STOCK-EXCHANGE PRACTICES

THURSDAY, MARCH 1, 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), Wagner, Barkley, Bulkley, Gore, Costigan, McAdoo, Adams, Townsend, 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, please. Now, Mr. Whitney, you may proceed, if you will, just in your own way.

STATEMENT OF RICHARD WHITNEY, PRESIDENT OF THE NEW YORK STOCK EXCHANGE—Resumed

Mr. WHITNEY. Mr. Chairman and gentlemen of the committee, yesterday we covered in some detail section 6 of the bill dealing with marginal requirements.

Section 7 of the bill deals with restrictions on members' borrowings, and contains 6 subdivisions. I think this entire section has been very thoroughly covered by Mr. Corcoran, and I think it would be repetitious for me to go into all the details unless it is the pleasure of the committee, or there are any particular questions.

The CHAIRMAN. There seem to be no questions. You may proceed.

Mr. WHITNEY. Section 8 of the bill deals with certain prohibitions against manipulation of security prices. Fundamentally we are in agreement with the purposes contained in this section, except that there are certain details that need clarification, in many of which cases it was agreed to by Mr. Corcoran; perhaps specifically in that connection, the necessity for arbitrage between various markets, which under subsection 7 seemingly would be prohibited.

Senator GORE. Subsection 7 of what section?

Mr. WHITNEY. Subsection (7) of section 8.

The CHAIRMAN. All right.

Mr. WHITNEY. Section 9 of the bill contains three subsections having to do with short selling, stop-loss orders, and the employment or use of any contrivance or device that the Federal Trade Commission deems detrimental to the public interest.

Short selling we have covered time and time again by way of explanation and stating our opinion of its necessity to a market.

As to stop-loss orders, we believe that any prohibition of them would be to the great detriment of the public.

Now, as to section——

Senator GORE (interposing). Mr. Whitney, I do not suppose it would do to make them compulsory. I have sometimes thought it might be better to make them compulsory than to abolish them.

Mr. WHITNEY. Do you mean stop-loss orders?

Senator GORE. Yes. But I understand that that would have a tendency to freeze your market in a way. But I did not mean that suggestion seriously, even though I have thought it might be better to make them compulsory than to abolish them altogether.

Mr. WHITNEY. Well, Senator Gore——

Senator GORE (continuing). But, you understand, I did not mean to make the suggestion seriously that you should make them compulsory.

Mr. WHITNEY. Section 10 of the bill purports to deal with the segregation and limitation of the functions of brokers, specialists, and dealers.

Now, as to the dealer, it is my understanding that various gentlemen have requested permission to appear before you to explain specifically wherein that materially and vitally affects their doing the business they are accustomed to engage in.

As to specialists, with your permission I request that a specialist of the exchange may have permission to appear and explain in detail just how he functions in the execution of orders intrusted to him. At the moment I think he is appearing before the House Committee on Interstate Commerce, so that if I may have your permission I will ask him later on to come before you.

The CHAIRMAN. All right.

Mr. PECORA. Mr. Whitney, how many specialists are there on the New York Stock Exchange?

Mr. WHITNEY. I believe about 350.

Mr. PECORA. Are there any who are specialists for more than one security?

Mr. WHITNEY. Yes, sir. Some have many, many stocks. Where a specialist has only one stock the presumption is that he has competition with other specialists in the same stock.

Senator GORE. I should like to ask one question right there on this stop-loss order business: I have heard it alleged that speculators would find out that there were a number of short stop-loss orders in, those who were on the short side of the market, and would redouble their efforts to hammer prices down so as to reach those stop-loss orders and thereby to avail themselves of the increased pressure by having stop-loss orders add pressure to the downward drive on the stock. Now, does one broker know of stop-loss orders on the part of others, or how is that arranged?

Mr. WHITNEY. Unless by some underhand means an individual should find out the fact that stop-loss orders exist on a specialist's books, I do not know how one could arrive at the information you suggest, Senator Gore. Specialists have never been allowed to divulge to anybody the fact that stop-loss orders exist on their books, or any kind of stop orders.

Senator GORE. I notice in the market reports ofttimes that one will see mention of the fact that stop-loss orders were reached in the

downward trend of a stock, and that that accelerated the downward tendency of the price of the stock. I suppose it becomes news after it happens.

Mr. WHITNEY. After it happens, yes; and the same thing can take place in a rising market as well.

Senator GORE. I do not get the point. Please explain it more fully.

Mr. WHITNEY. Stop orders exist to buy stock at a price as well as to sell stock at a price. And if a man is short of a stock and wants to put in a stop order he puts it in to buy at a price stop, where it becomes a market order, as soon as that price is reached or a higher price is reached.

Senator GORE. He puts in a market order to buy above the market price, is that it?

Mr. WHITNEY. Above the market price, presumably; yes, Senator Gore.

Senator GORE. Why would he do that?

Mr. WHITNEY. I will try to explain that: If a man sells 100 shares of General Motors short at 40, he may wish to limit his loss to 1 point. So he puts in an order to buy 100 shares of General Motors at 41 stop. That is the reason why they are called stop-loss orders.

Senator GORE. And that is true of a rising as well as of a falling market, is it?

Mr. WHITNEY. Yes, sir.

Senator GORE. I did not know that. I thought the use of it was to protect themselves in that sort of case.

Mr. WHITNEY. Perhaps they may, but of that I am not acquainted.

Senator GORE. They do that on the grain market I know, and I supposed that they did it on the stock market.

Mr. WHITNEY. It is very usual in such a case for them to use a stop-loss order.

The CHAIRMAN. Mr. Whitney, in reference to specialists, do I understand that a stock may have more than one specialist on the floor?

Mr. WHITNEY. Yes, sir. Any member of the exchange may become a specialist in any stock that he may desire to specialize in. That is his entire personal prerogative.

The CHAIRMAN. So that there may be more than one specialist in any particular stock?

Mr. WHITNEY. There are sometimes as many as 10 specialists. I think there have been 10 specialists at one time in the United States Steel common. And I believe there are——

Senator GORE (interposing). Mr. Whitney, I wish you would state their functions, what they do, and how they qualify to become recognized as specialists. What action has to be initiated in order to become a specialist?

Mr. WHITNEY. What they do in order to become a specialist, Senator Gore, is to advertise, to send out cards, I imagine very similar to what a lawyer or a doctor does, that they are going to enter that particular business. And they advise members of the exchange, and very often advertise it in the papers, that they intend as of a certain date to set themselves up as specialists in a particular stock.

Senator GORE. And they can do that of their own motion without any authorization to do it; is that so?

Mr. WHITNEY. Absolutely, sir. They then, as of that particular date, hope to receive orders in that particular stock, and they place

themselves at the particular post where that stock is designated to be traded in.

Senator GORE. Now, Mr. Whitney, will you kindly cover their activities in your statement?

Mr. WHITNEY. They receive and execute buying orders, selling orders, stop-loss orders, market orders, as well as limited orders, although the majority of the orders received by specialists are limited. They also have the privilege to buy and sell, as has any other broker on the exchange, for their own account.

Mr. PECORA. Mr. Whitney, would you mind, just for the sake of the record, defining for us the term "limited order" which you have just referred to?

Mr. WHITNEY. To give you an instance of a limited order: It is an order to buy, let us say, 100 shares of United States Steel at 56, or to sell 100 shares of United States Steel at a fixed price. Such orders, if given to buy below the market, are almost invariably given to a specialist. And if it is a selling order, and if above the market and limited as to price—which because of their nature must be limited—it is also given almost invariably to a specialist. These orders are entered in their books, that is, the specialists' books, which will be more specifically explained to you by the specialist I hope you will hear from; and when the market reaches those prices, if on a declining scale he buys the stock for the broker who gave him the order on behalf of his customer; or if on a rising market, he sells that stock which he has on order.

Senator GORE. Now, Mr. Whitney, if he has an order to sell United States Steel at 50, and if he also has an order to buy United States Steel at 50, does he have to give his customer preference instead of taking it himself? That is, the specialist cannot take the stock up in that sort of situation, can he?

Mr. WHITNEY. No, sir. He may not buy stock at 50 for himself if he has an order to buy for anybody else. Likewise, he may not sell stock at 50 for himself if he has an order to sell for anybody else at 50.

Senator GORE. That is my understanding of it.

Mr. WHITNEY. He also may not buy any stock for his own account if he has a market order, until that market order is filled; and, vice versa, he may not sell any stock for his own account if he has a selling order at the market, until that order has been filled.

Senator BULKLEY. Do you mean at any price? In other words, if he had an order to buy at 50 do you mean that he could not buy at 50⅛.

Mr. WHITNEY. Yes. But we will say that he has a buying order at the market, and then he may not trade for himself at any price until he has executed that order.

Senator GORE. But when he has corresponding orders, to buy and to sell, then he can buy and sell for himself, I take it?

Mr. WHITNEY. Yes; as may any other broker in the market.

The CHAIRMAN. Now, Mr. Whitney, in regard to separating the functions of these people mentioned in section 10 of the bill, I should like to get your view as to whether that is wise or not, I mean to attempt to do that. That is, as to whether a broker shall do a brokerage business, and a dealer shall deal in stocks.

Mr. WHITNEY. Mr. Chairman, I think that is a tremendously broad question. I personally feel that the elimination of trading for his own account insofar as the specialist is concerned, would be to the infinite detriment of the public.

Senator GORE. How is that? Will you please repeat that? I did not catch it.

Mr. WHITNEY. I feel that if a specialist were prohibited, as he is under the bill, from trading for his own account, subject to the rules of the exchange, it would be to the very real detriment of the public. I readily grant that there are divergent opinions on that subject in the same way perhaps as to other persons acting as dealer and broker. I think, as we have suggested, that that is a matter for real study, for great additional study I would add, before it is definitely prohibited.

Senator BULKLEY. What harm would it be to the public?

Mr. WHITNEY. I believe the public would not receive the same markets, as good markets, particularly in semiactive and inactive stocks. I believe if the market, as I have stated, for a stock was bid 30 and offered at 32, and the specialist were prohibited from trading for his own account, then if an order were received to sell at the market the immediate sale would have to be at 30. And the next order might be a market order to buy 100 shares, and it would be immediately executed at 32. The buying order would have to be immediately executed at 32. If, as is the present custom, the specialist wished to make a market between those figures it would be to the advantage of the customer, the public who wanted to trade.

Mr. PECORA. Mr. Whitney, is there any obligation on the specialist to do that under the existing rules of the exchange?

Mr. WHITNEY. There is no obligation, but that is the fairly universal practice.

Senator BARKLEY. Is there any possible conflict of interest between the specialist as a trader in his own name and in his representative capacity.

Mr. WHITNEY. There is in one regard, Senator Barkley; and if I may explain it?

Senator BARKLEY. Please do so.

Mr. WHITNEY. If a specialist has limited orders to buy stock, and let us say again to buy Steel at 50, or to sell Steel at 50½, and he buys that stock from his customer or sells that stock to his customer, both being brokerage houses representing the public, he does it only after a bid and offering in the open market so that if anybody else wishes to trade or intervene in the trade they may do so. I mean any other broker. And he has to send for the representative of the customer, the other broker, and get confirmation and approval of the trade and the price. And the contract is then entered into between the specialist and the other broker who represents the public. The individual who puts his order in to sell, let us say, at 50½, the stock which the specialist takes from him, has of his own volition and election to put that order in to sell it at 50½. To my mind I cannot think there is any conflict of interest that can enter in there, because he can only sell that stock at the price that the customer has elected to sell it at, or at a higher price. He cannot sell it at less.

Senator BARKLEY. Suppose that I, through some broker here in Washington, give an order to sell 100 shares of Steel at 50, and that

is telegraphed up to New York and is then turned over to a specialist. Suppose that specialist in his own name happens to be long of 100 shares of Steel and he sells to me his 100 shares instead of buying it on the open market. He ceases then to be a public representative and becomes simply a dealer between himself and me, doesn't he? Does that ever occur?

Mr. WHITNEY. That may occur, sir; but the fact is, if I understand your question correctly, you have elected to buy 100 shares at 50. The specialist then bids 50 for the stock and offers 100 shares at 50⅛ in the open market. And, as I say, anybody else can take his 100 shares at 50⅛ and sell to you at 50——

Senator GORE (interposing). Mr. Whitney, will you please state that again?

Mr. WHITNEY. A specialist having the order bids 50 for 100 shares and offers 100 shares at 50⅛. Any other broker may offer to take the 100 shares at 50⅛ or to sell 100 shares at 50. If anybody does, then the broker, in the instance suggested, sells 100 shares at 50. Now, as I understand it, that was your election, to buy that stock at that price, and I cannot see any conflict of interest.

Senator BARKLEY. It may not make any difference to me for I am in the market for 100 shares at 50; if he sells to me and if it so happens that the specialist on the floor at the time has 100 shares and is willing to sell them to me instead of buying 100 shares from somebody else for me. It may not make any difference to me individually, but it does seem to me to establish a dual capacity there, in which it is very hard to draw a line of demarcation between him as the representative of me, or as the go-between between me and somebody else who wants to sell 100 shares of Steel, but there is that relationship between buyer and seller that exists if he has 100 shares and I want to buy.

Mr. WHITNEY. There does exist a dual capacity, but that is surrounded by very stringent rules of the exchange, as to how he may so trade, and as I have said, I shall now repeat——

Senator BARKLEY (interposing). Of course, if he trades in his individual capacity he has to sell what he buys to somebody.

Mr. WHITNEY. Yes, sir.

The CHAIRMAN. Now, let us say that a specialist has an order to sell at 30 and an order to buy the same stock at 32. Then he can buy the stock at 30 and sell it at 32 himself, can't he?

Mr. WHITNEY. No, sir. If he has an order to sell any stock at 30 and an order to buy the same stock at 32, he cannot trade for his own account to the disadvantage of either of those customers.

Mr. PECORA. How would he execute those orders?

Mr. WHITNEY. That would entirely depend upon the market at the time.

Mr. PECORA. Well, assuming that that was the market.

Mr. WHITNEY. And that the last sale was——

Mr. PECORA (interposing). Assuming that the offer to sell was at 30 and that the offer to buy was at 32.

Mr. WHITNEY. And that the last sale, let us say, was at 30?

Mr. PECORA. Yes, sir.

Mr. WHITNEY. The presumption is that those two orders would be crossed in the technical term by the dealer at the price of 30, unless he could buy the stock at a cheaper price for the 32 buyer.

Senator BARKLEY. If he were able to sell in a coincidental transaction 100 shares at 30 while he represented a man who put in an order to buy at 32, wouldn't it be his duty to buy those 100 shares at 30 or anything below 32 that he could get the stock for?

Mr. WHITNEY. Absolutely yes; as I have said——

Senator BULKLEY (interposing). In that particular case, where he has an order to sell at 30 and an order to buy at 32 there would be nothing to prevent him from buying for his own account at 30⅛, which would give the customer one eighth more than he offered, and then to sell that stock to the other fellow for, say, 30⅜.

Mr. WHITNEY. No, sir; he could not do that. If he had an order to sell 100 shares at 30 and also had an order to buy 100 shares of the same stock at 32, those two orders would have to be taken care of before he could trade for his own account.

Senator MCADOO. That is a rule of the exchange, is it?

Mr. WHITNEY. Absolutely.

Senator GORE. In that case he would buy at 30 instead of at 32.

Mr. WHITNEY. He would buy at 30, or less, if he could, in the market for the benefit of his purchasing customer who put in an order to buy 100 shares at 32.

Senator BULKLEY. Is the general result of a specialist trading for his own account a profit to the specialist?

Mr. WHITNEY. That is very difficult to answer because I do not know the answer. I would say that if a specialist is correct in his judgment as to the trend of the markets, then he will make money. But as to whether specialists as a group have made money over the last few years, my belief is that they may have made a living or they may have lost money. At any rate, I do not know of any very opulent or rich specialists.

Senator BARKLEY. That observation might be applied to everybody else who has been in the market over the last 4 years, I take it.

Mr. WHITNEY. I do not think they are any exception to the general rule. I do not think they are any wiser than anybody else.

Senator GORE. It would seem to me that if he could segregate orders, and operate on his own account, with the direct object of making a profit in the transaction and at the same time accommodating his customers and placing himself in a position to accommodate them in the future, that that might have a part in it.

Mr. WHITNEY. I do not think I understand your question, Senator Gore.

Senator GORE. Well, I am not sure that I do myself. [Laughter.] That is the reason I am searching my mind. I am seeking the motive, and I do not know whether it exists or not. That is, whether a specialist might operate on his own account in a given transaction with the hope of getting a profit for profit's sake in that particular transaction, or that he might sometimes operate in order to accommodate customers, buying and selling, and thereby put himself in the situation to continue to accommodate them.

Mr. WHITNEY. I think your question is a double question. I, of course, grant that specialists trade for their own account in the belief that they are going to make money thereby. Now, to answer the second part of your question, it is my firm belief that specialists who trade for their own account are the ones who get orders from commission houses because such houses believe that by giving orders

to specialists who do the trading, their customers will be the better served.

Senator GORE. In regard to the second part of my question, which, as you say, may be a double question, I thought he might carry on just if he broke even, without a specific profit in a particular case, in order to carry on his business of accommodating his regular customers.

Mr. WHITNEY. I think that is often true, as well as in order to create a market.

Mr. PECORA. Mr. Whitney, the outstanding virtue that is claimed for the right of the specialist to buy and sell stock that he handles is that it enables him to keep a closer market in the stock, isn't it?

Mr. WHITNEY. Yes, sir; and to create markets.

Mr. PECORA. And to create markets.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Well, now, in view of the fact that there is no obligation upon him to buy or sell for his own account for the purpose of keeping a closer market or to create a market, what would persuade or tempt him to make a transaction in his own behalf?

Mr. WHITNEY. As I have stated——

Mr. PECORA (interposing). In other words, does he do it for the altruistic purpose of keeping the market close or of creating a market?

Mr. WHITNEY. I think he does it for two purposes, perhaps as suggested by Senator Gore; certainly because he believes in the main that he can make money, that his judgment is right, just as we all use our judgment in our business, whatever it may be, that we think we are going to be right, and yet sometimes, quite naturally, we are very wrong. So it is in the case of the specialist. And I do frankly believe that the specialist in attempting to trade for himself attempts to create a market, which is probably to the advantage of all concerned, himself included.

Mr. PECORA. Which would be altruistic.

Mr. WHITNEY. In some cases that is true without question.

Mr. PECORA. Now, in view of the fact that he might have a double motive, one being self gain and the other the altruistic purpose of preserving a more orderly market for the general public, it is pretty hard to say, isn't it, to what extent the motive of self gain or profit might prevail over the other one, the altruistic one?

Mr. WHITNEY. I grant that. And as I have already said, I think this is a very deep and involved subject and deserves tremendous study from the people who are going to pass upon it from the point of view of making the bill restrictive.

The CHAIRMAN. Isn't it true that where the specialist can make money by trading on his own account he ceases to serve other people; that he could make that profit for his customer if he saw fit to do it instead of making it for himself?

Mr. WHITNEY. No, sir. In that case the customer must of necessity get a lesser price. That is, the customer would get a lesser price if the specialist did not trade for his own account.

Senator KEAN. Mr. Whitney, I should like to ask you this question: Isn't it true that, in order to obtain orders from commission houses, a specialist often will buy for his own account; and when he is doubtful as to whether he can sell again that, in order to get

orders from commission houses, he often makes a market so as to show them that he is really doing business?

Mr. WHITNEY. Exactly. And that is what I mean by the altruistic point of view of creating the market.

Mr. PECORA. In other words, transactions undertaken in that spirit by a specialist have a tendency to build up goodwill.

Mr. WHITNEY. I think so.

Mr. PECORA. Among other brokers and the public as well.

Mr. WHITNEY. Yes. Just the same as any broker seeks to execute an order entrusted to his care to the best of his ability.

Mr. PECORA. Well, frankly, I have discussed the question of the right of the specialist to trade in stock that he handles with persons having diverse views on the subject, and it does seem to me there are benefits that would accrue to the public from the right of the specialist to buy and sell for his own account. At the same time I think that right ought to be restricted in such fashion as to either entirely eliminate whatever evils may be incidental to that right, or restrict him as much as possible. Now, Mr. Whitney, could you suggest any formula by which that can be done? In other words, by which the benefits that flow from the right of the specialist to buy and sell for his own account could be preserved and the evils or incidental evils that may arise therefrom could be eliminated or restricted?

Mr. WHITNEY. Well, Mr. Pecora, I regret to state that the answer to that query is no. We have done everything we know by way of restricting trading by specialists to the end that the basis of such trading may be proper. If you will tell us, or if anybody else will tell us, what further should be done in that regard so that a specialist might still have the ability to create markets by trading for his own account we will be indeed grateful. But after years of the most serious consideration of this subject we do not know of any system that could be put into effect upon the floor of the exchange which would be better than the present system.

Mr. PECORA. Suppose you were to adopt a rule making it obligatory upon the specialist to report at the end of each day his own trades in the stock he is specializing in, I mean his trades for his own account. Is there such a rule in existence now?

Mr. WHITNEY. No, sir.

Mr. PECORA. Well, do you think that the adoption of such a rule might help toward reaching that desideratum?

Mr. WHITNEY. Mr. Pecora, you must have some idea in mind in asking such a question, so I can only answer by asking you what you think will help. We are seeking light.

Mr. PECORA. I am merely advancing a thought. I think you are better qualified to arrive at a judgment as to whether or not the thought if consummated, the idea if consummated, would be helpful.

Mr. WHITNEY. I do not quite see how it could be done. If you will explain what your idea is, perhaps I will get a better idea of what you have in mind.

Mr. PECORA. In this sense, that if the business-conduct committee of the New York Stock Exchange, for instance, were to have furnished to it every day a statement by each specialist of his trades for his own account, the members of that committee might be enabled thereby to determine fairly and equitably whether or not the trades were calculated to benefit the public more than otherwise;

and if a specialist's transactions as reported by him showed a too direct tendency in favor of self-gain on the part of the specialist, they might make suggestions to him that he abate a little bit in his trades, and so forth, at given times.

Mr. WHITNEY. If what you have in mind is to be used as a basis for further study of this entire subject, possibly that might do some good. But may I impress upon you that if a specialist trades for his own account in reference to any order that he has, that is, if he takes stock on sale at 50½ because he has an order to sell it at that price, he must send for the broker who gave him that order, or the representative of that broker, who has to come to the specialist, and he has it within his power and it is his obligation to inquire as to the time when that trade was made, find out if the price was fair in keeping with the market, and must confer and approve that trade on behalf of his customer; and thereby at that time he makes a contract with the specialist that he has sold to the specialist on behalf of his customer 100 shares of Steel, let us say, at 50½. Now, it is my opinion that——

Senator GORE (interposing). Mr. Whitney, will you please state again the first point in your proposition, the first assumption about the transaction?

Mr. WHITNEY. The broker who gave the specialist the order to sell 100 shares of United States Steel, let us say, at 50½, or the broker's representative, must go to the specialist's post, and he, representing and acting for the customer, who is an individual of the public, you understand——

Senator GORE (interposing). Yes; the man who wants to sell the stock at 50½.

Mr. WHITNEY. Yes. He goes to the specialist, from whom he has had a message: Please come regarding so-and-so. And then upon his being assured, I mean the broker being assured in his own mind that the price was fair and in keeping with the market, says, "I agree to sell you 100 shares of Steel at 50½", thereby giving his confirmation and approval to the trade, and making a contract on behalf of his customer.

Senator BARKLEY. Does the specialist ever execute orders that are not limited, market orders?

Mr. WHITNEY. Yes, sir; particularly at the opening of the markets, particularly, sir, when the floor broker gives him an order to execute at the market, because the floor broker has the belief that the specialist can execute that order in the interest of the floor broker's customer better than the floor broker could do it himself.

Senator BARKLEY. Well, now. is this possible through a specialist? Suppose a specialist happens to have a number of shares of Steel that, let us say, he has purchased at a price below 50, and he wants to sell them as high above 50 as possible when he gets out, and he has an order to execute for some purchaser at 50. Does the self-interest of the specialist impel him to try to run that Steel up sufficiently high to enable him to make a personal profit, with the result that his customer would not be able to buy it at 50? Could that happen?

Mr. WHITNEY. If I understand you correctly, the specialist could buy stock at 50⅛, 50¼, 50⅜, 50½, if he wanted to; yes.

Senator BARKLEY. But that is not my point. I am asking if the specialist might be deeply enough interested in the stock because of its own performance, either prior or concurrently, that through his own efforts to make a profit himself he could be instrumental in advancing the stock sufficiently, rapidly, and high so that the man who had put an order in at a given price might not be able to have it executed, and in that way there might be a conflict between the specialist's personal interest and his representative interest.

Mr. WHITNEY. He could not do that without buying stock.

Senator BARKLEY. He has already bought it.

Mr. WHITNEY. But he has got to buy some more in order to influence the price and make it higher.

Senator BARKLEY. That is true; he could do that?

Mr. WHITNEY. That he could do. But he has got to get out of that stock——

Senator BARKLEY. If it goes up otherwise than by his own efforts, he is not responsible. But I am wondering if he might be so interested in the stock, because of its own performance, either prior or concurrently, that in order to make a profit himself he might be instrumental in advancing the stock so that the man who had put an order in at a given price might not be able to have it executed, and in that way cause a conflict between the specialist's personal interest and his representative interest.

Senator KEAN. Is it not true that if he advances the price and the stock sold at the price that he also had an order in for, he would be obliged to put it in at that price?

Mr. WHITNEY. Yes, sir.

Senator BARKLEY. Is your answer to my question "yes" or "no"?

Mr. WHITNEY. The answer is, I think, yes; that he might buy stock at a higher price than the limited order that he has on his books, but of course he is accumulating stock at the same time and he has got to get rid of it again some time, and the seller gets a better price.

Senator BARKLEY. Of course; but the man who wanted to buy at a given price has been deprived of the opportunity because the specialist may have advanced the stock beyond the price where he could buy it.

Mr. WHITNEY. That is true, Senator Barkley. So may any other individual who came in and wanted to buy. But as I see it, the individual who puts the order in to buy 100 shares at 50 elects to do so; and if that stock sells at 50 he will pay that much. So what happens in the market other than selling at 50 is of no particular interest to that particular man.

Senator BARKLEY. If the market went only at a normal pace without any artificial stimulation, he might get his stock at 50; but if the specialist happens to be long or thinks it is going to advance so he can make a profit and so he is encouraged to purchase for his own right, he might create a situation where the customer, who in a normal situation would be getting his stock at 50, because of this artificial stimulation could not get it at 50?

Mr. WHITNEY. I grant that it might happen; but the specialist is taking a very real risk in buying in that additional stock.

Senator BARKLEY. Let me ask one other question. How is the specialist compensated?

Mr. WHITNEY. He is compensated by a floor brokerage set by the exchange, which varies somewhat with the price of stock.

Senator BARKLEY. Is it a sort of commission basis?

Mr. WHITNEY. It is a commission basis; for the execution of every order per hundred shares he is paid a certain commission.

Senator BARKLEY. Who pays him that?

Mr. WHITNEY. The broker who gave him the order.

Senator BARKLEY. Is that a part of the commission that the broker charges the customer, or is that added to it?

Mr. WHITNEY. It is a part of it. In other words, the customer pays $15 a hundred, let us say, for the execution of the order for 100 shares of Steel at 50. If the house to whom the customer gave that order gives it out to a floor broker or to a specialist, and the order is executed, the house pays $2.50 to the floor broker or specialist.

Senator GORE. Let me ask you this: Is the primary function of a specialist in a way to match the bids and offers that come in from customers, to try to join their minds and hands and enter into a consummated transaction?

Mr. WHITNEY. Yes; partly, sir.

Senator GORE. Apart from that, he gets an offer but has not got a bid. Then he can trade on his own account, can he not?

Mr. WHITNEY. Yes, sir.

Senator GORE. And if he has both buyers and sellers it is his first duty to bring them together into the transaction; is that true?

Mr. WHITNEY. Yes, sir; if they can be brought together.

Senator GORE. And he cannot figure on his own account in that sort of a situation until that situation has changed?

Mr. WHITNEY. Not if his buyer and seller can get together first; no, sir—if I understand you correctly.

Senator MCADOO. I just want to say, Mr. Chairman, that I am obliged to go to the Finance Committee, and I will ask you to excuse me.

Senator GORE. I have to go too, Mr. Chairman.

Senator KEAN. I would like to ask you this question in connection with Senator Barkley's question. Suppose the market is 49¾ and a man puts an order in at 50. The specialist cannot buy——

Senator GORE. Is that an order to buy, or sell, Senator? Pardon me.

Senator KEAN. An order to buy. The specialist cannot buy for his own account at 50; he must take the order that the customer put in to sell at 50; is that right?

Mr. WHITNEY. I think I will have to ask you to repeat that, Senator Kean. I do not think I followed it.

Senator KEAN. If the market is 49¾ for Steel, bid, and you put in an order at 50 to buy 100 shares at 50, the specialist cannot bid that stock up to 50¼ because if the stock is sold at 50 he must put the order in at 50 for the customer?

Mr. WHITNEY. If I understand you correctly, Senator, the bid in the original case is 49¾?

Senator KEAN. Yes.

Mr. WHITNEY. Then an order comes in to buy 100 shares at 50. The specialist may not buy stock for his own account at 50 until he has bought the stock for his customer at 50.

Senator GORE. But he would not be allowed to buy at 50 even if the price is 49¾?

Mr. WHITNEY. If he has a bid of 49¾ and that is the best bid he can get, he can buy for his own account above 49¾. He may not buy at 49¾ until his order is executed.

Senator GORE. But as I understood Senator Kean's question, suppose the price was 49¾ and the specialist received an order to buy at 50 for his customer: would he be allowed to do that?

Senator KEAN. No; the specialist cannot buy.

Senator GORE. But would he be allowed to buy for the customer?

Senator KEAN. I am talking about Senator Barkley's position. He made the proposition that the specialist could bid this stock up to 50¼ for his own account. I say that if he bid it up over 49¾ and past 50 he would have to take all the stock offered at 50 before he could make the quotation above 50.

Mr. WHITNEY. That is correct.

Senator GORE. I misunderstood your question, sir. I thought you said that if the price at the last sale was 49¾ and he had an order to buy at 50. I do not see why he would execute that order unless somebody was going to try to move the market up.

Senator KEAN. Senator Barkley's position was that the specialist could buy this stock up for his own account without taking the orders on the way. That was the point.

Mr. WHITNEY. He certainly would have to take all stock that was offered to him or that he had on his books on the way.

Mr. PECORA. Does a specialist receive so-called "discretionary orders"?

Mr. WHITNEY. Sometimes, sir; yes.

Mr. PECORA. Would you mind defining discretionary orders as distinguished from fixed price orders or market orders or limited orders?

Mr. WHITNEY. May I give an instance?

Mr. PECORA. If you will. That probably would be the best exposition of the term.

Mr. WHITNEY. Supposing the customer of a house had 10,000 shares of stock to sell and the ruling price of the stock was around 30. He might say, "I will give an order; if you can sell this stock for me at 30 or better, use your discretion." That same order might be handed over to a specialist, and the specialist, as he felt in his judgment the trend of the market might be upwards, would sell that stock at 30 or at a price higher than 30.

Mr. PECORA. And likewise with the buying?

Mr. WHITNEY. Yes; likewise with the buying. The same discretion, Mr. Pecora, exists in any market of a sufficient size to warrant discretion.

Mr. PECORA. There have been evidences submitted to this committee, and doubtless you are familiar with some of them, anyway, where specialists have been participants in pools or syndicate accounts to trade in the stock that is to be handled as a specialist. That is true, is it not?

Mr. WHITNEY. I believe so, in the past.

Mr. PECORA. Under the rule which was adopted by your exchange on February 13 a specialist is no longer permitted to be a participant in a pool or joint syndicate account; is not that a fact?

Mr. WHITNEY. Yes, sir; that is correct.

Mr. PECORA. I presume that the adoption of that rule was due to knowledge that had come to the governing authorities that specialists in the past had been participants in pools or joint or syndicate accounts?

Mr. WHITNEY. I presume so.

Mr. PECORA. And the board of governors I also presume felt that the conditions required the adoption of the rule they put into effect a little over 2 weeks ago, prohibiting a specialist from being a participant in any such pool, joint or syndicate account in the stock he specialized in?

Mr. WHITNEY. I presume so; yes.

Mr. PECORA. You said that one of the useful functions of a specialist is that of making the market or creating the market?

Mr. WHITNEY. Creating a market; yes, sir.

Mr. PECORA. What is to prevent a specialist from creating a market in a manner calculated to improve his own position or interest?

Mr. WHITNEY. By buying stock or selling stock?

Mr. PECORA. By trading for his own account; yes, sir.

Mr. WHITNEY. I do not suppose that if that is done so as not to unfairly influence the market, there is any prohibition against it. He takes a risk whenever he buys or sells, as we all do.

Mr. PECORA. But specialists who have been examined here—one of them, at least, indicated very frankly that because he was a specialist he could tell the trend from the orders that he had on his books. Knowing the trend, that gives him a very substantial advantage in trading in stock for his own account.

Mr. WHITNEY. He was a very boastful man, sir.

Mr. PECORA. He might have been boastful, but I think perhaps his own performances, as admitted by him here, show that it was not an idle boast in his case.

Mr. WHITNEY. May I ask the gentleman's name?

Mr. PECORA. Mr. Wright.

Mr. WHITNEY. Did he not tell the committee that when he had some 50,000 shares currently to sell at the market he was long on stock for himself? Would that point out that his judgment was affected by the orders he had on his books or that he had gone contrary to them?

Mr. PECORA. He went even a little bit further than that in his testimony here. To refer to his language, he said he was "murdered" at one time.

Mr. WHITNEY. Yes.

Mr. PECORA. But nevertheless, despite the assassination, it left him $138,000 to the good, net, which I think rather demonstrates that it was not an idle boast on his part that he could tell the trend of the market from the orders on his books.

Mr. WHITNEY. He undoubtedly had been right in that instance.

Mr. PECORA. Now, if the specialist were required——

Mr. WHITNEY. I take exception, sincere exception, to that.

Mr. PECORA. To what?

Mr. WHITNEY. That he could tell the trend of the market by the orders on his books; and I don't think Mr. Wright made any such statement.

Mr. PECORA. What statement do you think he made?

Mr. WHITNEY. I think he said he was correct in his judgment of the trend of the market, but not that his books showed it. There I disagree, sir.

Mr. PECORA. We can refer to his testimony on that. I will not stop now to hunt it up, but I will later on, so that there will be no shadow of doubt between us as to just what he said.

Mr. WHITNEY. I am not questioning what he said specifically, but my contention is that it was not what his book told him as to the trend of the market; it was his general knowledge.

Mr. PECORA. His general knowledge was based, at least in part, on the orders he had on his book?

Mr. WHITNEY. At least in part; yes.

Mr. PECORA. So that the orders on his book made a contribution to his general knowledge that enabled him to determine the trend and to determine it so accurately in the instance that we have in mind that he certainly profited very substantially, despite the fact that he was slaughtered or murdered, to use his expression, on July 18 last.

Mr. WHITNEY. I think you are using a very strange example to prove your case.

Mr. PECORA. A strange example?

Mr. WHITNEY. Yes, sir. When a man has thousands and tens of thousands of shares of stock to sell at a price, and in spite of that he goes considerably long in the stock, you think that is an invariable rule of information to the specialist?

Mr. PECORA. Have I said it was an invariable rule of information to the specialist?

Mr. WHITNEY. You implied it, sir.

Mr. PECORA. I am merely telling you what Mr. Wright testified to.

Mr. WHITNEY. I claim that it was his experience and not——

Mr. PECORA. That was the very evidence adduced here.

Mr. WHITNEY. I claim, sir, that it was his experience and that showed him the trend, and not what his books showed him necessarily.

Mr. PECORA. You admitted just a few moments ago that the knowledge that he had from the orders on his book was a contribution to his knowledge of the trend.

Mr. WHITNEY. It might be in part; yes, sir.

Mr. PECORA. Don't you think that if a specialist were required to report to the governing committee or some other suitable authority of the exchange his daily transactions, the governing authorities would be in a better position to determine how far his own transactions were actuated by self interest or desire for self gain and how far they contributed to the maintenance of a fair market in the public interest?

Mr. WHITNEY. If you believe, Mr. Pecora, that there would be some advantage, I am readily glad to take your advice.

Mr. PECORA. I am not offering any advice, because I would not be so presumptuous. I have not had any experience on the exchange.

Mr. WHITNEY. And yet you wrote this bill?

Mr. PECORA. I wrote the bill? I sat in at the conference and made my modest contributions to it. I think, however, that the evidence that has been presented to this committee in the past year or two

would qualify almost any person possessed of knowledge of that evidence to make suggestions with regard to the evils which should be curbed, eliminated, or restrained.

Mr. WHITNEY. Certainly, sir; but as I understand it——

Mr. PECORA. That there are evils is readily acknowledged by you and by your confreres. That we agree in large part upon those evils and are able to designate them, I think, must be conceded, too. The only question, then, is how to deal with the evils. I am merely submitting to you now for your consideration—you can trample on it all you want; I have no pride of opinion about it—the thought of having specialists, if they are to be permitted in the public interest to buy and sell for their own account, report their trades daily to the governing authorities of the exchange so that those authorities would be in a better position to determine whether or not the specialists trading have functioned in the public interest at any given time or period of time, and, if they have not, they may make appropriate suggestions, if you please, to the specialist that would cause him to modify his way.

Is there anything wrong with that; or are there any disadvantages that would flow from the adoption of that rule?

Mr. WHITNEY. I do not think so, Mr. Pecora. The bill prohibits specialists trading.

Mr. PECORA. I am now seeking to get your judgment as the judgment of a seasoned, experienced mind, on the matter of preserving to the specialist by appropriate revision to the bill the right to trade for his own account and at the same time in a manner that would not be detrimental to the public interest.

Mr. WHITNEY. I am in entire accord.

Mr. PECORA. I have already indicated, Mr. Whitney, that the thought that I have personally given to this subject has left me somewhat in doubt as to whether or not a specialist should be permitted to trade for his own account.

Mr. WHITNEY. I have suggested, and I think, entirely admitted, that this is a subject upon which there are very real differences of opinion; and if your suggestion in your belief would bring further light to the subject, it might be very wise to do it. But you appreciate that it would be a considerable task upon the specialist or his office. It would not be in the hands of the business conduct committee until well after the fact. It would then have to be compiled. Whereas specific cases are immediately available to the business conduct committee at the present time if there is thought on their part that the specialist has misused his rights.

I am entirely open-minded on any suggestion that is going to shed more light on this question of the specialist trading for his own account. I believe he should be allowed to do so; but we grant that there are other points of view, and we therefore believe that thorough and sincere study should be made on the subject as we have suggested.

Mr. PECORA. Frankly, I think the right of a specialist to trade for his own account is neither an unmixed evil nor an unmixed blessing.

Mr. WHITNEY. Quite right.

Mr. PECORA. I am trying to get a formula that will preserve the blessings and minimize the evils.

Mr. WHITNEY. We are with you there, entirely.

The CHAIRMAN. Do you know from your experience whether it would be practicable to require a specialist to report daily to the committee?

Mr. WHITNEY. Whether it would be practicable?

The CHAIRMAN. Yes.

Mr. WHITNEY. Well, as I said, Mr. Chairman, it would mean more work upon them; and I think that such things should be considered, as to whether in asking them or requiring them to do so any benefit would result. It is entirely within the power of the exchange to demand that, of course, if that is what you mean.

The CHAIRMAN. Not only that, but maybe we are requiring a thing to be done that cannot be done. I do not know how much work these specialists have to do or whether it would be possible for them to make daily reports.

Mr. WHITNEY. It would be possible; yes.

Senator KEAN. But it would probably require another clerk on their part?

Mr. WHITNEY. It might well do so, during times of activity; yes.

I am not trying to advance any argument against it, except the slight one that it would be additional work; and I think there are so many reports demanded now, that, unless good would result, I think it would be harsh to require it. Good might result.

Mr. PECORA. I was merely advancing it for your consideration and I was rather hopeful you would be able to give us your judgment on it now. But if you think it requires further thought on your part, of course you should have the opportunity of giving it further consideration and deliberation.

Mr. WHITNEY. I think it would, Mr. Pecora.

The CHAIRMAN. Now we will proceed with the bill.

Mr. WHITNEY. Sections 11, 12, and 13 of the bill deal primarily with questions which affect listed corporations. In that connection it is my understanding that there may be representatives of these corporations appear before you to show their side of the question. Particularly with relation to section 13, I had planned to tell you the real hardship the proxy rule would bring upon corporations, but Mr. Corcoran admitted that he thought it a hardship, too; so I will forget it.

Senator GOLDSBOROUGH. Are not sections 15, 17, and 18 in the same category?

Mr. WHITNEY. A similar category.

Senator GOLDSBOROUGH. They all have an effect upon American business enterprise?

Mr. WHITNEY. Very much so.

I do want to say for the record, please, that Mr. Corcoran referred to my statement before the House committee to the effect that I said any corporation with a $5,000,000 capital might have to pay between $500,000 and a million dollars per year for auditors, as required under the bill. That was said in answer to a question which I may have misunderstood; but in any event my answer was made in the light that even a corporation of that size might be engaging in a type of business which would involve such a very high cost of audit—I was not seeking to exaggerate—it will be a large cost because of the necessity of independent audits quarterly.

Mr. PECORA. How about independent audits semiannually or quarterly reports? That is, every 6 months, with a quarterly report submitted, audited, and the other two quarterly reports not audited?

Mr. WHITNEY. Mr. Pecora, this is my personal opinion: I am very shortly going to ask Mr. Altschul to state certain opinions and facts to the committee, with the permission of the committee; but my personal opinion is this, that an independent audit once a year by a corporation gives enough of the auditing aspect to the public. If you demand an independent audit semiannually or quarterly——

Mr. PECORA. We will say, semiannually.

Mr. WHITNEY. Semiannually—the value of that to my mind is going to be largely lost to the public. I am informed by the American Telephone & Telegraph Co. that if they had to give an audit quarterly—we will apply it semiannually—an independent audit quarterly, that for the first quarter of this year ending on March 31, they could not possibly have it in the hands of the public until July or August of this year. A balance sheet, something prepared by themselves, with truth, naturally, and not subject to the necessary review of an independent auditor, could be put in the hands of the public far more promptly. As I see it, the benefit that you and we are striving for is that the public shall have currently the facts with regard to corporations. We are in entire agreement with that.

Mr. PECORA. Mr. Whitney, in taking the example of the American Telephone & Telegraph Co., are you not taking a rather extreme case and seeking to generalize from its base?

Mr. WHITNEY. It is an extreme case, without question; but I believe, sir, that certainly our experience—but I would like to ask you to hear Mr. Altschul, because he knows far more about it than I, he being chairman of the committee on stock list. But company after company, not of great size, where they have to present to the exchange independent audits, insofar as my knowledge and belief are concerned, do not give them to us for some months after the period which they cover they are set. The same thing is true of our own questionnaires of firms.

They are always set for the last day of the month or the first of the next month, and they do not have to be filed until the 20th of the month, and in many, many instances with the larger houses they ask for 10 days' or 2 weeks' extension because of the physical impossibility of the individuals compiling such documents.

Mr. PECORA. You recognize that when a corporation lists its securities on an exchange it impliedly extends an invitation to the public to become partners in its business, so to speak?

Mr. WHITNEY. I grant that; yes.

Mr. PECORA. It invites them to buy its shares and thereby become part owners of the business.

Mr. WHITNEY. It places its shares in position to be bought. Quite right, sir.

Mr. PECORA. And when such an invitation is extended to the public, you agree, I presume, in principle at least, with the thought that such a corporation should be required to give definite information at frequent enough periods so that the public that by implication

is invited to buy its shares and become a part owner of its business, might with more intelligence buy its shares?

Mr. WHITNEY. You and I are in entire agreement; yes.

Mr. PECORA. Then the only question is in what form that information, and how frequently that information, should be conveyed to the public.

Mr. WHITNEY. So that it will not work an unfair hardship on the company and upon the shareholders who own the company.

Mr. PECORA. In order to keep the investing public that is invited to buy the shares not too much in ignorance.

Mr. WHITNEY. Or, sir, to give them information that is current. I think you used the word "current."

Mr. PECORA. Yes.

Mr. WHITNEY. And independent audits would delay that current aspect of the facts regarding the company which you wish to give to the public.

Mr. PECORA And they would also have a better check, would they not, on the soundness of the information?

Mr. WHITNEY. I am not at all sure, unless you believe that fraud is practiced by our companies.

Mr. PECORA. I am afraid that we are impelled to that belief, in the light of evidence that this committee has heard within the last fortnight.

Mr. WHITNEY. That is not fair. All American companies? That is a harsh statement.

Mr. PECORA I did not say "all American companies."

Mr. WHITNEY. You are predicating your statement on fraud, though, as I see it.

Mr. PECORA. I know and Mr. Altschul knows, because he was in this room when the evidence was submitted to this committee in the past fortnight, that such frauds have been perpetrated.

Mr. WHITNEY. Mr. Altschul will be here in a minute. I cannot speak for him.

Mr. PECORA. But Mr. Altschul has already expressed to this committee his opinion, based upon the evidence that he heard here.

Mr. WHITNEY. Then it is a matter of record.

Mr. PECORA. I am not making a general accusation that all corporations are engaged in the practice and custom of peddling out or giving out false information. I do not believe that for one minute. Neither do I believe that corporations' officials become sacrosanct and free from all the frailties of human nature merely because they become corporation officers. We pass laws prohibiting the commission of certain acts which we define to be crimes in the public interest; not because we believe that all men are criminals.

Mr. WHITNEY. We advocate just such laws, and have done so for a long time. A year ago today, as I stated to this committee, you will remember——

Mr. PECORA. But if these reports are audited either quarterly or semiannually rather than annually, don't you think that the auditing of the reports would give greater assurance with respect to the authenticity, accuracy, and reliability of information that you admit the public should have?

Mr WHITNEY. Assurance, yes; current knowledge, no.

Mr. PECORA. Current knowledge or information, unless it is honest, is apt to do more harm than good, is it not, because of the false reliance that the public places upon it?

Mr. WHITNEY. Mr. Pecora, even accountants may not be honest.

Mr. PECORA. We are not going to enter into a discussion about the frailties of human nature.

Mr. WHITNEY. But you are right in that discussion now with respect to certain corporation officers.

Mr. PECORA. We have evidence to base my observation on, Mr. Whitney.

Mr. WHITNEY. I am not denying it.

Mr. PECORA. I am not making an idle statement when I say it is based upon evidence presented to this committee within the last 2 weeks.

Mr. WHITNEY. That is granted, of course; one case.

Mr. PECORA. The one case we investigated, Mr. Whitney. I could cite others.

Senator GOLDSBOROUGH. But it does not follow that we have discovered that everybody is dishonest.

Mr. PECORA. Certainly not; and I have been very careful to maintain that. I do not say, because the American Commercial Alcohol board gave information to the stock list committee of the stock exchange last summer on at least three occasions that did not square with the facts, that all corporations do that thing; certainly not.

Senator GOLDSBOROUGH. No. I quite agree that you are not making the implication go that far, I am sure.

Mr. PECORA. No. But if the public is invited to subscribe to shares of a corporation through the facility of having those shares listed on a public exchange, I submit that the public should be safeguarded as much as it can reasonably be accomplished in the information which is given to it and that it would enable the public to arrive at an intelligent judgment.

Mr. WHITNEY. We absolutely agree.

Mr. PECORA. Then, the only question is whether these reports should be audited once a year or twice a year?

Mr. WHITNEY. Yes, sir. Well, let us say four times, by the bill.

Mr. PECORA. I am now suggesting my own thought on the matter when I say twice a year rather than four times a year.

Mr. WHITNEY. And we are in no disagreement, as I believe, in that regard. The first question to be solved is whether it is too great a hardship or not.

Senator KEAN. But if this audit—and they do take long periods of time, I know—if this audit takes 4 months or 3 months, a great deal could happen to a company before the public would know what happened to it through an audit?

Mr. WHITNEY Too much can happen; yes, sir.

Senator KEAN. So would it not be a good thing for the public—we are trying to protect the public—if the company submitted its statement promptly every quarter or every 6 months, and then that they also had that statement checked by an auditor? Would not that be a good suggestion?

Mr. WHITNEY. I think all these questions resolve themselves on two points: The unfair hardships that might result to the corporation and then, too, to its shareholders who are the public. Let us not

forget that. Any money the corporation has to pay is out of the shareholders' pockets.

And number 2: Whether or not the information given will be current enough so that it will be of value to the investing public. It all resolves itself, as I see it, in the last analysis, on what is to the best interest of the public; and you and I, Mr. Pecora, I think entirely agree.

Mr. PECORA. I think so.

The CHAIRMAN. Very well. We will pass from that.

Mr. WHITNEY. Now, Mr. Chairman, with your permission, may I ask Mr. Altschul to make a statement in regard to the listing requirements of the exchange which affect very generally these particular sections?

The CHAIRMAN. I think that would be in order. We have had Mr. Altschul before us.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Mr. Altschul's prior appearance had to do with certain limited acts and transactions. Now, I think Mr. Altschul is being offered to give the committee, from his own judgment and experience, his views with regard to these particular provisions of the bill.

STATEMENT OF FRANK ALTSCHUL, CHAIRMAN, COMMITTEE ON STOCK LIST, NEW YORK STOCK EXCHANGE, NEW YORK, N.Y.

Mr. ALTSCHUL. Mr. Chairman, I have prepared a brief statement which, with your permission, I would like to read to the committee. [Reading:]

I would like to submit to you herewith a document covering the organization and work of the committee on stock list, the listing requirements of the exchange as they exist today, and an account of the changes in listing requirements and policies of the committee which have been made from 1926 to December 1933.

This material has been assembled on short notice; it is at present in process of correction and revision With your permission, as soon as this work is completed we shall furnish you with copies in their final form. This material has been brought together in order to make available to you in convenient form the fullest possible information

I would like to draw your particular attention to the section entitled "Outline of Revisions and Extensions, etc" The reason I do this is because this section will serve to give you some indication of the extent to which my committee has been engaged in a continuing effort to accommodate its listing requirements, agreements, and policies to the ever-changing aspects of American corporate procedure.

You will note a reference to action of the governing committee taken on January 27, 1926, in the matter of the issue of common stock without voting power. This device was being increasingly used to lodge control in small issues of voting stock, leaving ownership of the bulk of the property divorced from any vestige of effective voice in the choice of management

The committee felt that this tendency ran counter to sound public policy, and accordingly decided to list no more nonvoting common stocks. With this action of the committee, the period of the creation of nonvoting common stocks came to an end.

The section to which I refer contains a running account of such endeavors on our part. In a growing and developing economy like our own, corporate procedure is ever changing and at times its changing nature is accompanied by experiments of a character which require close scrutiny and sometimes prompt action if the public interest is to be served. To keep abreast of such developments, and occasionally possibly to anticipate them, requires a high degree of flexibility. In my opinion, this flexibility is most readily found in some such body as the committee on stock list, and such a committee is

peculiarly well adapted to consider and to resolve new problems as they arise because it is composed of men who are in intimate and daily touch with the world of business and finance.

I believe that flexibility in the formulation of these rules is of the utmost importance. Rules in this domain must of necessity be capable of adaptation to conditions which change from day to day. A statute crystallizing in law the rules of today may be utterly ineffectual to deal with the conditions of tomorrow. Such rigidity might easily obstruct the normal development of American corporate procedure where the object should be not to obstruct but to influence, in the public interest, the direction of such development

Notwithstanding the efforts made by the comm ttee on stock list, evidence of which you will find in the document which I have placed in your hands, we recognize that there is much that we have not been able to accomplish. One of our difficulties has its roots in the lack of uniformity in the corporation laws of the various States The competition between States in this field is a matter of common knowledge, and the tendency of many States to liberalize the provisions of corporate charters with a view to making their laws attractive for the incorporation of companies has led to practices which have often given us concern At times we have been able to resist such practices with a fair degree of promptness, but more often we have had to wait until, either as a result of our efforts or otherwise, public opinion had developed to a point where it would support determined action on our part

The remedy for much of this we have long felt lies in a Federal incorporation statute. We recogn ze the enormous political difficulties in the way of such legislation, but the importance of it from the point of view of the protection of investors generally is so great and the advantages of it are so obvious that we would, with all respect, like to urge upon you the desirability to having this question fully explored

Such an act would, for instance, furnish the means of clarifying and codifying such complicated questions as those growing out of preemptive rights, stock dividends, the par value of stock, or stocks of no par value It would permit the development and imposition of uniform methods of accounting within industries, a matter of great importance to investors generally. Furthermore, it would permit the general adoption of a desirable and simple provision to the effect that auditors should be responsible to the stockholders of a corporation rather than to its management, and should only be removable after a full hearing before a stockholders' meeting

Instances of deliberate misrepresentation in connection with listing applications have, insofar as we know, been camparatively rare, that they have occurred, however, admits of no dispute We are sympathetic to legislation providing penalties for false statements contained in listing applicat ons or in documents submitted in support of these; and I believe that such legislation would not alone be helpful to us in the work that we are trying to do but would prove an enormous safeguard to the investing public. Legislation which will act as a deterrent and will at the same time provide adequate punishment for transgressors—taken in conjunction with such legislation as I have suggested above—will, I believe, be most effective to accomplish the purposes which are being sought in the relevant sections of the bill Regulation which takes the form of an attempt at continuing supervision of corporate activities in order to prevent every conceivable kind of fraud will, in my opinion, not only fail to prevent fraud but will of necessity hamper the conduct of honest business

I have come prepared, Mr Chairman, to make a complete statement to you in regard to those provisions of the bill under consideration which relate most directly to the work of my committee If your time permits I would like very much to read this statement to you now, in order that you may have an opportunity of questioning me fully in regard thereto in case you care to I believe that such a discussion would prove most helpful to all concerned.

Now, Mr. Chairman, I have a statement dealing with the sections of the bill in detail, which I will hand to you for your convenience.

The CHAIRMAN. Very well.

Mr. ALTSCHUL. I believe some of these points have already been covered, and it may be expedient if when we get to them I skip over them.

Mr. Pecora, I will be very glad if you interrupt at any time in this statement to discuss the particular matters that we happen to be on.

Mr. PECORA. Mr. Altschul, would you pardon postponement of your reading of this statement just long enough to enable me to ask you one or two simple questions with regard to the statement you just read?

Mr. ALTSCHUL. Certainly.

Mr. PECORA. You say:

> Instances of deliberate misrepresentation in connection with listing applications have insofar as we know been comparatively rare, that they have occurred, however, admits of no dispute. We are sympathetic to legislation providing penalties for false statements contained in listing applications or in documents submitted in support of these; and I believe that such legislation would not alone be helpful to us in the work that we are trying to do, but would prove an enormous safeguard to the investing public

When you made that statement did you have in mind State legislation or Federal legislation?

Mr. ALTSCHUL. This statement was made in connection with a discussion of the Federal statute, and what I had in mind was that some of the benefits which you are obviously seeking in that statute, and with which we entirely agree, you would find a way to incorporate something in the statute which would cover. I am not a lawyer.

Mr. PECORA. You had in mind the Federal legislation?

Mr. ALTSCHUL. I was discussing the bill.

Mr. PECORA. Do you recognize that State legislation would be comparatively ineffectual?

Mr. ALTSCHUL. I recognize the difficulties, but I am not a lawyer. I am a layman. I cannot deal with the legal questions very thoroughly.

Mr. PECORA. And just one other question: In your reference in this statement to the efforts in the past made by the Committee on Stock List to keep off the board of your exchange stocks that contain no voting power, does that include voting trust certificates?

Mr. ALTSCHUL. It does not include voting-trust certificates.

Mr. PECORA. Do you recognize that that is a species of security which for a limited period of time at least deprives the purchasers, the stockholders, the public in other words——

Mr. ALTSCHUL. Quite right.

Mr. PECORA. Of an effective voice in management?

Mr. ALTSCHUL. Quite right.

Mr. PECORA. And it is an evil comparable to the one of nonvoting stock, except that the evil is limited as to time?

Mr. ALTSCHUL. No, sir. I think there is another important difference there. In the case of a nonvoting stock the purchaser buys an instrument that has been deprived of a vote in perpetuity right at the start of the operation.

Mr. PECORA. Yes.

Mr. ALTSCHUL. In the case of the voting-trust certificate it generally comes into being as a voluntary exchange of the voting-trust certificate for a stock certificate that had the voting power, and presumably the holder of the stock certificate who makes that exchange is making it for considerations that seem to him persuasive.

Mr. PECORA. How about the case of the Pennroad Corporation?

Mr. ALTSCHUL. Well, I am not familiar with the case of the Pennroad Corporation.

Mr. PECORA. Their certificates are listed, are they not?

Mr. REDMOND. Not listed on the New York Stock Exchange.

Mr. ALTSCHUL. I am not familiar with that.

Mr. PECORA. Then they are on the Curb, and I think they are listed on one of the New York exchanges.

Mr. REDMOND I think they have been dealt in on the Curb.

Mr. PECORA. Those were voting-trust certificates at the outset.

Mr. ALTSCHUL. There are two fundamental distinctions. In the case of the voting trusts the laws of the various States on voting trusts are set up providing limits of time at the end of which the stockholder again returns to his former status.

The second point is that in a great many cases and in most of those that we have seen in the stock exchange, voting-trust certificates are issued in exchange for the stock and the exchange was made voluntarily by the stockholder, who exchanged his voting right for what he considered to be a good reason, and there are at times good reasons of that sort.

We do not feel that that has any of the same general implications that the nonvoting stock has.

I shall attempt to place before you my views concerning those provisions of the proposed legislation which relate most directly to the work of my committee. I find myself in accord with certain of these provisions. As I shall point out in detail later, others appear to me to go much too far and to be of such a nature as to suggest the possibility that they may defeat the purposes of the measure.

I am heartily in favor of such measures as will afford the maximum degree of protection to the investing public. The efforts of the committee on stock list have constantly been directed to this end. While I feel that in the main these efforts have been constructive and helpful, I would be the last one to suggest that further progress cannot be made. To the extent to which the provisions of this bill represent such further progress, these provisions of course meet with my approval.

Briefly, the committee on stock list has developed certain standards and requirements which must be satisfied by applicant companies if their securities are to be eligible for listing at all. These standards and requirements are matters of gradual evolution, responsive to the changing aspects of American business life and to the constant development of corporate procedure.

In connection with an initial listing application, the committee requires a formal printed listing application containing such information and supported by the documents which you will find described in detail in the memorandum which I have submitted to you. In general, the listing requirements are designed to furnish information concerning the character and background of the business, the nature of its assets and operations, the record of its earnings and such other pertinent material as seems likely to assist the investor.

If the securities of a company have been admitted to the list and the company applies for the listing of additional securities, a similar listing application is required; and in this application there must be up-to-date financial statements of the applicant company together with a statement of the purposes of the issue applied for, a copy of

the resolution of the board of directors authorizing such issue, and an opinion of counsel, not an officer or director of the company, as to the validity of the issue contemplated. A strong and usually successful effort is made, in connection with the application for listing of additional securities, to have the company comply with the then current requirements. Such compliance is often made a condition of the listing requested.

While we have occasion to consult our own attorneys on many points, we do not have an independent staff of lawyers to determine whether all the legal requirements for the issued securities have been complied with, and while we take up many accounting questions with our consulting accountants, we do not have an independent staff of accountants to audit the accounts of applicant corporations. In the absence of contrary evidence, we accept the legal opinion furnished to us by responsible lawyers in connection with listing applications, and we accept the audits prepared in behalf of applicant companies by independent auditors.

In connection with applications for additional listings, we do not, in the absence of evidence of bad faith, seek to examine into the actions of boards of directors with a view to arriving at an independent determination as to whether they have acted in pursuance of sound business judgment or in accordance with proper standards of conduct; nor do we attempt to control such action.

It is the board of directors, not we, who are elected by and responsible to the stockholders for the outcome of their policies; the record of the company which persuaded stockholders to invest is the record of the management of the company, not our record. In my opinion, no central body, whether the stock-list committee or the Federal Trade Commission, can possibly succeed in performing the functions of the managements of all listed companies.

If there is anything in the application which appears to the committee to be open to question, then the committee makes every effort to have the question resolved in accordance with its views; but we have conceived our chief responsibility to be to see that the facts have been fully and adequately disclosed, and if this disclosure indicates nothing which appears to the committee to be unsound or improper, we do not undertake an independent investigation of the facts themselves. In other words, we accommodate ourselves to the general spirit of American institutions in dealing with persons appearing before us on the theory that they are honest until evidence to the contrary is adduced.

I approach the consideration of the pending legislation with the general view that stock exchanges perform a useful and an essential function in our national life. This I conceive to be primarily the furnishing of a market place for securities with a view to facilitating enterprises in filling their legitimate capital requirements and with a view to enabling investors to purchase and sell securities readily in response to their needs or desires.

I recognize that abuses have grown up about the market place which require correction in order that the public may be afforded proper protection, and I believe that the object of farsighted legislation should be to afford such protection while placing as few obstacles as possible in the way of the normal functioning of this important part of our economic mechanism. I suppose that there

would be general agreement with the principle that, to the extent that the provisions of the proposed legislation are so onerous in their application as to render it impossible for corporations to comply with their terms, these provisions must be looked upon as inconsistent with the conception of the useful and essential qualities of security exchanges and that accordingly such provisions should be either modified or eliminated.

With this general background, I proceed to an examination of the provisions of the bill before you insofar as they relate to the listing of securities on security exchanges. My comments should be read in the light of the foregoing general discussion. And before going into the particular discussion, Mr. Pecora, it may be that you have some questions that you would like to take up now on what we have covered.

Mr. PECORA. I have made some notations, but I think perhaps we could more advantageously enter upon a discussion after you have completed the reading of this document.

Mr. ALTSCHUL. Section 11—Registration requirements for securities:

I draw your attention to section 11 of the bill entitled "Registration Requirements for Securities." Before entering into a detailed comment upon these requirements, I would like to consider this section in its broader aspects. One effect of this provision is to require that all existing securities now listed on any exchange shall be registered in accordance with the provisions of the act at least 30 days prior to its effective date if they are to continue to be traded in thereafter on the exchanges on which they are now listed.

Securities now listed are held today in various ways largely in reliance upon the fact that there is a market for them on recognized exchanges. To deprive these securities, or any considerable part of them, of the market which investors and lenders alike have relied on would be disastrous. On this account, it is important to point out, in the first instance, that the registration requirements for securities, taken in their entirety, could very easily in a large number of instances have this effect.

In my opinion, it is a dangerous thing to impose onerous requirements in connection with the registration of new issues, as this so easily has the effect of damming up the capital market of the country, with resultant hardships to industries seeking capital for expansion or for meeting maturities. However, it is far more dangerous to impose such requirements upon existing securities because this can obviously have the effect of freezing a large part of the liquid capital of the country, with the most deflationary consequences to individual holders, banks, financial institutions, no less than to the industry of the country as a whole.

Difficult as the administrative features of the act are insofar as they apply to new issues, they are infinitely more difficult when they apply to that great bulk of securities already outstanding. If section 11 is read in conjunction with section 32, it becomes apparent that if any securities now issued are to be traded in on any security exchange after the effective date of the act, October 1, 1934, applications for registration thereof must have been made before September 1, 1934. The act presumably contemplates that applications so filed and the documents supporting them are to be reviewed by

competent persons. So stupendous would be this task that I am convinced that the work involved, if conscientiously done, would consume years rather than months, if it can be actually done at all.

Beyond this, I am convinced that the delegation to a Federal body, not in immediate and daily contact with the current operations of the country's business, of authority to pass upon the registration of all securities to be dealt in—old and new alike—is unnecessary for the protection of the public. I consider that this protection can be better secured by other means, and that the contemplated method places obstacles in the way of the normal functioning of our business machine so serious in their nature that they will unfavorably affect the very interests of that public which these measures seek to protect.

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 effect of this provision, read in conjunction with section (b), would appear to be to prevent dealings in any security until 30 days after the stock exchange had certified to the Commission that the security had been approved for registration and listing. In the case of new issues this 30-day delay might place such an added risk upon underwriters as to raise a serious question of whether the business of underwriting new issues for the purpose of financing the capital requirements and the maturities of existing corporations could go forward at all.

Apart from the question of underwriters, we have frequently had before us, in the past, applications for listings where prompt action on our part, in order to make possible the early issuance of the securities in question, was essential to the carrying out of an entirely legitimate corporate purpose highly in the interests of the security holders.

I am apprehensive that the delays imposed in connection with the underwriting of new issues and of the issuance of new securities at times without underwriting will place an obstacle in the path of perfectly legitimate transactions helpful to American business.

I am uncertain of the precise effect of the words "unless such security has been issued", but I assume that they are intended to prevent a "when, as, and if issued" market. While the New York Stock Exchange has, in recent years, been reluctant to list on a "when, as, and if issued" basis, and has only done so infrequently, and then only when it seemed largely in the public interest, we believe that the "when, as, and if issued" market has a legitimate place in the business of providing capital for industry, and we feel that any abuses that is sought to correct in connection with such a market are capable of being dealt with without eliminating such a market altogether.

Beyond this, I should point out that many types of securities are now listed for which it would appear that under no circumstances is it likely that a registration statement would be filed. The removal from the list of these securities already outstanding in the hands of investors under such a retroactive law would, in many instances, affect the interests of investors most unfavorably.

The following possibilities which might result from such a provision of the law should be considered. Stocks and bonds of many companies that are in the hands of receivers might be forced off the list because of the fact that the original issuer had no longer any power to file a listing application or registration statement, and it is uncertain how far the receivers would go in doing so. In many instances, these securities have been kept on so as to not use the influence of striking to force minority stockholders into reorganizations or into deposit agreements of protective committees. If this section of the law remains unchanged, even if the registration requirements were modified, many situations might arise where the new company, protective committee, or voting trustees might elect to register the securities which they have issued for listed securities, but no person would be in a position to apply for registration of the listed securities themselves in their original outstanding form.

Thus, possibly quite unintentionally, pressure would be brought upon minorities to deposit under plans of reorganization in a way in which the stock exchange has always been reluctant to bring pressure itself.

In other cases, where, through the exchange of shares, a company has acquired a very large percentage of stock of another company and desires to have the stock of its subsidiary removed from the list, this provision of the act might well result in the acquiring company making no provision for the registration of the securities of the underlying company, and in this manner dissenting minorities might well be forced into a consolidation or exchange of shares contrary to their expressed wishes, merely in order to obtain a listed security. It has been the consistent policy of the committee on stock list not to permit its listing facilities to be used to club minorities into action in this manner.

Furthermore, it is difficult to see why foreign governments or foreign corporations which have issued bonds so many years ago and which have no further present need of the American capital market should apply for registration.

The amount of such securities that might be forced off the list through the operation of the provisions of the bill as now drawn is, as you know, very considerable.

SEC 11. (a) 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. If the exchange authorities certify to the Commission that the security has been approved by the exchange for listing and registration, the registration shall become effective thirty days after the filing of such certification with the Commission: *Provided*, That if it appears to the Commission prior to the expiration of such thirty days that the application for registration does not comply with the provisions of this Act or the rules and regulations made by the Commission hereunder, it may, after appropriate notice and opportunity for hearing within such period, enter an order denying the application for registration unless the issuer shall withdraw its application or consent to the Commission's deferring action on its application for a stated period longer than such thirty days.

The difficulties which I find with this section are already covered by my preceding comment.

SEC. 11. (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.

That is a provision that requires an undertaking by the issuer that he will comply with all present and future regulations and will use his best efforts to have other parties comply with them as well.

I have grave doubt as to whether it is reasonable to exact any such far-reaching commitment in connection with an application for registration. This clause in itself may operate powerfully against registration.

SEC. 11. (*c*) (II)

Subject to detailed comment below on subtitles 1 to 11, I feel that information of the character specified in this subsection should obviously be available to investors and stockholders. This would seem to me to go little beyond what might properly be considered reasonable in connection with listing on the New York Stock Exchange. I recognize, however, that of necessity of requirements which appear reasonable as a prerequisite to listing on the country's primary security market, may be unduly burdensome when applied to many of the small exchanges of the country which, in their communities, perform a very useful function.

Accordingly, it would seem desirable to omit rigid requirements of this nature from the act itself, and to delegate the authority to prescribe listing requirements suitable to the needs of each exchange considered in the light of its own special problems to whatever agency may be designated by law to administer the provisions of the act. I am convinced that experience will prove this degree of flexibility to be essential if business is to go forward. In my opinion the New York Stock Exchange could then readily accept listing requirements drawn in accordance with the provisions of section 11 (c) (II) subject to such modifications as I have indicated as desirable or essential in my detailed comment which follows:

SEC. 11 (c) (II) Such information as to the issuer and affiliates in respect of:

(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.

In my opinion, information covered by (1), (2), and (3) above should without question be available to investors.

SEC 11 (c) (II) (4) particulars regarding the directors, officers and principal securityholders and underwriters, their remuneration and their interests in the securities of and material contracts with the issuer and affiliates.

I have some question as to the wisdom of that part of (4) which would appear, when read in conjunction with other sections of the act, to provide for the publication of the remuneration of officers of registered corporations generally.

I can see that in certain instances such publication may be desirable and in the public interest. Yet, it places a serious competitive handicap on corporations which are listed or registered as against privately owned business in that the salaries which they pay to executives will be disclosed for the benefit of their more fortunately situated competitors. That instance is equally true between any companies that are listed. One has a chance to see what the other is paying for executives.

Beyond that, it is hard for me to believe that by and large officers, merely because they happen to be connected with registered companies, should be subject to a form of publicity which other citizens are protected from.

SEC 11. (c) (II) (5) particulars regarding remuneration to others than directors and officers exceeding $20,000 per annum

There is some question in my mind whether the compensation paid for professional services should be given publicity, and my objection is based on the same general consideration as I urge in connection with the compensation of officers.

SEC 11. (c) (II) (6) Particulars regarding bonus and profit-sharing arrangements.

I am in sympathy with the full disclosure of bonus and profit-sharing plans and the aggregate cost thereof to the company However, I can see little reason why the distribution under these plans to the individuals participating in them should ordinarily be disclosed. I can see, of course, that in some instances it might be wise. Such a disclosure might at times prove a source of needless embarrassment to management in connection with the operations of the company.

Senator KEAN. What do you mean by that?

Mr. ALTSCHUL. We have had before us in committee at times—first of all, I would like to say this: We have discussed many times the desirability of the stock-list committee itself taking some forward step in the matter of these profit-sharing and bonus plans, and in connection with the study that we have carried forward there we have had occasion to discuss more or less informally with managements the viewpoint of managements. We have not so far reached a very definite conclusion, but we have found that in many cases reasons are advanced which would indicate that full disclosure would be undesirable.

There are cases inside a corporation, for instance, that have been drawn to our attention, where officers are getting compensation which the management considers adequate, where an officer is getting compensation which the management have determined upon, the executive officers have determined upon, as being the proper compensation for that man. The man happens to be a man who is very unpopular in the organization but very effective, and they consider him a very important element in their business. The disclosure of an additional amount of compensation that he receives through the operation of the profit-sharing plan has been urged upon us as being likely to create a situation where either they would lose a half dozen other men or that man would have to go. The total amount that is involved in the profit-sharing plan in the aggregate we would have no objection disclosing, but if we had to go into the refinement of

showing that Mr. John Jones gets $10,000 additional, then we would have Mr. Smith and all the others disaffected, and we would have a lot of trouble within the company.

There are practical reasons of that sort that have come to our attention ever so often that bid us pause in this matter. We have been studying it and we are interested in it.

Mr. PECORA. Do you think those reasons that are based upon possible personal embarrassment to the individual whose compensation is sought to be disclosed outweigh the advantages to stockholders of full information with regard to compensation paid to those whom they put in management of the company, or who are in the management of the company, whether with or without the will of the stockholders?

Mr. ALTSCHUL. You raise a very broad question, Mr. Pecora.

Mr. PECORA. That is the question involved here.

Mr. ALTSCHUL. Yes, naturally; but I want to separate it for a moment. In a limited sense that I was discussing the question, I would say that many times you will find occasions where the publicity as to the individual amounts would be harmful to the company itself and, therefore, to the stockholders. I do not say that is at all preponderating in the number of cases, but there are many cases that are distinctly advantageous to the company. We have had those drawn to our attention.

Mr. PECORA. You recognize, though, that in any question that is a question of public policy the rights of the individual must yield to the benefits of the community or the public?

Mr. ALTSCHUL. Quite right. Oh, we stand strong on that platform, of course.

Senator KEAN. The question is whether we can protect the rights of the public by giving simply the amounts instead of the names and the individuals.

Mr. ALTSCHUL. My thought on that, Senator, would be—but, first of all, in answer to Mr. Pecora's question: In this competitive world the disclosure of these facts as to the salaries of officers, by and large, is going to be an adverse factor from the point of view of stockholders.

To put it differently, it is going to have certain very important adverse elements in it from the point of view of stockholders generally. I am not now limiting it to this one case of John Jones, but by and large the disclosure of these salaries is going to be a disturbing factor and have certain elements that would unfavorably affect the interests of the very investors whose interests you are trying to protect; because, in the first place, as between listed companies both of whom have to disclose the facts, it immediately sets up the possibility of sniping for management and disrupting organizations and going and taking a man hero and letting him go there.

Mr. PECORA. Do you think that goes on anyhow?

Mr. ALTSCHUL. Oh, it goes on anyhow, but this is an open invitation. However, that may be a matter of opinion, and I do not think I am prepared to argue that.

Beyond that there is the serious factor that there are lots of privately owned concerns that have to give no such information, and they have an enormous competitive advantage then as against the

concerns that have to publish the amounts that they pay to their important executives. In a competitive industry people appraise pretty accurately the value of the services of the outstanding performers in that industry, and if you have a company, just because it is listed on the New York Stock Exchange or because it is listed with the Federal Trade Commission, having to disclose that they pay Mr. Jones a hundred thousand dollars, while some private company who has Mr. Smith does not have to say how much they are paying him, the private company has a distinct advantage.

Mr. PECORA. Don't you think such information has been cribbed in the past, and perhaps is apparently being cribbed from employees of private companies?

Mr. ALTSCHUL. I do not at all wish to be understood as suggesting that I know what salary is known to anybody else. I am sure a lot of information gets around, but this is equivalent to advertising on the front pages of newspapers so that nobody can possibly miss it, and it has certain difficulties.

I quite understand what the abuse is that you are aiming at, from disclosures that have been brought forth in various investigations in regard to bonuses of such a magnitude that stockholders would be interested in knowing about them. Those are perfectly patent. It might be that if the aggregate amount was set forth, then some properly constituted body would be able to determine whether the facts as to the distribution which was disclosed in confidence to them were of such a nature in special instances that they should be drawn to the attention of stockholders.

Mr. PECORA. Mr. Altschul, so far as you have gone you emphatically favor publication of particulars regarding bonus and profit-sharing arrangements.

Mr. ALTSCHUL. The amounts, the total amounts.

Mr. PECORA. Yes. In the past that has been a device resorted to to conceal compensation given to executive officers from the salary list.

Mr. ALTSCHUL. I did not understand that.

Mr. PECORA. In other words, in the past the device of giving an executive officer a bonus or a profit-sharing arrangement that yields him a substantial compensation in addition to his fixed salary has been adopted in order to conceal from stockholders the fact that such executive officers were getting a compensation that was not recited by the salary which they received, and which salary might have been made public to the stockholders.

Mr. ALTSCHUL. Mr. Pecora, I do not agree with that statement at all. The amounts of salary that the executive officers have been getting have in general probably been disclosed equally. The basis for the bonus and profit-sharing plan, as I have always understood it—I believe this to be the fact—the real basis for it has been to provide some means beyond the fixed salary by which unusual ability and unusual success in the conduct of business could be rewarded.

Mr. PECORA. Well, in instances that undoubtedly has been the reason, but in many other instances that so-called "reason" has been a mere pretext to permit of the payment of a compensation in a secret fashion.

Mr. ALTSCHUL. Of course, I have no knowledge of any such instances. I think the reasoning applied, broadly speaking, has been the reasoning I have given you, and I cannot see why we should per-

mit of the payment of this compensation in a manner secret from the stockholders, when the compensation they get by way of salary is not secret.

Mr. PECORA. I do not think any of those things should be secret.

Mr. ALTSCHUL. My point is that this does not add any new element of secrecy. You suggested that this was a device to provide for an element of secrecy in this distribution.

Mr. PECORA. I think it has been in the past, very frequently.

Mr. ALTSCHUL. They do not need any such device.

Mr. PECORA. Except that the salary might leak out, whereas bonuses or profit-sharing arrangements are more circumspectly guarded. As a matter of fact, in the case of the National City Co., which I recall at the moment, the evidence presented to this committee showed that the officers of that company participated in the distribution of the so-called "management fund", which enabled that company to pay huge sums in addition to very substantial salaries, to certain executive officers. The payment of those distribution shares in the management fund is effected through checks drawn upon a deposit account kept in another bank, so that even the employees of the bank through the clearance of those checks, would be able to know or find out, or even suspect, the existence of that management fund.

Senator WALCOTT. Let me add another thing. In one particular case we have in mind here the people who did the work did not get the extra bonuses. It was in proportion to the amount of salaries that they received in the holding or parent institution.

Senator COSTIGAN. What instance was that, Senator Walcott.

Senator WALCOTT. The National City Bank.

Mr. ALTSCHUL. Do not misunderstand me, Mr. Pecora. I think full information in regard to bonuses and profit-sharing plans should be disclosed. If you want to go beyond that and have the details of distribution placed in the hands of the commission, or whatever authority is going to be concerned with the administration of the provisions of this act, I think that is a perfectly reasonable request, but I do not think that the disclosure of the distribution should be made mandatory. I think that should be a matter of discretion, only to be used when there is some situation that you see, from the figures, is a situation the stockholders ought to be advised about.

Mr. PECORA. I do not think any company should be ashamed to make known to its stockholders the compensation it pays its executive officers, whether the compensation be in the form of salaries, bonuses, or profit-sharing arrangements, or what not; nor should those officers be ashamed to have their compensation which they receive made known to the stockholders.

Mr. ALTSCHUL. My objection to the provision has nothing to do with any question of shame. My objection is purely a practical one. In the competitive world, where you have companies that are listed on exchanges and companies that are not listed on exchanges, from the point of view of the investor himself, in the companies that are listed, I do not like to see the facts in regard to the compensation paid outstanding executives disclosed, so that their competitors, who have no such disclosure to make, have an important fact at their disposal which the managements of listed corporations do not have in respect to their own——

Mr. PECORA. Mr. Corcoran day before yesterday referred to certain statements made by some gentleman who appeared before the House committee on this bill last week, in which that gentleman made reference to the wide-spread system of espionage among competitive enterprises that virtually places, to a practical extent, not completely, such secret information as we are now discussing in the hands of all competitive corporations or businesses. Do you think that gentleman was venturing an observation not supported by fact?

Mr. ALTSCHUL. I do not know who the gentleman was, and I did not hear his observation. Of course, I know that in the competitive world an attempt is made by business men to inform themselves currently, as well as they can, about the operations of their competitors. but whether it goes to the extent of planting employees in places in order to get information or not I very much question.

Mr. PECORA. Not alone planting employees. A bookkeeper or employee in the accounting division of a corporation or private business, by reason of the nature of his employment, can learn these facts, and perhaps could readily be induced to make them known to some competitor.

Mr. ALTSCHUL. Mr. Pecora, while I think that the executives of leading American concerns are very zealous to protect the interests of their company, I am naive enough to believe that they would consider it highly indecent to embark upon a policy that could be designated as espionage. I do not know whether there is any espionage, or any counter-espionage. I think those things are more or less fantastical.

Mr. PECORA. I have no doubt that is your candid belief, Mr. Altschul. The only observation I venture to make about that is that you would probably find it enlightening if you could sit in the complaint room of the district attorney's office in any large community, say, a month or two.

Senator COSTIGAN. Mr. Altschul, is it not your view that it is in the interest of stockholders and in the public interest to be advised as to whether a corporation is efficiently or extravagantly conducted?

Mr. ALTSCHUL. I do, sir.

Senator COSTIGAN. I have reference now to information as to the payment of bonuses and other compensation, other than the ordinary compensation

Mr. ALTSCHUL. I entirely agree. The stockholders ought to be in a position to judge as to whether their company is being efficiently or extravagantly managed. I think, however, that that result can be accomplished short of giving these particular details of distribution as between individuals. We have tried, in the stock list committee, to prevail upon corporations to set up their accounts in such a way that the administrative expenses would be set forth as a separate item. We have made some progress, and here and there we have been able to accomplish it. We have not been able to enforce a general rule to that effect. That is one of the very things that would be covered by the uniform system of accounting within industries, and I think the results you are seeking are results we are entirely in sympathy with. I only raise some doubt as to the wisdom of going quite so far.

The CHAIRMAN. Do you think that a uniform system of accounting is advisable?

Mr. ALTSCHUL. I think, within industries, a uniform system of accounting should be developed and should be insisted on. We have tried very hard to bring it about. At present one of the things we have been doing is to try to get the oil industry, for instance, as a sort of test case, to adopt uniform principles. It is a question that requires an enormous amount of study in respect to each particular industry, to be sure that when you come out with your uniform system of accounts they do lead to a comparison between companies, and really mean something. You get into such ramifications, for instance, as finding companies that are in several different kinds of industries at the same time. On the other hand, I am entirely in favor of it. I think that while it is a thing we are not able to enforce to the degree we would like to see it done, it is one of the things we have always been urging.

Senator WALCOTT. Would you not add to that your statement that it must be by industries?

Mr. ALTSCHUL. I do say by industries.

There is one point in this connection that I think is worth making. There has been a disposition in some of these discussions—I do not know just where I have come across it; I think over in the House committee—there has been a disposition to point to the standardization of accounts in the Interstate Commerce Commission, and to suggest that the railroads handle their accounts this way, and public utilities handle their accounts this way, and industry should handle its accounts similarly.

There is, of course, one enormously practical point of difference. The railroads, after all, are a public utility. In fact, they have their rate structure fixed; they have their expenses determined by the Labor Board and by other agencies; and they have a monopolistic phase. There is no competition between them. When you get into those industrial concerns, you find that if you adopt a system that is as inflexible as the Interstate Commerce Commission system for accounts of railroads—with which I am entirely in sympathy—you then run into danger because you are applying the same system under which the railroads have worked, to a competitive industry, and you are handicapping companies as against one another—and, more important, companies as against some of their foreign competitors.

We come next to the clause that has to do with material contracts, not made in the ordinary course of business, and material patents.

From a theoretical viewpoint, compliance with this section is not impossible. Practically, it presents such difficulties as to make compliance extraordinarily difficult, if not actually impossible. This section provides that the registration statement shall set forth "particulars regarding material contracts not made in the ordinary course of business, and material patents." If it were possible to determine in advance which contracts and patents are material, and which are not, and which are made in the ordinary course of business, and which are not, then it might be possible to comply with the provision. But who will take the risk of determining whether a contract is or is not material, or is or is not made in the ordinary course of business, particularly when a mistake may prove so costly. The result must be that, if compliance is attempted at

all, all contracts and all patents will have to be summarized. This is the only safe method of procedure. It might well require the summarizing literally of thousands of contracts and tens of thousands of patents on the part of each of countless corporations. If we were to apply this provision to the case of a street railway company, for example, the company would have to summarize its easement contracts, its agreements for the placing of telegraph wires on the poles, the use of its property jointly with another carrier, and the agreements for the maintenance of crossings and of bridges, together with practically every element of operation which is covered by contracts.

In the case of businesses involving large numbers of patents, such as American Telephone & Telegraph Co., General Electric Co., or Radio Corporation of America, the work involved in such summarization would appear to be staggering beyond belief. In the aggregate, if this failed to discourage registration completely, it would still place an enormous burden upon applicant companies, and would result merely in the accumulation in Washington and in various exchanges of a mass of material so great that even the caring for it would present a problem and the digesting of it would be a matter of complete impossibility. I can see no practical advantages to be obtained for the security owners of the country from this provision. I have considered the possibility of amending the section, but I am unable to suggest any amendment which would seem to make it workable, and, accordingly, with all due respect, I am forced to the conclusion that it should be eliminated.

We now pass to the balance sheets for preceding years, and the profit-and-loss statements for preceding years.

I am uncertain just what is meant by the term "for preceding years" in the foregoing sections. Where companies have not been in the habit of having their accounts regularly certified, the task of getting merely the preceding year certified will in many instances itself present a difficulty. When it comes to extending this beyond the preceding year, many companies otherwise eligible for listing and registration may find themselves unable to comply with the provision either because of the expense involved or otherwise. In this connection I think I should point out that while the stock list committee has for a long time been urging on corporations the necessity of having audited financial statements, we did not have the support of public opinion to such an extent as to be able to make this a condition prerequisite to listing until very recently. We have now, of course, as you know, done so.

We come next to the section relating to copies of articles of incorporation, and also to the striking of securities from the list.

The documents referred to in paragraph 1 above should, in my opinion, clearly be made available to investors.

In connection with paragraph 2, I believe that the prompt exercise of this power is at times so necessary in the public interest that the stock exchange should have unquestioned authority to act in matters of this sort.

We now come to the question of annual, quarterly, and monthly reports. The first subsection in that has to do with requests for information of a general nature, unspecified.

This provision is so broad in its implications as to vest the designated agency with authority to exact information and documents from a company, the preparation and submission of which might prove extremely burdensome. Accordingly, I think this authority should be very much circumscribed, and perhaps defined.

Now we come to the thing that has been up for discussion a great deal this morning, annual and quarterly reports, including, among other things, a balance sheet and profit and loss statement certified by an independent public accountant.

This section imposes upon corporations requirements which I would be inclined to think could not be complied with in practice. As I understand it, it provides for the filing with the exchange, as well as the Commission, of quarterly reports, including a balance sheet and profit and loss statement certified by independent public accountants. If either the quarterly balance sheet or the quarterly income account has to be certified to, serious problems arise, not the least of which is that in many instances a physical inventory must be taken, and the actual disturbances involved in many industries in the year-end stocktaking would merely be multiplied fourfold. The cost of this work, which must ultimately fall upon the public either as stockholders or consumers, would be burdensome in the extreme, and in the case of many corporations, it would be unbearable. Beyond this, the cost would be great out of all proportion to any benefit that our practical experience in the matter of accounts would lead us to believe could be obtained for the investing public.

Quarterly reports are frequently more misleading than they are informative, on account of the distortion that of necessity occurs in an attempt to allocate earnings to too short periods of time. While we are in favor of obtaining quarterly income statements wherever we are satisfied that their publication is of real benefit to the investor, and when no disadvantages involved in their publication are apparent, we believe that a rigid provision requiring such publication in all instances would, on the whole, do more harm than good.

My experience with these matters leads me to the conclusion that there is a further intensely practical situation weighing against the inclusion of this provision in the bill. I am informed that there are not enough qualified accountants in the United States of America adequately to perform the work involved.

The suggestion might well be considered that as the agency designated by the Government to administer the provisions of this act is vested with broad powers to determine accounting requirements, these requirements need not be made in themselves rigid provisions of the act. It is altogether probable that flexibility in this regard may prove to be essential in the public interest.

Beyond this the question might well be considered whether such designated agency ought not at an early date to initiate a study looking to the development of uniform accounting practices within industries; and that when and as uniform accounting practices for an industry have been determined upon, corporations engaged in that industry, the securities of which are registered, be required to prepare their accounts in accordance with such uniform practices.

A measure advocated for some time by the New York Stock Exchange might also well be considered in this connection. I have already covered that in my early memorandum. I will not take your

time with that. As I understand, competent accountants will be heard by your committee in detail with regard to the accounting provisions of this bill.

Mr. PECORA. Mr. Altschul, before you leave that portion of your statement to pass on to a consideration of the next provision of the bill, would the arguments that you have made here with regard to quarterly reports, audited quarterly reports, apply to semiannual audited reports?

Mr. ALTSCHUL. Mr. Pecora, it would apply, not quite to the same degree but in theory it would apply. The expense item is reduced by half. The difficulty is reduced by half, but I think you still run several dangers. I do not think it serves any useful purpose.

We get annual audited reports now, and we make it a prerequisite of listing, and insofar as companies do not have audited reports, we are trying to bring them to the point where they do give us audited reports.

Mr. PECORA. My suggestion would simply involve the additional expense incident to two audited reports per annum instead of one.

Mr. ALTSCHUL. I think the only way one can view a question of that sort is to consider the item of cost, and the burden on the concern, on the one hand, in relation to the benefits to the public on the other. Mr. Whitney has pointed out that one of the disadvantages of this thing would be, even in the case of semiannual reports, the delay in the preparation of figures. I think that is a real disadvantage. We have audited reports from a very large number of companies today. We get quarterly unaudited reports from the preponderating majority of those companies. When we take the four quarterly reports put out by the company officers and tie them in with the annual report, in a case where there is any discrepancy that cannot be explained, such cases are extraordinarily rare. When a company has a company auditor, in most cases, while they do not certify to the quarterly reports, the same methods are applied uniformly by the company throughout the year, and we have the experience of seeing these things come in all the time, and taking the four quarterly reports, or the three quarterly reports that have come in before the annual report, and tieing the thing together to see whether the results of the year substantiate the figures that have come out of the quarterly reports. These cases where we see any discrepancy that cannot be explained are extremely rare. I do not remember one at the moment.

The cases in which you can see that there were a few year-end adjustments, in connection with the stocktaking, and all the normal incidents to corporate accounting, and where you can see that the quarterly reports have been fair and are representative of the true condition, are the rule.

There is another disadvantage in the semiannual report, and that is the same disadvantage that applies to the quarterly report, except in the matter of degree. A year, in most industries, at best is a short enough time to which to try to allocate earning power. When you begin to split that up into half year, or quarter year, you run the risk of attaching an importance to those figures, merely because of the fact that they are certified, that the figures are not entitled to have in themselves. The figures may be accurate, certified, or uncertified.

Mr. PECORA. That feature would attach principally to corporations conducting businesses that are seasonal in character.

Mr. ALTSCHUL. It is partly a question of the seasonal character of the business. It is very striking in corporations conducting businesses of a seasonal character; but beyond those conducting businesses of a seasonal character, fluctuations within any short period of time other than a business year are likely to be very deceptive, so much so that while the New York Stock Exchange has been urging, as you know, the publication of quarterly reports for years, and has been gradually getting more and more corporations to meet its views, there are a number of times when corporations come to us and give us reasons which, as reasonable people, we must accept, showing that the publication of these figures would mislead the investor almost every time they are released.

At times that is because of the seasonal character of the business. At other times it is because, let us say, a department store put on a sale in March one year, and did not put it on until April the next year. You get the comparative figures completely out of kilter, and if you were to try to explain those figures away, and make them mean something, nobody would understand what it was all about anyway.

Mr. PECORA. That applies to quarterly reports, even if they are not audited.

Mr. ALTSCHUL. Yes, it does; but my only point was——

Mr. PECORA. Your committee has striven for years to induce corporations whose securities are listed to make published quarterly reports.

Mr. ALTSCHUL. We believe in quarterly reports, and we think, in general, they should be made available; but we do not believe a rigid requirement should be introduced in legislation making them mandatory, because anybody, whether it is the body designated by law to administer this act, or the stock list committee, would, every now and then, have presented to it facts which would lead it to say that in the interest of investors themselves that requirement ought to be waived. That does not happen infrequently. That is a matter of fairly frequent occurrence. The distortion of earnings in short periods of time would be likely to mislead investors, and create movements one way or the other in market prices and have no relation to anything that was real at all.

Mr. PECORA. How would you deal with the problem in the aggregate?

Mr. ALTSCHUL. On the basis of judgment. In the case of corporations where the quarterly reports are informative—which I think is the case with the bulk of the companies that now publish them—we would have them published. In cases where they come and give us a persuasive reason which shows that the publication of those quarterly reports is going to mislead the investor we are seeking to protect, we give them relief.

The CHAIRMAN. You would have the power in the Commission to waive that requirement?

Mr. ALTSCHUL. I think that would be essential. You would find times when the condition of the quarterly report would be very damaging to the investor, and whoever had the responsibility would

be the first to say, "Well, we do not want that done, because there would be a great deal of undue enthusiasm or concern."

Senator WALCOTT. When you speak of quarterly reports, do you mean a balance sheet or a profit and loss statement?

Mr. ALTSCHUL. The quarterly reports that we get are quarterly income accounts. Occasionally there is a balance sheet included, but more generally it is purely an income account.

Senator WALCOTT. Do they include the gross sales?

Mr. ALTSCHUL. Most corporations that we deal with object very strongly to giving gross sales.

Senator WALCOTT. That is one of the points that has been raised here. They do not depend upon a physical inventory?

Mr. ALTSCHUL. No. The year-end report always catches up the inventory adjustments. Short of a physical inventory four times a year, or twice a year, there is no other way they can deal with that.

We have devised another scheme. We have felt that these quarterly reports in certain cases were misleading. Then we have suggested to corporations, when we are satisfied that these reports would be misleading, that they give us quarterly cumulative annual reports—in other words, that they give us, every quarter, the tie-up of the first three quarters, and the last quarter, annually, so that we get a certain continuity and avoid the distortion that you get in providing for the actual quarterly income accounts. That is another illustration of the fact that whatever agency deals with this subject must have a great degree of flexibility. Otherwise you will find that the rigid rules you have provided to protect the public in many cases will operate in such a way that if you had the power to change them they would have operated far better.

The CHAIRMAN. Proceed.

Mr. ALTSCHUL. The comment with respect to section 12 (a) (3) is practically repetition. I do not think it is important to go into that now.

Mr. PECORA. That merely gives the regulatory body discretionary power—that is, power which it may exercise in its discretion.

Mr. ALTSCHUL. As I read it, it said "monthly reports including, among other things, a statement of sales or gross income." I did not think it was discretionary from the point of view of sales or gross income. A statement of monthly sales is one of the most misleading things we run into.

Mr. PECORA. I am referring to subdivision (a) (4) of section 12.

Mr. ALTSCHUL. (a) (3) was the one I said was repetition. I had not finished with (a) (3). (a) (3) is repetition, and I do not think there is any need of going into it.

My feeling with respect to (a) (4) is that this provision is so broad in its implications that it vests the designated agency with an authority to demand reports the preparation and submission of which might prove extremely burdensome, and accordingly, I feel that this provision should be very much circumscribed, if not entirely omitted.

I have a similar feeling in regard to one other thing——

Mr. PECORA. As I read your comment with regard to section 12 (a) (4), it is, in substance, that because the power lodged in the regulatory body by this section might be capable of abuse, that no power at all should be delegated. That is true of any statute.

Mr. ALTSCHUL. Of course, the effect of that in this particular statute is the thing that bothers me, Mr. Pecora. While it is almost unthinkable, you might say, that corporations would refuse to register, there are some provisions, like this, that make it almost unthinkable that they would register. The whole object must be, it seems to me, to try to draft that clause in such a way that they will give you what you are seeking without making it impossible for corporations to comply.

Mr. PECORA. I think some of these comments conjure ghosts.

Mr. ALTSCHUL. I think you will find the American executive is a pretty good ghost conjurer when it comes to sending in these certificates. I try to place myself more or less in the position of the man who will have to look at this thing and decide what he is going to do about it.

Section 12 is not important.

With regard to proxies, there is no use in reading my comment on that. Mr. Corcoran dealt with that very adequately yesterday.

Mr. PECORA. Do you differ with Mr. Corcoran's views?

Mr. ALTSCHUL. No. We made, in general terms, the same recommendation as to the change he suggested yesterday. We went a little further, but that is a matter of no importance at this time.

The section I would like to cover is the section with regard to liability for misleading statements, because that, I think, is a very important section.

Mr. PECORA. A section that has teeth.

Mr. ALTSCHUL. Yes. It has more than teeth, I believe. I have covered that without any hesitation, because I think you know that the stock exchange is just as interested in avoiding the promulgation of false or misleading statements as the committee.

This section appears to me to be fundamentally unsound in principle in several particulars. In the first place, it makes liability result not only from a statement that is false, but from a statement which, while true, is found to have been misleading. The question of the truth or falsity of a statement is a question of fact; the question of the misleading character of a statement is clearly a question of judgment. To expose individuals to a liability for what may be a mere difference of opinion, and in the absence of any evidence of wrongful intent, seems repugnant to our ideas of fair play.

Mr. PECORA. I do not think the section, as worded, is subject to that criticism.

Mr. ALTSCHUL. My disadvantage is in reading this section as a layman, Mr. Pecora. That was what it meant to me.

In the second place, this section permits recovery, whether damage has been suffered or not and whether damage, if suffered, had an actual connection with the statements complained of. Beyond this, the measure of damage seems to me to be arbitrary and speculative.

These considerations, taken together, expose individuals whose function it is to exercise judgment to risks so serious, so unfair and so impossible to guard against as to be calculated to make those competent to accept such responsibility unwilling to do so.

I am of the opinion that the provisions of this section, as drafted, are of such a character as to be likely to render it impossible for corporations to comply with their terms. As now drawn, it would, I think, operate to prevent directors of corporations generally from

authorizing the filing of an application for registration, and in this manner it would tend to defeat the purposes of the act.

Accordingly, it would seem to be essential that section 17 be modified. In my opinion, it is only fair that the law should provide a remedy for one who has been misled by any misrepresentation willfully made contained in an application, report, or document filed in accordance with the requirements of the act. As I understand it, today such remedy, either does not exist or is only with the greatest difficulty enforced. The law should clearly go so far; but I can see no reason why it should go farther than this.

It seems to me possible that the civil provisions of the British companies act and those sections of the British larceny act, under which I am informed convictions of company officials have been obtained in Great Britain might well prove a helpful guide to legislators.

In this connection, it might be worth considering the provisions of the British Statute permitting the court to require security for costs and to award costs in its discretion. This is a provision intended to restrict the filing of strike suits while placing no obstacle in the way of the poor man who has a bona fide action which he wishes to initiate.

In regard to the effective date, there is nothing to be said about that. I will just close with my comment, if you have a minute to spare, Mr. Chairman.

So far, in my review of specific provisions of the bill, I have made an effort to recognize the reasonableness of certain features relating to the work of the committee on stock list and to offer suggestions designed to improve other features which appear to me to be burdensome or unworkable. However, I would not wish to be understood as implying that if the suggestions I have made are adopted the resulting provisions would embody my ideas as to what is required at the present time in relation to the matters with which they deal. Far less would I wish to appear as other than opposed to the bill as it stands and the philosophy which seems to me to underly it.

I recognize the gross abuses that grew up in the period of rank and unhealthy development that followed the war, and I heartily favor measures which will prevent or heavily penalize any repetition thereof. I do not believe, however, that in order to correct these abuses it is either necessary or wise to enact a law which threatens so seriously to destroy the normal functioning of a business mechanism which has been built up over a long period and which cannot be replaced overnight. On the contrary, it seems to me that in drawing such measures it is of the utmost importance to frame provisions which, while having the required deterrent and punitive effects, will not discourage the more responsible persons who will come under the law, nor subject them to such unjustifiable burdens and hazards as possibly to cause them to withdraw from the exercise of their responsibility.

In my opinion the restrictive character of the pending legislation, applying as it does to securities already listed, may profoundly decrease their present value and freeze a large portion of the country's liquid capital. The deflation and partial paralysis which this con-

notes is a condition which I am satisfied your committee would not willingly help to bring about.

The CHAIRMAN. It has been suggested that these provisions should not apply to existing contracts.

Mr. ALTSCHUL. Oh, yes. I understand that, sir.

I make this argument not merely as a member of the New York Stock Exchange but as a business man and investor profoundly interested in the welfare of American business. In view of the position which I have occupied and the practical experience which I have gained with such matters as are covered by this memorandum, I feel that I have the responsibility of expressing to you how profoundly I am convinced that the enactment of legislation such as that contemplated by the bill under discussion would be an adverse and deflationary influence tending to a great and unpredictable extent to counteract the progress that has been made toward recovery.

Thank you very much for your patience, Mr. Chairman and gentlemen.

Senator WALCOTT. May I ask you one question? Do you not think that a bill that is as stringent as this, and which places such broad powers in the lap of a Federal commission, whose personnel we know today and do not know tomorrow, but which is changing from year to year, would tend to disrupt an open market and force a great many businesses, large and small, to be even more secretive than they are now in their methods and as to what they are doing, by keeping away from the stock exchange?

Mr. ALTSCHUL. I think so, without question.

Senator WALCOTT. I do not think any point has been made of that here, and it seems to me that would be the natural effect of a bill of this character, unless it were severally modified.

Mr. ALTSCHUL. I think that is true without any question. I think much of the pioneer work the stock exchange has conducted in trying to get information from corporations would be upset by many of those corporations simply withdrawing into their shells and going back into some sort of closely held private concerns.

There is just one other thought that I want to mention in connection with these accounting provisions. As you know, we discuss these questions all the time with our consulting economist, because we are not accountants ourselves, and try to get the best information we can on these questions. Mr. May, of Price, Waterhouse & Co., or some of the accountants, were going to come down and discuss some of these questions with you, but there was one point Mr. May made in discussion with me which I would like to bring to your attention, because it is a very constructive feature.

He suggests that it might be possible to consider a rule for the publication of quarterly reports, one of which should be audited, leaving then, to somebody like the stock list committee, to decide with respect to different companies and industries, which quarterly report they wanted audited. That one, then, becomes part of the annual report.

The advantages of that are, in many cases, practical, because today the year-end work on accountants is perfectly terriffic, and if there were certain corporations whose business could be accounted for better from July 1 to June 30, it would make accounting practice

throughout the country much better, because the better men would be available to do the work.

Mr. PECORA. In other words, they would stagger their work?

Mr. ALTSCHUL. They would stagger their work. And if, beyond that, there were some discretion in changing the dates once in a while, perhaps, you would get some of these benefits that you are seeking in quarterly audited reports. Mr. May's suggestion specifically was four quarterly reports, one of which should be audited.

I think that is all I have.

The CHAIRMAN. Mr. Altschul, you will be back at 2 o'clock, please, for a few minutes. Right after that we want to hear from the Baltimore people for about 15 minutes, and then Mr. Whitney will resume.

The committee stands adjourned until 2 o'clock.

(Whereupon, at 1 p.m., Thursday, Mar. 1, 1934, a recess was taken until 2 p.m. of the same day.)

AFTERNOON SESSION

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

The CHAIRMAN. The committee will please come to order. I believe Mr. Altschul is with us.

STATEMENT OF FRANK ALTSCHUL, CHAIRMAN COMMITTEE ON STOCK LIST, NEW YORK STOCK EXCHANGE—Resumed

Mr. PECORA. Mr. Altschul, on page 4 of your elaborated statement on certain provisions of this bill, you say:

> In my opinion no central body, whether the Stock List Committee or the Federal Trade Commission, can possibly succeed in performing the functions of the managements of all listed companies

Do you make that statement because it is your opinion that the bill in question places upon the Federal Trade Commission, or purports to place upon the Federal Trade Commission, the responsibility of the management of all listed companies?

Mr ALTSCHUL. There seems to me to be in the bill a number of provisions that are so far-reaching they would be a burden on the administrative body, such a burden as would be very similar in many cases to that of the management.

Mr. PECORA. What, for instance?

Mr. ALTSCHUL. If you take, for example, the various bits of information that are supposed to be furnished to the Federal Trade Commission as parts of the business of registration I have gone on the assumption that they were not simply to be furnished for the purpose of being filed, but were to be furnished because the administrative body, whatever it is to be, was going to consider those things and reach some conclusion in respect of them, and possibly take some action or fail to take some action because of the conclusions they reach.

The information that will be asked according to the bill is so far-reaching in scope that it would seem to me that unless you conceive of that body as a body that would be qualified to examine that information coming to them with an informed business judgment in respect thereto, of the sort I would expect a management to exercise,

it is difficult to see just what value it will be to them at all. And if they are supposed to take some action after examining all that material, with the background of informed business judgment in respect of the material that comes to them, then their decision is going to be one that a management in the first instance makes. I am thinking particularly of the provision of the bill in regard to contracts and patents, which I have discussed rather extensively.

Mr. PECORA. The requirement of the bill that such information be furnished does not necessarily mean that such contracts are going to be left to the approval or revision or rejection of the Commission. You understand that, don't you?

Mr. ALTSCHUL I understand that, Mr. Pecora, but I do not understand——

Mr. PECORA (interposing). Those reports are called for in some instances for their informative character, and for the enlightenment they might give to stockholders and the investing public. Now, do you feel that under those circumstances the provision requiring the filing of such reports and information with the Commission is equivalent to placing upon the Commission the right as well as the burden, duty, and responsibility of managing the businesses of all listed companies?

Mr. ALTSCHUL. I went on the general assumption that in asking for this information you are asking for information that is going to lead to a decision by the Commission, whether in the course of 20 days or of 30 days, that registration will be granted or not. Just to have all that data placed on file without its having any bearing on the Commission's decision, would seem to me to be a burden that was not warranted, unless it was going to influence the Commission's decision, and that, therefore, the Commission would have to review those different documents occasionally with that idea in mind, and reach decisions.

However, that is not the only provision to which I am referring, and it may have been a misinterpretation of mine, although I do not think so.

Mr. PECORA. You say on page 5, no, near the bottom of page 4:

> If there is anything in the application which appears to the committee to be open to question—

Meaning the stock list committee of the New York Stock Exchange—

> then the committee makes every effort to have the question resolved in accordance with its views; but we have conceived our chief responsibility to be to see that the facts have been fully and adequately disclosed, and if this disclosure indicates nothing which appears to the committee to be unsound or improper, we do not undertake an independent investigation of the facts themselves

Now, you are referring there, I think, particularly to the procedure of the committee in passing upon applications for additional listings, aren't you?

Mr. ALTSCHUL. Well, I think that refers in general to all applications.

Mr. PECORA. Well, how could you possibly tell without inquiry if the facts you desire have been not only fully disclosed but truthfully disclosed?

Mr. ALTSCHUL. Well, of course, that is a thing we can only tell about on the basis of our experience, and I think our experience justifies us in the belief that by and large they are fully disclosed. However, anything that could be introduced into legislation that would make assurance doubly sure, such as some punitive provision of this legislation in regard to making a false statement, I think would be very welcome. I do not know whether that answers your question or not.

Mr. PECORA. On page 5 you say further:

I recognize that abuses have grown up about the market place which require correction in order that the public may be afforded proper protection, and I believe that the object of far-sighted legislation should be to afford such protection while placing as few obstacles as possible in the way of the normal functioning of this important part of our economic mechanism.

What were the abuses you had in mind when you wrote that?

Mr. ALTSCHUL. Well, that was a very general sentence. I had in mind not only the particular abuses that have occasionally cropped out in connection with listing activities, but I had more generally in mind the various abuses that have grown up in the market place itself and which Mr. Whitney suggested a means of dealing with through this body that he has recommended be set up; I mean that he himself has recommended in his memorandum. That covers practically the whole field of stock-exchange activities as I see it. And in whatever field abuses have occurred, as I have read his recommendations, machinery was to be set up for coping with them. And large numbers of them are being coped with by the stock exchange today.

Mr. PECORA. What my question was more particularly designed to elicit was your own view based upon the advantages of the observations you have had as a member of the exchange, as well as a member of one or more of its committees, as to just what the abuses were that you think have grown up about the market place and which require correction in the public interest. In other words, in order that the Congress might properly deal with the abuses, I should like to know what the members of the exchange themselves think the abuses are

Mr. ALTSCHUL. I think some of them have been brought out in your own investigation. The recently adopted rules of the exchange are an attempt to deal, as I understand it, with some of those abuses. I do not know whether I could undertake to make an inventory for you at this moment of them, but, for instance, the rule of the exchange recently adopted preventing participation in pool operations by specialists. That obviously was aimed at that kind of abuse which had been brought to the attention of the Government, and it was acted upon.

Mr. PECORA. Couldn't you enumerate the abuses that have grown up about the market place which requires correction in your opinon?

Mr. ALTSCHUL. Well, Mr. Pecora, I did not come prepared for that. I came to deal fully with stock listing questions. I should really want to be much more fully informed of the testimony which has been brought out in these hearings to attempt to deal with that. I think if you will permit me I will just glance through these sug-

gestions which Mr. Whitney made in regard to the power that might be given to the body he suggested. For instance, he suggests:

> The inclusion in the power given to this body of authority to regulate the amount of margin which members of exchanges must require and maintain on customers' accounts

But I am going a little off my beaten path and I hope you will pardon me.

Mr. PECORA. That is what I want you to do.

Mr. ALTSCHUL. An attempt has been made in the bill to deal with the question of margin in a rather rigid manner. It seems to me that a very strong argument could be made there, as in the case of the most of these provisions, for flexibility. If you take, for instance, an illustration from another field: No law provides rigidly that Federal Reserve banks should establish a certain discount rate and that that should be maintained. The discount rate is changed from time to time in accordance with conditions. In the same way it would seem to me quite reasonable to have a provision that margin requirements should not be made rigid but left capable of being adjusted from time to time in order to accommodate itself to the day-to-day or month-to-month development in the speculative market. In that case when things get to a point where the margin requirement should be obviously raised, the power would be vested in some authority to raise the margin requirement; and when the time came for the enforcement of such a margin requirement, when such a high margin requirement we might say was no longer necessary or desirable from the standpoint of economy as a whole, then there should be authority in some board to adjust it downward again.

Mr. PECORA. Don't you think it would be in the public interest that there should be a minimum margin requirement embodied in the statute, without reference to any particular minimum now? I am addressing myself to the principle of including in the bill a provision for a minimum margin requirement, with a degree of flexibility above that minimum.

Mr. ALTSCHUL. Are you speaking now of a minimum margin requirement on accounts as a whole?

Mr. PECORA. You might classify them in any way you see fit. But I am addressing myself to the principle of some minimum margin requirement, either one which will apply to all margin accounts or where the minimum might vary in accordance with the necessities of individual kinds of securities or bases of securities.

Mr. ALTSCHUL. Of course, you will understand I am very much out of my field here, because I do not know anything about the margin business as such. Therefore I hesitate to express a very positive opinion in regard to the matter. But it would seem to me that a minimum, if set sufficiently low to allow of a reasonable degree of flexibility to the body that was finally or from time to time to determine the minimum amount of accounts as a whole, would be a reasonable provision.

Mr. PECORA. Can you suggest what the minimum should be?

Mr. ALTSCHUL. I could not. I think the experience of those in the stock exchange, who deal with margin questions from day to day, would be much more valuable to you as a guide than any suggestion I might attempt to give you.

Senator KEAN. Let me suggest if that were the law, and a stock of a customer went down below that minimum, of course, you would have to sell him out at once, just because that would be the law.

Mr. PECORA. You would have to sell him out in accordance with the rules and regulations the commission may prescribe under the terms of this bill, Senator Kean.

Senator KEAN. I say, you would have to sell him out at once.

Mr. PECORA. That is what brokers do anyway when their customers' accounts become undermargined. They sometimes send them an hour's notice, and unless they make good they are sold out.

Senator KEAN. But as a rule a broker tries to get them to put up an additional margin, and if the quotation is only a very small amount below the margin, 1 percent or something of that kind, why, they may carry him over for a short time. But they could not do it if there were a rigid minimum provided in the law.

Mr. PECORA. As brokers see the market for the stock being approached, don't you think the broker would be keen to remind his customer and suggest that he put up additional margin so as to protect his account from becoming undermargined?

Senator KEAN. Surely. But very often there is a sudden drop in the market and a man may be under a little bit, and if you send him notice and he cannot get around until the next day, the broker carries the account over with the idea that the market will go up again, which it generally does after a bad break.

Mr. PECORA. That might be an argument for a minimum margin requirement which would be substantial so as to lessen the danger of that point being reached

Senator KEAN No. It does not make any difference what your margin is, if it is the law that a broker shall not carry an account below the minimum margin. He would then be in duty bound to sell his customer out. He could not wait.

Mr. PECORA. That, I think, would be putting into a law what has actually been done in practice.

Senator KEAN. I do not think so.

Mr. PECORA. Except, perhaps, under the power given to the Federal Trade Commission to prescribe rules and regulations for the selling out of an account of a customer, he might get a better break, so to speak, than he gets now from a broker.

Senator KEAN. Well, I know lots of people who do not sell people out right away.

The CHAIRMAN. Wouldn't this provision be rather a relief to the broker? In other words, he could answer any complaining customer that the law required him to make the sale and not expect him to put up a margin.

Senator KEAN. That is true, but it would be pretty hard on the customer. For very often while the market may drop suddenly, it may come back again and never drop that low again for a long time.

Mr. ALTSCHUL. I think that Senator Kean's point just again illustrates the dangers of rigid provisions, whatever they may be, because circumstances change from day to day and a rigid provision which might be put into a bill with the idea of protecting the investor might by accident result otherwise.

Mr. PECORA. Heretofore brokers themselves have arbitrarily fixed minimum margin requirements and imposed those requirements

upon their customers. There hasn't been any hard and fixed rule about that. It is left to the arbitrary judgment or determination by each broker, except within the limits of the rules recently promulgated by the New York Stock Exchange. Now, the investing public has been at the mercy of this arbitrary determination about margin requirements fixed by brokers themselves.

Mr. ALTSCHUL. Well, of course, as I say, you are now taking me out of my own field.

Mr. PECORA. Well, if you prefer not to go out of your field, I do not think it would be fair to ask you to do it.

Mr. ALTSCHUL. Well, I know very little, in fact, I might say I do not know anything about the margin business.

The CHAIRMAN. You may proceed, Mr. Altschul.

Mr. ALTSCHUL. The second point that Mr. Whitney makes is:

Authority to require stock exchanges to adopt rules and regulations designed to prevent dishonest practices and all other practices which unfairly influence the prices of securities or unduly stimulate speculation

Again the striking thing about that suggestion is that it vests in somebody a degree of flexibility. And my argument throughout has been that the danger of rigidity in all these things is easily apparent. That is, the practices which you may want to regulate, or which may arise, you do not contemplate the stock exchange is very alert about and is trying to prevent them. It is in sympathy with legislation that will tend to prevent practices which may unfairly affect prices of securities.

Mr. PECORA. On that point it might be well to recall that yesterday afternoon Mr. Whitney informed this committee that one or more rules promulgated by the New York Stock Exchange on February 13, last, was or were the result of several years' consideration of the subject. Senator Bulkley then asked him what opposition had been expressed to the formulation of the particular rule that was then under discussion, and Mr. Whitney said, "None, that he knew of." So, apparently, with regard to a rule as to which there was no opposition it required several years' consideration before it was promulgated.

Mr. ALTSCHUL. Mr. Pecora, I do not want to try to amplify or change the draft of Mr. Whitney's remarks, and I am not sure that I understand the situation correctly. My recollection of that was that he said the particular transaction had been undertaken within, oh, the last 6 months, and the information elicited by the business conduct committee, which gave them facts upon which they could proceed. While the thing had been under discussion, the actual incidents that led to the reform were much more recent than that, isn't that correct?

Mr. PECORA. I am simply calling attention to the statement Mr. Whitney made. He was the one who said that the rule was the outgrowth of several years' consideration of the question.

Mr. ALTSCHUL. Well, I am not familiar with that.

Mr. PECORA. Now——

Mr. ALTSCHUL (continuing). Mr. Pecora, I think when any body such as the one suggested by Mr. Whitney, is vested with the right to do the definite things that Mr. Whitney suggests should be done, you will accomplish the maximum amount of good with the mini-

mum amount of disturbance. And the reason for that, I want to repeat, is because it leaves the thing flexible, and because it does not crystallize in law at the given moment a number of rules which might be totally inadequate tomorrow.

Mr. PECORA. Now, just one or two more questions about the statement that appears on page 20 of your elaborated printed statement. You say:

I recognize the gross abuses that grew up in the period of rank and unhealthy development that followed the war and I heartily favor measures which will prevent or heavily penalize any repetition thereof

Now, again, I want to ask you what were the gross abuses that you had in mind when you penned that particular portion of your statement.

Mr. ALTSCHUL. Well, broadly speaking, I would say all the devices that developed which took on the nature of the fomenting of undue speculative activity. But my general idea is that speculation is a necessary part of an economy that functions as ours does, and that a stock exchange is a place where that speculative impulse should be allowed to express itself freely.

Mr. PECORA. You say freely.

Mr. ALTSCHUL. Yes; should be allowed to express itself freely. I think that while criticism may be leveled at speculation as such, there are times when the normal expression of the country takes a speculative turn. It may be necessary as a preliminary to recovery.

It may be necessary as a concomitant of a new period of forward movement and growth. When you get beyond that normal expression of speculative impulse that finds its urge in developing economy itself, and get into the different things that tend to foment it in an unnatural and exaggerated manner, those things generally constitute the abuses I was talking about. Some of them have been dealt with; yes, many of them I think have been dealt with; but they may take new forms tomorrow, and I think it only fair that somebody should have a change to review them as they arise.

Mr. PECORA. I want you to enumerate what you call in this portion of your statement:

the gross abuses that grew up in the period of rank and unhealthy development that followed the war.

Mr. ALTSCHUL. I think that the testimony given before your committee has brought out a good deal of information in regard to the speculative devices of trading against options, pool activities, and so on. I am not familiar with that testimony, and as to the most of it with me it is a matter of hearsay. But from what I have heard there is abundant evidence in that investigation to point to the character of the abuses I have in mind. They are mostly things that would be covered now by the recent regulations of the exchange, having to do with its operations.

Mr. PECORA. You recognize don't you, that the rules and regulations of the exchange are binding upon and enforceable only against its members, and that those same abuses might be perpetrated with similar detriment to the public interest by persons not connected with the exchange as members, but who employ the facilities of the exchange through brokers who are members. Now, in view of that, those abuses could only be dealt with by legislation,

in order to reach all classes of persons, whether members of exchanges or nonmembers, who were guilty of such abuses; don't you think so?

Mr. ALTSCHUL. I may be again speaking out of turn, but I would say that insofar as the exchange has recognized an abuse and tried to deal with it and to prevent it so far as its members are concerned, I cannot conceive that it would be otherwise than welcome if others were prevented by law, if they were prevented from indulging in abuses our own members cannot indulge in.

Mr. PECORA. Well, you realize that a law could not be made to apply simply to nonmembers of the exchange.

Mr. ALTSCHUL. Oh, no.

Mr. PECORA. I wish you would enumerate what you conceive to be the gross abuses that grew up in the period following the war.

Mr. ALTSCHUL. Well, that, of course——

Mr. PECORA (continuing). Instead of referring us to the record of this committee's investigation, which covers thousands and thousands of pages and millions of words. In other words, I should like to have the public, as well as the members of this committee, get the benefit of your observations and your knowledge with regard to those gross abuses, and get it in a phrase or two from you by means of your enumeration of those abuses. You cannot expect the public to read those thousands of pages of testimony taken by this committee.

Mr. ALTSCHUL. Well, of course, I have the feeling that the thousands of pages of testimony taken before the committee have been very well summarized to the public almost daily through the press. But apart from that, if I had come here with a view to speaking about topics beyond the particular scope of the committee on stock list, I would have tried to prepare for you a statement on that point. On short notice I would hesitate to do so, because I would be afraid I might include something I should not include, or leave out something that possibly I should include.

Mr. PECORA. I thought you had already given some consideration to the development soon after the war because of the reference you made in your prepared statement of a recognition of those "great abuses"?

Mr. ALTSCHUL. I have given a great deal of consideration to it, but before such a body as this I would hesitate to try to put that consideration into words on short notice. In general, I would consider within the category of abuses the different things which tend to unduly foment speculation and which would affect natural and normal development.

Mr. PECORA. Do you think that margin requirements have that tendency—I mean, to unduly foment speculation?

Mr. ALTSCHUL. No. I do not think that margin requirements have a tendency to unduly foment speculation any more than I think the discount rate of the Federal Reserve Board has a tendency to foment business.

Mr. PECORA. Why did the exchange authorities themselves during the first 6 months of 1929, or rather the individual members of the exchange, raise their margin requirements in a manner that created a minimum or an average of 40 percent of the market price of securities then being traded in by the public as their margin?

Mr. ALTSCHUL. Well, I do not believe that normal margin requirements unduly foment speculation. But I think it is quite apparent that as speculation develops a tightening of margin requirements is a force that operates against speculation.

Mr. PECORA. Against the practice of undue speculation?

Mr ALTSCHUL. It ought to be, I think; yes, it ought to be anyway, in my opinion.

Mr. PECORA. Very well. Now——

Mr. ALTSCHUL (continuing). In the same way again as the raising of the discount rate to a very high rate tends to slow up business at a time when business has gotten out of bounds. It seems to me the mechanism is very similar in character. But we have evidence before us that a low discount rate itself, when conditions are unpropitious, does not start a business revival.

Mr. PECORA. You add a saving clause to your answer, when conditions are not propitious.

Mr. ALTSCHUL. Yes. I do not think that low margin requirements or normal margin requirements, whatever they may be, will of themselves stimulate speculation if there is no disposition because of other circumstances for more speculation to develop.

Mr. PECORA. It might prevent giving impetus to speculation that would make it necessary to apply a brake with such sudden force and energy that the cart might be overturned.

Mr. ALTSCHUL. Oh, yes. But I again point out there that I do not think speculation is of itself under all circumstances a necessarily evil thing. On the contrary, it may be a very necessary thing at a time when business is liquidated and revival is being sought; and there may be a good many reasons why margins and speculative impulses are nothing more than a symptom of revival and growing economy.

Mr. PECORA. Well, if you think that speculation should be permitted do you think it should be permitted on a broad scale with other people's money?

Mr. ALTSCHUL. I know of no reason why a person should not borrow other people's money and use it to finance purchases of securities, just as he does to finance purchases of real estate. The only important thing is whether the loan is secure in that case, and beyond that, of course, the question whether the amount being used in that manner is growing so unduly in regard to the economy as a whole as to create disturbance in the business structure. Those are things that the Federal Reserve, cooperating with some other organization, such as Mr. Whitney suggested the creation of, could be dealt with in that manner.

Mr. PECORA. Let us confine ourselves to the stock market. Do you think that speculation in that mart should be encouraged with other people's money?

Mr. ALTSCHUL. When you use the words "should be encouraged"——

Mr. PECORA (interposing). That is, encouraged by low margin requirements, by lowering your margin requirements more, and on other people's money that the speculator uses in his particular operations; isn't that so?

Mr. ALTSCHUL. Well, I don't think so. When you say "lower margin requirements" you are using a relative term.

Mr. PECORA. Yes; I am.

Mr. ALTSCHUL. Take, for instance, the normal requirements in normal times of the stock exchange. I think if those normal requirements are enforced at times when there is great speculation and when there is very little speculation, the fact that they exist, in my opinion, does not stimulate speculation any more than the low discount rate stimulates business. To follow your thought in regard to this bill, I think speculation, which may be a perfectly normal concomitant of our economy in its early stages, or as it runs along, may at some stage reach a point where for many reasons it may be dangerous or is threatening to become dangerous, and at such a time ability to change the margin requirements, by reason of flexibility vested in some such authority as Mr. Whitney has suggested, would be a very helpful thing.

Mr. PECORA. Well, it is a rather trite thing to observe that the lower the margin requirement the greater the temptation to the speculator to speculate. If a person desiring to speculate in the stock market is required to put up his own funds only to the extent, say, of 20 percent of the purchase price of the security he is buying, he would buy twice as much as if he were required to put up 40 percent. I think that is obvious.

Mr. ALTSCHUL. It is a trite observation, I concede, but I think it is an inaccurate one.

Mr. PECORA. Why?

Mr. ALTSCHUL. Because I do not think that the fact that the margin requirements are low is in itself a temptation to speculate.

Mr. PECORA. You think the temptation to speculate is inherent in the person who speculates?

Mr. ALTSCHUL. No; I think the temptation to speculate is either inherent in the situation or is not inherent in the situation. It emerges at times in response to all sorts of factors.

Mr. PECORA. Is not the volume of speculation engaged in affected by the margin requirements?

Mr. ALTSCHUL. There is no question about that; I agree on that.

Mr. PECORA. That is the only point I was trying to make.

I have no further questions.

The CHAIRMAN. That is all. You may be excused now, Mr. Altschul.

STATEMENT OF RICHARD WHITNEY, PRESIDENT OF THE NEW YORK STOCK EXCHANGE—Resumed

The CHAIRMAN. Proceed, Mr. Whitney, where you left off when you were interrupted.

Mr. PECORA. You gave up to Mr. Altschul for the purpose of taking up listings requirements.

Mr. WHITNEY. May I point out with regard to the matter recently discussed, about margins, that I think Mr. Pecora has the wrong impression that the exchange had no requirement as to margin during the panic and that brokers themselves raised their margin requirements at will. The exchange did have a minimum requirement. Brokers did also raise at will their margin requirements. I think it is fair to point out, because it is interesting, at least, perhaps, that in spite of the margin requirements, the raising of them

by the brokers at their volition, nevertheless speculation continued in even greater and greater sum total in spite of those increased margins.

Mr. PECORA. Because of the mania that then afflicted the speculating public?

Mr. WHITNEY. Quite right, sir. Mr. Altschul also said that the surrounding conditions had a very great bearing on the situation, and the imposition of higher margins did not, though perhaps it would have been desirable—perhaps it was the idea back of the brokers raising their margins, but it did not prevent the increase of speculation; which is just what I tried to show to you yesterday.

Mr. PECORA. That might have been due to the fact that the impetus which had been given to speculation because of the ease and facility with which persons could engage in it with money that did not belong to them had become so strong and so great and powerful that when you tried to apply the brakes they were burned, and the result was that we had a wreck; the car crashed into a tree and went into the ditch.

Mr. WHITNEY. You have argued here—and I have not taken exception to it, because I think it is a part of the entire situation that has a very direct bearing upon it—but you have, I think, argued here that the use of higher margins will stop speculation just at those times when it should be stopped; but I am stating, purely as a matter of interest, the facts as I remember them happening in 1929 in that particular regard, merely in passing.

Mr. PECORA. But I am not confining myself to a consideration of what was done with regard to the raising of margin requirements in 1929. The thought that I am suggesting is that the reason that those increased margins proved ineffective to reduce or control the excessive speculation that undoubtedly went on was because prior to 1929 brakes had not been applied and the economic machinery of speculation had attained a speed, through the impetus given to it throughout the preceding 2 or 3 years of the so-called "bull market", that when the attempt was made to apply the brakes the brakes either proved ineffectual or they were burned out. The desirable thing would be not to permit the economic machinery to reach that dangerous rate of speed where the sudden application of brakes would be ineffectual or would only bring a stoppage with a serious jolt to the occupant of the car.

Mr. WHITNEY. Then no brakes are effective.

The CHAIRMAN. Oh, yes.

Mr. PECORA. The brakes will be effective if the rate of speed is not permitted to grow without limit.

The CHAIRMAN. The same thing happened, according to the admission of the Federal Reserve Board, when they were late in checking this undue inflation. If they had started earlier, they might have prevented it.

Mr. WHITNEY. True, sir.

Senator KEAN. The stock exchange has existed for how long?

Mr. PECORA. A hundred and forty-two years.

Mr. WHITNEY. Thank you. A hundred and forty-two years.

Senator KEAN. During that period margins were never called for beyond 20 percent, during all that period?

Mr. WHITNEY. I do not think so, Senator.

Senator KEAN. Until this last time.

Mr. WHITNEY. We have had very serious panics during those 142 years, besides the one in 1929.

Senator KEAN. So that the business has gone on successfully and has developed, and our industries and our railroads and our various industrial activities have increased all during those years with the assistance of floating securities, without any trouble?

Mr. WHITNEY. Very materially; and I think speculation has played a very important part in the setting-up of our corporations and our industries throughout this country; our railroads perhaps more than any others.

Mr. PECORA. The fact that the country has continued and has recovered from these various panics and depressions is comparable to the experience of the average human being, that in the course of his lifetime he runs into periods of illness and recovers from them—which is no reason why such illness should not be averted if it can be.

Senator KEAN. That is correct; but, Mr. Whitney, is it not true, also, that nobody in the world has yet succeeded in preventing upturns and downturns of the market, owing to the financial conditions that occur all over the world?

Mr. WHITNEY. I do not know of any formula that has ever been devised; and I think we would be the first to like to see such a formula.

Senator KEAN. Is it not also true, Mr. Whitney, that during the war there was a tremendous amount of capital destroyed, and that therefore the world had less capital to operate on, and that to try to bolster up things various governments expanded credit in every way they could so as to try to keep prices level with what they were before the war?

Mr. WHITNEY. I think that is true.

Senator KEAN. And when the final crash came it was a question of a large percentage of the savings of the world, of the capital of the world, having been destroyed, and we had a new measure of value to which everything had to be regulated?

Mr. WHITNEY. I think that is so.

Mr. PECORA. Is that all with the purpose of suggesting the thought, Senator Kean, that stock market speculation had nothing to do with the panic and with the depression since 1929?

Senator KEAN. That is only an incident. The price of wheat, the price of land, the price of houses, the price of everything else all over the world had to go down to be measured by the loss of capital which had been destroyed in the war.

Mr. PECORA. Senator, I shall be able to bring to your notice, and I propose to do it at the proper time, public expressions of opinion, not only by Mr. Whitney but by his predecessor, the president of the New York Stock Exchange, in which they very frankly avowed the responsibility of the speculation mania which preceded October 1929, before the depression—not the sole responsibility, but as a contributing factor.

Senator KEAN. Did that affect the prices in France?

Mr. PECORA. Did what affect the prices in France?

Senator KEAN. The speculative mania on the stock exchange in New York.

Mr. PECORA. Insofar as the whole world is more or less interrelated in an economic system, I venture to say it had its repercussions in France and every other land with which we do business.

Senator CAREY. What percentage of margin do the New York banks require when a person makes a loan on securities with a bank? How much will they loan?

Mr. WHITNEY. At the present time, and taking the same stock that we demand 30 percent on debit balance for, their requirement is 30 percent of the loan.

Senator CAREY. So if we put a limit on the stock exchange, a man will probably go to a bank and borrow on the securities?

Mr. WHITNEY. I believe so. As I granted yesterday, it might make it more difficult. Perhaps various things would be looked into by the bank, and there might be other agencies built up that would loan to him.

Senator CAREY. Is there a limit in the bill as to banks?

Mr WHITNEY. The limit in the bill is the same as brokers with relation to securities listed and members of security exchanges.

Mr. PECORA. If the borrowing is for the purpose of buying securities; yes But the bill provides that a man may go to a bank and borrow on collateral to an extent exceeding the so-called "margin requirements" in the bill, provided the securities that he offers as collateral have not been purchased by him within 30 days prior to the time of the borrowing.

Mr. WHITNEY. Thereby not allowing to such borrower any power of substitution of those securities that he might during that period buy.

Mr. PECORA. And thereby not allowing the borrower to overcome the margin requirements of the act.

Mr. WHITNEY. There is one point, Mr. Pecora—I did not think we were going to get into an economic discussion here—that I do think has a very great bearing, and I would like to state it, on all boom and panic periods, and I think it is fundamental, and that is that the earning power of corporations is bound to be reflected in their price; when they have good earnings, in an increase in price, and when they have bad earnings, a decrease. There is nothing in the world, to my knowledge, that is going to prevent prices going up, whether there is speculation or not, if the earnings of the corporation are great; and there is nothing in the world to prevent the prices of the shares of corporations going down if they fail to earn money.

Mr. PECORA. But those increases in price, where they are based upon actual earnings, and hence corresponding increases in earnings, would be justified by sound economic factors; but where the increases in price are brought about solely by speculation, I venture to say that your own opinion and belief is that those increases in price levels of securities are not wholesome.

Mr. WHITNEY. Yes; but the period of time one is talking about, whatever time, naturally has its direct effect upon all corporations. In other words, the general tendency is to earn money, and there are good times for the corporations That brings others perhaps not in that category, and vice versa——

Mr. PECORA. The moneys earned, whether realized or translated from paper profits into actual profits during the speculative mania that preceded 1929, were not reflected in the earnings of corporations,

as has been pointed out in documents issued by the stock exchange itself.

Mr. WHITNEY. I have a document here, if I may put it into the record, which shows composite earnings index of 166 companies from the first quarter of 1929 to the last quarter of 1933, and on it also is shown a monthly average of weekly stock price index of 421 stocks. During that period—it shows the height of the boom period and the depth of the depression—earnings fell faster and farther than did prices, and when earnings started to improve so did prices start to improve; but earnings went faster than prices. I merely bring this in, sir, as having a very important bearing upon a subject which is one of economics and in which there are many, many factors, as I think everybody will agree.

The CHAIRMAN. Do you wish that inserted in the record?

Mr. WHITNEY. I would like to have it in the record, Mr. Chairman.

The CHAIRMAN. It will be admitted.

(Photostatic copy of a graph showing monthly average of weekly stock price index for 421 stocks and a composite earnings index of 166 companies was received in evidence, marked "Whitney Exhibit No. 1, Mar. 1, 1934", and will be found reproduced at the end of today's record, in the committee's copy thereof.)

The CHAIRMAN. I think, Mr. Whitney, that the ordinary buyer of stocks of corporations on the market has very little conception of the actual earnings of those corporations. He just buys because it is his disposition to speculate, or what not; he does not go to the trouble to find out the actual, real value of stocks by the earnings of the corporation. Is not that true generally of the ordinary buyer?

Mr. WHITNEY. Mr. Chairman, I will agree that that may be more or less true, certainly in a period when the country is swept by a speculative mania. I think, during the times we have been passing through in the last 3 years or more, where he have seen the perfectly extraordinary increase in the number of stockholders in our larger corporations, where speculation was largely nonexistent, as shown by the debit balances of brokerage firms, those people have bought because they had faith in the companies' prospects, or on what they believed was a particular company's earning power. I do not think that those purchases were made from a speculative point of view at all. We have had perfectly terrific increases in the number of stockholders who own their stock and in whose name the stock is registered and for which cash was paid, and it was not bought on borrowed money.

Mr. PECORA. Has not that been due in part to the necessity for large holders of stocks to dispose of their holdings?

Mr. WHITNEY. There is always a seller for every buyer; yes.

Mr. PECORA. But you are putting the emphasis on the larger number of stockholders.

Mr. WHITNEY. I do not know any facts to verify your statement. It may be true.

Mr. PECORA. Do you think it is a violent assumption, based upon your own observations? You know there have been disbursals of large holdings of stock in the last 3 or 4 years.

Mr. WHITNEY. Yes; but I think that takes place at all times.

Mr. PECORA. Exactly. Don't you think it has been much more evident in the last 3 or 4 years?

Mr. WHITNEY. I don't know, if you are asking my personal opinion.

If I may proceed, we come to section 14 of the bill which purports to make it illegal for any person to use the mails or any means of interstate communication or transportation for the purpose of making a market in any security whether listed on a national exchange or not; in which, as I see it, complete control is given to the Federal Trade Commission on over-the-counter or outside market transactions.

That has been very fully gone into by Mr. Corcoran and I think there is but one point that I can add. As I see it, this gives to the Federal Trade Commission complete power to regulate the trading of State, county, municipal, and other governmental bodies, other than the United States Government, complete power to regulate the markets and how they shall be conducted in the indebtednesses or bonds of States and municipalities. I think that is a very dangerous power to give anybody, and might work to the terrific detriment of those particular governmental bodies.

Mr. PECORA. Do you know how markets are made generally in the over-the-counter market on securities that are traded in?

Mr. WHITNEY. Specifically, in what type of securities?

Mr. PECORA. Take any type that you want to use as an illustration of how markets are made in the over-the-counter market.

Mr. WHITNEY. Well, we will take New York State bonds. There are, I suppose, 5, 10, or perhaps 15 organizations—oh, there are more, but there are that many that deal actively and largely——

Mr. PECORA. Sort of specialize in it?

Mr. WHITNEY. Yes—in that type of securities. They make bids and offers and they very often send out lists as to their bids and offers. I am not sure they do it now, on account of the Federal Securities Act. Of if you inquire over the telephone, they will give you a bid and offer on these securities; and that is based largely on the question of the rate and worth of money at that particular time, taking into consideration, of course, the standing of that particular governmental body.

Mr. PECORA. There was some testimony presented to this committee last February—I think the witness whom I have in mind especially was a broker named Robinson who gave some rather illuminating testimony on how the over-the-counter market was operated. Do you happen to have read his testimony? I know you were down before the committee just about the time he was testifying.

Mr. WHITNEY. No; I do not think I read it.

Mr. PECORA. You may have heard him testify.

Mr. WHITNEY. I do not think I read it.

Mr. PECORA. Well, it is in the record.

Senator GOLDSBOROUGH. With regard to section 14, relating to over-the-counter markets, do you mean that that section would make it practically impossible to control the activity of nonmember dealers and that it would create a bootleg market?

Mr. WHITNEY. I will take it from two points of view. If the bill is enacted in its present form it would give the Federal Trade Commission, as I see it, complete authority to pass rules and regulations

with regard to over-the-counter markets in securities not listed; and I also feel that there is a very real danger that listed securities might be dealt in over the counter in bootleg markets, as you say; and as has been stated here by others, I think it very probable that under the conditions of this bill with reference to what you spoke about this morning, the imposition of rules and regulations upon corporations in order to be listed, their shares would also go into the bootleg or over-the-counter market.

Mr. PECORA. Mr. Whitney, if section 14 were to be modified so as to exclude from the operation of this provision Government bonds, State bonds, or bonds issued by any political subdivision, what would you say then?

Mr. WHITNEY. That would be progress in the right direction.

The CHAIRMAN. Has the New York Stock Exchange any rules or regulations with respect to open-market operations?

Mr. WHITNEY. I do not know just how to make myself perfectly clear to you. Our rules apply in the conduct of our members wherever they operate; but as to the securities that they shall deal in over the counter there is no rule, sir, if that is what you mean.

The CHAIRMAN. Yes.

Senator CAREY. Do you not read the bill to prevent anybody from selling any securities that were not listed on the exchange?

Mr. WHITNEY. As the definition now is, I think it would be subject to some review in a court as to whether that would not be so. Certainly one would be at his peril in selling any security over the counter unless done under the provisions set forth by the Federal Trade Commission, whatever they may be. They are not cited here.

Senator GOLDSBOROUGH. I gather from what you say that the market would be somewhat affected for municipal bonds and equipment trust certificates, bank stocks and insurance stocks?

Mr. WHITNEY. Very materially affected; yes, sir.

Senator KEAN. Would it not be practically impossible to trade in them?

Mr. WHITNEY. I think it would be impossible for any member of the securities exchange to trade in them, many of whom specialize, as part of their business, in that type of market. It happens to be true of myself. Therefore, I refrain from making any particular objection to it.

Senator KEAN. It is true of me, too.

Mr. WHITNEY. Section 15 comes under the remarks that Senator Goldsborough made this morning, in that it deals entirely with transactions by directors, officers, and principal stockholders of corporations and is very broad in its effect.

Section 16 requires every member of an exchange and every person transacting business, and so forth, to keep accounts, books and records such as the Federal Trade Commission may require.

Mr. PECORA. Pardon me. Mr. Whitney, but have you any opinion to express with regard to the provisions of section 15?

Mr. WHITNEY. We entirely approve, and as we suggest in offering the Federal incorporation law as a suggestion, we believe that anything to control dishonest acts should be done in that direction. But this is very broad. It goes into detail under which, in my belief, it would be extremely difficult for a management to operate.

Frankly, I do not think that such a subject should be incorporated in a stock exchange bill.

Mr. PECORA. You recognize the difficulty of any speedy enactment of the Federal incorporation law, do you not? It has been adverted to by representatives of the exchange who have already appeared before us.

Mr. WHITNEY. I do not know, sir, whether such a bill has ever been presented in either the Senate or the House for consideration.

Mr. PECORA. No; but there are very serious legal constitutional questions that are involved in that.

Mr. WHITNEY. Yes; I think there are very serious questions probably involved in the passage of any bill, just as I think we find very difficult questions arising in the consideration of rules and regulations to be adopted by the exchange.

Mr. PECORA. You are suggesting, if I correctly understand you, that the provisions of section 15 should not be found in a measure of this character?

Mr. WHITNEY. And other provisions.

Mr. PECORA. They more logically should find lodgment in a Federal incorporation bill? Is that the point you are making?

Mr. WHITNEY. Yes.

Mr. PECORA. If there is a rainstorm, and an umbrella is not handy, a newspaper might sometimes give shelter temporarily, anyway?

Mr. WHITNEY. Possibly.

Senator GOLDSBOROUGH. Under section 16 to which you referred a moment ago, the records of corporations are subject to inspectors, are they not, by the Federal income-tax representatives?

Mr. WHITNEY. Oh, yes.

Senator GOLDSBOROUGH. Are the people who are to be so inspected required to pay the expense of the inspectors?

Mr. WHITNEY. No, sir. I was coming to that. I think this imposes a very, very severe hardship upon members of exchanges and the exchanges themselves. Besides, as we will get to later, there is a so-called "fee" imposed upon exchanges, which is nothing more nor less than an additional tax on the purchase and sale of securities; and we now have in New York a Federal tax, a State tax, and also in some other States there are taxes affecting exchanges other than the New York Exchange.

Mr. PECORA. I think the fee you have mind is five-hundredth of 1 percent?

Mr. WHITNEY. Yes, sir; but in our case, taking a fair average, it would amount to $500,000 to $1,000,000 a year. Perhaps that is a small sum when we talk of billions, but it is pretty large to us.

Mr. PECORA. I just want to call attention to the fact that what you refer to as a tax amounts to one five-hundredth of 1 percent.

Mr. WHITNEY. I don't think that really changes the question, does it? It is what that develops into in dollars and cents. In the case of the New York Stock Exchange it would be large. Presumably not in every case.

Mr. PECORA. Because of the great volume of business transacted there?

Mr. WHITNEY. Yes; and it is, nevertheless, in the last analysis, presumably another tax upon the people who trade there.

Mr. PECORA. This provision that Senator Goldsborough has referred to, section 16, is somewhat similar to the provision we find in the National Banking Act which imposes the cost of examinations of banks upon the banks.

Senator GOLDSBOROUGH. It being based on the capital resources of the institution?

Mr. WHITNEY. This is not based upon the capital resources of any member of the exchange, nor in any way limited to the business to be conducted in the particular office under inquiry It is terribly broad.

Mr. PECORA. It was freely acknowledged 2 or 3 days ago here when Mr. Corcoran was discussing this section that a calculation might indicate that this fee of one five-hundredth of 1 percent might yield a revenue that would defray the cost of these examinations so as not to impose a burden on the subject of the examination.

Mr. WHITNEY. Section 17 deals specifically with the responsibility of persons making any statement in any report or document filed with the Federal Trade Commission which is, in the light of the circumstances under which it is made, false or misleading. It can impose, as I see it, a very tremendous responsibility upon officers of corporations.

Mr. PECORA. Is it a responsibility that should not attach to them if they make false and misleading statements to the damage or detriment of one who relies upon them?

Mr. WHITNEY. I think it is so worded, sir, that what might be perfectly true at the time might prove at a later time to have been misleading; and I think the breadth and scope of the provision impose a terrific responsibility.

Mr. PECORA. To what particular language do you attribute that?

Mr. WHITNEY. Perhaps I can give an instance——

Mr. PECORA. Why not take the language of the bill itself that you think has that effect?

Mr. WHITNEY. I have just read it, sir—"false or misleading in respect of any matter sufficiently important to influence the judgment of an average investor."

I beg your pardon. I did not read that last part. It is conceivable that a director or an officer of the corporation might authorize an accountant or certain junior officers to give out statements regarding the company or information regarding the company that was considered perfectly proper at the time. It might happen that, innocently or otherwise, the junior officer might have issued something that was false or misleading, and yet the directors or officers of the company who had been responsible for having such a report or statement issued would be held liable under the very severe penalties in this provision of the bill.

Mr. PECORA. Aren't you overlooking this provision in subdivision (a) of section 17, which provides:

unless the person sued shall sustain the burden of proof that he acted in good faith, and in the exercise of reasonable care had no ground to believe that such statement was false or misleading

Mr. WHITNEY. I recognize that qualification, sir, but I still think, as I said, that there is a very severe possibility of penalty to be imposed.

Senator GOLDSBOROUGH. Is that where the 2-year provision is made?

Mr. PECORA. No, sir; that is subdivision (e) of section 17.

Senator GOLDSBOROUGH. Under section 8 have you a 2-year term of liability based upon the discovery of alleged violations of the act?

Mr. PECORA. That is subdivision (e) of section 17.

Senator KEAN. Was it not agreed, practically, that we would change that?

Mr. PECORA. Yes; I think it is one that might very well be considered.

Senator GOLDSBOROUGH. An order might be given over the telephone and not come to light for 2 years.

Mr. PECORA. Subdivision (e) of section 17 reads as follows [reading]:

> No action shall be maintained to enforce any liability created under this section unless brought within 2 years after the discovery of the violation upon which it is based

There might well be added a provision that "in any event such action will be brought within 6 years of the alleged violation."

Senator CAREY. In line 8 on page 32 it says [reading]:

> Unless the person sued shall sustain the burden of proof that he acted in good faith

That means that the man who is sued has to prove that he is innocent, rather than the man that sues has to prove that he is guilty?

Mr. PECORA. He has the burden of proof imposed upon him.

Senator CAREY. Is that fair?

The CHAIRMAN. He must show first that the statements are false or misleading. That establishes your cause of action. He can be relieved of that if he can show that he acted in good faith.

Mr. PECORA. And evidence showing that he acted in good faith is obviously, in such an instance, more under his control and available of development than would be evidence to show that he did not act in good faith under the control or power of the Government or the plaintiff. There are many counterparts of this provision in various branches of the law, even in the criminal law. There are criminal statutes whose constitutionality has been upheld, where the burden of proof is placed by the statute upon the defendant, in apparent violation of the rule that the burden of proof shall never shift to the defendant in a criminal case.

Senator CAREY. Does this not mean that anyone can charge a man with having made a false statement?

Senator BULKLEY. He has got to prove the statement and the falsity of it.

Senator CAREY. The man that makes the charge?

Senator BULKLEY. Yes.

Mr. PECORA. Or the misleading character of it.

Senator CAREY. I think the misleading part is the most serious part.

Mr. PECORA. The defendant can show on his own behalf that he did not make such false or misleading statement wilfully and that he acted in good faith by putting out a statement that was in fact false or misleading, and no liability would attach.

The CHAIRMAN. There is the same provision in the Securities Act. The defendant can put in a plea of confession and avoidance.

Senator GOLDSBOROUGH. You drew a distinction between a misleading and a false statement. I did not catch that.

Mr. WHITNEY. I said that the word "misleading" was one that presented grave difficulties to any officer of a corporation.

Senator GOLDSBOROUGH. It is too broad, you mean?

Mr. WHITNEY. Yes, sir; because in the future some one might, under this act, sue and prove, perhaps conclusively, that a statement was misleading as a result of what had happened since the time of the issuance of the statement, but at the time it would be very difficult on the part of the officer to prove that he had not intended to make it misleading.

Mr. PECORA. Conceivably a half truth is a more subtle form of falsity than an outright lie. It is also conceivable that only a part of the truth might be given in a statement which would make that statement perhaps not false in terms, but would make it misleading to the person who it was hoped would rely upon it. I think that is what that language is aimed at.

Mr. WHITNEY. Perhaps it is, sir; but I take it we are trying to deal with honest men as well as with crooks.

Mr. PECORA. We are trying to deal with all men; and those who are not honest we are trying to punish in the hope that the fear of punishment will be a deterrent to their dishonesty.

Mr. WHITNEY. It is my opinion, and merely my opinion, that the breadth of these provisions and the wording could make it a very grave position for a perfectly honest man inadvertently to have violated some of the provisions of this act.

Mr. PECORA. It is always open to a law-making body, where injustice develops in the operation of a statute, to modify the statute.

Senator KEAN. We are calling here in the bill, as it now stands, for an audit every quarter. Suppose that you get an audit for a quarter and that shows that the company has earned a great deal for that quarter. Is not that misleading to the people that expected it to earn the same amount for the other three quarters?

Mr. WHITNEY. I don't know, sir.

The CHAIRMAN. It is misleading, as was said in the English case, where the whole truth was not given. What was stated was true, but they failed to state that the dividends paid were not paid out of earnings, but out of surplus and reserve.

Mr. WHITNEY. Section 18 of the bill grants special powers to the Federal Trade Commission. Some of them are in regard to stock exchanges and members of exchanges, and others refer to authority over corporations who list on such exchanges. Again, as Senator Goldsborough said, the latter are very broad.

Senator GOLDSBOROUGH. You mean, the power goes beyond supervision and regulation?

Mr. WHITNEY. Yes, sir; in my opinion it does, far beyond.

Mr. PECORA. What is the language in that section that, in your opinion, has that effect?

Mr. WHITNEY. The specific language with respect to corporations as to the information that they shall file—

the items or details to be shown in the balance sheet and earning 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——

Mr. PECORA. Pardon me; I cannot find that language in the bill.

Mr. WHITNEY. Section 18 (b). I am reading from S. 2693.

Mr. PECORA. Yes.

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, the items or details to be shown in the balance sheet and earning 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 so forth. Yes.

Does not that power relate principally to the matter of prescribing uniform systems of methods of accounting, and isn't that the very thing you say the stock exchange may be unable to effectuate?

Mr. WHITNEY. It may, sir. It may. But I think it goes far beyond that, as well.

Mr. PECORA. I do not see where.

Senator GOLDSBOROUGH. Do you mean that because it includes substitution of the commission for the governing bodies of the security exchanges?

Mr. WHITNEY. No. We have no power over any corporation, sir, unless they freely come to us and desire to list on our exchange. Then they have to meet our requirements. Here the commission is given power on all corporations now listed or that may seek to list, not only the power designated, but, as I see it, further power as the commission may itself in the future prescribe.

Mr. PECORA. Which all relates to the power to make rules and regulations and modify them from time to time with respect to the form of information and other data which under this section must be filed with the Commission?

Mr. WHITNEY. Yes, sir. It all refers to that.

Mr. PECORA. I take it that this section is the basis for the contention that I see has been advanced by you in some of the printed material that has been submitted to this committee and to the House committee also, and in which you say, in effect, that this gives to the Commission the power to control and manage all business corporations?

Mr. WHITNEY. This and other parts of the bill.

Mr. PECORA. Well, I do not see how the power to manage and control and operate companies whose securities are listed is conferred upon the Commission merely by this provision of the act which gives them the power to prescribe the form in which information shall be given to the Commission for the purposes of enforcing this act.

Mr. WHITNEY. May I read?

Mr. PECORA. And carry out its purposes and provisions.

Mr. WHITNEY (reading):

SEC 18 (a) The Commission shall have authority from time to time to make, amend, and rescind such rules and regulations as it may deem necessary or appropriate to carry out and implement, administer, and enforce the provisions of this act, including rules and regulations governing the form and content

of registration statements [to which we are referring] and reports for various classes of exchanges, members, securities, and issuers [they being the corporations], and define the accounting, technical, and trade terms used in this act.

To my mind, Mr. Pecora, that is so all-embracing and could be so onerous as to give the Federal Trade Commission absolute control of a corporation.

Mr. PECORA. I wish you would be specific about that and show how the exercise of that power would operate in that fashion.

Mr. WHITNEY. By the imposition of forms of accounting, the frequency of reports and all of the things that are stated clearly here in the provisions of the bill upon corporations.

Mr. PECORA. You think that the power to impose forms of accounting is equivalent to the power to step in and run the business of a corporation?

Mr. WHITNEY. I have said I think that I am referring to section 18 and the other provisions affecting corporations in the act.

Mr. PECORA. But I would like to see what the other provisions are.

Mr. WHITNEY. I think we have covered a great many of them, sir.

Mr. PECORA. That you regard as affording a basis for your contention in that respect. The word has gone forth in printed documents that I understand were prepared by you to the executives of business corporations all over the country that this act——

Mr. WHITNEY (interposing). Listed corporations.

Mr. PECORA. Listed corporations—that this bill if enacted would put the Federal Trade Commission in the saddle of management and operation and control of every such corporation.

Mr. WHITNEY. If they choose.

Mr. PECORA. And I seriously and emphatically challenge that statement or that contention.

(Mr. Whitney conferred with Mr. Redmond.)

Mr. WHITNEY. If the chairman would allow, I would like Mr. Redmond to answer from the more technical point of view.

The CHAIRMAN. Yes; he may do so if necessary.

Mr. REDMOND. I ask the permission only because Mr. Whitney's statement is based on my interpretation of the act.

If you will turn to section 18 (a), it gives the Commission not only power to regulate the form of the information, Mr. Pecora, but also the content thereof.

Mr. PECORA. Yes.

Mr. REDMOND. And having the power both to regulate the form and the content of registration statements, the Federal Trade Commission could require as a condition of registration the including of anything it wanted in those statements. The right to include anything, to force a corporation to include anything, in effect is a club over management which would allow it to control management. And that is the basis of my opinion.

Mr. PECORA. Well, I think that is the most——

The CHAIRMAN (interposing). Specifying the content of a statement does not seem to me to control the management.

Mr. PECORA. I think that is the most fantastic kind of ghost to conjure.

Senator BULKLEY. I would like to clear this up.

Mr. REDMOND. Yes.

Senator BULKLEY. Do you contend that the control over the corporation is by any direct words in the act, or is it by the Commission having the power to make itself such a burden and a nuisance that it can indirectly control where it does not directly have the right to do it?

Mr. REDMOND. Exactly, Senator.

Senator BULKLEY. It is the latter?

Mr. REDMOND. It is the latter.

Senator BULKLEY. You do not base it on the former at all?

Mr. REDMOND. Not on the former.

Senator BULKLEY. Is that your view, Mr. Whitney?

Mr. WHITNEY. Yes, sir. I tried to express it before.

Mr. REDMOND. It even goes to the extent that the Commission could demand a corporation to make daily reports, on condition that if those reports are inaccurate in the least degree the directors and officers who would be required to file them would be liable both criminally and civilly. Now, you could imagine that if you face the board of directors with the alternative of certain action or having to file daily reports, the only action that that board could take would be to comply with the wish of the Commission. In effect it is a weapon that would allow the control of corporations.

Mr. PECORA. Mr. Redmond's statement in effect is saying that because a person is appointed to the Federal Trade Commission, in the event of the enactment of this bill, he would automatically be deprived of all sense of reasonableness and of mentality and that he would seek to discharge duties in the most vicious fashion possible.

Mr. REDMOND. No, Mr. Pecora.

Mr. PECORA. And with a view designed not to carry out the well-recognized purposes and provisions of this act, but simply to impede and hamper business corporations in the conduct of their business.

Mr. REDMOND. No, Mr. Pecora. My opinion is——

Mr. PECORA (interposing). You can make that argument with regard to any public officer who is given any discretionary power at all, as an argument why there should be no such public office.

Mr. REDMOND. No. My opinion, Mr. Pecora, is simply limited to this, that this bill gives that power. Whether that power in fact would be abused is an entirely different question.

Mr. PECORA. There are many laws which give the executive head of the Government a power that is capable of abuse, as for instance the power to pardon. He could make a general jail delivery of every Federal jail in the country under that power. Would you think that because it is possible under the executive power of pardoning that the President should be deprived of all such power?

Mr. REDMOND. No. That is an act of clemency, Mr. Pecora.

Mr. PECORA. Oh—it is a legal provision. It is an act that is vested in the Executive by the statutory authority, and it is capable of abuse.

Senator KEAN. Hasn't it been abused, Mr. Pecora?

Mr. PECORA. As I recall it, a Mr. Morse once was pardoned.

Senator KEAN. Don't you recall that in cases in South Carolina a Governor let out everybody in jail?

Mr. PECORA. No; I do not.

Senator KEAN. Don't you recall that in California a Governor pardoned everybody almost?

Mr. PECORA. I don't recall that; no, sir.

The CHAIRMAN. We are getting outside of the subject matter, now.

Senator GORE. Mr. Redmond, in that connection, this may be more or less academic, but if you had a man that is chairman of the Federal Trade Commission or a member of the Federal Trade Commission, or members who are really opposed to the existing system, sometimes called the "capitalistic" system, who wanted to bring about a situation where you could not sell securities in this country, where you could not finance new enterprise, where you could not refinance an old enterprise, wanted to bring about a situation where all industry would be driven to the Government as the only lender of money, so as to bring industry into the lap of the Government, subject to Government control—do you think that this legislation would lend itself to that sort of an operation?

Mr. REDMOND. Senator Gore, I think the power exists, and it is only on the basis that the bill vests such a power that I gave my opinion to Mr. Whitney and the exchange.

Senator GORE. I might say that I have heard such fantastic fears expressed as that something of that sort might be latent in somebody's breast.

The CHAIRMAN. Let us go on.

Mr. WHITNEY. That is section 18. It also gives infinite power with regard to exchanges and their members, as I stated.

Section 19 imposes liability upon persons controlling any other person liable under the provisions of the bill.

That was gone into at some length by Mr. Corcoran.

Section 20 authorizes the Federal Trade Commission to investigate for the purpose of determining whether a person has violated or is about to violate any provision of the bill.

Sections 21 and 22 refer to hearings before the Commission. They shall be public.

Section 23 refers to the review in the courts, this section having been covered at some length by Mr. Corcoran

Senator GOLDSBOROUGH. Let me ask you about 23, about brokers and dealers. Does section 23 (a) modify the sentence or finding of the Commission as to the facts "if supported by evidence shall be conclusive"?

Mr. WHITNEY. I do not think it does modify.

Mr. PECORA. You do not think it modifies?

Mr. WHITNEY. It says, "the findings of the Commission as to the facts, if supported by the evidence, shall be conclusive." To my mind the review allowed is not what I would think was a thorough review. I am speaking as an individual, sir, and not as a lawyer. I don't know.

Mr. PECORA. Frankly, you do not know really what is within the purview of this kind of a provision?

Mr. WHITNEY. Yes; but I am a business man, and it would frighten me dreadfully if I had no chance except as against the facts presented by the Federal Trade Commission.

Mr. PECORA. Well, don't you realize that on those hearings before the Federal Trade Commission you would have a right to present evidence, too?

Mr. WHITNEY. I would have the right to present evidence; yes.

Mr. PECORA. And the determination would be based upon all the evidence?

Mr. WHITNEY. As I understand it, however, if the finding of the Commission as to the facts, if supported by fair evidence, they shall be conclusive.

Mr. PECORA. Supported by the evidence before them, not the evidence which the Commission procures, but all of the evidence in the hearing. This says "if supported by evidence", and the evidence might be found in the testimony introduced in behalf of not the Commission but the persons brought in for hearing before them.

Senator BULKLEY. Is it "evidence" or "the evidence"?

Mr. PECORA. "If supported by evidence."

Senator GOLDSBOROUGH. It means the weight of evidence, doesn't it?

Mr. PECORA. I think it would be so construed by any court.

Senator KEAN. Would it be so construed as the weight of evidence?

Mr. PECORA. I think so; yes.

Senator KEAN. You think it would be the weight of evidence?

Mr. PECORA. Yes.

Senator BULKLEY. I think it should be made clear it means that.

Mr. WHITNEY. I agree, Senator Bulkley. It does not read that way to me. The inference is here that it was the evidence produced by the Commission and not the weight of evidence given before them.

Senator BULKLEY. What I would be afraid of is that it might mean "if supported by any reasonable evidence at all."

The CHAIRMAN. That is what it means, I think, "if supported by any reasonable evidence." That is the Interstate Commerce phraseology. However, we will reconsider that.

Mr. WHITNEY. Section 24 deals with the criminal penalties which may be imposed for any violation of any provision of the bill. That has been gone over in some detail by Mr. Corcoran.

Section 25 has to do with the jurisdiction of offenses and suits and vests them in the district courts of the United States.

Section 26 deals with the effect of the bill on existing law of various States.

Section 27 deals with the validity of contracts and affects, as I see it, all types of contracts.

Senator GORE. It what?

Mr. WHITNEY. Deals with contracts, the validity of contracts.

Senator GORE What is that?

Mr. WHITNEY. Shall I read?

Senator GORE. No. [Laughter.]

Mr. WHITNEY. I think, Senator Gore, that the wording of the bill makes contracts even more nebulous than ever.

Senator GORE. I know there is something in the Bible somewhere that says "Where there is no law there is no sin." I don't want to hear it.

Mr. WHITNEY. Section 28 of the bill refers to the control of transactions on foreign exchanges.

Senator CAREY. Let us go back to 27 (b). Mr. Pecora, do you think this bill should contain a provision which will invalidate a contract that is already made? As I read this section (b), a contract which is made before this act goes into effect becomes ineffective.

Mr. PECORA. "Whether the contract was made before or after such effective date."

Senator CAREY. A man might have a contract to sell stock——

Mr. PECORA (interposing). If the cause of action were to arise after the effective date of this statute.

Senator CAREY. But would that not mean that if a contract was made previous to the passage of this law that suit could be brought either on the contract or the contract would not be a valid contract?

Mr. PECORA. If the cause of action arose after the effective date of the enactment, yes; I think it probably would.

Senator CAREY. Assume that the contract was in effect. Would that invalidate the contract?

Mr. PECORA. I think where the contract itself was made before this enactment but the cause of action arose afterward, the course of action perhaps would be created by this enactment.

Senator CAREY. By this law?

Mr. PECORA. Yes.

Senator CAREY. And would affect an existing contract?

Mr. PECORA. It would under those circumstances.

Senator CAREY. Is that a fair provision?

Mr. PECORA. I think under certain circumstances it would be upheld. This was taken from the securities act.

Senator CAREY. But that would not really make it stand; because it was in that act it would have to be in this act.

Mr. PECORA. But suppose an exchange now, suppose the New York Stock Exchange now were to make certain contracts between itself and its members, the effect of which would be to make certain acts of theirs prohibited by this bill valid. Would such a contract be enforceable as a means for evading the provisions of this act?

Senator CAREY. No; it should not be permitted, but I think there might be other contracts which would not be intended as evasions in any way.

Mr. PECORA. I think the reasonable intendment of the enactment is always something considered by the courts in construing its terms.

Senator CAREY. It seems to me this language could be modified or clarified or something. That was all.

Mr. PECORA. Suppose, for instance, the exchange today, before the enactment of this bill, were to make certain rules and regulations or impose certain conditions upon corporations desiring to list its securities or stock with the exchange, and those requirements were not in accordance with the provisions of this act. It simply means that the mere fact that such an agreement or contract was made between the exchange and the corporation would not save that corporation from the provisions of this act with regard to such listings if they are inconsistent with the provisions of the act.

Senator CAREY. Well, presuming a contract was made between individuals a year or two ago or before this securities act was enacted, it would be possible that they could be prosecuted under this act; either that or the contract would be invalidated.

Mr. PECORA. I cannot conceive of such a contract, Senator. Have you anything particularly in mind?

Senator CAREY. I haven't anything particularly in mind, but this language reads to me like it could mean that.

Mr. PECORA. Well, I do not think the courts would go astray on that.

Senator CAREY. This is certainly going to be a good bill for lawyers, with all these things.

Mr. PECORA. Every bill is.

Senator CAREY. This bill, particularly.

Mr. WHITNEY. Section 28 attempts to control transactions on foreign exchanges, as I stated.

Section 29 is that section which refers to so-called "license fee", which I frankly claim is a tax and regarding which we have spoken.

Section 30 authorizes the Federal Trade Commission to employ and fix the compensation of employees, and further exempts all such employees from the provisions of the Civil Service Act.

Senator GOLDSBOROUGH. Do you object to that because it is with no regard to cost? Is that what you mean?

Mr. WHITNEY. That would be a serious objection, as applied under section 16, whereby any number of such employees could be put into our offices and for any length of time paid whatever the Federal Trade Commission elected, and we would have to pay the bills, which is a pretty serious contemplation It has serious possibilities, at least.

Senator GOLDSBOROUGH. Then the objection lies to the excessive cost of administration, is that it?

Mr. WHITNEY. Yes.

Mr. PECORA. Insofar as that portion of the cost that might represent the cost of making examinations would fall upon the subject of the examination.

Senator GOLDSBOROUGH. Yes.

Mr. PECORA. That is your principal concern, isn't it?

Mr. WHITNEY. And the possibility of extreme—I hate to use the word "nuisance"—to the officers and members if the particular persons so engaged were not competent in their work and did not fulfill what they were hired to do, and I think you know, Mr. Pecora, that the stock exchange member's business is a very technical one from the accounting point of view.

Mr. PECORA. I have in mind also, Mr. Whitney, that perhaps many bank executives in the past have found bank examiners to be nuisances, regardless of their competency.

Mr. WHITNEY. Possibly.

Mr. PECORA. That is no reason for abolishing examinations?

Mr. WHITNEY. No. No. Not at all. I just spoke the point. That was all.

Senator KEAN. It is also true, Mr. Whitney, isn't it, that a lot of these people come into the offices and expect your clerks to do all the work for them?

Mr. WHITNEY. I have known that to happen, Senator.

Sections 31 and 32 of the bill provide for the separability of its provisions in the event that any of them are invalid, and make October 1, 1934, the effective date of the bill.

That, gentlemen, covers the review of the bill insofar as I am concerned. There are a few words that I would like to say in this connection, but if there are any questions I would be very glad to answer them.

Senator KEAN. Mr. Whitney, before you begin on that, don't you think that employees and officers that are managing this bill should be prohibited from owning any stocks, bonds, or other securities?

Mr. WHITNEY. They certainly should be so controlled that they could not make use of any information that they obtained because of their official position.

Mr. PECORA. I do not think that is open to debate, even.

Senator KEAN. That is suggested.

Mr. PECORA. My own modest opinion is that that is not even open to debate.

Senator GORE. That is theoretically true, but whether it is practically possible or not I do not know.

Senator KEAN. I am just throwing it out as a thought.

The CHAIRMAN. Are there any other questions you want to ask Mr. Whitney?

Senator KEAN. I have a lot of questions I want to ask him.

The CHAIRMAN. Proceed with them, and let us get along.

Senator KEAN. All right. Mr. Whitney, if you will turn to page 5.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. Of the printed bill, Senator?

Senator KEAN. The printed bill. The term "dealer"—do you think that that definition of a dealer is clear?

Mr. WHITNEY. I think it could be amplified, if I understand your question properly.

Senator KEAN. My question is this: As I read this, why, a person who is retired from business and came into your office and bought a hundred shares of stock one day, sold a hundred shares of stock the next day, under this provision would be termed a dealer.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. I am rather inclined to think that is a very exaggerated interpretation of the section.

The CHAIRMAN. You mean he is engaged in the business?

Senator KEAN. Yes; that is his only business. He is doing it for himself and for his own account.

The CHAIRMAN. That is not a regular business.

Senator KEAN. I am referring to page 25, line 13.

Mr. PECORA. Furthermore, Senator, you probably recall that Mr. Corcoran made a suggestion on that.

Senator KEAN. Yes, he did. He agreed with me.

Mr. PECORA. Yes; he indicated that section 5 would require some clarification.

Senator KEAN. I just wanted to get it from Mr. Whitney.

Now, Mr. Whitney, on the subject of selling short: What page is that?

Mr. WHITNEY. Page 20, line 12.

Senator KEAN. On that, do you think that is a good provision? In the first place, we will go over on page 20, to subdivision (e), above there. I have exactly the same objection to that penalty as I had to the other penalty. Have you any objection to changing that, Mr. Pecora?

Mr. PECORA. I think the same reasoning should apply to this provision as should be applied to the other one, Senator.

Mr. WHITNEY. That is section 17 (e) on page 33?

Senator KEAN. Well, that is the other one.

Senator GOLDSBOROUGH. This is (e) on page 20.

Senator KEAN. Page 20.

Mr. WHITNEY. Of section 8; yes, sir.

Senator KEAN. Lines 3, 4, 5, and 6. It seems to me that that just gives a chance for blackmail.

Now, then, the effect of short selling: What do you think that this bill will do to that? Do you think that this is all right in regard to that?

Mr. WHITNEY. The act as written prohibits short selling entirely, "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." It absolutely, as it now reads, prohibits short selling. In my opinion, short selling is a necessary economic function, and I have stated it so much that I hate to bore you again with it.

Senator KEAN. In other words, I have gone into a dry-goods store and they have had some carpet in the store, and I said that was not satisfactory, it was not long enough, or something of that kind, and they have said, "Next week we will sell you a piece of carpet of that length." Now, they sold that carpet to me short.

Mr. WHITNEY. Yes, sir.

Mr PECORA. You mean because it was not long enough? [Laughter.]

Senator KEAN. This would prevent any transaction. For instance, a man might know where he could buy and he knew a man was anxious to sell a hundred shares of stock, and he knew he could get that stock at a price. This would prevent him satisfying a customer with that stock, because he would have to sell it short—that is right?

Mr. WHITNEY. That is right. It involves a great many considerations, all of which I believe I have covered here before you in the past 2 years, with regard to the sale of stock short other than when a man just plain deliberately sells it short for no other purpose. It prevents the sale of stock from a distant point in order to take advantage of the market.

It entirely prohibits the odd-lot business as indulged in by the large dealers on the exchange, and it entirely eliminates the selling short by any members of the exchange, more particularly perhaps the specialists, as we referred to them this morning.

Senator KEAN. In addition to that, Mr. Whitney, I am accustomed to getting a great many cables from abroad asking me to sell 500 shares, a few shares, something or other. That stock is mailed to me as soon as I report the sale. But I could sell seller 30. That would mean if I sold seller 30 that I had to sacrifice, say, 1 or 2 percent in the price, and the only way I can do it to satisfy my customer is to sell that stock short, borrow the stock till the steamer arrived with the stock on board it.

Mr. WHITNEY. Yes, sir.

Mr. PECORA. There have been members of the exchange who within recent days declined to characterize such a sale as a short sale. They say it may be a short sale technically, but where the customer actually, at the time of the making of the sale, owns the security it is not the kind of short sale that has come to be more or less condemned.

Senator KEAN. That is the only kind of short sale that I ever indulge in.

Mr. PECORA. That is a sort of short selling against the box, selling against the box, which is different.

Senator KEAN. There is a difference between my customer and yours, of course.

Mr. PECORA. But this provision would not cover a sale against the box, which technically is a short sale.

Senator KEAN. Yes.

Mr. PECORA. So you see that is not the kind.

Mr. WHITNEY. But it is prohibited by this section.

Mr. PECORA. Oh, no; it is not. It is not. It prohibits the making of a sale not owned at the time of the sale, seeking to effect the sale. But it does not even do that. When you say that this section prohibits short selling, you are absolutely ignoring what amounts to one half of this section, the portion which says:

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.

Mr. WHITNEY. Let us be fair, Mr. Pecora. I read that myself, with the qualification. So I do not see how I could have ignored it.

Mr. PECORA. You say that this absolutely prohibits short selling.

Mr. WHITNEY. As written, I said it does.

Mr. PECORA. I do not agree to that, because to say that it prohibits short selling as written is to ignore the presence of those words in this section. It may very well be that the Federal Trade Commission, if this bill is enacted, will go as far as you go in your justification of short selling under certain conditions. They might even go further than you. You or I or anyone else is in no position today to say what rules and regulations the Federal Trade Commission may make with regard to this, but this section does not forbid short selling.

Mr. WHITNEY. They can prescribe rules that will allow it.

Mr. PECORA. Yes.

Mr. WHITNEY. And then they can immediately take the rules off again.

Mr. PECORA. Yes; just as the governors of the stock exchange may do the same thing.

Senator KEAN. Mr. Whitney, what rules have you in regard to short selling at the present time? You have rules regulating short selling, have you not?

Mr. WHITNEY. Yes.

Senator KEAN At the present time, if you are suspicious about short selling, can you not call for, from the members of the exchange, a written report as to what they have sold and for whose account they have sold it?

Mr. WHITNEY. And we do it often. Periodically such reports are filed now and have been over a term of years.

Senator KEAN. Did you, on or about the 9th of February, ask who had sold short United Aircraft Corporation, Aviation Corporation of America, North American Aviation, National Aviation, Douglass Aircraft, and Wright Aeronautic?

Mr. WHITNEY. Yes, sir.

Senator KEAN. Have you those reports?

Mr. WHITNEY. With me here?

Senator KEAN. Yes.

Mr. WHITNEY. No, Senator Kean; I have not. I have some of them in Washington.

Senator KEAN. Will you produce those reports for the benefit of the committee?

Mr. WHITNEY. If it is your desire.

Senator KEAN. I so desire.

Mr. WHITNEY (after conferring with an associate). If I may add, Senator Kean, those contain, as you know, personal information, and I think, in order to protect the exchange, in justice, they should be produced under subpena, because otherwise we are divulging private information.

Senator KEAN. Mr. Chairman, I ask that they be subpenaed.

Senator GORE. Was that on the eve of the revocation of the mail contracts?

Mr. WHITNEY. Yes.

Senator KEAN. He has them here, and I ask that they be subpenaed.

Mr. PECORA. I have not any objection to it at all. I cannot even suggest any objection.

The CHAIRMAN. Without objection, a subpena will be issued.

Senator KEAN. I am perfectly willing, Mr. Chairman, that they be produced in executive session.

Mr. PECORA. I do not even see any occasion for producing them in executive session.

Senator KEAN. I do not care.

The CHAIRMAN. We will issue a subpena that they be produced before the committee.

Mr. PECORA. If you will give us a statement, I will have a subpena prepared and served on Mr. Whitney before the end of the day. If Mr. Whitney will tell me how soon he can respond to the subpena and produce the data the subpena will call for, I will make the return day of the subpena accordingly.

Mr. WHITNEY. I think I have a compilation of those answers to the questionnaire here with me in Washington. Please understand I may be in error on that, and I do not want you to understand that the actual questionnaire answers are here. They are lodged with the business conduct committee at New York. I have merely the compilation, which I think shows all the facts.

Mr. PECORA. Shows all the facts Senator Kean has adverted to?

Mr. WHITNEY. I think so.

Mr. PECORA. And that could be produced tomorrow?

Mr. WHITNEY. Tonight.

The CHAIRMAN. We will make the subpena returnable tomorrow morning.

Mr. PECORA. Senator Kean, what period of time do you want covered?

Senator KEAN. Just before that date.

Mr. PECORA. How long before?

Senator KEAN. Three or four days.

Mr. PECORA. What period of time is covered by your questionnaire, Mr. Whitney?

Mr. WHITNEY. I think the short sales from January 26 to February 9. May I request this, Senator Kean, that the originals be asked for? Our compilation might be in error in some way, and we will have those here in Washington tomorrow.

Mr. PECORA. All right.

Mr. WHITNEY. Will you make it returnable Monday, so that we can be sure we will get the things?

Mr. REDMOND. We do not know what condition the records are in in New York We would rather put it off until a later date.

Mr. PECORA. Is that agreeable to you, to make it returnable Monday, Senator Kean?

Senator KEAN. Yes.

Mr. PECORA. Personally, I think the mere request made at this public hearing of you, Mr. Whitney, by the chairman, at the suggestion of Senator Kean, would relieve the exchange of any reproach for having produced those, which release it would get by the service of a subpena. I think you could comply with the oral request of this committee, but if you insist upon a subpena I will have one prepared.

Mr. WHITNEY. I must be guided by counsel, and if it is not objectionable to the committee, I request a subpena.

Mr. PECORA. You prefer a subpena?

Mr. WHITNEY. Yes, sir.

Mr. REDMOND. It is a mere matter of form, Mr. Pecora, but it will be easier in our files if we have a subpena.

Mr. PECORA. The record here is just as good as any written record of that subpena.

Mr. REDMOND. But this record will ultimately be put away in libraries.

Mr. PECORA. It is a part of the public record?

Mr. REDMOND. Yes.

Mr. PECORA. Have you a copy of the questionnaire?

Mr. WHITNEY. I do not think I have it here.

Mr. REDMOND. We can furnish you that by tomorrow morning.

Mr. PECORA. From January 26 to February 9, both dates inclusive?

Mr. WHITNEY. Both trading dates inclusive, I believe, but we will get you a copy of the actual questionnaire sent out.

Senator BULKLEY. Mr. Whitney, I would like to have your comment on the suggestion that short sales be prohibited except at a price at least one eighth higher than the last sale.

Mr. WHITNEY. I think, Senator Bulkley, that suggestion has been made sometimes, and I think, frankly, from my own point of view, that that would eliminate short sales almost entirely, because it would seem, by such a rule, that only 100 shares could be sold at every eighth.

Senator BULKLEY. Do you think the rule could be stated in such a way that it would be of any value?

Mr. WHITNEY. I will be very glad to go into it further, but I do not believe it could be so stated, and I honestly do not see how it could be properly policed.

Senator GORE. Mr. Whitney, may not a long sale have a more depressing effect on the market in times of stringency than a short sale?

Mr. WHITNEY. Yes; it may, and for that reason, Senator, very often when it is desired to sell a block of stock the order will be given to a notorious short seller to execute, so that the purchasers——

Senator GORE. A long sale?

Mr. WHITNEY. A long sale; yes, sir.

Senator GORE. So as to get the impact of that?

Mr. WHITNEY. No; so that the people will think that it is a sale by this man, who is a notorious "bear."

Senator GORE. As a layman, it seems to me that a long sale would always have a more depressing effect on a declining market than a short sale.

Mr. WHITNEY It has, because it does not have to be bought back, and the short sale has to.

Senator GORE. That is one point. It is just a deadweight dropped on the market.

Mr. WHITNEY. You are quite correct.

Senator GORE. I was just wondering whether we could prohibit those.

The CHAIRMAN. Senator Kean, have you any more questions?

Senator KEAN. In connection with page 38, subdivision (d), my son is a little worried for fear he cannot be a broker if I am an underwriter or dealer. How about that?

Senator TOWNSEND. You mean father and son?

Senator KEAN. Yes.

Mr. WHITNEY. Are you asking me, sir?

Senator KEAN. Yes.

The CHAIRMAN. If he lives in the same house?

Senator KEAN. No.

The CHAIRMAN. They have to reside together. It says "or a child or parent residing with such person."

Senator KEAN. But there must be lots of fathers and sons that reside together that would like to do separate businesses. Do you think that that would preclude a son being a member of the stock exchange if his father was a dealer?

Mr. WHITNEY. If he lived with the father, unquestionably.

Senator KEAN. I do not think that ought to be. A boy ought to have a chance.

Mr. PECORA. He could live next door.

Senator CAREY. Mr. Whitney, it is complained that this act will cause the liquidation of bank loans, brokers' loans, and so forth, as soon as it becomes effective, on account of the margin provision.

Mr. WHITNEY. So we have contended; yes.

Senator CAREY. Would it be helpful if the effective date of this act were made later than October 1, 1934—or is it July 1, 1934?

Mr. WHITNEY. No; it is October 1.

Senator CAREY. Would the banks be able to have the customers liquidate these loans in the time allowed?

Mr. WHITNEY. I think that is almost an impossible question to answer properly, because it is my feeling that if this entire bill were made law, the liquidation would start right then.

Senator CAREY. It would not wait until that time?

Mr. WHITNEY. No, sir.

Senator GOLDSBOROUGH. I did not hear the question.

Senator CAREY. I asked if this act would cause the liquidation of many loans on account of the provision for margin.

Senator GOLDSBOROUGH. What was the reply?

Senator CAREY. The reply was that it would, and I asked if the date were put off for a longer period, whether that would help in that particular.

Mr. PECORA. The suggestion has been made here, Senator Carey, that the provisions of this bill be amended or modified so as to save present margin accounts. That has already been quite fully discussed before the committee, I think.

Mr. WHITNEY. Very briefly, I would like to say this in conclusion if I may. We feel, as stated, that the question of credit and the control of corporations lies without any stock exchange bill, and therefore what we have most particularly in mind affects the free and open market that we and other exchanges attempt to offer, and therefore the liquidity of such markets. Let us not forget that there are held, by the investors of the United States, in round figures, some 100 billion dollars worth of listed securities.

Senator GORE. Does it amount to that much now? I remember the figure when the crash came in 1929. It was about 90 billion.

Mr. WHITNEY. I think there are listed——

Senator GORE. That is the market value.

Mr. WHITNEY. There are 73 billions listed on the New York Stock Exchange alone, at the market value February 1.

Senator GORE. Of this year?

Mr. WHITNEY. Of this year.

Senator GORE. I saw a figure the other day of 37 billions.

Mr. WHITNEY. I think that is stocks, sir.

Senator GORE. Yes, sir.

Mr. WHITNEY. There are a large amount of bonds as well.

Senator GORE. You are including bonds as well?

Mr. WHITNEY. Yes; 73 billions. From our way of looking at it, and I think that of the framers of the bill, I presume that we must not disrupt the liquidity of our security markets. But from that point on there may be disagreement, and I am presuming that what Mr. Corcoran said the other day typifies the point of view of the other framers of the bill, in the main, subject to certain changes agreed upon or suggested.

He feels, however, that the margin requirements will not have a very serious affect upon the liquidity of the market; that only a diminution and not an entire strangulation of speculation will take place as a result of the imposed margins, or the suggested margins. He feels that the market, although there may be a broader element between the bid and offer in securities, will not be upset. We differ with that materially. We think the free and open market given by stock exchanges today will be ruined from the point of view of liquidity because, under the margin requirements here set forth speculation will be eliminated; and without speculation we do not know of any method of preserving a market. Instead of the rather regular, undisturbed market that Mr. Corcoran believes will exist if such a bill is enacted, we believe we will have panic and an absolute breakdown of the security markets of this country, naturally to the great detriment of those investors holding these listed securities.

Mr. Corcoran very, very kindly states that he does not believe that anybody can be an expert in stock-exchange technique, and he grants that he is an amateur; but he and the other drafters of the bill, although admitting little or no knowledge of stock-exchange practices——

Mr. PECORA. Of the stock-exchange practices, did you say?

Mr. WHITNEY. Yes.

Mr. PECORA. I want to be modest, but I make no admission that I have no knowledge of stock-exchange practices.

Mr. WHITNEY. All right, sir.

Mr. PECORA. I will say, however, in connection with that, that the principal knowledge I have acquired has been through the medium of the evidence presented to this committee. I have learned a great deal about those practices.

Mr. WHITNEY. Not complete knowledge of stock-exchange practices.

Mr. PECORA. I am not a technician.

Mr. WHITNEY. Some of them acknowledge not very great knowledge as technicians. On the other hand, we of the stock exchange, who have been lifetime students of this subject and claim to be technicians, differ in point of view. There are the two sides. Now, who is right?

The bill, as drawn, presumes that the drafters have the supreme knowledge of this subject, and grants to us no knowledge. I am perfectly willing to concede that neither side knows it all, and that neither will ever know it all. But I do feel that there is a middle course here, granting sufficient, or something, to both sides.

This bill is so rigid and inflexible in its provisions as, in our opinion, to absolutely hamstring and freeze security markets. We therefore suggest an authority which shall study, which shall have power to make regulations, but which, in itself, will not be hamstrung by the provisions of a bill which cannot be changed except by another act of Congress. We therefore suggest the middle course. If an authority is to set up, allow it to be flexible and mobile, and do not have it inflexible, so that if disaster does come, as we predict, it cannot be changed without another act of Congress.

With your permission I would like to read what was said on this general subject by Oliver Wendell Holmes, the Justice, in his opinion in the case of *Board of Trade* v. *Christie Grain & Stock Co.* I am not presenting this from the standpoint of a constitutional argument at all. He says, in part [reading]:

> People will endeavor to forecast the future and to make agreements according to their prophecy Speculation of this kind by competent men is the self-adjustment of society to the probable Its value is well known as a means of avoiding or mitigating catastrophes, equalizing prices, and providing for periods of want It is true that the success of the strong induces imitation by the weak, and that incompetent persons bring themselves to ruin by undertaking to speculate in their turn But legislatures and courts generally have recognized that the natural evolutions of a complex society are to be touched only with a very cautious hand, and that such coarse attempts at a remedy for the waste incident to every social function as a simple prohibition and laws to stop its being are harmful and vain

Along this line, gentlemen, we have suggested an authority which, we believe, after study and proper consideration, will not be harmful and vain.

In closing perhaps I can remark that where we suggest this point of view, modern-day liberalism has become absolutely dogmatic in the suggestion of the bill proposed.

Senator GORE. On that point, we have heard a good deal about the social philosophy. Its limits are not very well fixed and defined in my mind, but suppose somebody had a social philosophy that envisaged an industrial democracy and economic set-up where the

Government would finance all industry so as to control all industry—in the general welfare, of course—and as an incident to that desired to destroy stock exchanges and dealings in securities to make it impossible to finance private industry from private resources. Do you think such social philosophy, if anybody entertained it, might probably be facilitated through legislation of this sort?

Mr. WHITNEY. It could be, sir; yes.

Mr. PECORA. Mr. Whitney, you said a few minutes ago that the approximate market value of securities listed on the New York Stock Exchange on February 1 of this year was $73,000,000,000.

Mr. WHITNEY. That is my memory.

Mr. PECORA. Could you get from the records of the stock exchange the approximate value of the securities listed on its board on the 1st of May 1929 and also on the 1st of December 1929?

Mr. WHITNEY. Yes, sir.

Mr. PECORA. I think that might be helpful too.

Senator GORE. The 1st of September 1929, as I remember it, it was about 90 billions. It went off 22 billions after the crash, and it got down to about 16 billions, did it not, Mr. Whitney, in June a year ago?

Mr. WHITNEY. I think, Senator, you have in mind stocks alone.

Senator GORE. I am figuring on stocks alone.

Mr. WHITNEY. I think you are low.

Mr. PECORA. You might include in that March 1, 1933.

Senator GORE. As I remember, May 1, 1932, the aggregate value of stocks listed was 20 billions, and the 1st of July it was 16 billions. Then it turned up the 9th of July.

Mr. WHITNEY. I could not possibly attempt to refute you, sir. Your memory is wonderful and mine is very poor. I just do not remember.

Senator GORE. I am speaking from memory, and I may be wrong.

Senator CAREY. You speak of setting up a commission. The commission proposed in your statement is really an ex officio commission. Do you not think that a commission made up of some men who have knowledge of stock exchange matters would be better than an ex officio commission?

Mr. WHITNEY. My suggestion, as you know, includes amongst the seven, two men representing stock exchanges who, I presume, would be technicians in the business, and I think they could point out, or they certainly would have the right of pointing out, to the rest of the commission their attitude on stock exchange matters, and the effect of rules and regulations upon that business.

If, in spite of what they did say—if they said, "Don't do this", and the commission did not take their advice, then, of course, it would be on the heads of the authority if the authority's judgment proved wrong. But the authority could move immediately to correct any mistaken point of view, or the mistaken imposition of rules that proved wrong; whereas, under this act, nobody, under the provisions as stated, could change it except Congress when it was in session.

Senator CAREY. I understand that; but what I was trying to bring out was this: A commission made up of officers who have other positions usually does not meet very often or pay very much atten-

tion to the business. We tried that with the Power Commission and afterward created a full-time Power Commission. I think if a commission were set up other than the Federal Trade Commission, it should be a commission not made up of ex-officio officers but made up of full-time officers who would be in a position to act, if they had to act, quickly. I am afraid your commission would be rather slow in moving.

Mr. WHITNEY. Any commission that could act quickly and promptly, and on which were represented the exchanges of the country, would be entirely satisfactory to the exchange, in my belief.

Senator CAREY. Two or three Cabinet officers would not be available very often to meet with the commission.

Mr. WHITNEY. Mr. Chairman, there is a member of the governing committee, and also a specialist here, Mr. Raymond Sprague, and I would take particular pleasure if you would hear him tomorrow, if that is satisfactory to the committee.

Senator GORE. He is a specialist?

Mr. WHITNEY. He is a specialist on the exchange and active all the time there. If he is to appear tomorrow, may I say to the committee that naturally I hold myself at your entire disposal, as does counsel, and any of the staff of the exchange. We will answer questions or give of ourselves in any helpful way we can to the committee. We truly mean it.

I thank you for your courtesy to me.

The CHAIRMAN. We are very much obliged to you, Mr. Whitney. Senator Costigan had some questions he wanted to ask, but he is not here. Will you be here tomorrow?

Mr. WHITNEY. I will be anywhere you want me.

The CHAIRMAN. Mr. Gould, we will be glad to hear from you. Please state your name, residence, and occupation.

STATEMENT OF THEODORE GOULD, BALTIMORE, MD., MEMBER AND SECRETARY-TREASURER OF THE BALTIMORE STOCK EXCHANGE

The CHAIRMAN. Mr. Gould, do you want to be heard on this bill?

Mr. GOULD. Yes; if I may.

The CHAIRMAN. You may proceed in your own way.

Senator GOLDSBOROUGH. Mr. Gould, as I understand the situation, you want to speak more particularly to section 10 of the bill.

Mr. GOULD. Yes, sir.

The CHAIRMAN. You may proceed.

Mr. GOULD. I represent the Baltimore Stock Exchange, which is a small exchange composed principally of small brokers and dealers. It is not our purpose to discuss the many objectionable features of this bill as now written but rather to call to your attention a few points which are vital to the small broker and dealer and to the small exchange.

Our exchange has had a long and honorable history. It was founded in 1838. From the time of the War between the States to the World War it aided materially in the reconstruction of the South. Much southern financing was done through Baltimore, and a ready market on our exchange was a factor in making capital willing to enter this field. At the present time the Baltimore Ex-

change is principally a local market filling an important local need. Nearly all of its active listed securities are those of Maryland corporations, and they are largely held locally. Our market is a cash market, where buying and selling orders meet. We know, and Maryland corporations and investors feel, that we fill a vital need in the business life of our city.

We have 65 full members, only 11 of whom are also members of the New York Stock Exchange. Of the remaining 54, 40 actively conduct a general brokerage and dealer business.

Section 10 of the proposed bill would force our members to choose between two closely allied functions of their business; namely, the handling of brokerage orders in securities on the one hand and the purchase of securities and their resale to the investing public on the other. The bill would not permit one member to do both. We do not believe there exists or would exist in our community sufficient business in either of these two functions apart from the other to give our members a fair opportunity to earn a living for themselves and their employees.

They would not be able to maintain the statistical departments and other features which many of them have for the convenience of their customers. The small broker and dealer has an entirely different problem from that of the larger broker with many branches or from that of an underwriting house. He executes commission orders for his customers, and when he can buy a block of securities he considers sound at an attractive price he buys them for his own account and then undertakes to distribute them to the investing public, making a reasonable profit between a wholesale and retail situation.

There is no reason why he cannot fill both of these functions without detriment to the public interests. There have been times when there were no investors brave enough to buy good securities at any price, and when but for the willingness of some broker-dealer to take a commitment for such securities there would have been a situation where a seller who had to sell could not find a buyer at any price. We had a case recently where a block of bonds of one of the political subdivisions of the State of Maryland was held by a county bank upon which there was a run. The bank was enabled to dispose of these securities only because of the willingness of a broker-dealer to take them on for his own account and hold them for resale to investors when the skies had brightened.

If the local broker-dealer is required to confine himself solely to commission orders and is not permitted to aid in the making of a satisfactory market in local securities, it will be increasingly difficult for such local enterprises to finance and refinance their normal business requirements.

Another part of the bill, section 7, works, what we believe, additional undue hardships on the small broker. Many of our members handle no margin accounts, carry no inventory, and require little capital. They take no part in syndicates. They conduct a cash business as broker and dealer in listed and unlisted securities.

Should one of these members secure from a bank or insurance company an order for a quarter of a million Government bonds upon which he can make one thirty-second of 1 percent, he would be unable to handle the order, if this bill becomes law. His capital

employed in the business is usually less than $25,000 and his loan capacity under the bill would be too limited to finance the deal. At present he would have no difficulty in having a bank or correspondent receive and pay for these bonds for his account, delivering and collecting for them from his customer and crediting him with the profit on the deal of $78.13.

Again the small broker and dealer would be unduly handicapped and might be eliminated entirely by the prohibition against his borrowing from a broker-correspondent, which is often the most convenient method of clearing cash trades.

We also call to your attention those portions of the bill which would entail considerable added expense to all brokers. In many cases this additional cost would mean the difference between profit and loss at the end of the year.

Returning to the position of the smaller exchange, it is, of course, true that the existence of the exchange depends upon that of its members. Outside of dues from members we have only listing fees as income. Many of the small corporations whose securities are listed on our exchange could not afford the heavy accounting fees which would be necessary to enable them to keep their securities listed. They might, however, withdraw their securities from listing and thus deprive the many small holders of their stocks and bonds from having a free and open market for their holdings.

We fear that new listings would be few and far between. The corporation executives will have to decide whether to subject themselves to the cost and risks of listing under the Federal Trade Commission and thus secure a free and open market for their securities, or to deprive their stockholders and bondholders of such a market by not listing.

We are convinced, and I am sure you gentlemen will agree with us, that in the interest of public protection an open, free, and public market in securities is much to be preferred over unknown, undisciplined dealings which could never be adequately regulated. We fear that such undesirable dealings will supplant our exchange on the date this proposed bill becomes law.

We urge, in lieu of this bill, a more flexible method to accomplish the end sought. Recent experience with prohibition has taught us that human nature cannot be changed by law. The purpose of prohibition was to eliminate certain evils practiced by only a comparatively few of our 120 million citizens. The effect was to substitute new evils greater than those sought to be eliminated.

The purpose of this act is the elimination of certain other evils apparently practiced by a few unscrupulous people. By this rigid law, affecting millions of honest corporation executives and employees, investors, dealers, and brokers, we might force the abandonment of the nefarious operations of the few; but this same law would also destroy all that is good in our markets which have grown up in over a hundred years of free trading, and we may find ourselves confronted with troubles and problems many times worse than the old. We cannot change the hearts of crooks and thieves by this legislation, but will send them to clever allies to figure out new ways to carry out their depredations.

How much better it would be if, instead of such drastic action, we should create a commission composed of representatives of the

Government, the exchanges and the investing public, to oversee exchange activities, leaving to the exchanges, under such supervision, the power to control abuses in the most effective way, and granting to such commission broad powers over interstate transactions in unlisted securities.

America has grown great through the reinvestment of earnings into new enterprises. This has been made possible largely through our exchange facilities for quickly turning securities into cash. We do not favor unbridled speculation but do favor every facility for investment, and we are convinced that this Senate bill, no. 2693, will dry up our security markets without accomplishing the aim sought.

I thank you.

The CHAIRMAN. Mr. Gould, how many members have you?

Mr. GOULD. We have 77 memberships, or at the present time 65, and the others are grouped and held by four members. The others are held either in estates or one of the members has what is known as "taken the membership."

The CHAIRMAN. Your objections are more particularly to sections 7 and 10 of the bill?

Mr. GOULD. Yes, sir.

The CHAIRMAN. Have you any suggestions to make as to modifications or changes in the bill that ought to be adopted?

Mr. GOULD. I believe the real purpose of section 10 of the bill is that one which applies more forcibly, so far as the small broker is concerned, on the question of the small broker acting in some cases as the dealer, and in other transactions, but never in the same case, as a broker, that that should be prohibited by law; and that is, of course, against the laws of the stock exchange and against the laws of the State of Maryland. I mean for a man to be both a broker and a dealer in the same transaction. Orders that come in to our smaller brokers are executed as commission orders in the case of listed securities. But in addition to that, there being not enough of that business for the broker to make a living, he has to, through his knowledge of the business, pick out securities which he thinks are attractive, and if he comes across a block of 25 bonds which he thinks are very attractive for a bank or an individual, he buys those bonds for his own account, and then he turns around and goes out to call upon prospective customers. He has marked up the bonds one half point, and he goes out and sells those bonds to customers. And it is a perfectly proper and satisfactory transaction from every standpoint. But if this bill should become law he would then have to either confine himself to handling that kind of business, and would not be able to handle the commission business, or he would have to handle the commission business and not be able to handle the other business.

Senator GOLDSBOROUGH. That is what you wanted to bring more particularly to the attention of this committee?

Mr. GOULD. Yes, sir.

The CHAIRMAN. All right. If that is all, Mr. Gould, we are very much obliged to you for your appearance.

Mr. GOULD. And I wish to thank you gentlemen.

(Thereupon Mr. Gould left the committee table.)

(Thereupon, at 4:40 p.m. Thursday, Mar. 1, 1934, the committee adjourned to resume at 10 o'clock on the following morning.)

WHITNEY EXHIBIT NO. 1. MARCH 1, 1934