

STOCK EXCHANGE PRACTICES

FRIDAY, MARCH 2, 1934

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

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

Present: Senators Fletcher (chairman), Barkley, Bulkley, Gore, Costigan, McAdoo, 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. I believe we have a gentleman from Philadelphia who was promised to be heard. If he will just come forward to the committee table.

Mr. NEWBOLD. Thank you.

STATEMENT OF JOHN S. NEWBOLD, JENKINTOWN, PA., A MEMBER OF THE FIRM OF W. H. NEWBOLD'S SON & CO., PHILADELPHIA, PA.

The CHAIRMAN. Mr. Newbold, will you please state your name, residence, and business or occupation?

Mr. NEWBOLD. My name is John S. Newbold, Jenkintown, Pa.

The CHAIRMAN. And what is your business or occupation?

Mr. NEWBOLD. I am a member of the New York Stock Exchange, and we have been dealers for 90 years in general securities.

The CHAIRMAN. Have you examined this bill, S. 2693, that is pending before the committee?

Mr. NEWBOLD. Yes, sir.

The CHAIRMAN. We will be very glad to have you tell us your views about it.

Mr. NEWBOLD. I think I will stand, if I may, in presenting my views?

The CHAIRMAN. You may proceed in your own way.

Mr. NEWBOLD. For the sake of brevity and more concise presentation I have a memorandum to present concerning two provisions of the bill affecting investment dealers. I will first discuss section 10 of the bill.

The CHAIRMAN. Very well; you may proceed.

Mr. NEWBOLD. This group of investment dealers have engaged in the business of selling investment securities to their clients in

the city of Philadelphia, Pa., throughout the course of a long career. The names and the period of time which these firms or their predecessors have rendered this service are:

	<i>Service, years</i>
Biddle, Whelen & Co.....	170
E. W. Clark & Co.....	97
W. H. Newbold's Son & Co.....	90
Bioren & Co.....	69
Cassatt & Co.....	62
Edward B. Smith & Co.....	42
Graham, Parsons & Co.....	38
Elkins, Morris & Co.....	28
Janney & Co.....	27
Yarnall & Co.....	9

The investor in this country is properly deeply interested in the kind of man he must turn to in the safeguarding of his savings. The investment dealer should possess honor, good faith, and sound judgment. These, coupled with wide practical experience in testing values in all kinds of investment markets, are indispensable requisites in the man or group of men who hope to embark on a successful career in looking after the financial interests of other fellowmen. The investor should be no less concerned with the facilities the investment dealer puts at his service.

It seems to us who have been in the business many years that as complete an understanding as possible should be established between client and principal. Unless this understanding exists, the investor is likely to have an unbalanced list of securities not adequately suited to his needs. It is obvious that such an understanding is hard to create and must be the result of constantly growing confidence, and therefore easier to establish with one person than with several. It is equally obvious that the wider the scope of the investment dealer the more competent he will be in handling his customer's account in all its ramifications. If this scope is narrowed as contemplated in this bill, we feel that both customer and investment dealer will be seriously damaged.

The problems which are created by the provisions of section 10 not only for the investment dealers, but also the purchasers of securities from such persons, are far more serious than one not familiar with the necessities of the business of dealing in securities may imagine. Section 10 of the National Securities Exchange Act of 1934 contains this provision:

SEC 10 It shall be unlawful for any member of a national securities exchange or any person who as a broker transacts a business in securities through the medium of any such member to act as a dealer in or underwriter of securities, whether or not registered on any national securities exchange

This section proposes to incorporate into the Federal Statutes a prohibition against the transaction in a perfectly normal way of a business which has been engaged in for more than a century by those who have conducted it with integrity, with honor, and to the credit of this branch of the securities business, as well as to the satisfaction and protection of their customers.

The record of those who are generally classed as investment dealers, substantially all of whom also buy and sell securities as brokers on a commission basis, may well be envied by the representatives of any other business in this country that can show a continued service over so long a period of years.

The power to transact a business in securities as a broker at the same time that a person is acting as a dealer in or underwriter of securities is found by those presently engaged in such business to be essential to the conduct of such business in a manner that will produce a reasonable profit to the person so engaged and a greater protection and service to the customers of such person.

The report of the so-called "Dickinson Committee" disposes of the suggested segregation as follows:

8 *Segregation of brokerage and other forms of business.*—Your committee has given careful consideration to various proposals that the business of underwriting and retailing securities should be completely divorced; that those who underwrite securities and who are members of a stock exchange should not be permitted to carry margin accounts for customers; and that those engaged in the retailing of securities should not be permitted to be members of any stock exchange

The various activities in which the members of the stock exchange engage, such as underwriting, acting as broker, carrying margins, etc., are all closely intertwined in our financial structure. Any such proposed segregation should not be accomplished before we are in a position to calculate its cost and to foresee its repercussions. As an abstract matter, the segregation of these various activities has much to commend it. Such an important decision as this can hardly be left to the discretion of an administrative authority. Segregation, if it is to be accomplished, must be accomplished by legislative fiat. Your committee finds that there is not yet available sufficient information to enable it to recommend such a far-reaching decision. It recommends, therefore, that the stock exchange authority be charged with the task of assembling information to permit such a decision to be made intelligently and with assurance by a later Congress.

The investment dealers presenting these objections to section 10 of the proposed act are confident that if a stock exchange authority shall be created by the legislation of this session of Congress and shall assume the task of obtaining information concerning those persons engaged in the security business rendering both a brokerage and a dealers' service, that such authority will find sound and convincing reasons to maintain the existing powers and no substantial basis for attributing to this industry generally methods of business or courses of dealing which have been detrimental to the interest of those doing business with them.

Among the convincing reasons why this relationship should be maintained are the following:

1. The combined service rendered to their customers by investment dealers, which cannot be efficiently rendered by one who is a broker only, is of such value that it ought not to be destroyed by the proposed segregation. The investment dealer who is a broker also is able to supply the needs of his customers by purchases of securities upon the exchange to the extent that they are available, and by sales from securities then owned by the investment dealer or other dealers to the extent that they are not available by purchases on an exchange. It frequently happens that the demands of a customer exceed the available supply of a security then for sale on an exchange, and it is this balance which the ownership of such security by the investment dealer is supplied from the dealer's holdings, thereby making a transaction possible which otherwise might not be completed for a long period of time. The reverse also occurs, and to the advantage of the customer, when the market will not absorb at a fair price the quantity of a given security which the customer desires to sell, and it then becomes possible to complete the transaction for that cus-

tomer by the purchase from him by his investment dealer of the quantity of the security not then salable upon an exchange. In both instances, if the services demanded by the customer were to be rendered by one who was either solely an investment dealer or solely a broker, the transaction could not be promptly, efficiently and economically accomplished for the best interest of the customer.

2. The volume of business available to the houses here represented acting only as dealer or broker is not sufficient at all times to permit of a continuance in business with a reasonable profit, and it is therefore essential to the existence of the business that additional sources of revenue should be available from both types of business. This is particularly true of investment dealers in the great majority of small cities and towns throughout the United States and is clear to those familiar with the economic situation of these dealers that the attempted segregation would deprive them of a livelihood. It is to be remembered that not only does this affect the members of the firm, but a large group of employees whose training has been such that the only livelihood in which they could maintain an existence might be destroyed.

3. The investment dealers afford the personnel, experience, and what may be called the machinery for marketing new capital and new municipal issues, the latter including State and county bonds, which cannot be supplied by a broker under the terms of this bill. Those members of the stock exchanges throughout the country engaged solely in the brokerage business have neither the experience nor the machinery to afford a distribution for such new issues to the advantage of the investing public as well as to the issuers. This is particularly true as regards State, county, school district, and municipal bonds, and it is obvious that the proposed segregation would be greatly to the disadvantage of the municipalities concerned and to the investing public seeking such means for investment. The proposed segregation would require the investment dealer to elect between bidding for municipal issues or continuing his sales and purchases for customers as a broker. Such election, if in favor of the brokerage business, would deprive the municipalities and his customers of his services.

4. The elimination of the investment dealers as factors in the business of buying and selling securities, would deprive the stock-exchange business of what has been one of its most stabilizing and conservative influences. The record and place of the investment dealers in the history of the stock-exchange business has shown a consistent position on the conservative side and a helpful influence upon the markets.

The only apparent reason why the authors of the National Securities Exchange Act of 1934 have ignored the wise recommendation of the Dickinson committee and have included in this drastic legislative document the provisions of section 10 would seem to be a failure upon the part of the authors to understand the fundamentals of the business of a dealer in securities.

Now, Mr. Chairman and gentlemen of the committee, the other memorandum that I have is in relation to section 14 of the bill.

The CHAIRMAN. Before you pass from section 10 let me ask you: Do you propose any modification or change of that section, or do you want it eliminated entirely?

Mr. NEWBOLD. We think in principle it should be eliminated; that in principle there is no reason why a man should not be a dealer and a broker. That is essential to the best interests of the investor, without whom the dealer cannot live, and of course he must keep the confidence of the investor, which we think we have had as an experience extending over many years, and we think that mode of dealing is proper and necessary.

The CHAIRMAN. All right.

Mr. NEWBOLD. Would you like me to present what I have in regard to the function of the investment dealer?

The CHAIRMAN. Yes.

Mr. NEWBOLD. The function of the investment dealer is to give general and balanced financial advice to his customers whether it be in regard to bonds or stocks.

The business of the investment dealer is divided into three main divisions: (1) Sponsoring new issues. (2) Dealing in securities over the counter; that is to say, their purchases from or sales to customers or other dealers and where the investment dealer acts as principal. (3) Acting as a broker either in buying or selling bonds or stock for his customer.

The part of his business where the investment dealer sponsors new securities has been regulated by the provisions of the Securities Act of 1933.

The method of his approach to or relation with his customers where he acts as principal will be taken care of in the Code of Fair Practice for Investment Dealers, to be adopted under the N.R.A.

I might say for the information of the committee that we are not at liberty to produce that document because it has not yet been submitted to the President of the United States. However, we have all seen it, and I might say that it represents what has been the aspiration and the hope of those of us who have been in the business for a long time, and we have the highest regard for it, and feel very happy to have the matter put in a position where it can be enforced by and large throughout the country.

The brokerage end of the business is that of buying or selling securities for a customer's account and is a matter of mechanics. The question of giving advice to customers in doing this has been regulated by the provisions of the Securities Act of 1933. That is burdensome but wise. The rules or regulations issued by the various exchanges must be followed out in the execution of orders.

It does not follow because legislation of some form might seem necessary in respect to the operation of stock exchanges that the investment dealers of the country should be deprived of being allowed to act as brokers for their customers, thus making it impossible for them to give complete service and financial advice relative to purchases of stocks or of other securities registered on the security exchanges.

The CHAIRMAN. Now you may proceed with your remarks about section 14 of the bill.

Mr. NEWBOLD. The provisions of section 14 prohibit the making of "over-the-counter" markets for unregistered securities, unless such market is made in accordance with rules and regulations promulgated by the Federal Trade Commission. The passage of this

section in its present form would mean the delegation by Congress of power to the Federal Trade Commission, if it were so inclined, to prevent any market whatever for such securities by imposing drastic conditions which might be even more severe than the regulations applicable to registered securities traded in upon national exchanges. If the purpose of this section is to prevent speculation in unregulated securities, consideration should be given to the character of securities now commonly sold in the over-the-counter markets. This class of securities are dealt in largely by investors and not by speculators. They do not lend themselves easily to speculation, as may be realized when it is known that they consist largely of Federal land-bank bonds, Home Owners' Loan Corporation bonds, other Government securities, State, county, school district, and municipal obligations, bank and insurance company stocks, railroad equipment trust certificates, and bonds secured by trust mortgages upon real estate.

In addition to such unlisted securities, this over-the-counter markets afford an opportunity for transactions in large blocks of listed securities primarily for the benefit of institutional investors. The over-the-counter markets afford little opportunity for uncontrolled speculation, not only because of the character of the securities traded in and the transactions occurring there, but because of the type of customers with whom the investment dealer has the majority by volume of such transactions. These customers are such as insurance companies, savings banks, National and State banks, and trust companies, educational and charitable institutions, and corporate trustees. A different class of persons. These customers are advised by persons of long and extensive experience in the purchase and sale of such securities who are frequently as familiar with the market values as the representatives of the investment dealers trading with them. By saying "these customers", we mean the persons who are buying these things. I do not believe that anyone who is not in the business now realizes the change that has taken place in the last 10 years in the financial advice that all big purchasers of securities now have at their disposal. It is very difficult for the dealer, I might say, to know as much in many cases as the statistical department of the institution to whom he has to offer a security. The purchases made are for investment and not for speculative profit, and almost invariably are cash transactions not on marginal accounts. The problems arising out of such transactions are clearly not comparable to those which trading upon the national stock exchanges present, and a totally different treatment is required to control such practices, if any, that may have been indulged in by a small minority of the dealers. The subject matter of this section is dealt with by the Dickinson committee, as follows:

10 *Unorganized or "over-the-counter" markets*—No study of regulation of organized stock exchanges would be complete without giving consideration to the problem of the unorganized or "over-the-counter" markets. Because of their importance, and because of the fact that certain transactions and practices could still be engaged in on the "over-the-counter" markets which, under the proposed regulation, would be prohibited on the organized exchanges, your committee has considered whether and to what extent it would be possible to regulate such "over-the-counter" markets. On the basis of the consideration which it has been able to give to this subject, your committee has come to the conclusion that the problem of the "over-the-counter" markets cannot be satisfactorily dealt with by Federal governmental action. It has not yet

found any method of controlling such markets which it considers feasible or which could be applied without building up a Federal policing agency on such a scale as to be impracticable. It is, therefore, not prepared to recommend any Federal legislation for the regulation of such markets, but, if a further study on this subject should be considered desirable, your committee will undertake to proceed therewith.

In view of the fact that the evils which are complained of, due to individual transactions by a few dealers engaged in the over-the-counter market transactions, will be dealt with in a most comprehensive manner in the proposed fair-practice provisions of the investment bankers' code, which may be adopted before any national securities exchange act is finally passed, it would seem unnecessary to enact the provisions of section 14 at this time.

These memoranda present reasons why sections 10 and 14 of this bill should not become law, and the undersigned investment dealers of Philadelphia urge the serious consideration of them by the Members of Congress.

	Established
Biddle, Whelen & Co.....	1764
E. W. Clark & Co.....	1837
W. H. Newbold's Sons & Co.....	1844
Bioren & Co.....	1865
Cassatt & Co.....	1872
Edward B. Smith & Co.....	1892
Graham, Parsons & Co.....	1896
Elkins, Morris & Co.....	1906
Janney & Co.....	1907
Yarnall & Co.....	1925

The CHAIRMAN. Now, Mr. Newbold, in your business if a customer comes to you and wants to buy, say, some Federal land-bank bonds, or some farm-loan bonds, what is the process? That is, how do you proceed to get those up for him?

Mr. NEWBOLD. I beg pardon, Mr. Chairman.

The CHAIRMAN. What is the process now of serving him in such a case?

Mr. NEWBOLD. I try to find where the cheapest market is if he is going to buy, and where the highest market is if he is going to sell. And if I happen to have any in my list and they correspond to those market prices I sell them to him. If mine are higher than the market I either come down to meet the market—and, of course, there are fluctuations from time to time in the market—or else I buy them, frankly, in the cheapest place for my customer. And that has been going on in that way all the time, and it is done by going to a house that specializes possibly in the security. For instance, for all governments you deal through special houses who do hundreds of thousands of dollars or I might say millions of dollars of business a day, and there is backing and filling in these things with investors.

The CHAIRMAN. Where does your compensation come in? Do you charge a commission?

Mr. NEWBOLD. We charge a commission.

The CHAIRMAN. About what commission do you charge?

Mr. NEWBOLD. Well, in the case of Government bonds it is one thirty-second of 1 percent, I believe.

The CHAIRMAN. And how about in the case of Federal land-bank bonds?

Mr. NEWBOLD. I haven't bought any Federal land-bank bonds for some time and will have to ask. [After asking someone sitting behind him.] I am informed it is about a quarter of 1 percent in that case, and it is because there is nothing like the activity in Federal land-bank bonds or in home loan bank bonds that there is in Government bonds. That is, a sale of 20 million dollars of United States Government bonds is not at all unheard of, and therefore the commission is very low. And in the case of the more limited market, the more risk a man takes who takes a position in the market, the larger the commission is. But a quarter of 1 percent as suggested to me I think would prove to be high. I think the investor would not have to pay that much.

The CHAIRMAN. Are there any questions that any member of the committee wishes to ask?

Senator TOWNSEND. I do not wish to ask any.

Senator BARKLEY. I have no questions.

The CHAIRMAN. We are very much obliged to you, Mr. Newbold.

Mr. NEWBOLD. And I thank you both for myself and in the name of all our firms for your courtesy in hearing me.

(And Mr. Newbold left the committee table.)

The CHAIRMAN. We will now hear Dean Witter who has come on here from San Francisco. I understand that some gentlemen from California have been here all week, and they want to get away. I think we should accommodate them for about half an hour. I believe that is the time you requested?

Mr. WITTER. I think I will not take as much as that of your time.

STATEMENT OF DEAN WITTER, SAN FRANCISCO, OF DEAN WITTER & CO.

The CHAIRMAN. Please state your name, place of residence, and occupation.

Mr. WITTER. My name is Dean Witter. My residence is San Francisco, and I am both a broker and an investment banker.

The CHAIRMAN. Mr. Witter, the committee will be very glad to hear your views on this bill, S. 2693.

Mr. WITTER. I am authorized to speak for 204 dealers on the Pacific coast, about 30 of whom have seats on some exchange and who do both a brokerage and dealer business, and the remainder of whom have no stock exchange seats. All of these dealers also operate as brokers. Attached to this statement are copies of wires providing this authority. I should like to read them into the record. I particularly represent small dealers rather far removed from the financial centers.

I am allowed only 15 minutes of your time and will try not to repeat testimony already given. May I complete my statement, which is brief, and then I shall be glad to answer questions.

I am in favor of Federal supervision and control of stock exchanges. I am in favor of complete and accurate reports to stockholders; I am in favor of punishing misrepresentation, fraud, and other acts by either brokers or dealers which are detrimental to the public interest. I am opposed to pools, corners, and the manipulation of markets.

I have certain general objections to the regulation of stock exchanges by rigid and fixed statute. I do not think that a fixed statute endeavoring to deal with all the complex and intricate problems of the brokerage business can be so drawn as to eliminate the possibility of abuses without at the same time destroying the functions of exchanges and the free and open market for securities to the great detriment of the public.

Time does not permit me to cover the entire subject matter of the bill and I will therefore confine my statement to the effect of the first sentence of section 10 and section 19(b) insofar as this section relates to this sentence and section 7(c), which separate dealers and underwriters from brokers.

The presumed purpose of these sections which provide for the divorce of broker and dealer is, (1) to insure that the customer knows whether he is dealing with a firm as a broker or a dealer, and, (2) to prevent the use of the same capital for the conduct of two businesses. I do not presume that the bill was intended to enforce a hardship upon the conduct of legitimate business nor to further reduce the already decimated ranks of the dealers although these sections would do both. I shall later suggest how the purposes of these sections can be fulfilled without damage to public interest.

As drawn these sections would destroy the business of many small firms in smaller communities as these firms depend for their livelihood and their usefulness upon providing both brokerage and investment service to their customers. This would injure the investor. There may be no legitimate firms left in many smaller towns. If this is the case, it would make investment difficult and precarious. If there are any left, they would be wholly separate firms, which would have difficulty earning a livelihood. The investor could not buy municipal bonds and listed common stocks from the same firm. Neither the broker nor the dealer could take a comprehensive and disinterested view of the investors' requirements. Pressure will be exerted on the dealer to recommend only unlisted securities to his clients in order to handle all of their business. A broker is likely to be prejudiced in favor of listed common stocks only. I do not see how the public will be benefited by the proposed separation.

I believe the country as a whole will be injured. First, if I am correct in the assumption that many small dealers will be forced out of business or would become brokers only, then it will become even more difficult than it is at present for deserving local enterprises to be financed. Secondly, municipalities are largely financed by small dealers, who are also brokers and who purchase municipal obligations and redistribute them to the individual investor. Experience has shown that this type of financing cannot be handled on a brokerage basis. If an arbitrary separation is imposed, it would greatly curtail the market for municipal bonds and small local issues. I shall not go further into this phase of the matter because of limitations of time.

It would not be constructive to object to the divorcement of the brokerage and dealer business without suggesting some means which would insure the public against confusion of functions. This can be done by the segregation of the two businesses under one owner-

ship, and by having all letterheads printed either "Bond department" or "Brokerage department." All statements showing transactions with customers should be clearly phrased to indicate without possibility of misunderstanding whether the firm is acting as a broker or a principal in that particular transaction. This has been comprehensively provided for in the Investment Bankers' Code recently adopted.

The CHAIRMAN. But not yet signed or approved by the President.

Mr. WITTER. No, sir.

The CHAIRMAN. You may proceed with your statement.

Mr. WITTER. Our bond department has eight separate forms showing purchase and sale of securities and clearly setting forth whether we are acting as a broker or a principal. In the event that we are selling securities in which we have a profit that fact is also stated. I attach hereto copies of the eight forms which we use and in which we say in so many words that "We act as principal", if that is the case. If we act as principal in the sale of securities in which we have no profit or a loss we obviously omit the phrase "which includes a profit to us", and unfortunately we have had much use for this particular form.

In the conduct of my firm and many others we have scrupulously segregated our brokerage-department premises, books, accounts, organization, capital, personnel, and functions. In general our brokerage departments and bond departments are as separate as though they were two different firms except for mutuality of name, ownership, and general policy. I think that no harm and some advantage have come to the customers of each department through the dual functions of the firm. No brokerage department customers' man is allowed to sell our own participations or underwritings to his customers. The reason is practical as well as ethical. If we sell our own underwritings to brokerage-department customers, who often carry securities on margin, the securities are not permanently placed, and we have not fulfilled our obligation to the company whose securities we have been paid to sell. If we sell our underwritings to marginal customers, we are using our own capital for the purchase of our own securities. In the event of adverse developments we would be frozen with these loans. In addition brokerage-department customers have reason to resent biased advice, and the recommendation of our own issues would destroy our brokerage business.

I do not believe that it is practical to provide by statute that the two businesses should be as completely segregated as ours, as small dealers cannot afford the segregation of capital and premises. The large dealer, of course, could afford to segregate his business as between two departments; and I think, perhaps, it would be proper to insist that the large dealer do so. But I do not think that is a practical suggestion from the viewpoint of the small dealer. The main purpose of segregation is served by making it clear whether the dealer is a broker or a principal. This should be indicated in verbal statements and in written bills and confirmations.

The dealer and underwriter business has recently been largely confined to the purchase and sale of municipal bonds. These bonds are rarely, if ever, listed and under the provisions of Section 7 (c) a dealer can neither use his capital to carry such securities nor could he borrow money against them.

In passing I think I should point out that it is impossible for a brokerage firm to refrain entirely from acting as a principal, as in the case of errors which must be cleared, and that no dealer, whether member of an exchange or not, can refrain from acting as a broker unless it refuses to handle customers' orders to buy securities not owned by the firm. A strict interpretation of this portion of the bill would destroy the investment banking business and, consequently, the capital market which I think is admitted to be prerequisite to normal recovery.

Section 6 of the proposed bill forbids lending on unlisted securities which would enforce a great hardship upon the market for unlisted securities and particularly upon the smaller communities and the smaller firms. Section 14 regulating "over-the-counter" markets enforces a particular hardship on outlying territories as there are a multitude of unlisted bonds and preferred stocks traded in which are in most cases obligations of companies so small that their size would preclude compliance with any expensive listing requirements. The Los Angeles group have pointed out that there are over a thousand issues of companies traded in which provide in some cases some sort of collateral, and with which they could not deal if this bill become effective.

The Dickinson report to the Secretary of Commerce recommended control by a "Federal Stock Exchange Authority" and through a flexible mechanism to further study the means of regulating the stock exchanges and advised against placing stock exchanges in a strait-jacket. It urged that the law be limited to minimum requirements and that broad discretionary power be given the authority. Regarding the segregation of brokerage and dealer business it said:

Any such proposed segregation should not be accomplished before we are in a position to calculate its cost and to foresee its repercussions.

I think that the authority designated to exercise control of stock-exchange firms should be authorized to extend the segregation of the two businesses as far as its further study indicates it to be necessary in the interests of the public.

[Western Union]

SAN FRANCISCO, CALIF., February 27, 1934.

DEAN WITTEB,

Hotel Carlton, Washington, D C :

At a joint meeting of Security Dealers Association of San Francisco, local I.B.A. members and nonmembers, totaling 53 firms, a resolution was unanimously adopted authorizing you to represent them before the Senate Banking Committee and the Interstate and Foreign Commerce Committee of the House and to express for them their disapproval of the Fletcher-Rayburn bill as now written. Group wishes specific opposition registered to sections 6, 10, and 14. Dealers object to section 6, which in present form precludes extension by banks of credit on unlisted securities in regular course of business which would stifle public market for majority of Pacific-coast issues and cause deflationary liquidation, thereby impeding further national recovery. Dealers feel Pacific-coast market requires security dealer to act both as investment banker and broker in order to properly handle and diversify clients, investment account which must be given first consideration. Dealers therefor oppose section 10 because it encourages exclusive broker to favor and sponsor only securities on his particular exchange for commission consideration and likewise causes exclusive underwriter or dealer to recommend only those securities in which they personally are interested.

175541-34-PT 15-22

In view of the excellent self-regulatory measures embodied within the fair practice provisions of Investment Bankers Code approved by this group today section 14 of bill is not only burdensome but unnecessary. Furthermore, believe section 14 destructive to unlisted market here because majority of western issues are not listed on any exchange and their marketability would be narrowed to detriment of both corporation and security owners. Partial list houses present follows: Anglo-California National Bank, American Trust Co, Bank of America, N H Bennett & Co, Bennett, Richards & Co., Brush Slocumb & Co, Blyth & Co, Cavalier & Co, City Co., Conrad, Bruce & Co, David Skaggs & Co, Denault & Co., Elworthy & Co, Eyre Palmer & Co, Heller Bruce & Co, Hellman Wade & Co, Henderson & Co, Heron & Co, Martin Judge, Jr. & Co, Leppo & Co., Mitchum Tully & Co, R H. Moulton & Co, R N Miller & Co, Collins & Sons, Inc, Schwabacher & Co., Shaw Hooker & Weeden & Co, Dean Witter & Co, Wulff Hansen & Co.

SECURITY DEALERS ASSOCIATION OF SAN FRANCISCO.

[Postal Telegraph]

LOS ANGELES, CALIF, *February 27, 1934*

DEAN WITTER,

Carlton Hotel, Washington, D C :

Security Dealers Association of Southern California a voluntary association composed of 71 investment dealers all operating in southern California, 20 members having seats on some exchange operating both as broker and dealer, and 51 members having no stock exchange seats but acting both as broker and dealer, had a meeting today, unanimously authorizing you to represent their association before Senate Banking Committee and Interstate and Foreign Commerce Committee in connection with Fletcher-Rayburn bill Our group here particularly concerned with section 6A, which we feel in present form would preclude extension of credit by banks on unlisted securities in regular course of business and feel should be definitely clarified. Section 10 we feel affects particularly legitimate small investment dealers whose relationship with client makes it necessary for them to act both as agent and principal in giving rounded investment service Dealer who is intrusted with client's investment account should surely be allowed to act as agent for that client if he feels it necessary Section 14 presents a particular problem in this territory as there are more than 1,000 issues unlisted bonds and preferred stocks traded in which are in most cases obligations of companies so small that their size would preclude compliance with any rigid rules that may be set up by Federal Trade Commission. We are wiring directly to committee as an association and some of our members also wiring members of the committee. Please advise in what way we may be of further assistance.

SECURITY DEALERS ASSOCIATION OF SOUTHERN CALIFORNIA,
By EDW McWILLIAMS, *Secretary*

[Western Union]

PORTLAND, OREG, *February 28, 1934.*

DEAN WITTER,

Carlton Hotel, Washington, D C

The board of governors of the Investment Bond Club of Portland, having 33 dealers as members, would like you to represent the organization before Senate and House committees in regard to Fletcher-Rayburn bill. Our organization is disturbed by provisions in the bill which seriously hamper investment houses which are primarily dealers, these same provisions failing in our opinion to afford investing public any protection Sections 10 and 14 are particularly offensive in this connection Section 6 A would seriously injure holders of high-grade unlisted bonds In general we see no occasion for provisions of act which hamper investment dealers who occasionally act as brokers for convenience of customers. After all we have the Securities Act of 1933 and our code besides State regulations

INVESTMENT BOND CLUB OF PORTLAND
R H MARTIN, *President.*

[Western Union]

SEATTLE, WASHINGTON, Feb 28 1934

DEAN WITTER,
Carlton Hotel, Washington, D C

The Washington State Securities Dealers Association, a voluntary association composed of all dealers in securities in the state of Washington, at a meeting yesterday, unanimously authorized you to represent their association before the Senate Banking Committee and the House Interstate and Foreign Commerce Committee in connection with the Fletcher-Rayburn bill. While all members of our group are in accord that some regulation is desirable, they believe the bill in its present form will be detrimental not only to their own business but to industry in general and hence detrimental to the best interests of the public. Our members believe the following section will work an undue hardship upon their operations. Section Six A would prohibit banks from extending credit on unlisted securities in the regular course of business, thus depriving dealers of the credit they now receive on bank drafts as well as on inventory except in the case of listed securities. Section ten prohibits a dealer from acting as both dealer and broker. All dealers in this state have found it necessary to act both as principal and agent in order to render a complete investment service. This would work a particular hardship on dealers in this state whose businesses are of course smaller than in larger financial centers. The same result could be accomplished by requiring the dealer to state at the time the transaction is made and to typewrite or stamp on his confirmation whether he acted as dealer or broker or both.

Section fourteen, which purports to control over-the-counter transactions in unlisted as well as listed securities, would completely destroy the market for such unlisted issues. The stock of only one corporation and the bonds of only one corporation incorporated under the laws of the state of Washington are listed on a recognized national exchange—the New York Curb. Practically all securities issued by Washington corporations are in amounts too small to comply with the listing requirements of national exchanges. Destroying the market for such securities and taking away their collateral value would be detrimental not only to security dealers but to the entire community. Our group desires to make the following comment as to the effect of certain sections on general business and financial conditions: Under subsection two of Section six the fixing of margin requirements should be left to the Federal Reserve Board inasmuch as that body is responsible for financial policies in the United States. Margin provisions as fixed under this subsection would force liquidation of listed and unlisted securities not only from brokers but also from banks which is most undesirable at this stage of our recovery. Inasmuch as all banks are subject to supervision and examination by national and/or state banking department, they should be permitted some latitude in the making of collateral loans. Not only is this denied them under subsection three but also they are deprived of a highly satisfactory safe and liquid type of loan. Section twenty-two provides that all information filed with the Federal Trade Commission shall be made available to the public; thus intimate details regarding the business of every corporation whose securities are traded in are made available to all competitors whether domestic or foreign. The requirements for listing are so onerous that many small corporations may find it impossible to comply.

Moreover, there are apparently no limitations as to the number and nature of reports to be required from time to time by the Federal Trade Commission. The provisions relating to the responsibility of officers filing reports and the provisions governing the actions of officers, directors and stockholders owning or acquiring five per cent or more of a single issue appear after careful consideration exceedingly dangerous to the interests of the public. Moreover, the penalties provided thereunder bear no relation to any losses incurred and place a premium upon the activities of a litigious chisler. The Washington State Securities Dealers Association is composed of forty-eight investment bankers, all operating both as broker and dealer within the State of Washington.

WASHINGTON STATE SECURITIES DEALERS ASSOCIATION
LYLE WILSON, *Secretary*.

Senator BARKLEY. Mr. Witter, are you filing the balance of this statement?

Mr. WITTER. Yes, sir; I should like to file it in full. I did not read it in full because a good deal of it was included in what Mr. Newbold presented to you.

The CHAIRMAN. But do you want all of these included?

Mr. WITTER. Yes, Mr. Chairman; if you please.

The CHAIRMAN. What is the name of your firm?

Mr. WITTER. My firm is Dean Witter & Co.

Senator McADOO. Mr. Chairman, I want to say that Mr. Witter is one of my constituents; that his firm stands very high in California, and that Mr. Witter himself is a man of character and capacity, and I am very glad to have him come here and explain the views of investment bankers.

The CHAIRMAN. We are very glad to have heard him.

Senator McADOO. Mr. Witter, you represent about all of them, do you not?

Mr. WITTER. I represent, I think, all of the dealers out there.

Senator McADOO. Now, we have, as I understand it, in California a great many stocks that are dealt in on exchanges that would not be susceptible of listing on any exchange.

Mr. WITTER. Yes, sir.

Senator McADOO. For instance, like mining stocks, or some of the oil stocks, representing adventures in enterprises which may or may not turn out successfully, and many people lose money in that sort of thing. Do you think it would be well to impose some drastic regulation upon such issues?

Mr. WITTER. Well, I think, Senator McAdoo—

Senator McADOO (interposing). Or do you think that would be objectionable. That is, that if you were to rigidly restrict that kind of enterprise, even though there have been some losses, that it would prevent a thing that has developed many successful enterprises and served that section of the country?

Mr. WITTER. By so doing you would undoubtedly restrict the development of some very worthy enterprises. But the main effect of providing any reasonable requirement for the listing of such stocks would only mean the driving of them from recognized exchanges to the bootleg markets of the country, as they would be purchased and sold in just the same way, and to the greater detriment of the public.

Senator McADOO. Then you do not feel that they are susceptible of regulation?

Mr. WITTER. I do not know of any means by which that class of securities could be estopped.

Senator McADOO. Well, now, in the matter of segregation of the investment business, to which you alluded in your statement, are there any abuses so far as you are aware of a conspicuous character resulting from the combination of activities of firms in California which engage in the investment banking business and also in the brokerage business?

Mr. WITTER. I do not believe that any firm can operate as a dealer, as I have said before, without also operating as a broker at times. That is, if they are going to provide any sort of service to their customers. I think there always have been and always will be some abuses of public confidence, both by dealers and by brokers, but I think a segregation of the two functions would make it more difficult to prevent such abuses, not less difficult.

Senator McADOO. Well, would it be possible by regulation to prevent the abuses without compelling segregation?

Mr. WITTER. I do not recognize any abuses that come from the joint functions of broker and investment banker in the same firm. The fact has been stressed here that there were three or four very large New York firms that went bankrupt to the detriment of themselves and the community in the period following the crash of 1929. But as to those three or four large firms—and I do not think there were more than that number—while they were both broker and investment banker, their business was handled in such a way that they would most certainly have gone broke whether they had served the dual function of broker and investment banker or not.

Senator McADOO. Then you do not think there are any abuses because of nonsegregation that would be cured by segregation?

Mr. WITTER. No; I think they would be aggravated by segregation.

Senator BARKLEY. In your statement you do not oppose the bill as a whole, do you?

Mr. WITTER. No, sir.

Senator BARKLEY. Do you discuss marginal requirements in your statement?

Mr. WITTER. No, sir; I do not. I do not feel that I am competent to discuss marginal requirements, except to say that I feel as a trader the marginal requirements proposed in the present bill are so severe, and the prohibitions against lending on unlisted securities are such, that it would result in practically an embargo on the brokerage business. In other words, the marginal requirements provided in the bill are much more severe than they appear to be on their face, because while there is a 60 percent margin provided, that might mean in reality a 150 percent margin. And if there were a fixed percentage beyond which a brokerage firm could not allow his customer's account to go, he would not be able to start with the 60 percent margin, as the bill provides, because if the market went down that day he would only have 59 percent and would have to sell his customer out entirely or in part, so that he would probably have to insist upon 80 or 90 percent in order to make his customer safe in the first instance.

Senator GORE. Is it your understanding that when it broke the margin line the broker would sell out the stock? Do you think that is the reason it has to be maintained, because there is no flexibility about this bill? In other words, if it starts at 60 percent you would have to maintain at least that percentage?

Mr. WITTER. I think while in a measure it may be flexible, yet it is greatly excessive.

Senator GORE. It certainly is not flexible if you cannot bend it at all.

Senator McADOO. Mr. Witter, would you think it in the public interest to put an embargo on stock transactions on margin altogether?

Mr. WITTER. No, sir. But I am getting on a subject that I am, perhaps, not as familiar with as others who are here. But I think it would be a catastrophe to the financial interests of the country if that were done.

Senator McADOO. Do you think abolition of exchanges altogether would be a good thing?

Mr. WITTER. No, sir.

Senator BARKLEY. Is the existence of a market for the purchase and sale of stock, for instance, in the case of the United States Steel Corporation, a matter that has any direct bearing upon the amount of steel that company makes, or the amount of steel that will be used in the case of railroads, automobiles, or other industries?

Mr. WITTER. Well, the fluctuations in prices of the various stocks has been alleged to have brought about all of our troubles, and that is the theory of the statement which has been made that the Government should do this, that, and the other. But I do not think there is any support that can be given to that contention.

Senator BARKLEY. The question is whether there is any public end served—I am speaking from your viewpoint only and not at present my own—that ultimately means the welfare of the people, to permit a man simply to go in one day, simply to buy Steel because he thinks it is going up and selling it the next day if it does not go up and holding it 3 days if it does not go up, or a week or a month—what effect that has on the actual business of the Steel Corporation. And the same question might be asked as to all corporations, whether it creates business for the steel company and whether it creates employment for their employees. The fact that I go in and buy a hundred shares of Steel and make a hundred dollars on it or \$500—what good does that do the steel company and what good does it do the people who are working for the steel company and those who have their money invested in the steel company?

Mr. WITTER. It does not do the steel company any good or any harm, and it does not do the people who have money invested in the steel company any good or any harm, except to the extent that those transactions provide a market which permits any investor that wants to buy, to buy, and any investor who wants to sell, to sell.

Senator BARKLEY. You are speaking about the investor now. I am speaking of traders.

Mr. WITTER. Yes, sir.

Senator BARKLEY. Day-to-day traders.

Mr. WITTER. Yes, sir.

Senator BARKLEY. Of course, if I made \$500 and needed some steel, it would help me to buy it. That might help the company.

Mr. WITTER. Yes, sir.

Senator BARKLEY. But on the whole I have been debating in my own mind, in consideration of this bill, what the debit and credit in the country, of business as a whole throughout the country, by which I mean productive business, the actual production of commodities and their consumption and sale, transportation, distribution would be; what effect the day-to-day trading on the stock market would have.

Mr. WITTER. I do not pose as sufficient economic authority to answer questions as broad as that, but I cannot see any direct harm or good that may come out of that transaction directly to the steel company, in the purchase of commodities.

But I think that a listed market for securities which provides a free and open market, a market place where those securities can be bought or sold, is fundamental to our present economic scheme

Senator BARKLEY. I agree to that, that if anybody wants to invest in steel he ought not to have to go to the home office of the steel company and sit down at a desk there in order to buy a hundred shares of Steel or any other amount. He ought to have some convenient place where he can go to get the Steel if he really wants to invest in it.

But is there an economic necessity for providing a place where a man simply can go in and buy something today that he never sees and never expected to see, and sell it tomorrow to somebody else he does not know and never heard of and never expected to see, know, or hear of? Is that really an economic necessity?

Mr. WITTER. Insofar as it is a factor which creates markets I think it is an economic necessity, because I do not think the country can endure without a market for securities.

Senator BARKLEY. Do you think that a market to enable people who want to invest in good faith would not be maintained or supported unless you allow all of these short-time transactions to which I have referred?

Mr. WITTER. Unless you allow speculation, the present markets could not be maintained.

Senator BARKLEY. Do you interpret this bill to prevent a man who has stock in a local company, like a lumber company or tobacco company or some local enterprise, that never expects to see the stock exchange and would not ever be registered on it—nobody wants to register on it because it is not that sort—from putting that stock up as collateral in a bank in the local community to obtain money to put into his business or to carry on any legitimate transactions locally that he might see fit to carry on?

Mr. WITTER. If there is a 30-day provision I doubt that it would prevent his offering that stock as collateral with his local bank, but I doubt the local bank would have any inclination to make a loan against the stock for which there was no market.

Senator BARKLEY. There would not be any market for that sort of stock without this bill.

Mr. WITTER. There is some market in the unlisted and the inactive markets for a great many securities.

Senator BARKLEY. I am speaking of the local stocks, of which there are thousands, purely local enterprises, making money, declaring dividends, but not on any stock exchange and not dealt in over-the-counter or any other way. They are closely held by the people in the community. Would you think that any law ought to be passed that would prevent me, as a stockholder in a lumber company in my home town, which is making money, from going to a bank there and borrowing money on it for 30 days or 90 days or 6 months?

Mr. WITTER. I have read the bill carefully, sir, but I think it takes an attorney to interpret that bill, and I think the attorney's interpretation might then be either uncertain or wrong, and if I endeavor to pass upon the intricate provisions of that bill I am afraid I will get myself into deep water.

Senator BARKLEY. If it should do that, do you think it ought to do it?

Mr. WITTER. I most certainly think it should not.

Senator GORE. Is not a stock exchange in the larger sense a mere market where securities are bought and sold, and is not such a market place essential to the liquidity of securities?

Mr. WITTER. It is absolutely essential to the liquidity of securities.

Senator GORE. Is not the liquidity of securities essential to the borrowing of money at the banks under existing conditions?

Mr. WITTER. It is almost prerequisite.

Senator GORE. And would not the abolition of a market place where you can buy and sell securities dry up the sources of credit largely and be an extremely deflationary movement?

Mr. WITTER. It would be the most deflationary thing that I think this country has ever known. It would destroy credits in the banks and would hamper business. I think it would make our present system of capitalism impossible.

Senator GORE. Well now, speaking of capitalism, the background of all this business is the theory or the assumption that capital for the enlargement of existing businesses and establishing of new business ought to be supplied out of the savings of the people of the country. Isn't that true?

Mr. WITTER. Yes, sir.

Senator GORE. That is the general assumption; and that these market places provide an institution or a place where people who have savings and who desire to invest them can go and buy securities when they get ready?

Mr. WITTER. Yes, sir.

Senator GORE. That seems to me to be the justification for it. Now, when you depart from investment on the one hand and embark on the field of speculation, the theory as I understand it is that speculation is essential to a free and open market or to a wider market, and it contributes to stability. Isn't that the theory?

Mr. WITTER. Yes, sir.

Senator GORE. Of course, it is the speculation end that we are trying to get at and correct the abuses of.

Mr. WITTER. I do not think you can legislate in such way as to prevent the American public from speculating. If they do not speculate publicly and openly, they will speculate in a manner which will be much more detrimental to them.

Senator GORE. Of course, I take it there is legitimate speculation and illegitimate speculation, so to speak. If you would run a dividing line between the two, you would be getting somewhere. I do not know that that can be done, but I think that is what we ought to address ourselves to.

Mr. WITTER. I think speculation has been blamed for a great many evils for which it was not at all the cause.

The CHAIRMAN. Do you draw any distinction between speculation and gambling?

Mr. WITTER. I am not familiar with the two definitions, sir. I would in my own mind.

Senator BARKLEY. Speculation sounds better; that is about the only difference?

Mr. WITTER. No; I think gambling goes to greater extremes.

Senator BARKLEY. I know the word "gambling" is an ugly word that we never like to have applied, but if I go in today and buy a hundred shares of stock thinking it is going up tomorrow, and with

the intention of selling it tomorrow and making a profit, what difference does it make whether you call it "speculating" or "gambling"?

Mr. WITTER. By that definition, all business is gambling.

Senator BARKLEY. I realize that. I agree to it. All life is gambling, so far as that is concerned.

Senator GORE. Anybody that buys anything for a rise is speculating.

Senator McADOO. That absolutely applies to every sort of commodity and every transaction and everything.

Senator BARKLEY. It applies even to running for office.

Senator McADOO. Yes; you gamble on that; and sometimes it is a very unfortunate gamble.

Senator BARKLEY. And sometimes is very unfortunate if you are defeated.

Senator McADOO. And sometimes very unfortunate for the country if you are elected.

The CHAIRMAN. Do you know what the requirements as to margin are in San Francisco?

Mr. WITTER. I think they have no rigid requirements as to margin.

The CHAIRMAN. What is the practice for margins?

Mr. WITTER. The practice is always for a broker to lend, first, what he thinks is safe, and second, what he can reborrow from the bank or from some other source to permit him to carry the loan which he is making.

The CHAIRMAN. It is purely arbitrary with him as to when he will sell a customer out or when he will carry him?

Mr. WITTER. Entirely a matter of judgment, sir. If there were margin rules as to 30 or 50 percent, no brokerage firm could conduct his business fairly to his customers without at times making a temporary and justified exception to that rule. If that were enacted into statute so that it was a violation of a crime, I think the conduct of the brokerage business would be impossible.

Senator BARKLEY. Do you think that marginal requirements ought to be based upon a situation that is brought about by a sudden decline in stocks, called a crash, or a sudden rise in stocks, called a boom, or ought to be based on the average, normal fluctuation or probabilities with respect to stock over a period?

Mr. WITTER. I think they ought to be based upon intelligence, and you cannot make any rules for intelligence.

Senator GORE. Well, that is hopeless now.

Senator McADOO. Mr. Witter, I of course in my questions heretofore and in all questions that I ask in this committee have assumed that there are two interpretations, because the questions I asked do not reflect my views frequently. I only ask them to bring out some point or to get your point of view.

On this question of margin, the broker really does exactly what the banker does.

Mr. WITTER. Certainly.

Senator McADOO. When he makes a loan against the stock that the customer purchases.

Mr. WITTER. Yes, sir.

Senator McADOO. The broker might say that 20-percent margin with a man of well-established credit and who is known to be fully

responsible would be sufficient, and that you could really carry his account on a less margin basis than you could the account of somebody who had no large credit or sources.

Mr. WITTER. Yes, sir.

Senator McADOO. But whose character might be all right, of course. Now, those risks the broker has got to judge for himself, just as the banker does?

Mr. WITTER. Yes, sir.

Senator McADOO. And any attempt to impose an arbitrary basis for credit, either in a bank or brokerage house, would be incapable of enforcement perhaps and would be very unfortunate in its effects, would it not?

Mr. WITTER. Yes, sir. And how are you going to distinguish between Government bonds and municipal bonds and inactive bonds and bonds that are highly speculative on the one hand, and between good stocks and bad stocks, between stocks that are so-called "investment" stocks and those that fluctuate wildly in the market, with any fixed rule, unless it is a minimum and beyond that minimum places the power to regulate in the hands of an intelligent authority?

Senator McADOO. Precisely. For instance, if you are carrying a margin account in a stock which has a very wide market all of the time and in which the fluctuations are for that reason not extreme, or less extreme than a stock which has not a wide market, where you can afford to do that upon a less margin than you could on a stock that was more susceptible of wide variations in price—

Mr. WITTER. Yes, sir.

Senator McADOO. All those are matters essentially of judgment on the part of the man who lends the money; isn't that a fact?

Mr. WITTER. Yes, sir.

Senator McADOO. And you could not by law impose some arbitrary restriction or rule there that would be workable, could you?

Mr. WITTER. No, sir. Nor do I subscribe to the theory that the amount that is loaned upon a stock will lend an effective bar to the enhancement of that particular stock, and I speak with at least some precedent, because it so happened that in San Francisco there were certain stocks listed in the exchange and very active, such as Bank of Italy and Bank Italy Corporation and later Transamerica, and those stocks were never good collateral in any bank or in any brokerage house, and still the stocks rose to fantastic heights and they broke very much farther than the market broke in similar issues or more active issues, because there was no short account, there was nothing to support the market. People were all enthusiastic about them one day, and the investors were all terrified the next.

So that I have never subscribed to the theory that the amount loaned on a stock will provide an effective bar to the heights which those stocks may reach in speculative times.

Senator McADOO. What you say about the banks that you have mentioned could be said of some of our best banks in California, where the stocks rose to extraordinary heights.

Mr. WITTER. Yes, sir.

Senator McADOO. And where the shrinkage was tremendously great, perhaps not so great and so far as New York banks, because even those banks of highest character are even worse than those in California.

Mr. WITTER. And I doubt that bank stocks have ever been recognized as the best type of collateral. They have not by my firm.

Senator GORE. Double liability has something to do with that, hasn't it?

Mr. WITTER. Yes, sir.

Senator GORE. Let me ask you this: Is it your interpretation of this bill as drawn that if a 60-percent margin is required and put up when the stock has declined to that point where your margin is reduced one point, say 59, then the broker would have to close out the account, under this bill?

Mr. WITTER. Yes, sir; that is what the law says if I read it correctly.

Senator GORE. Isn't that a good deal like when you hang a man and you spring the trapdoor and he reaches the end of the rope and something happens? There is no giving at all, no flexibility.

Mr. WITTER. No, sir.

Senator GORE. It looks to me a good deal like that. You just reach the end of your tether and that is all.

Senator McADOO. Mr. Witter, what you mean is that if a 60-percent margin is required and that margin, because the price of the stock should decline 1 percent to 59 percent, you would either have to sell the customer out or he would have to respond to a call for additional margin to maintain it at a 60-percent level?

Mr. WITTER. Yes, sir; I so understand.

Senator McADOO. You think this bill as drawn exacts that, do you?

Mr. WITTER. I again have to say that I am not an attorney, but I may say that that is my understanding of it.

Senator BARKLEY. That is the practice anyway, isn't it, largely?

Mr. WITTER. No, sir.

Senator BARKLEY. If a man lets his margin get below the requirements of the broker and does not put up some more money, the broker can sell him out?

Mr. WITTER. Yes, sir.

Senator BARKLEY. And usually does, unless there is such personal and credit relations between the two that he is willing to carry it for a few days, even though it is undermargined, in the hope that it will come back to normal?

Mr. WITTER. The difference is that the rule in any exchange is susceptible to justifiable exception.

Senator BARKLEY. Do you think that there ought to be a rigid rule laid down by the law that all stocks should be equally margined, or that there ought to be some discretion somewhere, either in the Trade Commission or the broker, to fix a different marginal requirement on the volatile stock like American Commercial Alcohol or Auburn Automobile or some others that rush up the hill and then rush back down before anybody can keep up with them either way?

Mr. WITTER. I think the Government would be assuming a very grave responsibility if it undertook to fix a limiting rate upon every stock in this country. I do not think it is practical. I do not think it could be done. I do not think it is a responsibility the Government should assume. If it were to be exercised, I think it ought to be exercised through the Federal Reserve banks.

Senator BARKLEY. Assuming that there should be some requirement as to margin in the law, you think there ought to be some discretion lodged somewhere to make exceptions or to give a certain leeway in the way of requirements that would depend somewhat upon the character of the stock and its fluctuations over a period of time or the circumstances surrounding it?

Mr. WITTER. Yes, sir. I believe most heartily in control and in supervision of the stock exchanges. I am perhaps out of step with some of my associate members of the stock exchange in that respect. I think that the Dickinson report, which was very carefully drawn up and which I heartily approve, provides a very proper basis for the drafting of a law which would provide for requirements and which would leave in the discretion of an intelligent and honest authority, which by the way, should devote its entire time to that job, which would be a big one—to see that the stock exchanges of this country are conducted in a manner which is in the public interest and not detrimental to the public interest. I think that is fundamental. It should be controlled.

Senator GORE. The broker is under every motive to protect himself with reference to these margin accounts, and I believe it has been testified here and the records show that there were not any losses; the brokers did not lose any money. Isn't that true?

Mr. WITTER. No, sir. There are a lot of brokers lost a lot of money, and some brokers became bankrupt because of their carelessness.

Senator GORE. Wasn't that, though, when they were trading on their own account?

Mr. WITTER. No, sir. Margins were the source of very great losses.

Senator GORE. I think they went so far as to say in New York there was not a known loss.

Mr. PECORA. Senator, I think that testimony related to the brokers' loans; the lenders of brokers' loans did not lose any money.

Mr. WITTER. Exactly.

Senator GORE. Oh, I see, and not to the extent that the brokers themselves did not lose?

Mr. PECORA. No, sir.

Senator GORE. I thought the evidence was that brokers trading on their own account took losses along with other people, but so far as accounts of their customers were concerned they sold them out in time to protect themselves.

Senator McADOO. Mr. Witter, as a practical question here, where there are vast amounts of securities of all kinds and characters, differing in value because of the merits of the investments themselves, we are undertaking in this bill to regulate by some arbitrary standards saying that 60 percent margin, if I interpret the bill correctly, shall apply to all loans made against securities that may be traded in through these banking houses.

Now, would it not be equally reasonable to say that all banks should require some fixed amount of margin or security on the multiplicity of loans with infinite varieties of securities back of them that are the basis of credit in the country?

Mr. WITTER. Yes, sir.

Senator McADOO. If it is, and we attempted that, to substitute the discretion of government for the discretion of boards of directors

and responsible officers of these banks, would you think as a practical question that the Government could administer it?

Mr. WITTER. Oh, I do not think that the Government could at all. I think that the Government when it assumes the function of governing all credit and governing all loans and providing rules and regulations for the lending of each bank and of every brokerage firm, is undertaking a job which it cannot possibly handle effectively.

Senator McADOO. On the other hand, I think that we all realize that there have been many abuses in the conduct of the exchanges throughout the country and that they need to be corrected. I think myself that some reasonable measure of regulation is highly desirable in the public interest. The question is, What is reasonable and what is practicable to meet the very complex and difficult problem that is presented, not only by this security business, trading in stocks and bonds but by the general credit situation?

Mr. WITTER. Senator, the Dickinson report sets forth a formula, after careful study, which provides for that type of regulation, and in this report I heartily approve.

Senator McADOO. I am very much impressed by the Dickinson report. I think it offers a beginning that, if adopted, would probably lead to satisfactory results. But I think the line ought to be drawn between regulation and management.

Mr. WITTER. Yes, sir.

Senator McADOO. Regulate is one thing, and to attempt to manage a complex business is a very different thing.

Mr. WITTER. I think it would be a disastrous thing.

Senator GORE. The general complaint urged here has been that the brokers have been a little too liberal with respect to margin accounts and let too many people in and made it too easy for themselves to wade in and get drowned soon or later, a lot of them. Is that your understanding?

Mr. WITTER. I think that is probably a just criticism. And the New York Stock Exchange has taken certain steps in the direction of increasing margins to remedy that particular thing. I would not object if they went further.

Senator GORE. I would like to say here for the record that if we invest some Government agency with the power to regulate margins and margin requirements when there is a general movement downward, Senators will find themselves under a good deal of pressure to try to exercise their influence with that institution to get them to liberalize the margin requirements and save their lives. That is politics.

The CHAIRMAN. Is there anything further you want to say, Mr. Witter?

Mr. WITTER. No, sir. I want to apologize for getting as far off the subject that I was authorized to talk upon as I did, because my purpose in appearing here, sir, was to say that those people whom I represent most definitely object to the provisions of the bill which separate the functions of dealer and broker.

Senator GORE. You say they object to that?

Mr. WITTER. They objected to those sections of the bill which have the effect of absolutely separating the brokerage and invest-

ment business, because the investment business cannot be carried on in this country without permitting the dealer to also act as a broker.

They object to section 6, which has to do with unlisted securities. They object to section 14, which has to do with over-the-counter markets.

On those subjects that I am authorized to speak for them I have gotten a long way away from, I am afraid.

(The papers submitted by Mr. Witter for the record are as follows:)

[Form No 1, specimen only Sale of owned securities in which firm has profit]

DEAN WITTER & Co.,
486 CALIFORNIA STREET,
San Francisco, December 28, 1933

Mr JOHN SMITH,
Russ Building, San Francisco.

DEAR MR SMITH: At the request of Mr. John Doe, we are pleased to confirm sale to you of \$1,000 par value Pacific Gas & Electric Co First & Refunding 4½ % Bond due June 1, 1950. Price 87½, plus accrued interest.

In this transaction we act as principals, confirming at a net price which includes a profit to us

We understand you wish to complete this transaction tomorrow, December 29.

Thanking you for this business, we are

Yours very truly,

DEAN WITTER & Co,
By _____

JJQ: SJ
LMK

[Form No 2 specimen only Sale of owned securities in which we have a loss To another dealer]

DEAN WITTER & Co,
486 CALIFORNIA STREET,
San Francisco, December 28, 1933

BLYTH & Co,
Russ Building, San Francisco.

As a matter of record we are pleased to confirm sale to you of \$1,000 par value Pacific Gas & Electric Co., first and refunding 4½ percent gold bond, due June 1, 1960 Price 87½, plus accrued interest

In this transaction we act as principals, confirming at a net price.

Delivery, regular.

Thanking you for this business, we are,

Yours very truly,

DEAN WITTER & Co,
By _____

[Form no 3, specimen only Brokerage transaction, showing purchase for account of customer with commission shown on attached bill. Note bill specifies "Bond Department"]

DEAN WITTER & Co,
486 CALIFORNIA STREET,
San Francisco, December 28, 1933

Mr JOHN SMITH,
Russ Building, San Francisco.

DEAR MR SMITH: At the request of Mr John Doe, we are pleased to confirm purchase for your account of—

\$1,000 par value Pacific Gas & Electric Co first and refunding 4½ percent gold bond, due June 1, 1960, price 87½, plus accrued interest plus commission

We understand you wish to complete this transaction tomorrow, December 29, 1933

Thanking you for this business, we are,
Yours very truly,

DEAN WITTER & Co.,
By _____

JJQ: SJ
LMK

NOTE—On this form we will include the legend: "In this transaction we act as brokers."

[Specimen No. 3]

DEAN WITTER & Co
486 CALIFORNIA STREET
EXbrook 7211

Bond Department

SAN FRANCISCO, 2-20-34

Mr. JOHN SMITH,
Russ Building, City

Purchased for your account:

1,000 Pacific Gas & Electric Co 4½s, due 6-1-60 (87½)----	\$875.00
Commission-----	2.50

Int J & D 1 accrued int 28 days-----	877.50
	3.50

Due Dean Witter & Co.-----	\$881.00
----------------------------	----------

Please add _____ additional interest per day if not paid on _____.

[Form No 4 (specimen only)—Brokerage transaction showing sale for account customer indicating commission charge Bill to accompany and to be marked "Bond Department"]

DEAN WITTER & Co.,
486 CALIFORNIA STREET,
San Francisco, December 28, 1933

Mr. JOHN SMITH,
Russ Building, San Francisco.

DEAR MR. SMITH: At the request of Mr John Doe, we are pleased to confirm sale for your account of—

\$1,000 par value Pacific Gas & Electric Co. First & Refunding 4½%
Gold Bond due June 1, 1960
Price 87½, plus accrued interest less commission.

We understand you wish to complete this transaction tomorrow, December 29, 1933.

Thanking you for this business, we are
Yours very truly,

DEAN WITTER & Co.,
By _____

JJQ: SJ
LMK

NOTE—On this form we will include the legend, "In this transaction we act as brokers."

[Form no 5 (specimen only)—Sale to customer from inventory in which we have profit See attached bill marked "Bond Department"]

DEAN WITTER & Co,
486 CALIFORNIA STREET,
San Francisco, December 28, 1933

Mr JOHN SMITH,
Russ Building, San Francisco

DEAR MR SMITH: At the request of Mr. John Doe, we are pleased to confirm sale to you—

\$1,000 par value Pacific Gas & Electric Co.
First & Refunding 4½% Gold Bond due June 1, 1960.
Price 87½, plus accrued interest.

In this transaction we act as principals, confirming at a net price which includes a profit to us.

Our detailed statement is attached hereto.

We understand you wish to complete this transaction tomorrow, December 29, 1933.

Thanking you for this business, we are
Yours very truly,

DEAN WITTER & Co
By _____

JJQ SJ
LMK
encl

[Specimen No 5]

DEAN WITTER & Co
486 CALIFORNIA STREET
EXbrook 7211
Bond Department

SAN FRANCISCO, Feb 20, 1934

Mr JOHN SMITH,
Russ Building, San Francisco

Sold to			
1,000 Pacific Gas & Electric Co 4½s due 6-1-60.....	87½	875 00	
Int J & D 1 accrued int 28 days.....		3 50	
Due Dean Witter & Co.....			\$878 50
In this transaction we act as principals, confirming at a net price which includes a profit to us			
Please add.....additional interest per day if not paid on.....			

[Form No 6—Specimen only. Sale from inventory for own account if we have a loss in securities sold]

DEAN, WITTER & Co,
486 CALIFORNIA STREET,
San Francisco, December 28, 1933

Mr JOHN SMITH,
Russ Building, San Francisco

DEAR MR SMITH: At the request of Mr John Doe, we are pleased to confirm sale to you of—

\$1,000 par value Pacific Gas & Electric Co First & Refunding 4½ percent bond due June 1, 1960. Price 87½, plus accrued interest

In this transaction we act as principals, confirming at a net price
We understand you wish to complete this transaction tomorrow, December 29, 1933

Thanking you for this business, we are
Yours very truly,

DEAN, WITTER & Co,
By _____

JJQ SJ
LMK

[Form No. 7.—Specimen only. Sale to another dealer of securities in which we have a profit]

DEAN WITTER & Co.,
486 California Street,
San Francisco, December 28, 1933.

BLYTH & Co,
Russ Bldg., San Francisco:

As a Matter of Record We are Pleased to Confirm sale to you of—
\$1,000 par value Pacific Gas & Electric Co. First & Refunding 4½% Gold Bond,
due June 1, 1960.

Price 87½, plus accrued interest.

In this transaction we act as principals, confirming at a net price
which includes a profit to us.

Delivery: regular.

Thanking You for This Business, We Are

Yours very truly,

DEAN WITTER & Co.,
By _____.

		No.
		San Francisco,, 193.
Received from	DEAN WITTER & CO.	
The following securities		
\$1000 PACIFIC GAS & ELECTRIC CO. 4½s due 6-1-60 No.....		
6-1-34 et seq cpns attached		
@ 87½ 875 00	In this transaction we act as princi-	
0-28 3 50	pals, confirming at a net price, which	
	includes profit to us.	
878 50		
Name BLYTH & CO. INC.	FEDERAL TAX STAMPS	
Address: S.F.		
Remarks: JJQ	(Signature)	

[Form no 8 (specimen only) —Purchase of securities for own account; says we act as principals]

DEAN WITTER & Co.,
486 CALIFORNIA STREET,
San Francisco, December 28, 1933.

Mr. JOHN SMITH,
Russ Building, San Francisco.

DEAR MR SMITH: At the request of Mr. John Doe, we are pleased to confirm
purchase from you of—

\$1,000 par value Pacific Gas & Electric Co.
First & Refunding 4½% Gold Bond due June 1, 1960
Price 87½, plus accrued interest.

In this transaction we act as principals.

We understand you wish to complete this transaction tomorrow, December
29, 1933.

Thanking you for this business, we are
Yours very truly,

DEAN WITTER & Co.
By _____.

JJQ: SJ
LMK

The CHAIRMAN. Very well. We are very much obliged to you.
Now you are excused. Mr. W. G. Paul.

175541—84—PR 15—28

**STATEMENT OF W. G. PAUL, LOS ANGELES, CALIF., SECRETARY
OF THE LOS ANGELES STOCK EXCHANGE**

The CHAIRMAN. Mr. Paul, state your name and place of residence, and occupation, please.

Mr. PAUL. My name is W. G. Paul. I am from Los Angeles, Calif. I appear before your committee in two capacities: First, as secretary of the Los Angeles Stock Exchange, to present to you gentlemen or answer questions which you may have concerning that particular market.

And second, I wish to appear before you in all humility as representing a little fellow in our business, and as such I would like to present for your consideration serious consequences which this bill imposes upon the smaller man in our business, particularly in section 7 and section 10. I, of course, have certain opinions and ideas on the general sections of the bill, but they have been so ably presented by others, and you still have to listen to others present those arguments, that I prefer to confine myself to those two sections.

Senator McADOO. My attention was distracted for the moment, Mr. Paul. What were those sections?

Mr. PAUL. Sections 7 and 10. Section 7 deals largely with the capital requirements for a stock broker, limiting the amount of business he may do with the capital he has, and as Mr. Corcoran very definitely stated, implying that that capital should be absolutely cash. I do not want to be glib in my expressions, but in all sincerity I believe that section 7 could conceivably put out of business a vast majority of the smaller units in our business who, after all, to an extent are the backbone of our business. I can conceive where the sections would concentrate the business, and by putting a pure premium on capital as such, possibly further centralize power through sheer money control.

I think the best answer or the best presentation of our objection to section 7 is in our own records as brokers. I think it is conceded, certainly records will demonstrate, that the mortality financially among brokers as such during the very trying period we have just gone through is on the whole an excellent one. Certainly, our own record in Los Angeles I am prepared to stand upon and defend. We have had some failures, but aside from the first failure, which was a direct result of the terrific crash in October, no failure has affected the public to any serious extent, and only two failures have even affected the public.

In other words, we in our business have always made a strenuous effort to see that those brokers who are members of our stock exchange shall conduct their affairs at all times in such a fashion that their financial condition shall protect the public with whom they are dealing. And I submit that the record, the actual record of failures on our exchange, and I believe the majority of exchanges is such as to justify some consideration to the tempering of the iron-clad capital requirements of section 7.

It is well known that many of us are financed through friends or relatives who come into our business in the relationship of special partners and who, instead of presenting to us actual cash, give us perfectly sound, liquid securities which are used as capital.

In our exchange audits and in our exchange questionnaires, through which we control the capital structure of our members, we are particularly and very keenly critical of any form of capital which is not purely liquid. Many of our brokers do margin business only to a limited extent, and to require them to keep capital in absolute cash position would seem to me to be an undue penalty, and I submit that those stringent provisions of section 7, in the light of past experience, can and should be very seriously considered before they are made a matter of basic law.

I do not care to take a great deal of your time on section 10, because it has been so ably argued, and yet again I want to present our position in that respect. In other words, I want to submit the records of brokers in the conduct of their business. And furthermore, I want to submit that in my humble opinion a member of a recognized stock exchange, such as a national securities exchange would be, under any form of legislation is, with all respect to the very high caliber of the majority of men who are not members of those exchanges and who conduct their businesses in unlisted or over-the-counter markets—it is my humble opinion that to permit the members of national securities exchanges to conduct also the dealer or unlisted business is in a way a safer medium to the public than in the other because, through the method of control which you have over such members, certainly any phase of their business will be subject to that control.

I want to further submit that we as exchanges have always exercised that control. We not only control the relation of our members to their clients as respects securities which are listed, but we say to any member of our exchange: We reserve the privilege of examining any transaction which you may have in any security with the public; and the net result is that in California, at least, I know that the listed brokers in the conduct of their dual capacities have certainly always exhibited a very high standard of conduct.

Senator GORE. How many listed brokers have you?

Mr. PAUL. There are 67 members of my exchange. They represent approximately 56 organizations, firms, or individuals doing business. My own experience in different committees in my exchange over the past few years would bear out the fact that we closely scrutinize such conduct.

In addition to that, the State of California, as I imagine most States, has in its statutory laws very definite provisions governing the relation of principal and agent. In other words, the statutes of my own State require me doing business in that State to observe the penalties and the written law governing my relationship to anyone if I should step out of the capacity of agent and act as an undisclosed principal. The securities act of the State of California, which is administered by the corporation commissioner, who is comparable to securities commissioner in other States, in that act itself are stipulated the laws of principal and agent. In our own exchange rulings we have it.

And I want to submit, if not the original, I will secure it if you wish—when I arrived in Washington and this discussion on section 10 was brought up, naturally I had thought about it all the way across the continent, and it occurred to me that in the light of my own experience in California, in the light of the relationship which

I have enjoyed with the authorities in California, particularly the corporation commissioner's office, our records demonstrated that the conduct of that dual business by members of the exchange in California had always been on a very high plane.

I was rather reluctant, and frankly questioned whether the commissioner of corporations of California would be willing to interject his opinion or statement, which naturally would be used as he knew I would want to use it. And yet I did, I wired to California and asked if they would approach Mr. Daugherty, who is our corporation commissioner, and ask him if, in view of the experience of his office, he could and would express an opinion as to the experience of his office—and his office licenses and controls all securities dealers in California—if he would give me an opinion or expression which I might use. The approach was made through counsel for the exchange. This letter is a copy of the letter which he wrote. [Reading:]

STATE OF CALIFORNIA,
DEPARTMENT OF INVESTMENT, DIVISION OF CORPORATIONS,
San Francisco, California, February 23, 1934

MR. EARL C. ADAMS,
Attorney at Law,
c/o Loeb, Walker & Loeb,
Pacific Mutual Building,
Los Angeles, California.

DEAR SIR: Replying to your wire of even date, I beg to advise you that I have discussed with some of the members of the Division of Corporations who have handled complaints against brokers licensed with this Division as a matter of daily routine

The substance of opinion is that there are practically no complaints against brokers who are members of the New York Stock Exchange. Compared with individuals and firms licensed in this State as brokers, there are very few complaints registered with us against members of the Los Angeles Stock Exchange or the San Francisco Stock Exchange.

There are a vast number of complaints lodged in proportion against individuals and firms holding or having held brokers' certificates from us who are not members of any exchange.

To obtain the actual number of complaints registered against individuals or firms in any given period would necessitate the work of a fair sized force for several weeks.

Yours very truly,

EDWIN M. DAUGHERTY,
Commissioner of Corporations.

Senator GORE. Could you say how many of those certificates are outstanding in Los Angeles in connection with your exchange as compared with the licensed brokers?

Mr. PAUL. I am sorry, Senator, I could not, but I am confident that it is vast. It seems to me that almost everybody in California is either a real-estate broker or a securities broker. I can get the exact numbers and will be very glad to do that for you, the number of licensed brokers in California.

Senator GORE. That would not be so important. But what function do these certified brokers or near brokers perform as compared with listed or licensed brokers?

Mr. PAUL. If you secure a securities license to be a broker in California, that means that you may conduct any phase of the securities business. In other words, you may act as a broker of securities which are unlisted or even listed without being a member of an exchange necessarily; that you may trade in the obligations

of the State or any bond, or that you may represent a corporation in the sale of its securities to the public if those securities have been sanctioned by the corporation department. In other words, to be a member of an exchange you must also hold a license with the State.

Mr. PECORA. Mr. Paul, do those statutes which require the issuance of licenses to dealers and brokers in your State confer any supervisory power upon a State officer?

Mr. PAUL. Oh, yes; our corporation commissioner, of course, has complete power.

Mr. PECORA. Yes, to do what? Has he a power of examination and visitation?

Mr. PAUL. Yes, sir.

Mr. PECORA. I want to say that, to be exact, in 1923 I helped draft a bill which was introduced in the New York State Legislature seeking to enact that very principle. The bill failed of enactment principally because of the opposition of the New York Stock Exchange to its enactment. I was then in the district attorney's office, and we were in the midst of this bucket-shop campaign, and we sought to have legislation of that sort enacted in the State of New York. The principal opponents of the bill, which passed the State senate and failed in the assembly, was the New York Stock Exchange.

Senator GORE. Could you tell us how far the laws of California supervising the exchanges of California correspond with the provisions in this bill? What are the points of resemblance and difference?

Mr. PAUL. Well, I should say that the corporate securities act of the State of California in its provisions governing brokers is similar in this respect, that it is general; it confers the powers of supervision upon the corporation commission. Our securities act deals chiefly with the issuance of securities in that State which are to be sold to the public. I should say just from pure memory that the provisions in that act as relate to brokers are to a very limited extent specific. That is, there are no set phrases, such as a broker may or may not do this, he may and may not do that. It merely licenses him as such with our securities commissioner, and the presumption is that the securities commissioner shall take such steps as in his judgment may be necessary to protect the public in the relationship of that broker.

Senator GORE. Does it give the commission power to regulate margin accounts?

Mr. PAUL. No, sir.

Senator McADOO. He has no inquisitorial power?

Mr. PAUL. Oh, no.

Senator McADOO. Or power of visitation and examination?

Mr. PAUL. He or his representative may come to your office and examine your records.

Senator McADOO. With respect to the conduct of your business.

Mr. PAUL. I would say he possibly has that power, although he rarely exercises it.

Senator McADOO. His chief function is with respect to complaints?

Mr. PAUL. That is right.

Senator McADOO. Due to the fact that the initial issues of the corporation—either stock or bonds—do not comply with the requirements of our statute. Is not that about the extent of his authority?

Mr. PAUL. Yes.

Senator McADOO. But so far as any regulatory power over the conduct of the broker's business or anything of that sort is concerned—

Mr. PAUL. I should think he had that if he cared to invoke it, but it is more of a police power in that when occasion arises he may exercise it.

Senator McADOO. Upon complaint; but I mean to say he has not general inquisitorial power of his own volition.

The CHAIRMAN. He can revoke licenses.

Mr. PAUL. Yes; after hearing, and for cause.

Senator KEAN. He has got to have a hearing, and it must be for cause.

Mr. PAUL. Yes.

Senator GORE. Does it fix or regulate the relationship between the amount of capital and the amount of business transacted by a broker?

Mr. PAUL. No, sir. Furthermore, in California, as a prerequisite for a license, we require the filing of a surety bond in the amount of \$5,000.

Senator GORE. What are the stipulations of the bond—to do what?

Mr. PAUL. To protect any person doing business with that broker in the amount of \$5,000 against fraud.

Senator McADOO. That is not a very heavy bond.

Mr. PAUL. If I may continue for just a minute, I have presented here the implication that because we are carefully surrounded by laws in California the conduct of our business has been on a high standard, as exhibited by my own statement and as confirmed by our corporation commissioner. But frankly I think it goes deeper than that. I have heard certain expressions here in the hearing as it has been conducted to which I would take particular exception if they were intended as their inference might have led you to believe.

I do not believe any man can exist in any business unless his standards of ethics and business conduct are generally on a high level or a high plane. I do not know of any broker who could exist in business if his business were predicated upon taking advantage at every opportunity of his customer. Certainly, that is the basis for the contention which we make on section 10. I certainly could not hope to get the brokerage business of a customer of mine with my right hand if with my left hand I was dealing with him unfairly in the so-called "investment end" of his business. Most of the men—of whom I may say, in all humility, I am presenting myself as an example here—deal largely on a personal basis. Our clients to a great extent are friends who, over a given number of years, have learned to trust our judgment, in spite of 1929. They trust our integrity and our honesty, and they come to us more or less as you would go to a physician, with their financial problems. We discuss all phases of investment with that type of person, and certainly no investment account of any character can confine itself to any one class of securities, any more than a well-balanced meal could be all dessert.

Senator GORE. I can see how that might apply to regular customers, the so-called "bulls and bears." How about these "lambs" that just wander into the shambles occasionally and never get out?

Mr. PAUL. Can you produce a specimen for me, sir? I think, to a great extent, the brokers were "lamb."

Senator GORE. I would not want to indulge in anything personal here, but I think I could produce 1,000,000 corpses, perhaps, by going back to 1929, if that is specific enough.

Mr. PAUL. That is rather specific.

Senator GORE. You know what I have in mind. It is the babe in the wilderness that sees the market going up for quite a while, and he sees other people buying stock and selling it for more than they paid for it, and he decides that he will gamble, and takes a chance; and he feels that he will win. Have you any requirements with respect to margins that afford him a sort of safeguard against himself?

Mr. PAUL. May I approach that from two standpoints?

Senator GORE. I wish you would.

Mr. PAUL. Your margin I will discuss after I present another phase of that.

Senator GORE. There is a man who has excited the sympathy and pity of the country, and who has aroused this movement, largely.

Mr. PAUL. I believe there is great danger of your margin theory, which is being so seriously discussed, defeating its very purpose. I have been engaged in this business since 1919—very obviously I came into it right out of the war—and, frankly, one of the great problems I have faced, trying to be a conscientious man in my business, has been the problem of the pirates and bootleggers that have been mentioned here who are beyond the pale of all law. You cannot pass laws to stop those fellows. In fact, the more laws you enact, in my humble opinion, the better basis they will have to operate upon, because it begins to tie the hands of the fellows with whom, possibly, these very "lamb" should do business.

In this 15 years of business experience, I positively shudder at some of the things that have gone on—not excusing the broker, as such, now, but it is human nature, when things are boiling, that this little fellow we speak about begins to get the urge, and frankly, I think that a great danger has always existed, and might exist even more under terrifically stringent regulation, to force that fellow into the hands of the very fellow who would make no effort to protect him. I question whether you could protect that man through a margin requirement, as such, because if you limit the member of a stock exchange, over whom you would have, through your regulation, full control in his relationship to this "lamb", you force that very fellow to seek out some person who will do business with him. And, with no disrespect to the vast number of honest brokers in this country who are not members of stock exchanges, you would unquestionably force that man into the hands of the blue-sky operator, who would not even leave a skeleton.

Senator GORE. You think you would send the "lamb" to the Wolf of Wall Street, instead of the "bulls and bears"?

Mr. PAUL. No; I do not, sir.

Senator McADOO. The real solution is to prevent the propagation of "lamb", is it not?

Mr. PAUL. Has not that been a great problem since the earth was created?

Senator McADOO. If we could do that, we would not have any problem so far as they are concerned, but the difficulty is that in spite of any law or regulation—

Senator BARKLEY. There is another committee considering a bill of that sort in the Senate now.

Senator McADOO. Which committee is that?

Senator TOWNSEND. Birth Control [laughter].

Senator GORE. We will have to apply birth control to these "lambs."

Senator McADOO. Under no form of regulation can you prevent people from making unsound investments. Our "blue sky" laws are intended to provide this much protection, that only such securities as are considered good by the corporation commission of our State will be permitted to be sold on our exchanges or otherwise, but we know how ineffective even those laws are to protect people who have not the judgment to make investments. I think the exchanges, however, do need more regulation than they have had. Take your own exchange the Los Angeles Stock Exchange. You know that the regulations there were so insufficient that some very great tragedies have happened in our own community.

Mr. PAUL. That is right.

Senator McADOO. That might have been prevented if the regulations had been more stringent.

Mr. PAUL. That is right.

Senator McADOO. Even if they had been as stringent as those of the New York Stock Exchange, because many precautions were not in your regulations. So that there is no doubt about the fact that a reasonable measure of regulation of the stock exchanges would be greatly in the public interest, but the question is to find out what would be reasonable as well as practicable.

Mr. PAUL. I think that is true, and I think that is the reason we are here.

Senator McADOO. We are trying to find out.

Mr. PAUL. Yes.

Senator BARKLEY. A moment ago you said there are a vast number of perfectly honest brokers who are not members of any exchange. Do you mean that they have no connection with people who are members of exchanges? How can they transact business? It costs a lot of money to be a member of the New York Stock Exchange, and probably other exchanges, but these men you refer to as being perfectly honest men and I do not doubt that at all—have connections with people who are members of exchanges, do they not?

Mr. PAUL. Senator, those transactions which they would have with their customers in listed securities, they would execute through some member of a stock exchange, and probably would have no compensation from it.

Senator GORE. No what?

Mr. PAUL. They would receive no compensation from that, because the laws of the exchanges do not permit the splitting of commissions with nonmembers, and they would conduct that business to a degree incident to their broader business, which, in the case of the type of men I refer to, is the large municipal bond houses, the investment houses, the investment bankers, so-called, who act largely as dealers or as brokers in unlisted securities.

Senator GORE. And are not themselves members.

Mr. PAUL. No; they are not members of any stock exchange, and yet they are a very important unit.

Senator GORE. Would they be these certified brokers you spoke of a while ago, that are not licensed?

Mr. PAUL. Certified?

Senator GORE. Yes.

Senator McADOO. Licensed.

Mr. PAUL. Licensed. They would be licensed to conduct a securities business, but their conduct of their business would be off all stock exchanges.

Senator GORE. But they would be licensed by the State, and not by the exchange.

Mr. PAUL. That is right. The exchange would have no control over them, except in their relationships to the members.

Senator BARKLEY. Are there enough of the so-called "bootleggers", to which reference has been made, in the country to affect materially, one way or the other, the prices of stocks?

Mr. PAUL. Not to affect the prices of stocks, Senator, because their activities are such that they cannot affect the prices of stocks, but they are the type who do this—not in the sense of the old bucket shop, as we knew it, where it was organized, and where you could go in and more or less make a bet, but they are the type of fellows—let me interject this. The exchanges usually control the type of advertising which they will permit their members to do. We do not permit them to go out with flamboyant advertisements, advertising that they are the investment experts of the world for various reasons. The other type of man I refer to is not limited by any such restriction, either by law or as a member of an organization. The net result is that he is the fellow who does put these very attractive ads in the paper, and to him naturally flock the very "lambs" that we are discussing.

Senator BARKLEY. How does he operate? What sort of stocks does he sell, and through what agency?

Mr. PAUL. In the majority of cases, he does not ever buy or sell a stock. We have had them in California—and I am glad this came up, because it might be of interest to you in your consideration of these loan situations. We have had in California a very serious problem in the so-called loan organizations which were formed. They would offer to loan you more than your bank could or would loan on a security. Naturally that was tempting, and they usually offered it at a very reasonable rate of interest. You took your security to this particular organization, and they did advance you, we will say, 80 percent of the market value, and then they immediately proceeded to sell the stock, in the hope, first, that you would never come back; and second, that if you did, they would be able to pick it up again some place. That is a very difficult thing to control. Those fellows advertise their heads off, and they attract the very person who has no other means to protect himself.

Senator BARKLEY. In their individual transactions with men who are hard up for money, they might work a fraud upon them.

Mr. PAUL. It is fraud, of course

Senator BARKLEY. But even taking all such transactions, combined, throughout the country, are they sufficient to affect materially, one way or the other, the prices of stocks on the market?

Mr. PAUL. They have, in my opinion, probably no effect on the market price of stocks, but it comes down, in my opinion, to what is the essence of our proposed legislation here. It seems to me that the great thing we are all afraid of is fraud, individually, and my contention is that by far and large the vast number of members of the stock exchanges—whether it is New York or the smaller units—are far and above the practice of fraud in the daily conduct of their business. I am speaking for the vast majority. Certainly we can pick out cases of fraud by individuals, but I maintain that that does not mean that the whole moral structure of all brokers should be placed on that plane.

Senator GORE. You spoke a few minutes ago about the impossibility of prohibiting bootlegging entirely. I saw the other day that lotteries are conducted and authorized in thirty or thirty-two countries in the world and that the current business in this country, notwithstanding it is against the law, amounts to quite a volume throughout the year. That typifies what you have in mind, does it not?

Mr. PAUL. To a degree. It is extremely difficult of control. I think, along the lines Senator McAdoo has suggested, we presume we must have regulation of exchanges, and I think that the problem that you gentleman face is in the framing of that regulation so as not to restrict the men you are going to regulate to the extent where they are not even able to protect themselves or the public.

Senator GORE. To regulate and not prohibit.

Mr. PAUL. That is right.

Senator GORE. Do you have any rules and regulations in connection with your exchange that are not in force on the New York Stock Exchange, that you think would be advisable to apply to that institution?

Mr. PAUL. I have a great deal of respect for the experience of the New York Stock Exchange, upon which they predicate their rules, and we have in large measure followed very closely in line with their rulings, in the protection of our exchange.

Senator GORE. And your range of dealing covers pretty much the same as theirs?

Mr. PAUL. Yes; on a much smaller scale.

Senator GORE. With short sales, options, puts, calls, privileges, and so forth?

Mr. PAUL. I think the Pacific coast exchanges have had little difficulty with the so-called "option" or "pool", because, if they have been conducted, they have been conducted on a much smaller scale, and have not presented a problem either to the public or to us as an exchange.

Senator GORE. You do not think, as the result of your experience, then, you have made any improvements that might well be applied to the New York Stock Exchange?

Mr. PAUL. I would hesitate very much to say that, sir.

Senator KEAN. Do you figure that if this bill were enacted into law the effect of it would be to curb the legitimate business on the exchanges and promote the bucket-shop business?

Mr. PAUL. I do very much, Senator, and in that respect I would like to draw again to your attention this, that a member of an exchange is virtually like the proverbial goldfish. Every action he takes is subject to very close scrutiny. Every transaction he has with his customer can be traced down to its finest detail. As contrasted with that, the other lines of trading cannot. In other words, if I execute an order for a customer of mine on a stock exchange, I can prove, down to within a fraction of a minute, just exactly what I did. Contrary to that, if I am dealing in unlisted security, my customer is absolutely at my mercy and judgment, trusting that I may be able to find the best market, and when I report that market to him, he has no other check except my word for it.

Senator KEAN. And if this law were enacted it is your opinion that it would create a lot of bootleggers, or, in other words, bucket shops. In a bucket shop what they do is to bet against your judgment, so that if you give them an order to buy 100 shares of stock, they do not buy 100 shares of stock, but they look at the quotations and sell you 100 shares of stock at the quotation, or about the quotation. Is not that right?

Mr. PAUL. Of course, that is the bucket shop as we knew it.

Senator KEAN. Yes.

Mr. PAUL. Frankly, I think there is no question that if the regulation imposed upon members of national securities exchanges were too stringent and rigid, it would invite a type of man who would say to this small fellow, or the lamb, "You come and trade with me. You cannot trade with a member of the New York Stock Exchange, but I will take care of you." Quite frankly, I believe we will all concede that regardless of how woolly he may be, at least if he were dealing with a member of a securities exchange, we would have some control over that particular member.

Senator KEAN. Senator Gore thinks that the Lord tempers the wind to the shorn lamb. Is that right?

Senator GORE. Yes; unless there is more wind than lambs, Senator.

The CHAIRMAN. Mr. Paul, you said you thought that it was in order to have some regulation of the exchanges. What kind of regulations do you favor, and to what extent, and what would be accomplished by them?

Mr. PAUL. That would be rather presumptuous for me to say, because that would invite me to write the act.

The CHAIRMAN. Not necessarily; but I am trying to get at your idea.

Mr. PAUL. My reaction to that, to express it as briefly as possible, would be this. Apparently public opinion is such that they feel that the conduct of the securities business should be more subject to review and control by the Federal Government. I am not so sure but that such control, properly exercised, would be to the benefit of the business itself. Therefore I am prepared to say that I would not be undisposed to regulation, where that regulation was such that it would accomplish the desirable purposes, but, at the same time, not strangle the business it attempts to regulate. I am not meaning to generalize too much by that, but I do mean this, that I think it is impossible for any group to sit down here on the 2d day of March or the 3d day of March 1934, and place in a statute

regulations which, 6 months from now, they might themselves be very sorry are there, but which cannot be changed because of their nature. In other words, I am arguing for a degree of flexibility, even regardless of the amount of power which you may vest in any regulating authority. I think the greatest danger in an act such as this would be the straight up-and-down lines which could not be erased except by subsequent action similar to the process which created it.

Senator BARKLEY. You mean by that that you do not think the act itself ought to fix any metes and bounds at all, but just leave it to somebody else to fix them?

Mr. PAUL. It would depend, Senator, upon what particular functions you were going to limit by any definite metes and bounds.

Senator BARKLEY. You told us what kind of regulation you do not want. I would like to know what kind you would be in favor of.

Mr. PAUL. That is true. It seems to me we are burdening you with repetition of these outstanding things as they impress us. Frankly, I very definitely feel that a fixed, definite percentage on the margin basis might be extremely dangerous, I do not care how liberal you made it, or how severe you made it. It is impossible, in my opinion, to look so far into the future that the rigid line might not be subject to a very desirable change.

As I say, in connection with section 7, I cannot agree with Mr. Corcoran that that capital should be purely cash. I think that would be an extreme penalty on a great many organizations. I think possibly the capital requirements for business may be entirely too strict, because that absolutely penalizes a smaller unit in my business, which is perfectly solvent, and has remained perfectly solvent through all this period, by placing that arbitrary limit upon his business. It compels him to operate within that limit, unless he were able to introduce new capital, which, we will all grant, at least under present conditions, would be difficult.

Senator GORE. To what extent would you liberalize this cash requirement?

Mr. PAUL. As I understand it, any form of regulation will have to be, and should be under the control of some governmental agency, and it would seem to me that these definite lines of demarcation could very well be left to such regulations as they should propose from time to time.

Senator GORE. What is the custom in your market now in that regard—instead of cash, what?

Mr. PAUL. Marketable securities. Mr. Corcoran, of course, mentioned the highest grade, United States Government bonds. We do not go quite so far. We do demand that they be absolutely liquid, in the sense that they must not be local securities with a limited market. We take every case upon its individual situation. We penalize the capital statement of our member whenever a preponderance of any one particular security appears in his statement, which takes care of the danger of the underwriting situation. If we find, for example, a member of our exchange who is concentrating his business in any one particular issue, we immediately limit him, or penalize him, making it unprofitable, or rather difficult, for him to go ahead and take on more of that particular type of business.

Senator GORE. Sort of mixing his motives.

Mr. PAUL. That is it. Frankly, I think that under no circumstances have we ever permitted beyond 20 times, instead of 10 times, as stated in this bill. As has been stated by others, there are some securities—in fact many—which, at different times, we would give no credit to at all.

The CHAIRMAN. Do you have any difficulty out there, or any problem with the investment bankers sending out trained solicitors to place securities or sell them to the public?

Mr. PAUL. In the sense of difficulty, no, Senator. Of course the Securities Act went a long way to take care of that uncontrolled solicitation of business, and the misrepresentation of those facts.

The CHAIRMAN. Yes.

Mr. PAUL. Frankly, I can see exactly what Mr. Corcoran had in mind in his proposal to segregate, but I consider that an indictment on character.

The CHAIRMAN. Do your investment security people send out agents to sell securities to individuals?

Mr. PAUL. To a certain extent, yes—not, of course, nearly to the extent it had been done in the past. A broker does not; in other words, we do not send solicitors out.

The CHAIRMAN. There is some evidence before this committee to the effect that large investment houses have not only sent out these agents, but they held schools and trained them in what to sell, what to say, how to act, and how to conduct themselves. They go out among the people. We have evidence of one instance where a woman had \$10,000 in Liberty bonds, and this agent persuaded her to take some stock because it paid 7 percent. She took the stock, sold her Liberty bonds, and now she has nothing.

Mr. PAUL. Senator, the letter I offered in evidence here from my own corporation commissioner is along those very lines. In other words, in California, at least, his experience has been that, compared to dealers who were not members of exchanges, complaints of that nature have been very few.

The CHAIRMAN. Are there any other questions of Mr. Paul? Have you finished, Mr. Paul?

Mr. PAUL. Yes; thank you.

The CHAIRMAN. We are very much obliged to you.

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

The CHAIRMAN. Now, Mr. Whitney, do you want to call the specialist?

Mr. WHITNEY. If it is agreeable to the committee, sir, I would like to have you hear Mr. Raymond Sprague and Mr. Paul Adler, both governors of the exchange and both active specialists. They will endeavor to describe the functions of a specialist, and, of course, to answer any questions the committee may put to them.

The CHAIRMAN. Very well. We will hear Mr. Sprague.

Senator ADAMS. Mr. Whitney, may I ask you a question? How does a man become a specialist, and what limitation is there upon the number who may become specialists in a particular stock?

Mr. WHITNEY. It is purely voluntary, sir, and there is no limitation—voluntary on the part of the broker who is a member of the exchange.

Senator ADAMS. Any broker who saw fit to set himself up as a specialist in United States Steel might do so?

Mr. WHITNEY. He may do so, and may solicit orders from the other members of the exchange; yes, sir.

Senator GORE. And nobody else. The specialist deals with brokers.

Mr. WHITNEY. He deals with brokers entirely, as such.

Senator ADAMS. Is the surrender of his right to deal with other people a matter of regulation or of custom?

Mr. WHITNEY. There are some specialists who have business apart from specializing, but when acting as a specialist on the floor of the exchange, except in scattered instances, all of their orders come from other members of the exchange.

Senator GORE. And when they function as specialists, that is universally true, is that the idea?

Mr. WHITNEY. No, sir; there are instances where a specialist may do a commission business as well, and where his customers give orders in the stocks in which he specializes. There would be that dual situation.

Senator GORE. That would be his private customers.

Mr. WHITNEY. Yes; his private customers.

Senator KEAN. But, Mr. Whitney, as a rule, while he is a specialist he makes a specialty of dealing in the stocks in which he is a specialist.

Mr. WHITNEY. As a rule; yes.

Senator GORE. There is no essential conflict in his obligations?

Mr. WHITNEY. I do not think so, sir; because the same rules of the exchange would apply to him in so dealing, as has been already explained to you.

Senator ADAMS. How many specialists do you have?

Mr. WHITNEY. About 350, sir; out of 1,375 members.

Mr. PECORA. How many books do they handle?

Mr. WHITNEY. Some handle only one. Some may handle as many as 50. Mr. Sprague has 11, and he is alone. Mr. Alder, with eight brokers, has fifty-odd stocks.

Mr. PECORA. How many securities are covered by specialists' books?

Mr. WHITNEY. When I say "book" that means one stock.

Mr. PECORA. You mean there are 350 issues that are handled by specialists?

Mr. WHITNEY. No.

Mr. PECORA. How many issues are handled by specialists?

Mr. WHITNEY. Twelve hundred-odd stock issues listed on the exchange, and there are approximately 350 specialists.

Mr. PECORA. But how many of the 1,200 issues that are listed are handled by specialists?

Mr. WHITNEY. All of them.

Senator ADAMS. But there is a larger number listed. All the listed stocks are not handled by specialists. There is a margin of listed stocks that are not included within any of the specialists' books.

Mr. WHITNEY. No, sir. They are all handled by specialists. There is what we call our "inactive crowd", where the very inactive stocks are placed, but there, again, they are handled by the specialists in that crowd.

Senator BARKLEY. No specialist would make much money in handling a stock nobody wanted. In order to be compensated, he must have a rather active stock, must he not?

Mr. WHITNEY. Not necessarily, Senator Barkley.

Senator BARKLEY. If he is working on a commission, as was testified the other day, it seems to me he would be rather discouraged to become a specialist for a stock that was not being sold or bought to any great extent.

Mr. WHITNEY. Many specialists, sir, are very much discouraged in that way, and are seeking the placing of stocks by the committee of arrangements at the particular post where he has been in the habit of transacting his business, so that he may increase that possibility of compensation.

Senator GORE. Is there any way of estimating what percentage of the daily transactions pass through specialists, and what percentage goes by a different route?

Mr. WHITNEY. I think Mr. Pecora has some figures on that.

Mr. PECORA. What is that? I did not hear.

Mr. WHITNEY. The percentage of the daily business that passes through the hands of the specialists.

Mr. PECORA. We have data on that. I do not have them with me. I will have them before the committee here on Monday. We have gathered data that would indicate that, from our returns to the questionnaires made by the members of your exchange.

Senator GORE. Is it substantial?

Mr. PECORA. The task of recapitulating the data and tabulating it has been so tremendous that we have not yet finished it, but we will have it finished by Monday.

Senator GORE. Is it substantial?

Mr. PECORA. Oh, yes; it is quite substantial.

Mr. WHITNEY. It is substantial.

Senator KEAN. Mr. Whitney, suppose you have an order on three stocks. A broker may execute two of those orders for his own account. The third order, because he cannot wait, has to go to the other posts, and he gives it to a specialist. That is the way the business is done.

Mr. WHITNEY. You mean a representative of a commission house has three orders given him at one time, and possibly he may be able to execute two by himself, and the other, of necessity, he has to hand to the specialist.

Senator KEAN. Yes.

Mr. WHITNEY. There are some commission houses—I think I have stated this to you before—that give all of their business to specialists and to floor brokers, and their representatives do not attempt to execute any of their orders whatsoever. They act more as messenger boys than anything else.

Senator GORE. Then their representatives in that instance would not be members of the exchange.

Mr. WHITNEY. Absolutely members of the exchange; but they feel their best interest is served by giving all their orders to other

floor brokers and specialists. And when I say their best interest I mean that of their customers.

**STATEMENT OF RAYMOND SPRAGUE, NEW YORK, N.Y., A
MEMBER OF THE NEW YORK STOCK EXCHANGE**

Mr. SPRAGUE. Mr. Chairman and gentlemen, we particularly want to talk on section 10, just because of its drastic provision. This provision destroys the specialist dealer.

Senator ADAMS. May I ask, Mr. Chairman, who the witness is?

Mr. SPRAGUE. Pardon me. My name is Raymond Sprague. I have given my name to the reporter.

Senator GORE. Would you mind, Mr. Sprague, defining and describing a specialist to us—what he can do, and what, as a rule, he does do?

The CHAIRMAN. I suppose he will get to that in a minute, Senator.

Senator GORE. He started to analyze the section. Go ahead in your own way, if you have that in mind.

Mr. SPRAGUE. I intended to do that, Senator, as I came to it.

The CHAIRMAN. State your name, official residence and occupation.

Mr. SPRAGUE. The stenographer has it. My name is Raymond Sprague, 39 Broadway, member of the New York Stock Exchange and specialist.

We intend to take up section 10 of the bill as it deals with the specialist dealer. This provision absolutely puts the specialist dealer out of business, and provides no adequate substitute. It affects us quite directly, but I believe it affects the public more, in this respect, than it affects the general liquidity of the market.

The bill goes further, in that it provides that the specialist may execute none other than fixed-limit orders. I have a few statistics, which I hurriedly had my office get together, asking them to select at random from the files the volume of orders received on given dates, and the percentage of market orders in that respect.

Senator GORE. How is that? State your categories again.

Mr. SPRAGUE. I had my office select at random from the files, orders of specific dates, and tabulate those orders, showing what percentage were market orders, as related to limited orders.

Senator GORE. That is Greek to me, Mr. Sprague. I do not know what you are talking about. I wish you would define what fixed-limit orders are.

Mr. SPRAGUE. I will define orders for you, Senator.

Senator GORE. Yes.

Mr. SPRAGUE. Orders are in three general classes: Market orders, which are such. A market order to buy is an order to buy at the best price obtainable. An order to sell is an order to sell at the best price obtainable.

Senator GORE. That is a market order?

Mr. SPRAGUE. That is a market order, sir.

The CHAIRMAN. Whose orders? Where do the orders come from?

Mr. SPRAGUE. These orders come from the public, through the commission houses.

The CHAIRMAN. Brokers?

Mr. SPRAGUE. And brokers; yes, sir.

Mr. PECORA. Are you speaking now of orders to the specialist?

Mr. SPRAGUE. I am describing the general character of all orders. The second are what we call limited orders, which, in effect, say "Buy for my account so many shares of stock, at a price, and no more." The reverse is to sell.

Senator GORE. You mean not above that price?

Mr. SPRAGUE. Not above that price; yes, sir.

Mr. PECORA. That is, it fixes the maximum price at which the customer wants to buy?

Mr. SPRAGUE. Correct.

Mr. PECORA. But the direction to the broker is to buy at any lower price if possible.

Mr. SPRAGUE. Yes, sir.

Mr. PECORA. It just fixes the maximum at which he will buy?

Mr. SPRAGUE. That is implied, sir.

The other side is the sale order of the same character, which sets the limit on the sale side. He must not sell below the limit, but may sell above if he can do so.

The third order is the stop order. The buy stop order, in effect, says "When the market reaches this price, buy 100 shares at the market—that price or higher." A sell stop order—

Mr. PECORA. Buy at that price or higher?

Mr. SPRAGUE. What I mean by that is, when it reaches that price or higher. It takes an actual sale to set that order in motion, and that order then becomes a market order.

Senator GORE. Are your prices going up or down, or either?

Mr. SPRAGUE. In effect, that would have to be a higher price, Senator, to go into effect.

Senator GORE. He would tell you to buy at a price higher than the last quotation?

Mr. SPRAGUE. Then the existing market. In other words, may I describe just an ordinary order such as that. Possibly it would clarify it.

Senator GORE. I wish you would; and after that, I want to get at the motive of the man who gives you that order.

Mr. SPRAGUE. The market in a given stock is $34\frac{1}{2}$ bid, which means that is the price that would be paid. One hundred shares are offered at 35, which means it will be sold at that price. We term that the market— $34\frac{1}{4}$ —35. That is technical.

A stop order may be entered to buy 100 at 36 stop, which means that when the stock sells at or above that price, it immediately becomes a market order.

Senator, to answer your question, that might be for two purposes; one, to limit the loss on a short sale—

Senator GORE. I can see that.

Mr. SPRAGUE. And the other might be that the customer might feel that if the stock reached that price it would sell higher, but he was not interested in the current market.

Senator GORE. He is just an optimist, isn't he?

Mr. SPRAGUE. Does that explain to you, Senator, the character of it?

Senator GORE. Yes; I think it does. That is involved, sometimes, in these spreads, is it not? I do not want to divert you.

Mr. SPRAGUE. On the other side, the order to sell stock is a protective order, where the customer desires to limit his loss and wants protection at that point. In other words, he says—

Senator GORE. When he had sold short and did not want to ride down?

Mr. SPRAGUE. He was long in that case, and he did not want to take a chance.

Senator GORE. He did not want to get out and carry a loss. That is the way they do on the grain and cotton exchanges, I know.

Mr. SPRAGUE. May I proceed with the tabulation of the percentages, Mr. Chairman?

The CHAIRMAN. Yes.

Mr. SPRAGUE. On October 23 we had a total of 930 orders—

Senator GORE. Last October?

Mr. SPRAGUE. Yes, sir. These were selected at random. My instructions were to go through the file and select at random and pick one large day out so we could get a comparison of the difference. This day showed 930 orders of which 27 were market orders. That is approximately 3 percent.

On October 20, 1933, we received 999 orders, of which 44 were market orders; approximately 4 percent.

On November 21, 1933, we received 968 orders, of which 23 were market orders; practically 2 percent.

On November 22 we received 581 orders of which 19 were market; approximately 3 percent.

Senator GORE. Was that on a Saturday?

Mr. SPRAGUE. I have no record of that here, sir.

The CHAIRMAN. What were the other orders that were not market orders?

Mr. SPRAGUE. They were limited orders, sir, limited as to price.

Senator TOWNSEND. Do you have the percentage there as to buy and sell?

Mr. SPRAGUE. No, sir.

Senator BARKLEY. Was that a fair average normal business day?

Mr. SPRAGUE. These were normal days, sir.

Senator BARKLEY. Was that a fair average over a year as to the percentage of market orders as compared with limited orders?

Mr. SPRAGUE. I have no adequate means of checking that, Senator. These were selected at random.

Senator GORE. You do not show how many limited orders or stop orders there were?

Mr. SPRAGUE. No, sir. These are all characterized as market orders as against limited orders—

Senator BARKLEY. What is the object of selecting a few at random unless it enables you to use it as an average?

Mr. SPRAGUE. These were selected at random because I wanted to show a general picture.

Senator BARKLEY. A general picture would call for a general average.

Mr. SPRAGUE. What I am attempting to show you is that these average days as against a day larger than the average would have an effect, where the provision is made—

Senator BARKLEY. Is the percentage any greater on a bigger day than on a smaller day?

Mr. SPRAGUE. Yes, sir; that is what I intended to show. There are 3 other days where the percentages are 3 percent, 1½, and 3 percent.

On July 21, 1933, which was an active day, we received 1,676 orders. There were 335 market orders. The percentage there was 20 percent.

Senator ADAMS. Was that a day of rising or falling?

Mr. SPRAGUE. I believe that was a day of falling prices.

Senator ADAMS. Do you get more market orders on a day of falling prices than you do on a day of rising prices?

Mr. SPRAGUE. I believe the percentage would be about the same. In other words, when we have an emergency market and the orders are sent to you directly, the brokers give them to you because they are hard of execution.

Senator ADAMS. In a time of a falling market you have those who are lending money on securities, and margins not being supplied those stocks are thrown on the market, are they not? Are they thrown on ordinarily as market orders or as limited orders?

Mr. SPRAGUE. You would have a greater percentage of orders made at the market in a day such as that, either on a rising or a falling market.

Senator GORE. They are taking to cover.

Senator ADAMS. Is it the practice of a bank or one who is loaning upon market securities, when they are forced to foreclose or sell, to turn them in to sell at the market or to fix the price?

Mr. SPRAGUE. That, sir, we have no way of telling.

Senator ADAMS. You have been there a long while, and I thought you could possibly answer that.

Mr. SPRAGUE. I would assume at most times, if the orders were not in the form of stock orders, they would be at the market.

Senator ADAMS. Would not that tend to increase the percentage of market orders on those days of decline when they were foreclosing on securities?

Mr. SPRAGUE. Yes; but I think the same thing is true, Senator, where you have market orders originating from customers who do not like the looks of the market and want to get out. It is not a question so much of margin as it is their feeling that they want to sell and be free.

Senator GORE. Before the margin is gone?

Mr. SPRAGUE. For protection purposes. I say I cannot identify what would come from banks or what would come from margin requirements. It is a question of their selling because of the feeling that they want to get out of the market.

I cite that because the provision of the bill states that specialists should only handle fixed-limit orders. It shows that in times of stress and bad markets the specialists perform a function that the other broker cannot perform, by handling market orders. It is a physical impossibility in many cases for brokers to handle the orders themselves.

Mr. PECORA. If that phrase were changed to "limited-price orders" instead of "fixed-price orders", would that relieve the hardship of which you speak?

Mr. SPRAGUE. I do not think that would change it, Mr. Pecora, because you still have limited orders. Whether you say fixed orders

or limited orders, it means practically the same thing, and it would prevent the commission houses from adequately performing the function which they do perform; that is, giving service to the public.

Mr. PECORA. What limitation, if any, would you put in the statute?

Mr. SPRAGUE. I do not think you can—

Mr. PECORA. You would not put any limitation in?

Mr. SPRAGUE. I do not think you can; sir.

Senator GORE. You think you would likely do more harm than good if you did?

Mr. SPRAGUE. Yes; I think it would be a very dangerous thing to do, because it puts a limit on your operation at a time when it is needed.

The CHAIRMAN. You do not think there ought to be any provision with reference to specialists at all?

Mr. SPRAGUE. Well, sir, my feeling is that we probably may not be perfect, but we are doing the best we can, and we certainly believe we should not be rigidly forced out of the business without an adequate examination and a thorough survey, which I do not believe can be done in a few months. I believe statistics are cold; that you cannot take statistics and make them live. The time at which a specialist really performs a function is in a time of emergency when called upon to fill a breach.

The CHAIRMAN. Are there no abuses at all with reference to specialists? Don't they become traders and all that sort of thing?

Mr. SPRAGUE. I believe we have to go on the assumption that men are honest, Mr. Chairman.

Senator BARKLEY. If we could do that we could repeal all criminal laws throughout the country.

Mr. SPRAGUE. They do not prevent crime.

Senator BARKLEY. But you would not repeal them on that account, would you?

Mr. SPRAGUE. No.

Senator GORE. I was wondering if it would be wise to put a provision in that the specialist should be honest?

Mr. SPRAGUE. The rules of the exchange do limit us in our tradings.

Senator GORE. You say there are times when the specialist steps in and closes the breach, or words to that effect. Describe that operation, please. That is what I want to get at.

Mr. SPRAGUE. You find many days, sir, of emergency where many selling orders pour into the market and the market will not take those orders. There is not sufficient buying power to absorb those selling orders. We do step into the breach in that case and we do purchase stocks when we cannot get the public to buy; we cannot get anybody but a speculator to buy.

Senator GORE. You take over those selling orders; you buy stock?

Mr. SPRAGUE. At a fair price; yes.

Senator GORE. Let me ask you this—because I am 100 percent ignorant on this business. Suppose steel is selling at 50 and I wire you or give you an order to buy steel at 49, and Senator Barkley gives an order to you to sell steel at 51. Does that create a situation where you function, and, if so, what do you do?

Mr. SPRAGUE. That might be answered in this way, Senator. As I understand it, you have given me an order to buy at 49?

Senator GORE. Yes I think maybe Steel will go up, but I do not want to pay 50; I am trying to buy a little below the last quotation. Senator BARKLEY thinks he can unload at 51. I thought maybe that was one of those breaches where you kind of work the situation out and serve both of us. Of course, you could not do both.

Senator BARKLEY. That situation itself creates a market.

Mr. SPRAGUE. Yes; so there is no problem

Senator ADAMS. You might put the man who sent the stock in to be sold at the market, at a point where his stock, normally running at \$30 a share in the absence of a market, would be left at the mercy of the speculator later to offer \$10, and that would be the only market.

Mr. SPRAGUE. Maybe I can make it a little clearer by a practical example.

Senator GORE. I want you to do that; but just before you do, let me ask you this: Further orders would have to drift in between those margins in order for you to function in that situation, would they not?

Senator TOWNSEND. No; because one is to buy and the other is to sell.

Mr. SPRAGUE. I do not quite get that clear. You have a limited order to buy at 49 and a limited order to sell at 51. In the absence of any other orders that creates a market.

Senator GORE. That is what I say, and further orders would have to come in in order for you to perform any function at all?

Mr. SPRAGUE. That is right, sir.

Senator GORE. And they would have to be market orders?

Mr. SPRAGUE. They might come at limits in between, or they might be market orders.

Senator BARKLEY. As long as you have only got those two orders you do not do anything at all; you could not?

Mr. SPRAGUE. I might choose to make a market in between by bidding 49½ on my own account—

Senator BARKLEY. But that still would not execute either the 49 or the 51 order?

Mr. SPRAGUE. No, sir; it would not.

Senator GORE. In some cases you do that?

Mr. SPRAGUE. Many times we create a market.

Senator GORE. I want to get at what you might do and what you sometimes do do.

Mr. SPRAGUE. It is a very simple case to explain.

The CHAIRMAN. In that case could you not, as a specialist, buy at 49 from Senator BARKLEY?

Senator BARKLEY. Not if I put in an order at 51.

Mr. SPRAGUE. No, sir; I could not buy. The rules provide specifically that while in possession of a market order to buy I cannot buy for my own account.

Senator GORE. That is one of the points that I was trying to bring out.

Mr. SPRAGUE. I cannot buy for my own account until I have filled that order. On the reverse I cannot, while in possession of an order to sell at the market, sell for my own account any securities until I have filled the order in hand. It also is provided that I cannot, while in possession of an order to buy at a limited price, buy for my own account at that price without first filling the orders I have in hand.

On the reverse side I cannot sell for my own account at a limited price until I have already sold my orders at that price.

Senator BULKLEY. Does anyone know you were in possession of it a given time, or is it all a matter of your own conscience to observe that rule?

Mr. SPRAGUE. I would say that is more or less my duty.

Senator BULKLEY. It is your duty, but in the enforcement of it do you rely wholly on your conscience or is there any way of checking it up?

Mr. SPRAGUE. I am impelled to trade at fair prices. I do not disclose my book; I can disclose my market, but not my book. In other words, if I have a market of $49\frac{1}{2}$ -50 and I wanted 200 shares at $49\frac{1}{2}$ and 300 offered at 50, I do not disclose what is above or what is below those prices.

Senator BULKLEY. I am not talking about a disclosure; I am talking about this question, that if you have, for instance, an order to sell at 49 and to buy at 50, you have a margin in there, and you could not accept either one of those for your own account, according to the rule?

Mr. SPRAGUE. No, sir.

Senator BULKLEY. But does anybody else know that you have those orders at that time?

Mr. SPRAGUE. Nobody knows, because there will be a transaction that will take place on those orders—

Senator BULKLEY. You understand that this is not personal at all, but what I mean is this, that if anyone should want to make a personal profit out of a situation like that, could he not do it without being detected?

Mr. SPRAGUE. No.

Senator BULKLEY. Why not?

Mr. SPRAGUE. Because the sale you make is public. It is printed on a ticket. It goes out, and that is the price at which the contract is made. A man wanting to buy at 50 while another man wants to sell at 49 must meet at some point between those two prices. I cannot intervene either personally or for any account in the transaction.

Senator BULKLEY. Suppose you should do it: how would you get caught? What would be the process of your getting caught?

Mr. SPRAGUE. You could not do it, because of the fact that it is a public transaction, and the man having an order to buy at 50 and seeing the transaction on the tape at $49\frac{1}{2}$ would claim that price as his price.

Senator BULKLEY. If he happened to be looking at the ticker at the moment. But, of course, the majority of them send in from somewhere else, and they do not know at what moment the orders are executed.

Mr. SPRAGUE. I would like to explain that a little bit.

Senator BULKLEY. Yes; I would like to have you.

Mr. SPRAGUE. The houses themselves have set up forces to check on that. They check those transactions both as to time and as to place.

Senator BULKLEY. You mean that the broker through whom you received your order would be watching you?

Mr. SPRAGUE. Correct, sir. The broker is the guardian of his customer's account, and he sets up that function. If the customer

happens to be sitting in the office, he also can check it; but the function itself is under the supervision of the house, and it in turn must see that the customer receives a fair price. So the transaction, if made under 50, would entitle the buyer to stock at that price. Likewise, if made above 49, the seller would be entitled to it at that price. So the contracts would meet at a price which would be determined by the market.

Senator BULKLEY. Is there a record of the precise time at which all these transactions take place?

Mr. SPRAGUE. Yes, sir; there is a time record. Most houses have that facility, and it is quite generally used.

Senator TOWNSEND. Is there any record on your book of the time you receive the order?

Mr. SPRAGUE. No, sir; we have no time record.

Senator GORE. Reverting to my illustration, Mr. Sprague, when steel was selling at 50 I ordered you to buy at 49, and Senator Barkley ordered you to sell at 51. You cannot buy on your own account while my order is unexecuted?

Mr. SPRAGUE. At 49, sir; right.

Senator GORE. And you cannot sell at 51 while Senator Barkley's order is unexecuted?

Mr. SPRAGUE. No, sir.

Senator GORE. What can you do?

Mr. SPRAGUE. I might try between those limits to make an order for my own account at prices in between. I might bid 49½ or 50½.

Senator ADAMS. But you are limited to that narrow space there?

Mr. SPRAGUE. Yes, sir. I cannot trade or execute an order for my own account which would interfere with those orders.

Senator BARKLEY. You could execute an order for your own account at a definite figure, could you not? Or are you limited to executing market orders? You know what the market is all the time. If you have an order to buy stock at the market or sell at the market, until you have executed those orders you cannot buy or sell at the market in your own name, can you?

Mr. SPRAGUE. I might buy in the event that a seller came in—

Senator BARKLEY. If a seller came in, then he would sell to the man who had given you a market order to buy, would he not?

Mr. SPRAGUE. The procedure in that case would be that your buying order and selling order would meet at the price of the next sale.

Senator BARKLEY. They would cancel each other?

Senator GORE. Is that what is called a "cross-transaction"?

Mr. SPRAGUE. That is a cross transaction. Everything being equal and no other orders in the market, you would bid at a price which would be fair. If another order or orders enter into the transaction, they would be the determining factor in the price.

Senator BARKLEY. What percentage of your compensation is derived from your duties as a specialist as compared with your personal transactions?

Mr. SPRAGUE. I do not know that I could give you that in percentage figures. I would make more money in trading than I would in commissions; but I would also qualify that by saying that more money is made by buying stocks and carrying them through a period.

Senator ADAMS. You may lose on your own transactions, whereas a commission transaction is a profit to you?

Mr. SPRAGUE. Yes, sir. We very often lose. I can carry them over a period or determine that I would make the market in between. The function that I would like to outline is that by drawing the market together and buying for my own account I have stabilized and sustained the market and I do perform a function that benefits the buyer and the seller.

Senator GORE. I have understood that to be one of the functions, but I was trying to see how it happened.

Mr. SPRAGUE. In this way, sir. Using the example you gave me, that of orders at 49-51. I could quote my market at $49\frac{1}{2}$ - $50\frac{1}{2}$. A seller might come into the market and sell to me at $49\frac{1}{2}$. If my bid was not there he would have to sell at 49. After having bought a hundred at $49\frac{1}{2}$ I then could close my market so that a subsequent buyer then would buy at 50 instead of 51, and in that way I have benefited both the buyer and the seller to the extent of a better market.

Senator GORE. If your order to buy exceeded your order to sell by 300 shares you would cancel them out as far as they were crossorders, and then you would have the rest left on your hands one way or the other?

Mr. SPRAGUE. No, Senator. If I had 300 to buy and only 100 to sell I could sell 200 for my own account, thereby drawing in all orders at the same price—

Senator GORE. How is that?

Mr. SPRAGUE. I say, if I had 300 to buy and only 100 to sell at the current market, I could sell 200 additional for my own account and satisfy all customers; but if I had three single hundreds to buy at the market and only 100 to sell at a price reflected by a fair market I could not buy 100 for one account without having claims from both other accounts for stock at the same price.

Senator BARKLEY. How do you get to be a specialist?

Mr. SPRAGUE. I, sir?

Senator BARKLEY. Anybody.

Mr. SPRAGUE. I would say it is mostly a matter of choice.

Senator BARKLEY. Choice of yourself or somebody else?

Mr. SPRAGUE. Choice of myself. Mr. Whitney said that a specialist could set himself up in business. We have had two other cases of that type. One is a request type, which would be that if the commission house felt that a fair market was not being maintained—and that very often happens because a specialist does not trade for his own account—they would ask some broker to open a book in particular stocks so they might give him their orders.

Senator BARKLEY. Do specialists have to be members of the exchange?

Mr. SPRAGUE. Yes, sir.

Senator BARKLEY. So you cannot walk in and go to specializing?

Mr. SPRAGUE. You cannot, sir. May I qualify myself a little bit? I am in my thirty-third year in Wall Street. I started when I was 14.

Senator GOLDSBOROUGH. Do I gather from your evidence that you do not think this act ought to prescribe anything in regard to specialists?

Mr. SPRAGUE. I would not be as broad as that. I would say that I do not think that the law should be so rigid that it would drive the present system out of business entirely. I am not afraid of regulation, but I want you to look at our case.

Senator GOLDSBOROUGH. Have you any suggestion that you want to make as to what ought to be included in the act in reference to regulating specialists?

Mr. SPRAGUE. Frankly, I have no suggestions to make. We are progressing as we go along. There are things that develop, and it is a series of evolutionary moves. My feeling in this is that by this rigid regulation you are depriving the public of a better market. If you drive the dealer out you are going to put the public at the mercy of a market that does not exist in many cases.

Senator GOLDSBOROUGH. And it is for that reason that you think the act ought not to have any such regulation?

Mr. SPRAGUE. I do not think it should be rigid, sir. I am perfectly willing to go over a period of time and let you examine into our case and see what we do, and get statistics, but not to take statistics over a short period of time and attempt by those statistics to tell whether the specialist performs his duty or not. You cannot set up a rule of thumb on this.

Senator BARKLEY. Being a specialist, and objecting to this provision, would you undertake to submit one to the committee for its consideration?

Mr. SPRAGUE. A provision, sir?

Senator BARKLEY. Yes.

Mr. SPRAGUE. I do not know of any at the moment in my mind.

Senator BARKLEY. You say you are not afraid of regulation, and you would not go so far as to say you object to any regulation. How far would you be willing to go in regulation?

Mr. SPRAGUE. I do not pretend to say that we are perfect. I think we have gone as far as we can go along the lines as they develop. We are perfectly willing to sit down and go over these various features over a length of time so that the thing can be studied from an impartial point of view and then see whether there are abuses that can be regulated.

Senator BARKLEY. Of course it is difficult for you or for anybody up in New York to sit down with this committee over a period of time and work out some provision that might be acceptable. We have the bill before us for consideration, and inasmuch as you object to what this bill provides, and you state that you are willing to be regulated, I was wondering if you could submit something in a concrete form that would meet your ideas.

Senator GOLDSBOROUGH. Your thought is that you might submit an amendment to section 10?

Mr. SPRAGUE. What I object to is that its rigidity drives us out of business.

Senator BARKLEY. Can you suggest some let-up on the rigidity so it would not drive you out of business?

Mr. SPRAGUE. We would like to take the matter under consideration and see if we can furnish you with a suggestion.

Senator BARKLEY. All right

Mr. ADLER. May I make a statement, Mr. Chairman?

The CHAIRMAN. Yes.

STATEMENT OF PAUL ADLER, NEW YORK, N.Y.

The CHAIRMAN. Will you state your name so the reporter will know who is talking.

Mr. ADLER. Paul Adler; 15 Broad Street, New York.

Mr. PECORA. Will you further identify yourself by reference to your business?

Mr. ADLER. My business is that of a specialist.

Mr. PECORA. You are a member of the New York Stock Exchange?

Mr. ADLER. Yes, sir. I have seven partners, all members of the New York Stock Exchange, and we deal and specialize in about 50 issues.

Mr. PECORA. That is, you and your partners combined?

Mr. ADLER. Myself and my partners.

Senator BARKLEY. They are all specialists, too?

Mr. ADLER. Yes, sir.

Mr. PECORA. All floor operators?

Mr. ADLER. We do trading on the floor of the exchange.

Mr. PECORA. Will you give your firm name?

Mr. ADLER. Adler, Coleman & Co.

I think Mr. Pecora's suggestion was a good one, to take over a period of time the amount of stock dealt in by a specialist for his own account, also the stock handled for the account of others, and I think we could go over this matter and come back with a constructive suggestion. Certainly we would try to.

The important part of section 10, as you have heard it explained by others, is taking a liquid market out. In other words, the fewer the dealers and traders in any one thing the harder it is for the customer, a member of the public, to obtain a fair and reasonable market immediately. I speak for the traders on the floor plus the specialists. Twenty-five years ago a trading specialist was more or less unknown. Over a period of the last 25 years, not only by the desire of specialists to trade, but at the request of commission houses who are our customers, the trading specialist and the trading and dealing specialist firm has come into being. He has come into being more or less from a natural demand. For me to say that we should trade as a natural demand possibly might be out of order. There is a gentleman here representing one of the big international commission houses who is most emphatic in saying that he believes it furthers, aids, and abets his business, which is taking care of his customers, to have specialists every ready to deal and take up the slack in the market as they might occur.

Senator GORE. All of the 1,200 or 1,300 stocks listed are apportioned out among 25 or 30 posts?

Mr. ADLER. Yes, sir. At post 30, which is an inactive post, there are probably 200 or 300 stocks. There are several stocks which are very actively dealt in. They are taken care of by one firm of people.

Senator GORE. Very few people would care to be hitched to that post?

Mr. ADLER. No; it is good business. The commission is a little higher.

Would you care to hear Mr. Moore, who is a representative of a banking house that I mentioned, and who might give you one

short case where a specialist enabled him to execute an order for their foreign account? I think it is a rather interesting one.

The CHAIRMAN. The primary function of a specialist is to act on commission for another house?

Mr. ADLER. Yes

The CHAIRMAN. He is an agent; that is his primary function. When he goes to trading for himself he is acting in a different capacity altogether. Do you do both?

Mr. ADLER. Yes, sir.

The CHAIRMAN. That seems to be the question here, whether one man can act for others in 1 minute and then act for himself at the same time or in the next minute.

Mr. ADLER. I think a very good illustration of this is to hear a representative of a commission house who can tell you and let you judge of that situation.

Mr. SPRAGUE. I think that would be a good idea, because it brings out a point in question.

Senator BARKLEY. Have you finished all that you wish to say?

Mr. SPRAGUE. No, sir; I have a few more remarks, sir

Senator TOWNSEND. I think Mr. Sprague should be allowed to finish.

Senator BARKLEY. Are we going to have an afternoon session, Mr. Chairman?

The CHAIRMAN. Yes. There are several other people yet to be heard.

Senator GOLDSBOROUGH. Can we not have Mr. Sprague finish?

Mr. SPRAGUE. The suggestion was to introduce Mr. Moore as part of the corroboration of the general picture.

The CHAIRMAN. If you prefer to finish, go ahead.

Mr. SPRAGUE. I would like to, sir. I think the question of liability is very important in any general consideration. I do not think it is generally known that the specialist has a direct liability for every order he handles. In other words, I am paid, roughly, \$2.50 per hundred shares for the execution of an order. For the execution of that order I am absolutely responsible to that customer. I am also liable under contract for the making good of the customer's order. In other words, if I accept an order from a commission house to sell 100 shares of stock, and that house should fail, I must assume that contract. That is my liability. The same thing is true of a limited order. We have had many orders in very strenuous times, of large size. We cannot pass over by general disclosure the liability which attaches itself to us on a contract. I cannot give up the name of a commission house and by passing that name off pass my liability with it. I am held accountable for any contract I make.

I think that has been very much misunderstood, because in most cases we have been described as parasites who just simply sit there and take all that comes with no responsibility.

We also have no monopoly of orders. We receive a certain percentage of orders. Most of the orders that we receive are orders that cannot be readily executed by brokers. Brokers who can execute orders do so. It is a matter, then, as to whether we are to get them because of the fact that the orders are away from the market and cannot be handled by the broker, or that the emergency in the

market is such that they cannot fairly execute the orders and must leave them with us.

We have heard many times the fact described that we can tell by our books what the market is going to do, what the stock will do; that we have the whole picture in front of us and know exactly what is going to happen. That, sir, is a fallacy; that is untrue. I have a book of a corporation having 4,932,000 shares outstanding. This is an actual book of a day. The total orders on the book with a price range of 38 to 57, were 31,500 shares; that is, in the entire day's orders within that price range.

Mr. PECORA. What stock was that?

Mr. SPRAGUE. That, sir, was Sears, Roebuck, which is a fairly active stock.

Senator GORE. It fluctuated that much?

Mr. SPRAGUE. Yes, sir; that was the price range of orders on the book, between 38 and 57. There were in all 31,500 shares of stock entered on that day.

Senator GORE. What day was that?

Mr. SPRAGUE. That was last Monday, sir.

Senator BARKLEY. You mean 38 was the last price at which anybody wanted to buy and 57 was the last price at which anybody wanted to sell?

Mr. SPRAGUE. I quoted the price range because I am not sure whether there were more orders below that price and more above 57. In this book which I would like to leave with you, book B, there are 490,367 shares of stock, and the total orders on that entire day were 4,900 shares. That was all the orders on the book.

Senator BARKLEY. What stock was that?

Mr. SPRAGUE. Book B was New York, New Haven & Hartford Railroad Co. preferred stock. Book C, which is Postal Telegraph & Cable preferred stock, which is the only stock of that company listed, has 305,295 shares outstanding, and the total orders on the book were 4,900 shares.

I think if you will examine those books they will not tell you much as to what the market is going to do, but the character of the market.

Another preferred stock which I have—the total outstanding stock is 186,453 shares and the total orders on my book were 600 shares.

Senator GORE. What is the point you are making? I happened to be out for a moment. I am sorry.

Mr. SPRAGUE. The point I am making is that we have been charged with a monopoly of orders and therefore are in a position to know exactly what the stock is going to do and that therefore we can govern our trading and make money; that we have access to information that nobody else can get.

Senator GORE. That figure of 600 represents your orders?

Mr. SPRAGUE. It represents the total orders in that stock on that day, out of an issue of 186,453 shares.

Senator GORE. When you say "total orders", you mean the total orders that came in?

Mr. SPRAGUE. The total orders on my book for the entire day.

Senator GORE. Do you have any record of how many shares turned that day?

Mr. SPRAGUE. Yes, sir; 100; and I purchased them.

Senator BARKLEY. Most limited orders to buy are below the market, are they not?

Mr. SPRAGUE. They may be below or they may be above, depending on the market.

Senator BARKLEY. Of course if they are above and the market goes up, they would be executed. If they are below when it goes up, they will not be?

Mr. SPRAGUE. Right.

Senator BARKLEY. And the more market orders come in on a rising market the less likely limited orders below the market are to be executed?

Mr. SPRAGUE. That is right.

Senator BARKLEY. And the same on a declining market?

Mr. SPRAGUE. Yes, sir.

Mr. ADLER. I wanted to further say, in answer to your question, that while we know when we handle these orders that we have a certain number of orders, as Mr. Sprague explained to you we do not know what the other holders of the stock intend to do or will do when the stock goes up or down. While we might see very few sale orders in sight, we do not know what will happen or what some stockholder might make up his mind to do if the stock advances. We might have 500 or 600 to sell and we have no way of telling or deciding what some stockholder might do who may possibly have 10 or 50 or 100 shares of the stock.

Senator Fletcher, in answer to your question about the dual capacity, may I state that we have tried in every conceivable way to conduct our business properly, and there have been put into effect very stringent rules to make sure that no advantage is taken by a specialist in his dual capacity. Certainly suggestions along that line would be helpful. It has already been done by the exchange authorities, and I know Mr. Pecora knows the rules as well as I do, and that they are very strict and thorough rules protecting the public, not a specialist acting in a dual capacity.

The CHAIRMAN. I cannot quite understand how it can properly be claimed that the specialist under this act would have to go out of business simply because he is prohibited from trading. Why cannot that be separated and still preserve the specialist?

Mr. ADLER. I can answer that in this way, that a specialist does a certain volume of business in these inactive stocks, and it would be very difficult, I think, to find a specialist who would be able to cover these stocks. The public, therefore, would not get the markets as promptly. That might not be so very important. But the errors that can creep in and the liability are important. Mr. Sprague has an example here, Senator Fletcher, where he executed an order on a commission basis for 100 shares of stock. An error was made in that—and I will let Mr. Sprague take it up from this point to show you how that worked out and how it would be economically unsound for a specialist to take those risks which he must take in acting under his duty where he is only trading on a commission. I think Mr. Sprague has a very good example of what happened to him on 100 shares of a stock.

Mr. PECORA. Does not every broker take a risk of liability of error in executing an order?

Mr. ADLER. Yes; but he only executes one order at a time, whereas a specialist in an active time might be forced to handle a dozen or twenty orders and work at a much more rapid pace than any broker does that has an individual order.

Mr. PECORA. He can get other brokers to help out in times of activity of that sort.

Mr. ADLER. He does that.

Mr. SPRAGUE. Mr. Chairman, this is an actual case and explains, I think, very well, why it would be hard to obtain specialists in stocks of that character.

On July 26—this was in 1932—I sold in error 100 shares of stock at 36, preferred stock. That order was a clerical error left in my book that should have been canceled. By the time we had run down and found the error, which was done promptly, the report had been cabled of the purchase. Necessarily we had to make good on the contract and sell 100 shares at 36. We were able to cover that transaction on August 1 at 44½, which was a net loss of \$850 plus expenses accrued.

The shares traded in of that stock for the entire year were 10,200. That is on the average of about 100 shares per 3 business days. Total commissions, if I had had half of those would be \$255 for the entire year. If I had commissions on the entire transactions and represented both buyer and seller, my commissions would have amounted to \$510. So the net result of the error was about \$340 out of the entire year. It is hard to get men who will take that chance.

Mr. PECORA. What contention that you are seeking to make does that sustain?

Mr. SPRAGUE. The risk of accepting orders in stocks where the commissions are so scarce, without the ability to trade which the bill denies to specialists would cause us to pause appreciably before accepting that risk.

Senator GORE. Just what mistake did you make? I did not quite follow you.

Mr. SPRAGUE. We sold 100 shares of stock in error, through a clerical error.

Senator GORE. At 36?

Mr. SPRAGUE. Yes, sir; and we had to cover that transaction at 44½, which was a net loss of \$850.

Senator GORE. I was called out a minute ago and did not quite finish my interrogation, so I want to ask you this. Suppose you had an order to sell 500 shares of United States Steel at the market, and an order to buy 300 shares. I believe you stated that you have to execute the order as a whole.

Mr. SPRAGUE. If the orders were separate orders. If there was one order, we take that into consideration. You are talking of five single hundred-share orders?

Senator GORE. Here is what I have in mind. John Doe orders you to buy 500 shares of steel. Richard Roe orders you at the same time to sell 300 shares. As I understand you, if you fill those orders to buy 500 shares you have got to supply 200 shares in addition to the 300 that Richard Roe authorizes you to sell.

Mr. SPRAGUE. That would not necessarily follow.

Senator GORE. That is what I want to find out.

Mr. SPRAGUE. Where the orders are of the character you have described—where the order was 500 shares for one man and 300 shares for the other, then we would execute the 300-share order and attempt to execute the other 200 thereafter. If, on the other hand, you had five separate orders to sell and three separate orders to buy, then each of the sellers and each of the buyers would expect the next sales price, and it would be necessary for you to find a buyer for the other 200.

Senator GORE. Or else buy them yourself as a specialist?

Mr. SPRAGUE. That is correct.

Senator GORE. It looks to me like there is one function that the specialist really performs in carrying the market on.

Mr. SPRAGUE. Yes, sir. Mr. Chairman, I have a telegram from the San Francisco Exchange citing their experience in trying to operate without a specialist. There is also a letter from the Los Angeles Exchange which confirms that.

Senator GORE. They all tried it?

Mr. SPRAGUE. They tried without and found it was impossible to do business. I have letters from representative commission houses in New York citing facts, and I would like at this time, if you will hear him, to have Mr. Moore state personally to the committee his experience

The **CHAIRMAN.** Very well.

STATEMENT OF HARRY H. MOORE, PARTNER IN THE FIRM OF HALLGARTEN & CO., NEW YORK, N.Y.

The **CHAIRMAN.** Please state your name, address, and business for the record.

Mr. MOORE. My name is Harry H. Moore, 44 Pine Street, New York. I am a member of the New York Stock Exchange and a partner in the firm of Hallgarten & Co., which, by the way, has been in business for over 75 years.

I have never been a trader or a specialist, but for 25 years a commission broker for the customers of my firm, who are the public. I have been impressed by the value of trading at the posts in that it unquestionably facilitates the search for best prices for customers. I have observed over the years that the rules of the stock exchange governing specialists' trading progressively improved until today I am convinced that whenever a specialist trades for his own account he confers a benefit upon either a public buyer or seller; frequently both

I have executed selling orders in panics when my heart was gladdened by a specialist's bid to cover previously established short positions, or because of willingness to assume a long one at a price level higher than the public. I have, in rampant bull movements, bought stock for my customers cheaper than the selling public was willing to sell. These are not casual experiences but the rule at such times; and I believe the commission broker owes it to the situation to testify to the value of the practice.

I cite two personal experiences of very recent days, one to show the detriment in its absence and the other to prove the value to the public in its presence.

From Switzerland I received an order to buy a somewhat inactive stock, 1,000 shares at 80. The previous sale on the same day was 73. The specialist's book had for sale 100 at 76, 100 at 79, and 100 at 80—

Senator GORE. They had sold it at that?

Mr. MOORE. It had sold, Senator, at 73 just before I came in, and he had one in his book which he was willing to sell, a public order, at 76, another at 79, and another at 80. This specialist would not trade. I asked him to. It required 2 days to fill the order, with the last and bulk of the stock being bought at 80. When I finished the book bid was 70—\$10 below my last purchase. Had a selling order similar to my buying order happened to follow, the stock would have sold down to 60 and a 20-point over-all range established because a specialist would not trade.

Incidentally, I notice that stock today or yesterday was 60 bid, offered at 78—a typical example of a market without trading and the wide range at which the public must sell or buy its stocks without trading.

Mr. PECORA. Is that a usually inactive stock—the one you have reference to?

Mr. MOORE. It is a usually inactive stock; yes, sir.

Mr. PECORA. And a wide spread is observed in all inactive stocks, is it not? It is not exceptional to a particular issue such as you are referring to?

Mr. MOORE. I should say it is exceptional, Mr. Pecora, because when an inactive stock is in the hands of a trading specialist he does not allow that condition to exist; he makes a closer market.

The CHAIRMAN. What service did the specialist render that was of any particular value there?

Mr. MOORE. None, Senator, in this case. I am saying that this is a case where I did not have the benefit of his services by his trading being injected.

Mr. PECORA. He did not trade simply as a matter of personal disposition?

Mr. MOORE. Correct. It was certainly harrowing to me as I reflected that each one point of increased cost to my customer was \$1,000, and I verily believe that had I met a trading specialist I would have saved my customer at least \$5,000. It was also distressing to realize that I must leave the book with a bid 10 points below my last purchase.

Senator GORE. You say the stock closed at 70?

Mr. MOORE. Eighty, Senator, I paid for the last stock, and then the best bid when I finished my thousand-share order was 70.

Senator GORE. Did you sell at 70?

Mr. MOORE. I did. I bought my stock at 80. When I finished there was only a bid of 70 for the next seller who might come in.

Critics of the practice will say that this specialist benefited his customers by not offering to trade below their price—

Mr. PECORA. May I interrupt at this moment to ask you a question? You say you are a member of the exchange, and, of course, you are familiar with its rules. You know that a specialist today is under no duty to trade or make a market. When he does it, he does it as an act of volition and personal disposition on his part?

Mr. MOORE. Correct. I am not trying to prove that this specialist violated any particular rules of the exchange by not trading.

Mr. PECORA. No; I see the point you are trying to make; but so long as a specialist under the existing system has no duty to make the market or to support the market, the same thing that you are referring us to might happen at any time with any specialist in any stock?

Mr. MOORE. Correct.

Mr. PECORA. It all depends upon the whim, caprice, or the will of the specialist?

Mr. MOORE. Yes, sir.

Senator GORE. Is it your theory that his presence minimizes the risk?

Mr. MOORE. When a specialist does trade he benefits the commission broker and his customer.

Mr. PECORA. Do you think he trades at a disadvantage to himself as a rule?

Mr. MOORE. I think he endeavors not to, but quite frequently they trade at a disadvantage to themselves.

May I present the other case?

Mr. ADLER. May I just add one thing? I can safely say for the specialists that they do feel it their duty. They are not forced to trade, but they do feel it their duty to their customers, who are commission houses, to sustain and keep as close a market as possible, sometimes to their great disadvantage, and sometimes being forced into that position to do their duty to their customers. I could cite numerous instances at openings or in fast markets one way or the other, where we have felt it our duty to step into a breach whether it was profitable or not.

Mr. PECORA. Those instances where a specialist steps into the breach and has found it unprofitable to do so are comparatively rare, are they not?

Mr. ADLER. Well, they are not so rare.

Mr. PECORA. They are not nearly so frequent as cases where, through the medium of trading on your own account, it was at a profit to yourself?

Mr. ADLER. I just want to bring out the point that we do feel it a duty to our customers at all times, if possible, to sustain and keep a good market.

Mr. PECORA. Mr. Moore, whose appearance has been urged by you, is telling this committee of instances where a specialist ran away from the stock to the disadvantage of Mr. Moore's customers.

Mr. ADLER. Exactly.

Mr. PECORA. I do not see the force, then, of Mr. Moore's argument here to sustain the point that you are seeking to make.

Mr. ADLER. I think Mr. Moore is trying to show that if this specialist had traded it would have been better for the whole market in general on that particular issue.

Mr. PECORA. So long as the specialist is not under compulsion to trade, the same thing may happen over and over and over again?

Mr. ADLER. Exactly.

Mr. MOORE. That is correct, Mr. Pecora.

By contrast I want to cite here an instance in which a specialist did trade, hoping by the two instances to show the value of trading as against the damage of not trading.

Mr. PECORA. But, Mr. Moore, it is your candid belief that if specialists were placed under the compulsion of supporting the market they would be so eager to trade for their own account in any and all circumstances?

Mr. MOORE. I am unable to say that. That is a voluntary matter, and I presume it would be decided by each individual according to his capital and his inclination.

Mr. PECORA. And according to his interests?

Mr. MOORE. And according to his interests.

Mr. PECORA. His self-interest?

Mr. MOORE. His self-interest. A specialist trades as a matter of profit.

Mr. PECORA. Exactly.

Mr. MOORE. There is no question about that. We claim that his trading is done as a matter of profit.

A second instance which occurred in a fairly active, medium-priced stock, at an opening just the other day, was this. The closing sale the previous session was $29\frac{7}{8}$. There were brokers present with orders to buy 1,500 at the market, and the orders on the book of the specialist could only supply all of these at $34\frac{1}{2}$ —

Senator GORE. What was the price?

Mr. MOORE. The stock had closed at $28\frac{7}{8}$ the night before. This was the opening. No price had yet been established for the following day. There were brokers present who wished to buy at the market 1,500 shares, and the specialist could only supply all of these 1,500 shares at a price of $34\frac{1}{2}$, which would have been $4\frac{5}{8}$ higher than the previous day's closing, and would have been a very severe fluctuation on a price of 30, well over 10 percent.

After calling for governors' advice and receiving approval, the specialist sold 1,500 shares for his own account at 31, thus establishing a price of only $1\frac{1}{8}$ above the previous close, and in the following hour, with the purchasing power he thus established, he maintained a market at $30\frac{5}{8}$ low and a high of 31, and into that market came numerous buyers and sellers in 100-share lots of stock. So in that time 1,700 more shares were traded in within the hour in that narrow range.

Mr. PECORA. What was the result to the specialist?

Mr. MOORE. His personal profit or loss result?

Mr. PECORA. Yes.

The CHAIRMAN. What did he make or lose?

Mr. MOORE. I could not answer that because I don't know. He had 1,300 shares that he was long on. That was the inventory that he had accumulated.

Mr. PECORA. For his own account?

Mr. MOORE. Yes, sir, in trading in previous days, and 200 shares he did not have to supply. He had to go short 200 shares. I presume on the 200 shares that he went short and which he covered at $30\frac{5}{8}$ he got \$75 gross, for his expenses had to be deducted. What he made on his long inventory I don't know, because I don't know the cost.

I was there and saw this and was sufficiently pleased at the moderation of the overnight price change and the aftermath of an orderly stabilized market to make these notes of the incident.

In this instance the specialist benefited all public buyers and created a splendid after-market. He could only have benefited his booksellers by creating disorder. The balance of the result was beneficent, just as in the other case the result of the specialist not trading was damaging.

I think the public lacks education as to the value to it of the trading of a specialist. The customer or public buyer seldom knows that his purchase has cost him less because of it, or the public seller that he receives more because of it. The buying public, whose limited orders are overbid, usually denounces the specialist because his order is not executed—overlooking that in free and moving markets the overbidding is as likely as not to arise from other public buyers as from the specialist; and always in its criticism the public ignores the fact that the sellers, who are an equally important part of the public, are benefited by receiving higher prices. The selfishness of human nature limits his appraisal to his own disappointment, and the other side of the picture holds no interest for him.

It is educational to recall the transition from the ruthless, competitive trading specialist of my early experiences, who gleefully exploited the anxious commission broker, bent on faithful performance of service, to the cooperative, helpful trading specialist.

Trading by the specialist is a voluntary matter. Most specialists indulge in its practice and are willing to risk their capital for this purpose. Here and there one will not, and in such cases the disadvantage to the public stands out distinctly. One almost is inclined to wish that it were compulsory for all specialists to so perform.

Today the specialist's concept of service is as keen as that of the customer's specific agent, the commission broker. The specialist's limitations are written large in the law of the New York Stock Exchange, and he has responded willingly to the present-day philosophy of public service which inspired their adoption.

I thank you, Mr. Chairman.

Senator GORE. I want to ask a question of Mr. Sprague.

STATEMENT OF RAYMOND SPRAGUE—Resumed

Senator GORE. Mr. Sprague, you were talking awhile ago about these orders to buy above the market. You said a customer might give an order to buy above the market figure, and if the stock was active enough it might go higher?

Mr. SPRAGUE. Yes, sir.

Senator GORE. I can see how that might operate; but we have had testimony here as to the operation of pools and syndicates who are undoubtedly calculating on that very instinct of human nature and who apparently run the price up just to catch those fellows who are lying in wait to buy on the activity of the stock. In other words, these pools create activity and signs of activity and they might bid the stock up. Would there be any serious impairment of the freedom of the market if we were to put a stop to those fellows who calculate on that trend of the market? I can see how innocently John Doe and Richard Roe might give you an order to buy Steel at

51 when it was selling at 50. On the other hand, I can see how a group such as we have had testimony here concerning might take advantage of that very disposition to carry on the operations of these pools and syndicates. It looks to me like it would stop mischief if we prevent that.

Mr. SPRAGUE. Senator, to answer that, that order might have been placed by a man who had sold his stock out and did not want to lose it; he intended to replace it at a higher or lower value. In other words, he had a hundred shares of stock that he was in possession of and he decided to take his profit at the time with the idea that he would replace it at a lower figure. He might then feel that he would want the stock back either at a higher or lower figure—

Senator GORE. Figuring he had made a mistake?

Mr. SPRAGUE. Yes. I would say that those orders are fairly rare in my experience.

Senator GORE. Would it not be better to let him take the consequences of his mistake than to let a customer serve a sinister motive, if such there be—and I think there are at times in those who are engineering these pools and syndicates and just lying in wait for just such fellows as that.

Mr. SPRAGUE. I would hate to outlaw a man's right in that respect.

Senator GORE. To pay more for a thing than it is worth? Is that any serious impairment of a man's constitutional, inalienable right—to prevent him from paying more for a thing than is necessary?

Mr. SPRAGUE. He does not pay more for it until it arrives at that price.

Senator GORE. If he can buy it at 50 when he placed the order, and the order is not executed on his direction until it reaches 51, it looks to me like you are letting the lambs be fed to the wolves.

Mr. SPRAGUE. I never had a wolf on my side, Senator.

Senator GORE. You know there have been such enterprises in the past. You do not profess to be ignorant of that?

Mr. SPRAGUE. I have not read all of this testimony, but I believe that is a fact.

Senator GORE. That is, you believe there are pools and syndicates?

Mr. SPRAGUE. Oh, yes.

Senator GORE. You have a rule now, do you not, or you did have, that you cannot make a short sale at less than the last preceding long?

Mr. SPRAGUE. That is correct.

Senator GORE. Is not the point in that to keep a fellow from selling? Suppose steel is selling at 50 and a short operator comes in. You would not let him sell for less than 50?

Mr. SPRAGUE. That is, to maintain a long?

Senator GORE. You would not let him sell at 49?

Mr. SPRAGUE. No, sir.

Senator GORE. Why not, if you let a fellow buy above the market? I think it is a good rule, as little as I know about it. That is still the rule, is it not?

Mr. SPRAGUE. Yes, sir; it is.

Senator GORE. I can see that it prevents just hammering the price down like a triphammer, and I do not see why it would not work as a protection against some of the abuses that undoubtedly do exist and some that ought to be corrected and cut out and some of the

abuses that you people ought to help cut out. It seems to me that it should work both ways. If a man wants to sell stock for less than he can get for it, I think you ought to stop him from doing that. If he wants to pay more for a stock than he can buy it at, I think it ought to operate there. I am speaking without knowing all the intricacies of this business, but that is the way it looks to me at the moment.

Mr. ADLER. A man that owns stock may sell it below the last sale. A man who wants to purchase can buy it above the last sale if he chooses.

Senator GORE. I understand that. You can make a long sale at half what it is selling at, of course; but a man's motive of self interest will protect him against that. I think when a man offers to buy at above the market price he may have a perfectly legitimate motive, as you say, figuring if it goes that high it will go on up; but he might have some other motive that would not be justified or justifiable.

The CHAIRMAN. It is half past one, now, gentlemen, and we will take a recess until half past 2.

(Whereupon, at 1:30 p. m., a recess was taken until 2:30 p. m. of the same day.)

AFTERNOON SESSION

The committee resumed at 2:30 p. m on the expiration of the recess

The CHAIRMAN. The committee will come to order, please. Mr. Sprague, I think Mr. Pecora wants to ask you a few questions.

Mr. SPRAGUE. All right.

STATEMENT OF RAYMOND SPRAGUE, NEW YORK CITY, MEMBER OF THE NEW YORK STOCK EXCHANGE AND A SPECIALIST—Resumed

Mr. PECORA. Mr Sprague, is it possible for a specialist to ascertain the trend of the market in the security in which he is specializing by the orders on his books?

Mr SPRAGUE. Mr. Pecora, to answer that question I would say that the orders on the books of a specialist do not indicate in general the trend; that the phenomenon of the market is very often that it rises through the volume of the stock and declines through the volume of bids. In that respect I would say that the book offers no trend.

Mr. PECORA. Take in the ordinary market, would the specialist be able to judge the trend of the market from the orders on his books?

Mr. SPRAGUE. I would say in that respect, not from the orders on his books but from the general trend of the general market.

Mr. PECORA. Do you mean that—

The CHAIRMAN (interposing). Wouldn't the orders on his books, being orders to sell or to buy so many shares, respectively, indicate somewhat the market trend?

Mr. SPRAGUE. To explain that, Mr. Chairman: In rising markets we very often find the volume of the selling orders is greater than the volume of the buying orders on our books; and in a declining

market the volume of the buying orders is greater than the volume of the selling orders on our books.

The CHAIRMAN. But that is not usually the case, is it?

Mr. SPRAGUE. That is quite often the case. I would say that in a majority of the times you would find that true. Now, the reason for that is that we have mostly limited orders on our books to sell, whereas the orders that show the trend of the market are orders executed by other brokers. So that the volume of the orders on our books usually are heavier on the selling side in a rising market, and heavier on the buying side in a declining market. Those orders are placed to purchase below the market, or placed to sell above the market. They have been limited as to their price at which to buy or sell.

The CHAIRMAN. According to that a specialist would have to do just the contrary to what his book indicated.

Mr. SPRAGUE. Very often that is true.

Mr. PECORA. Mr. Sprague, you know Mr Charles Wright, don't you?

Mr. SPRAGUE. I know Mr. Wright to speak to him.

Mr. PECORA. At least you know he is a specialist.

Mr. SPRAGUE. Yes, sir.

Mr. PECORA. On the floor of the New York Stock Exchange.

Mr. SPRAGUE. Yes, sir.

Mr. PECORA. And a very active one.

Mr. SPRAGUE. I presume so, although I have no personal knowledge of it myself.

Mr. PECORA. Well, now, he has given testimony before this committee within the last 2 weeks, and I will read to you a portion of his testimony on that point, and am going to ask you how far you would confirm what he testified to:

Mr. PECORA. And with that information—

That is, information obtained from knowledge of the buying and selling orders on his books:

And with that information are you not in a better position to determine what the trend of the market is going to be?

Mr. WRIGHT. No, sir.

Mr. PECORA. Why does not that information give you that advantage?

Mr. WRIGHT. I just told you.

Mr. PECORA. Because the trend of the market is the other way?

Mr. WRIGHT. Because the trend of the market is opposite to what the book is.

Mr. PECORA. Doesn't that give you knowledge of the trend of the market if it runs opposite from the trading indicated by the buying and selling orders on your book?

Mr. WRIGHT. Yes; you could say it did.

Mr. PECORA. Is not that an advantage?

Mr. WRIGHT. Sometimes, sometimes not.

Mr. PECORA. When is it an advantage and when is it a disadvantage?

Mr. WRIGHT. That I cannot answer. I would have to have a book in actual operation to be able to tell you.

Mr. PECORA. From your general knowledge and experience can you not tell us without having a concrete case before you?

Mr. WRIGHT. No, sir, I could not describe it.

Mr. PECORA. It is an advantage to one trading in the market to know what the trend of the market is likely to be, is it not?

Mr. WRIGHT. It certainly is.

Mr. PECORA. That is always an advantage, is it not?

Mr. WRIGHT. Yes.

Mr. PECORA You always have that advantage from the knowledge you have as a specialist, do you not?

Mr. WRIGHT If I always had that advantage, I would not ever lose money; and I very frequently lose money

Mr. PECORA. It might not be an advantage which conclusively would enable you to make money every time on a trade, but it is always an advantage, is it not, to have that knowledge?

Mr. WRIGHT Yes, sir; if you have it

Mr. PECORA. And the specialist has got it?

Mr. WRIGHT At times.

Mr. PECORA Has he not always got it?

Mr. WRIGHT. No, sir. Lots of times your books will bare and you don't have bids and offers on the stock What advantage is the book then?

Mr. PECORA. Then he probably would not trade; is not that so?

Mr. WRIGHT. Yes.

Now, that is the substance of the testimony given by Mr. Wright with regard to whether or not a specialist, because of the knowledge he has of the orders on his books to buy or sell stock that he specializes in, can judge the general trend of the market, or of that particular issue he is dealing in. Would you differ from the opinion Mr. Wright has expressed before this committee in the answers he made to the questions I have just read to you?

Mr. SPRAGUE. I would differ in this respect: That I do trade when there are no bids. I do trade when there are no offers. As far as the trend itself is concerned.—

Mr. PECORA (interposing). When you do it under those circumstances what is your purpose in doing it?

Mr. SPRAGUE. I create a market to an extent. I back my judgment to that extent, to the extent that I am wrong for the time being but I am right for the long time.

Mr. PECORA. That is usually done at the opening, isn't it?

Mr. SPRAGUE. Oh, no. I very often have had a book in an active stock, such as Sears-Roebuck, where my nearest bid would be a point and a half away from the offer.

Mr. PECORA. Mr. Wright was asked these other questions, to which he made these answers:

Mr. PECORA Are there times when, due to market conditions, a specialist makes the market for the stock?

Mr. WRIGHT Yes, sir

Mr. PECORA Under what circumstances is the specialist called upon to do that?

Mr. WRIGHT. When there are no bids or no offers of stock

Mr. PECORA. How does the specialist make the market in that situation?

Mr. WRIGHT He does it under the supervision of a governor of the exchange.

Mr. SPRAGUE. I do not think that question was clear, Mr. Pecora.

Mr. PECORA. Well, he answered it.

Mr. SPRAGUE. Well, I would say that I do not think his answer is correct, and for this reason: That he says when there are no bids or offers he makes the market under the supervision of a governor of the exchange. What he was referring to there, if I gather it correctly from his testimony, is that when, in the absence of bids, he very often is called upon to buy stock, that in that case a governor of the exchange supervises it, and sees that the price is fair. But it is an extraordinary case.

Mr. PECORA. When a specialist trades for his own account for the purpose of making a market or keeping the market close, does

he do it as a rule under circumstances that will tell him in advance he is going to lose by the operation?

Mr. SPRAGUE. I do not think you can say he will do it in advance with knowledge that he will lose by the transaction. But he takes a chance of losing. He also is using his judgment as to whether he will make a profit. It may be that he, in order to keep his market closer and more orderly, will quote his market closer and be closer.

Mr. PECORA. Were you ever a participant in any pool or joint account in a stock in which you were specializing?

Mr. SPRAGUE. I have never been a participant in any joint account, syndicate, or pool in my own stocks, nor have I been such participant in any other stock. I think they are rare.

Mr. PECORA. You think they are what?

Mr. SPRAGUE. On the part of specialists I think that is rare.

Mr. PECORA. What was that word?

Mr. SPRAGUE. Rare.

Mr. PECORA. Well, there has been considerable testimony presented to this committee to show that specialists have participated in pool operations for their own account.

Mr. SPRAGUE. In their own stock?

Mr. PECORA. In their stock; yes, sir.

Mr. SPRAGUE. Well, I have absolutely no knowledge of it, and my impression was that that was the exception and not the rule. It is rather the exception.

Mr. PECORA. It is what?

Mr. SPRAGUE. The exception.

Senator WALCOTT. And in connection with directors of the corporation in whose stock they were dealing?

Mr. PECORA. Yes; Senator Walcott, circumstances of that sort have only recently been brought to the notice of this committee in sworn testimony and documentary evidence.

Mr. SPRAGUE. May I say that I have been specializing since 1918, and I worked with specialists from 1912 on up to 1918; and I have traded as a firm and as an individual, and I have never had any such connection, and have never seen anybody in my stocks have such connection.

Mr. PECORA. Well, you yourself have heard of instances where specialists were participants in pool accounts trading in their stock, haven't you?

Mr. SPRAGUE. I have heard that recently.

Mr. PECORA. Did you hear it only recently?

Mr. SPRAGUE. I have never heard anything I could verify to that extent until recently. I have heard common gossip to that effect, but I have no absolute information.

Mr. PECORA. Have you heard that gossip on the floor of the exchange?

Mr. SPRAGUE. I have heard that gossip, I do not know whether on the floor or off the floor, years ago.

Mr. PECORA. I mean in recent years.

Mr. SPRAGUE. I would say that all that has come to my knowledge recently has been the testimony that you have had here.

Mr. PECORA. Don't you remember the testimony this committee heard in 1932? Take for instance the radio pool.

Mr. SPRAGUE. That is what I refer to.

Mr. PECORA. In which Mr. Meehan was a participant.

Mr. SPRAGUE. That is what I am referring to, both the Meehan and the Wright testimony.

Mr. PECORA. The Meehan testimony was given here in 1932, or rather testimony with regard to that particular pool operation; and Mr. Wright's testimony and Mr. Day's testimony were given here only within the last two weeks.

Mr. SPRAGUE. Well, I am referring to the——

Mr. PECORA (continuing). The testimony with regard to Mr. Meehan's pool related to pool operations back in 1928 and 1929. The testimony recently given by Mr. Wright and Mr. Day related to pool operations in the summer of 1933.

Mr. SPRAGUE. I have heard many times that a pool was operating here or there, but I never had any evidence of it.

Mr. PECORA. And you did not go out to seek the evidence, did you?

Mr. SPRAGUE. I did not.

Mr. PECORA. You did not go out and try to confirm the gossip you heard, did you?

Mr. SPRAGUE. I did not.

Mr. PECORA. What do you think is the extent to which a specialist trades as compared with the general or public trend in his stock? What would be a fair average or proportion?

Mr. SPRAGUE. I would be unable to answer that question directly.

Mr. PECORA. Then answer it from your own experience.

Mr. SPRAGUE. I would say that it varies with the activity of the market.

Mr. PECORA. What would be the proportion in your case?

Mr. SPRAGUE. Well, really I could not give you that except generally. I might say 15 or 20 or 25 percent.

Mr. PECORA. That is, from 15 to 25 percent of the trading.

Mr. SPRAGUE. I would say so; yes, sir.

Mr. PECORA. That is it in stock as to which you handled the book? That is, it is done by you as specialist for your own account?

Mr. SPRAGUE. You are asking me a question I have no knowledge of. I am merely guessing.

Mr. PECORA. I mean in your case.

Mr. SPRAGUE. I am unable to give you the facts. I am guessing.

Mr. PECORA. Your guess ought to be pretty good because based upon your own experience.

Mr. SPRAGUE. I do not know, because I have not sought that data.

Mr. PECORA. Couldn't you tell from your experience based on your daily operations over a number of years, about what proportion of the trading you, as a specialist, do for your own account as compared to the entire trading in the security for the public account?

Mr. SPRAGUE. I actually could figure it out for you if I went to the book and got the figures. I could not guess at it.

Mr. PECORA. I am not asking you to tell me exactly but to give me an approximation.

Mr. SPRAGUE. I would not want to give you an approximation. I would rather give you the facts.

Mr. PECORA. Give us an approximation if you can, and then if you want to supplement it with the actual figures after you have an opportunity to gather them meanwhile, do it.

Mr. SPRAGUE. I would rather gave you the actual figures than to guess at it. In the matter of inactive stocks I might participate to a much larger extent, because in that case I am needed. I can give you an instance of the other day where there were traded in 600 shares and I purchased 300 shares, and that would be a 50-percent participation. In some recent—

Mr. PECORA (interposing). I am asking you for the average based upon your experience as a specialist. I am not seeking to pin you down to isolated transactions but am trying to get your general average.

Mr. SPRAGUE. I am trying to give you that without making a statement to that effect. I would rather get the actual figures and tell them to you than to guess at it, which I do not think is a fair way to get it.

Mr. PECORA. Well, your guess would not be a guess based upon no knowledge, would it? It would be a guess based upon your full transactions over a period of years.

Mr. SPRAGUE. Not necessarily.

Mr. PECORA. Couldn't you tell this committee, generally or approximately, the percentage of the entire trading that is represented by the trades you make for your own account in the stocks of which you handle the books as specialist?

Mr. SPRAGUE. I have told you I cannot guess at it.

Mr. PECORA. I do not want you to guess, but to give us your best approximation, and if you want to call it a guess, all right, we will take it as a guess.

Mr. SPRAGUE. I have given it to you as 15 to 25 percent.

Mr. PECORA. You said from 15 to 25 percent of the trades

Mr. SPRAGUE. Yes, sir; that is a guess. I do not know.

Mr. PECORA. If you find subsequently that you have made a wild guess, give us the exact figures and we will let the record show them.

Mr. SPRAGUE. How long would you like that to cover altogether?

Mr. PECORA. Oh, I do not want to put you to any particular trouble about it. Anything that you think will operate to—

Mr. SPRAGUE (interposing). It does vary, you know.

Mr. PECORA (continuing). Anything that you think will operate to indicate a fair average.

Mr. SPRAGUE. All right.

Mr. PECORA. Mr. Sprague, how long have you been on the stock exchange?

Mr. SPRAGUE. Since 1918.

Mr. PECORA. Would you say that the trading you have done for your own account in the long run proved profitable to you?

Mr. SPRAGUE. I would say so, but I would qualify that by saying that in my instance in a great many stages of stocks I have taken a position and stayed with those positions, and I believe there is where the money is, and not in in-and-out trading. I might also say in reference to that, in the case of many stocks I might buy other securities on the same basis, either for short or long range.

Mr. PECORA. What advantage does the specialist see in giving support to a falling market?

Mr. SPRAGUE. The answer to that question is this: Now, I am not trying to place myself in the position of being a public benefactor, but—

Mr. PECORA (interposing). I am glad to hear you say that, because I am afraid the impression has been created here by statements of those who attempted to paint the specialist in just that role.

Mr. SPRAGUE. Well, now, you didn't let me finish my answer.

Mr. PECORA. Go ahead.

Mr. SPRAGUE. I say I do not wish to put myself on record as being a public benefactor, but give me a selfish motive and I create a better market in my stocks so that people will invest or speculate in my stocks. In that way a man can buy or sell with knowledge that there will be a market that he can buy or sell in. And I think to that extent it is an advantage to the investor just as well as it is to speculator, because when an investor seeks stocks for investment purposes the first thing he looks at is marketability, liquidity, how he is going to be able to get out once he gets in. And whether he is a speculator or an investor that is a factor.

Mr. PECORA. And by prompting the liquidity of the market in that way you are making it easier and more attractive for the public to step in and either invest or speculate.

Mr. SPRAGUE. Well, I would say that I would not be making it easier, but they do it. It does make for a liquid market, so they can buy and sell if necessary or thought desirable.

Mr. PECORA. And that makes it more attractive to the average investor or speculator to go into the market?

Mr. SPRAGUE. It supports the market to such an extent that they may feel they will have a follow-up market in even they want to sell their stock.

Mr. PECORA. And that encourages them to go into the market.

Mr. SPRAGUE. I would not say that would encourage them. I do not think they need any encouragement.

Mr. PECORA. The arguments made here repeatedly in favor of liquidity would suggest that liquidity is desirable, because it enables an individual at any time to go into the market and either buy or sell the security he is interested in.

Mr. SPRAGUE. Yes, sir; but you are talking now about the difference between liquidity and encouragement.

Mr. PECORA. Well, as liquidity decreases don't you think speculation or even investment may decrease?

Mr. SPRAGUE. It might be very much to the damage of the customer who had already invested in those securities. There are apt to be a lot of people in them and they are entitled to a fair market if you can make it for them.

Mr. PECORA. And wouldn't there be a fair market if the specialist were not permitted to buy or sell for his own account?

Mr. SPRAGUE. In many cases I am afraid not.

Mr. PECORA. Wouldn't the market in those cases be a market made by the public trading itself?

Mr. SPRAGUE. I think in that event it might be a very, very poor market, because at times an owner of stock wants to sell his security. He is very much damaged in that by reason of absence of a market.

Mr. PECORA. That is not likely to be true in the case of securities more or less actively traded in, is it?

Mr. SPRAGUE. At times inactive stocks of one day are active stocks of another day. They vary accordingly.

Mr. PECORA. Well, now, there are certain stocks listed on the stock exchange that are generally recognized throughout the year as active stocks, aren't there?

Mr. SPRAGUE. Yes, sir.

Mr. PECORA. As compared with other stocks on the list that are generally recognized throughout the year as being inactive stocks.

Mr. SPRAGUE. There is also a third class, semiactive stocks, which are very important, and they are stocks which need the protection of a fair and decent market.

Mr. PECORA. Now, to what extent does the specialist stand by the market, even in the case of active stocks, when there is a period of considerable activity that may disturb prices?

Mr. SPRAGUE. Not having had what you might call an active stock it is hard for me to answer you in behalf of such a stock. But I would say that trades in that stock mean that he narrows the quotations so that there is a better market, a more liquid market, for the purpose of anybody availing himself of it who is willing to buy or sell.

Mr. PECORA. Doesn't the specialist as a rule, even in the case of an active stock, run away from the support of the market when he thinks he is going to be hurt by standing by?

Mr. SPRAGUE. No, sir. In answer to that question I will say that I have seen many cases where men did not run away but stood there and took it and we had to do it in 1929.

Mr. PECORA. To what extent in 1929?

Mr. SPRAGUE. To a great extent.

Mr. PECORA. To what extent, if any?

Mr. SPRAGUE. I can cite my own instance, where I stood by and took blocks of stock with no bids on my book, and stabilized my market.

Mr. PECORA. How long did you stand by?

Mr. SPRAGUE. It was plenty long enough in one particular day.

Mr. PECORA. How long did you stand by?

Mr. SPRAGUE. One day at the very height of it.

Mr. PECORA. Because Mr. Wright told us about his standing by and getting murdered on July 18, last, in American Commercial Alcohol Corporation stock, and yet upon further inquiry he frankly admitted that after he was murdered he was left with a net profit of \$138,000.

Mr. SPRAGUE. Well, I was not murdered, but I stood by and stabilized the market when there were no bids.

Mr. PECORA. Just one minute.

Mr. SPRAGUE. Mr. Pecora, perhaps you would like to look at a book.

Mr. PECORA. Mr. Wright showed us his book in American Commercial Alcohol Corporation stock.

Mr. SPRAGUE. But this is a little bit different I am afraid.

Mr. PECORA. What issue is that?

Mr. SPRAGUE. This is the Curtiss-Wright, and shows the volume of orders at various times. The book I am handing you is Mr. Adler's

and he probably would explain it to you. That will give you an idea of a book of that type. There are several other books here of various types if you would like to look at them for the purpose of getting an idea of what the book means to you.

Mr. PECORA. Well, I will be glad to listen to any exposition Mr. Adler may want to make of this as a sample book.

Mr. ADLER. I should like to suggest in answer to your earlier questions as to whether a specialist by looking at his book makes up his mind which way the stock is going, that this is what we call a volume book, and the bids are to be found on the left side. Would you like to see one of these, Senator Walcott?

Mr. WALCOTT. I shall be glad to look at it.

Mr. SPRAGUE. And we have others if any other members of the committee wish to look at them.

Mr. PECORA. Go ahead, Mr. Adler.

Mr. ADLER. If we may develop this a little—and it will only take a few minutes—I should like to show you a very interesting point, where we inject a bid. In this type of stock it practically takes care of itself on the book [pointing on book]. This is what we call the real volume stock, and when it gets down to a level of this sort you will see on the bid side possibly a couple of thousand shares wanted at $4\frac{1}{8}$ and a very small amount offered at $4\frac{1}{4}$ and $4\frac{3}{8}$, and then the volume again starts on the next page at $4\frac{1}{2}$, $4\frac{5}{8}$, and $4\frac{3}{4}$. I frankly tell you that the specialist trading in a situation of this sort does not hinder or help the situation. It is a more or less automatic job; in fact, we call these book markets. Now, I have here—

Mr. PECORA (interposing). Well, now, on this book that you have shown us and which we are using as a sample, do the entries indicate that the specialist is trading for his own account?

Mr. ADLER. There is no entry here to indicate that at all. Personally I wouldn't do that, trade for my own account. I watch the action of the stock and the activity of people who buy a block or a small amount, and stay with it. You see, I cannot trade in this stock under the rules of the New York Stock Exchange. The stock is $4\frac{1}{8}$ bid by customers and offered at $4\frac{1}{4}$, and all sales at those prices are done for those customers, for others. I am prohibited from dealing in that stock unless I buy $4\frac{1}{4}$ stock.

Mr. PECORA. Give us an example of what you say, under what circumstances you would trade or have traded.

Mr. ADLER. I will be very glad to do so.

Mr. PECORA. Have you such a book here?

Mr. ADLER. I should like first to give you an actual example of a trade that I made last week, and I can also give you an example of a trading account under the same conditions where I made a profit. Last week the market in Wilson & Co. preferred was 73 bid and offered at $74\frac{1}{2}$, and the last sale was $74\frac{1}{2}$.

Mr. PECORA. Is that one of the stocks on the list—

Mr. ADLER (interposing). In which I specialize.

Mr. PECORA. You characterize as an active stock?

Mr. ADLER. No, that is in the semiactive class. That is the class where the specialist's trading really counts for more.

A broker walked in from a firm and said, "I have 1,300 shares of this stock to sell at the market." And I said, "Well, there is a hundred wanted at 73 and a hundred at 72 and a couple of hundred

at 70." He said, "Well, I don't want to sell them there." I said, "I will give you 73½ for the 1,300 shares." He said to me, "I don't want to sell it down a dollar or a half dollar without conferring with my customer." I said, "By all means, go back to your telephone. Tell your customer that your specialist will buy his entire block at 73½ if he wants to sell them."

He went back to his phone. As it happened, he told me the order was from Australia, but the office partner had instructions to handle it, and the office partner, after deliberating, sold the 1,300 shares to me at 73½.

Now, the interesting part of that is, Mr. Pecora, that if I had not made that bid and he had sold the stock in the open market he might have sold it down to 68. As it subsequently developed, I got rid of 100 shares of this lot which I had purchased at 74½. Then some other broker came in and sold a couple of hundred at 73. Then I had to buy a couple of hundred at 72. Then it sold at 71. And the next morning there was 600 for sale at 70, which I bought, after conferring in the same manner with the broker.

Now, luckily, the next day this stock rallied to between 73 and 74 and I was able to liquidate some stock. As it happened, the following day an announcement came out in the morning paper that the packing stocks, or the packers, were under observation or scrutiny by a Government committee, and they broke badly. But I frankly, had gotten out of some of my stock. The packing companies were under inquiry. In that case I really frankly think we made a liberal bid. The customer was very satisfied. He had all opportunity to make up his mind whether he wanted to sell it or not. He might have come back to me and said, "No; I don't want to sell you that stock. You handle that order for me." Then, as luck might have had it, I might have sold the stock at 74½ or 74¾, or I might have been forced to sell it all the way down if the market happened to break or that particular stock had started down.

Mr. PECORA. That is a chance that everybody takes?

Mr. ADLER. That is a perfectly legitimate chance with an order. However, by my making this bid at that moment it satisfied that customer.

Now, there is just one more instance I would like to give you of an interesting happening.

Mr. PECORA. Before you give that instance, would you say, Mr. Adler, that such an act on the part of the specialist enables the keeping of a closer market?

Mr. ADLER. I think so, Mr. Pecora.

Mr. PECORA. A narrower spread between bid and asked?

Mr. ADLER. I think it does two important things, and I do not like to appear one-sided on the thing.

Mr. PECORA. That is one of the important things you advocate for it?

Mr. ADLER. Yes.

Mr. PECORA. Doesn't that have a tendency to encourage persons to speculate?

Mr. ADLER. I would not call that encouragement. That is, a man that holds 1,300 shares of Wilson preferred stock—naturally an investment—and my making that bid at that time enabled this man

to switch his entire investment. He might have wanted to sell that and buy something else, and his buying might have been contingent on his getting a fair price for that stock.

Mr. PECORA. A general effect flowing from such operations on the part of the specialist, resulting as it does in the making of a narrower or closer market, is an incentive to speculation on the part of the public, isn't it?

Mr. ADLER. I would say it performs a function that an investor—an investor, as this case showed—had a chance to get out when he felt like it. In other words, it created a very good market for the investment.

Mr. PECORA. By the preserving of narrow markets or a close spread between bid and asked prices encouragement is given to the general public to take a chance on speculation if they are speculatively inclined, doesn't it?

Mr. ADLER. I always had a theory on that, definite one, that an investor when he sells something is not very much interested whether he sells it to a speculator or a specialist or anybody else.

Mr. PECORA. He is only interested in the price he gets?

Mr. ADLER. And the fact that the market is there is made either by another investor or a specialist or a speculator. And we will say that the speculator or the investor is attracted to a stock where there is a better market. I think not only for the speculator; it goes for all three classes.

Mr. PECORA. The better market would include the feature of a narrower spread between bid and asked prices?

Mr. ADLER. That is what we term as a good market.

Mr. PECORA. Yes.

Mr. ADLER. And that is what the commission houses require of us.

Mr. PECORA. So that by keeping a narrow market or keeping the market close in these stocks that you handle you encourage persons to trade in those stocks, don't you?

Mr. ADLER. Well—

Mr. PECORA. Whether that be your purpose or not, that is the effect of maintaining a close market, isn't it?

Mr. ADLER. I don't think it would encourage speculation in that stock.

Mr. PECORA. Doesn't it encourage trading in the stock?

Mr. ADLER. Well, our theory is this: I am a specialist in a tobacco stock, and I say if I make a good close market in that stock the investor or the trading public will buy or sell that property much more readily than trading in something that has a terrifically wide spread.

Mr. PECORA. Exactly. That is just the point I am seeking to make, Mr. Adler, and that is a necessary result which flows from the making of a close market or keeping within as narrow a range as possible, the spread between bid and asked prices, isn't it?

Mr. ADLER. I think it would penalize a buyer or a seller if I did not make it as close as possible. Don't you?

Mr. PECORA. I do. Certainly. That is just the point I am seeking to make, that one of the results directly flowing from the function of the specialist, this useful function that you refer to of the specialist, trading in a manner for his own account that enables him to

make a close market, is that the market is made more attractive to the average speculator to trade in that stock.

Mr. ADLER. Well, couldn't we say average speculator or investor?

Mr. PECORA. Or investor; yes.

Mr. ADLER. Yes; I think an investor.

Mr. PECORA. Yes; the trader.

Mr. ADLER. I would not want to say that we make a market close for the average speculator. I think it is very important when I make a close market if possible in American Tobacco preferred, which I do whenever I can; I think that is important from an investment angle.

Mr. PECORA. And don't you think that adds to the amount of trading that the public indulges in in that security?

Mr. ADLER. In that particular security? Yes, I do.

Mr. PECORA. Yes. That results in more business for the broker and more commissions?

Mr. ADLER. Yes.

Senator WALCOTT. Although it might be an entirely investment market or investment stock?

Mr. PECORA. Yes.

Mr. ADLER. Entirely an investment stock, because most of my activity I think comes in the less active issues which are more of an investment type. But I am a specialist in quite a number.

Let me explain to you one thing that happened, as I remember it very distinctly. In the last day of the panic in 1929, which is one of the proud moments of our career as specialists and our firm, we had 1,500 shares of American Tobacco preferred to sell at the market in single lots at quarter of 3, and the best bid was either par or \$95 a share, with the last sale 115.

Now, you and I know very well that when American Tobacco preferred comes on the market that is the best stock—or in my opinion one of the finest preferred stocks there is.

Mr. PECORA. You will probably get more orders tomorrow. [Laughter.]

Mr. ADLER. My partner is sitting here, and I said to him at that time, I said, "I am not going to let this stock sell down to par." And we sent a message to each one of the brokers that had given us this order, that had entrusted this order to us, that we would guaranty them the bid price. Now, I don't remember whether bid was par or 95. We said we would guarantee them the bid price overnight.

In other words, if that stock had opened at 80 the next morning, I was bound to take 1,500 shares at 95, and that is actual fact. We guaranteed them the bid price overnight.

The next morning every order was in there again to sell at the market, and a gentleman walked in with 1,500 shares of American Tobacco preferred to buy at 115, and I am not quite sure of the fraction at which I sold him this stock, but it was between 114 and 115, and in opening at that figure I had a couple of hundred more to sell, which I took for my own account and gambled my way out of.

And what I think is one of the important functions is to protect a stock in that way. Now, I dare say I cannot afford to do that every day, but that is one of the ones that I remember very well.

The CHAIRMAN. He wanted 95 and sold at 114?

Mr. ADLER. I did not buy it at all. I did not let stock sell. I did not trade in the stock for my own account at all. I took a chance on losing some money, not much, but held that sale up overnight until the market recovered to an extent to execute those orders properly—at least what I thought was properly.

That might happen, Mr. Pecora, a dozen, fifty, or a hundred times a day in a small way, where there is no bid for a stock and I will quote this stock 62, 63, and I will guarantee a man 62 for his stock. That is what is termed "stopping a hundred" for a man. In other words, I guarantee him a 62 price and maybe I sell it at 62½ or three quarters and maybe I don't.

Now, frankly, I do not do that every minute of the time. But one of my duties as a specialist is, if possible, to maintain a fair market for my customers, because if I do not, I am going to have competition the next week and he is going to get the business. That is one of the ways I have to trade to keep my business together.

Mr. PECORA. That is to build up a good will?

Mr. ADLER. Exactly. That is advertising account.

Mr. PECORA. Just as a department store or any store will offer a special sale of a commodity or give an article of merchandise to you even below the cost price?

Mr. ADLER. Yes; but I cannot cut the rates.

Senator TOWNSEND. Suppose you had had an order to buy American Tobacco at the market the next morning?

Mr. ADLER. Supposing I had had an order to buy it at the market?

Senator TOWNSEND. Yes, the 1,500 shares; suppose you had had an order to buy 1,500 shares at the market. What would have been your course?

Mr. ADLER. Supposing I had had that order?

Senator TOWNSEND. Yes; or that some broker had given it to you.

Mr. ADLER. Some broker has given me an order to buy 1,500 at the market while I had 1,500 shares to sell of the other brokers?

Senator TOWNSEND. Yes.

Mr. ADLER. I would have to arrive at a fair price. I might do that in consultation with another governor of the stock exchange to arrive at a fair price where both of my clients are going to be perfectly well satisfied. The fair price would be based on the other orders in the stock. In other words, if the stock had developed where there was stock wanted at 110 and offered at 115, after conferring with my partners and possibly another governor of the exchange, I might open that stock at 113 or 112½, some figure to arrive at where both people are perfectly well satisfied, because they are both my clients and they both pay me the identical commission.

May I just add one thing before I forget it, Mr. Pecora?

Mr. PECORA. Yes.

Mr. ADLER. And explain it to the gentlemen of the committee. That is that any unusual movement in one of the stocks—for instance, before a stock is allowed to break perhaps 3 or 5 points a member of the Business Conduct Committee is usually sent for, the situation gone over, and then the specialist is told, "Well, you may trade at that price because the situation demands it." But in all unusual occasions one of the Business Conduct Committee or one of some other committee must be sent for to confirm that price. In fact, I as a governor of the exchange, send for a member of the

Business Conduct Committee myself on rare occasions when I have an unusual price movement in the stock.

Mr. PECORA. And by the way, Mr. Adler, in view of the fact that you have mentioned that subject, how many of the governors of the stock exchange are also specialists?

Mr. ADLER. I think 7.

Mr. PECORA. Only 7?

Mr. ADLER. I think that is the count. I am not sure.

Mr. PECORA. Seven out of the 40?

Mr. ADLER. Maybe it is—it is either 7 or 10. Someone mentioned to me that there were 7 not long ago, but I know—or at least I am very well certain—that there are not over 10. I think the number is 7.

Mr. PECORA. I have heard the number placed at 15.

Mr. ADLER. Well, if I had a Stock Exchange directory I could verify it very quickly, if there is one in the house. I can find that out for you before I leave.

Mr. PECORA. In what proportion of cases where you trade for your own account for any purpose whatsoever, either to support the market or to create a market or to maintain a close market, have you incurred losses in the trading as compared with the number of cases where your trading is at a profit to yourself?

Mr. ADLER. I do not think the number of times we take losses is as against the number of times we take profits.

Mr. PECORA. Give us that, and then you can make any explanation you want of that or bring in any collateral matter that you may want to bring in.

Mr. ADLER. I could not really tell the number of, we will say, the winning trades.

Mr. PECORA. The proportion, I mean.

Mr. ADLER. The proportion?

Mr. PECORA. The general proportion.

Mr. ADLER. But I know the theory of our trading is this, that if we are wrong get out, and if we are right stay in. So, I might make 4 trades out of 5 that are losing trades, and on the fifth one I might possibly show a profit on the whole thing.

Mr. PECORA. Then let me put it this way: Taking the trading for each day as a unit, in what proportion of your daily tradings do your trades for your own account show profits, as against the proportion in which they show losses?

Mr. ADLER. I never really—I know we have done nicely at times. For instance, from last July on I could not get right for months. [Laughter.] I was in about 16 businesses all at once. I got very optimistic, and I am still optimistic.

Mr. PECORA. Did you get right by the end of the year?

Mr. ADLER. Well, I find that this rally or improvement in general prices has helped us be right to a certain extent, but I am an optimist and I am going to stick to my story, and I am going to keep those stocks.

Mr. PECORA. Could you give the committee any enlightenment along the lines I have asked for based upon your own personal experience?

Mr. ADLER. On the actual number of profits made during the day against losses? I can guess at it.

Mr. PECORA. No; I mean taking each day's trading as a unit, not each trade during the day but the entire trading each day as a separate unit. On how many days does the trading that you engage in for your own account result in a profit to you throughout the business year, as compared to the number of days that your trading results in a loss to you?

Mr. ADLER. I think we make money 3 out of 5 days. I wish it was bigger.

Mr. PECORA. And at the end of the year you are always on the right side of the ledger?

Mr. ADLER. We have been so far.

Mr. PECORA. You would not say that is true of the general public trader, would you?

Mr. ADLER. Well, it is a peculiar thing, Mr. Pecora. I have done very well as a business. It is a business with us. It is not a trading business. In my own personal investment which we made with the money that we had earned I did exactly what everybody else did. I lost a very handsome fortune in the best stocks in the world. I had the finest looking list that I had ever seen, and I did just what everyone else did; I kept them too long. I got "murdered."

Senator WALCOTT. That was from 1929?

Mr. ADLER. We will say I started to invest—I have been in business for 25 years. I have been a member of the stock exchange since 1917.

Mr. PECORA. You have incurred heavy losses in common with most persons in the market when you took a line of stocks for a long period of time?

Mr. ADLER. This is both in my time and as a personal investment?

Mr. PECORA. Yes.

Mr. ADLER. Yes, sir. We have incurred heavy losses in our daily trading.

Mr. PECORA. But your transactions as a specialist, undertaken for purposes of giving support to the market or creating a market, and so forth, result in profits to you from the beginning to the end of the year as a whole?

Mr. ADLER. I think our main profits are made from the beginning to the end of the year as a whole in being right or wrong on the market, not on the specialist jobbing. In other words, I am probably going to be right this year because I have got stocks.

Mr. PECORA. There is a directory of the stock exchange.

Mr. SPRAGUE (examining directory). I am checking it, Mr. Pecora. It shows seven to my count. I am just going through it again.

Mr. ADLER. May I check it?

Mr. SPRAGUE. Yes; you check it.

(Mr. Adler proceeded to check the directory.)

The CHAIRMAN. Then your business as a specialist is a perfectly safe business? You run no risks there, and the commissions are fairly good pay?

Mr. SPRAGUE. I would not say we run no risk.

Mr. ADLER. Our risks are terrific at times, not every day. It is a legitimate business man's risk. My risks in 1929 in the panic, frankly, I did not know whether I was broke or not, I admit, about 7 nights in a week. Because, as Mr. Sprague explained this morning, when I bought a block of stock for another customer, for another

house, if the other house failed and could not take it in I must, and during 1929 for those few weeks that was quite a worry, because I did have some very fine supporting orders and some very fine buying orders. Executing them from those people at \$2.50 a hundred and having to guarantee the contract, in those days, or in days like last July, when we did not know what was happening, that is a big order.

Mr. PECORA. I may say, Mr. Chairman, that we will have some evidence to present to the committee that has been culled from the returns to the questionnaires that we sent out to members of the New York Stock Exchange that will show in their own figures the outcome to the members of the exchange of their own trading.

Mr. ADLER. May I add that in our particular business we have a couple of side lines. I do not do any margin business in our firm whatsoever, but we have what we call an arbitrage department, and we do a little in the commodity markets for our own account.

Mr. PECORA. Mr. Adler, while you are here I want to ask you if you care to discuss with this committee or tell this committee your views concerning stop-loss orders?

Mr. ADLER. Stop-loss orders as far as a broker is concerned are very difficult orders to execute and to give satisfaction on. Why? A sell stop order when it is elected and becomes a market order is a sell order in a weak market. The market must be weak or the order would not be elected, as we call it. Therefore, you have a sell order in a weak market. To execute a sell order in a weak market with any degree of proficiency is a very difficult thing to do.

Mr. PECORA. What is the effect on the trend of the execution of, say, a substantial volume of stop-loss orders?

Mr. ADLER. It might develop at times, at rare times, into a serious situation. I can answer that in this way, though: At the present time there are very few stop orders. In fact, I have a list here, if you don't mind my referring to a note, because I thought you might be interested in that particular thing. In Curtiss-Wright I have orders to buy on my book, which you have in front of you, 82,000 shares. I have sell orders for 118,000 shares. And my total stop orders on the buy side are 200 shares, and my total sell stop orders are 1,100 shares. So you can see that the percentage of stop orders is not big.

In Tobacco B, in which I have bids of 6,300 shares total in the book, as against offers of 8,500 shares, I have 100 shares to buy on stop and 400 shares to sell on stop in the entire book.

I will frankly say that at times a large volume of stop orders in a stock can seriously disturb that market, but as a general rule—and I think that our ideas are to do this for general times and not for one specific day out of a hundred—the stop orders are not an important factor.

And I tell you one thing, though, that they are very difficult orders for a specialist to execute with any degree of success.

Senator WALCOTT. Suppose a broker goes to you as a specialist and you are willing, which is against the laws of the stock exchange, but you are willing to give him the picture that you have just given us now. A broker knows pretty well what to do in the way of executing orders buy or sell for the next 24 hours, because you are going to clear up that situation if you can.

Mr. ADLER. I have always been a staunch advocate of not giving out the books.

Senator WALCOTT. Exactly; but I wanted to emphasize that here, because he has given you a perfect picture as to what to do if you are going to speculate in that stock after tomorrow. For instance, if that were today's picture, you would know exactly what to do tomorrow if you got the inside secret from the specialist.

Mr. PECORA. That information is possessed by the specialist, necessarily, from the fact that he maintains a book

Senator WALCOTT. It is always possessed by him, but it should never be divulged to an outside broker.

Mr. PECORA. There is a provision in this bill to that effect.

Senator WALCOTT. I wanted to bring that out, though, because there is a perfect picture.

Mr. ADLER. Here is the book on the J. C. Penney Co. at the close of business February 26, 1934. When that stock opens on February 27, the next day, there might be a brand new picture in there. In other words, I might have all kinds of orders to buy and sell, depending possibly upon what general news had come out, or what particular news has come out on this stock.

Senator WALCOTT. Exactly; but before you had cleaned up on that picture there, if you had had the picture, say, at 2 o'clock in the afternoon, if you had divulged it to a broker, or if you were acting for him, you would know pretty well what to advise that broker.

Mr. ADLER. If you can make that a little clearer to me—I confess I am a little dense on that question. In other words, is this the point, that if there were a preponderance of buy or sell orders, and I informed somebody—

Senator WALCOTT. If, as a specialist, you knew all the orders that had come in on a certain stock during the day, it would be a very material guide as to what to do, provided you were just going in and out, making turns.

Mr. PECORA. In other words, it would inform you on the trend, and you could be guided by it in trading for your own account.

Senator WALCOTT. It is always of value to a man who is speculating to know whether there is a long or short interest in a certain stock, is it not?

Mr. ADLER. I do not think so. It does not do me any good.

Senator WALCOTT. You are the only one I have ever heard say that.

Mr. ADLER. I have seen some of the biggest short interests right in the last few years, and I confess I thought they were all wrong. I saw the market go down through these books for 3 years, and I knew very well I was all wrong, and I saw it right under my own eyes.

Senator WALCOTT. I am talking about the technical position of a specialist.

Mr. ADLER. I am even talking about technical positions with my own stock, Senator. I was not successful on the short side, in spite of seeing other people sell stock short.

Senator WALCOTT. That is a little different thing. You are avoiding my question.

Mr. ADLER. I am not trying to avoid it.

Senator WALCOTT. I do not think you are, but you are avoiding it unintentionally. The situation I am describing is that of an in-and-

out man, what we call a ticker-tape watcher. He sits there all day and watches the tape back and forth. If he had the exact position of all the stocks, either for sale or for buy, of the specialist in that stock—if he could get that picture, say, at 2 o'clock, he probably could make a turn before the clean-up that night.

Mr. ADLER. I do not think he could.

Senator WALCOTT. I think he could.

Mr. ADLER. Because I find it difficult enough to make that turn for myself, and I am naturally in a position to do it much more quickly than he is.

As I say, I am a firm advocate of not divulging the contents of the books. I think that these orders, which are given to me by clients, should be kept in my book.

Senator WALCOTT. I think that is the only concern of a Federal Government, or a State government, to see that a position is not divulged. I am not sure that it is a Federal function, either. It may be a State function. But, at any rate, that is getting into details.

Mr. ADLER. Perhaps Mr. Sprague can answer that a little better than I can.

Mr. SPRAGUE. Senator, I wonder whether you are referring to the presence of stop orders on the book or general orders?

Senator WALCOTT. I am referring to the whole picture, the buying and the selling orders and the stop orders, on both sides.

Mr. SPRAGUE. On stop orders the specialist is absolutely prohibited from initiating a transaction. As to the general picture, as I tried to explain before, I do not think the book truly reflects the situation, unless you guess at the way it goes. If you have a volume of stock on the up side, the phenomenon of the market is that it goes through all stock. You may not have any near bids. Ordinarily a man looking at it will say "there is the place to sell it, because all this stock is overhead", and yet if you sell you will find you are wrong nine times out of ten.

Mr. ADLER. Let us take this Curtiss-Wright book. They started to buy stock at $4\frac{1}{4}$ and $4\frac{3}{8}$. The bids on my book still might be $4\frac{1}{8}$. Then the stock starts to go through a half, which, as you see, in front of you, is full of stock. It looks as if there is a lot of stock there. I do not keep the buy orders to put that stock up, because the buy orders must be at the market, or the stock would not go up. In other words, the stock would not go up and through $4\frac{1}{2}$ if everybody put in orders to buy at $4\frac{1}{4}$. In order for that stock to go up, of necessity those orders must be at the market, which carries the stock through the price. I frankly confess that when I first got on the floor a number of years ago, and I did get a book of this type, and a lot of sell orders, I would absolutely be sure that stock was a sell, and I would sell it, and it would cost me a lot of money to find out I did not know anything.

Senator WALCOTT. You are talking about selling at a stated price. I am talking about buying or selling at the market. If you get that position the market does not carry through orders at the market, because they carry along with you.

Mr. SPRAGUE. I do not think the Senator was here this morning when we explained the rule in that respect.

Senator WALCOTT. You have a rule?

Mr. ADLER. There is a rule.

Mr. SPRAGUE. We cannot buy for our own account while in possession of orders to buy, before we have completed the orders.

Senator WALCOTT. I know that rule, of course. That is an old rule. But somebody else might learn from you the secret of the position which is shown on your book, and might profit by it. That is the only point I am trying to make. If you told somebody else he could profit by it. I am only trying to draw attention to the fact that you are in possession of expert knowledge with reference to a given stock in which you are a specialist, which would enable somebody else, if you divulged that position, to profit by it.

Mr. SPRAGUE. Are you talking about market orders?

Senator WALCOTT. Market orders.

Mr. SPRAGUE. I think that is not confidence at all.

Senator WALCOTT. Of course it is not. I am not accusing you of anything that is unethical. I am calling attention to the fact that you are in possession of facts which would enable an outsider, if he knew those facts, to profit by them.

Mr. SPRAGUE. If you made your book public. It has been suggested that if you made that public you would invite competition, whereas in this particular case we are not inviting competition, because that is a confidence; and if you abuse that confidence, you are subject to strict discipline.

Senator WALCOTT. I understand that. We agree, then, as to the fact.

Mr. ADLER. Senator, may I interrupt to this extent? While I say I have always been firmly against divulging the book, there is a definite rule of the stock exchange today which prohibits a specialist from divulging his book to anyone except a member of the business conduct committee upon request.

Senator WALCOTT. I know that, and yet in the course of the investigation of 2 years ago we found important specialists who were taking the directors of certain concerns in with them in partnership, in pool operations. They would always get the advantage of the insider's knowledge, and the insider—in other words, the specialist on the stock exchange—would have the advantage of the director of a corporation who knew just what orders were on the books of the corporation, so that he would know, if they were short of orders, to go short on the stock; and if they were long of orders, to bull the stock. There is a combination which you cannot beat.

Mr. SPRAGUE. That is also regulated against.

Senator WALCOTT. It is as a result of our investigation.

Mr. PECORA. Mr. Adler, when was that rule put into effect? Was that the rule promulgated on February 13 last?

Mr. ADLER. I think that is the one.

Senator WALCOTT. Both rules were following the investigation here.

Mr. ADLER. Prior to that, though, Mr. Pecora, we have discussed this thing a number of times in committee.

Mr. PECORA. Mr. Whitney testified the other day that that rule represented the result of several years of consideration, during which time he had not heard any opposition expressed to the rule.

Mr. ADLER. While it has not been in writing, it has always been in the best interests to divulge that book for any other than constructive business purposes. In fact, I said at one time "I think we should close the books", but it was said that there are a number of instances when it is for constructive business purposes, and if you close them up definitely, it might obstruct the man that really wants to invest some money. Let me illustrate what I mean by constructive business purpose. For instance, a man might come to me and say, "How can I buy 500 Liggett & Myers?" I used to tell him "There are 100 here at $74\frac{1}{2}$, 200 at $74\frac{3}{4}$, and 200 at 75." He gives that information to his customer. His customer has asked him, perhaps, how he can buy two or three different stocks, and if I offer him the stock, he picks out what he wants to buy. That is showing the book, or divulging information for constructive business purposes.

On the other hand, if a man asks you what is on the book, and you tell him, and he finds that out for somebody, or in order to mark the stock up quickly on a light volume, that would be divulging the book against the best interests of the public, or against the best interests of the exchange.

Senator WALCOTT. That was the only point of my question, to bring out that fact. You and I agree.

Mr. ADLER. You and I agree. That has always been, though, more or less the rule on the stock exchange, even if it was not in the rule book.

Senator WALCOTT. It is an ethical practice.

Senator TOWNSEND. If I give you a stop-loss order on a thousand shares of stock at 80, and the first sale is 100 at 80, or 79, what happens to the other 900? Is it a market transaction immediately?

Mr. ADLER. May I explain how a stop order becomes effective?

Senator TOWNSEND. Yes.

Mr. ADLER. You give me a thousand shares of a stock to sell at 80 on stop. That becomes a market order to sell 1,000 shares when that particular stock either sells at 80 or below. As soon as 100 shares of that particular stock is sold by someone else at 80 or $79\frac{3}{4}$, I then have 1,000 shares of stock to sell for you at the best price obtainable.

Mr. SPRAGUE. Mr. Chairman, may we present one other man for about 3 or 4 minutes? He is a commission broker in New York, and I would like to have him go on record.

The CHAIRMAN. Yes.

Mr. SPRAGUE. Mr. Weicker.

Senator WALCOTT. Mr. Chairman, I ought to go to another meeting. Are we going on with the bill, or some particular section of the bill?

Mr. PECORA. These gentlemen are discussing section 10 of the bill.

The CHAIRMAN. There is also a gentleman here from California.

Senator WALCOTT. May I read for the record at this point, because we are on section 10, a paragraph from a letter from a friend of mine who is a broker, quoting this part of section 10. [Reading:]

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

The particular point that this covers is with reference to municipal bonds. Here is the comment, which I would like to have in the record. [Reading:]

This would make it illegal for a member of the New York Stock Exchange to bid for and buy for his own account and sell and distribute State, city, town, and other municipal obligations. Has it not been true that the greater part of the debts, long time as well as short, of the Connecticut cities and towns, for example, have been handled through houses that are members of the New York Stock Exchange? And is it not true that unless exception is made in this section the market for Connecticut city and town obligations will be reduced and restricted? No matter how many investment dealers there are, still the elimination of the members of the New York Stock Exchange houses from the bidding, and as a means of distribution, would materially decrease the market for Connecticut municipal obligations and the obligations of municipalities all over the country.

That is entirely relevant to the discussion going on just now, but it does apply to section 10.

Mr. PECORA. To another provision of section 10.

Senator WALCOTT. I think it is a fair criticism.

Mr. SPRAGUE. Mr. Chairman, may I present Mr. Weicker?

Mr. ADLER. Mr. Pecora, would you like the copies of these books left here for the interest of the committee?

Mr. PECORA. All right. They may be left here. They will not be spread on the record, because it is hard to reproduce them.

(The following are two communications referred to by Mr. Adler in the course of his testimony:)

LOS ANGELES STOCK EXCHANGE,
OFFICE OF THE SECRETARY,
Los Angeles, February 26, 1934

Mr. RAYMOND SPRAGUE,
39 Broadway, New York, N Y

DEAR SIR: In connection with your analysis of the "Specialist System" in the operation of Stock Exchanges, the experience of the Los Angeles Stock Exchange may be of interest.

When we first instituted Specialists we denied them the privilege of trading for their own account in those stocks for which they acted as Specialists. Our rule was conceived under the theory that they were in the possession of certain confidential information and therefore should not be in a position to take advantage of it. From the inception of this plan studied disapproval began to manifest itself, Specialists were so restricted that their very purpose—the conduct of an orderly market—was being defeated. Finally as an experiment, not being willing to entirely surrender the theory upon which our original ruling was based, we decided to permit Specialists to trade and now, after several years operation of the "experiment" I doubt that a return to our original plan would even be considered. Our rules are such that a Specialist can never place his interests ahead of the public or a member broker and every transaction in which he participates as a principal must have the approval of the interested broker. Through our system of time stamping all orders and executions every action of a Specialist is subject to closest scrutiny down to the fraction of a minute and thus far we have found in no instance the necessity for disciplining any Specialist for any action detrimental to the public or the Exchange. We find our Specialists develop a pride in maintaining fair markets which obviously is of real advantage to the Exchange, its members and in turn the public.

Trusting this information will be of service to you, I am

Yours very truly,

W F PAUL, *Secretary*

[Radiogram]

SAN FRANCISCO, CAL., February 24, 1934.

PAUL ADLER:

*Adler Coleman and Co,
15 Broad St, New York*

When SF Stock Exchange adopted specialist system May nineteen twenty six specialists were prohibited trading their own account A complete test was given and found inadequate from market as well as public point of view Specialists were then allowed to trade their own account beginning May nineteen thirty We found this change to be to best interests of public

F. M. DWYER,
San Francisco Stock Exchange

**STATEMENT OF THEODORE WEICKER, JR., NEW YORK, N.Y.,
MEMBER OF THE NEW YORK STOCK EXCHANGE**

Mr. WEICKER. Mr. Chairman and gentlemen of the committee, the business conducted by my firm is that of acting as brokers for brokers. My partners and I devote ourselves entirely to the handling and execution of orders originated by the member firms of the exchange on a commission basis. In acting as the agents of such firms we never engage in trading for our own account—except in error—for the reasons that carrying a position in a large number of stocks would involve us in too great a risk. Secondly, that the business of executing orders in some stocks while watching a position in other stocks at the same time would be impossible, and, thirdly, if we were to do any trading for our own account in an effort to make a better market for our customer whose order had been entrusted to us for execution, we would be duplicating a function already carried out by the specialist who is always familiar with conditions in a stock at any particular time.

By far the majority of the firms for whom we do business have their own exchange-member partners and so our services merely supplement the service our customers provide. However, through having nine members of the exchange in our partnership in addition to the services of a number of associate brokers who are also members of the exchange, plus quite a complete set-up of mechanics developed over a period of years with the assistance of the exchange authorities, we are able to be of definite service to approximately 60 of the largest commission houses in the business at different times and under varying conditions.

I sincerely hope you will pardon me for having devoted so much of your time to a description of my business, but it is important that you should be clear on the point that our entire business is that of acting as the agent of a member of the public and also that the scope of our work justifies me in making certain general observations based on our experience.

We receive business primarily because we render service in two respects: First, because of our ability to obtain satisfactory executions when we are buying and selling; and, secondly, because, with the assistance of the exchange authorities, we have provided every available mechanical device we know of which will facilitate our advising our principal as promptly as possible as to the price at which he has bought or sold or at what price he is protected. Both of these factors depend very largely upon the specialist's being able to act as broker and dealer.

If the specialist were not permitted to trade for his own account, we would be unable to satisfy those whose orders were entrusted to us for execution, because of the spread that would most likely exist between the bid and asked price. For instance, if the market in a stock were 31 bid and 33 asked, and we received 100 shares to buy at the market, and we were obliged to take the stock offered at 33, which would be printed on the ticker tape, and then shortly afterward we or someone else received an order to sell 100 shares in the same stock at the market, and we were obliged to sell the stock for 31, both customers would be most dissatisfied, and to dissatisfy will eventually lead to a complete loss of confidence in the market for securities.

It is my belief that a continuous market is the basis on which confidence in the liquidity of listed securities rests and that this is the principal advantage and difference possessed by a listed as compared to an unlisted security. In addition, if the specialist were unable to trade, there would be many occasions when, due to the size of the spread between the bid and asked price our broker instead of being able to execute his order promptly would be obliged to remain in the stock with a market order and be unable to give his principal anything definite concerning the price at which his order can be executed.

It has been our experience that the more promptly an execution or some definite information can be reported to a customer from the floor of the exchange, the more confidence the customer has in the particular stock he is interested in, and it is also interesting to mention here that it is our experience that the farther away a customer is from New York City, where the exchange is located, the more desirable it becomes to expedite in every way possible all reports on transactions made for such an individual, and it is therefore our belief that by preventing the specialist from trading for his own account, our firm, which has made a specialty of handling the orders of the public, will be unable to give such service as we believe they are entitled to.

Another point that does not seem to be sufficiently understood lies in the fact that the specialist's field of activity is not a business in which he has an exclusive franchise. In fact, specialists have inadvertently invited competition in their stocks by other brokers willing to act as specialists in the same stocks due to either, first, their willingness to trade sufficiently for their own account in order to make as orderly and continuous a market as possible, or secondly, if they were unable to handle the volume of business in their stocks efficiently.

Certainly we would be obliged to take our limited orders away from any specialist who gave us inferior service in any respect, if another specialist in the same stock enabled us to do better for our customers, not matter how long our relationship with the first specialist had existed.

Speaking for my partners and myself, we believe that there is no difference between the best interests of the public whom we serve and the best interests of ourselves as brokers and, in the light of our experience that by preventing the specialist from trading in his own stocks and for his own account, irreparable damage may be done to

the market for securities in which we are all so anxious to develop the greatest amount of public confidence.

I thank you for your very kind attention to these remarks and sincerely hope they may assist you in reaching your decision with regard to the specialist's function, which my partners and I myself consider so essential to a well-run and orderly market.

The CHAIRMAN. Do I understand you are members of the New York Stock Exchange?

Mr. WEICKER. Yes, sir; nine members of the exchange in one partnership.

The CHAIRMAN. You are doing a brokerage business?

Mr. WEICKER. A brokerage business on a commission basis.

The CHAIRMAN. We are very much obliged to you.

Mr. Frederic H. Johnson, president of the San Francisco Curb Exchange, will be heard at this time. We will close the hearings with his statement.

STATEMENT OF FREDRIC H. JOHNSON, PRESIDENT OF SAN FRANCISCO CURB EXCHANGE

The CHAIRMAN. Please state your name, place of residence, and business.

Mr. JOHNSON. Fredric H. Johnson; San Francisco, Calif; president of the San Francisco Curb Exchange.

Mr. Chairman and members of the committee, I present a problem quite different from that of most exchanges. The San Francisco Curb Exchange was formed January 3, 1928, to take over the unlisted securities of the San Francisco Stock Exchange. In addition to these securities, listings were made as interest in stocks developed in San Francisco.

Stocks are admitted to trading through sponsorship of a member and not by direct application by the corporation. The Curb Exchange was formed primarily to provide a market for securities in which the public of this vicinity were interested and for which there was no organized market.

The governing board has always felt in its service to the investing public that the imposition of too drastic listing requirements, in the absence of registration or other requirements, regulating over-the-counter sales, would drive the majority of the local securities to over-the-counter dealers, whose charges are frequently excessive, in contrast to the fixed moderate commission of an organized exchange. Furthermore, in over-the-counter transactions the customer is deprived of published quotations and sales and is frequently compelled to work in the dark.

Several issues listed on major markets in the East are also admitted to trading on San Francisco curb. Only such stocks where there is a genuine public interest are admitted to trading. This trading is demanded due to the time difference between eastern markets and the Pacific coast where during daylight saving, the New York market closes at 11 o'clock San Francisco time. A business man on the Pacific coast hardly arrives at his office when the New York market is closed. The afternoon market in San Francisco, which lasts until 2:30, gives him ample time in which to consum-

mate the purchase or sales of securities without having to wait for the next business day.

That, by the way, is used at times of importance, such as announcements on the part of the president, on matters of corporate interest. Our exchange has been used by Paris, by Shanghai, by St. Louis, and by parts of the country. We feel, in extending this service, that we are rendering a continuous market to the people of the entire United States, as well as those who live on the coast.

We have felt in the past that the function of our exchange is primarily that of supervision of the method in which securities are dealt in rather than regulation of the corporations. Such regulation is the function of State or Federal agencies. The curb exchange feels that a public market is the only manner in which the public at large can be assured of a fair price for the purchase and sale of their securities.

In other words, if such regulations are passed as are provided for in this bill, it undoubtedly will cause the closing of our curb exchange and the forcing of our local securities, of corporations which do not wish to list on their own part, into the street market again. Their reasons for not listing are matters of their own importance. We obtain their yearly statements and their semi-annual statements. We scrutinize the history of a company before we admit it to listing. We endeavor to give the public a free market, rather than a restricted market, such as the over-the-counter markets naturally are, and we are making our plea for a liberalization in this bill, to maintain such benefits, rather than to have to force our stocks off a board, which can be regulated, and into an unorganized market.

The CHAIRMAN. Are there any particular sections of the bill that you object to, Mr. Johnson?

Mr. JOHNSON. We do not object to the sections of the bill, Senator. We wish to live and we wish to continue in this service, which would be impossible if we had to register ourselves, these stocks, because these corporations, for purposes of their own—some of them are very small—cannot pay a large registration fee. Some are not interested in listing at all. We are not interested in what the corporation wants. We are interested in providing a market in which stock is sold to the public. We are interested in regulating that market and providing a continuous market at all times.

The CHAIRMAN. Do you object to any supervision or regulation by the Federal Government?

Mr. JOHNSON. We realize that supervision and regulation are coming, and we will gladly conform to those principles at any time, Senator. What we do not want is to be put out of business, because we are not conforming to the listing requirements in the manner that the New York Stock Exchange does. We could not live if we had to.

We also admit to listing the stocks of corporations in the Hawaiian Islands, which have looked to San Francisco for their banking for years. These corporations have distributed their stocks to the public. They feel that they are not interested in the market in their stocks whatsoever. You will find that is quite true in the western part of the country, our situation being different to that degree. We also list the stocks of Alaskan Corporations, such as certain salmon packers and certain gold mines, and those corporations are not interested

whatsoever in the market for their stocks. We are interested to provide that market for those stockholders, and they would have none that I know of otherwise.

If there are any questions I shall be glad to try to answer them. My plea is to allow the curb exchange to exist rather than to throw from an organized floor all these stocks back on the street.

Senator TOWNSEND. What part of the bill is most objectionable to you?

Mr. JOHNSON. The part of the bill that would be detrimental to us in particular is the part, not that would license exchanges—we do not object to that—but the part that would require us to list all of our stocks. We could not list them. It seems to me that the Government can require from those corporations annual statements. We have not the speculative interest on the coast that is centered in the larger exchanges. We are not subject to pools, or we have not been. We are a new exchange.

The CHAIRMAN. Do you have any requirements now as to listing?

Mr. JOHNSON. Yes, sir; we have. An issue must be sponsored by a member, who gives the complete history of the corporation and the stock outstanding. We enter into no contract with the company whatsoever.

The CHAIRMAN. How many members have you?

Mr. JOHNSON. We have approximately 78 members. I may be slightly wrong on that. Seventeen of them are solely curb members. The others are joint members with the San Francisco Stock Exchange.

The CHAIRMAN. You are not a corporation, are you? Are you a joint-stock association?

Mr. JOHNSON. We have the same sort of charter that the San Francisco Stock Exchange has. In other words, we operate exactly as they do.

Senator, my thought is not to destroy what we have known as a curb market, and throw our stocks to the mercy of street markets, or over-the-counter markets, but in some way to preserve what we have there, which is in the public interest, most decidedly.

The CHAIRMAN. Is that all?

Mr. JOHNSON. Yes.

Early in 1933 the governing board discussed additional requirements for admitting securities and on June 8 a revised application for trading form was adopted. On October 13 supplementary requirements for mining stocks were adopted.

The volume on the San Francisco Curb from 1929 to 1933, inclusive, is as follows: 23,793,988 shares of stock, \$6,011,500 par value bonds. The same for the first 2 months of this year is: 352,203 shares of stock, \$28,000 par value of bonds, proving an established market and a necessary one in the industrial and civil life of the coast.

The CHAIRMAN. Thank you very much.

I have been handed a statement by Mr. Van S. Merle-Smith, of New York City, representing certain investment houses serving banks and insurance companies. I would like to have that inserted in the record.

(The statement of Mr. Van S. Merle-Smith is as follows:)

MEMORANDUM SUBMITTED BY VAN S MERLE-SMITH, 30 PINE STREET, NEW YORK CITY, ON BEHALF OF CERTAIN INVESTMENT HOUSES SERVING SAVINGS BANKS AND INSURANCE COMPANIES

The undersigned firms wish respectfully to outline the particular type of business in the investment field carried out by them.

These firms or their predecessors have been doing business in this field for generations—one of them over 130 years

Their clients are largely investment institutions such as savings banks, insurance companies, commercial banks, charitable and educational institutions, trustees of trusts, corporate and individual investors, who are primarily interested in the highest grade of seasoned investment securities. Most of such clients have done business continuously with the undersigned firms for many years

Our business has been threefold, security analysis, acting as brokers, and acting as dealers

This threefold business has been developed over a long period because of the requirements of our type of clients. Our customers require careful and continuous study of particular securities coupled with expert knowledge of markets and normal price ratios between securities. The larger institutions also must have means provided whereby to purchase and sell advantageously large blocks of securities.

To accomplish such purposes the undersigned firms were forced to build up their statistical and research organizations until the expense involved for this purpose amounted to a heavy proportion of overhead. The value of such service is indicated by the continuous demand for information and advice

Due to the narrow market for bonds on the exchange, large blocks cannot be purchased on the board without a material effect upon the price of the securities. Many issues of seasoned bonds are of the closed-mortgage type, which have long been held by investment institutions and accordingly change hands so infrequently that there is seldom an active market for these bonds on the floor of the exchange. Moreover, many of the high grade or seasoned investment bonds, such as State and municipal bonds and railroad equipment and other securities are not listed on any exchange at all. They must be bought and sold over the counter in both broker and dealer transactions

To meet this general situation the undersigned firms became merchandisers of securities and are accustomed to gradually accumulate from time to time blocks of desirable seasoned securities which are sold when required to the larger institutions at prices, if the securities are listed, closely approximating the prices on the exchange. These blocks are acquired partly on the board and partly directly from many institutions and individuals with which we are in touch.

Over a period of years a very considerable proportion of all the business of this nature with the larger institutions in seasoned securities has been done through the undersigned firms

Conversely, when these institutions are faced, for one reason or another, with the necessity of selling very large blocks of securities, such firms as ours supply a vital market or distribution agency. For instance, during the savings-bank runs in Philadelphia in 1932, or in New York or New Jersey in 1933 shortly before the banking holiday, millions of dollars of high-grade securities were marketed for the savings banks through our firms in order quickly to supply the cash urgently needed to meet demands. The market for such securities on the exchange had largely collapsed, but this distribution was accomplished quickly and at reasonable prices largely on a brokerage basis. This was successfully accomplished because the liquidating banks and the other institutions who were able to help were willing to rely where necessary upon the knowledge and fairness of our firms in arranging the transactions and setting prices fair to both sides in spite of the market chaos that then existed. These special incidents furnish dramatic examples of a vital service in secondary distribution which the undersigned firms have and are continuously rendering.

To collect or dispose of blocks of securities for such institutions it is vital that our firms be permitted to buy and sell, not only over the counter but also upon the exchanges and without the additional cost of employing a broker middleman

At times the exchanges offer the only outlet for securities, particularly when the dealer feels it cannot recommend purchase by one of its own clients. If, as dealers, we are forbidden, as might be construed from the act, to buy and sell upon the exchanges, the ultimate purchaser or seller must suffer because of the price spread which must be asked in order to compensate for the increased risks of delay in distribution or acquisition. If forbidden to be members of an exchange but permitted to transact business on the exchanges through other brokers, the added expense involved would probably necessitate the abandonment or severe curtailment of our research department. We believe that from a financial standpoint it is only possible for us reasonably to finance an adequate statistical research service by a combination of a broker-dealer business. The earnings of the brokerage business, or from the dealer business, in high-grade securities (which yields only a very limited turnover profit) will not, in our opinion, separately justify the expense of an adequate statistical research department.

Furthermore, both institutional and other clients from time to time desire, or we recommend, that certain transactions be carried out upon a brokerage basis, sometimes on the exchange and sometimes on the over-the-counter market. The price spread required to compensate for the risk to the dealer involved in the chaotic markets during the last few years would make dealer transactions often too costly for our clients. Smaller investors buying small blocks usually can more economically be served by transacting their business as a broker. If, as is the case with some of us, we give continuous supervision of a list of securities for a fee, all transactions for such clients must be carried out as a broker.

In addition, it is obvious that each client presents a different investment problem, whether in the type of security desirable for his list or in the maturity of the bonds which may be best suited to his needs. Obviously, such firms as ours cannot hope to keep in stock, in view of the heavy risks involved, a list of securities adequate to meet every need of our clients.

We submit the conservative investors need and should have a combination of broker-dealer investment house which is a member of a National Securities Exchange. The advisability of this triple service can easily be confirmed by those investors of capital funds best qualified to know, such as savings banks and insurance companies, as well as individual and corporate fiduciaries. It would not seem in the public interest to disrupt relationships between such houses as ours which have existed in some cases for generations, nor would it seem in the public interest to restrict a secondary market which seems vital to large investment institutions through crippling by legislation the complex and important machinery which has for so long a period served its purpose to the satisfaction of these same institutions. We feel that the legislature, desiring perhaps to correct certain abuses which may have grown up in connection with the use of the market provided by the exchanges, should consider carefully before passing legislation, the provisions of which will indirectly cripple the various services we have outlined.

In this connection we should make it clear that the broker-dealer business to which we refer is done on a cash basis.

To what extent the restrictions of the act will affect our capacity to finance our own business through the banks is not very clear. Many institutions, such as savings banks and insurance companies, have stringent rules affecting the investment of their funds which postpone the date for the acceptance of and payment for securities purchased until the necessary formal ratification of the transaction has been concluded. During the intervening period and until payment is made the securities so contracted are customarily carried by the investment house. Our firms must also carry a large inventory of securities which are necessary if we are to continue the services referred to. If the restrictions in the act relating to margins and ownership of the collateral over a period, are applicable to all borrowings to finance the carrying of securities as outlined above, it will unnecessarily curtail both our volume of business and the service we render.

We would not be in a position to bid at public sale for issues of State and municipal bonds or railroad equipment obligations. In such cases the amounts to be purchased are often large and have to be paid for upon delivery and may have to be carried in whole or in part for some time before the investment house can in turn sell them. The proposed restrictions would necessarily curtail the market for issues of municipal bonds.

We understand that the Public Works Administration is preparing to receive bids for securities held as collateral for loans made by it to certain municipalities. The normal bidders for these bonds would, to a very large extent, be investment houses like our own. If we could not finance the purchase of these securities by immediate bank loans we doubt very much if the Public Works Administration could obtain satisfactory bids.

In the case of bank loans for such purposes we see no logical need for legislative restrictions. We believe the security of such loans may safely be left to the discretion of banks or other loaning institutions, particularly when the type of collateral offered is considered.

We take pride in our business. We have spent many years in building up a clientele among institutional and individual investors. We believe that they have faith in our integrity and fair dealing, and if desired will so testify. We are convinced that restrictions that may indirectly cripple our capacity to render investment advice are not in the public interest. We believe our clients are entitled to the services we can render without curtailment. We believe they are entitled to a market for their investments which is as free and unrestricted as is possible in the public interest. To that end we believe that investment houses doing the type of business we have outlined above should be permitted and encouraged to continue a broker-dealer-advisory service.

Respectfully submitted

R L DAY & Co.
DICK & MERLE-SMITH.
R W PRESSPRICH & Co.
RUTTER & Co
SALOMON BROTHERS & HUTZLER.
WOOD, STRUTHERS & Co

SUPPLEMENTAL MEMORANDUM

This memorandum is intended as a supplement to that already submitted by the undersigned firms.

In respect of specific recommendations for amendment of the bill in question our interest lies mainly in the provisions of the first sentence of section 10, which forbids members of an exchange or any person who as broker transacts a business in securities through such member to act as a dealer.

We are informed that a suggestion has been made in the House committee that the act be amended to permit members to act as broker-dealers, provided they carry on their business upon a cash basis.

A study of this committee's memorandum describing the type of business done by the firms we represent will show that from our point of view such an amendment would be wholly satisfactory and would permit us to continue our business as presently conducted.

We have been reluctant to propose or argue for such an amendment, realizing that the question of restriction, of margin trading though not of importance in our business, involves considerations affecting other firms both large and small throughout the country now rendering valuable service in the investment field. It furthermore raises difficult questions which probe deeply into the fundamental fiscal policy of the United States, embracing as it does questions of deflation and the inadvisability of restricting a form of credit which may be of considerable importance in meeting and sustaining the capital needs of industry.

For such reasons we have been disposed to recommend that the first sentence of section 10 be stricken out because we feel that joint broker-dealer service is in the public interest, believing that the general question of margin credit should be the subject of further study.

On the other hand, it is only fair to our own interest to restate that from a personal point of view the opportunity to conduct a threefold broker-dealer-advisory service, provided it is done on a cash basis would be wholly satisfactory.

Respectfully,

R. L. DAY & Co.
DICK & MERLE-SMITH.
R. W. PRESSPRICH & Co.
RUTTER & Co
SALOMON BROTHERS & HUTZLER.
WOOD, STRUTHERS & Co.

The CHAIRMAN. We will now adjourn until 10:30 Monday morning.

(Whereupon, at 4 p.m., Friday, Mar. 2, 1934, an adjournment was taken until Monday, Mar. 5, 1934, at 10:30 a.m.)