. Then he would not have to put up any margin.
Mr. CORCORAN. And if you are interested in not having men cleaned out, as a social problem, the deeper margin you make them take the less chance there is they will get cleaned out.
Senator GORE. Have you considered undertaking to fix it so that small purchases, $1,000 or less, could not be made on margin?
Mr. CORCORAN. I think there is a rule of the New York Stock Exchange now—I do not know; Mr. Redmond can tell you—by which brokers refuse to take accounts under a certain amount, and most brokers as a matter of fact would not handle a small account.
Mr. REDMOND. It is a question of individual decision.
The CHAIRMAN. How is that, Mr. Redmond?
Mr. REDMOND. It is a decision made by each member or firm to either take the account or refuse it, Mr. Chairman. There is no fixed minimum.
Mr. CORCORAN. It might be wise, Senator Gore, to put such a provision in. It would be something additional to the present protection of the bill.
Senator GORE. I have wondered about it a good deal, what the reactions would be and whether it would really prevent people who want to become small investors from buying at all.
Mr. CORCORAN. Most reputable brokers, the people who do the big business, will not take an account of that size. A bank, of course, will take an account for its customer of almost any size.
Senator GORE. I was wondering if it would not be better to force them to go to the bank, where they could at least get the banker's advice—not that it is good advice always.
Mr. CORCORAN. That might be added to the bill, sir. It is a question whether, under the present practices, brokers who are acting as if such a statute were in effect would know where they would get their commissions.
Senator GORE. As it is, he gets his commission whatever happens to the unfortunate trader, but if you eliminate that so far as brokers

are concerned and turn those people to the banks, it might be a sort of a protection, I don't know.

Mr. CORCORAN. There is one more point, and one very serious point, about these provisions for margin. Why should there be any rigid roof beyond which no commission is given discretion to raise the permissible loan value on securities?

A great many people have said—

> We agree with the social policy of cutting down the amount of borrowed money in the market, but you should not say 40 percent; you should give some commission power to fix that rate in its discretion.

The answer to that involves a pure problem of practical statesmanship. If you believe that there is a public interest to be served in having the amount of borrowed money and the amount of margin operations in the market curbed—and we drew the bill on the supposition that there was such a public policy—you will have to make a drastic cut in margin trading or you will not have influenced the market sufficiently to have achieved your purpose at all. Secondly, there is one immutable law of political physics, as of all other physics, and that is, when an irresistible body meets a movable object the movable object goes just as far as the irresistible force wants to push it.

Behind low margin requirements is all the vested interest of the brokerage fraternity. Perfectly legitimate—it is bread and butter to them. Any Government commission that is put down here with complete discretion to fix margins at any point that seems desirable is going to be under terriffic pressure all the time to push those margins to the limit.

The placing of a bright line beyond which discretion cannot go assures you that you do achieve the maximum of the social policy you are trying to effect. If you are afraid that these margins are too high, it would be far better to move the bright line to a higher loan value, say 60 percent, and stop there, than to take away the bright line and put a commission down here under the terrific pressure that will always be on them to extend their discretion to the limit.

There is one possible exception to that rule. It may be that for normal purposes you will want a bright line at 40% or at 60%. We think 40, because unless you really cut into this margin business, you may just as well not play with it at all. It may be, however, that the line you would want as a norm under usual circumstances may need a little flexing in cases of national emergency. The theory of this bill is that if you catch the market now you will not have another 1929, because you will never get another run-away market. There will not be enough borrowed money to make a run-away market possible.

But if you are thinking of the possibility of a 1929 you might provide something like this: The bright line is 40 percent, but it might be possible to lessen those margin requirements, upon a finding of national emergency and for a definite length of time, not of just one commission in Washington, but of the Federal Reserve Board and the Federal Trade Commission and possibly the Secretary of the Treasury. Then you make discretion something that can be exercised only in really unusual emergencies, and you make it a mighty hard thing to exercise.

Senator GORE. Mr. Corcoran, have you been able to figure out in that connection any way to protect the lambs who want to buy real estate on margin?

Mr. CORCORAN. No. There is no way to protect the lambs.

Senator GORE. That is the worst situation. The stock market buries its dead, and these farmers and home owners who bought on margin; their ghosts are stalking. They are what is giving us trouble. These fellows who lost in the market are dead and buried.

Mr. CORCORAN. I am trying to take care of one species of lamb at a time, Senator. After we take care of the stock-market lamb, as far as we can take care of him, perhaps we can try to take care of the others.

Senator BARKLEY. We are feeding the other lambs out of the Public Treasury in the form of bonds.

Senator GORE. I think suicide is the hardest thing to prevent in the world.

Mr. CORCORAN. Of course, you have two purposes to serve when you are dealing with margins: One is to protect the lamb; another, and probably the more important of the two, although it does not appeal to one's human instincts as completely, is the protection of the national business system from the fluctuations that are induced by fluctuations in the market, which in turn stem back to this very exquisite liquidity you get when you have a lot of borrowed money in the market. That is the point which Dr. Goldenweiser made yesterday. From the sheer unmoral standpoint of public policy it is probably more important to protect the business system from the effects on the market of too much borrowed money than it is to protect the lamb.

Senator GORE. Mr. Corcoran, that is the point which always discourages me. If you can prevent men from buying on a rising market and selling on a falling market, if you can repeal that law of human nature, you can stop this business.

Mr. CORCORAN. You cannot repeal it, sir. You can help it a little by seeing that they do not buy as much and do not sell as much. But that is all.

Senator GORE. I hope you are right.

Senator BARKLEY. There are some stocks that are very volatile, go up and down very rapidly. There are others that are more or less stable over a period of years.

Mr. CORCORAN. Yes.

Senator BARKLEY. Even in depression the fluctuation in value of certain stocks is not very great. Would you give the Stock Exchange or anybody else any discretion to fix margin requirement, depending upon the volatility of the stock?

Mr. CORCORAN. There was an attempt to do that, sir; in this section 6(b), the 80-percent alternative about which we have been doing so much talking. That was an attempt to do that. It does not work out perfectly, as Mr. Redmond showed. It has a general tendency to favor the staple stuff for margin accounts over speculative accounts——

Senator BARKLEY. I was attending another committee and did not hear that testimony.

Senator GORE. Did you consider this point? I assume you did, because you seem to have carefully considered the matter. That is the advisability of placing some sort of limit upon daily fluctuations, like they undertook to do in the Grain Exchange in Chicago, so that it could not fluctuate more than 10 percent of the open price, up or down. My point is that that might help to stop a stampede, just a frenzy of selling or buying.

Mr. CORCORAN. Senator, I am not enough of an economist to know whether such an interference with a free market is a wise thing or not. Those artificial limitations of that kind on the fluctuations of securities tie up with the real problem of the wisdom of permitting short selling and all other activities of a free market. I honestly do not know enough about the economics involved to be able to give you an opinion on that subject, sir.

Senator GORE. Of course, I believe in a free and open market, subject to reasonable limitations.

Mr. CORCORAN. I know that Mr. Redmond would have apoplexy if that sort of thing were put into the bill.

Mr. REDMOND. No; I would not. I think the market would take care of itself very rapidly.

Mr. CORCORAN. In other words, there would not be any market?

Mr. REDMOND. Precisely.

Senator GORE. The grain exchange functions under that limitation.

Mr. CORCORAN. It functioned last summer under it.

Mr. REDMOND. But if you remember, for a number of days, Senator, the grain market went along with very small transactions, immediately dropping down to the permissible limit, so that although there was no volume of activity, grain prices were carried very, very low indeed; and then it turned around and rebounded.

Senator GORE. I watched those stocks drop like a plummet, 30 or 40 points in an hour. It ought to be a reasonable market, so far as can be, where some sort of reason prevails. But you have seen times when reason just took flight and people were seized with frenzy. Sometimes you put an individual in a straight-jacket and in a padded cell to prevent him from doing violence to himself. I want a market place where people can buy and sell, and I only want to guard against those things that are preventable. We do not want to undertake to prevent things that we cannot prevent. Then we would do more harm than good. We would be attacking impossibilities.

Senator KEAN. We have in New York the Bank of Montreal, the Bank of Nova Scotia, and lots of individuals. There is no difficulty in any of them selling their 60-day bills in the open market and then selling their demand and thereby receiving large sums of money to loan on the market. If the market in London is 2½ percent and it is 5 percent in New York, that is a very profitable business.

Mr. CORCORAN. Yes.

Senator KEAN. Why can they not lend on any margin?

Mr. CORCORAN. As long as they do not lend on these securities.

Senator KEAN. I have letters from people who say that they now have their stocks listed on the stock exchange, and if this bill goes

into effect they are going to withdraw their stock from the stock exchange and have it traded in on the curb, in the open market.

Mr. CORCORAN. Of course if it is traded in on the curb, it would still be subject to this bill. That is a problem which I wanted to come to later, but which we might just as well face now. That is the statement that if we put restrictions upon trading in listed stocks, and if we require companies, as a condition of such trading, to furnish adequate information to its stockholders, all of the companies will withdraw their listings and get off the stock exchanges. There is a provision in this bill which empowers the Federal Trade Commission to regulate the over-the-counter market. Just exactly how you are going to regulate that market, no one has yet worked out. Undoubtedly it can be done; so long as you have control over mails and over interstate commerce you can work out a way to handle the over-the-counter market.

There are two other factors in this threat of the flight of securities from the exchanges. Number one is that stockholders for whose benefit all these supposedly onerous requirements of reporting are made, are not going to let their directors pull off the stock exchanges. You remember, about two years ago, the fight that the Stock Exchange had, and it was a very creditable fight with reference to Allied Chemical & Dye Corporation. It was carrying in its accounts a large number of shares of its own stock. It was required to report more fully to the stockholders. The management threatened to get off the exchange. There were other fights going on for other reasons in that situation; but the stockholders prevented the directors from pulling off the exchange. The requirement of supposedly onerous bulletins and reports and publicity put upon listed stocks will not cause the stockholders to permit the directors to pull a corporation off the exchange.

Senator KEAN. I think that is quite right; but I am talking about the onerous part of trade in these stocks.

Mr. CORCORAN. Now, sir; as far as the onerous part of trading in the stocks is concerned, in the first place, you have given listed securities an advantage over unlisted securities in permitting brokers to carry them in accounts while you do not permit unlisted securities to be carried in their accounts. What onerous provisions are there in this bill as to listed companies that are not for the benefit of the stockholders? After all, sir, the stockholders determine whether companies keep their shares listed, not the directors.

Senator KEAN. That is right, and I hope they always will; but there are many provisions in this bill which makes it onerous on the boards of directors and also on the margin accounts——

Mr CORCORAN. Now, let us take them one by one, sir. Insofar as the onerous requirements on the board of directors are concerned, they are all for the benefit of the stockholder. A stockholder is not going to say, "Pull the stock off the board because my directors cannot deal in that stock and make profits on their inside information and because they don't want to tell me what is going on in the company." So far as any requirement on the director is concerned, it is all for the benefit of the stockholder; and no stockholder is going to force his company to pull off the board because it is doing the right thing by him.

Insofar as restrictions on trading are concerned, you have given listed stocks a premium over unlisted stocks for the purpose of margin accounts.

Senator KEAN. Yes; you have given it to a certain extent; but do you take it that no curb stock can be dealt in by a broker here?

Mr. CORCORAN. Sir, any curb stock that is listed can be dealt in.

Senator KEAN. Listed where?

Mr. CORCORAN. Listed on the curb. There is a problem in connection with the New York Curb, if that is what you are thinking about, as to which you will undoubtedly hear from counsel for the curb exchange. The fact is that a great many stocks that you normally think are listed on stock exchanges are not listed at all. If you have a New York paper here this morning and you look at the report of transactions on the New York Curb Exchange, you will notice that a certain number of stocks quoted have a little star opposite them, which means fully listed on the curb exchange. That is, the issuing company has listed the stock on the exchange, giving the information required for listing on the exchange, and has entered into certain covenants with respect to its activities.

Stock exchanges throughout the country, however, have made a practice of attempting to hold out for trade on the exchange securities that are not listed at all. A broker for instance vouches for a security, not the company. He gives the listing committee a certain amount of information with respect to the security. The issuing company has never listed nor has ever entered into any covenant to observe the requirements upon listing companies. Nevertheless that stock can be traded in. I think Electric Bond & Share is in the category of an unlisted stock right now. The problem of the effect of this legislation on the New York Curb and whether the Curb can force presently unlisted stocks into full listing depends completely on the degree to which you can make listing desirable under the terms of this bill and how you can control the over-the-counter market to which the unlisted securities would run.

That is my opinion, and there is nothing but opinion in this matter. It is my opinion that no shareholder is going to have the liquidity of his shares jeopardized by having his company run off the exchange simply because of rules under which listings can hereafter be had requiring directors to shoot straight with the stockholders and tell the stockholders something about the management of the company.

Senator KEAN. I agree with that; but at the same time, where a man controls the company, or his family controls it, he may object to some of those rules or may not.

Mr. CORCORAN. What you are saying, sir, is that a majority stockholder or a majority of the stockholders may want to take their shares off the exchange. In a case like that, that is a possibility. But most of the cases we are dealing with are cases where we do not have the majority of the stock held so closely.

Senator GORE. When England went off the gold standard, did not the stock exchange close for a day or place certain limitations on short transactions?

Mr. CORCORAN. That is true, sir.

Senator GORE. Did the stock exchange survive?

Mr. CORCORAN. It survived, sir.

Senator GORE. We will have to corroborate that by Mr. Redmond.

Mr. CORCORAN. It is a very live corpse, sir, if it did not.

Senator KEAN. Yesterday we had a discussion on the subject of the London Stock Exchange. Is it not true that in their fortnightly settlements, at one time, about 1926 or somewhere around there, the cash settlement was postponed for 3 or 4 years because they were unable to settle their accounts?

Mr. CORCORAN. I do not know much about the London Stock Exchange, sir.

Senator KEAN. It was brought up here yesterday. As I remember it, when there was a large drop in London—I think it was in 1926 or somewhere thereabouts—London was unable to settle on their regular settlement, and I think it was a year or two before they could complete the settlement.

The CHAIRMAN. That was before our day.

Senator KEAN. No; it was not before your day.

Mr. CORCORAN. Shall we go on, sir, to the next section?

The CHAIRMAN. Yes.

Mr. CORCORAN. As a summary of this margin section, there is no argument of social policy against cutting down margins except what I think is the weak argument that borrowed money is necessary to a liquid market, which we have discussed. On the other hand——

Senator KEAN. Pardon me. Let me interrupt you right there. Is not borrowed money in speculation necessary to make a broad market in close quotations? I mean, that if you take a bond that is dealt in once a month, or something like that, the bid price is 4 or 5 percent or 3 percent different from the offered price, and that is not a satisfactory market, because if you want to buy you have got to sacrifice half a year's interest.

Mr. CORCORAN. That is the problem which I was discussing with Senator Bulkley—whether the much vaunted advantages of liquidity of the market were worth the cost to society of the abuses resulting from the margins believed necessary to make such liquidity possible.

Senator KEAN. One of the reasons is that there has been testimony here as to billions of dollars or hundreds of millions of dollars loaned on the stock exchange, and that they did not lose 1 cent.

Mr. CORCORAN. That is, the broker didn't lose, nor the bank that loaned didn't lose. But how about the fellow that bought stocks on margin? He did lose.

Senator KEAN. Yes.

Mr. CORCORAN. I do not think we need legislation particularly to protect the broker all the time. They normally won't lose.

Senator KEAN. I do not know. If you get a narrow market, they might lose. The liquidity of the market is what they loaned money on.

Mr. CORCORAN What you are talking about, Senator, is the social desirability of accepting all the perils that have been perfectly evident to us over the last 5 years of excess of borrowed money in the market. You are balancing those perils against the advisability of having quotations that will run an eighth or a quarter of a point instead of 2 or 3 points——

Senator KEAN. What I am saying is this, that the money market in New York has been of continuous benefit to protect banks and

trust companies all over the country so they might have a liquid form of loan which they knew they could give back to their customers and to their depositors at any moment. To illustrate: As I understand it, a bank in New York has so much commercial paper, so much permanent loans, time loans and so much demand loans on the market. They have a debit balance in the clearing house at 9 o'clock in the morning of $1,000,000, and they want so many brokers' loans. If, on the other hand, they have a credit balance of so much money, they loan so much money in the market and that gives them the opportunity of using the floating money in their bank that may be called out tomorrow. It gives them an opportunity.

Mr. CORCORAN. What the ultimate simplicities of that argument come down to, Senator, are just this, that society should take on all the burdens we have had with margin speculation in the market so that the New York banks will have a place where they can lend liquid funds. That is what it ultimately comes down to.

Senator KEAN. I think you are right in that the margins ought to be sufficient. If you create a margin of 35 or 40 percent, I think that you are doing all you can in this matter to protect the individual. I think if we insist upon that kind of a margin and that becomes the law, that margin will be so great that it will protect the public from losing their money the way they have on many occasions.

Mr. CORCORAN. To summarize, we have on the one hand the argument of social policy against margin money in the market, both from the point of view of its effect upon business and upon the social fabric which was described to you yesterday, and from the point of view of loss to the individual investor.

Against that we balance the advantages of liquidity in the market from the standpoint of having a place where banks can lend liquid funds and where investors can realize on securities. I am not trying to make that balance. For me there would be no choice. If I had to sacrifice liquidity of the market in the sense that sales had to be within a quarter of a point rather than within two points to prevent 1929 from occuring again, the decision would be easy for me; but that is a question of policy. If you do, as a matter of policy, decide that you want to limit margins, then you are up against the propositions that to effect that policy you must limit margins in banks as well as in brokers' loans and that you must make a real limitation of margins, if you are going to have any effect upon the market big enough to carry out the purposes of your social policy. And to be able to make the margin limitation effective, you must have a bright, rigid line with any discretion removed or made as difficult of application as possible.

Mr. REDMOND. Do I then understand that this bill really carries out the social principles of the persons who drafted it?

Mr. CORCORAN. No; not the social principles of the persons who drafted it, any more than the social principles of Mr. Goldenweiser who talked here yesterday. It embodies the philosophy that too much borrowed money in the market is a dangerous thing for the economic structure of the country as well as for the people who go into the market on borrowed money. To the extent that it embodies

that philosophy, it does embody not only the philosophy of most of the people who drafted it, but of a lot of other people as well.

Senator GORE. You stated earlier in your statement who did draft the bill. I was not here.

Mr. CORCORAN. It was drafted as the result of cooperation between two groups. Senator Fletcher asked Mr. Landis of the Federal Trade Commission to cooperate with Mr. Pecora, who is counsel for the investigating committee and counsel for this committee, now. He asked Mr. Landis and Mr. Pecora to cooperate in the drafting of a bill. Mr. Landis asked several persons to help him. I was one of those. Mr. Pecora had several members of his investigating staff helping him; and the two groups cooperated in the drafting of the bill.

Senator GORE. Do you know who Mr. Pecora's assistants were?

Mr. CORCORAN. Mr. Pecora is here himself, sir; he can tell you.

Senator GORE. I thought maybe you knew. He is not a witness. I would be glad to have it in the record, however.

The CHAIRMAN. I do not see that it makes any difference at all. Is not the conception really that the purpose of reducing these loans and reducing the amount of money flowing into speculation is to leave some funds for agriculture, commerce, and industry throughout the country?

Mr. CORCORAN. That is true to a certain degree, sir. To be perfectly fair, as Dr. Goldenweiser pointed out yesterday, the stock market does not really divert funds from industry; it merely redistributes funds as between agriculture and industry. But the fact is that it did take money from agricultural communities and put it into securities of large corporations, and it took money that normally would have gone to the financing and developing of small corporations and routed it into the coffers of large corporations.

Senator GORE. Do you not think it acted as sort of a suction drawing funds from all parts of the country into New York?

Mr. CORCORAN. That is true, sir; but to be perfectly fair, that money, it went into the purchase of securities and hence into the coffers of the corporations offering those securities or it went out in the expenditures of persons who made profits on the securities and eventually got back into the channels of trade somewhere.

Senator GORE. But in consequence of that, the concerns floating the stock took advantage of the opportunity to get this money which might otherwise have remained in the interior parts of the country devoted to carrying on legitimate business; so that the crash, when it came, might have found a real cushion instead of a more or less artificial one?

Mr. CORCORAN. That is true, sir.

Senator GORE. It not only withdrew money from my part of the country, but from Europe as well. Europe sent immense funds over here.

The CHAIRMAN. Proceed.

Mr. CORCORAN. Section 7. We have talked about margins in the sense of getting credit into the market through the borrowings of persons operating in the market. Section 7 deals with an attempt to control the amount of credit that goes into the market by restricting borrowings of brokers. You will notice in section 7 that it provides [reading]:

It shall be unlawful for any member of a national securities exchange or person who transacts a business in securities through the medium of such member, directly or indirectly——

That language should be amended to make it certain that it does not cover banks. [Continuing reading:]

(*a*) To borrow on any security registered on a national securities exchange from any person other than a member bank of the Federal Reserve System.

New legislation puts in the Federal Reserve Board the power to limit the loans which a member bank makes upon securities. The purpose of canalization through the Federal Reserve bank of borrowings going into the market through banks to brokers is to make it practicable to exercise the control over money going into securities which the Glass-Steagall bill attempts to give to the Federal Reserve Board.

There is another provision which should go in at this point. It comes in from page 23. You will notice on page 23 that any issuing company, as a condition of registration, must agree, if it is not a Federal Reserve member bank, not to lend to carry securities. On page 23 it is provided [reading]:

The rules and regulations of the Commission in regard to registration shall require—

(I) An undertaking by the issuer to comply with and so far as is within its power to enforce compliance by its officers, directors, and stockholders with the provisions of this act and any amendments thereto and with the rules and regulations made or to be made by the Commission thereunder and, unless the issuer is a member bank of the Federal Reserve System, not to lend any funds in the money market of any exchange or to any member thereof or to any person who transacts a business in securities through the medium of any such member except in accordance with such rules and regulations as the Commission may prescribe

That is to control these outside corporation loans which you were discussing yesterday.

Section 7, then so far as we have gone in connection with this other provision, limits the borrowings of brokers, first, from Federal Reserve member banks; secondly, from outside lenders under such rules and regulations as the administrative commission may prescribe.

Senator KEAN. I do not think that would interfere in any way with a company lending to its directors and officers money to purchase their own stock; do you?

Mr. CORCORAN. No, sir. The internal corporation laws ought to require that. A New York corporation cannot lend to its shareholders.

Senator KEAN. Most of the companies give to their employees an option to acquire so much stock a year.

Mr. CORCORAN. You see the lending is simply made subject to any rules and regulations of the Commission; and if there were any question of that kind, undoubtedly the rule would except such a situation. [Continuing reading:]

(*b*) To permit the aggregate indebtedness of such member or person to all other persons, including customers' deposits, to exceed such percentage of the net current assets owned by the borrower and employed in the business not exceeding 1,000 per centum as the Commission may by rules and regulations prescribe

Roughly, what that says is that a broker cannot borrow more than 10 times his capital to lend to his customers. I understand from

Mr. Whitney's statement that that does not constitute a burden on New York Stock Exchange members at the present time. I understand that there has been some objection from smaller exchanges that their members simply cannot carry on their accustomed volume of business if they can only borrow from the banks 10 times the amount they have invested as capital.

This is a provision to make certain that brokers do not operate on a shoestring and that there is a capital cushion for their customers. I understand that some brokers during the crash—Mr. Redmond can check me on this—were permitted to borrow up to 50 times their capital.

Mr. REDMOND. Not that I know of. It may have happened in a particular case where a firm was being reorganized, or something like that.

But what is the definition of the term "net current assets owned by the borrower and employed in the business"?

Mr. CORCORAN. It is substantially as you put it in your brief.

Mr. REDMOND. Is not that a very vague term?

Mr. CORCORAN. No.

Mr. REDMOND. "Net current assets"?

Mr. CORCORAN. No. It is his current assets after you deduct his liabilities. You know what we are after. If you can suggest a better way to phrase it I should be very glad to accept your language. I do not care how you define it.

Mr. REDMOND. That term "net current assets" would normally be the difference between your current assets and your current liabilities. That is quite different from capital.

Mr. CORCORAN. No, but it does represent the cushion of protection immediately available for the protection of your customers.

Mr. REDMOND. I think not.

Mr. CORCORAN. Mr. Redmond, as long as you and I know what we are after, I will be perfectly willing to accept any suggestions you have for the redefinition of that term.

Mr. REDMOND. I am simply raising the question that the term at present is not accurately defined; and being a point on which criminal liability would turn, I think it should be very definitely defined.

Mr. CORCORAN. I agree.

Mr. REDMOND. Is there going to be any provision made for those cases that are bound to arise where a man, no matter what good faith he may have exercised, would fall below the fixed ratio?

Mr. CORCORAN. No; because there, again, Mr Redmond, you are up against what I call the irresistible force and the movable object. You have got to fix a limit somewhere. This provision fixes 1,000 percent as the top. The Commission can require that brokers actually borrow on a smaller ratio of borrowing. Somewhere there has to be a top. Below that the commission can adjust. But you must not have an administrative commission in the position where it is certain to be under pressure all the time.

Mr. REDMOND. I have greater faith than you have, apparently, in the ability of the commission to resist pressure.

Mr. CORCORAN. I have been trying to resist it for 2 years. It is much harder than you think.

Mr. REDMOND. The last 2 years may have been exceptional.

Mr. CORCORAN. All pressure always finds exceptional circumstances, sir.

Mr. REDMOND. The Reconstruction Finance Corporation was rather inviting pressure, was it not?

Mr. CORCORAN. I am not going to talk about that——

The CHAIRMAN. You say, it is 10 times the capital?

Mr. CORCORAN. Yes, sir. That is the ratio on which a bank normally takes deposits.

The CHAIRMAN. Would it improve it any to specify 10 times the capital, inasmuch as this is 1,000 percent?

Mr. CORCORAN. Mr. Redmond thinks that the term "net current assets" is ambiguous and should be redefined. I think we agree generally on the figure we are trying to reach as a basis, and that can be straightened out as a matter of language.

Mr. REDMOND. Do not take anything I say as an agreement. I am raising points to clarify the situation.

Mr. PECORA. In other words, he wants to find out how far you will agree, and then he will not agree.

Mr. CORCORAN (reading from the bill):

(c) To use, if a broker, the capital employed in the business to carry or finance the carrying of securities for himself or for others than bona fide customers excluding any partner or employee of such broker

That proceeds on the proposition that a broker should have a fund or capital as a cushion against losses and that he should not employ that cushion in trading for his own account

The two biggest failures we had during the 1929 debacle, and one in 1930, arose not because the brokers' loans were unsafe, because as a matter of fact brokers' accounts for their customers are usually very safe. They arose rather because the capital of the house became involved in positions for its own account.

(Reading further from the bill:)

(d) To hypothecate or arrange for the hypothecation of more of any securities carried for the account of a customer than is fair and reasonable in view of the indebtedness of such customer

And (e) should be considered with it [reading]:

(e) To hypothecate or arrange for the hypothecation of any securities carried for the account of a customer under circumstances that will permit the commingling of the securities of one customer with those of any other person, without the written consent of such customer

A broker, to lend you money, must borrow money on the same securities on which you borrow from him.

Senator KEAN. Do you mean you have to separate each customer?

Mr. CORCORAN. Unless you get the customer's consent.

Senator KEAN. You always do get the customer's consent?

Mr. CORCORAN. You normally do in operations on the New York Stock Exchange or in operations under the statutes of the State of New York, from which these subsections are practically excerpts. You always do get the customer's consent. But that is not always the case in other States nor under the rules of other exchanges than the New York Exchange. So we simply put it in here to make very sure that the rule becomes general throughout the country.

Mr. REDMOND. May we for one moment go back to (c)? The definition of the term "to carry or finance the carrying of securi-

ties"—would that go so far as to exclude a man who had a business capitalized by, let us say, Liberty bonds?

Mr. CORCORAN. You mean, it is the old problem of whether you have to have cash capital?

Mr. REDMOND. Precisely.

Mr. CORCORAN I should say you would, under this, have to have cash capital.

Mr. REDMOND. That would mean that not only would the man engaged in that business have cash capital employed in that business, but could not carry any securities for his own account.

Mr. CORCORAN. No; he would have to segregate a certain amount of his capital for that business. I am perfectly willing to agree with you that possibly there should be investment in Government bonds or anything else that is comparatively safe for the capital of the broker. As the section now reads, it requires cash capital.

Mr. REDMOND. You would not draw any distinction between the man who was borrowing money so as to acquire securities and the man who owns the securities and contributed them as capital?

Mr. CORCORAN. No, sir. There has to be a certain capital cushion in the business.

Mr. REDMOND. There would be a capital cushion. If I have securities and put them in as capital, the capital is there.

Mr. CORCORAN. Not unless they are perfectly safe securities. The customer takes a risk on the value of them. Again, it is a question of degree. It is a sheer question of degree as to the safety of the security. I say that, as the section now reads, the broker has to have cash capital which is a cushion for his customers. You say, "Why should he not be allowed to have Government bonds? They are just as safe as cash." Then, when I say, "All right," you push me one more and say, "Why should he not be able to invest it in Atcheson bonds?" And I say, "All right," and you push me one more. Pretty soon you will have me assenting to investment in securities on the Produce Exchange. It was intended that there should be a safe cushion of capital in the business.

Mr. REDMOND. The reason I asked it was that I did not understand the principle of it. I should think it would have said simply that the capital to be employed in the business of a broker shall be contributed and maintained in cash. That is the thought, then?

Mr. CORCORAN. As the language now reads, that is the thought. I have no objection to a concession as to Government bonds. But the difficulty with going any further is that you reach a degree when you start on the toboggan chute and never know when you are going to land at the bottom.

(Reading further from the bill:)

(*f*) To lend or arrange for the lending of securities pledged by or carried for the account of any customer without the consent of such customer and without crediting the interest received on account of such lending to the account of the customer

That deals with a broker's lending his customer's security in connection with request made upon him by other brokers for the loan of securities to cover their short accounts. The stock exchange has criticised that language with respect to the interest provision, and it is absolutely right. The language is badly drafted. When

a broker lends stock to another broker he normally gets back as a deposit the market value of that stock in cash. No interest is usually paid on this deposit.

The theory of the section is this: After all, there is no reason why a broker should have the privilege of lending his customer's stock to cover the short accounts of other brokers, unless he pays for that privilege; and even if he does not receive any interest on the deposit himself, he must, during the time that the stock is loaned out to another broker, credit his customer with an amount of interest at some given rate on the market value of the securities while they are out.

I understand perfectly that there is difficulty in allocating such interest as between customers; but it is something that can be worked out, and certainly as a matter of fairness between the broker and his customer there is no reason why the broker should use the customer's securities to lend to another broker who has to cover a short sale, and not pay something for the privilege. And if you do not believe in encouraging short selling, and believe in putting at least some discouraging minor obstacles in the way of it, this would be one of those obstacles.

Mr. REDMOND. Is it not true, if you have looked into the question, that attempting accurately to credit interest on this theoretical basis which you have described, to the customers of a large firm, would be so impossible that no lending could in fact take place?

Mr. CORCORAN. Not impossible; rather difficult. But again, as I say perfectly frankly, this is intended to put a minor obstacle in the way of short selling.

Mr. REDMOND. And if it should develop to be a major obstacle and simply prohibit the lending of securities, that would be deemed to be socially good, too, I take it?

Mr. CORCORAN. If, and I am not one of the persons who goes along with that idea, you think short selling is bad.

Mr. REDMOND. What would you do in the case, which is very common, of a man who orders securities sold when he is out of town? Let us say a broker in Texas orders securities sold. For the days during which those securities would be in transit from Texas to New York for delivery, securities have got to be borrowed to be delivered on the New York contract.

Mr. CORCORAN. That is not a short sale for profit. That is a short sale by reason of the physical unavailability of the securities.

Mr. REDMOND. But what I am pointing out is that that would require the borrowing of securities and the out-of-town seller would therefore have to pay this extra premium.

Mr. CORCORAN. That is quite true, and perhaps that particular provision for interest, the accounting difficulties of which I perfectly well realize, ought to be changed to make some allowance for that kind of a situation. But as I say, whether you will eliminate it entirely depends upon your attitude toward the advisability of short selling.

Senator GORE. That, however, involves, as a rule, a long sale.

Mr. REDMOND. Yes; but you nevertheless have to borrow.

Mr. CORCORAN. It is a sale against the box.

Mr. REDMOND. A sale against securities in transit.

Mr. CORCORAN. Yes.

Senator KEAN. There are a great many women that order you to sell some bonds, and then they do not come down for 2 or 3 days, but you are forced to deliver them.

Mr. CORCORAN. Sir, I cannot pretend in this statute to govern the vagaries of women customers.

The CHAIRMAN. The committee will take a recess at this time until 2:15.

(Whereupon, at 1 p.m., a recess was taken until 2:15 p.m. of the same day.)

AFTERNOON SESSION

The committee resumed at 2:15 p.m. on the expiration of the recess.

The CHAIRMAN. The committee will resume, please.

## STATEMENT OF THOMAS GARDINER CORCORAN—Resumed

The CHAIRMAN. Mr. Corcoran, you may resume where you left off, which I believe was section 7.

Mr. PECORA. Mr. Chairman, we had just finished with section 7 of the bill.

The CHAIRMAN. All right. You may proceed, Mr. Corcoran.

Mr. CORCORAN. We are through, then, with the provisions relating to the control of the amount of borrowed money that gets into the stock market.

We can now begin with section 8, the provisions to protect the investor from evils in the present set-up of the market machinery.

The CHAIRMAN. All right.

Mr. CORCORAN. If we may now begin with section 8, Senator Fletcher, those provisions have been drafted from suggestions of your counsel in charge of the work of investigating stock-exchange practices. In other words, most of them have been evolved as a result of the investigation that has been carried on before your committee for the last year and a half.

I will begin now by reading section 8:

SEC 8 (a) It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange—

(1) To effect any fictitious transaction in any security registered on a national securities exchange, or any transaction which purports to be a sale of any such security but involves no change in the beneficial ownership thereof

That was intended to prohibit wash sales. A wash sale is a transaction designed to create the illusion of activity in a stock. A trader orders one broker to sell a security at a certain price, and orders another broker to buy the same security at the same price. The stock exchange quite agrees that wash sales should be prohibited, but raises the point that possibly subsection (1)—no, it is on the next point that the stock exchange makes objection——

Mr. REDMOND (interposing). Mr. Corcoran, might I ask you a question right there?

Mr. CORCORAN. Yes.

Mr. REDMOND. Would there be any reason why that provision should not be extended to any security, whether registered on an exchange or not?

Mr. CORCORAN. That immediately raises a constitutional point.

Mr. REDMOND. Does it? I thought it was limited to transactions through the mails or by means of interstate transportation.

Mr. CORCORAN. Yes. But it raises the same point of constitutionality that has been raised as to the over-the-counter market provision.

Mr. REDMOND. Precisely.

Mr. CORCORAN. I do not see why it could not be done if, in the committee's judgment, it thinks it desirable that it should be done.

Mr. REDMOND. Of course it is the law of the State of New York, and the rule of the New York Stock Exchange as well, that fictitious transactions should not take place. But it just struck me that the constitutional question exists as to many other provisions of the bill, and that at least you might go as far as striking out the words "registered on any securities exchange."

Mr. CORCORAN. It might seem proper to the committee to go that far.

Now we go to subparagraph (2):

(2) To effect, or to authorize another or others to effect for such person's account, transactions for the purchase and sale of any security registered on a national securities exchange at substantially the same time at substantially the same price, whether such transactions of purchase and sale be with the same or with different parties, except transactions made on the exchange as a matter of record only and appropriately recorded and reported as an "arranged transaction"

That provision is intended to catch match orders, where by prearrangement a buy order and a sell order at a given price go into the exchange together to create the illusion that there is activity in the stock, or to create a quotation on the stock for the purpose of helping salesmen distribute the stock.

The CHAIRMAN. Mr. Redmond, would you suggest that the words "registered on a national securities exchange" be stricken out there?

Mr. REDMOND. I think it might be well to strike that out. Of course, Mr. Chairman, the possibility of matched orders except upon an organized exchange is very remote. But I think it might be just as well to strike those words out there if they are going to be stricken out in the first instance.

The CHAIRMAN. The committee will consider that.

Mr. REDMOND. Mr. Corcoran, isn't the language of subsection (2) capable of a much broader meaning than just a prohibition of matched orders

Mr. CORCORAN. I do not think so. But I have noted the objection you have made to it, on page 14 of your brief, and if the committee will permit me, I would suggest to Senator Fletcher that possibly some clarification of it, to prevent the section being given an interpretation which will prevent a man, in the course of a single day, buying and selling the same security, might be considered.

Mr. REDMOND. The essence of the difference being what you yourself stated a minute ago, and that is, that by prearrangement orders are sent in to buy and to sell at the same time.

Mr. CORCORAN. And the exception would just be restricted to bona fide buying and selling on the same day, without any intention to create the illusion of activity or to make a quotation on the stock.

The CHAIRMAN. You may proceed, Mr. Corcoran.

Mr. CORCORAN. We now take up subparagraph (3):

(3) To effect, either alone or in concert with one or more other persons, transactions for the purchase and sale of any security or securities registered on any national securities exchange for the purpose of raising or depressing the price of such security or securities or for the purpose of creating or with the expectation that there will be created a false or misleading appearance of active trading in such security or securities, or a false or misleading appearance in respect of the market for such security or securities

The stock exchange would prefer that this prohibition should be confined to cases where there is an intentional effort to unfairly influence the price of securities for the purpose of making a profit. The difficulty with such a restriction is that once you accept a word that leaves so much leeway as "intentional" and is susceptible of so many difficulties of proof, or a word like "unfairly" that has the same difficulties about it, you really have emasculated your provision. To prove that a man intentionally operated a pool to unfairly influence the price of a security is a refinement that is impossible of practical administration.

Mr. REDMOND. Well, don't we then fall on the other horn of the dilemma. Nobody buys a security with the idea that his purchase is going to leave the market price entirely unaffected, and, therefore, under this bill if it is given the broadest possible interpretation every purchase or sale of securities would be for the purpose of raising or depressing the price, and hence every buyer and seller would be a criminal.

Mr. CORCORAN. No; I do not think so. I do not think language relating to transactions which take place for the purpose of raising or depressing the price of securities brings within the normal meaning of that language the inevitable effect upon the market of any transaction in securities. What you are saying is that since any transaction in securities must in some way influence the price of the security, even by reason of the very existence of the transaction, therefore if a statute says that you must not carry out a purposeful transaction for the purpose of raising or depressing the price of securities, the mere fact of buying and selling securities without any ulterior purpose except the buying or selling of the security is within that language.

Mr. REDMOND. Exactly.

Mr. CORCORAN. Oh, no. I respectfully disagree.

Mr. REDMOND. What, then, is going to be the norm by which people might guide themselves?

Mr. CORCORAN. There cannot be any norm, Mr. Redmond, in the interpretation of language like that, any more than there can be in any case where you are working with standards and questions of degree.

Mr. REDMOND. But we are dealing with a criminal statute here.

Mr. CORCORAN. We are, that is true.

Mr. REDMOND. And isn't it generally true that crime requires intent, and it is the criminal intent that distinguishes a crime from many acts which otherwise would not be punishable in any form?

Mr. CORCORAN. No. I do not believe that is any longer a norm of the criminal law. I think it was a norm of the old criminal law, and I still think that so far as more serious offenses are concerned the criminal law requires intent to be proved, but in modern society there are many things you have to make crimes which are sheer matters of negligence. As you know, there are many statutory crimes, such as those in connection with driving an automobile, where intent is not required.

Mr. REDMOND. Do you mean as to the speed statute?

Mr. CORCORAN. No. If you drive an automobile when drunk, it is not necessary to prove an intention to become drunk, or to drive an automobile when drunk. You can still be put in jail for it, whether intent is proved or not.

Mr. PECORA. That is, mala prohibita.

Mr. REDMOND. But even so, Mr. Corcoran, in your automobile case if by reason of speed while intoxicated you run down a man normally you can be tried for manslaughter but not for murder.

Mr. CORCORAN. But manslaughter is a crime. And this is not murder.

Mr. PECORA. That is because of the statutory definition of that crime.

Mr. CORCORAN. What you are saying to me, Mr. Redmond, is that you have to have intent in order to hold a man for crime. I say that no matter whether you are tried for manslaughter or for murder under the automobile case manslaughter is a crime, just as murder is a crime. So for the purpose of settling the point as to whether the modern criminal law requires intent, you must concede that manslaughter, without any requirement of specific intent, is a crime just the same as murder.

Mr. REDMOND. Not necessarily, because manslaughter ties in with the requirement that the man must be conscious of what he is doing.

Mr. CORCORAN. Not necessarily.

Mr. REDMOND. Let me finish my sentence. Here, ordinarily, a man is engaged in the ordinary process of buying or selling securities, or of buying or selling property, and suddenly you say to him: If you do this for the purpose of raising or depressing prices—and we give here no indication beyond that as to what distinguishes a legitimate commercial transaction from a criminal act—you are doing a criminal act? How are people going to know how to guide themselves?

Mr. CORCORAN. Mr. Redmond, I may agree with you that if you are trying to skin corners as closely as you can, you cannot tell at exactly what stage a kitten becomes a cat in determining whether a man bought or sold on the market for the purpose of raising or depressing the price of securities. But for practical purposes, the language is adequate. You cannot be able to decide ahead of time just where the line falls. That is the question present in every problem that a law court has to decide.

Mr. REDMOND. I should just like you to give me some instance in the criminal law in which a man may become a criminal when doing ordinary commercial work, doing a perfectly ordinary commercial transaction.

Mr. CORCORAN. Mr. Redmond, you do not need any precedents in the commercial law for that. Once you establish the principle

of law that intent is not necessary for every crime, we can establish a new crime here within that principle without the necessity of having other precedents in the commercial law. Now, Mr. Redmond, are you arguing with me on the question of policy?

Mr. REDMOND. No.

Mr. CORCORAN. Or are you arguing with me on the question of law?

Mr. REDMOND. I am arguing with you on the question, that this provision gives no means by which the average citizen can tell when he is going to fall within the scope of the criminal provision or not.

The CHAIRMAN. Well, it says it must be done for the purpose of raising or depressing the price.

Mr. REDMOND. But every purchase might be so termed.

Mr. CORCORAN. That is not a fair interpretation of the language at all.

Mr. PECORA. Oh, no. Perchance it might be in fact as an incident to the act, but where the act is done for the specific purpose set forth in the statute, then the statute is violated.

Mr. REDMOND. But that specific purpose may be assumed the case of a large insurance company which holds half a million dollars of a certain issue of bonds, and they go and buy $50,000 more, and this purchase actually increases the price of that security.

Mr. PECORA. But they purchase not for the purpose of increasing the price.

Mr. REDMOND. Yes; but even then.

Mr. PECORA. This has to do with avowed market operations, where a specific purpose is sought to be effectuated by the operation.

Mr. REDMOND. Well, then, shouldn't we have the clause in the bill clearly describe that, if that is to be the intention of the statute?

Mr. PECORA. I think it does insofar as it specifies what the purpose shall be in the case of an unlawful act. Under that purpose the act done may be unlawful, or is to be declared unlawful.

Mr. REDMOND. Mr. Pecora, you yourself a minute ago said this section had to do with an avowed market transaction. Couldn't we find some language which would show clearly what this clause is intended to cover? Otherwise I fear people will not know whether they are on the verge or on the edge of the criminal law or not.

Mr. PECORA. I think the language of the section as it now stands is clear enough.

Mr. REDMOND. Well, I have raised my point.

Mr. PECORA. Excluding from its scope an act that is not done with any ulterior motives or purposes, as set forth in the act.

Mr. REDMOND. Aren't you then treating "purposes" the same as "intent", which Mr. Corcoran objected to?

Mr. CORCORAN. I did not object to it.

Mr. PECORA. You might regard them as synonymous terms.

The CHAIRMAN. But you have to prove the purpose, which is practically the same thing as proving the intent.

Mr. PECORA. Yes. You may treat them as synonymous terms, Mr. Redmond.

Mr. REDMOND. All right

The CHAIRMAN. You may proceed, Mr. Corcoran.

Mr. CORCORAN. Subparagraph (4) provides:

(4) If a dealer, broker, or member or a person in the employ of a dealer, broker, or member, to circulate or disseminate in the ordinary course of business information to the effect that the price of any security or securities registered on a national securities exchange will or is likely to rise or fall partly or wholly because of the market activity of any one or more persons, if the person disseminating such information has reason to believe that the circulation or dissemination of such information on his part may induce the purchase or sale of any such security in the expectation of such market activity;

That section deals with dissemination of rumors of pools. As Mr. Redmond points out in his brief, such acts are already prohibited by the rules of the New York Stock Exchange.

Mr. REDMOND. Simply for the purpose of the record, Mr. Corcoran, that is Mr. Whitney's brief.

Mr. CORCORAN. All right. And it is not your brief?

Mr. REDMOND. I was merely setting you right on that.

Mr. CORCORAN. Now we will take up subparagraph (5):

(5) To circulate or disseminate information regarding any security registered on a national securities exchange which statement is, in the light of the circumstances under which it was made, false or misleading in respect of any matter sufficiently important to influence the judgment of an average investor, if the person disseminating such information has reason to believe that the circulation or dissemination of such information on his part may induce the purchase or sale of such security, and does not prove that he acted in good faith and in the exercise of reasonable care had no ground to believe that the statement was false or misleading

I would suggest, Mr. Chairman, if I may be permitted, that the language of that subparagraph should be amended a little to make it clear that the statement must be made for the purpose of inducing the purchase or sale of the security. Not because I do not think the subparagraph is perfectly clear now, but there has been some apprehension on the part of perfectly legitimate houses dealing in investment information, like the publishers of standard manuals, and investment counsel, and trustees administering estates, that they might be unwittingly caught by that provision even though they acted with the best intentions in the world. I would suggest that the amendment proposed in Mr. Whitney's brief, on page 15 thereof, be considered.

Mr. REDMOND. Might I say one word right there, because I think there again it might be wise to strike out the limitation as to securities registered on national securities exchanges, so as to prevent a false statement in regard to unlisted securities.

Mr. CORCORAN. I will next take up subparagraph (6):

(6) To pay or cause to be paid directly or indirectly any consideration or anything of value to any person to circulate, disseminate, or finance the cost of circulating and disseminating, information to the effect that the price of any security or securities registered on a national securities exchange will or is likely to rise or fall partly or wholly because of the market activity of any one or more persons;

That relates to the financing of tips of pools. I do not think there is any substantial objection to a provision of that kind, is there, Mr. Redmond?

Mr. REDMOND. None. And I think we would like to see it go further so as to prevent the activities of tipster sheets, which, as I

read subparagraph (6), does not do, because it is limited to the statement in regard to the market activity of one or more persons.

Mr. PECORA. Tipster sheets might be covered by subdivision (5).

Mr. CORCORAN. With respect to new securities at least they are covered by the present provisions of the Securities Act.

Mr. REDMOND. Yes; in regard to new issues of securities.

Mr. PECORA. Tipster sheets certainly ought to be brought within the provisions of this bill, and if the language of the bill in its present form is not certain to do that, it ought to be clarified and strengthened accordingly.

Mr. REDMOND. I think certainly within the scope of one of these two sections that result could be accomplished.

Mr. PECORA. Yes.

Mr. CORCORAN. I will now take up subparagraph (7), and from now on the entente cordiale disappears. [Laughter:]

(7) To engage in any series of transactions or in any operation for the purchase and sale of any security registered on a national securities exchange which has the purpose or effect of pegging, fixing, or stabilizing the price of such security without having prior thereto reported to the exchange authorities and to the Commission such information regarding the purpose and nature of such transactions or operations, the details thereof, and the person or persons interested therein as the Commission by rules and regulations may prescribe as appropriate or necessary in the public interest or for the protection of investors

With this section we enter upon the whole problem of the advisability of artificial price operations in the market. The theory of this subparagraph is simply this: There is so much discussion of good pools and bad pools to stabilize and to fix prices that the safe thing to do is to say: "Let us not absolutely prohibit them, but let them be carried on only under such rules and regulations as the Commission may devise and after they have first been reported to the Commission."

Mr. REDMOND. Of course, we all recognize that there are perfectly proper transactions in the matter of stabilizing prices. Our own Government, in fact, has used that method very largely in the flotation of its own issues of securities. I personally very much question the wisdom of putting in a criminal provision and requiring every such transaction to be reported to the commission, because I think you are going to flood the regulatory commission with a whole set of details which it might well exclude by general regulation. I think it has been the experience already of the Federal Trade Commission under the Securities Act that there are certain types of transactions that they would like very much to exempt from the provisions of that act, because they recognize that they are small in amount or of a nature which does not require registration. Now, if you should vest this power in the regulatory commission rather than make it mandatory and a crime, unless the commission is notified in advance, you will have accomplished all of the same possibilities of regulation without in any way hampering ordinary and legitimate business transactions.

Mr. CORCORAN. Well, doesn't that objection, Mr. Redmond, go to the amount of information which would be piled in upon the commission, and couldn't the commission by its own rules and regulations prescribe, if necessary or if thought advisable, limits to the amount of such information—Perhaps it would only be necessary

to state the fact that a pool was to operate in a certain stock with the purpose of stabilizing it within certain limits—and then there wouldn't be any administrative burden upon the commission? Even the mere fact of the prior filing of information would warn the commission that such an operation was to take place, so that if it wanted to make an investigation to see whether it desired further information, it would have at least a warning that something was up of which it should possibly take cognizance.

Mr. REDMOND. That is true, but remember that there is another aspect of this problem. The records of the commission are public documents, and, therefore, if you should form a group to stabilize the price of a security, and announce it to the public, you open a new door to fraud that might be more vicious even than what you are striking at.

Mr. CORCORAN. Why shouldn't the public know that an artificial operation is being carried on in a stock? And in that connection should be considered the broad question of the social advisability, the wisdom from an economic standpoint, of having secret operations in a stock taking place while the public in complete ignorance of the situation is buying and selling in the market on the faith of the quotation going out on the ticker.

Mr. REDMOND. But you cannot make these things binding. For instance, let me give you an example that I have in mind. Suppose a group of people announce to the Federal Trade Commission that they are going to stabilize the price of a certain security at a point between 45 and 50, and that they had formed a group for that purpose with resources of a million dollars or of 5 million dollars. That might lead many people to believe that that security would remain within the range at which the group was stabilizing the price, and that group might refuse to buy or sell a single share, and the price might go down to 30 or up to 60.

Mr. CORCORAN. Well, the commission at the time it makes the details of the intended operation public might clearly warn the public. This subsection requires merely a filing of a statement of intention. The process is just like the taking out of a marriage license. We warn you that nobody knows whether the pool operators are going through with the operation or not.

Mr. REDMOND. Isn't the answer to that, that the information given to the public is of no value?

Mr. PECORA. In other words, it defeats the purpose.

Mr. REDMOND. Yes; completely.

Mr. CORCORAN. The public knows that there is an intention to carry on pool operations.

Mr. REDMOND. And the public will rely on that published intention and may be misled.

Mr. CORCORAN. But if the public is warned at the time that possibly the pool operators will not carry out their filed intention, the public does not need to be misled. It is only a question of how accurate is the information given to the public.

Mr. REDMOND. I think, Mr. Chairman, I have expressed the doubt that exists in my mind as to the value of this provision as a mandatory provision, and that really is the point that I was trying to make. Whether it might not be better to treat it as a permissive one.

Mr. CORCORAN. There is one other point raised by the Exchange in connection with this subparagraph (7), and that relates to arbitrage. An arbitrage transaction, of course, is one intended to keep in line on different exchanges, the respective quotations for some security, or to maintain the relative prices of securities within a given relation to each other. With your permission I should like to say I do not believe that arbitrage transactions, which merely adjust prices of securities one to another, come within the provisions of subsection (7). If they do, then possibly the committee would like to consider whether it wants to exclude or include arbitrage transactions, or, if they are not in there, whether the committee wants to include them.

Now we come to subparagraph (8):

(8) To acquire substantial control of the floating supply of any security registered on a national securities exchange for the purpose of causing the price of such security to rise on the exchange because of such control of the floating supply;

That relates to cornering a security. I do not believe there is any substantial objection to that.

Mr. REDMOND. None except the vagueness of the definition of floating supply, which I think should be, as this seems to be a criminal statute, made definite and certain.

Mr. CORCORAN. I will now take up subparagraph (9). It shall be unlawful—

To effect by use of the facility of any national securities exchange——

The CHAIRMAN (interposing). Before you pass from that, Mr. Corcoran, what do you mean by floating supply?

Mr. CORCORAN. The supply that is in the market. That again is a market term. Of the outstanding shares of stock a certain amount is always held by more or less permanent investors, while a certain other amount of the stock is sold back and forth on the exchanges, usually represented by substantially the same certificates. That floating supply is the stock which figures on the market and in the quotations, and it is that floating supply which, if cornered, puts anybody else who comes into the market at tremendous disadvantage as against the person who has cornered that floating supply of stock.

Mr. PECORA. Mr. Redmond, do you seriously think that the term "floating supply" is one that needs elaboration in the bill?

Mr. REDMOND. I do, and I think that under the definition which is given by Mr. Corcoran, it would be impossible, under this provision, to proceed against those who actually cornered the market, because even when there is a corner there is always a residual amount of stock that is in the hands of brokers that could be said to be floating supply. A corner is, of course, a perfectly definite thing.

Mr. PECORA. You easily see the principle underlying this particular provision, do you not?

Mr. REDMOND. Yes; and we have it in our constitution.

Mr. PECORA. But you mean the effectuation of that principle by a suitable provision in the bill.

Mr. REDMOND. Yes. And we go one step farther and suggest that it be not a criminal provision but effective control by giving the regulatory body power to fix the settlement price. I will say that the exchange adopted that rule in 1925, in its constitution, and there has been no approximation of a corner since then.

Mr. PECORA. If you do that you might put the culprit into the position of holding on to a part of his loot if he is detected.

Mr. REDMOND. Wouldn't he be permitted to do this under that provision——

Mr. PECORA (interposing). He might take the chance, but the penal arrangement would cause him not to take the chance. For instance, a pickkpocket might not be deterred if he gave up half of his loot in event of detection, but if the penalty is a penal arrangement it might deter him.

Mr. REDMOND. Suppose you were to make it so the pickpocket could not profit at all?

Mr. PECORA. That is just the plan, to set up a more effective deterrent.

Mr. REDMOND. It is a question of method, then.

Mr. PECORA. We are agreed that the principle should be inserted in the bill, are we not?

Mr. REDMOND. Entirely, and I think the New York Stock Exchange was the first institution that adopted such a plan.

Mr. PECORA. All right.

Mr. CORCORAN. Next we have subparagraph (9) that it shall be unlawful:

To effect by use of the facility of any national securities exchange—

(1) Any transaction in any security whereby any party to such transaction acquires any put, call, straddle, or other option or privilege of buying a security from or selling a security to another party to the transaction without being bound to do so; or

(11) Any transaction in any security with relation to which he has, directly or indirectly, any interest in such put, call, straddle, option, or privilege, or

(111) Any transaction in any security for account of any person who, he has reason to believe, has, directly or indirectly, any interest in any such put, call, straddle, option, or privilege with relation to such security; or if a member, directly or indirectly, to have or guarantee any interest in any put, call, straddle, option, or privilege in relation to any security registered on a national securities exchange

The puts, calls, straddles, mentioned specifically in this subparagraph are particular kinds of options. A put is a right to sell to a given person at a given price within a definite time. A call is the right to buy from a given person at a given price within a given time. And a straddle is a combination of the two.

This subparagraph raises the whole problem of what Congress thinks should be the policy of regulation in respect of options. The exchange argues in its brief that there are good option transactions as well as bad option transactions. The theory upon which this subparagraph was drafted is that there is no satisfactory way of distinguishing good options from bad options, or of knowing when an option originally taken for a good purpose turns into a bad option, and therefore, faced with the inability to distinguish between kittens and cats, it is better on the balance of convenience to prohibit options altogether.

Now, shall I go on, Mr. Chairman?

The CHAIRMAN. Yes.

Mr. REDMOND. I think Mr. Whitney's brief states the fundamental objection, and that is that you are destroying completely a perfectly legitimate form of contract, purely because it is capable of abuse. But that, of course, is true of every single form of business in the

whole world. Abuses can exist. But that does not mean that business should stop.

Mr. PECORA. I have not seen the exchange's brief yet, Mr. Redmond.

Mr. REDMOND. It was Mr. Whitney's statement made before the House committee that Mr. Corcoran is referring to, I think.

The CHAIRMAN. Does the exchange approve of puts and calls?

Mr. REDMOND. The exchange does not permit trading in puts and calls on the floor, and it does not recognize them as exchange contracts until notice of their exercise has been served. Foreign exchanges, particularly the London market, not only recognizes option contracts but permits dealing in them exactly as if they were dealing in securities. That is also true of the Paris Bourse and the Berlin Boerse. That is practically true the world over

Mr. PECORA. Give us an illustration of that.

Mr. REDMOND. We will assume a corporation has a large block of securities to distribute. It may give an option to a dealer so that that dealer may go out and distribute them in a perfectly proper way.

Mr. PECORA. It also dangles before the dealer the temptation to resort to market operations.

Mr. REDMOND. Well, temptations exist in everything.

Mr. PECORA. All of the evidence before this committee in regard to options that has been presented up to the present time consist of instances where options have been prostituted to ulterior uses and purposes.

Mr. REDMOND. Well, isn't it true that your investigators have had access to the files of the committee on business conduct of the New York Stock Exchange, where all options have been reported since, I think, the first of August 1933?

Mr. PECORA We haven't had the time nor the facilities for investigating all of those options or the activities of the persons holding those options

Mr. REDMOND. It does not necessarily follow just because the evidence which has been presented to this committee, a very limited number of cases, did involve operations in the market in connection with options, that all options must be connected with market operations.

Mr. PECORA. Well, I think a generalization to that effect may be said to have been made by members of the exchange who have operated under options. They have frankly said what their purpose was.

Mr. REDMOND. In some instances that is true, but I think——

Mr. PECORA (interposing). I think in some instances members of the exchange who have been examined here have testified that that was the general purpose for obtaining such options.

Mr. REDMOND. But they were members of the exchange, if I remember correctly, who were primarily floor men I think you are referring to the testimony of Mr. Wright.

Mr. PECORA And he was not the only one.

Mr. REDMOND. And that of Mr. Mason Day?

Mr. PECORA Those two, and this committee has heard testimony of dealers and investment bankers generally along similar lines.

Mr. REDMOND. But I do not want, of course, to go into an argument on the basis of the evidence, because I am not here to give

evidence. But it is I think true, and I think the committee should consider the possibility that option contracts in large quantity entirely for legitimate purposes, do exist.

The CHAIRMAN. Very well, Mr. Corcoran, you may proceed.

Mr. CORCORAN. I next take up subsection (b) of paragraph (9), and I might explain that the next three sections which I shall read give a civil right to an individual——

Mr. PECORA (interposing). May I interrupt you for just a moment?

Mr. CORCORAN. Certainly.

Mr. PECORA. This bill insofar as it prohibits options prohibits the use of them through the facilities of exchanges, don't they, Mr. Redmond?

Mr. REDMOND. That is true. But the facilities of an exchange——

Mr. PECORA (continuing). And therefore would not cover an option given by a corporation to distribute a part of its stock through means other than the facilities afforded by an exchange.

Mr. REDMOND. But the facilities of an exchange are defined in such broad language that it might easily sweep in the entire securities business of the country. For instance, section 3, subsection (2), provides:

> The phrase "facility of an exchange" includes its premises, tangible or intangible property, whether on the premises or not, any right to the use of such premises or property or any service thereof, including, among other things, any system of communication to or from the exchange, by ticker or otherwise, maintained by or with the consent of the exchange, and any right of the exchange to the use of any property or service

Therefore if a person used a ticker to see what the quotations were in connection with a dealer's operation me might be said to be using a facility of the exchange.

Mr CORCORAN. If I may be permitted to suggest, Senator Fletcher, it may be possible to except from the provisions of this section, warrants or options that are registered on an exchange, except that that raises again the whole problem of whether warrants or options should be registered.

Mr. REDMOND. What would you do with rights to subscribe?

Mr. CORCORAN. On a great many exchanges they are listed, aren't they?

Mr REDMOND. Yes.

Mr. CORCORAN. I would say in a case like that that you might make an exception for those warrants and options that it is advisable to have listed on an exchange.

Mr. REDMOND. I think the section deserves, and this is the only point I wish to make, further consideration before a useful and normal commercial practice is made criminal.

The CHAIRMAN. We will consider that, Mr. Redmond.

Mr. REDMOND. All right.

Mr. CORCORAN. Now, going on with the next three paragraphs, (*b*), (*c*), and (*d*), these give to any individual injured by reason of having been induced, by reason of any practices forbidden by the preceding sections, to buy or to sell securities at the price at which he did buy or sell them, the right of civil action for damages for the amount of the injury done him.

The criticism the Exchange made of these sections is that they do not confine the measure of recovery to the actual damage suffered by a person who has actually sold or bought securities after the first transaction which he was induced to make by these manipulative practices. That is, the bill as now drafted does not limit civil liability to actual damage which can be proved to have resulted from a violation of the preceding paragraphs of this section, as it can be proved, in the case of the man who buys on the faith of a pool tip and actually sells out, or of the man who sells short on a pool tip and then actually buys in and covers, so that you know what the exact damage is.

I would suggest that possibly the section should be amended to make certain where you can prove actual damage, that that be the limit of the damage. The sections as they are now drafted—but perhaps I had better read them:

(*b*) Any person who participates in any act or transaction in violation of subsection (*a*) of this section shall be liable to any person who shall purchase any security, the price of which may have been effected by such act or transaction, and the person so injured may sue in law or equity in any court of competent jurisdiction to recover the difference between the price he paid for such security and the lowest price for which such security shall have sold on the exchange during the 90 days preceding and the 90 days following such purchase, and such additional damages, if any, as the person suing may prove that he sustained as a result of any such transaction

The theory of the section is that if a pool is operating, or if a tip is circulated that a pool is operating, a person might buy a security at a price at which he might not otherwise have bought it. Then if you cannot prove actual damage to him by reason of reliance upon the pool tip, you will give him the difference between the very high price at which he did buy and the low price during the 90 days before and after the transaction, which in a very, very rough way measures the price at which he might have bought if it had not been for the pool tip that induced him to buy at the particular time that he did.

The principle of civil liability for the damage, with which I do not think the exchange agrees, is moreover not only a matter of justice to the person injured but is also the surest way of guaranteeing that there will be some compliance with the section. In other words, there is no policeman so effective as the one whose pocketbook is affected by the degree to which he enforces the law.

Now, the Exchange will reply to that, that it opens the law up to a great many strike suits. That is the objection you hear in connection with other sections of this bill, and it has to be looked in the eye right now. It is the same objection made to the liabilities under the Securities Act. It is the bugaboo that there will be a great many unjustified strike suits by which unscrupulous lawyers will hunt up clients with whom they may make up cases to shake down defendants.

I might say that the strike-suit bugaboo has been talked about so much in connection with the Securities Act that, so far as purely informational purposes go, there is hardly need to talk about it here. Some lawyers, whose judgment is probably as good as that of others, will tell you that ordinarily a strike-suit lawyer won't take on a case unless there really is a pretty good case, for other-

wise he won't be paid. And that, as a mater of fact, about the only effective weapon there is for keeping certain big financial operators in line and within some semblance of the law is the fear that the strike suiter might be just around the corner. Futhermore, there are a great many people who think that the strike suit is a weapon of social utility not to be discouraged rather than something to be shouted about as a species of unfortunate blackmail.

As a matter of fact, I think I have a strike suit right here that was approved by the Supreme Court of the United States the other day in the National Radiator Co. reorganization.

Mr. REDMOND. Was it a strike suit? I didn't know it.

Mr. CORCORAN. Why, you know, Mr. Redmond, that the three plaintiffs in that case must have been called the name that you and I are familiar with all over the street for months and months.

Mr. REDMOND. Well, Mr. Corcoran, I do not think it is profitable to discuss a particular case, but I would like to point out what I understand to be the result of that decision and see whether its social utility is so great. I believe some 95 percent of the bondholders agreed on a plan of reorganization. Five percent did not agree. Th company having been in a bad way, the reorganization was a drastic one. The company has had further reverses, and I understand that as a result the 5 percent who recover under that decision will take the entire property which belongs to the 95 percent. I question very much whether the strike suit which has a result like that is to the benefit of the public as a whole.

Mr. CORCORAN Well, Mr. Redmond, here is the decision of the Supreme Court of the United States.

Mr. PECORA. Mr. Corcoran, that was a unanimous decision.

Mr. CORCORAN. It was a 9-judge decision, and the nine judges seemed to think that the reorganization had been pretty bad, not only for the 5 percent who did not consent to it but also for the 95 percent, probably 60 percent of whom did not know what they were doing when they consented to it

Mr. REDMOND. I do not know anything about what they had in their minds when they consented to it, nor do I question the soundness of the decision, because the decision was predicated upon a very technical point, and that was that an equity receivership was used in a case which ought to have fallen within the provisions of the bankruptcy law. I think I am stating the legal principle correctly.

Mr. CORCORAN. I am afraid the court, whether by way of dicta or otherwise, certainly went much further than that in the language it used in the case.

Mr. REDMOND. It may have; but I think probably we are consuming the time of the committee with a technical legal discussion.

Mr. CORCORAN. I am just, sir, trying to find an accolade of justification for a strike suit, and I cannot think of anything better than a decision of the Supreme Court of the United States on the matter. All strike suits are not bad.

The CHAIRMAN. What case was that?

Mr. CORCORAN. First National Bank of Cincinnati against Flershem & Co., handed down by the Supreme Court on January 8 of this year.

We come now to section 9, on the regulation of manipulative devices.

It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce or of the mails or of any facility of any national securities exchange—

(*a*) To effect the sale of any security registered on a national securities exchange, which at the time of such sale was not owned by such person or his principal except in accordance with such rules and regulations as the Commission may prescribe as appropriate or necessary in the public interest or for the protection of investors,

(*b*) To use or employ or to execute or accept for execution any stop-loss order in connection with the purchase or sale of any security registered on a national securities exchange except in accordance with such rules and regulations as the Commission shall prescribe as appropriate or necessary in the public interest or for the protection of investors

What that comes down to is this, that it shall be unlawful to sell short or to use stop-loss orders except under such rules and regulations as the Commission may prescribe. That avoids a decision as to the utility and advisability of short selling and stop-loss orders by putting it up to the administrative commission to permit their use under such regulations as it shall deem advisable.

In connection with the short selling it is interesting to notice that in this morning's Herald Tribune—no, it is the Tribune of the 21st—there is a quotation from another report of the Twentieth Century Fund on short selling, which to a slight degree disagrees with the position of the Exchange that short selling is a very valuable factor in cushioning a falling market. This is from the report of Mr. Evans Clark·

Whatever influence short selling does have on general price movements is to accelerate the downward trend of prices during the early and middle phases of a decline, and either to check the price trend in the lower phase or accelerate the recovery after prices have turned upward

Then outside the quotation from the Herald Tribune:

According to figures gathered by the Fund, short selling does not have any appreciable effect on limiting the extremes to which prices may rise

I am simply calling the attention of the committee to that report, because in considering what the policy should be in respect of short sales that report may be very useful to the committee.

The CHAIRMAN. Do you understand the provisions of the bill now prohibit or prevent stop orders?

Mr. CORCORAN. It prohibits stop-loss orders except in accordance with such rules and regulations as the commission shall prescribe.

The CHAIRMAN. What line and page is that?

Mr. CORCORAN. It is on page 20, sir.

The CHAIRMAN. I have had some criticism to that effect, that they ought not to be absolutely prohibited.

Mr. CORCORAN. They are not, sir, as the bill is now drawn.

The CHAIRMAN. Yes. I did not think it was, myself.

Mr. CORCORAN. Now, if we may go on to the next section, on the segregation and limitation of the functions of broker, specialist, and dealer. Possibly we would better first read the section (reading):

It shall be unlawful for any member of a national securities exchange or any person who as a broker transacts a business in securities through the medium of any such member to act as a dealer in or underwriter of securities, whether or not registered on any national securities exchange It shall be

unlawful for any member of a national securities exchange to act as a specialist unless registered as such with the exchange, subject to such rules and regulations as the Commission may prescribe, and it shall be unlawful for any specialist on a national securities exchange (a) to effect on the exchange any transaction except on fixed-price orders or (b) to disclose to any other person information in regard to orders placed with him which is not available to all members of the exchange An exchange may provide that officers or employees of the exchange may perform the functions of specialist subject to such rules and regulations as the Commission may prescribe

I shall not attempt to go into that section too much in detail, because, sir, you will probably hear more about that section from other witnesses before this committee than about any other section of the bill.

The situation which that section meets in a certain way—and there may be other proposals for ways to meet it—is simply this: At the present time there are operating as part of the machinery through which the public buys securities underwriters who underwrite and distribute a security, and for the sake of their own reputation, as well as out of a sense of duty to their customers, attempt to maintain a good market in that security after it has been distributed.

There are on the other hand brokers who act theoretically as agents for customers who send in to them orders to buy or sell securities on exchanges.

As I told you before, a good deal of the business done on exchanges, although all actual orders on an exchange are executed by brokers who are members of such exchange, originates with brokers who are not members of the exchange but who clear their transactions through an exchange broker.

Intermediate between the underwriter, who has a very special interest in sponsoring and maintaining the market for a particular stock or security, and the broker who acts only as a commission agent to execute an order to buy or sell for a commission, there is a group of dealers who, as merchants, buy and sell securities for their own account and resell them to the public.

Very often a stock exchange house will be a broker, it will also be an underwriter, and it will also have a dealer's department in which it peddles out stocks or bonds that are bought on the exchange. And you have two evils that arise out of that duality or tripality of function.

First of all, if a broker is also an underwriter, or to a less extent if he is a dealer, and a customer comes to him, he acts as a practical matter not only as the commission agent to execute the transaction on the exchange but also as the customer's investment lawyer and gives the usually bewildered customer advice as to what to buy. The broker thus may be in a very tempting position—a little too much for ordinary humankind. A customer comes to him and says: "I want to buy some stock. What shall I buy?" And thus, in connection with every broker's office there is an informal investment service going on. If the broker unconsciously has real faith in a security because, as an underwriter he promoted it, or if he is not quite that honest and wants to get as many orders as possible into the market to hold up the price of the security that he has floated, he is in a very tempting position to advise the customer to put in an order to buy that security in which he is personally interested.

The other difficulty is that the capital in the brokerage business becomes involved in the operations of the broker in his capacity as dealer or underwriter.

As we said this morning, the four biggest failures in the Street, Prince & Whitely, Pynchon & Co., West & Co., and Bauer, Payne, Pond & Vivian, were cases where insofar as their brokerage accounts were concerned the houses were perfectly solvent. But their assets were involved in positions in securities which they had sponsored or in which they were interested, and when they were wiped out in their positions in such securities the bankruptcy pulled the brokerage clients down with them.

On the other side of the picture you have the fact that at the present time both in New York City and throughout the country there is a great deal of actual combining of all these functions. You will hear argument before you from other witnesses that if you drive a person to choose, as this bill would do, between being a broker on a stock exchange and a dealer or an underwriter or a broker off the stock exchange, you will make it very, very difficult for many houses to continue in business at all

You must remember that one of the advantages to a dealer in being a member of the stock exchange is that he does not have to pay regular stock-exchange commissions, and that a good many dealers operate on a spread which at the present time would not permit them to stay in business if they are to pay a full broker's commission..

You have another complication in the situation arising out of the position of the so-called "odd-lot dealer." The New York Stock Exchange does not deal in lots of less than 100 shares. If a small investor wants to buy less than 100 shares the order he gives to his broker is not met by the offer of another broker on a stock exchange as a brokerage transaction. The broker really buys 10 shares from an odd-lot dealer who has purchased those shares and taken a position under an arrangement with the exchange whereby he agrees that he will sell odd lots at any time within a given fraction of a point, one quarter or three eights, or a half, of the last transaction in the security.

Mr. REDMOND. Mr. Corcoran, for the sake of the record, that differential is one eighth.

Mr. CORCOCAN. That is on the New York Stock Exchange?

Mr. REDMOND. Yes.

Mr. CORCORAN. How about the odd-lot dealers in securities on other exchanges? The Curb is higher than that.

Mr REDMOND. There is no organized odd-lot dealer, as I remember it, on the curb. The specialists do the odd-lott business. But on the New York Stock Exchange the differential is one eighth on the active stocks.

Mr. CORCORAN. The problem before you is, how are you going to handle the situation where it is undoubtedly very much to the advantage of an investor that he should be dealing with a broker who has nothing to sell him but is willing to act as a completely unbiased agent, and with a broker who is not going to imperil the customer's position by investing his capital in positions of his own as a dealer or an underwriter? How are you going to reconcile that with the fact that the brokerage, investment, and dealing business is in many cases today organized as a unit?

The underwriting business is not profitable today. The underwriting business is a feast and famine business. The backlog of many of the houses that in better times carried on the bulk of the underwriting business is brokerage commissions at the present time.

It is very clear that one exception should be made to the provisions of the section as now drawn, and if I might suggest, Senator, I would like to recommend that in the case of the odd-lot dealer who really has to clip his spread very close to serve the public which wants to buy odd-lot securities, some exception should be made to the rule expressed in this section, which demands that nobody can be a member of the exchange except a broker.

I should like to suggest, if I might, that the provisions of this section that only brokers can be members of exchanges might be modified to permit odd-lot dealers also to be members of the exchange and to have the advantage of not having to pay full brokerage commissions, under such rules and regulations as the Commission may prescribe.

Now, as for the treatment of the rest of them: As this section is drawn it says the exchange has no justification in the economic system except as a market place in which the orders of the investing public can be executed. Therefore, no one can be a member of the exchange except a broker.

A suggestion has been made that if, as a matter of fact, the hardship that will be worked on houses doing a combination business at the present time is too great, if because they choose to do a dealer or an underwriting business, they would under this rule have to withdraw from the exchange as brokers, some arrangement might be worked out to enable them to operate for a limited period, say 1 or 2 years, off the exchange, but with the privilege of splitting commissions under very careful rules and regulations with members of the exchange. That is, a house that had been a member of the exchange but wanted to concentrate in a dealer or underwriting business would withdraw from the exchange but would be permitted to have an arrangement under which it could split commissions for a time on the brokerage business that came into it with a broker on the exchange, so that it would not have to pay full brokerage commissions during the period of transition.

That would, you see, permit a house to do a brokerage business off the exchange as well as act as a dealer or underwriter, but it would not have a broker's privilege of going on the floor of the exchange, nor would it, except for this transition period, be able to do business at ordinary stock exchange member rates or without incurring any commission at all. It would only be able to do business through another broker on the exchange but at a very much reduced rate.

The further suggestion has been made that if that sort of a compromise is worked out some arrangement should be made to insure that the capital of such a house which continues to stay off the exchange in the brokerage business, and in the dealer business, the underwriting business should be divided and segregated so that a certain portion of it would be definitely allocated to the brokerage business and a certain portion of it definitely to the dealing and

underwriting business. The result would be that if there should be a crash in the house, for reasons connected with its dealer business or its underwriter business, that crash would not involve the safety of the customers who were trading with it as a broker. [Addressing Mr. Redmond.] Do you want to step in here?

Mr. REDMOND. No; unless you are through.

Mr. CORCORAN. Now, the next point relates to the specialists. You will undoubtedly hear a great deal about specialists from the witnesses who will follow. Your committee has, of course, heard a great deal about specialists in the investigations that have been held before you. We may read section 10 again with respect to specialists. It provides [reading]:

It shall be unlawful for any member of a national securities exchange to act as a specialist unless registered as such with the exchange, subject to such rules and regulations as the Commission may prescribe.

There is no objection to the language so far.

It shall be unlawful for any specialist on a national securities exchange (*a*) to effect on the exchange any transaction except on fixed price orders or (*b*) to disclose to any other person information in regard to orders placed with him which is not available to all members of the exchange. An exchange may provide that officers or employees of the exchange may perform the functions of specialists subject to such rules and regulations as the Commission may prescribe.

The specialist—and as an amateur I hesitate to talk about such an intricate subject—the specialist is a combination of a clerk who keeps the books for orders, and also a kind of dealer who trades for his account to make a market in a security between the extremes of the orders that are on his books. If there are orders to buy at 90 and to sell at 93, the theory of the function of the specialist is to keep the buying orders on his books until they meet selling orders, or himself to buy and sell at some point in between the difference between the bids and offers, so that a market may be maintained at the time when no natural juxtaposition of the buy and sell orders occurs and there is no natural market for the security.

Now, the abuses that have arisen out of the specialist system: The specialist, of course, always knows what is on the books and has, so long as he is trading for his own account, an inside look at the cards of a poker game. The difficulties of the specialist system have been completely brought out in investigations before your committee.

There is in the brief of the stock exchange a long argument for the specialist system as it is at present set up. Without attempting to decide between them, I think it might be a good thing if I should read to you a slightly different attitude toward the specialist, which was reported this morning by the Twentieth Century Fund, the report of the 30 experts who, acting completely independently of any pros and cons toward this stock exchange bill and under the auspices of a very trustworthy board of directors, have reported on several phases of market regulation. There is a report given this morning on collusion of specialists with pools. May I be permitted to read it for the record?

The CHAIRMAN. Yes.

Mr. CORCORAN (reading):

The testimony of members of the New York Stock Exchange given before the Senate Committee on Banking and Currency tends to confirm the common knowledge of "the Street" that collusion with specialists has been a method of price manipulation used by pools This practice is almost impossible to prove, but enough evidence has been cited in the survey to establish a reasonable presumption that it exists

The key position of the specialist in the operation of the market is clearly revealed in a special statistical study of original source material included in this survey This covers a detailed examination of the actual books of 69 floor members in 151 typical active, semiactive, and inactive issues made available for this purpose by those concerned for 4 periods of 1 week each in 1933, representing periods of slow and rapid advances and declines of prices The records show that about one half of all the transactions in the New York Stock Exchange go through the specialist's hands While the specialist is prohibited by the Stock Exchange rules from divulging the orders on his "book", he himself has at all times a clear picture of the buying and selling orders which would become effective at various price levels The specialist acts not only as a broker, but also can trade on his own account—except that he is forbidden to act as broker and dealer in the same transaction

The specialist is expected to "make the market" in his stock To enable him to carry out this duty he is permitted to buy or sell for his own account shares of the stock in which he is the specialist When he acts as a commission broker he is an agent, but when he buys or sells for his own account he acts as principal It is through his personal transactions that he may influence market prices

It appears that the influence of the purchase and sales of the specialist will vary because of certain conditions prevailing at the time. In a dull market a comparatively small percentage of trades, if made on one side of the market, will probably produce as definite a reaction as a larger proportion in a more active market The condition of his "book" will materially affect the influence of his transactions and alter the percentage of total sales required to produce a specific result. That the specialist, by the very nature of his relationship to the market, is in a position whereby his influence may be readily converted into a price factor of major importance, and may even become the price determinant, is scarcely open to question.

The records included in this survey show that the personal trading of specialists for their own account bulks large in the day-to-day operations of the New York Stock Exchange About 15 percent of all transactions are of this nature While this personal trading of the specialist is justified by defenders of the practice as making a continuous market, the facts show that this trading constitutes a larger proportion of total transactions in the active stocks which would have a continuous market without his personal trading than in the less active stocks.

Furthermore, there is serious doubt as to whether the specialists' personal activities exert a stabilizing effect on the market. The records of their trading for their own account does not disclose any pronounced tendency to trade either with or against the trend of the market, but they show that the specialists' activities are of the in-and-out variety and that their profits and losses are based largely on price changes within each trading session.

That is the report of about as expert a group as you could have. It is very interesting—I think I have the report here—in connection with this subject to see what the Twentieth Century Fund did recommend as to the segregation of brokers and other operators on the exchanges. This is section 6 of the filing committee's report read on February 9. I am reading from the New York Times report:

No individual or firm doing a commission business in securities should be permitted to act as a dealer in securities or to trade in securities, either on margin or otherwise, for his or its own account

The difference between the provisions of this bill and the Twentieth Century report is that this bill refuses to allow a dealer to be on the floor at all.

And with respect to specialists:

Specialists, as well as other exchange members, should be permitted to function either as traders or as brokers but not as both.

There is one other operator on the exchanges who operates solely for his own account whom the bill would prohibit being a member of the stock exchange, and that is the so-called "floor trader." I understand that of the 1,300-and-odd members of the New York Stock Exchange there are at the present time approximately 100 members who, though entitled as members of the exchange to carry on any of the operations on the floor of the exchange, including brokerage, simply trade on the floor for their own account. Those are the so-called "floor traders."

Under the terms of this bill a floor trader could not be a member of the exchange. Only brokers could be members of the exchange.

It has been argued for the floor trader that his constant operations in and out of the market make for a more even and constant market. The argument is because of the floor traders as well as the specialist, who is a species of floor trader, in not quite so concentrated a form, the differences between sales are a quarter or an eighth of a point instead of being two or three points.

That, again, is one of those arguments for liquidity in the market, in which the advantages of liquidity may be well weighed against the disadvantages of having on the floor of the exchange a body of men who have no function with relation to the public but whose activities on their own behalf are supposed, without any intention on their part, to operate to the benefit of the public.

Floor traders may cut down the spread between sales from sale to sale, but they do not in any way cushion the market over the day, because the floor trader, who knows and senses the trend of the market better than any individual broker, knows where it is going much better than the people on the outside who have to buy from the ticker, naturally follows the trend.

Most floor traders actually unload in the course of a day. This bill would drive the floor trader from the floor.

Just before we finish on this segregation section and I turn it over to Mr. Redmond, there is one argument being made in connection with permitting brokers, dealers, and underwriters to continue in a unified business that really from the side of the economic structure deserves some of your attention.

It is argued; the underwriting business at the present time is unprofitable; if you do not allow the present underwriting houses to have a bread and butter commission business they will have to go out of business, and then what will happen to the necessary national machinery for distributing securities?

In all fairness, and I think I have fairly stated and recognized the practical problem of immediacy in divorcing these three-in-one businesses, it might not be such a bad thing if a lot of the underwriting outlets did have to go out of business. One of the difficulties with the market of 1928 and 1929 and with the kind of security that was put out in that underwriting market of 1928 and 1929 was that

the securities-distribution machinery had been built up to the point where there were so many outlets, so many men, and such an investment in the business that securities had to be found at any cost to keep that machine going. Matters had reached a point where the maintenance of the mechanism had become more important than the quality of the merchandise that the mechanism had to sell. Dr. Goldenweiser told you yesterday that we reached a point where issues advertised by underwriting syndicates were sold and snapped up before anyone really knew what the issue was about.

We had a very much overbuilt underwriting and distributing mechanism in 1928 and 1929. In the opinion of many well-informed people, it was not a good thing for the country to have such an overbuilt mechanism. And it might be well in considering the validity of the argument that these three-in-one businesses must be left so that there will be an outlet for the underwriting of securities when underwriting again becomes possible, to consider that it might not be such a bad thing if we did not have quite so much underwriting machinery, with a temptation which the size of that machinery entails to sacrifice the quality of securities.

The CHAIRMAN. Was that responsible to some extent for the over-issue of securities?

Mr. CORCORAN. Yes; very definitely so, Senator.

Mr. REDMOND. Mr. Chairman, you undoubtedly will have many witnesses more qualified than I to discuss the complicated questions that are touched on by this section. The only thing I would like to point out is that this section carries out certain theories, which have been based upon certain conclusions drawn from the evidence before this committee or upon the study made by the twentieth century fund, and makes mandatory these separations.

Senator GOLDSBOROUGH. May I ask you what section you are dealing with?

Mr. REDMOND. Section 10, page 21.

Mr. Whitney, in his statement to the House committee, merely had this to say in describing the powers which might be vested in the stock-exchange authority:

> That this authority should also have power to study and, if necessary, to adopt rules in regard to those cases where the exercise of the function of broker and dealer by the same person is not compatible with fair dealing.

That I take it is the position of the exchange; that instead of a mandatory provision this question of the segregation of the functions of broker and dealer should be studied and only those prohibited that are incompatible with fair dealing.

The CHAIRMAN. Is your membership now, Mr. Redmond, limited to brokers?

Mr. REDMOND. I did not get the question.

The CHAIRMAN. Is your membership limited to brokers?

Mr. REDMOND. No, Mr. Chairman. A member of the exchange can act, as Mr. Corcoran said, as a broker or as a dealer or as a floor trader.

The CHAIRMAN. Yes; but is anybody eligible for membership in the exchange except the brokers?

Mr. REDMOND. Yes; any person who is a citizen of the United States, more than 21 years of age, as I remember the constitutional provision.

The CHAIRMAN. So you would not like to have the membership limited to brokers as this bill provides?

Mr. REDMOND. As this bill provides, Mr. Chairman, that would prevent entirely many of the dealing functions which are now and have been for many years a normal part of the market.

Mr. PECORA. That is, you would prohibit those functions being exercised by persons who also exercise the functions of a broker?

Mr. REDMOND. Insofar as that, after study, was found to be incompatible with fair dealing.

The CHAIRMAN. You agree, though, that no man ought to be in position to serve two masters at one time?

Mr. REDMOND. I would not quite make that generalization, Mr. Chairman. I think in many things that we do, we serve two masters.

Mr. PECORA. Well, if two masters include self, do you think that principle should be followed?

Mr. REDMOND. I think it is perfectly possible. It is done in all lines of business, isn't it, Mr. Pecora?

Mr. PECORA. I think it has come under the ban of our courts quite extensively.

Mr. REDMOND. I think the court of appeals in a case not long ago took the position that, while dealing as a broker and as a principal raised a question that required investigation, there was nothing in that relationship which in and of itself was unlawful.

Mr. PECORA. Apart from the question of legality, how do you deal with it on the basis of morals? Do you think a man should be put in a position where he may have to make a decision that would involve consideration on the one hand of his own interests and on the other hand the interest of his customer or client?

Mr. REDMOND. I think that we are faced in life every day by questions of just that kind, and that that is why we have ethical standards. Some people cannot stand the temptation, but the vast majority of honest people can. It goes without saying as Senator Gore said this morning, that you cannot legislate temptation out of the way.

Mr. PECORA. You may not legislate it entirely out of the way, but when you legislate against a situation which creates the temptation or accentuates it, it might be a good thing to do.

Mr. REDMOND. That is what we did in the prohibition law, isn't it, Mr. Pecora?

Mr. PECORA. This is not a sumptuary law like the prohibition law. You are not using a fair analogy, in my opinion.

Mr. CORCORAN. Section 11, registration requirements for securities: This is the section on which you have heard perhaps the loudest thunder from the exchanges, and this is the section which the exchange has advised all corporations in the United States puts them completely under the domination of the Federal Trade Commission. I think it might be a good thing, at the expense of boring you a little, to read the section through before we start to talk about it.

SEC 11 (a) It shall be unlawful for any person to effect any transaction in any security on a national securities exchange unless a registration is effective

as to such security in accordance with the provisions of this act and the rules and regulations made by the Commission thereunder and unless such security has been issued.

The rest of this section in effect permits the Federal Trade Commission more or less to dictate within certain limitations the listing requirements for securities on stock exchanges. When a security is fully listed for trading on a stock exchange it is required to meet certain requirements before it is admitted to listing. To be listed on the New York Stock Exchange security has to be seasoned 2 or 3 years to make certain that it is well distributed; and, furthermore, to make certain that it has a certain quality. Otherwise, the New York Stock Exchange will not deal with it. To a lesser degree similar requirements are made of securities listed on all exchanges.

This section in effect says the Federal Trade Commission will have something to say about the listing requirements in the event that the listing requirements imposed by the exchanges are not stiff enough to meet what the Federal Trade Commission thinks is decent protection of the public in buying that security.

Now, the very fact that the stock exchanges universally require the filing of certain information, the making of certain reports to the stockholders and the observance of certain covenants as to practices by listed companies, shows that listing requirements for the securities and the enforcing of compliance with certain decent standards of operation is a normal part of the function of a securities exchange or of any other securities market.

With that background, let us go on and read section (b):

A security may be registered with a national securities exchange upon application by the issuer, by filing with such exchange and with the Commission such undertakings, information, and documents as the Commission may by its rules and regulations require in the public interest and for the protection of investors, together with such additional undertakings, information, and documents as the exchange may require

Now, it is upon an interpretation of the breadth of that language that the exchange, outside of reliance upon the power of the Commission to enforce uniform accounts, depends for its charge that this bill puts all American business under the heel of the Federal Trade Commission: The specific language is that a security may be registered, that is, it may be listed, only upon the "filing with the exchange and with the Commission of such undertakings, information and documents as the Commission may by its rules and regulations require in the public interest for the protection of investors."

The language is "such undertakings as the Commission may by its rules and regulations require" but notice the qualifying phrase that comes afterwards—"in the public interest and for the protection of investors." The exchange has put an interpretation upon that language that says there is no limit to the kind of undertaking which the Commission may demand as a condition of listing; that the Commission will be in a position where, if it just does not like a further investment in a particular industry during a year, it may say, "No more capital goes into that industry. We just arbitrarily refuse to let you list, because in our judgment industry does not need this particular issue."

Now, I am facing this thing squarely and hammering on the language because I think that when you read the rest of the section

in the light of which that allegedly too loose language has to be interpreted, you will see by the kind of things asked for in the specific parts of the section that it is an unfair interpretation of the language to say that there is any intent to set up a capital issues committee in the Federal Trade Commission, seeking under the guise of prescribing listing——

Mr. REDMOND. Might I interrupt you there, simply because you have said that it is an unfair interpretation, and I take full responsibility for interpreting the legal aspects of this bill to the exchange. You are aware, are you not, Mr. Corcoran, that in another and later provision the findings of the Federal Trade Commission as to the facts are made conclusive?

Mr. CORCORAN. That is a provision that is a prerogative of every administrative commission. It is one of the first principles of administrative law that an administrative body, when appeal is taken from its decision to a court, is in the position that its findings as to facts, unless absolutely unsupported by the evidence, are conclusive.

Mr. REDMOND. But you will admit, will you not, that that power given in this provision—that these regulations be such as the Commission will require in the public interest and for the protection of investors—allows the Federal Trade Commission, whenever it thinks that a thing is in the public interest and for the protection of investors, to demand it?

Mr. CORCORAN. Yes; but I say, however, that the general language at the beginning of this section has to be read in connection with the specific illustrations of the kind of things the Commission is expected to require in the succeeding pages of the section.

Mr. REDMOND. Then, I will wait for further discussion.

Mr. CORCORAN. Let us jump (b), which sets forth the mechanical provisions of registration, and go to subsection (c) on page 23.

Mr. REDMOND. Do you want to discuss the 30-day provision, which I think is provided for in the balance of (b)?

Mr. CORCORAN. I will let you pick it up. I have not much time.

Under subsection (c)—and this is an illustration of the specific thing that the Commission is entitled to require—it is provided [reading]:

(c) The rules and regulations of the Commission in regard to registration shall require—

(I) An undertaking by the issuer to comply with and so far as is within its power to enforce compliance by its officers, directors, and stockholders with the provisions of this act and any amendments thereto and with the rules and regulations made or to be made by the Commission thereunder and, unless the issuer is a member bank of the Federal Reserve System, not to lend any funds in the money market of any exchange or to any member thereof or to any person who transacts a business in securities through the medium of any such member except in accordance with such rules and regulations as the Commission may prescribe.

Certainly so far innocent enough.

(II) Such information as to the issuer and affiliates in respect of—

As we enumerate these things, let us see if there is anything which you could not fairly say a corporation should disclose in its registration statement and in its listing application to a stock exchange for

the information of its stockholders and those who are expected to buy that stock in the open market [reading]:

(1) The organization, financial structure, and nature of the business
(2) Particulars regarding the terms, position, rights, and privileges of the different classes of securities outstanding.
(3) Particulars regarding terms on which securities have been or are to be offered to the public
(4) Particulars regarding the directors, officers, and principal security-holders and underwriters, their remuneration and their interests in the securities of and material contracts with the issuer and affiliates.
(5) Particulars regarding remuneration to others than directors and officers exceeding $20,000 per annum.
(6) Particulars regarding bonus and profit-sharing arrangements.
(7) Particulars regarding management and service contracts.
(8) Particulars of options in respect of securities existing or to be created.
(9) Particulars regarding material contracts not made in the ordinary course of business, and material patents.
(10) Balance sheets for preceding years certified by independent public accountants.
(11) Profit and loss statements for preceding years certified by independent public accountants; and such other information as the Commission may by rules and regulations require as necessary and appropriate in the public interest or for the protection of investors
(III) Copies of articles of incorporation, bylaws, trust indentures, or corresponding documents, whatever the names, underwriting arrangements, and other documents of the issuer and affiliates which the commission by rules and regulations may require as necessary in the public interest or for the protection of investors

Now, Mr. Chairman, if I may, to make sure that there can be no charge that this earlier language goes so far as to set up a capital issues committee dominating American industry, I should like to suggest that, in the light of the specific provisions in this long section, the general language, which, of course, takes its color from the kind of thing specifically asked for, no fair construction such as that which is put upon it as a bugaboo by the Stock Exchange. But to make absolutely sure that there cannot be any charge of any such intent on which industry can be rallied against this bill, I would suggest that you do change the language in section (*b*) where it says:

such undertakings, information, and documents as the Commission may by its rules and regulations require in the public interests——

The CHAIRMAN. What line?

Mr. CORCORAN. It is line 12, page 22. Change it to read in such a way that there will be no question that the rules and regulations which the Commission may make are only those to insure fair protection to investors and honest dealing in the securities. Then I think the bugaboo vanishes.

Another indication of the way in which that general language should be interpreted is obtained after you read section 12, which indicates the kinds of documents which the Commission should require. Let us read section 12. It relates to the reports which the Commission can require every listed company to file with it and with the exchange for the information of its stockholders. And while we are on this, just remember again that as part of stock exchange practice in relation to the corporations whose securities are listed with them, the stock exchanges, as Mr. Whitney's brief says, have always sought for more publicity on the part of the companies whose securities are listed with them and have considered that every advance they

could make in that direction was something very much to their credit as exchanges and something very much in the line of their duty to the public as an exchange [reading]:

SEC 12 (a) Every issuer of a security registered on a national securities exchange shall file with the exchange and with the Commission, in accordance with the rules and regulations to be prescribed by the Commission and in such form and in such detail as the Commission may by rules and regulations prescribe in the public interest and for the protection of investors—

(1) Such information and documents as the Commission may require to keep reasonably current the information and documents filed pursuant to section 11,

That is the section that we have just read. [Reading further from the bill:]

(2) Annual and quarterly reports, including, among other things, a balance sheet and profit-and-loss statement certified by an independent public accountant

Senator KEAN. Do you not think that to require quarterly reports is putting a pretty big task on them?

Mr. CORCORAN. I will discuss that in just a second, sir [reading]:

(3) Monthly reports—

worse than quarterly ones—

including, among other things, a statement of sales or gross income

Now, there are two objections made to those reports. One of them is in connection with other provisions, that you are requiring the corporations to report too frequently. The second one is that even if you are not requiring them to report too frequently, you are making it too expensive because of the cost of certified public accountants.

A further objection is made that you are putting the Federal Trade Commission in a position where it can prescribe uniform accounting rules for particular industries. The problem about uniform accounting arose before the House committee the other day, and as Chairman Rayburn pointed out, if accounts are going to mean anything they have to be compiled in accordance with some uniform accounting principles; and the awful situation that the Exchange points out of some Government commission being in a position to prescribe uniform accounting rules for particular kinds of businesses has been a fact for many years with the railroads through the Interstate Commerce Commission apparently to the benefit of all concerned, and nobody has died yet.

Senator KEAN. Except the railroads.

Mr. CORCORAN. No; they have not died either. They are probably in a little better shape than they were before, sir.

The second point, with reference to the cost of auditing accounts. Mr. Whitney stated before the House committee that a corporation with a capitalization of $5,000,000 would probably have to pay—and check me if my figures are incorrect—from $500,000 to $1,000,000 a year to have its accounts audited monthly and quarterly. My humble judgment, and the judgment of a great many other people is that if that is so, accounting is a great business to get into. I just don't believe that is so. Furthermore, I don't believe that if you had business accustomed to keep accounts on the basis of uni-

form rules prescribed by the Commission, the accountant's job would be anywhere near so hard as it is now or justify any such fees.

Then we get to the last point—whether you are asking too much of industry to give these annual and quarterly reports and these interim monthly reports that show at least gross sales and gross income.

If I might I would like to read into the record at this point a statement which appeared in the New York Times on the eighteenth and which is in substance a paraphrase of testimony before the House committee of a Mr. Fred Y. Presley who is the manager of a very large investment trust in New York, a professional investor in the securities market who makes it his business, as I understand, since the information offered him in published reports is so inadequate, to go around himself and see what he can learn by consultation with the managers of companies. If I might just read this at the present time [reading]:

"It has been stated in connection with the bill that the quarterly reporting of pertinent facts would cause companies to divulge trade secrets that would lay domestic companies open to foreign competition", Mr Presley said. "I know of no 'trade secrets', or other significant facts concerning the operation of leading companies that are not already in the possession of concerns, domestic or foreign, that are worthy of being regarded as competitors Therefore, quarterly reporting would not place such secrets in the hands of competitors"

Parenthetically, every one who has ever dealt with industrial engineers knows that the system of commercial espionage that exists at the present time in the United States is so perfect that normally the directors of a corporation know much more about their competitors' business than they do even about their own; that any competent engineer for a manufacturing concern, for example, who knows the location of that plant, the prevailing rates of wages for labor, the cost of raw materials, railroad rates to the nearest market and other costs of transportation, all now on almost a uniform basis, can, according to one of the best engineers I know who sat with me the other night, compute the cost of production and the cost of selling of any competitor's product down to 1¼ percent.

But to go on with Mr. Presley [reading]:

If by the terms "trade secrets", opponents of this measure mean excessive margins of profit, which would be revealed only by the publication of earnings against sales, then these critics have cited the best reason for publication of the figures

If margins of profit are too wide and prices are too high, the consuming public should be afforded the protection of open competition and investors should be apprised that the margins are so wide as to become untenable through competition

Some directors and executives of corporations have failed to keep pace with the progressive transfer of control from private groups to the public The directors today are merely employees working in the interest of the investing public The latter never intended to place the directors in a preferential position with regard to information concerning the company's earnings, but this situation exists in hundreds of companies today

Pool operations in recent years have been concentrated largely in stocks of companies which report annually and which thus preserve secrecy and mystery concerning their earnings for months at a time

A study of hundreds of companies in the last 7 years has convinced me that the units which do not report adequately on their operations and financial status have either been losing ground competitively, have been pursuing policies which they do not care to have exposed, have been operating on margins

of profit which are clearly excessive, or have been influenced in their public relations by private groups, which have not yet recognized the shifting of ownership of great corporations to the public and are not sensitive to the fiduciary responsibilities of directors and officers.

The reporting of large corporations has improved in recent years, partly as a result of the leadership of the New York Stock Exchange and because of the increasing recognition of the rights of the smaller investor, which has been produced by the recent depression.

If the corporate form of organization is to endure, millions of investors must be protected by legislation that will ensure that the small stockholder and the large one will be treated on a basis of equality.

The major problem of investors and investment trusts is the appraising of values Whenever the financial community has gotten too far away from values and loses its perspective, as in 1929 and the summer of 1933, there has been trouble

The problem of appraising values depends on three factors General business conditions, on which Government agencies, such as the Federal Reserve Board and the Department of Commerce, present full information; the condition of the industry in which one is seeking to invest funds; and the financial record of the individual companies The success of the investor in ascertaining facts regarding industries and individual companies is dependent largely on the policy of companies as to issuing adequate and frequent reports

All that the investing public wants is a quarterly statement, audited by public accountants, showing what has actually transpired in the way of earnings and sales and containing the financial position of the company. It does not seek to learn future plans, disclosure of which might prejudice the company's competitive position

I do not believe that any company would have the effrontery to seek to evade the reporting requirements of this bill by withdrawing its shares from listing on any exchange in this country.

The CHAIRMAN. I think there is some ground for a complaint he has made. I have numerous letters from people who say that under this bill they would have to have auditors and accountants in their establishments practically continuously, at enormous expense. That is one thing. Then, take a corporation engaged in manufacturing products, say, only 3 months in the year. The rest of the time they are doing nothing. Their plant is practically idle. What is the use of requiring that sort of a concern to make monthly reports or even quarterly reports?

Mr. CORCORAN. Senator, insofar as the first problem is concerned, as soon as you do work out uniform accounting principles on which companies can keep their books (and if you want to know what the importance of that means in corporate reporting, there is an article on the subject in Harper's for this month just come out which is well worth studying)—after you get uniform accounting principles set up, it will not be so hard for auditors to make reports on companies nor for companies to keep their own books in such shape that they know what is going on. Until that point is reached, what you are weighing is the cost to the company of keeping its books in such shape that an auditor can go over the books pretty easily, against the cost to the stockholders of not knowing what is going on and against the cost to the stock exchange of having pools operated on mysteries when no one really knows what the position of the corporation is.

As to your second point, that business is cyclical with a great many corporations, that is true. But the annual reports or quarterly reports would not necessarily fall on January 1 or April 1. Different businesses have their cyclical quarters at different times, and there would be no objection if the quarterly reports for different businesses should come out at different times. As for the objection that many

businesses do all the work they do during 3 months of the year, the answer is that the auditing job would be a snap for the rest of the year.

Senator KEAN. Yes; but they would have to pay for it just the same.

Mr. CORCORAN. They do not have to pay very much for it, sir.

The CHAIRMAN. I quite agree that there ought to be reports, but I do not know about monthly reports.

Mr. CORCORAN. The monthly report does not have to be audited by a certified public accountant. That is required only for the annual and quarterly statements.

Senator KEAN. If it was every 6 months that would be all right.

Mr. CORCORAN. That leaves 6 months of mystery in there in which a pool can operate. I do not pretend to be an expert on corporate reporting, but I have read into the record the testimony in reference to whether a quarterly or semiannual statement is adequate of a man who is.

Senator KEAN. I believe they should make monthly reports; I believe they should make quarterly reports, but I do not think you ought to ask them to have expert accountants do it.

Mr. CORCORAN. The Twentieth Century Fund report suggested since this sort of thing was done for the protection of stockholders, that just as in English practice the stockholders pay one director who acts as their inspector for their particular and separate benefit, the stockholders might pay for the report. But I do not see why the expense should not be on the company. I do not see why, in the first place, the cost of auditing reports cannot be brought down with a universal practice like this, with the prescription of a uniform accounting method; and I do not see why it is not the duty of proper management to let the investor know what he is buying.

Senator KEAN. I think you ought to have a uniform system; I agree with that.

Mr. CORCORAN. But you object to the cost of the report.

Senator KEAN. The cost of the report.

Mr. CORCORAN. There is one more point which I would like to talk about before I finish this section.

Senator WALCOTT. Let me ask you a question. What do you mean by a quarterly report that has to be audited? Do you mean a physical inventory or a book inventory?

Mr. CORCORAN. I should say a book inventory, sir.

Senator WALCOTT. Suppose the Federal Trade Commission requires, as it may—it has the authority to require such a thing—a physical inventory quarterly, and suppose you are running a gross of, say, 30 or 40 or 50 million dollars. Have you ever been connected with a large business yourself?

Mr. CORCORAN. Yes; I know what the problem of physical inventory is.

Senator WALCOTT. Have you been associated with a large business?

Mr. CORCORAN. Only as a lawyer.

Senator WALCOTT. You have never been through that, then.

Mr. CORCORAN. You will have to depend to some degree, and I think you can reasonably depend, upon the Commission's being a little reasonable in that respect.

Senator WALCOTT. I don't know about that.

Mr. CORCORAN. You are not setting up any God-given group of men completely removed from public criticism when you give this Commission that power.

Senator WALCOTT. It is too great a power, because they could easily require a physical inventory which would be almost a physical impossibility. They would barely take one physical inventory when they would be starting on the next one.

Mr. CORCORAN. That is true. I completely agree with you on that.

Senator WALCOTT. I think it ought to be hedged about in some way to show exactly what is meant.

Mr. CORCORAN. Possibly, sir, that should be done.

There is one more idea that should be ventilated before we finish with this section, and that is the suggestion of the New York Stock Exchange that all this publicity required of corporations, together with the standard of fidelity to the corporation required of officers and directors is the matter of a Federal corporation law. Such matters do not belong in any stock-exchange bill, they say.

There are two answers to that: First of all, if you were to have a Federal incorporation law, the same provisions that we have here would have to go into it.

The second thing is that, looking matters right square in the face, talking about a Federal incorporation law is just a dilatory plea, as a lawyer would put it. It is a red herring to put action off. The legislative course of a Federal corporation law is going to be a lot longer than anybody thinks now. There are a great many people who believe in this bill and in the principles of stock-exchange regulation who think there are serious objections to a Federal corporation law. Furthermore, to say that decent accounting of corporations to their stockholders should be put off until there happens to be put through Congress a law which deprives all States of their present powers over their corporations is to put off until the millennium. A Federal incorporation law, granting that it is desirable, is something so far in the future that to avoid putting provisions in a stock-exchange bill because it would be much more artistic in a Federal incorporation law, looked at candidly, means a 4- or 5-year postponement.

Mr. REDMOND. I do not want to take time to discuss the particulars that you have taken up, because I am sure witnesses will be here before this committee who are much more competent that I to give information—based on actual facts and experience and not purely upon hearsay—as to the expense of these audits, if not as to the actual impossibility of corporations complying with these requirements of the bill. I would like, however, to say just two things, first of all, because you originally said that my interpretation of this act was an unfair interpretation, and that there might be some amendment. I think an amendment along the lines that you suggested, if it was clear, would go a long way toward removing my objection. My opinion was based upon this bill as it was drawn; and I pointed out to you that the powers given to the Commission were unlimited when read in relation to the other provision of the law which makes the findings of the Commission as to facts conclusive.

I also want to point out that these broad powers run right straight through the bill.

Mr. CORCORAN. Yes.

Mr. REDMOND. It was not just in subdivision (*b*) of section 11 that I found unlimited powers given to the Commission. You read a list of the specific things which had to be filed as a condition of registration; but if you will notice the final part of subparagraph 11, it reads [reading]—

and such other information as the Commission may by rules and regulations require as necessary and appropriate in the public interest or for the protection of investors

Again a repetition of the language which I pointed out to you was the equivalent of unlimited power.

Mr. CORCORAN. And again to be read in the light of the specific language contained in the same section——

Mr. REDMOND. Let me continue. If you will turn to subdivision (4) of section 12, you will find this language [reading]:

Such other reports and at such time as the Commission may by rules and regulations prescribe in the public interest or for the protection of investors or with a view to insuring that the security holders' interests shall not be prejudiced by the use of information for the advantage of any special group or interest

Again unlimited power.

Mr. CORCORAN. And again in a section in which you have some indication of what specific things are expected.

Mr. REDMOND. Well, let us not rely too much on that, because when you turn to subdivision (*b*) of section 18, where specifically it is provided [reading]:

The authority above given the Commission shall include, among other things authority to prescribe the form or forms in which required information shall be set forth——

Mr. CORCORAN. That is the uniform accounting.

Mr. REDMOND (continuing reading):

The items or details to be shown in the balance sheet and earnings statement and the methods to be followed in the preparation of accounts, in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the preparation, where the Commission deems it necessary or desirable, of consolidated balance sheets or income accounts of any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer

Mr. CORCORAN. But that again comes down to uniform accounting methods, which we have just discussed, and nothing more.

Mr. REDMOND. That, as I see it, deprives management of the right to determine——

Mr. CORCORAN. No more than railroad managements are now deprived of their right to determine how they want to carry depreciation and depletion, and differentiate recurring and nonrecurring income.

Mr. REDMOND Remember that our railroads have been under regulation for many years, and those accounting rules have been developed from many years of practice and experience.

Mr. CORCORAN. As these will have to be developed, because no one expects them to come full fledged from the head of Jove on October 1.

Mr. REDMOND. Let me finish my statement about the railroads. The railroads are all engaged in one particular type of business, where the Interstate Commerce Commission has power to regulate their rates, and likewise largely to regulate their expenditures.

Mr. CORCORAN. Yes.

Mr. REDMOND. We all feel that the railroads are under the domination of the Interstate Commerce Commission, and I do not think it is too much to say, reading these provisions, that all commerce and industry registering on these national exchanges would likewise be under the domination of the Federal Trade Commission. That is my opinion, and I am prepared to stand by it.

Mr. CORCORAN. Will you go along, now, if we make the kind of a suggestion we have suggested for the first paragraph?

Mr. REDMOND. If it be clarified to carry out what you say, and it runs right through the bill, not only will we go along, but I say it is the New York Stock Exchange which is responsible for the fact that American corporations do give current information.

Mr. CORCORAN. That is absolutely correct.

Mr. REDMOND. The New York Stock Exchange established the idea of quarterly reports.

Mr. CORCORAN. And this is just along the line you have been working for yourself for many years, and we are helping you get what you have wanted for a long time.

Mr. REDMOND. There is the old expression, Mr. Corcoran, "God save us from our friends." Sometimes it is more than true. This time our friends have pushed it beyond the limit of common sense.

Might I say one final thing? You used the expression "a red herring" in regard to the suggestion that these corporate provisions properly belong in a national incorporation law. That is not a red herring. That has been the position of the exchange for years. It is not put forward at this time to delay or otherwise prevent any act regulating the exchanges.

Mr. CORCORAN. But, frankly, you do not expect the passage of a Federal corporation law for a long time, do you?

Mr. REDMOND. We do not know whether it can or cannot be done, but we do say that it is the sound way, the right way, and the only way in which corporate practice in this country can be regulated. We should not regulate simply the corporations that are listed upon an exchange.

Mr. PECORA. Mr. Redmond, is there any legal authority now which would restrain the governing authorities of the New York Stock Exchange from imposing any requirements that, in their judgment, they saw fit to impose as a condition to listing a stock?

Mr. REDMOND. Legally, no; but practically——

Mr. PECORA. Then they exercise their judgment, which is untrammeled or unrestricted by law.

Mr. REDMOND. But practically there is a limit which is stronger than any legal control.

Mr. PECORA. That is common sense.

Mr. REDMOND. If we put on false or undue listing requirements, corporations simply would not list.

Mr. PECORA. That is based upon the principle of common sense.

Mr. REDMOND. And freedom of contract.

Mr. PECORA. And it is just as fair to assume that the Federal Trade Commission would exercise that same degree of common sense as the governing authorities of the New York Stock Exchange may be expected to exercise.

Mr. REDMOND. No, Mr. Pecora. The issue is different. It is not a question of common sense. It is a question of freedom of contract. There is no action the New York Stock Exchange can take to compel a corporation to list, whereas under this bill penalities are put upon unlisted securities. Attempts are going to be made to drive them into these national securities exchanges, and then to submit themselves to such regulations as the Federal Trade Commission may see fit to adopt.

Mr. PECORA. Do they not now submit themselves to regulation by the Stock Exchange, within its requirements?

Mr. REDMOND. Only when they are willing to do so. That is freedom of contract, and there is no freedom of contract, as we see it, in this bill.

The CHAIRMAN. The Stock Exchange has to keep in mind the thought of competition, does it not?

Mr. REDMOND. Competition? Barely, Mr. Chairman. The corporations that want listing on the Stock Exchange want it because they feel that they have the size or the number of stockholders to warrant it. They could get listing on easier terms on other exchanges, but still they come to the New York Stock Exchange, because they are willing to give their investors the degree of information that the exchange requires.

Senator KEAN. They also receive a larger market.

Mr. REDMOND. A larger market, naturally.

Mr. CORCORAN. And that advantage of the larger market is such an advantage that it will compensate for a great deal stiffer requirements for giving information before a company will actually withdraw from listing.

Senator KEAN. In that connection I would like to show you that letter [handing a paper to Mr. Corcoran].

Mr. CORCORAN (after examining paper). That is typical.

Senator KEAN. I would like to have it go into the record. You have read the letter?

Mr. CORCORAN. Yes.

Senator KEAN. I offer for the record a letter from a man who says he would withdraw his securities from the New York Stock Exchange if this bill went through.

The CHAIRMAN. You want to offer the letter?

Senator KEAN. I have offered the letter. May it be received?

The CHAIRMAN. Yes.

Mr. PECORA. May the letter be read?

(Senator Kean hands paper to Mr. Pecora.)

Senator KEAN. I do not know the man. He is a stranger to me.

The CHAIRMAN. We have filled up a good many pages of this record with letters. I got a letter from a man the other day who said that his children were without shoes, and he did not have any money.

Senator KEAN. I have lots of those.

The CHAIRMAN. He wants us to bring suit against the three concerns for $15,000, which he has lost through buying worthless stock.

and still he protests against this bill and says he wants to be free to buy some more.

(The letter referred to is as follows:)

MONSANTO CHEMICAL CO,
GENERAL OFFICES,
*St Louis, February 21, 1934*

HON HAMILTON F. KEAN,
*United States Senate, Washington D C*

MY DEAR SENATOR. My father devoted his lifetime to building up this company I have spent my entire career since the war in it and have been its president since 1928 Our common stock is listed on the New York Stock Exchange Neither my father nor myself has ever speculated in the stock of this company There have been no pools and neither of us has ever sold a share short Although I cannot speak for the other officers and directors, I am confident in my own heart the same applies to them

The Fletcher-Rayburn Bill now pending before Congress to regulate the Stock Exchanges of the country would have a most disastrous effect on the community at large and upon our stockholders I say without hestitation that should this bill become law we would remove our stock from listing on the New York Stock Exchange, thereby denying the benefit which our several thousand stockholders, the great majority of whom are small investors, now have in a ready market for the sale of their securities and a definite loaning value at the banks

Although I have never issued and never will issue any misleading statements or accounts regarding our corporate affairs, this company cannot afford to pay me and other officers' salaries which would be commensurate with the risks we would take under the liability provisions of the act The provisions of the act would place our company at a decided disadvantage with those of our competitors, whose securities are not listed, to have our monthly sales and profits, and any other information which the Federal Trade Commission demand of us a matter of public information and available to our domestic and foreign competitors

There are many other provisions of the bill which are extremely impracticable and objectionable both to corporations and the Exchanges

I believe it would not accomplish its lofty purpose It would result in bootlegging of securities, the loss of an orderly market in which investors can go to buy or sell, and deprive corporations of the means of securing necessary working capital from time to time

It would be a severe blow to the recovery which is now being evidenced and shatter the confidence of corporation executives throughout the country, who, after all, must be relied upon by the United States Government to maintain employment in their own and heavy construction industries, as the Government cannot do so indefinitely Not only would their confidence be shattered, but their wherewithal to make the necessary investments would be denied to them.

I am very sincerely in hopes you will oppose the passage of this bill in its present form, or that it be so materially amended that it would have practically no resemblance to the present measure

Sincerely yours,

(Signed) EDGAR M. QUEENY, *President*

Senator WALCOTT. What is the alternative, Mr. Corcoran, if a concern is not satisfied with the operation of this bill and the excessive powers given to the Federal Trade Commission, and wants, therefore, to withdraw from the exchange? What can a man do to still operate his company?

Mr. CORCORAN. In a very few cases possibly there would be withdrawals from the stock exchange, except that there always hangs over the head of those companies that are withdrawing from the stock exchange they will still be subject to the possibility of working out a control over the over-the-counter market, such as is provided for in here. You were not here when I was discussing with Senator Kean this morning the suggestion that since practically all these requirements are for the purpose of making information available

to stockholders, insofar as there is an interest in the stockholders in having the shares listed on the stock exchange, the shareholders just simply will not permit the companies to be withdrawn from the stock exchange because of these requirements.

Senator WALCOTT. Of course, there are thousands of companies, many of them of large size, that prefer not to have their securities listed on any exchange.

Mr. CORCORAN. Yes, sir.

Senator WALCOTT. Would you deny them the right to operate those corporations?

Mr. CORCORAN. No.

Senator WALCOTT. They are not interested, necessarily, in the public buying any securities, or selling securities.

Mr. CORCORAN. No.

Senator WALCOTT. There is nothing in this bill to curtail their operations?

Mr. CORCORAN. No. There is a provision in here, on page 27, section 14, with regard to over-the-counter markets, which would put the Commission in a position where it might prescribe rules and regulations for companies, the securities of which are sold through the mails or in interstate commerce. Just how that will be worked out, nobody knows. Neither the Dickinson report, nor the Twentieth Century Fund, nor this bill has any specific ideas as to how you would reach the over-the-counter market, but certainly there is some way it can be reached.

Senator KEAN. Suppose the company is not offering any securities?

Mr. CORCORAN. You are talking about new securities now?

Senator KEAN. Yes.

Mr. CORCORAN. This deals only with securities that are listed on an exchange. New securities do not normally reach an exchange until a year or so after they are issued and have been distributed.

Senator KEAN. Suppose you have a company that has, say, $5,000,000 capital or $10,000,000 capital, and they do not offer their securities. Their securities are out. They have no interest in whether there is any market for them or not.

Mr. CORCORAN. Is there an over-the-counter market for the securities?

Senator KEAN. Yes.

Mr. CORCORAN. The regulations which the Commission would try to impose in that case, where there was very little of a public investor, interest would, I should think, be very, very slight, if any at all.

Senator KEAN. They can say, "Here, it is of no interest to us. We do not care whether anybody buys these securities or not. We have got the money. We are doing the business. We do not want anybody to buy our securities."

Mr. CORCORAN. It might be difficult to reach them.

Senator WALCOTT. Why would you want to reach them?

Mr. CORCORAN. You would not want to reach them, unless there were a real public interest in the seucrities, and some public turning over of the securities.

The CHAIRMAN. The committee will now take a recess until 10 o'clock tomorrow morning.

(Whereupon, at 4:45 p.m., Tuesday, Feb. 27, 1934, an adjournment was taken until tomorrow, Wednesday, Feb. 28, 1934, at 10 a.m.)