STOCK EXCHANGE PRACTICES

TUESDAY, MARCH 6, 1934

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

The committee met at 10:30 a.m., pursuant to adjournment on yesterday, in room 301 of the Senate Office Building, Senator Duncan U. Fletcher presiding.

Present: Senators Fletcher (chairman), Goldsborough, 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; Roland L. Redmond, counsel to the New York Stock Exchange; also R. E. Desvernine, counsel to Association of Stock Exchange Firms.

The CHAIRMAN. The committee will come to order. Is Mr. Babbage present?

Mr. BABBAGE. Yes, Mr. Chairman.

The CHAIRMAN. Please come forward to the committee table.

STATEMENT OF RICHARD G. BABBAGE, NEW YORK CITY, ATTORNEY AT LAW, REPRESENTING THE REAL ESTATE BOARD OF NEW YORK

The CHAIRMAN. Mr. Babbage, please state your name, residence, and business.

Mr. BABBAGE. My name is Richard G. Babbage. My residence is 555 Park Avenue, New York City. My profession is that of lawyer, and I represent in this hearing the Real Estate Board of New York, of 12 East Forty-first Street.

The CHAIRMAN. We will be very glad to have your views about the bill under consideration, S. 2693. Just proceed in your own way.

Mr. BABBAGE. The Real Estate Board of New York is a corporation organized under the laws of the State of New York, having its place of business at 12 East Forty-first Street, New York City. Its membership of 2,348 is made up of owners of New York City real estate and of management agents and brokers. It is the representative real-estate association of the Borough of Manhattan in said city.

As a result of an investigation, we find that the stock-exchange tenants occupy at least 5,000,000 square feet of space in the city of New York. At an average price of $3 per square foot, this would produce a rental of $15,000,000. In this space there are employed

over 35,000 employees, who, it is reasonable to suppose, receive an average salary of $1,500 a year, which would make the aggregate salaries amount to $52,500,000.

Another great class interested in this real estate are those who hold the mortgage securities issued against it. It is impossible to state the number, but these securities are held by savings banks, life-insurance companies, and individuals in all walks of life.

Anything that affects the value of real estate affects these owners and holders of mortgages. A serious vacating of space at the present time might cause the rentals to be insufficient to carry the properties.

That, Mr. Chairman, is what I base my request on to appear before you, because anything that would destroy the industry in securities in New York would very gravely affect our real estate, and we owners of real estate are passing through a period of depression when a change of that kind might have a very, very serious result.

The real-estate board having given consideration to the provisions of the proposed bill is of the opinion that the act would greatly deflate the securities industry, if it would not destroy it. All the interests, therefore, represented by the real-estate board would sustain a very serious loss in connection with the devaluation of their properties.

We do not contend that the stock exchange does not need regulation but we do contend that it is unnecessary to pass a law which would be so serious in its effects that it might destroy that organization. We have the impression on reading the act that its draftsman was not so much concerned over curing the evils in the exchange alone but was seeking to bring around governmental operation of the industry and of the listed corporations, and to make it so difficult and expensive for them to carry on business that the industry would be dissipated. An act of this character should be drafted by some unprejudiced person. It is to be hoped that the act, when amended, will be the result of a competent, intelligent, and sympathetic draftsmanship and will be confined to its alleged purpose of curing the evils instead of fixing absolute governmental control upon the stock exchange and the corporations listed on it. The provisions making it difficult and dangerius to do business under the act and imposing unnecessary expense should be eliminated.

The different provisions of the act have been subject to so much discussion that I shall not attempt to take them up again with the committee. To sustain the foregoing statements, I will call attention, however, to one or two of them, which, I think, illustrate the general character of the act.

The provision in relation to proxies is so written that it would be practically impossible to hold a corporate meeting under it. The requirement for filing a statement with a list of stockholders and the later requirement that you are to send a copy of that statement to every stockholder from whom you desire a proxy, is entirely impracticable and out of line with all corporate practice. It is elementary that the purposes of the meeting are stated in the notice of meeting and that the proxies should enable persons holding them to vote for any question that can be legally brought before the meeting. It is necessary in order to obtain a quorum that some system of obtaining proxies should be adopted.

The other provisions, forbidding the disclosure of any confidential information, which is intended to prevent officers of corporations from giving to some favored few information which may affect the value of the stock, will do away with the great improvement which has taken place of late years in relation to the contact of officers of corporations with their stockholders. This contact should be encouraged and, in my opinion, the stockholder should be furnished with all information in relation to the corporation's activities that he may desire. Under this provision, however, the officers of a corporation, especially those against whom the section is aimed, will find a ready excuse for not furnishing a stockholder with information, except through public statements, while the confidential information is carried in some indirect way to the favored few. Any information that an officer may give in relation to his company is liable to have some bearing upon the value of its stock and might, therefore, be held to be confidential.

The provision in relation to registration is also extremely onerous. Why should a corporation agree to comply with the law? It has to comply with the law, if the law be constitutional. The documentary evidence which will have to be produced in connection with the registration of a corporation would incur a heavy burden especially as the officers of today would become responsible if there were any inaccuracies in the accounts of past generations. It is a very serious thing for a corporation to agree to comply with any rules that a public body may hereafter promulgate.

We, therefore, call these matters to the attention of the committee and the serious damage which may be done to the interests represented by us, and we trust that the committee in its wisdom may confine the proposed bill to remedying such evils as may exist but not to approve in its final form an act which will be so rigid and severe that the industry of our public exchanges will be crippled or destroyed.

I feel very strongly, Mr. Chairman and gentlemen of the committee, in relation to that disclosure of confidential information. I think it is extremely necessary that stockholders be given access to their corporation, to their directors and officers, in order to obtain all information they may wish to know about in regard to their company, and any law which would cause an officer to say that he could not give information because he was forbidden by law to do so, or that he feared to do so because of what he construed the law to be, would be very unfortunate indeed.

The CHAIRMAN. You say that stock exchange tenants occupy so much space, and that the rental from such tenants amounts to about 15 million dollars a year?

Mr. BABBAGE. Yes, sir.

The CHAIRMAN. What property is included in that?

Mr. BABBAGE. That means all the different office buildings in New York City.

The CHAIRMAN. Owned by the stock exchange as well?

Mr. BABBAGE. No; not owned by the stock exchange. But stock-exchange firms rent their quarters in the different office buildings?

The CHAIRMAN. You mean stock-exchange members?

Mr. BABBAGE. Yes, sir.

The CHAIRMAN. But you say stock-exchange tenants. What do you mean by that?

Mr. BABBAGE. Well, I mean persons connected with the stock exchange.

The CHAIRMAN. Those who are members of the stock exchange, and persons of that sort?

Mr. BABBAGE. I mean brokerage firms and their brokerage offices throughout the city of New York.

Senator KEAN. The New York Stock Exchange does not own any building that is rented to brokers for their offices, does it?

Mr. BABBAGE. Except their own exchange building, for their purposes. I was merely speaking to show you gentlemen that anything that would affect the stock exchange as an industry would have very grave effect on innumerable other people who have built up their lifework around it.

The CHAIRMAN. The stock-exchange building itself is owned by a realty company, as I understand it.

Mr. BABBAGE. Well, I am not familiar with that. It is probably owned by some company connected with the New York Stock Exchange.

Senator KEAN. But in that particular building there are no offices of brokers, as I understand.

Mr. BABBAGE. Well, I know that there are certain firms of brokers in the stock exchange building. There are several buildings there, whether you take the New York Stock Exchange or not, that there is an office building, a sort of annex to it at the corner. And I know there are a number of brokers there. But I am not familiar with the details. I was not so much concerned with the people who may be in the stock exchange, because that building is largely occupied by stock-exchange tenants. But if you should diminish the tenancy of those connected with the stock exchange, brokers for instance, say, by 50 percent, it would mean that a building which is now productive would then become unproductive.

The CHAIRMAN. That would depend on whether or not the New York Stock Exchange continued to do business as it has heretofore done.

Mr. BABBAGE. Yes, sir. They are all closely related.

Senator KEAN. It is also true that stock exchange firms have many branch offices all over the city.

Mr. BABBAGE. Yes; and that is included in my figures.

The CHAIRMAN. Well, I think there is no idea of abolishing the stock exchanges.

Mr. BABBAGE. Well, sometimes we can do a thing unintentionally, I mean by indirection, which we would not do directly, and it is to guard against the committee doing anything that might indirectly bring this around that I take the privilege of appearing before you.

The CHAIRMAN. And we are very glad to hear from you.

Mr. BABBAGE. I feel that we ought to speak up in these matters in case we have anything to say.

The CHAIRMAN. That is entirely right.

Mr. BABBAGE. And I thank you gentlemen.

The CHAIRMAN. Very well, if that is all.

(Thereupon, Mr. Babbage left the committee table.)

Senator GOLDSBOROUGH. Mr. Chairman, with the consent of yourself and the committee I should now like to offer a letter from Mr. Michael S. Haas, president of the Associated Mutual Savings Banks of Baltimore. And I might say that these banks are entirely mutual, and have no stock issues whatever, and have deposits aggregating approximately 20 million dollars.

The CHAIRMAN. The letter will be made a part of the record.

METROPOLITAN SAVINGS BANK,
Baltimore, March 5, 1934.

Hon. PHILLIPS LEE GOLDSBOROUGH,
United States Senate, Washington, D. C.

MY DEAR SENATOR GOLDSBOROUGH: As you are fully aware, the mutual savings banks of Baltimore enjoy a long and outstanding record of useful service to the people of Baltimore. They have afforded a means for safekeeping the savings of people of small means and at the same time furnishing an available supply of funds for investment in mortgage loans for the building of homes.

In order to adequately protect and diversify the investment of their depositors' savings, these Mutual Savings Banks for many years have also been purchasers of large amounts of high grade investment bonds. Many of these bonds are the public securities of states, counties, and municipalities, as well as large amounts of equipment trust certificates and underlying railroad and public utility obligations, which are not listed on any exchange for obvious practical reasons.

The purchase and sale of such bonds are made through recognized security dealers, many of whom in order to render better facilities to their clients are also stock-exchange members. These dealers through their knowledge of investment conditions and through their contacts with other dealers and institutions in different parts of the United States are enabled to locate and determine whether their customers are best served in the execution of such transactions on the stock exchanges or through the over-the-counter markets.

Frequently it is much more advantageous to institutions such as our mutual savings banks to deal with such security dealers when they are acting directly as principal in the transactions. Our experience is that it is decidedly to the interest of institutions such as ours, and therefore our many depositors, to be able to handle such transactions through recognized security dealers whose combined facilities enable them to render either dealer or broker service.

Naturally the mutual savings banks are not interested in fostering speculation in securities, and unquestionably practices have developed that justify correction and a regulation of these speculative activities, but it is certainly obvious that serious consideration should be given to the effects of that portion of the Rayburn-Fletcher bill which provides for segregation of the dealer-broker business and its effect on the investment transactions of the mutual savings banks, which are truly representative of the thrifty people of small means.

Very truly yours,

MICHAEL S. HAAS,
President Associated Mutual Savings Banks of Baltimore.

The CHAIRMAN. We will now hear Mr. Frank R. Hope.

STATEMENT OF FRANK R. HOPE, PRESIDENT OF THE ASSOCIATION OF STOCK EXCHANGE FIRMS, NEW YORK CITY

Mr. Hope, you want to be heard on S. 2693, I take it?

Mr. HOPE. Yes, sir.

The CHAIRMAN. You may proceed.

Mr. HOPE. Mr. Chairman and gentlemen of the Committee: I speak on behalf of the Association of Stock Exchange Firms, a voluntary association of substantially all member firms of the New York Stock Exchange. Our members are the house partners and

therefore the persons in the New York Stock Exchange business who are in constant and immediate contact with the customers and the public.

It is for this reason that we are so particularly concerned with this bill which we have analyzed particularly from the point of view of our relations as brokers acting on behalf of our customers in executing their orders on the exchange. The stock exchange, as such, is the place and instrumentality through which we operate and which is necessary for the clearance of our transactions and, therefore, we are fundamentally concerned with any regulations of stock exchanges to the extent that they may limit or interfere with our ability to render efficient service to our customers.

In order to save your committee's time, and as requested by your chairman, I will not again discuss matters already fully presented to you but desire leave to file with the committee the analysis which our association has made of the entire bill as introduced. Furthermore, representatives of the various phases of the stock exchange business have appeared or will separately appear to present the peculiar problems incidental to the particular phase of the business in which they are engaged and, therefore, I will not specifically discuss their separate problems.

Mr. Whitney made a proposal to the House Committee on Interstate Commerce, on behalf of the New York Stock Exchange, suggesting the creation of a stock exchange coordinating authority; and, on behalf of the Association of Stock Exchange Firms, I endorsed that proposal. Mr. Whitney's proposal conceded the principle of governmental regulation. The regulatory body which he suggested seems to us a sound, workable, and efficacious body which could as a practical matter exercise efficient and effective supervision over the stock exchanges, especially because it provides for coordination with the other branches of the Government having jurisdiction over finance and credit. The very nature of the brokerage business makes such coordination essential. The entire credit and financial structure of the country is fundamentally involved and affected. Without presuming to urge upon Congress the selection or creation of any particular body, as the regulating body, we must clearly point out that whatever regulatory body might be selected it should, as a matter of its basic structure, be equipped with a personnel experienced in matters of credit and finance.

Although some form of regulation of stock exchanges might be deemed in the public interest, we must particularly point out that no such form of regulation can be considered except one which will permit the efficient functioning of the stock exchanges and the brokerage business as a means of supplying a broad market place where the public can freely deal in securities. We wish to express our desire to cooperate in any effort to develop a form of regulation which will correct alleged abuses which have arisen in stock exchange business without so restricting that business that much of its usefulness as a means for facilitating legitimate business in securities will be lost. With that in mind, the analysis of the bill which we have submitted must be considered, for, although the bill is entitled and is intended primarily to regulate the stock exchange business, it would seem not to be limited to that matter but to have three fundamental parts of almost equal importance. They are:

1. To regulate certain stock-exchange practices.
2. To restrict and control the granting of credit on investments.
3. To control many of the practices of the corporations themselves, their officers, directors, and stockholders.

Any bill, such as the one before you, which embodies fundamental provisions respecting these three phases of business goes far beyond the express purpose of stock-exchange regulation; and in fact becomes by its far-reaching provisions, a vehicle for the regimentation of credit and corporate practices. The effects of the bill are so fundamental upon existing financial and corporate practices and so drastic and far-reaching that every consideration must be given to its content and possible consequences.

The direct supervisory control given to the Federal Trade Commission by the bill should be carefully considered in connection with the so-called "Roper report." In that report it was contemplated that the governmental agency exercising supervision over security exchanges would primarily have power to interfere with an exchange only in the event of certain improper conditions arising in respect to the operation of the exchange and the conduct of its members or because of an exchange's failure to adequately prescribe and effectively carry out the principles established by law. Until such conditions arose, the operation, control, and management of the exchange and the responsibility therefor would be primarily that of the exchanges themselves and their officials. The bill, however, would subject the exchanges to such rigid and minute direction in its management and affairs that the discretionary control and immediate responsibility which would remain in the exchanges under the Roper report would be lost. The governmental regulatory body, as well as an exchange itself, must have elasticity and discretion, even if somewhat restricted, so as to practicably meet situations as they arise. This is a serious consideration when the nature of the functions of exchanges and the requirements for prompt action is considered.

The bill has many desirable purposes. To the extent that it establishes uniform practices corrective of alleged abuses and elevates the trading standards of all exchanges and all members of exchanges to the highest practicable level, requires full disclosure to the public of all material facts necessary to a reasoned judgment as to value and outlaws manipulative practices against the public interest, it must be sponsored. But, as pointed out in our brief and as here discussed, it unnecessarily and dangerously exceeds these necessary objectives and for all practical purposes attempts to regiment credit and business generally and in many respects is impracticable and unworkable. The desired objects can be attained without unintentionally destroying a useful and necessary business if a full consideration of the technique and operations of the business is relied upon.

The Association of Stock Exchange Firms, a voluntary association of substantially all the members and member firms of the New York Stock Exchange, respectfully submit to the Committee on Banking and Currency of the Senate the following memorandum which is an analysis of the proposed "National Securities Exchange Act of 1934", as set forth in Senate Bill No. 2693.

This memorandum is only intended as a brief analysis and explanation of the possible effect of the bill entitled "National Securities Exchange Act of 1934." It does not challenge the advisability of regulation nor is it to be understood as an attack on the bill as such. The bill is, however, so fundamental in its effect upon existing financial and corporate practices and so drastic and far-reaching that full consideration must be given to its contents and possible consequences. To help make these clear is the sole purpose of this memorandum and it must be so interpreted.

The two bills presented in Senate and House are identical and are designated as bills to provide for the registration of national securities exchanges operating in interstate and foreign commerce and through the mails and are to prevent inequitable and unfair practices on such exchanges and for other purposes. The references to sections will therefore refer to each bill.

Section 1 is entitled "Short title" and merely gives the name of the bill as the "National Securities Exchange Act of 1934."

Section 2 is entitled "Regulation of Exchanges Using the Channels of Interstate Commerce and the Mails Necessary in the Public Interest."

This section attempts to set forth conditions purporting to sanction and justify regulation of stock exchanges primarily under the power of Congress to enact regulations for interstate and foreign commerce and through the use of the mails. It is more in the nature of an argument than a statutory enactment. The conditions recited primarily tend to describe a national interest; but they are fundamentally different from those that have heretofore been relied upon to describe an interstate commerce transaction. In other words, national interest and interstate commerce are not synonymous; and the fact that the matters regulated affect the public as a whole is itself not sufficient to justify regulation of such matters as interstate commerce. For a discussion of the organization, functions, and place of stock exchanges in the financial structure and their relation to and effect upon interstate commerce and all related legal problems we refer to the study entitled "The Extent of Federal Power to Regulate Stock Exchanges and Stock Exchange Firms" and the supplement thereto prepared by Mr. Raoul E. Desvernine, counsel for the Association of Stock Exchange Firms.

The bill, however, exceeds its express purposes of exchange regulation and investor protection and in fact becomes by its far-reaching provisions a vehicle for the regimentation of credit and corporate practices through the medium of stock-exchange regulation. To illustrate, it vests in the Federal Trade Commission the power to control collateral loans and interest rates; to prescribe the forms of reports, balance sheets and earning statements and methods of accounting in the appraisal or valuation of assets and liabilities, and in determining depreciation, and so forth, to be employed by corporations whose securities are registered on any exchange; it dictates the conduct of officers, directors, and stockholders of corporations; it requires annual and quarterly reports, balance sheets and profit-and-loss statements (certified by independent public accountants), as well as monthly reports and statements of sales or gross income of all corporations whose securities are registered on

any exchange; and gives absolute regulatory power over all securities, registered or unregistered. The Federal Trade Commission is given an indirect but potentially effective directional control over the investment of all capital.

Section 3 is entitled "Definitions."

The definitions do not need specific consideration here but must be considered from time to time in relation to the provisions to which they apply.

The definition of "interstate commerce" should, however, be specially considered. The proponents of the bill attempt to justify its constitutionality primarily as an exercise of the power of Congress over matters of interstate commerce. Therefore the constitutionality of the bill depends largely on whether the matter regulated actually is interstate commerce. This is a question for the courts to decide; and Congress cannot by its own fiat or by merely extending the meaning and scope of its delegated authority beyond interpretation judicially arrived at endow itself with jurisdiction or power not conferred by the Constitution. Therefore, the validity of the definition will depend on such constitutional limitations.

The only securities which are exempted from the bill (subsection (10) of this section), are "direct obligations guaranteed as to principal or interest by the United States." It is not clear from this language if it is intended to only include guaranteed obligations and to exclude direct obligations. Furthermore, State, municipal, and bonds of quasi-governmental bodies, such as port authorities, and so forth, are not exempted, which will result in an impairment of the value of these obligations and will result in the forced sale of many of such securities now held as collateral.

Section 4 is entitled "Prohibition of the Use of Channels of Interstate Commerce and the Mails to Unregistered Exchanges."

Unless the exchanges are actually instrumentalities of interstate commerce and subject to direct regulation under the commerce clause, Congress probably has no power to require compliance with detailed regulations as a condition of the right to use the instrumentalities of interstate commerce or the mails. It is a well-established principle that Congress cannot regulate matters outside its jurisdiction merely by passing a statute which in form is a type of statute within the power of Congress.

The mere fact that one or more isolated transactions of an exchange might require the utilization of an instrumentality of interstate commerce does not ipso facto, and cannot ipsa jure, make the entire exchange and all its facilities and all its transactions subjects of interstate commerce. To attempt to thus reach out and even embrace "any person, directly or indirectly", is to completely destroy all and every intrastate act or transaction. If a New York corporation having all its business in the State of New York should utilize the mails in writing a letter to Chicago, the use of this single instrumentality of interstate commerce does not make it generally and all its intrastate business and transactions subject to interstate commerce regulation.

Section 5 is entitled "Registration of National Securities Exchanges."

Apart from the questions of legality the following considerations respecting the practical operations of the proposed requirements for registration should be considered.

The most outstanding characteristic of the proposed form of regulation is that the Federal Trade Commission is to be granted detailed and complete supervisory power over all the transactions on the exchanges and that as a condition of registration, an exchange must agree to abide by any future rule or regulation made by the commission. In this connection it should be pointed out that the Roper report contemplated that the governmental agency exercising supervision over security exchanges would primarily have power to interfere with the exchange only in the event of certain improper conditions arising in respect to the operation of the exchange and the conduct of its members. Until such conditions arose the operation, control, and management of the exchange, and the responsibility therefor would be primarily that of the exchange itself and its officials and governors. The present proposal gives the Federal Trade Commission power from time to time to change all rules and requirements, including the power to prescribe regulations for the election of officers and committees of the exchanges; for the suspension or disciplining of members, and so forth, thus substituting itself to the fullest extent in the place of the private management of the several exchanges.

This is a real problem because it renders the present exchanges absolutely impotent to effectively and efficiently act; it deprives them of all self-government and implies the principle that the Government will in fact run, not alone supervise, the exchanges.

Most careful consideration should be given as to what body should be given such powers and to the special and expert knowledge and technical skill of the personnel. The Roper report signalized the importance of this.

Control of the Federal Trade Commission would tend to centralize the financing and management of all security investment in the Federal Trade Commission without reference to the other governmental departments and agencies having similar and concurrent jurisdiction. Confusion and conflict in policy and regulation would result. It would seem that some means of coordination with the Treasury Department and the Federal Reserve System would be indispensable. The broad powers over the entire credit and financial system of the country given, directly and indirectly, by the provisions of this bill must be self-evident.

Subdivision 4 (d) of this section should be considered, for it appears to require the expulsion of a member of an exchange for any infraction of the rules. No discretion is apparently granted to the exchange or to the Commission, and there are no provisions for reinstatement or other adjustments of penalty or variation taking into consideration the relative gravity of the offense. This is particularly arbitrary in view of the fact that violations of the rules may occur through mistakes without any wrongful intent or any gross negligence on the part of the member. It is difficult to conceive of why a person should invest substantial amounts in a business from which he may be arbitrarily expelled permanently and without recourse or the right of reinstatement.

Also subdivision 4 (f) prevents an exchange withdrawing its registration except on rules that the Commission may from time to time provide. This means that if any group wishes to organize an exchange they must in advance sign an agreement to abide by any changes in the rules for the conduct of that business that the Commission may at any time in its own discretion establish and that they cannot withdraw from the business except on the permission of the Commission.

Section 6 is entitled "Margin requirements on long accounts." Subdivision (a) of this section makes it unlawful for any person who transacts a business in securities through the medium of a member of an exchange to extend credit on securities unless the securities are registered on an exchange. Banks throughout the country, particularly outside the city of New York, extend the service to their depositors of forwarding orders for the purchase and sale of securities and to that extent engage in the business of securities through the medium of a member of an exchange. This section would, therefore, prohibit any such bank from making any loans on unregistered securities. The effect of this on the banking business, the extension of credit, and the people as a whole is tremendous for they would either lose the facilities of the banks in getting credit on unregistered securities, which include the shares of stock and bonds of thousands of small corporations (unless, of course, all such securities were registered), or it would make it necessary for persons living outside the great metropolitan centers to establish direct connections with those centers in order to invest their funds. The difficulties caused by this subdivision on all parts of the country, outside of New York cannot be overestimated.

The effect of this section is also extremely deflationary. To the extent that it increases the margin requirements or makes any of the pledged securities illegal collateral it requires calling of the loans. This will be caused even in cases where the borrower is in good financial condition, because it prevents the putting up of any securities other than registered securities and a person with large holdings of State and municiapal obligations, bank stock, insurance stock, or stock of small corporations which are not registered cannot use them as collateral even though they would be entirely satisfactory to the lender. A person only having unregistered securities available, no matter how valuable they may be, could not protect his equity by using them as collateral and would be compelled to a forced liquidation, thereby sacrificing his entire equity.

Conversely, a broker cannot accept unregistered securities to augment a customer's collateral and in a rapid price decline might thereby be obliged to suffer a loss by a forced sale without the possibility that now exists of protecting his loan by receipt of any collateral. This might even cause the broker's insolvency.

The effect of making unregistered securities ineligible as collateral would greatly reduce the market value of such securities. To outlaw by one stroke the legality of State and municipal obligations and bank shares, insurance shares, equipment trust certificates, and other presently unlisted securities as collateral for exchange firms and also as above pointed out for many banks, can only tend to make such securities less desirable and attractive for investment purposes

and will impair the credit value of all such unregistered securities. To that extent securities worth billions of dollars will be frozen as a basis for credit in the country at a time when credit is most needed.

In considering the effect of these provisions the assumption cannot be made that the securities presently listed on exchanges will be registered under the act and thus made eligible for collateral. The restrictions placed by these bills upon corporations which register their securities and the officers, directors, and principal stockholders of such corporations may result in many listed securities not being registered.

This discrimination against unlisted securities will operate unfairly against hundreds of thousands of small corporations which are locally owned throughout the United States. It should be particularly noted that, insofar as this section is concerned, brokers may arrange for, and actually extend, loans to customers secured by real property, chattels, and commodities—the only restriction being that, if the loan is secured by securities, the securities must be registered. This distinction seems wholly arbitrary.

The same subdivision (a) also prevents a member of an exchange from arranging for any credit for a customer except on registered securities. This restriction is not confined only to the usual transactions between the broker and customer, but would prohibit a member from assisting a person who happens to be a customer in obtaining any loan whatsoever from any third party unless the securities given as collateral are registered securities.

The effect of these requirements for collateral will undoubtedly render ineligible much of the collateral now pledged throughout the country. This will necessitate calling of loans as above pointed out and to the extent that the collateral, although adequate under normal conditions, cannot be liquidated under these forced conditions, losses will result to banks throughout the country. Collateral maintained for loans throughout the country has not been maintained on a level which will permit a forced liquidation by nationwide governmental action, without causing such a drop in the market value of the securities to be liquidated that the realizable value of such securities will probably be reduced below the amount of the loans.

Subdivision (b) of this section prohibits brokers lending an amount exceeding 80 percent of the lowest price at which a security has been sold in the preceding 3 years, or 40 percent of the current market price, whichever is higher. This provision seems clearly unsound, for depending on the course of the market it would require brokers to obtain margins varying between 25 percent (which is less than the minimum margin now required by the New York Stock Exchange) and 150 percent of the debit balance. The latter figure is clearly excessive. It would create a volume of cumulative selling by those unable or unwilling to bring their margins up to the new requirements. Every decline in price would precipitate further liquidation. It would force liquidation of a large amount of credit outstanding today in banks against security collateral. In round figures, brokers' loans are $1,000,000,000 and bank loans to customers against security collateral about $3,500,000,000. It is certain that the margin of all these loans is substantially less than 150 percent of the amount due—particularly when unlisted securities are elim-

inated from consideration. The effect of fixing such margin requirements will obviously require additional margin or will cause terrific deflation of such loans. As unregistered securities cannot be accepted, this seriously reduces the available supply of additional collateral to comply with such demands, and the effect of these requirements would, therefore, undoubtedly start a Nation-wide deflationary movement. The fact that such liquidation need not be completed for 7 months does not change the fundamental effect of the margin requirements. Liquidation on such widespread scale to be completed by the specified time would have to be started long before its completion was required.

Inflexible margin requirements throughout the country would also add to the serious effect of this provision, because a drop in the market prices of a registered security might make it ineligible for loans throughout the country unless additional collateral was put up. Certainly a general market drop would, because of the rigidity of the margin requirements, cause liquidation throughout the country and would probably cause cumulative selling, resulting in stock-market panics each time there was a comparatively slight general reaction.

It is true that the Commission is given right to change margin requirements above the requirements specified in the statute. The amounts specified are such as may cause serious difficulty under the present conditions; but even assuming subsequent adjustment to those conditions and the development of requirements more drastic even than those, it is difficult to conceive of how the Commission would have sufficient time to change rules so as to establish the flexibility, and elasticity needed to meet constantly and suddenly changing conditions.

A further error in these mandatory margin provisions lies in the fact that they do not discriminate between high-grade investment securities and highly speculative issues which fluctuate greatly and are of less certain value as security. In the last analysis the determination of what constitutes a sound margin involves questions of opinion as to the evaluation of actual and potential values and therefore requires the exercise of experienced and trained judgment in the appraisal of conditions which change from day to day. No fixed legislative formula can be used as a substitute for such a judgment and appraisal.

The power granted to the Commission by this section to adjust loan values, gives the Commission power to expand and contract credit. It can, by increasing margin requirements, immediately cause the liquidation of loans throughout the country. (It cannot reduce requirements because the statutory limitations although exceeding the present requirements are specified as minimum.) All margin accounts could be automatically forced to liquidate. Furthermore, arbitrary distinctions could be made between different classes of securities. This, of course, may not have been contemplated, but to give to any governmental agency such complete arbitrary control over the credit structure of the country is such a drastic step that it should be considered with the utmost care, and adopted only if it is absolutely certain that there is little chance that the power can be mistakenly used.

Subdivision (c) attempts to prevent all banks or other persons from extending credit on listed securities and purchased by the borrower within thirty days of the date of the loan, except on terms identical with those which must be required by brokers. This unquestionably and in addition to the conditions above pointed out, extends the unsound margin provisions of the bill to our entire banking system, and emphasizes the deflationary influences which will probably be put in motion by the bill.

Subdivision (d) gives the Commission right to establish rules as to the notice and method of closing accounts. This means that the Commission, in an endeavor to protect the borrowing public might require such length of notice and procedure for foreclosing loans as would make the security of little value. In other words, marketable securities have been taken as collateral in many cases because the lender is able to realize on his collateral promptly, and thus avoid loss. If some third party can dictate the terms on which the lender can exercise such right, the certainty of the realizable value of such collateral is diminished, and the attractiveness and safety in attempting such collateral for loans will be impaired. The further fact that these rules can be established after the loan has been made greatly increases the uncertainty and introduces another deflationary element, because it removes a large part of the collateral now relied upon for a tremendous volume of credit.

Section 7 is entitled "Restrictions on members' borrowing."

Subdivision (a) of this section would have a most far-reaching effect which was probably not intended. It prohibits a member from borrowing on any registered security from any person other than a member of the Federal Reserve System.

This would prevent loans from special or general partners, and many other forms of special or emergency borrowings from others where even registered collateral is to be given as security. In emergencies, frequently hurried loans are imperative and can only be obtained from individuals thoroughly familiar with all the circumstances of the existing, and in many cases local and peculiar, conditions of the credit situation, and without having the time to clear a banking transaction. This may have serious effect by eliminating important sources of help at times when they are most needed, and may thus precipitate additional deflationary forces when they are most dangerous. The bill prevents a firm requiring such emergency loans from securing them with sound collateral, registered or unregistered, which it might have available from any source as can be done at present. To so unqualifiedly confine borrowing to the Federal Reserve System may therefore deprive members from emergency relief with serious consequent dangers to everyone.

This provision also prevents many normal and customary personal loans and the utilization of private credit. Any such step results in the collectivization of all financial relationships between individuals into a Government-controlled banking system and restricts some of the private uses of private capital and therefore should be most carefully considered.

These borrowing restrictions may also cause the closing of many branch brokerage offices and thereby the forcing of local business into the large metropolitan centers.

Subdivision (b) limits the aggregate indebtedness of members to a percentage, based on the "net current assets" employed in their business. Considering the fact that "net current assets" are not defined, it is a grave question as to whether that method is the sound basis for determining the credit responsibility and risk of any such member. The commission could from time to time by classifying assets as current or otherwise thus cause the liquidation and insolvency of firms whose practices it did not like.

Section 8 is entitled "Prohibition Against Manipulation of Security Prices."

This section is directed primarily against "wash sales", fictitious transactions, and pools, which are in many respects already prohibited by the rules of the New York Stock Exchange and the laws of several States. However, some of its subdivisions would appear to go very much further and to cause much greater damage than any possible benefit that could accrue.

Subdivision 4 makes it unlawful for any broker to give information that the price of a security is likely to rise or fall partly because of the market activity of certain individuals if he believes that the person may purchase securities on the basis of such information. Widespread circulation of such information might have some harmful effects, but it is not seen what purpose is gained by prohibiting a broker from giving such information personally to his customers. To forbid a broker to so advise his customer might be depriving the customer of information useful to him in the protection of his interests.

Subdivision 5 makes it unlawful to give information which in the light of circumstances is misleading, if the broker giving such information has reason to believe that the person to whom it is given will rely upon it in the purchase of securities. The broker is granted the defense that he acted in good faith, but to put the burden on him to justify every statement and to give every customer the right to put his broker to the proof of every statement made, can only result in the refusal of cautious brokers to give any information whatsoever. Certainly this cannot be in the public interest.

The liabilities imposed are severe and would undoubtedly be used by unscrupulous purchasers, when they made an unfortunate purchase, as a means of forcing some settlement or contribution from the broker. They would have nothing to lose and everything to gain. They could engage in speculative purchases and could keep the benefits if the purchases turned out successful. If they were unsuccessful they would try to recover from their broker because of something they claimed that they had heard him say, and if they could not recover, possibly force a settlement because of the drastic penalty provisions.

There is moreover nothing in this section which limits the type of information to which this subdivision refers to being matter specially within the knowledge of the broker. The liability might be based on misinformation which was being generally circulated and to which the customer had just as good source of information as the broker himself. Nor is there any requirement that the mistaken information have any relation to the purchase of the security or its market value.

This liability of the broker would probably drive much of the business from responsible houses to unreliable brokers willing to gamble on such liability and to give any advice to their customers on the chance that they could evade liability.

The measure of damages exacted by this section between the price paid and the last price for which such securities shall have sold during the 90 days preceding and the 90 days following such purchase seems entirely arbitrary. There is no reason why such penalty as that should be exacted. The price of the stock 90 days preceding a transaction has no relationship to the transaction whatsoever, and the price 90 days following is entirely too long. It gives an added opportunity to an unscrupulous person to play against the broker for 90 days without assuming any risk whatever himself. This is particularly true when the customer can wait for 2 years without bringing any action and still bring suit for damages against his broker.

The restrictions of this section against the giving of advice and the heavy liability provisions hereinbefore discussed also will render practically obsolete the business of investment counsel and may tend to eliminate the possibility of people desiring to invest getting any practical advice from those more experienced. The result may thus be to put a greater difficulty in the way of the small investor in his efforts to make a real investment which will not exist in regard to the wealthy investor who may have statisticians and assistants in his service to make his personal surveys.

Subdivision 7 requires reports as to pegging being given to the Commission as well as to the exchange authorities. This adds to the complications and details of the operation of a delicate mechanism such as the stock exchange and the credit structure of the country. With the other provisions for supervision and control, many of the provisions for detailed information and reports should be sufficient if the information and reports were filed with the exchange authorities and not both with the exchange and in Washington.

Subdivision (9) forbids any person to effect by use of the facility of any exchange any transaction whereby a put, call, straddle, or other optional privilege is acquired.

Subdivision 9 (i) will result in the absolute elimination of any transactions with warrants, and subdivision 9 (iii) will likewise make impossible any transactions in convertible bonds.

Section 9 is entitled "Regulation of the Use of Manipulative Devices."

This section gives the Federal Trade Commission blanket control over short selling, stop-loss orders, and the right to establish rules for the use of "any device or contrivance" in connection with the purchase or sale of any security. The danger of putting in the hands of anybody not in intimate and immediate contact with minute-to-minute developments the power to change rules affecting matters having such direct effect on the entire stock market situation as short selling is extremely dangerous and may lead to results entirely different from what is contemplated. The elimination of stop-loss orders is undoubtedly against the public interest. The last subdivision of this section giving them control over devices and contrivances might be construed to mean almost anything.

Section 10 is entitled "Segregation and Limitation of the Functions of Broker, Specialist, and Dealer."

This section forbids a broker from also being a dealer or an underwriter. It completely divorces the commission business and the investment banking business of the issuance, underwriting, and original distribution of securities, and would, therefore, be extremely harmful outside of New York City where, because of the small volume of business, a dealer in securities must, of necessity, act as both broker and dealer. There are few, even in the large metropolitan centers, and none outside, who could possibly live on only one of these branches of business alone and who could command enough business to justify their keeping in operation as only a broker or a dealer.

One of the most striking effects of this section is that it absolutely prohibits the existence of the odd-lot house, which is the only efficient means that modern exchange facilities have developed whereby the small investor may purchase shares of stock in lots of less than the minimum unit of trading without paying exorbitant premiums. Furthermore, it might well increase the cost to a small investor tenfold above the present level if the basic unit of trading were eliminated. Small units of trading would not fairly reflect the true market. The reporting of quotations on such a multitude of small trades in different numbers of shares and the clearance thereof would impair and retard the entire mechanical efficiency of the exchange. Moreover, if the purchaser of small lots is restricted by the elimination of the odd-lot dealer, the small investor's market is put out of existence and he is required to be a speculator in a larger number of shares. Why the useful service of odd-lot houses should be prohibited is not understandable. It is possible that it was not realized that the odd-lot houses conduct their transactions as dealers and not as brokers. However, the fact remains that they are members of the exchanges and deal as members in their negotiations with other members and purchase and sell odd-lots from such other members. They do not receive commissions. Section 18 (c) indicates that the continuance of the odd-lot house is contemplated, therefore the wording of this section is either a mistake or put in through a misunderstanding of the nature of the odd-lot business.

This section will also absolutely prohibit floor trading. This phase of the stock-exchange business accounts for a considerable volume of transactions and thereby promotes marketability of securities and liquidity of credit. Before it is summarily dismissed the possible effect of such action, particularly under present conditions, should be carefully considered.

This section also gives the Commission blanket control over specialists and absolutely prohibits a specialist from executing a market order. The effect of such latter prohibition might result much more to the hardship of the investor than to the specialist or to the speculator. The extremely important and necessary position that the specialist plays in the market cannot be too carefully considered The effect on the operation of the market as a whole through drastic action along these lines will be great for, even though there may be, in extremely isolated cases, abuses in connection with the opera-

tion of specialists, they are important in maintaining the present market liquidity and stability.

There is also the possibility that this section prevents a stock-exchange member from investing in securities for his personal account. In other words, a stock-exchange member could only buy and sell shares on commission for others. This may not be intended but is a possible interpretation of the restriction of members acting as dealers in securities. In view of the serious liabilities imposed for violation of the bill, it is doubtful if an exchange member would be willing to take a chance on his possible right to invest in securities for his account and thus to the extent that the commission business does not provide adequate income may force stock-exchange members to withdraw from the brokerage business in order to be able to invest their personal capital in income-producing securities.

Section 11 is entitled "Registration Requirements for Securities."

There is nothing to indicate whether these requirements apply only to securities to be registered in the future or whether a relisting of all presently listed securities is required. The possible effect of this must be fully considered. The enormous expense entailed in relisting all these securities and collecting and furnishing data would be tremendous. In fact, one corporation recently, in order to qualify a single bond issue for $15,000,000 under the Securities Act of 1933 before the Federal Trade Commission, reports that it was required to spend approximately $250,000 therefor. It is not inconceivable that the Federal Trade Commission would require somewhat similar data for registration on exchanges, and one should consider the expense of these requirements if every outstanding security presently listed on an exchange must go through somewhat similar procedure.

Furthermore, some of the issues may be denied registration under the new requirements and under the provisions of the bill practically at the discretion of the Commission. This might have serious effect on the credit situation of the country, the credit of corporations whose securities are presently listed, and the value of such securities in the hands of the public.

This section also requires that the registration information must be filed with the Federal Trade Commission, in addition to being filed with the stock exchange. Furthermore, the information must be filed at least 30 days before the registration becomes effective. If the bill goes into effect on October 1, 1934, the mass of information required from all the corporations having presently listed securities must be filed by September 1, 1934. It would be difficult, if not impossible, to compile adequate information even if the rules as to what would be required were immediately issued. How any single commission could digest all that information in 30 days and decide what securities were to be registered and what not is a practical problem to be considered in the drafting of the legislation.

A restriction in this section affecting the corporations themselves is that they must file an undertaking to abide by all future rules and regulations of the Federal Trade Commission and agree not to lend funds in any money market or to any person who transacts business in securities except in accordance with the regulations of the Federal Trade Commission. By this and some of the following provisions this bill ceases to be a regulation of stock exchanges and becomes in effect a bill completely subjugating every business to the

absolute discretion of the Federal Trade Commission over most of, if not all, the important phases of its operation.

Furthermore, when a corporation has once qualified for registration and agreed to abide by the rules of the Commission it is bound to do so forever and cannot withdraw from registration except "upon such terms as the Commission may fix."

A corporation registering its securities is also required to furnish in addition to data as to its organization, financial structure, etc., particulars regarding material contracts of its directors and officers and principal security holders and also those regarding remuneration to others than directors or officers exceeding $20,000 per annum, and particulars respecting bonus and profit-sharing arrangements and management and survey contracts. Furthermore, financial statements are required not only for current years but also for preceding years and must be certified by independent public accountants. As is generally provided throughout the bill, the Federal Trade Commission is entitled to demand such other information and take such other steps as it deems advisable.

Section 12 is entitled "Annual Quarterly and Monthly Reports" and requires the filing with the exchange and with the Commission of such information and documents as the Commission may require. The blanket nature of the information and the frequency with which it can be required is left entirely with the Commission. The full effect of this section is made more evident when it is considered in connection with section 18 (a) and (b), which specifically authorize the Commission to prescribe the methods to be followed in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion and various other phases which seriously affect the management policy of a corporation.

Section 13 is entitled "Proxies" and prevents the solicitation of any proxy in respect of registered securities unless prior to the solicitation the person to exercise the proxy shall file with the Federal Trade Commission a statement setting forth the purposes of the proxy, the person to exercise it, his relations to and interest in the security and the names and addresses of persons from whom proxies are being required. Literally construed this would require every corporation sending proxies to its own stockholders to send each of them a list of the names and addresses of all stockholders. The provision is also contained that such further information can be required in such form and detail as the Federal Trade Commission may require.

Section 14 is entitled "Over-Counter Markets."

This section attempts to make it unlawful for any person to use the mails or any instrumentality of communication or transportation for the purpose of making or creating or enabling another to make a market for any security without complying with the rules of the Federal Trade Commission. The extent of the control given the Federal Trade Commission under this section is difficult to visualize. Many informal arrangements which are used in small communities for the exchange or sale of real-estate mortgages and other local securities would thus all be brought under the direct and blanket control of the Federal Trade Commission. Whether the restrictions of this section will add another element in the deflation of registered securities and the encouragement of bootleg trans-

actions by removing all legal right to conduct informal places for the exchange of securities is an important practical problem to consider. Its effect on unregistered securities in the large cities will undoubtedly be great, but its effect on the smaller cities will probably be even greater.

Section 15 is entitled "Transactions by directors, officers, and principal stockholders."

This section may have a place in a national corporation act, but it has no place in a bill purporting to regulate security exchanges. It restricts transactions by officers, directors, and also any stockholders who hold more than 5 percent of the class of stock of which they are stockholders; and requires all such persons to file monthly reports of changes in their holdings of the stock of the corporation, whether such holdings be of record or be beneficial. This would bring under the restriction of this section a broker in whose name there was registered more than 5 percent of a corporation's stock who might not own or have a beneficial interest in a single share. It also makes it unlawful for any such person to purchase any registered security of his corporation with the intention or expectation of selling the security within 6 months; and any profit which he makes, if he should sell the security within that period, must be paid over to the corporation. It also prevents any such person from selling short any securities of the corporation. It also makes it unlawful for any such person to disclose any confidential information affecting a registered security of the corporation, and not necessary to be disclosed as a part of his corporate duties. Any profit made within 6 months in respect to such security by any person to whom such information shall have been disclosed shall be paid by such person to the corporation.

The effect of these restrictions cannot be fully visualized but they have definite possibilities of seriously limiting the registering of securities by corporations. The credit value of the holdings of many stockholders may be seriously diminished through the restrictions on unregistered securities, because of these and other burdens thrown on the corporations and the officers and directors. If the burdens are as great as seem possible many corporations may not register their securities, for the benefit which the corporation receives from such listing may be small compared to the burden placed upon the corporation to maintain such registration.

Section 16 is entitled "Accounts and Records, Reports, Examinations of Exchanges, Members and Others."

This section gives blanket power to the Federal Trade Commission to examine all records of every exchange and the members thereof, and to send persons to make such examinations, all at the expense of the person being examined. This again gives power to the Federal Trade Commission without limitation, and even takes away the customary limitation on most actions that the person taking it must consider the expense. Here the Commission does not even have to think of that.

Section 17 is entitled "Liability for Misleading Statements."

The broad liability imposed by the bill makes this section particularly burdensome and puts tremendous advantages in the hands of a speculator to cover himself from bad speculation through endeavor-

ing to force recovery from his broker for alleged misstatements. The nature of this right has been discussed hereinbefore.

Section 18 is entitled "Special Powers of the Commission", and has been partially discussed hereinbefore in connection with section 12. It again gives the Commission broad powers over reports and information and gives the power to the Commission to subpena witnesses, administer oaths, and so forth. The Commission is authorized to investigate and publish information concerning any facts which it may deem necessary and proper.

Particular attention should be called to the part of subdivision (c) which gives the Commission power to prescribe the time and method of making settlements, payments, and deliveries, and the time of calculating margin requirements, and the time and method of closing out undermargined accounts. The control of these matters by a commission which is entirely outside the control of the persons conducting the matters regulated is likely to cause extreme damage to the business. The possibility of the Commission preventing closing out of margin accounts for a certain length of time which might be alleged to be in the interest of the investor, has been hereinbefore discussed. The great danger of such requirements and the prevention of freedom of contract in respect to them cannot be overestimated. It should also be pointed out that under this same subdivision the Commission is given the right to fix interest rates and charges and may summarily suspend trading in any registered security or even close the exchange itself. The dangers from these blanket delegations of authority also cannot be overemphasized.

Section 19 is entitled "Liability of Controlled Persons" and contains drastic provisions making every person who controls another through stock ownership, agency or otherwise liable for the acts of the controlled person as if such acts were his own. What is meant by a controlled person is not described and, therefore, the full effect of this section cannot be understood. There are many liabilities established for individuals by the bill, and to what extent an individual is a controlled person within the meaning of this section is difficult to understand.

Sections 20, 21, 22, 23, 24, 25, and 26 provide for various procedural and penal matters.

Section 27 provides for the validity of certain contracts.

Section 28 is entitled "Foreign Exchanges" and gives the commission power to restrict transactions on exchanges out of the United States. The effect of this section on American securities which have already been listed on the leading European and other exchanges should be carefully considered, for although the purpose of the section may be to prevent evasion of the bill by merely conducting the security transactions outside the exchange, the effect may be much greater.

Furthermore, this section applies only to brokers and dealers and, therefore, all individuals who are not brokers and do not come within the classification of dealers, may conduct any of the prohibited transactions on foreign exchanges.

Conclusion: From the foregoing, the bills may be seen to have three fundamental characteristics of almost equal importance: (1) to regulate certain stock exchange practices; (2) to restrict and con-

trol the granting of credit and investment; and (3) to control many of the practices of the corporations themselves, their officers, directors, and stockholders.

All these important subjects are by these bills placed under the supervision and control of the Federal Trade Commission, whose functions were confined (as its name would indicate) to the administration and enforcement of the Sherman Anti-Trust Act, the Clayton Act, the Federal Trade Commission Act, and related laws, all of which concern trade and commercial practices. Its personnel has been chosen for these special purposes. To so suddenly invest this body, however efficient it may have been in its own field, with the broad and absolute control over the delicate financial mechanism of the banks, corporations, stock exchanges, and the general markets for securities, to say the least, requires the most cautious consideration.

It should be further remembered that the Federal Trade Commission, in addition to its original duties, was, by the Securities Act of 1933, given control of the issuance of new securities. It thus has recently been given drastic control of new financing by the corporations of the country; but these bills now propose in addition to give it jurisdiction over the market for and trading in outstanding securities and also give it jurisdiction over many of the related credit transactions of the entire banking system of the country and of many corporate practices.

If this proposal is carried out, the Federal Trade Commission can, through its control of so many of the varied phases of the financial and economic life of the country, restrict the operation of and even destroy corporations that incur its displeasure. The Federal Trade Commission does not have to convict a corporation of any particular illegal transaction, but can regulate it out of existence by control of credit, restrictions on new financing, removal of its securities from exchanges, and so forth, without in any way justifying its motives or the soundness of its judgment. Although the bill provides for judicial review by appeal to the courts from the decisions and orders of the Federal Trade Commission, it must be appreciated that many such orders and decisions of far-reaching and fundamental effect would be primarily administrative orders involving the discretion of the Commission and might thus not be subject to review by the courts in a manner sufficient to present the full controversy for judicial review. Furthermore, immediate action, absolutely required by the very nature of the subjects involved, is impossible, and delay will prove a denial of justice.

Furthermore granting to the Federal Trade Commission the proposed broad control over financial matters further causes confusion and conflict in that it separates from the normal financial branches of the Government control over some of the most important phases of the financial and credit structure of the country. To so separate control of different parts of the financial system of the country in several independent branches with no coordination established between them presents much possibility for confusion, conflict, and disorder.

The CHAIRMAN. We are very much obliged to you, Mr. Hope. Do the members of the committee wish to ask any questions?

Senator KEAN. I do not.
Senator GOLDSBOROUGH. I do not.
The CHAIRMAN. All right, Mr. Hope.
(Thereupon, Mr. Hope left the committee table.)
The CHAIRMAN. Is Mr. Legg present?
Mr. LEGG. Yes, Mr. Chairman.
The CHAIRMAN. Please come forward to the committee table.

STATEMENT OF JOHN C. LEGG, JR., OF THE FIRM OF MACKUBIN, LEGG & CO., BROKER-DEALERS, BALTIMORE, MD., AND MEMBERS OF THE NEW YORK, BALTIMORE, AND WASHINGTON STOCK EXCHANGES

The CHAIRMAN. You desire to be heard on this bill, do you?
Mr. LEGG. Yes, sir.
The CHAIRMAN. Please state your name, place of residence, and occupation.
Mr. LEGG. My name is John C. Legg, Jr., of Baltimore, a member of the firm of Mackubin, Legg & Co., broker-dealers, members of the New York, Baltimore, and Washington Stock Exchanges.
The CHAIRMAN. You may proceed in your own way.
Mr. LEGG. Mr. Chairman and gentlemen, I represent 18 broker-dealers of Baltimore.
Attendance at 5 hearings before the Interstate and Foreign Commerce Committee of the House, followed by attendance at 9 hearings before the Banking and Currency Committee of the Senate, leads us to believe that most of the sections of the National Securities Exchange Act of 1934 have been adequately discussed, but also leaves us in doubt as to whether there is a clear understanding of a few sections upon which we desire to comment.
We do not come with apologies for the profession in which we are engaged. We know that our business is essential and any regulations which would seriously hamper its normal operations would unfavorably affect the public. Those interested in securities must, of necessity, have someone to whom they can turn for advice. My own firm, in association with two other banking firms, just completed what I believe to be one of the largest refunding operations of its kind ever attempted in the United States. A plan was worked out with the assistance of the Reconstruction Finance Corporation for the refunding by two large surety companies of approximately $80,000,000 of bonds secured by mortgages which had been guaranteed by those surety companies. Seven hundred and eighty security dealers located in 45 States and the District of Columbia cooperated with us in this plan, and more than 39,000 certificates of deposit were issued to 29,395 investors. The significant fact of this achievement is that thousands of bondholders relied upon the advice of those dealers to the extent of approximately 94 percent of the bonds affected.
This is only one illustration of what is constantly going on throughout the country; investors depending upon their local dealers for advice and counsel. Years of experience, constant study, and the expenditure of a substantial part of gross earnings on statistical departments are necessary to give adequate service to clients.

The cost, time, and expense involved precludes any but very substantial investors from maintaining adequate statistical organizations, making it necessary for smaller institutions and investors to seek the advice of security dealers.

The representatives of recognized stock exchanges scattered scattered throughout the United States have testified here that an overwhelming majority of their members are both brokers and dealers in securities.

To our mind the first sentence of section 10 is especially objectionable. It is necessary for a "broker" and "dealer" to combine their two functions in the smaller financial centers, and the smaller the city or town the more necessary this becomes if the "broker-dealer" is to have sufficient revenue to afford the overhead costs essential to provide the character of service desired by the investing public. In this bill there is a clause which does not allow an investment banking house to have any affiliation with the brokerage business, meaning the selling or buying of securities for their clients, either on a cash or part-cash basis. This bill, if unchanged, will force out of business the great majority of the bond and brokerage houses in the smaller financial centers, which in the aggregate number more than 6,000 firms, employing many thousands of people. Merely to act as dealer and underwriter and distributor of new issues would not bring them enough income to keep their businesses going. Who, then, would remain to underwrite and distribute new securities and perform the useful function of dealing in securities now outstanding?

Conditions of the securities markets may be such that at one time most activities in securities would be centered in the brokerage department of a broker-dealer while at another time the major activities are confined to the investment and over-the-counter departments, and only occasionally are conditions of the securities market such that all departments are active at the same time. The right to exercise both functions tends to keep the income from the business at a more uniform level than would otherwise be the case, which permits the broker-dealer to employ an average force much larger than if he is permitted to act as broker only, and in doing so, gives much better service to his clients.

It may be roughly estimated that of all transactions in bonds only 10 percent is made on the New York Stock Exchange, the remaining 90 percent being made on other exchanges and on over-the-counter markets, which are largely "dealer" transactions.

Very careful consideration should be given to the position in which the buyer of unlisted securities would be placed by segregation. Billions of dollars of securities—including State and municipal bonds—are traded in only "over-the-counter." If the broker-dealer retains his membership in an exchange he is prevented from exercising his latter function—that of dealing in securities—and so his clients who buy or sell such securities are forced to transact their business elsewhere—with a nonmember—a person unregulated except as the Federal Trade Commission may at some future date prescribe.

The Dickinson report and statements made here by Mr. Corcoran emphasize the difficulty in formulating effective control of "over-the-counter" markets. In what possible way can this segregation

be called a safeguard for the public? The activities of the broker-dealer as a member of a recognized exchange are under supervision, and his methods scrutinized. On the other hand, if we interpret the proposed law correctly, the nonmember dealer will be comparatively unregulated.

In February 1933 the bond market was completely demoralized. A sale of as few as 5 bonds would often cause a decline of several points from the last recorded sale. Bids at times were so far below last sales that frequently the stock exchange authorities would refuse to allow a sale to be made at the market but would fix a minimum price. Such action by the exchanges helped to stabilize the markets, but did not help the banks and insurance companies to raise the funds demanded by their depositors and policyholders. Frequently a broker-dealer would act as broker for his bank or insurance company customer and sell on the exchange as many bonds as the market would take at a fair price, and then in his capacity as dealer would negotiate with his client and purchase the balance of the block and through his own sales force distribute them.

A similar operation comes about through the function of broker-dealer in distribution of stocks and bonds through options on securities which are worthy of recommendation to his clients. We have in mind a block of stock held in a bank loan. Careful investigation convinced the broker-dealer of the merits of the stock. A circular was issued, and through their sales organization they distributed a substantial block of the stock. As broker they were able to stabilize the market by purchasing such stock as was offered for sale on the exchange and sell such stock as was wanted while the distribution was going on.

We believe the question of segregation which involves over-the-counter transactions is grave enough in its possibilities of harm to both the investing public and the broker-dealer and his employees to justify the appointment of a committee to study every phase of the proposed segregation.

Section 6 (a), Margin requirements on long accounts, may possibly have been designed to protect brokers, but would work serious hardships upon small corporations throughout the country and upon owners of their unlisted securities by destroying their collateral value. The burden of registration requirements under the act may force many small- and medium-sized corporations to remove their securities from listing on exchanges in smaller financial centers, thus aggravating the situation.

The drastic and rigid margin requirements under section 6 (b) would in all likelihood prompt further substantial liquidation of securities. Those responsible for the writing of this bill, no doubt, were largely influenced by the revelations made before the Banking and Currency Committee of the Senate, and, as is often the case, when concentrating upon abuses and their correction the suggested remedy may do an incalculable harm. Will the proposed commission at all times in the future be better able to regulate the amount that can be safely loaned on a given security than broker-dealers and the banks from whom they in turn borrow?

We believe that the volume of credit used by stock exchange members can be regulated under the Banking Act of 1933. The

effective curb to undue speculation is the curtailment of credit. Prices of stocks cannot be advanced inordinately unless the purchases can be financed. Officers of banks with their knowledge of security markets who pass upon collateral loans, when acting solely in the interest of the depositors and stockholders, are able to place proper loan values on collateral offered. Thus unwise and destructive speculation can be better regulated.

It is our belief that the reasons for regulating stock exchanges and their members arose from the disclosures developed by the investigations of the Banking and Currency Committee of the Senate in the past 2 years. We believe that the overwhelming majority of the members of the New York Stock Exchange are in whole-hearted sympathy with your desire to eradicate any practice detrimental to the best interests of the public and believe if the governors of the New York Stock Exchange had been more fully advised of the feeling in different parts of the country toward practices that some regarded as detrimental to the best interests of the public, that remedial measures would have been adopted sooner.

If, as we recommend, the management of the exchanges is to be left to the exchanges with such regulation as Congress decrees, we believe the opinions of the various parts of the country should be expressed through representation on the Board of Governors of the New York Stock Exchange by members located in various parts of the United States.

We are convinced that the day-to-day management of the New York Stock Exchange must be conducted by governors available for immediate decisions. For that reason it may be inadvisable to enlarge the governing committee to a point where it would be difficult to obtain a quorum, but the out-of-town members selected could be formed into an advisory committee to meet frequently with the governing committee.

Following our belief that the proposed regulations are suggested as a result of the disclosures of certain practices on the New York Stock Exchange we presume the regulations suggested are for the purpose of eliminating such practices and respectfully suggest that the regulations be confined thereto and not extended to affect other functions of broker-dealer business to the detriment of the general public.

With that in mind we suggest changes in several sections under the heading "Definitions." Section 3, subdivision 4, to read:

> The term "broker" means any person engaged in a business of effecting transactions in securities for the account of others, for which service a commission is charged

The definition as given in the bill could be interpreted to include banks and trust companies that buy securities for the account of others.

Section 3, subdivision 5 to read:

> The term "dealer" means any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, the chief purpose of which is to give investors a service that will enable them to buy or sell securities, whether listed or not, which cannot be purchased or sold to better advantage on a national securities exchange A dealer also may be an underwriter and distributor of securities

We urge the elimination of section 6 for reasons previously given.

We urge the elimination under "Restrictions of members borrowing", section 7 (a).

To prohibit a member of a national securities exchange from borrowing from any person other than a member bank of the Federal Reserve System would work an extreme hardship on broker-dealers located outside of the principal financial centers. In the ordinary conduct of business broker-dealers find it necessary to carry open accounts with their correspondents in the financial centers where the larger stock exchanges are located. If broker-dealers are denied the privilege of carrying such accounts with their broker correspondents, they could only use a member bank of the Federal Reserve System to clear their transactions. Even if practical, this would naturally incur another charge to be passed on to the public.

We suggest a change in the heading, "Segregation and limitation of the functions of broker, specialist and dealer", on page 21, to read "Segregation and limitation of the functions of broker and specialist."

It has been stated before your committee that the segregation of "broker" and "dealer" was to give greater security to the clients of brokers, reciting the failure of four New York Stock Exchange firms, chiefly because of their "dealer" commitments. Compare the remarkably low percentage of failures of private banking firms to other failures and we believe you will agree that there is no apparent need to prescribe such stringent regulations as would destroy the necessary part of our financial structure as would be the result of the proposed segregation of broker and dealer.

We strongly urge the elimination of the first sentence of section 10.

We appreciate the opportunity you have given us to appear before you and express our views on the pending legislation.

The CHAIRMAN. Can you suggest any modifications of sections 6, 7, and 10 of the bill, to which you have made reference?

Mr. LEGG. On page 5 I brought out our opinion about section 6 of the bill.

The CHAIRMAN. You want to eliminate it entirely, do you? Can you suggest any modification that you think might improve the situation?

Mr. LEGG. Well, I would not presume to do that. I think that margin requirements must be left to stock exchange regulations, and be flexible enough to keep us from selling our clients out without notice, which we would have to do under this bill as drawn.

Mr. PECORA. Mr. Legg, prior to October of 1929 wasn't the matter of margin requirements left solely to the judgment of stock exchanges and their individual members, with the result of a tremendous inflation of security prices due to the speculative mania that was encouraged by the undue extension of credit on margin?

Mr. LEGG. The requirements were left to brokers, but I do not think that resulted in undue inflation. Brokers had their own rules for margins, and I know that my house, and almost every other conservative house, had very stiff margin requirements.

Mr. PECORA. Do you recognize that prior to October of 1929 there was excessive speculation in securities?

Mr. LEGG. Yes, sir.

Mr. PECORA. Don't you think that that excessive speculation was prompted, in part at least, by the use of the margin requirements that were impose dby brokers on their customers?

Mr. LEGG. I cannot agree that the margin requirements were easy. I can only speak for the conservative houses with which I associate, and I know that our requirements were not low requirements.

Mr. PECORA. What were they?

Mr. LEGG. It depends of course upon the stock. In the case of a great many stocks——

Mr. PECORA (interposing). What would you say was the average at that time?

Mr. LEGG. It would be impossible for me to say. Let us take United States Steel before it had its big boom, and one might carry it possibly for 15 points. But there were a great many other stocks that I would not carry at any margin.

Mr. PECORA. You say on page 8 of your memorandum:

> We suggest a change in the heading "Segregation and limitation of the functions of broker, specialist, and dealer", on page 21 to read "Segregation and limitation of the functions of broker and specialist"

Was it your purpose to suggest to the committee that there be a segregation limitation of the functions of broker and specialist?

Mr. LEGG. No, sir. Our intention in suggesting that was to eliminate the dealer from that regulation.

Mr. PECORA. But you do think there ought to be a segregation of the duties or rights as between brokers and brokers who are specialists? Or to put it in another way, the bill as proposed would prevent a specialist who is a member of an exchange from trading for his own account. Do you approve of that principle?

Mr. LEGG. Mr. Pecora, my relations with the stock exchange are purely as a member for the purpose of the facilities of the stock exchange. I have been a member of the exchange since 1916, and have probably never been on the exchange 20 times in my life. I have great confidence in the management of the New York Stock Exchange, and I think the evidence which they have given here in reference to specialists would certainly be more illuminating to you than anything I might say about them.

Mr. PECORA. From the standpoint of your experience would you say that specialists should be permitted to trade for their own account?

Mr. LEGG. My experience with specialists has been nil.

Mr. PECORA. Then you have no opinion on it?

Mr. LEGG. No.

Mr. PECORA. On the first page of your statement occurs this sentence:

> Those interested in securities must, of necessity, have someone to whom they can turn for advice

Do you make that statement as a part of your argument that broker-dealers should not be required to segregate their duties? You recognize, don't you, that customers of brokers often turn to brokers for investment advice, and even for advice on stocks they might want to speculate in?

Mr. LEGG. Frequently.

Mr. PECORA. Don't you recognize that in such a situation a broker who is also a dealer is placed under the temptation of recommending transactions in securities in which that broker as dealer is also primarily interested?

Mr. LEGG. I think that circumstance would arise very, very seldom, speaking again for my own group.

Mr. PECORA. Wouldn't it arise in all cases where a broker-dealer is asked for investment or speculation advice by a customer?

Mr. LEGG. I think not, because it is very infrequent that broker-dealers are interested in an obligation for their own account. That has certainly been true for the past few years.

Mr. PECORA. Well, in the instance where a broker-dealer has an interest in securities, don't you think he is placed under the temptation of recommending, when his advice is sought by a customer, securities in which he is interested as dealer?

Mr. LEGG. I certainly would not think it would be a temptation. I think the broker-dealer would know from his customer what the customer needed.

Mr. PECORA. Well, he might be tempted to feel, because of his interest in securities, securities in which he has an interest or an underwriting, that that very security might be the one which his customer needs and might advise him accordingly.

Mr. LEGG. I think that can be done honestly.

Mr. PECORA. There is no question about that. But we also know by evidence presented to this committee that brokers, who have an interest as optionees in certain securities they were trading in, recommended the purchase of such securities to their customers, although in their own confidential reports, based upon a survey of the issuing company, they regarded the security as a purely speculative one at the same time they were advising their customers on the basis of investment.

Mr. LEGG. Well, I mentioned in my brief when speaking of options:

> A similar operation comes about through the function of broker-dealer in distribution of stocks and bonds through options on securities which are worthy of recommendation to his clients.

Mr. PECORA. Who is going to determine that?

Mr. LEGG. The broker-dealer.

Mr. PECORA. Exactly, and if the broker-dealer has an interest in the security as underwriter or sponsor that might tincture the advice he gives his customer, might it not?

Mr. LEGG. I cannot get your point, Mr. Pecora. I am thinking about the broker-dealer who is doing an honest business, who investigates a stock or bond, issues a circular and puts his recommendation on it. It certainly, as you say, tinctures his advice, because he believes it is the thing for his client.

Mr. PECORA. But it might tincture it because he believed it would be in his own interest to prompt its sale.

Mr. LEGG. You and I are not speaking of the same kind of broker-dealers.

Senator KEAN. Isn't it also true that, if a man comes into an office and says he has so much money to invest, that you give him a list of securities, some of which you may be interested in and

some of which you are not interested in, and that when you submit that list to him you say: On these we would not charge you any commission, because we own these securities?

Mr. LEGG. Yes, sir.

Senator KEAN. Therefore it is at the option of the purchaser. You try to give him all the facts that you have in regard to that investment; after you have made a study of that security you try to give him all the facts in regard to that proposed investment, so that it is his choice after knowing all the facts that you have worked up and put before him, I mean it is his choice as to whether he will buy that security or not.

Mr. LEGG. That is right.

Mr. PECORA. One of the biggest purchasers of securities that this country had was the National City Co., was it not?

Mr. LEGG. Yes.

Mr. PECORA. Are you familiar with the testimony introduced before this committeee with regard to the troubles of that securities selling company?

Mr. LEGG. I would not say I was familiar with it. I have read it over now and then in the papers.

Mr. PECORA. I think if you were familiar with that testimony you would find out one of the purposes of the provisions of this bill that you take exception to.

Mr. LEGG. Mr. Pecora, naturally your investigations have brought out the bad part of this business.

Mr. PECORA. It is only the bad part that it is sought to eliminate through the bill, not the good part.

Mr. LEGG. Yes. I am sure that every decent thinking person in my business wants to help you to eliminate such practices. We, speaking for the small broker-dealer are penalized in your efforts to regulate the few people even though it is the large people whom you have investigated and who have offended. That is the reason I ask that your efforts be confined to regulation of offenders and not spread throughout the country to the 6,000 broker-dealers who are doing a legitimate business.

Mr. PECORA. If you can find out any way by which Congress can determine what particular firms are liable to err in the future as they have in the past, that might be done; but I do not know any way by which that can be done. Do you?

Mr. LEGG. I do not know any way that it can be done, but I know what this bill will do to the honest broker-dealers throughout the country in your attempt to regulate the other side.

Mr. PECORA. It simply puts them in a position where they will continue to do business on a basis of good faith.

Mr. LEGG. No; I do not think we can continue to do business if you segregate the broker-dealer.

Mr. PECORA. Why can you not continue to do business as a dealer?

Mr. LEGG. Because there is not enough money in any one branch of the business, Mr. Pecora.

Mr. PECORA. That affects your private interest; it does not affect the public.

Mr. LEGG. It does affect the public.

Mr. PECORA. I do not think so.

Mr. LEGG. Because I can serve the public better as a broker-dealer than I can as either one individual.

I am sorry that Senator Goldsborough did not take the opportunity to read a letter that the Mutual Savings Banks Association in Baltimore wrote him yesterday, for the record.

The CHAIRMAN. I think that has been put into the record this morning.

Mr. LEGG. I am sorry that Mr. Pecora has not had the benefit of that.

Senator GOLDSBOROUGH. I have it in my hand, and I will ask that it be read.

Mr. LEGG. This letter is dated March 5, 1934, and addressed to Hon. Phillips Lee Goldsborough, United States Senate, Washington, D.C.

I might say, before I read this letter, that the mutual savings banks in Baltimore have deposits of approximately $200,000,000 [reading]:

MY DEAR SENATOR GOLDSBOROUGH: As you are fully aware, the mutual savings banks of Baltimore enjoy a long and outstanding record of useful service to the people of Baltimore. They have afforded a means for safe-keeping the savings of people of small means and at the same time furnishing an available supply of funds for investment in mortgage loans for the building of homes.

In order to adequately protect and diversify the investment of their depositors' savings, these mutual savings banks for many years have also been purchasers of large amounts of high-grade investment bonds Many of these bonds are the public securities of States, counties, and municipalities, as well as large amounts of equipment-trust certificates and underlying railroad and public utility obligations, which are not listed on any exchange for obvious practical reasons.

The purchase and sale of such bonds are made through recognized security dealers, many of whom, in order to render better facilities to their clients, are also stock exchange members. These dealers, through their knowledge of investment conditions and through their contacts with other dealers and institutions in different parts of the United States, are enabled to locate and determine whether their customers are best served in the execution of such transactions on the stock exchanges or through the over-the-counter markets.

Frequently it is much more advantageous to institutions such as our mutual savings banks to deal with such security dealers when they are acting directly as principal in the transactions. Our experience is that it is decidedly to the interest of institutions such as ours, and therefore our many depositors, to be able to handle such transactions through recognized security dealers whose combined facilities enable them to render either dealer or broker service.

Naturally the mutual savings banks are not interested in fostering speculation in securities and unquestionably practices have developed that justify correction and a regulation of these speculative activities, but it is certainly obvious that serious consideration should be given to the effects of that portion of the Rayburn-Fletcher bill which provides for segregation of the dealer-broker business and its effect on the investment transactions of the mutual savings banks, which are truly representative of the thrifty people of small means.

Very truly yours,

——— ———,

President Associated Mutual Savings Banks of Baltimore

Senator GOLDSBOROUGH. The savings banks belong entirely to the depositors?

Mr. LEGG. Yes, sir.

Mr. PECORA. That makes a rather favorable argument for regulation, because——

Mr. LEGG. I do not take it from the letter. I take it that it would mean the service which was rendered by the broker-dealer.

Mr. PECORA. I do not see why a dealer has to be a broker in order to give better service.

Mr. LEGG. That gentleman has had 30 or 40 years' experience in the purchase of securities, and that is his opinion.

Mr. PECORA. Do you mean to say that the mutual savings banks of Baltimore could not effect their transactions in the sale of securities through dealers who were not brokers, just as they do through those that are brokers?

Mr. LEGG. But the president of this association is stating that he thinks they can do it to better advantage through a combination house.

Mr. PECORA. I do not think he says they can do it to better advantage through a combination house.

Mr. LEGG. A broker-dealer, he calls them.

Senator GOLDSBOROUGH. I would like to ask a question. On page 6 of your memorandum, Mr. Legg, you referred to the fact that you are convinced that the day-to-day management of the New York Stock Exchange must be conducted by governors available for immediate decisions; but I understand that you also suggest that you think it would be wisdom that there should be formed an advisory committee to meet frequently with the governing committee?

Mr. LEGG. Senator, those two paragraphs do not jibe very well. It was written probably a little hastily. We had thought that the opinion of the investing public throughout the United States could be more adequately presented to the governors of the New York Stock Exchange if those out-of-town members had a duty or an obligation to confer with the governors. As it is now we do not see the governors from one year's end to the other. I do not criticise the governors for not sensing these opinions throughout the country, any more than I censor ourselves for not bring it to the attention of the governors. But there should be something done to get these things to the governors and there should be an obligation to bring it to them.

Senator GOLDSBOROUGH. My purpose in this question was to emphasize what you had said, because it seemed to carry some merit, at least to my mind.

Mr. PECORA. Is it your opinion that the bill takes the day-to-day management of the stock exchanges out of the hands of their governing committees and vests it in the Federal Trade Commission?

Mr. LEGG. That is the way I would read the bill, and fear it.

Mr. PECORA. You apparently are not familiar with the statements made to this committee by Mr. Corcoran at the opening of these hearings last week?

Mr. LEGG. Yes, sir; I heard Mr. Corcoran's statements.

Mr. PECORA. Have you read the bill?

Mr. LEGG. Yes, sir.

Mr. PECORA. Could you point to the provisions in it that in your opinion divest the exchange authorities of the power of self-management?

Mr. LEGG. There are a lot of things in this bill that you do not read. The Federal Trade Commission reserves to itself the right to adopt and prescribe such rules and regulations in the future as it desires. With that it certainly could take over the management of not only the exchange, but a great many other things.

Mr. PECORA. Do you think that it means that the governing authorities of the exchanges are divested and also divested of their power of self-management?

Mr. LEGG. I would fear it, from the bill. I think you would agree with me that the management of the stock exchange must be left in the hands of those who are available for emergency. I pointed out——

Mr. PECORA. I do not see anything in the bill that operates to deprive them of that day-to-day management and operation.

Mr. LEGG. I pointed out the 1933 bond market. I do not know whether you were as close to that as we were, but that was a very uncomfortable time. The assets of banks and insurance companies were being dissipated by the reduction in market values which were not justified by the small amount of securities which were offered. I saw several occasions when we had market orders to sell small blocks of bonds when the stock exchange would refuse to allow a client to sell at the bid price. It was so much below the last sale that they arbitrarily fixed a minimum price. It needs somebody on the stock exchange to take that kind of action.

The CHAIRMAN. At the time you speak of there was local management by the stock exchange itself. Nobody interfered with that.

Mr. LEGG. No; and they took action, Senator. If they had not, we would have seen bond prices very much lower than they were on very small liquidation.

The CHAIRMAN. We are much obliged to you, Mr. Legg.

Mr. REDMOND. May I place myself at the table, Mr. Chairman, in case I wish to ask any questions?

The CHAIRMAN. Yes.

STATEMENT OF HON. WILLIAM CLARK, PRINCETON, N.J., UNITED STATES JUDGE FOR THE DISTRICT OF NEW JERSEY

The CHAIRMAN. Please state your name, residence, and profession.

Judge CLARK. My name is William Clark. I live in Princeton, N.J. I am United States district judge for the District of New Jersey. I think that inasmuch as you have witnesses here who represent the stock exchange, I would like to appear as representing the victims of stock-exchange speculation.

The CHAIRMAN. We are very glad to hear from you, Judge.

Mr. PECORA. Do you mean that you are attempting to speak for the general public?

Judge CLARK. That is my idea, Mr. Pecora.

Mr. Chairman and Senators, I have accepted your committee's kind invitation to impose on their time for one reason only. I have strong feelings on the subject of the margin section of the proposed bill. I believe that section does not go far enough. I believe that the stock exchange should be put on a cash basis. Those feelings and that belief are not manufactured for this occasion, nor are they simply the result of cloistered thinking by an enfeebled intellect. In 10 years on the Federal bench, I have had personal observation of the tragic consequences of margin trading in three respects.

First: I have had to send men to prison because they had used the money entrusted to them by poor depositors to "protect" their

margin accounts. The district attorney for my district advises me that about one half of our national bank embezzlements in the last 5 years are the result of stock speculation.

As far back as 1931 the Department of Justice, Bureau of Investigation, informed me, for the purposes of a speech which I was making, that the average for the country generally runs as high as 60 percent.

If you examine the records of bonding companies and of prosecutors' offices you will, I think, find that officers in State institutions and public officials have been equally inclined to use other people's money for investment in the stock exchange. The judicial function of punishment is always heartrending to exercise. In the case of certain classes of crimes, the nature of the offense and of the person committing it leaves the emphasis on the necessity for protecting society. To sentence a drug peddler is one thing; to punish a leading citizen of the community for betraying the neighbors who trusted him is quite another. Furthermore, in dealing with the professional criminal one has the feeling that the causes of his erring (environment, inheritance, physical and mental condition, and so forth) are deep rooted in any civilization and yield only gradually to elimination. In the case of the bank officer, however, there is obviously only one cause: His inability to resist the insidious temptation of following the crowd in seeking what looks like safe and easy money.

Second. There has been since 1929 an increasing number of suits in my court on insurance policies where, under the terms of the standard policy, the issue was: Accident or suicide? The company has been, therefore, obliged to establish motive, and in nearly every instance the motive has been "wiped out in the stock market." The number of these cases caused me to inquire of insurance executives about the causes of suicide under straight-life policies. The answer was again mostly stock-exchange speculation. The situation became so serious, I am informed, that the companies considered abrogating the 1-year incontestable clause in their policies. Sometimes this first and second respect can be combined, because the particular bank officer or public official prefers death to dishonor and anticipates the court with a pistol. We had such a case in Princeton, where I live, 2 years ago. The cashier of one of our banks killed himself, and it was discovered that a local brokerage office (it has now folded its ledgers and departed) had covered his margins with about $100,000 of the bank's money and about $50,000 of the local churches for good measure.

Third. In 1930 and 1931, I conducted with the aid of the Yale Law School and the Department of Commerce, what we called a "bankruptcy clinic"—we examined a large number of persons who had filed petitions in the New Jersey court for the purpose of discovering the whys and wherefores of their unfortunate condition—hoping that we might be able to chart the seas instead of just salvaging the wreck. We were shocked to find the large number of individuals, both business men and wage earners who had taken a fling in the market as a sideline, with, of course, fatal results.

My knowledge of these things led me to the conclusion that margin trading in an unconscionable number of cases led to either death, dishonor, or distress. I have been endeavoring for several years

now to impart that conclusion to the stock-exchange authorities themselves. Through the newspapers, in speeches, and even through personal correspondence, I have endeavored to suggest that they would be wise to alter a system that fostered such dreadful results. You gentlemen who have experienced the cooperative spirit of the exchange will not be surprised to hear that I did not accomplish much except perhaps qualify myself in their regard for a place in the United States Senate.

In fact, I was met by the same plaintive cry (it reminds me of a sort of financial Mother Carey's chicken) that you must be pretty sick of "The stock exchange is a market place." One has heard this so often that one almost expects to see the floor brokers becomingly draped in white aprons and to smell fish instead of stocks. One might suppose that Shakespeare's famous phrase had ended the argument by giving a name. The stock exchange is not a market place any more than margin trading is per se gambling.

The stock exchange is a very important institution in our economy and should be governed according to sound principles of political economy. One of these principles is undoubtedly that it should be a place where stocks can be bought and sold. Another is that it not be a place where people are tempted to indulge in unreasonable risks. Clearly, if everyone could purchase stocks for the asking and without the humiliating necessity of putting up some cash, the number of transactions would increase and multiply and the widow and orphan could sell or buy every split second. (I might digress to remark how curious it is that tears for the widow and orphan appear wherever a utility or stock exchange goes on the operating table.) Equally clearly, a margin transaction involves a real risk. It is not gambling in any technical sense. It is simply a purchase money mortgage with a chose in action (the stock) as security. Because that security is very volatile in its nature it is subject to wide and rapid fluctuations. Because it is subject to those wide and rapid fluctuations, the mortgagor purchaser is always in danger of having to bolster the impaired security and if he can't, of being foreclosed out of his purchase money.

We must, it seems to me, arrive at a social balance between these conflicting values. The widows and orphans can afford to wait a few hours to get their money for their securities in order that others of their fellow human beings may not be widowed or orphaned (for dishonor is a worse form of death) or forced into poverty because their loved ones have succumbed to the temptation of unreasonable risks. How is the social balance to be reached? In my very humble judgment by putting, as I said in the beginning, the stock exchange on a cash basis.

It would not be too much to say that among the most obvious of the much talked about causes of the much talked about depression is the abuse of credit. You gentlemen have seen it in your investigation of foreign loans and in your investigation of a few banks. You have not seen as much as I have, perhaps, of the great American institution of instalment selling. During the glad gone days it was fashionable to exalt that system. Personally I never could see the soundness of buying anything but necessities until the money was in the bank. It costs more, it is subject to the whim of fate

and it only anticipates enjoyment at the expense of thrift. However that may be, we who investigated the 1,000 bankruptcies I have spoken of, had ample opportunity to observe the economic effect of the unbridled instalment mania of the last decade. The instalment houses, like the stock brokers, point with pride to the fact that they lost nothing. That is no doubt true. It is the poor fools that fall for the blandishments of both that have done the losing.

No one will maintain that stocks are necessaries in the sense that shelter, covering, food, and transportation are essential to human welfare. There seems no good reason accordingly why stocks should not be paid for by money that has first been saved, rather than the saving should come out of the rise or fall of the market. That is certainly true in all cases where the mortgagor purchaser is not in a credit position to meet the fluctuations of his security.

Who determines that mortgagor purchaser's credit position? As things are now, the one man least fitted to do so—the broker. Least fitted for two reasons. He has not the capacity or the incentive. The business as at present constituted, is not conducive to the development of inherent talent. The floor trading could certainly be carried on by Western Union messengers and it has been even suggested that a pari mutual system could be worked out. The office work is largely routine and the chief difference between a bad broker and a good broker seems to be in his ability to make friends—a beautiful quality, surely, but sometimes expensive for the friends. In France a member of the Bourse has to be both a chartered accountant and a member of the bar.

Worse than lack of capacity, the incentive of the stock broker is towards the abuse of his power to extend credit. His temptation is, of course, to ignore the credit position of his customer. He makes first some interest on the money he loans, and then he earns the livelihood by the number and size of his transactions. As long as he has enough to cover during the time needed for him to sell out, he does not care whether the customer must dip into the till to put up more margin, or kills himself, or loses his home because he can't. It is true he may lose his customer, but he is comforted by Barnum's aphorism. The stock and commodity broker are the only go-betweens I know of that exercise the credit function. Their stake is not in the use of credit in the interest of the community or its members, but in, naturally, lining their own pockets with as many commissions as possible. They immediately become unable to estimate the wisdom to the particular individual and through him to society of any credit line.

I have avoided discussing the gambling instinct and its suppression as relates to the stock exchange. We are all of us lazy, and we would all like to make some money without working for it. We have not been as a Nation very successful in the legislative suppression of instincts I am only suggesting that if we want to make money without working for it, by operating in the stock market, we should either have the cash in our jeans or we should borrow it from some source which is both more or less expert in the exercise of the credit function and which has no bias in favor of exercising rather than refusal. Such a source manifestly exists in the banking system, which, whatever its past mistakes, must have a vital interest

in the economic wisdom of all of us and must govern their loans by an honest desire to build up the country rather than by the wish to have a new crop of the "something-for-nothing boys" every few years.

I have also not dwelt upon the fatal effects of the abuse of credit by the stock brokers on our whole economic life. To do so seems hardly necessary after what we have just been through. A people can scarcely base its investment policy on borrowing to buy stocks whose value arises principally because everyone is borrowing to buy them and benefit by it. We have sown margin trading and are now reaping the depletion.

I hope I have not been presumptuous, gentlemen. I have seen with my own eyes what margin trading has done to its victims. It has not been a pleasant sight. I hope that the Congress will have the courage and wisdom to put an end to it.

May I close with two warnings? First, the stock-exchange authorities have attempted to arouse the country to some chimera of the nationalization of industry. Very patriotic, if true; but let me assure you that the real interest lies in the margin provision because that is where the money is. Second, they are professing great concern for the small investor, as they euphemistically term him. I even read that your committee was contemplating modifying the margin requirements for the small investor's protection. The word should have been "destruction." The interest of the stock exchange in him, after what has happened, reminds me of the interest of a much older wolf than the big bad one in a little girl with a certain-colored hood.

The CHAIRMAN. Judge, do you see any economic dangers in this bill?

Judge CLARK. As to what section, Senator?

The CHAIRMAN. As to any part of it. I lay the whole bill before you to see if you can find in the whole bill dangers that will bring injuries to business and bring about bad economic conditions.

Judge CLARK. Of course, Senator, I have not considered as carefully the other sections of the bill as I have the margin section. I can only say that my impression is that the opponents of the bill have tried to twist the language to give it an unfavorable interpretation. I am sure that the draftsmen of the bill for your committee have certainly no intention to harm business, and that if those sections that they object to, as far as business is concerned, can be shown to harm it, I think the language will be narrowed.

I might add one thing, Senator I have been amazed at the apparent criticism of the margin section. The newspapers to some extent, and the people generally, seem to act as if that was a revolutionary innovation. The fact is of course that in nearly every other country in the world margin trading does not exist.

I have here a book on the stock exchange, and it says this, reading one short paragraph [reading]:

> In London margin trading of the kind and to the extent prevalent in New York is unknown Brokers do not require margin of customers trading "for the account" or on the "term-settlement" basis This fact contributes to the more personal relationship existing between broker and customers, mentioned in the general discussion of "term settlement" above. Credit for carrying securities is customarily arranged, not through margin accounts with brokers, as in New York, but by means of bank loans

Mr. PECORA. Judge, from what book are you reading?

Judge CLARK. Stock Market Control.

The CHAIRMAN. Do you feel, Judge, that there ought to be some supervision or regulation by Federal authority of stock exchanges?

Judge CLARK. Apparently, Senator Fletcher, that seems to be the only recourse, does it not?

The CHAIRMAN. Some of us feel that way.

Judge CLARK. I think everyone can agree—I should imagine that everyone could agree—that our system of Government makes it wise that the Government not step in where people eliminate their own abuses. I have assumed that the reason that this bill has been offered is that such abuses have not ben corrected.

The CHAIRMAN Have you any questions, Mr. Redmond?

Mr. REDMOND. There are one or two questions that I would like to ask, Mr. Chairman.

Senator KEAN. I have a question or two

Judge CLARK. Do you want to wait until Senator Kean has asked the questions?

Senator KEAN. No; never mind.

Mr. REDMOND. Oh, I beg your pardon, Senator I thought the chairman asked me if I wanted to inquire.

Senator KEAN. Go ahead, Mr. Redmond.

Mr. REDMOND. In regard to the English method, you appreciate that they have no margin accounts because they do not require margins? In other words, they go to the full extent of not even asking a customer to put up margin Would not that entail a greater degree of speculative activity?

Judge CLARK Mr. Redmond, I have not personally made an examination of the operation of the London Stock Exchange. I have assumed that the committee would be given the benefit of testimony as to the practices of all foreign exchanges. I should think the committee would want such information.

Mr. REDMOND. I thought you made the statement——

Judge CLARK. I read from this book [indicating].

Mr. REDMOND. But you made the generalization that margin accounts as we know them do not exist in any other country in the world; and I was just wondering whether that was literally true.

Judge CLARK. I read from this book.

Mr. REDMOND. Do you know anything about the practice in France?

Judge CLARK I have not personally studied it; no.

Mr. REDMOND. You made some statement as to the qualifications of a man in order to be a member of the French Bourse. Of course that might apply to the official bourse, but it does not apply, does it, to what is known as the Coulisse, who are the active brokers in Paris?

Judge CLARK. I understand, without going into a discussion of the matter in detail, that the persons I referred to were the agents de change.

Mr. REDMOND. The official bourse numbers 70 people, but the main market is carried on, is it not, by what is commonly termed the coulisse, which is a separate organization in the bourse, and which is much larger and contains the active stocks?

Judge CLARK. If you care to have me submit a thorough discussion of comparative stock-exchange practices I would be glad to do it.

Mr REDMOND Judge Clark, you made the statement, and I simply wanted to find out and develop the facts before the committee.

I have no further questions.

Senator KEAN. We have in New Jersey, and also in New York, a large number of companies which have taken mortgages on property all over the State, and all over New York City, and issued certificates against them. You are familiar with those companies, are you not?

Judge CLARK. Some of them seem to be in the hands of receivers.

Senator KEAN. Every one of them has failed, so far as I know, or has practically failed. Now, that was an investment which was supposed to be the safest that you could obtain, was it not? I mean to say, the charities in New York and in New Jersey bought these certificates and they were recommended as the safest that one could possibly invest in. They have all gone; they are all in trouble. You did not include them in your statement. They are entirely outside of the stock exchange.

Judge CLARK. But, Senator Kean, I think there are very unfortunate things that have happened to the whole investment structure. I do not think anybody can deny that. I was only devoting myself to one particular part of it. I think it might be said—maybe unjustly, but still it might be said, perhaps—that the stock-market collapse, which some people think was due to the excessive speculation, brought about the general economic condition and brought about the unfortunate condition in which these companies find themselves.

Senator KEAN. Perhaps it might be said that their collapse brought about the other.

Judge CLARK. Is it not, chronologically speaking, sir, correct to say that the stock market touched off the others?

Senator KEAN. I do not think so. I think perhaps the stock market started a little bit sooner than the others, but they all went down together. Here are these investments in mortgage bonds, in homes, and everything else. A great many people committed suicide because they were about to lose their homes; and the reason they were about to lose their homes was that they had bought their homes and had a mortgage on them.

Mr. PECORA. In other words, bought them on margin?

Senator KEAN. Bought them on margin, if you choose. But are you going to stop all the building and loan associations so that people cannot buy a home on a building loan? Would you stop them so that they cannot get a mortgage on anything?

Judge CLARK. Of course, Senator, is there not a distinction between a mortgage on real estate and a mortgage on stock? Real estate is not as volatile as stock. If I lose my home by foreclosure it does not immediately and to such a great extent affect the market for other stocks.

Senator KEAN. It affects the market for homes in the neighborhood, because you have a record just the same as you have on the stock exchange. You have made a record that that house in that block has sold for that amount of money, and that calls everyone's attention to it that owns a house with a mortgage in that block.

Judge CLARK. I think it does have some effect; yes.

Senator KEAN. I would like to make the statement for the record that in the London Stock Exchange they do not require margin, but their stocks are payable every 2 weeks. They have a settlement and they pay a commission. When the drop in the market came it took more than a year, certainly, for the London Stock Exchange to settle their commitments. It was much worse than the stock-exchange conditions in New York, because they settle from day to day.

Judge CLARK. I was of the impression, Senator Kean, that the events in the London Stock Exchange did not compare with ours. Maybe I was wrong.

Senator KEAN. That is partially true, because the volume of business that they do is not to be compared with ours. But as far as they went, their situation was very unfortunate.

I have nothing further.

The CHAIRMAN. I think the record might show that on October 1, 1929, stocks listed on the New York Stock Exchange were selling at $87,073,000,000. On July 1, 1932, stock was selling at approximately $15,663,000,000, a loss of $71,440,000,000. That grew largely out of the speculative mania that culminated in October 1929, did it not?

Judge CLARK. Yes, sir; I should certainly suppose it did.

The CHAIRMAN. Statistics further show that the value of bonds on the New York Stock Exchange on October 1, 1929, was $49,456,000,000, and on July 1, 1932, $48,000,000,000. It is further shown that in 1929 the value of all the properties in the United States was estimated at $452,000,000,000; 4 years after that at $252,000,000,000—in other words, a loss of about 40 percent on the value of all property in the United States. The income of the United States, taking the whole country, has dropped about one half in the last 4 years.

Senator KEAN. Judge, you have no figures in your mind as to the total amount of these mortgage companies, have you?

Judge CLARK. You mean, the ones that are unsuccessful?

Senator KEAN. They are all unsuccessful, I think. They run to a great many hundreds of millions of dollars, do they not?

Judge CLARK. I would imagine so.

Senator KEAN. I think more than a billion dollars of these mortgage companies that have issued certificates on first mortgages, that these charity organizations bought and everybody else bought——

Judge CLARK. I would very much like at perhaps some other time, Senator, to suggest what should be done. Some of them have been in my court; but I do not understand that they are within interstate commerce. I am afraid that it would have to be taken up with the individual States. I think, undoubtedly, Senator Kean, there have been great abuses.

Senator KEAN. If you will look over the charities of New York and New Jersey, and also the endowment funds, you will find that a large part of their investments have been in these mortgage certificates or mortgages; also life-insurance companies. All these companies have invested tremendously in these mortgage certificates covered by first-mortgage bonds, and they are all of them either wiped out or in the hands of receivers or in trouble.

Judge CLARK. Is not that partly, Senator Kean, because of the speculative management of those companies? I know of a large savings bank in Newark, with which you are familiar, and of which I happened to be manager. I asked the president the other day how many of his mortgages were in default. They have, of course, a very large amount of mortgages. He said, less than 1 percent. They have managed well. Whereas, the mortgage certificate company in Newark is in the hands of a receiver. I examined their list of mortgages the other day, and I certainly would not have invested in them.

The CHAIRMAN. Of course this depreciation in values extended to real estate as well as to all other kinds of property.

Senator KEAN. I believe it got down to Florida, didn't it, Mr. Chairman?

The CHAIRMAN. Somewhat; but Florida is coming back. Everyone wants to get down there now to buy. So there is a change in that situation.

Judge CLARK. There was an article to that effect in the paper just the other day, Senator. I do not know whether you noticed it.

The CHAIRMAN. It is quite true. People who have land which they acquired in the boom days are not very anxious to sell it now. There is a good deal of demand for it.

Aside from that, people who hold certificates and mortgages on real estate are not entirely wiped out. There is something left there for most of them. With stocks and that sort of thing they are gone absolutely.

Judge CLARK. With stocks you are out the window. With mortgages you have some chance.

Senator KEAN. I hope they all come back.

Mr. REDMOND. Judge Clark, may I ask you one more question?

Judge CLARK. Certainly.

Mr. REDMOND. You referred to the excessive amount of credit on the stock market. The chairman has just mentioned——

Judge CLARK. I do not think I used the word "excessive." But let that go.

Mr. REDMOND. The chairman has mentioned the total valuation of stocks on the New York Stock Exchange in October 1933. If you will remember the figure of brokers' loans, it was about $8,500,000,000, which represented slightly less than 10 percent of the market value. Do you think that 10 percent is an excessive amount to borrow against property?

Judge CLARK. I do not think I used the word "excessive" I will look at my statement again and see. My objection to the brokers loaning money is that they have an incentive to loan; they are not impartial. I may be that in certain cases they are able to overcome that temptation; I do not know.

Mr. REDMOND. But you doubt it?

Judge CLARK. My judgment, from what has passed, is that they are not able to overcome it.

Mr. REDMOND. That is all.

The CHAIRMAN. Thank you, very much.

STATEMENT OF ALFRED L. BERNHEIM, NEW YORK CITY, DIRECTOR OF THE SECURITIES MARKETS SURVEY OF THE TWENTIETH CENTURY FUND, INC.

The CHAIRMAN. State your name, please, and your address and occupation, for the record.

Mr. BERNHEIM. Alfred L. Bernheim, 27 West Eighty-sixth Street, New York City. I am director of the Securities Markets Survey of the Twentieth Century Fund.

The CHAIRMAN. Do you wish to be heard on this bill, Mr. Bernheim?

Mr. BERNHEIM. Yes, sir.

The CHAIRMAN. We will be very glad to hear you. You may proceed in your own way.

Mr. BERNHEIM. I am appearing before the committee in my capacity as director of the Securities Markets Survey Staff of the Twentieth Century Fund, Inc. The staff has recently completed a nonpartisan scientific study of the security markets from the point of view of the interests of the American public. A digest of the findings of the staff and their recommendations for Federal regulation of the markets, published in book form under the title "Stock Market Control", by the D. Appleton-Century Co. of New York, has been formally submitted to the members of the committee and its special counsel.

The statement I am about to make has been drafted on the basis of the findings and recommendations of the staff, as summarized in this volume. It is endorsed by the other editors who were associated with me in the preparation of the book: Evans Clark, director of the Twentieth Century Fund; J. Frederic Dewhurst, the fund's economist, and Margaret Grant Schneider.

At the outset I want to say that I am in full accord with the basic purpose of the National Securities Exchange Act of 1934 which, as stated in section 2 of the act, is the regulation of security exchanges in order to eliminate manipulation and control of prices and, in general, to prevent the volume of speculation in securities from reaching excessive and harmful proportions. The point of view I represent, as developed after several months of intensive study of security markets, is summarized in the following words in the recently published digest of the findings and recommendations of the Security Markets Survey staff:

> Security exchanges render certain economic services which are essential under a capitalistic economy. However, excessive and uncontrolled speculation, especially when accompanied by manipulation, not only makes the price we pay for these services out of proportion to their value, but it also may result in a positive disservice to investors by distorting security values It follows from this that public policy requires that speculative activities be brought under such control that they will add to and not detract from, the value of the functions which security exchanges are designed to perform, and so that such activities will no longer create credit disturbances and other maladjustments throughout our economic structure

This quotation makes it clear that the general conclusions reached by the staff of economists who conducted the survey of security exchanges on behalf of the Twentieth Century Fund, coincide with those which were apparently in the minds of the framers of the

"National Securities Exchange Act of 1934." I am appearing before you to advocate the principles and objectives of the act. I believe that the prompt enactment of these principles and objectives into law is a matter of urgent importance to the economic welfare of the Nation—especially to the proper working of the Nation's banking and credit system and the flow of commerce between the States. I am of the opinion, however, that the bill could be improved, strengthened, and brought into closer conformity with its own declared purposes by certain changes which I beg leave briefly to bring to your attention.

GENERAL ANALYSIS

I can best summarize my views at the outset by saying that, in my opinion, the bill as drafted lays too heavy a hand of Federal control upon some of the activities of the markets and of corporations whose securities are bought and sold in them, while other activities are either left without control by the Federal Government or subject to undefined and unpredictable regulation at the discretion of the Federal authorities. If the bill were to be passed as drafted I believe the result might be the strangulation of some useful and beneficial activities which play an important part in the economic functioning of the markets, while other practices, which seriously interfere with the proper performance of the markets' functions, would be left unrestricted.

Let me be more specific. The bill, for example, could be so administered as to subject the organized exchanges to such complete domination, even in the routine details of their administration, by the Federal Trade Commission that the quick and effective responsibility of the exchange authorities might be seriously impaired. I believe that as a matter of broad policy certain minimum requirements of exchange practices should be clearly set forth in the statute and then that the enforcement of these provisions be made the responsibility of the exchanges themselves, with penalties provided if they or their members should fail in their duties and obligations.

On the other hand, the bill completely exempts the corporation whose securities are not listed on the exchanges from the requirements as to accounting and reporting and the security transactions of officers which are—and I believe on the whole wisely—imposed upon those concerns whose securities are listed.

EXCESSIVE POWER VESTED IN FEDERAL TRADE COMMISSION

A few examples will illustrate what seem to me to be unmistakable instances of undue and unwise grants to an administrative agency of what amounts to legislative power.

One · In relation to margin requirements on long accounts, the bill provides in section 6 (b) that—

> The Commission may by rules and regulations prescribe lower loan values as may be deemed appropriate in the public interest or for the protection of investors during any stated period of time or in respect of any specified class of securities

Two: In relation to the regulation of the use of manipulative devices, the bill, in section 9 (c), makes it unlawful for any person—

To use or employ * * * any device or contrivance which, or any device or contrivance in a way or manner which the Commission may * * * find detrimental to the public interest or to the proper protection of investors

Three: Section 14 makes it unlawful for any person to create an over-the-counter market—

without complying with such rules and regulations as the Commission may prescribe as appropriate in the public interest or for the protection of investors

These three provisions, as well as others in the bill, obviously bestow wide discretionary power upon the Commission, but the grant of sovereignty is made all-embracing and absolute in section 18—"Special Powers of Commission." Here, in substance, the Commission is given the authority to "make, amend, and rescind" any rules and regulations which, in its own discretion, it finds necessary in order to effectuate the purposes of the act.

It is, of course, necessary to give an administrative agency sufficient latitude to enable it to carry out efficiently the duties with which it is charged. We do not suggest that in this instance the Federal Trade Commission should be tied to the letter of the provisions appearing in the bill as it reads, or that the bill should be elaborated and extended so as to include a full set of rigid rules and regulations covering all contingencies. On the other hand it seems to us unwise to give virtually unlimited power to an administrative agency, not only to interpret and put into effect the will of the legislature but, beyond that, to assume to a certain extent legislative prerogatives. I cannot endorse a dictatorship such as the bill sets up, even though I am as firmly convinced as are the authors of the bill that security exchanges must be brought under thorough-going Federal regulation.

EXCESSIVE LIABILITIES AND PENALTIES PROVIDED

Section 8 (a) prohibits certain manipulative practices. Section 8 (b) provides as follows:

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

Section 8 (c) establishes a similar liability at the sales end of the transaction, namely it gives the seller the right to sue, under certain circumstances, for an amount representing the difference between the price he actually received and the highest price at which the security in question sold during the 90 days preceding, and the 90 days following, the date of sale. Of course, the same person may sue over both the purchase and the sale price.

Under these sections a person may incur only a small loss and yet have a cause of action extending into thousands of dollars. Thus he may have bought 100 shares of stock at $50 per share and sold

at $49, losing $100, plus commissions and taxes, but he may sue for, say, $3,100, if during the 6 months' period the price of the stock ranged between a low of $40 and a high of $70.

A provision of this sort invites blackmail and nuisance suits. Every person who has taken a flyer in the market and has been disappointed in the results will be in a position to sue, or threaten to sue, some one who may have been buying or selling the same security during the 6 months' period.

If it is hoped to do away with the abuses listed in section 8 (a)—and without question they should be eliminated—by making perpetrators liable for heavy damages, then the bill should be amended so that the plaintiff in an action cannot benefit to an extent disproportionate to the damage he has suffered. A defendant against whom a judgment is rendered could be made liable, for punitive purposes, as now provided in the bill, but the plaintiff should be entitled to nothing more than the actual loss sustained, plus certain expenses such as lawyers' and accountants' fees to an amount stipulated by the court the remainder of the judgment, if any, going to the Government.

Section 17—"Liability for Misleading Statements"—presents a similar example of a situation conducive to indiscriminate and wholesale lawsuits, threats of suits, and even blackmail The deliberate issuance of false or misleading statements should be severely penalized, but a person who as a result has sustained only a small loss should not be a potential beneficiary to the extent of a sum which may be hundreds of times the amount of his loss

The fines and penalties prescribed in section 24, while no doubt justified in some cases, would be too severe if applied to their full limits to any but the most flagrant offenders. The bill should make some broad classification of offenses to avoid the danger of unjustifiably heavy sentences.

Activities left unregulated: In sharp contrast to the stringency of the provisions I have just discussed is the absence of any, or of sufficiently definite, provisions in respect to other trading and corporate activities which, in my opinion, call for Federal control.

Consider, first, the corporations whose securities are not listed on the exchanges. As I have pointed out before, the bill as drafted leaves them completely out of the picture of Federal regulation, not only as to their accounting and reporting practices but also as to the transactions of officers and directors. To get a perspective on the extent of the area of corporate activity left unregulated by the bill, it must be remembered that the number of companies whose securities are not listed is many times larger than the number with listed issues. To impose excessive burdens on the listed companies and none at all on the others would appear to tempt companies to limit dealings in their securities to the unorganized markets.

In the preparation of our recommendations the security markets survey staff of the fund was most particular to lay an even hand of regulation over all corporations engaged in interstate commerce and over all areas of the markets. We suggested that this be accomplished by the passage of a Federal incorporation law and by specifying in the Securities Exchange Act itself regulations which, as far as practicable, apply with equal force both in and out of the exchanges.

So much for my more general comments on the bill. May I now consider the measure section by section?

Mr. PECORA. Mr. Bernheim, would you mind if I asked you a question in reference to the last statement you made, wherein you recommend the enactment of a Federal incorporation law? Have you any notion that such a law could be enacted speedily?

Mr. BERNHEIM. Mr. Pecora, we could not, in the nature of our work, consider the possibility of the speed of the enactment of such law. We have analyzed the situation, and we feel that it calls for a Federal incorporation law. I do not know anything about the situation as to legislation or possibilities of legislation.

Mr. PECORA. If such an enactment would be long deferred, don't you think some other vehicle could be created by Congress to take care of the abuses that you speak of in this statement, before a Federal incorporation law could possibly be enacted?

Mr. BERNHEIM. I certainly do not suggest that this legislation should be held up until such time as a Federal incorporation law should be passed. I am merely pointing out the desirability, and I believe the absolute necessity, for a Federal incorporation law in order to accomplish the purposes of the act.

Now, the detailed analysis:

Section 5 (a) (1):

This section provides that each exchange undertake to comply and to enforce, as far as is within its powers, compliance by its members and by issuers, with any provision of the bill and any amendment thereto and any rules and regulations made or to be made thereunder.

This is too sweeping in respect to its binding force upon exchange members to abide by provisions, rules, and regulations not in existence at the time an exchange applies for registration. Section 5 (d) is subject to similar criticism.

Section 6 (a):

This section provides that no members of a security exchange and no person who transacts a business in securities through the medium of such member may extend or maintain credit upon any security not registered upon a national security exchange—that is to say, upon an over-the-counter security.

This disqualifies thousands of securities of substantial merit which have splendid records of price and earning stability. Many public utility bonds and common and preferred stocks, banks, and insurance company stocks, guaranteed railroad stocks, industrial stocks and bonds, and State, county, and municipal bonds would become worthless as collateral for loans in exchange transactions, although the issuers are sound and substantial enterprises or political divisions; while any security—as long as it were listed on some national security exchange—would be eligible for credit under the bill. Furthermore, there is nothing in the bill itself to prevent a broker from lending as much as he sees fit on real estate, mortgages, chattels, or even the unsecured notes of his customers.

The meaning of the phrase, "any person who transacts a business in securities through the medium of any such member", is not clear. It should be defined so as to avoid confusion regarding the extent of the application of section 6 (a). As it now stands this phrase is subject to the entirely plausible interpretation of including any bank

which buys or sells any securities on behalf of its depositors through the medium of a member of a national security exchange. Under this interpretation, unlisted securities would not be eligible for loans at such banks. The effects of this would, we imagine, go beyond what the framers of the bill have in mind.

It is difficult to grasp the intent behind section 6 (a). If it is to bring pressure upon issuers to apply for listing of their issues, then it should be borne in mind that many unlisted issues are for one reason or another unsuitable for listing on an exchange, and would not be accepted by a conscientious exchange acting solely on its own initiative. If the purpose is to encourage trading and investing in certain issues and to discourage activity in others, then the question arises as to what the basis of classification should be. Why should such issues as, for example, the Newark Gas Co. first 6-percent bonds of 1944, which enjoy the very highest rating, not be eligible for a loan just because they are not listed, while, on the other hand, many bonds of railroads in receivership can be used as collateral merely because they appear on the list of some security exchange.

Section 6 (b):

This section makes it unlawful for any member of a national security exchange or any person who transacts a business in securities through the medium of any such member to maintain or extend credit on a registered security in excess of 80 percent of the lowest price at which such security has sold during the preceding 3 years, or of 40 percent of the current market price, whichever is the higher.

I believe that the principle of relating collateral loans solely to market values is essentially unsound, no matter at what point the margin is set. This method permits a pyramiding process—higher loans as prices are rising and accelerates liquidation when prices are dropping. This is particularly true under the alternative devices provided in the bill which, it appears to me, will serve to permit pyramiding during the late stages of a bull market when it is most dangerous, while it will impede the flow of credit into the market during the early stages of recovery when, if ever, speculation in stocks is helpful.

It is my opinion that only by relating loan values to the earnings applicable to the collateral can these unfortunate results be prevented. In the report of our findings we recommend that this principle be adopted, and we suggest that, tentatively and experimentally, the maximum loan value of a share of stock be twice the aggregate net earnings applicable to it over the 5 years preceding the date of the loan, not to exceed, however, 60 percent of the current market price.

I have had prepared a table which shows for four prominent stocks—F. W. Woolworth Co., United States Steel Corporation, American Telephone & Telegraph Co., and General Motors Corporation—the maximum amount that could have been borrowed against one share of each according to, first, present New York Stock Exchange regulations for debit balances both above and below $5,000; second, the alternative provisions of the bill for this committee; and, third, the recommendations of the Twentieth Century Fund staff. Three points of time are used for the comparison:

September 3, 1929, nearly the peak of the bull market; June 1, 1932, approximately the low point; February 1, 1934, a convenient point in the present upswing. It must be borne in mind that our comparisons are hypothetical, since, had the margin requirement of either the bill or the Twentieth Century Fund been in force in 1929, prices presumably would not have reached the heights they did.

I present at this time charts showing graphically the loan relationships of the different plans for each of the four stocks studied The numerical data are contained in exhibit 1.

The CHAIRMAN. Very well, those will be incorporated in the record of your statement.

(The charts and data exhibits submitted by Mr. Bernheim will be found in full at the close of his statement, in the printed record only.)

Mr. BERNHEIM. Summarizing the charts and the table, the following facts stand out:

1. At the peak in 1929:

(*a*) The fund's margin provisions were very much more conservative than those of the New York Stock Exchange in each instance.

Senator KEAN. What was the amount of margin required in 1929 under the bill?

Mr. BERNHEIM. We assume that the bill was in effect in 1929?

Senator KEAN. Yes; I say assume the bill was in effect in 1929, what would be the margin required in 1929?

Mr. BERNHEIM. It is shown on my exhibit 1. Under the bill the margin on Woolworth for September 3, 1929—rather the loan value—would have been $30.80, and at the time the market price of the stock was $99.50. That would have been based at that time on the current market price, 40 percent.

Senator KEAN. And that would have been 40 percent of the current market price?

Mr. BERNHEIM. Of the current market price at that time.

Senator KEAN. So that you could have borrowed 60 percent out of it, is that right?

Mr. BERNHEIM. You could have borrowed under the bill 40 percent, $38 and some fraction of a dollar.

And under the plan of the Twentieth Century Fund, which would relate the loan value to the earnings applicable to the stock, you could have borrowed only $29.

Under the present regulations of the stock exchange, had they been in existence since 1929, a customer of a brokerage house, said customer carrying a debit balance under $5,000——

Senator KEAN (interposing). Over?

Mr. BERNHEIM. Over; he could have borrowed $77, and under, he could have borrowed $66.

Senator KEAN. When all the banks were asking 30 or 35 percent margin, how do you figure he could have borrowed $77?

Mr. BERNHEIM. He could have borrowed that from the brokerage houses. We are not discussing in here what might have been borrowed if he had dealt with the banks.

Senator KEAN. Most of the brokerage houses that I know required the same margins as the banks did.

Mr. BERNHEIM. The margins that are here given for the brokerage houses are about as stringent as the stock exchange ever demanded, as far as I know.

Senator KEAN. Did they not demand 30 percent in 1929?

Mr. BERNHEIM. This would be over 30 percent for debit balances under $5,000.

Senator KEAN. No, no; I am talking about over $5,000. Under $5,000 they required the whole thing to be cash, did they not?

Mr. BERNHEIM. No, sir; not to my knowledge, Senator. Those are the requirements at the present time, and as far as I know, they were no more stringent in 1929 than they are at present.

Senator KEAN. Certainly they were 30 percent; most houses were 30 percent or more in 1929.

Mr. BERNHEIM. On debit balances?

Senator KEAN. On debit balances.

Mr. BERNHEIM. This would be more than that, I think.

Senator KEAN. Your figures are wrong, I think.

Mr. BERNHEIM. If the purchase price were, let us say, $100 a share——

Senator KEAN. Then they could borrow 70?

Mr. BERNHEIM. If they borrowed 77——

Senator KEAN (interposing). No.

Mr. BERNHEIM. If they could borrow $70——

Senator KEAN (interposing). They could borrow up to $70, that is all.

Mr. BERNHEIM. According to the information we had they could borrow more, and some brokerage houses considerably more, because these regulations were not in effect in 1929.

Senator KEAN. I think the testimony is that they put them in effect in 1929. Isn't that right?

Mr. PECORA. What is that, Senator?

Senator KEAN. That they put into effect that they had to have over 30 percent margin?

The CHAIRMAN. August 1933.

Mr. PECORA. That was August 2, 1933.

Mr. REDMOND. It is true, though, Senator Kean, that the ruling of the exchange in 1929 was that the margin had to be sufficient so that the securities would carry themselves. Therefore, in effect, the exchange requirement meant at least the same amount of margin as the banks were currently demanding.

Senator KEAN. The bank was 35?

Mr. REDMOND. The banks carried margins which varied, depending upon the nature of the security in 1929.

The CHAIRMAN. Proceed, Mr. Bernheim.

Mr BERNHEIM. The second relationship is:

(*b*) The Fund's margin provisions were appreciably more conservative than those of the bill in three out of the four instances.

(*c*) The bill's margin provisions were more conservative than those of the New York Stock Exchange in each instance.

2. At the bottom in 1932:

(*a*) The Fund's margin provisions were slightly more conservative than those of the New York Stock Exchange in each instance.

(*b*) The Fund's margin provisions were slightly more conservative also than those of the Fletcher-Rayburn bill in each instance.

(*c*) The bill's margin provisions were very slightly more conservative than those of the New York Stock Exchange for debit balances over $5,000 in 3 out of the 4 instances, and the same in 1 instance. They were less conservative in each instance when comparison is made with the exchange's provision for debit balances under $5,000.

3. During the recovery in 1934·

(*a*) The Fund's margin provisions were more liberal than those of the bill in each instance.

(*b*) The Fund's margin provisions were, however, more conservative than those of the New York Stock Exchange.

(*c*) The bill's margin provisions were much less liberal than those of the exchange in each instance.

It is plain from the above comparisons that during a period of recovery the loan values suggested by the Fund staff would be more generous and therefore less hampering to general reviving than those proposed by the bill. On the whole, loan values as recommended by our staff related as they are primarily to earnings and only secondarily to market values, would be subject to fluctuations less violent than loan values as now regulated by the stock exchange or as proposed in the bill. This relative stability in credit resources available for trading should be reflected in greater stability in market prices of securities.

Mr. PECORA. Mr. Bernheim, might I interrupt to just ask a question there? How long did it take, tell us, to establish the loan values under the plan proposed by the Twentieth Century Fund?

Mr. BERNHEIM. For what, for all listed stocks?

Mr. PECORA. Yes.

Mr. BERNHEIM. I do not think I could answer that question. I think it would take a considerable period of time.

Mr. PECORA. You mean by that perhaps several years?

Mr. BERNHEIM. I don't think it should take several years to cover the listed stocks; no, sir. I think it would take about a year, perhaps a year and a half. And, frankly, my own feeling is that you should not in this case perhaps wait until loan values could be established, but that this should be the goal to aim at, and that gradually loan values should be transferred whenever you have covered, let us say, an industry, so that you can have a comparison of stocks and put that industry on a somewhat uniform accounting basis. I do not think it would be necessary to wait until you had covered all your listed stocks. I think you could make some changes month by month as you were ready for it.

Mr. REDMOND. Mr. Bernheim, could I ask you one or two questions to develop the way this plan would work? Would you have to wait until the end of each year before you would change the loan value?

Mr. BERNHEIM. You might be able to work it on the basis of quarterly or semiannual reports, but I don't think it would be necessary, because the effect of a change for a single quarter or half year would not be appreciable.

Mr. REDMOND. In effect then you would really come very close to establishing a loan value that would remain substantially unchanged for a 12-month period?

Mr. BERNHEIM. It would if you disregard quarterly and semiannual earnings. It would not change for the year. Then if you wanted to take into consideration quarterly or semiannual earnings, the loan value would change twice at the end of each quarter.

Mr. REDMOND. Have your staff considered at all the effect of this provision on, say, industries that have had a particularly bad time during the depression, like the railroads?

Mr. BERNHEIM. Yes. We came to the conclusion that it would not be wise to have an absolutely rigid rule; that after some study, after considerable study, it will be necessary to devise, let us say, credits and debits for other matters besides earnings, but that essentially earnings should be the base on which loan values were to be fastened, but there could be some credits given and debits.

Mr. REDMOND. In other words, this is more or less the principle to be applied without being actually written into the law as a definite mandate, that not more than twice the aggregate of the last 5 years' earnings should be established as to the loan value. I am just trying to find out.

Mr. BERNHEIM. I think that we should go beyond establishing this as a principle, but I think that perhaps there should be a waiting period. As I suggested before in reply to Mr. Pecora's question, you would have to wait 6 months or a year and make studies of the effect of this suggestion, and then perhaps devise for either groups of stocks or individual stocks certain differentials to be applied for certain circumstances, and those could be made administrative rules and regulations.

Mr. REDMOND. Would you not have to develop those almost immediately? For instance, take a wasting industry where your income may reflect actually the wastage of the property. There your formula in regard to income would have to be revised or you might get an unduly high credit.

Mr. BERNHEIM. You certainly would have to take great care that what was a distribution of capital was not considered income in determining your loan value.

Mr. REDMOND. Of course, that is nearly always, isn't it, a question of the discretion of the board of directors?

Mr. BERNHEIM. It is perhaps a question of accounting methods plus some discretion, I presume.

Mr. REDMOND Therefore, it is a question of making good, whatever is in the capital account?

Mr. BERNHEIM. At least we could put the companies within the industry on a comparable basis.

And another thing that I think must be kept in mind, Mr. Redmond; we have suggested here that the loan values are to be maximum.

Mr. REDMOND. Yes.

Mr. BERNHEIM. In other words, the market price would to some extent take care of exaggerated earnings.

Mr. REDMOND. I am thinking of the case where the market price might reflect other factors, like a great concentration of holding,

where there might be a demand which might drive the price up fairly rapidly. Your loan limitations here would be on earnings?

Mr. BERNHEIM. Essentially on earnings; yes. But they would have to be the true earnings. You would have to attempt to determine what the true earnings were applicable to the security.

Mr. REDMOND. What would you do with new enterprises?

Mr. BERNHEIM. I think you would have to devise certain special rules for new enterprises. Perhaps if there were mergers of previously existing enterprises, you might be able to compute the earnings that would have accrued to this company had the merger taken place some years before. Or you might perhaps, in some cases, have to reduce your period of time. Instead of a 5-year period reduce it for new enterprises to 2 or 3 years.

Mr. REDMOND. There are constantly new enterprises for which there would be no past history.

Mr. BERNHEIM. Yes. Of course, it might be advisable not to apply it for credit purposes to entirely new enterprises. Naturally you would want to have some experience, and for the new one you would have no experience and no record and no history.

Mr. REDMOND. And not give them any value——

Mr. BERNHEIM. Until perhaps they had been in existence and shown some stability and earning power for a period of time.

Mr. REDMOND. Would that not tend to interfere with the flow of capital into industry? I am thinking of the other side of the picture now.

Mr. BERNHEIM. I think it would interfere more with the speculative interest in the issues. I do not think the investor purchases securities and then immediately seeks to borrow on them.

Mr. REDMOND. Is it not true that a large part of the capital for industry has always been raised by borrowing money? That is our credit system in the last analysis, isn't it, Mr. Bernheim?

Mr. BERNHEIM. The money naturally comes from somewhere.

Mr. REDMOND. And there must be some borrowing?

Mr. BERNHEIM. Well, you mean the original underwriting, that the underwriters borrowed?

Mr. REDMOND. No; I am speaking of actual distribution to investors. They do not always buy outright.

Mr. BERNHEIM. I think it depends upon the times. I suppose what you say was very true in 1928 and 1929, and I think that was one of the very unfortunate aspects of the situation; that investors, and speculators also, extended their credit resources as far as possible and wanted to get in on every new issue. And I think we therefore had overissuance, and if that were made difficult it might perhaps be very beneficial.

Mr. REDMOND. I think we might all agree on the fact that it might be wise to devise something that would make it more difficult, but would not your formula practically amount to a prohibition? Is there not some midposition that would allow capital to flow into industry with some use of credit?

Mr. BERNHEIM. I think most of the new corporations that are being floated or have been floated were based upon previously existing companies whose earnings could be computed. They were incorporated or they were merged or consolidated in some way or other.

Mr. REDMOND But very often it would be impossible to use the old figures, would it not? I mean you would get a merger in which a part of one business is merged with another going concern What part of the income of the first unit should be attributed to the new one would be very difficult to determine.

Mr. BERNHEIM. I do not pretend to claim that there would not be difficulties

Mr. REDMOND. Yes.

Mr. BERNHEIM. And I think that the administrative agency would have to be given some discretion within the general principles.

Mr. REDMOND In effect it would be giving wide discretion to this administrative agency, with a mandate to establish this principle as its guiding principle in formulating the loan values of stocks?

Mr. BERNHEIM. I think that over a period of time you could gradually get down to a body of rules and regulations and precedents which would cover a very large proportion of issues. And, then there would be a small section—I think it is necessary to admit that, that there would be a small section of corporations which would have to be governed by discretion solely.

Mr. REDMOND. Yes.

Mr. BERNHEIM. Or ruled out from any loan value entirely.

Mr. REDMOND. I just wanted to develop the problems connected with this formula.

Mr. PECORA. Mr. Bernheim, in order to apply the principle or formula for determining loan values that you advocate, would it not be necessary for the regulatory body or body entrusted with the power to fix those loan values to have the sort of information from corporations that the Fletcher-Rayburn bill in effect calls for with regard to their condition?

Mr. BERNHEIM. Yes, indeed; it would be necessary. And I think that that would be one of the valuable byproducts of such a law.

Mr. PECORA. In framing the principle or formula with regard to the creation or establishment or ascertainment of these loan values that you recommend, was it your purpose—when I speak of your purpose I mean the purpose of yourself and others associated with you in this enterprise—to fix a certain minimum loan value representing a certain percentage of the market value of securities?

Mr. BERNHEIM. You mean in addition to the principle of basing loans on earnings?

Mr. PECORA. That is, the formula that you have advocated here for determining and fixing loan values, is it or is it not so drawn as to require a minimum margin requirement of a certain percentage of market value?

Mr. BERNHEIM. I still don't quite understand your question, Mr. Pecora.

Mr. PECORA. Did you strive in formulating this principle of ascertaining loan values to have those loan values based upon a minimum percentage of the market value of the security?

Mr. BERNHEIM. No; maximum percentage.

Mr PECORA. Maximum?

Mr. BERNHEIM. We provided that in no case, no matter what earnings were, should anyone be permitted more than 60 percent of the market value, and then, of course, banks and brokers would have discretion to lend less if they wished to in any case.

Senator KEAN. Mr. Bernheim, I would like to ask you some questions. In the first place, I would like to ask you what experience you have had in markets, in securities, and what is your history? I do not happen to know your history. I would like you to describe yourself a little bit.

Mr. BERNHEIM. I have not been in the securities business, and my contacts with securities have been partly as one of the great investing and speculating public, and to some extent as a student of economic matters, and primarily during the past 5 or 6 months as the director of this research project which was carried through by the Twentieth Century Fund.

Senator KEAN. Who is the Twentieth Century Fund?

Mr. BERNHEIM. The Twentieth Century Fund is an endowed institution which was founded largely through the efforts of Mr. E. A. Filene, of Boston, and has a board of directors of some 5 or 6 other gentlemen whose names I can let you have.

Senator KEAN. I have those names.

Mr. BERNHEIM. And it does research work in economics, and also contributes to the support of other organizations doing work in similar fields.

Senator KEAN. What is your experience in research work?

Mr. BERNHEIM. I have been doing research work of one sort or another——

Senator KEAN (interposing). In the first place, where were you educated?

Mr. BERNHEIM. I went to Columbia College. I was born in New York and went to school in New York at the College of Columbia. After that I went in business for a period of about 5 years.

Senator KEAN. What kind of a business?

Mr. BERNHEIM. I was a tanner in Hoboken, N J. And about 1920 or '21 I became interested in economic research, and I joined an organization——

Senator KEAN (interposing). Your experience as a tanner——

Mr. BERNHEIM (interposing). Was not very helpful as to securities.

Senator KEAN. Your experience as a tanner—the price of hides in 1920 was—what was it, 50 cents? Went up to 50 cents a pound, or something like that.

Mr. BERNHEIM. I don't remember. I got out when hides were about at the top.

Senator KEAN. You were lucky Now a calf's hide is worth something like $2 or $2.50, as against $30 or $40 at the time you got out. So that that has been a greater depression than any of these stocks.

Mr. BERNHEIM. I don't remember that the price was ever quite as high as you just quoted, Senator, but I know it was higher than at the present time.

Senator KEAN. Well, go ahead with your story, after you got through tanning.

Mr. BERNHEIM. Oh, my personal story?

Senator KEAN. Yes.

Mr. BERNHEIM. After that I joined an organization known as the Labor Bureau, Inc., which devotes—which is still in existence—and devotes its time to research in the field of labor problems, cost of living, and financial analyses of corporations and studies of indus-

tries and price trends, matters of that sort. I left the labor bureau temporarily to assume the——

Senator KEAN (interposing). Who supports the labor bureau?

Mr. BERNHEIM. It is supported by its clients, by fees from its clients.

Senator KEAN. Who are its clients?

Mr. BERNHEIM. Well, they are largely labor unions, and to some extent coorperatives or educational institutions and in some cases it does work for employers and employees jointly. It handles arbitrations and matters of that sort. It was organized about 1920 as a New York corporation and is still in existence as such.

Senator KEAN. And then you joined——

Mr. BERNHEIM. I went temporarily to the Twentieth Century Fund to conduct this survey.

Senator KEAN. And your survey in this bill was what would happen to all the little towns in the United States where the banks and perhaps little local companies that the people want to buy their securities for investment in, under this bill they would be absolutely precluded from borrowing from the local banks, would they not?

Mr. BERNHEIM. In this bill?

Senator KEAN. In this bill.

Mr. BERNHEIM. In the Senate bill?

Senator KEAN. Yes.

Mr. BERNHEIM. As I understand the bill, they could not borrow on an unregistered security through a member of a security exchange or anyone doing business through such member. Is that correct? You are more familiar with it than I am. But they could borrow, I presume, through anyone, a bank that is not a member of a securities exchange or did not do business through any such member.

Senator KEAN. Yes, sir; but suppose that you happen to be a broker in New York and you want to buy a house and you got some local securities which the bank knew were perfectly good and you wanted to borrow at your local bank to buy a house. You could not do that under the bill?

Mr. BERNHEIM. I presume you could not

Mr. PECORA. Probably buy the house subject to a mortgage.

Senator KEAN. And then have the mortgage foreclosed and wiped out.

Mr. PECORA. That is what happens to margin customers every day in the year.

Senator KEAN. Yes.

Mr. BERNHEIM. Of course, as I pointed out in my analysis, Senator, I do not see why you should not be allowed to borrow on some unlisted securities of some class and category.

Senator KEAN. That is all I have.

Mr. PECORA. Mr. Bernheim, is it not a fact that your proposal for margin requirements is based upon and would provide for a minimum margin of 40 percent of market price?

Mr. BERNHEIM. Oh, the minimum might be lower. The maximum would be 60 percent. The minimum might be very much lower than 40 percent. If a company had an unfortunate record of earnings and no other factors were taken into consideration, the loan value might be a good deal less than 40 percent.

Mr. REDMOND. Mr. Bernheim, have you available any figures, on the same comparable basis as you have given in your report for Woolworth & Co. and American Tel. & Tel. and General Motors, for typical railroads, steamship companies, and coal companies?

Mr. BERNHEIM. No; we have not made any other analyses as yet. We prepared this hurriedly when we knew we were coming down here.

Mr. REDMOND. Yes.

Mr. BERNHEIM. And we naturally took what we considered four of the most representative companies from the point of view of their investment interest.

Mr. REDMOND. And four of the most successful, too?

Mr. BERNHEIM. Well, it depends upon what period of time you cover. If you consider United States Steel during the past 3 years, I don't think you could characterize it as being very successful. Of course, in the past it has been. You could pick out a lot of companies that have been more successful since 1929 than either Steel or Woolworth.

Mr. REDMOND General Motors and American Tel. & Tel. and Woolworth, are all rather exceptional are they not?

Mr. BERNHEIM. In some respects they are exceptional, but I think primarily because they are very large and there is a great investment interest in those companies They have many stockholders, and they are I think to a large extent investment stocks.

Mr. REDMOND. So is American Car & Foundry, and yet I assume that——

Mr. BERNHEIM (interposing). It was.

Mr. REDMOND. It still is, isn't it?

Mr. BERNHEIM. I don't think so.

Mr. REDMOND One of the great stocks of the old days?

Mr. BERNHEIM. In the old days, yes, sir; not any more.

Mr. REDMOND. It has still a large number of stockholders?

Mr. BERNHEIM. Well, I suppose—I know the experience they undoubtedly had. They did not get out in time, so they are involuntary investors.

Mr. REDMOND. True, but that often happens to be the case whether it is a real-estate transaction or stocks or anything else?

Mr. BERNHEIM. I am afraid it is; yes.

Mr. REDMOND. But you haven't any data available for what I would consider——

Mr. BERNHEIM (interposing). We have none available at the moment, no sir; except on these four companies.

Mr. REDMOND. Would it be possible to get the data on something like New York Central Railroad or some of the typical big railroads?

Mr. BERNHEIM. Yes; it would be quite possible to work that out. It takes some length of time, because you have to take into consideration the changes in capitalization, both in respect to earnings and in respect to market price. You have got to go very carefully over the past history to see that you are not led astray by any additional issues of stock that have been made. But it can be worked out. If you would like to have that worked out, when I get back

to New York, if you suggest a few other stocks to us we would be very glad to send you the results.

Mr. REDMOND. I make the suggestion to the committee that it might be well to have a cross section, so to speak, of the listed securities, rather than just a few outstanding industries, and certainly the outstanding public utility of the country.

Mr. PECORA. Suppose you suggest two or three issues.

Mr. BERNHEIM. We will prepare it and mail it down to the committee this week or the first of next week, if the committee would be interested in getting that.

Mr. REDMOND. Suppose I talk to Mr. Bernheim after the meeting is over, Mr. Pecora, because I want to choose companies that are fairly representative, and not just choose those that have been outstandingly successful.

The CHAIRMAN. Very well. Proceed, Mr. Bernheim.

Mr. BERNHEIM. Section 6 (c): This section makes it unlawful for anyone not a member of an exchange to lend on securities registered on a national security exchange to an amount in excess of what a member of a registered exchange may lend, unless the borrower certifies that he acquired and paid for the collateral in full more than 30 days prior to the making of the loan.

Strictly interpreted, this section would govern certain types of loans which presumably it is not intended to cover, such, for example, as private loans between two individuals, or loans by corporations to employees or customers under a stock-purchase plan. The section should be clarified and perhaps modified.

What is more important, however, is that it be clearly realized that the 30-day clause would permit pyramiding of purchases. Assume that a person with $10,000 purchases 100 shares of stock at $100 a share. Thirty days later he takes these 100 shares to a bank and obtains a loan of, say, $7,500 with which he now buys 75 additional shares at $100. After another month he again goes to his bank, and on these 75 shares he now borrows $5,625 and makes a further commitment of 56 shares. If this process is repeated for a total of 12 successive 30-day periods, the purchaser of 100 shares of stock for cash on January 1 of one year, will, on January 1 of the following year own approximately 390 shares of stock and owe his bank approximately $28,000. An original $10,000 in cash is now represented by more than $39,000 in stock. It has, of course, taken the speculator a year to build this pyramid but he has succeeded in the end.

A picture of the process is presented in one of the graphs, and the detailed figures are contained in exhibit 2. If the framers of the bill propose to reduce the amount of money that can be borrowed on securities in order to reduce the volume of speculation, they should consider whether section 6 (c) does not provide a loophole that may nullify this purpose.

Section 6, as a whole, combined with section 7 (a), is rather peculiar in that it permits a nonmember of a national security exchange, provided that he does not do a business in securities through a member, to borrow on unregistered securities any sum which a lender is willing to advance.

Section 8 (a) (3): This section makes unlawful any transactions in a security on a national security exchange—

for the purpose of raising or depressing the price of such security or securities or for the purpose of creating or with the expectation that there will be created a false or misleading appearance of active trading in such security or securities, or a false or misleading appearance in respect of the market for such security or securities

The above prohibition is commendable as to its goal but, in our opinion, is unrealistic and unenforceable. To prove "purpose" or intent which are essentially subjective in their nature, would seem to be an almost hopeless task As the result of our own study of security markets we are inclined to believe that pools cannot be controlled by direct prohibition as readily as they can through control of the weapons they use and by exposing them—and the security markets in general—to the greatest possible amount of honest and intelligent publicity.

This section prohibits any dealer, broker, or member, or anyone in their employ, to—

disseminate * * * information to the effect that the price of any security or securities registered on a national securities exchange will or is likely to rise or fall partly or wholly because of the market activity of any one or more persons, if the person disseminating such information has reason to believe that the circulation or dissemination of such information on his part may induce the purchase or sale of any such security in the expectation of such market activity

Like the previous section, this one embodies a salutary idea, but it is obviously so difficult to enforce and so easy to evade as, in all probability, to be meaningless in practice.

Section 8 (a) (5): The same thing can be said about this section, which makes it unlawful:

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

There are certain other objections to this section besides difficulty of enforcement. In the first place, it subjects to an exceedingly heavy liability, and places a heavy burden of proof upon, any person who says anything about a registered security—no matter how honest and well-intentioned that person may be—which happens to mislead the average investor. In the second place, it sets up the concept of an average investor—an animal as mythical as a chimera.

Section 8 (a) (8): This section makes it unlawful for any person to—

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

This, in my opinion, is another of those provisions which are vague, tenuous, and difficult to enforce. Except for a very few stocks, no one knows what the floating supply of an issue is, although, of course, it is quite possible, as we ourselves have suggested, to compile periodic statistics on the extent of floating supply. There

is the further difficulty, however, of determining what "substantial control" of floating supply is.

Section 8 (a) (9): This section prohibits all transactions involving puts, calls, straddles, or other options.

This is too sweeping a prohibition. Under certain circumstances options perform a legitimate function. Furthermore, there are outstanding today in the hands of the public options and warrants, many of which are traded in now on the organized exchanges.

Section 9 (a): This section prohibits short selling—

except in accordance with such rules and regulations as the Commission may prescribe * * *

In the absence of knowledge as to what rules and regulations the Commission will prescribe, it is difficult to pass judgment on this section. I should like, however, to read our general conclusions on short selling reached after careful consideration of a mass of factual data. [Reading:]

Our study of short selling has led us to the conclusion that while this practice fails in large measure to perform the useful function which its proponents claim for it, it also does not in the aggregate cause the havoc to the general price structure with which its opponents charge it

In any discussion of short selling it should always be borne in mind that it is the speculative excesses on the long side which create a condition of the market where short selling can become a disturbing factor Long buying and short selling are complementary aspects of the same problem—speculation—and to attempt to solve this problem by an attack on only one of its dual aspects does not promise fruitful results Yet while it is common to extol those whose activities result in driving prices upward, it is almost universal to condemn their speculative counterparts who strive to produce the opposite effect.

As we see it no moral question is involved either in long buying or short selling, but only one of utility To the extent that speculation on either the long or short side aids the security markets in the performance of their functions, to that extent only should speculation be countenanced

In view of the fact that short selling is relatively unimportant we do not believe that, as a general technique, it requires further regulation than now exercised by the New York Stock Exchange We believe, however, that there is need of more rigorous control in respect to short selling of individual issues at particular points of time, especially where engaged in suddenly and in large amounts. Under such circumstances short selling has a pronounced and depressing influence upon prices

Section 10: This section covers the general subject of the segregation and limitation of the functions of broker, specialist, and dealer It contains several provisions which I should like to discuss.

One of these is that no member of a national security exchange may act as a dealer in, or underwriter of, securities. I interpret this to mean that no member may buy or sell securities for his own account or for the account of his firm While the fund staff endorses the principle of the separation of the broker from the dealer function, I believe that, following the general London practice, an exchange member should be permitted to function either as broker or dealer.

I do not see any valid reason for prohibiting a nonbroker exchange member from buying and selling securities for his own account, that is to say, from trading and speculation, as long as trading and speculating may be indulged in freely by nonmembers. In permitting margin trading, the bill, ipso facto, puts its stamp of approval on speculation in securities, for margin trading is the essence of stock

speculation. Sure the committee does not believe that the nonmember is better qualified as a speculator than the member. Furthermore, if exchange members may not deal in stocks, the odd-lot business, as at present conducted, can no longer be carried on. The committee should consider whether it wishes to bring about this result.

It is unlawful under section 10, furthermore, for—

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 question arises whether the principle of segregation should be extended—as it is here—to such persons as banks which, while not actually in the brokerage business, do execute orders for the purchase and sale of securities for their depositors through the medium of national security exchange members. In a small community, in particular, the bank may be the only institution through which a resident can conveniently consummate a transaction in a security; yet, in accordance with section 10, the bank that performs this function may not act as a dealer in, or underwriter of, securities, or, under a strict interpretation, may not even be allowed to purchase and sell securities for its own account.

Another specific provision of section 10 is that a specialist may execute only fixed-price orders; that is to say, may not execute market orders. In view of the fact that according to the bill a specialist will be permitted to function only as a broker and will not be permitted to act as a dealer, there seems to be no purpose to this prohibition. It should, therefore, be eliminated since its presence would tend to interfere with the efficient execution of orders.

This section further makes it unlawful for a specialist—

to disclose to any other person information in regard to orders placed with him which is not available to all members of the exchange

The fund staff concluded that it is impossible to enforce a prohibition against disclosing orders, and it therefore prefers a requirement to the effect that orders on the books of a specialist should be available to every member of an exchange.

Section 11: In our opinion the purposes of section 11 could be better effectuated by a Federal incorporation act in respect to corporations in interstate commerce than by this indirect and uncertain method.

Section 11 (c) (I): The first part of this section provides for—

an undertaking by the issuer to comply with and so far as is within its power to enforce compliance by its officers, directors, and stockholders with the provisions of this act * * *

I do not believe that a corporation has any power over its stockholders and therefore consider it meaningless to require an undertaking by an issuer to attempt to enforce compliance with the provisions of the act by stockholders.

Section 15: This section as a whole deals with transactions of directors, officers, and principal stockholders. Insofar as its provisions are sound, and insofar as they apply to corporations engaged in interstate commerce, they should, in my opinion, be embodied in a Federal incorporation act. I question whether that part of section

15 which pertains to owners of securities, who are not officers or directors, is practicable and enforceable.

Section 15 (b) (1): This section provides that an issuer may sue any of its directors, officers, or certain owners of its securities, for profits derived by them as the result of a purchase and subsequent sale within 6 months of a security of the issuer, the profits being calculated on the basis of the difference between the highest and the lowest price at which the security sold during the 6 months' period.

While I deem it highly desirable to stop directors and officers—and if possible, large stockholders also—from speculating in the stocks of their corporation, I am afraid that the provisions of section 15 (b) (1) will result in wide-spread violations, subterfuges, and evasions. Our own recommendations provide merely for prompt publication of all transactions by directors and officers in the securities of their own corporation. I believe that publicity will cure the worst of the evils surrounding the stock-market operations of "insiders", and I am of the opinion that our recommendation could be effectively enforced through corporations and their transfer agents.

Section 15 (b) (3): forbids the stockholder—

to disclose, directly or indirectly, any confidential information regarding or affecting any such registered security not necessary or proper to be disclosed as a part of his corporate duties

While heartily approving of the purpose of this section, I am of the opinion that it will prove largely meaningless, because it will be virtually impossible to enforce.

Section 28: This section in effect makes it unlawful for any broker or dealer to consummate a transaction in an American security in a foreign security exchange except in accordance with rules and regulations of the Commission. While it is proper for the bill to provide safeguards against the flight of the securities business from the United States, it should be borne in mind that section 28 can be evoked to prevent arbitrage transactions between this and foreign countries, a trading technique which, under ordinary circumstances, can scarcely be considered harmful.

I have briefly commented upon some of the major provisions of the National Securities Exchange Act of 1934.

To repeat what I said at the outset of this statement, I am thoroughly in sympathy with the objects which the act seeks to achieve—to bring speculation in securities under control, to reduce its volume, to eliminate manipulation, to prevent fraud, to put an end to the advantages enjoyed by "insiders", to make available to investors information about issuers and issues, and, in general, to standardize, regulate, and control the business conducted on and through security exchanges.

My criticism is not directed to the purposes of the act but to some of the methods by which the bill proposes that these purposes are to be achieved.

I believe that it confers too much discretionary power upon the Federal Trade Commission and that the grant of such extensive power by the legislature to an administrative agency is not wise.

I believe that it imposes liabilities and penalties which, on the whole, are excessive and some of which are likely to result in blackmail and wholesale litigation, and which, in addition, will stimulate evasion and subterfuge.

I believe that it errs in leaving certain activities unregulated.

I believe that in several respects it is unenforceable and unrealistic.

In spite of these criticisms, however, I am convinced that the bill is based on sound principles. Suitably amended, it should prove to be a highly beneficial piece of legislation.

Thank you very much.

Mr. REDMOND. Mr. Bernheim, just for the sake of the record, have the trustees of the Twentieth Century Fund approved this report?

Mr. BERNHEIM. No, sir; they have not taken any action on the report.

Mr. REDMOND. I see.

Mr. BERNHEIM. As I understand it, the trustees of the fund are in the same relationship toward a research project as are the trustees of a college. They do not assume personal responsibility, and in this case, due to the great haste of the final preparation of the report, they did not even have a chance, as far as I know, to make a careful study, and in some cases to make any study, of the findings and conclusions.

But I do not want to speak for the fund. Mr. Clark, the secretary of the fund, is here, and if you want to ask him that question, he can give you a much better answer than I can.

Mr. REDMOND. I just wanted to establish that for the record.

Mr. BERNHEIM. But they have not assumed the responsibility. That I am quite sure.

Mr. PECORA. The trustees of the fund do, however, assume responsibility for the employment of the research men?

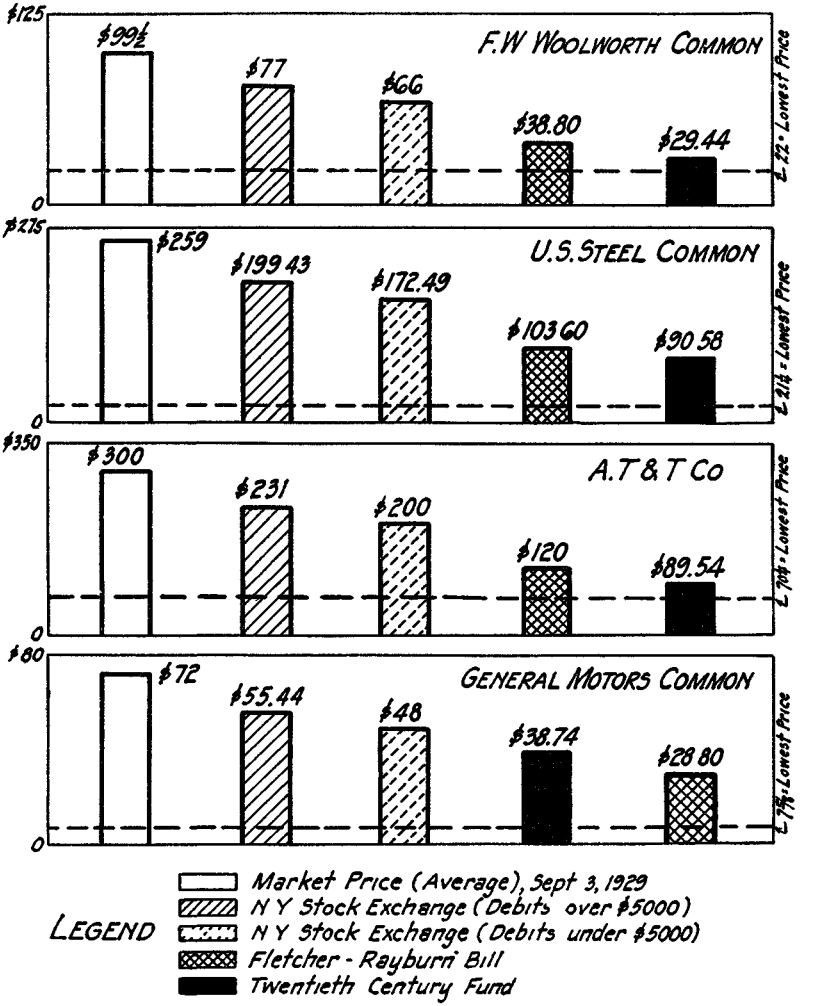
Mr. BERNHEIM. They authorize the project, appropriate the money, and from that point on I do not know just exactly what they do. I was engaged through the secretary of the fund. Now, whether it was his discretionary authority to engage me or whether he was empowered to do so by the trustees, I do not know, but he is right there, Mr. Pecora, if you wish to go into that at all. Mr. Clark is here.

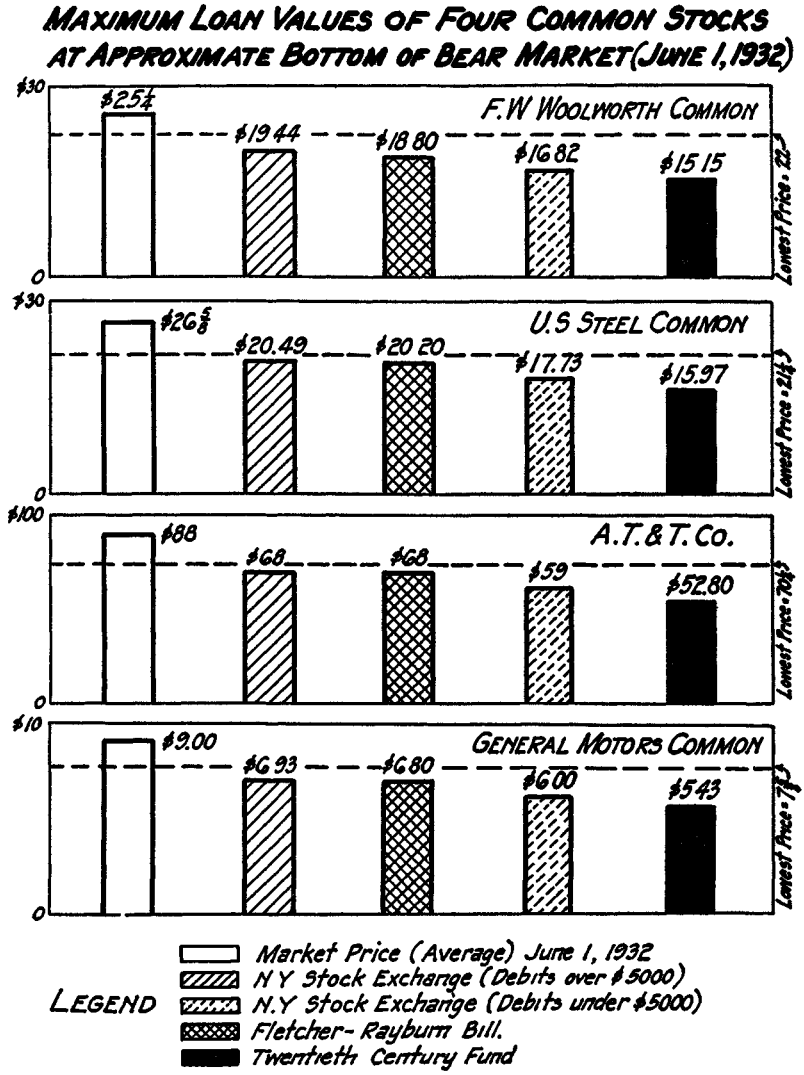
Mr. PECORA. Mr. Evans Clark, secretary, is here?

Mr. BERNHEIM. Yes; he is here, and he can answer those questions much better than I can. Do you want him?

The CHAIRMAN. Mr. Clark.

MAXIMUM LOAN VALUES OF FOUR COMMON STOCKS AT PEAK OF BULL MARKET (SEPT. 3, 1929)





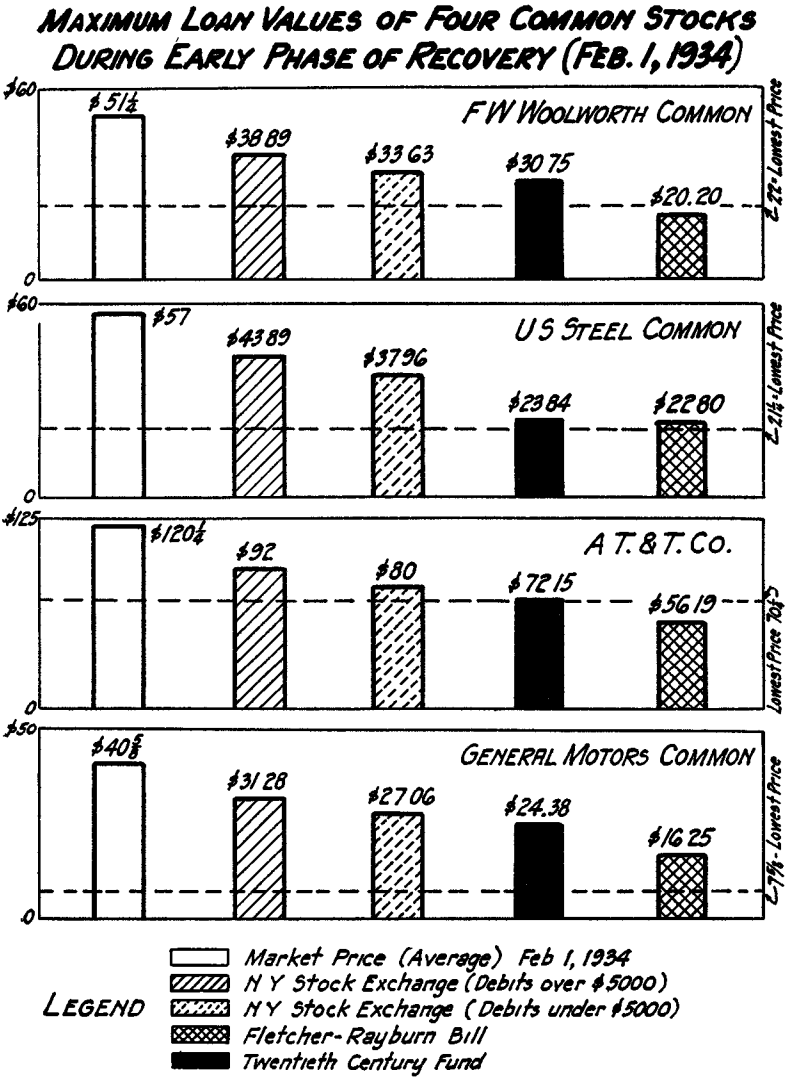


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EXHIBIT I—*Loan values of four common stocks compared with market values*

F W WOOLWORTH COMMON

	Sept 3, 1929	June 1, 1932	Feb 1, 1934
Market Price (average)	$99½	$25¼	$51¼
Loan values			
Twentieth Century Fund	[a] 29 44	[b] 15 15	[b] 30 75
Fletcher-Rayburn Bill	[b] 38 80	[c] 18 80	[b] 20 20
New York Stock Exchange			
(debits under $5000)	66	16 82	33 63
(debits over $5000)	77	19 44	38 89

U S STEEL COMMON

Market Price (average)	$259	$26⅝	$57
Loan values			
Twentieth Century Fund	[a] 90 58	[b] 15 97	[a] 23 84
Fletcher-Rayburn Bill	[b] 103 60	[c] 20 20	[b] 22 80
New York Stock Exchange			
(debits under $5000)	172 49	17 73	37 96
(debits over $5000)	199 43	20 49	43 89

AMERICAN TELEPHONE AND TELEGRAPH COMMON

Market Price (average)	$300	$88.	$120¼
Loan values			
Twentieth Century Fund	[a] 89 54	[b] 52 80	[b] 72 15
Fletcher-Rayburn Bill	[b] 120	[c] 68	[c] 56 19
New York Stock Exchange			
(debits under $5000)	200	59	80
(debits over $5000)	231	68.	92

GENERAL MOTORS COMMON

Market Price (average)	$72	$9.	$40⅝
Loan values			
Twentieth Century Fund	[a] 38.74	[b] 5 43	[b] 24 38
Fletcher-Rayburn Bill	[b] 28 80	[c] 6 80	[b] 16 25
New York Stock Exchange			
(debits under $5000)	48.	6	27 06
(debits over $5000)	55 44	6 93	31 28

[a] Based on earnings adjusted for changes in capitalization
[b] Based on current market price
[c] Based on lowest price for preceding three years, adjusted for changes in capitalization.

POSSIBLE PYRAMIDING IN ONE YEAR UNDER SECTION 6 (c) OF FLETCHER-RAYBURN BILL.

(ASSUMING LOANS OF 75 % OF MARKET VALUE)

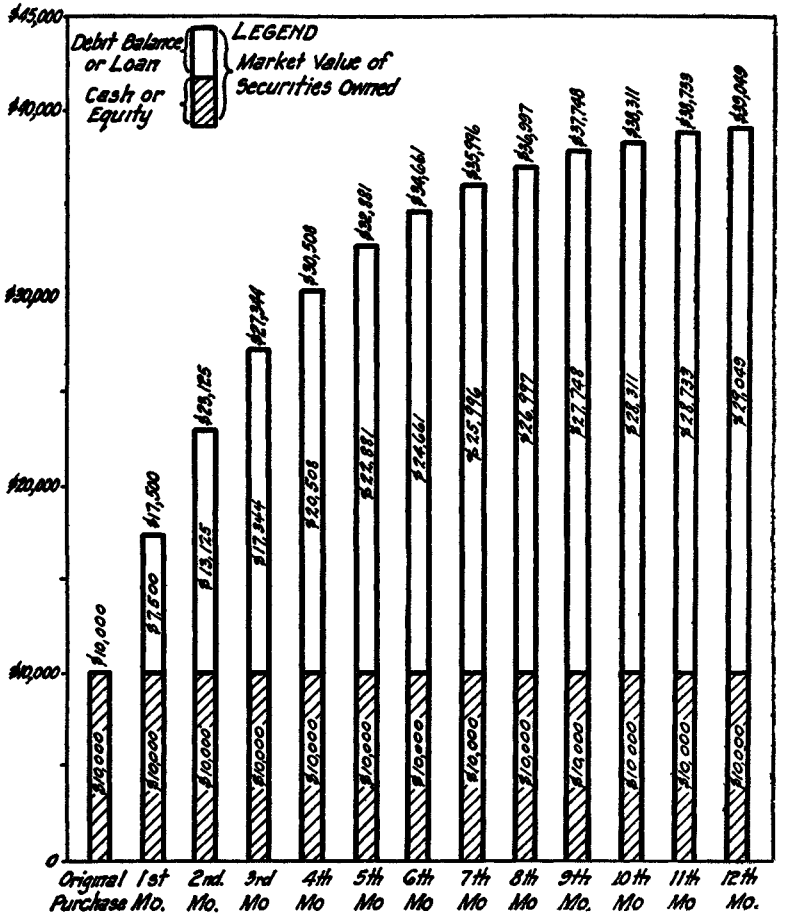

EXHIBIT II—*Possible pyramiding in one year under section 6 (C) of Fletcher-Rayburn bill (assuming loans of 75 per cent of market value)*

	Cash	Loan	Debit balance	Value of securities owned
Jan.	$10,000			$10,000
Feb.	10,000	7,500	7,500	17,500
Mar.	10,000	5,625	13,125	23,125
Apr.	10,000	4,219	17,344	27,344
May	10,000	3,164	20,508	30,508
June	10,000	2,373	22,881	32,881
July	10,000	1,780	24,661	34,661
Aug.	10,000	1,335	25,996	35,996
Sept.	10,000	1,001	26,997	36,997
Oct.	10,000	751	27,748	37,748
Nov.	10,000	563	28,311	38,311
Dec.	10,000	422	28,733	38,733
Jan.	10,000	316	29,049	39,049

STATEMENT OF EVANS CLARK, EXECUTIVE DIRECTOR TWENTIETH CENTURY FUND, NEW YORK CITY

The CHAIRMAN. Mr. Clark, you are secretary of this Twentieth Century Fund?

Mr. CLARK. Executive director is my title.

Mr. PECORA. Could you tell the committee very briefly, Mr. Clark, the circumstances under which the survey that has been referred to by Mr. Bernheim was undertaken and carried out by the fund or on behalf of the fund?

Mr. CLARK. Yes; I will be glad to. The project was originally suggested by an executive committee of the fund, and the outline of the research we had in mind was then suggested to the executive committee and to the full board, and was approved, and the money necessary to carry it on was appropriated by vote of the board. Since then, as Mr. Bernheim said, the trustees have not taken any action one way or the other on the findings. Just as he said, they have in the past and they do now have the same relationship to the findings of the technical staff as a board of college trustees do. They do not interfere in any way.

The CHAIRMAN. So the board has not acted on this report made by Mr. Bernheim?

Mr. CLARK. That is correct, Senator.

The CHAIRMAN. That is all, then. We will take a recess until half past two.

(Accordingly, at 1:08 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 now come to order, please. Mr. Butcher, we will hear you.

Mr. BUTCHER. Thank you, Mr. Chairman.

STATEMENT OF HOWARD BUTCHER, JR., PHILADELPHIA, PA., VICE PRESIDENT OF THE PHILADELPHIA STOCK EXCHANGE

The CHAIRMAN. You may proceed State your name, residence, and occupation

Mr. BUTCHER. My name is Howard Butcher, Jr., Philadelphia. I am vice president of the Philadelphia Stock Exchange.

The CHAIRMAN. Do you wish to be heard on this bill, S. 2693, Mr. Butcher?

Mr. BUTCHER. If you please, sir.

The CHAIRMAN. Very well. You may proceed in your own way.

Mr. BUTCHER. Mr. Chairman and gentlemen of the committee, the Philadelphia Stock Exchange desires to cooperate to the fullest degree in any proper effort to prevent any abuses affecting the stock market and to restrain unwise or excessive speculation.

Its governing committee believes, however, that this proposed legislation imposes regulations, restrictions, and prohibitions, which vitally affect the existence of exchanges throughout the country, which gravely injure the business of a vast number of brokerage houses in every section of the country, which impair the credit facilities of individuals and of industry everywhere, and which tend by reason of their severity and the limitations placed upon Federal authority, to defeat many of the purposes of the Act.

The act as drawn gives to the Federal Trade Commission complete domination of every stock exchange in the country, through powers of management affecting every single activity of a stock exchange, including the admission, supervision, and expulsion of its members, the election of its officers, the appointment of its committees, its rules for the conduct of business, and all its brokerage practices.

The domination the act gives to the Commission, the manner in which the regulatory power of the Commission is made effective and the penalties imposed by the act upon an exchange, its officers and its members for violations of the rules and regulations of the Commission must inevitably weaken the authority of the governing bodies of security exchanges, discourages all initiative and substantially impair the functioning of an exchange in the marketing of securities.

The requirements of the act with respect to accounts, records, reports, and examinations of members of national securities exchanges impose undue burdens, including the exercise of inquisitorial powers which are capable of grave abuse.

The requirements with respect to registering of securities upon a national security exchange, the obligations imposed upon the issuer of a registered security and the penalties imposed upon officers and directors of corporations whose securities are registered on a national security exchange, make registration prohibitive in the case of many corporations, and unduly burdensome in respect of all issuers of securities.

The prohibition upon members of an exchange with respect to the extension or maintenance of credit to or for a customer on any securities not registered upon a national securities exchange, making all unlisted securities ineligible as collateral in margin accounts is an unreasonable limitation upon investors in connection with their

margins in brokerage accounts, and unfairly discriminates between brokers and other lenders of money in the amount of credit which can be advanced upon unlisted securities.

The minimum margins established in the proposed act are unsound in principle and unworkable in practice. They attempt to set up a rigid formula for a subject which requires a very flexible rule.

The act imposes unnecessary restrictions and arbitrary limitations upon borrowing by members of national security exchanges.

The provisions of the act which prohibit any member of an exchange and any person who as a broker transacts a business in securities through a member of the exchange from acting as a dealer in or underwriter of securities would in effect deprive purchasers and sellers of listed stocks in amounts of less than 100 shares of the benefits of a market on the exchange; would eliminate methods of trading which have become an essential part of every important market for securities; and in respect of many brokers and brokerage houses throughout the country would compel them to cease business.

The provisions of the act with respect to "over-the-counter" market activities in unlisted securities, giving to the Federal Trade Commission power to control all dealings in unlisted securities, would in conjunction with other provisions of the act, practically destroy the market for unlisted securities insofar as the control of the Commission is applicable, and stimulate to an enormous degree the business of the completely unregulated "over-the-counter" markets.

The penalties both civil and criminal provided in the act are excessive and unreasonable.

The enactment of the bill in its present form will gravely affect the entire credit system of the country, and will seriously prejudice not only all stock exchanges and brokers and dealers in securities, but all banking institutions, industry, and all investors.

Such regulatory legislation as is deemed necessary should provide for a regulatory body or authority conversant with the technical problems connected with the operation of stock exchanges, with power to require within reasonable limitations the adoption by stock exchanges of rules and regulations for preventing practices which unfairly influence the price of securities or unduly stimulate speculation.

May I say a few more words informally, Mr. Chairman?

The CHAIRMAN Yes. You may proceed.

Mr. BUTCHER. It is estimated that there are approximately 200,000 employees of stock-exchange firms or of securities dealers in the United States, with an estimated pay roll of probably well in excess of $300,000,000. Many of these men, of course, are paying income taxes, and many other taxes, including State, city, county, and otherwise. If this bill is enacted in its present form, it is my very definite opinion, and I should like to express it politely, of course, but as firmly as I may, that these men would become unemployed almost immediately. It would immediately, or almost immediately, certainly within less than 30 days, produce a frozen condition in the matter of securities that would perhaps be even worse than now exists in the case of real estate.

It is estimated that there are about 11 million citizens, men and women, who hold stocks and/or bonds in the United States; and that there are probably another 15 million people who are directly interested through life-, fire-, and accident-insurance companies in the liquidity of the securities market. There are 25 million people, therefore, it is estimated, and in my opinion many more, who would be very seriously affected by the passage of this bill in its present form.

It is furthermore my opinion that no one act could be done at this time by Congress which would more seriously slow down, if not stop, recovery, which we are all anxious to have brought forward as rapidly as possible, as would the passage of this bill.

This bill contemplates, apparently, the inclusion of most directors of the larger corporations, and their officers, the holders of 5 percent of their securities, and the brokers, in a group against which it is proposed to apply penalties. It is proposed to put these men, many of whom have honorable records over two generations, into a special class, an unholy class, so to speak. It would be a serious reflection upon those men and upon their integrity. It would mean that a majority of those men having honorable records would be placed in a group of men who are to be considered as undeserving the confidence and respect of the Nation. The very fact that this bill is being considered by this committee and a committee of the House of Representatives has already had a very serious effect in slowing down a great many actions that those men would otherwise have taken.

It seems to me that the bill does not take into consideration what President Roosevelt has repeatedly said, that we must go forward in a united group, that we must fight the depression, that we must make a united effort toward recovery And I do not believe there has been any group of men who have responded more readily and more thoroughly than stockbrokers to that desire expressed by the President. It is certainly our earnest wish to help, but if we are going to be deprived of the officers down to the rank of sergeant, in this army that is expected to go forward in the fight against depression, and ask the army to go forward without those officers, there will be, I am afraid, very little motion. If you are going to eliminate those men I have mentioned, the officers and directors of the larger corporations from reasonable and just consideration, and I want to say to you very firmly that I feel this bill is unjust, a very grave and serious set-back to recovery must inevitably follow.

Mr. PECORA. What are those directors to be eliminated from that you are now speaking of?

Mr. BUTCHER. It seems to me that a man who is now a director of any corporation would, in event of the passage of this bill, of necessity have to resign his position prior to the passage of the bill.

Mr. PECORA. Why?

Mr. BUTCHER. Because if he did not, then through the inadvertence of some clerk somewhere, he would become immediately subject to a $25,000 fine and/or a 10-year jail sentence

Mr. PECORA. For doing what?

Mr. BUTCHER. For violating, perhaps entirely unwittingly, some provision of the rules and regulations of the Federal Trade Commission, which is to have authority under this bill.

Mr. PECORA. What provisions do you find in the bill that such director might violate unwittingly?

Mr. BUTCHER. I should think that any one of probably 12 or 14 different provisions—well, I haven't them by heart, of course, but any one of probably 12 or 14 different paragraphs of the bill would bring a man under very serious penalty, or might very readily do so.

Mr. PECORA. I wish you would be more specific about it.

Mr. BUTCHER. Any unintentional misrepresentation of fact, even to a very slight degree, would bring a man under the penalties of the bill. Now, I have been a governor of the Philadelphia Stock Exchange for many years, and certainly I would not act as a governor of that exchange nor as a director of a corporation if this bill were enacted And I think you will find, with all due respect, it would compel a group of men to act as directors very similar to the men who now act as straw men in connection with real-estate mortgages.

Mr. PECORA. To act as what?

Mr. BUTCHER As straw men in connection with real-estate mortgages.

Mr. PECORA. What do you mean by that?

Mr. BUTCHER. Men would have to act only if they had no means and might not be unduly perturbed about a possible jail sentence.

Mr. PECORA. Are you referring to the provisions of section 15 of the bill, entitled: "Transactions by Directors, Officers, and Principal Stockholders"?

Mr. BUTCHER. That is certainly one of the sections.

Mr. PECORA. Don't you think the practices aimed at in section 15 are harmful practices?

Mr. BUTCHER. Mr. Pecora, I believe if you and I were to sit down together for a very few minutes we would arrive quite quickly at a conclusion as to the undesirable things which now exist.

Mr. PECORA. Well, take the undesirable things referred to in section 15 of the bill, or the things which are sought to be prohibited by section 15 of the bill, would there be any dispute between you and me in regard to the proposition as to whether or not the practices there aimed at are unwholesome, undesirable and unethical?

Mr. BUTCHER. Mr. Pecora, I am not familiar with this thing by heart. I have read the bill several times carefully but have not got it by heart. I will say that am in accord with you very largely, if not perhaps entirely, as to what should be eliminated. But I am very much opposed to the manner in which it is sought in this bill to eliminate those things. As a matter of fact I have devoted a very material part of my working life, for the past 12 or more year, trying to eliminate some of the very things mentioned in paragraph 15 of the bill. At the same time I think the bill defeats itself. I offer that thought very respectfully, but I fear the bill as framed would defeat itself.

Mr. PECORA. Section 15 is the one that seeks to prohibit certain specific acts or transactions by directors, officers, or principal stockholders. If you can find anything there that you think should not be prohibited, I wish you would point it out instead of making a blanket attack upon the provisions by saying it would cause directors to resign. Furthermore, let me call your attention to section

24, which prescribes penalties for violations. You are fearful that directors may be sent to jail for unwitting violations. Section 24 of the bill specifically says:

> Any person who wilfully violates any provision of this act or any rule or regulation made thereunder—

becomes subject to the penalties prescribed in the bill. That is something far different from an unwitting or innocent violation, isn't it?

Mr. BUTCHER. That is what that language appears to say, but——

Mr. PECORA (interposing). It not only appears to say it, but it does say it, because the word "wilfull" is in there, and it has a very definite meaning and connotes something that is done wilfully.

Mr. BUTCHER. Don't you yourself think that if you were a director in a corporation you would resign if this bill were enacted into law?

Mr. PECORA. I will say to you that I think this: That directors would find it convenient to resign in event their sense of duty to their stockholders involved a betrayal of their trust by means of which such directors might profit. We have had many notable instances during our hearings here of directors doing that, including transactions by bank directors and/or officers.

Mr. BUTCHER. Mr. Pecora, I want to say that I am heartily in accord with you in the fact that a great many of those actions were what I would call, in the vernacular, entirely out of bounds. I have no sympathy with a great many of those actions, and I feel that I am very much in accord with you in what you wish stopped along that line, but I do want to say as to this bill——

Mr. PECORA (interposing). Well, what we wish to have stopped is set forth in section 15 of the bill so far as they may be applied to officers and directors of corporations.

Mr. BUTCHER. But I very respectfully feel that you will be defeating the very thing under that section that you are attempting to reach.

Mr. PECORA. You are now merely making a dogmatic statement to that effect. How would the purpose of the bill be defeated? First let me ask you: Do you admit that these evils should be exterminated; I mean the evils referred to in section 15 of the bill?

Mr. BUTCHER. I believe that every one I can now recall should be prevented.

Mr. PECORA. All right. How are we going to exterminate them?

Mr. BUTCHER. I do not believe that you can ever legislate 100-percent honesty in human beings.

Mr. PECORA. No; that is admittedly impossible until the millenium arrives or until human nature entirely changes, but that same argument would apply to any legislation that is designed to prevent crime. The fact that our laws against kidnaping has not prevented kidnaping is no argument for repealing the laws

Mr. BUTCHER. Not in my opinion; no.

Mr. PECORA. And the fact that our laws defining murder to be a crime has not succeeded in preventing all murders is no reason for repealing those acts, is it?

Mr. BUTCHER Not in my opinion, but as to this bill——

Mr. PECORA (interposing). It seems to me you are making an argument predicated upon that theory.

Mr. BUTCHER. Oh, no.

Senator KEAN. Mr. Butcher, isn't this bill something like the eighteenth amendment, and we found out that did not prevent violations, and it had to be repealed so that we could get law enforcement; isn't that so?

Mr. BUTCHER. I am entirely in accord with that thought, Senator. Now, Mr. Pecora——

Mr. PECORA (interposing). Well, I don't know how a sumptuary law can be compared to the enactment of the sort that is proposed here.

Mr. BUTCHER. I am not technically familiar with the law as you are, Mr. Pecora, but——

Mr. PECORA (interposing). Well, one deals with morals and the other deals with habits.

Mr. BUTCHER. Mr. Pecora, I take off my hat to you as a man who has been a very capable prosecuting attorney, but this is not as I see it—and I am a layman and not a lawyer, although I feel very deeply about it, and in what I say, if I may seem unduly serious, I mean to say in all courtesy and politeness; but I feel that in your desire, which I share, to stop these things is a proceeding much like the farmer who had four sons and who said he would not give any of them an education because he was not going to have a forger in his family, that he wasn't going to allow any one of them to learn how to write. And so it is that I say by this bill you are going to defeat what you are trying to carry out.

Mr. PECORA How are we going to defeat the laudable purpose that you admit the bill has. How does the bill do that?

Mr. BUTCHER. It would operate in that way to this extent—and I want to say that I have talked recently more to stockholders than to business men—I am satisfied it would mean that certainly nine tenths, if not all, of the board of governors of the Philadelphia Stock Exchange, which I represent here, would immediately resign. Now, there is a group of men I have intimate knowledge of. They are a straight, square-shooting, forward-looking group of men, good citizens, and——

Mr. PECORA (interposing). Why would they resign?

Mr. BUTCHER. Because they could not afford, and I could not afford, to face the provisions of this bill, which would bring them into constant litigation. We would be constantly defending all sorts of actions, of blackmail suits, for instance We would be in danger all the time of the action of the Federal Trade Commission, of something being brought up against us, which in the ordinary course of business I would say since 1790 has been straightforward and all right. It is a very cleverly written bill but it would in the end defeat the things you would like to carry out and that I would like to carry out.

Mr. PECORA. You are as I understand in accord with us in regard to the laudable purposes of the bill and the necessity for preventing the existing evils which the bill seeks to exterminate.

Mr. BUTCHER. I am in accord with you, as I said in my opening paragraph, to prevent any abuses affecting the stock market and to

restrain unwise or excessive speculation But it seems to me the bill goes further than that, and——

Mr. PECORA (interposing). In order to prevent excessive speculation you have to control the extension of credit more or less, don't you?

Mr. BUTCHER. Extension of credit should be controlled more rather than less, perhaps, but not in this way as I see it

Mr. PECORA In what way would you propose to control it?

Mr BUTCHER. I would very much prefer to see it done through the Federal Reserve banks. I do not believe the object you have in mind would be accomplished by trying to control it in this way.

Mr. PECORA. Then if the power sought to be vested in the Federal Trade Commission with regard to control of credit were vested not in the Federal Trade Commission but in the Federal Reserve Board, you would approve of it?

Mr BUTCHER. I should like to read that paragraph very much more carefully than I can recall it from memory in order to answer that question, but there was very little in those paragraphs that I approved of. The bill, it seems to me, would defeat its own end. You spoke just now of the objects of the bill, and I frankly say to you that I do not know the objects of the bill.

Mr. PECORA. Mr. Butcher, you made a rather impassioned extemporaneous statement to the committee with regard to the effect any kind of bill would have upon officers and directors of corporations who might feel that its potential penalties are such as to cause them to resign. And the argument you made was that they would be subject to the penalties of the bill for unwitting violations. I have pointed out to you that section 24 of the bill, which provides the penalties, would not cover an unwitting violation, that the penalties of the bill only apply to persons who may willfully violate the provisions of the bill. I am just wondering what other portions of your argument in opposition to the bill might have been based upon a misconception of the actual provisions of the bill.

Mr. BUTCHER. May I reply to that?

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

Mr BUTCHER. It is my opinion, yes; it is my considered opinion, sir, that within 1 week more or less before this bill becomes a law, if it is to be enacted, 98 percent of the directors I speak about, and all governors of stock exchanges, will resign. That is my considered opinion. Now, I am not a technical lawyer, and I cannot argue successfully which particular provision of the bill it applies to more than another, but let me say this: In the fantastic requirements of the margin paragraph of the bill, and I am familiar with the margin business, having been in the brokerage business for 33 years, although I have lots to learn and am learning every day, but in the case of a market that comes four or five times a year, an active market—that is, up and then down and up again—that even with only 12 or 15 margin accounts I do not see how it would be physically or financially possible for my firm to keep those margin requirements in accordance with this bill. I would therefore, if I kept my firm open, be violating a provision of the bill when I simply would be doing that which in the ordinary course of business we have been doing right along entirely within the law.

Mr. PECORA. Don't you know that the bill provides the Federal Trade Commission may adopt such rules and regulatitons with regard to the manner and method of closing out margin accounts as in its judgment should be adopted?

Mr. BUTCHER. Do I understand that——

Mr. PECORA (continuing). And that members of exchanges who violate the rules and regulations of the Federal Trade Commission with regard to closing out margin accounts would not be deemed to be guilty of any violation of the literal provisions of the bill with regard to inflexible marginal requirements?

Mr. BUTCHER. Mr. Pecora, I have said that as to marginal requirements under the bill—and as I have already said, I have been in the margin business for a number of years—I believe it would be physically impossible for me, earnestly and honestly as I would try by quadrupling our margin group in our office, to comply with the provisions of the bill in an active market. Now, as to what rules and regulations the Federal Trade Commission might give out, I don't know. They might easily this afternoon——

Mr. PECORA (interposing). Why not credit them with the desire to promulgate such rules and regulations as would be fair and reasonable and as would be well calculated to carry out the provisions of the statute generally?

Mr. BUTCHER. Mr. Pecora, I want to say to you——

Mr. PECORA (continuing). Why assume that the Federal Trade Commission in functioning under this bill is going to divest itself of all common sense?

Mr BUTCHER. I have a great deal of respect for the Federal Trade Commission, and they certainly have my best wishes, but in my opinion it would be physically impossible for that group of men, with a bill like this as their text, to issue and carry out reasonable and common-sense requirements.

Mr. PECORA. Well, I would be disposed to think that if the Federal Trade Commission felt the same way about it they would be down here before this committee urging that same contention. But I do not think we have heard from the Federal Trade Commission to that effect, have we, Mr. Chairman?

The CHAIRMAN. No.

Senator KEAN. The Federal Trade Commission has never been trained in these functions, have they, Mr. Butcher?

Mr BUTCHER. To my knowledge they know nothing about the stock-exchange business. And the people who wrote this bill I am satisfied, with all due respect to them, have had no experience in the stock-exchange business. To you, Mr. Pecora, my hat is off as a prosecutor, but even you, I believe, have had no stock-exchange experience.

Mr. PECORA. I have never been in a broker's office in my life.

Mr. BUTCHER. Well, I hope you will come into my office sometime.

Mr. PECORA. I have never had any experience in the matter of trading. I am a lawyer and not an investor or speculator. But, Mr. Butcher, you don't know, do you, whether or not persons who had the task of writing this bill consulted and obtained the opinion of experts, men of experience in the stock market, including brokers?

Mr. BUTCHER I believe they did, sir.

Mr. PECORA. Well, I can assure you that they did.

The CHAIRMAN. Isn't it a fact that your real objections to this bill are based on apprehension, not on the provisions of the bill but the apprehension of harm that may come out of it? You cannot specify any provisions of the bill that would bring about all this disaster you mention, but you apprehend that that may follow, and the result is that you are not in favor of any legislation although you admit the existence of abuses that ought to be corrected.

Mr. BUTCHER. Senator Fletcher, I am not only apprehensive but am scared to death. [Laughter.]

Mr. PECORA. Mr. Butcher, do you remember the hue and cry raised by the banking fraternity some 20 years ago over the possibility of the enactment of the Federal Reserve bill?

Mr. BUTCHER. I can remember back much more than 20 years, Mr. Pecora, but I do not remember that apprehension.

Mr. PECORA. Do you recall the opposition presented by bank officials to the enactment of the Federal Reserve bill?

Mr. BUTCHER. I was not closely in touch with that.

Mr. PECORA. Well, they predicted all sorts of dire evils that would happen in event of the passage of that bill.

Mr. BUTCHER. May I reply to Senator Fletcher's remark about my not wanting any legislation?

The CHAIRMAN. Certainly.

Mr. BUTCHER. In the last paragraph of my memorandum, I say: Such regulatory legislation as is deemed necessary should provide for a regulatory body or authority conversant with the technical problems connected with the operation of stock exchanges, with power to require within reasonable limitations the adoption by stock exchanges of rules and regulations for preventing practices which unfairly influence the price of securities or unduly stimulate speculation.

The CHAIRMAN. In other words, you want the stock exchanges to regulate themselves.

Mr. BUTCHER. Far from it. I did not say so in that paragraph, if you please.

Mr. PECORA. Then who should regulate them in your opinion, if not themselves.

Mr. BUTCHER. I believe that a commission specially formed for that purpose, with plenary powers and with knowledge of stock exchange matters, a commission that can study the matter carefully and that would give the thing little by little a try-out, would restore some of the confidence that has already been restored, would permit the very useful functioning of the present to go forward in this time of great need.

Mr. PECORA. The claim has been made here repeatedly by almost everybody that the rules and regulations which the stock exchange may adopt for the conduct of the business of its affairs can only apply to the members of the exchange. You recognize that to be a fact, do you not?

Mr. BUTCHER. The member of the board of governors of the Philadelphia Stock Exchange, I have no jurisdiction over the members of any other exchange.

Mr. PECORA Or of any nonmember, whether he is a broker or a market operator or speculator Your rules and regulations apply only to your own members.

Mr. BUTCHER. They have very far-reaching effects in some respects, but, generally speaking, I would say you are right, sir.

Mr. PECORA. Many of the evils this committee has found to exist in stock-market practices and customs flow from the act of nonmembers who would be outside the pale of influence or binding force and effect of rules and regulations of the exchanges themselves. Hence, if the activities of those persons are going to be placed under the ban effectively, they have got to be placed under a ban which will have to be pronounced by a body having the power to declare the ban, and the power to enforce penalties for violations. That power, it seems to me, is in the Congress of the United States and nobody else.

Mr BUTCHER. The Congress of the United States has great power, sir, and I have a great deal of respect for its power and its wisdom. You used the expression "common sense." I see no common sense, sir, in destroying the stock exchanges in order to reach some of these nonmembers.

Mr. PECORA. You are assuming that all stock exchanges are going to fold up their tents and pass out as soon as this bill is enacted.

Mr BUTCHER. I am not assuming that. I am making that as a very serious statement, based on my considered opinion.

Mr. PECORA If I were inclined to speculate on my judgment, I think I would speculate against that.

Mr BUTCHER In your position, I guess you would have to, would you not?

Senator KEAN. I have a question I would like to ask you. Were you familiar with the situation on the 4th of last March, the banking situation?

Mr BUTCHER. Generally speaking, very familiar.

Senator KEAN. We have heard here that people thought that great disaster might follow the organization of the Federal Reserve banks. Was it not the run on the Federal Reserve bank that practically caused the bank holiday on the 4th of March?

Mr BUTCHER. That was the immediate cause, as I understand it, sir.

Mr PECORA. Senator Kean, you do not argue, do you, that the Federal Reserve law should be repealed?

Senator KEAN. No; I do not argue that. I argue that the Federal Reserve banks ought to be strengthened. I argue that——

Mr. PECORA. Perhaps 20 years from now there will be persons coming to Congress, if this bill becomes law, who will think that its provisions ought to be strengthened and the powers of the Federal Trade Commission increased.

Senator KEAN. Perhaps; but I say that the danger that some people estimated in the Federal Reserve bank was realized on the 4th of last March, when they practically had to declare a bank holiday all over the country owing to the condition of the Federal Reserve bank.

Mr. PECORA. It was not due to any provisions of the Federal Reserve law. That was due to fundamental economic conditions that were generally prevalent, was it not?

Senator KEAN. It was due largely to the Federal Reserve bank's condition, and the fact that it was not strong enough to stand the tremendous strain that was put upon it.

The CHAIRMAN. It was due to some mistaken administration, but no one can say that the Federal Reserve System has not been of great benefit to the country.

Senator KEAN. I do not say that for a minute. It has, undoubtedly.

The CHAIRMAN. I have heard Senators on the floor of the Senate predict all sorts of disaster and distress if that bill ever passed.

Senator KEAN. That was not I.

Mr. BUTCHER. Mr. Chairman, I wish to express my appreciation for your courtesy in hearing me, and Mr. Pecora's courtesy. I still hope for a visit. [Laughter.]

Mr. PECORA. If I am ever in Philadelphia I will drop into your office.

The CHAIRMAN. I will bet you do not go out of business. [Laughter.]

Mr. BUTCHER. You propose, then, not to have this bill passed, I take it, sir? [Laughter.]

STATEMENT OF LEWIS J. STERN, PARTNER OF FRANK B. CAHN & CO., MEMBERS NEW YORK STOCK EXCHANGE

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

Mr. STERN. Lewis J. Stern; partner of Frank B. Cahn & Co., members of the New York Stock Exchange.

The CHAIRMAN. You say you are a member of the New York Stock Exchange?

Mr. STERN. No. I am a partner in a member firm.

The CHAIRMAN. You are engaged in the brokerage business?

Mr. STERN. Yes, sir.

The CHAIRMAN. How long have you been engaged in that business?

Mr STERN. Since 1928.

The CHAIRMAN. You wish to discuss this bill. We will be glad to hear your views about it.

Mr. PECORA. What was the firm name?

Mr. STERN. Frank B Cahn & Co.

The proposed stock exchange legislation may be broadly divided into four parts:

First. Criminal legislation dealing with the offenses against sound morals, such as the rigging of markets, dissemination of false information, breaches of trust by those holding fiduciary positions, and kindred offenses.

Second. Segregation of the business of brokerage from that of issuer and dealer in securities, the desirability of which is highly controversial

Third. Full and detailed publicity of corporation accounts necessary for intelligent action in the purchase and sale of securities. This is usually recognized as desirable.

Fourth. The regulation of the flow of credit into marginal operations.

The first suggestion meets with universal assent—it represents the difference between right and wrong, and makes wrong criminal.

The fourth classification—marginal credits—is surrounded with extreme difficulty, and it is this section that is here discussed.

Marginal trading is a tremendous factor in the maintenance of the liquidity of those intangible assets, generally known as stocks and bonds; but, in addition, it is of surpassing importance in its function of assistance in raising capital, not only of existent railroad, public utility, and industrial corporations, but also for the establishment of new enterprises which employ labor and consume capital goods. To impede unnecessarily, by drastic restrictions, the delicately adjusted markets for securities will stagnate efforts made by the National Government in its extensive program for national recovery. To speak colloquially, it will throw a monkey wrench into the machinery of recovery so recently erected. That the machinery of the stock exchanges has been abused, none with intellectual integrity will deny for a moment, but in the correction of these abuses, meticulous care should be taken not to destroy the budding public confidence that has been nursed with such solicitude.

In connection with the use of credit is marginal trading, there are two elements: First, the rapidity of the flow; second, the volume. Too little attention has been given to the time element existing in the movements of all securities prices. An advance in price, based on merit, is not objectionable, unless it is so precipitate as to foster undue speculation with a resultant abrupt collapse.

The percentage of margin, and the basis of selling price for its calculation, under the submitted legislation is so high, and so inflexible, that as has often been pointed out in these hearings, it would destroy the liquidity of present issues, and would make extremely difficult the raising of capital for both old and new enterprises. It is apparently assumed that a large margin, in itself, is more or less of a guarantee against substantial loss, and yet, the time factor, as will be subsequently illustrated, may be of such importance that a small margin is better protection at one period than a large margin is at another.

An apt illustration of this theorem is presented by a study of the fluctuations in American Commercial Alcohol in the month of July 1933.

American Commercial Alcohol advanced from a level of 30 to approximately 90 in less than 3 weeks. Its subsequent history shows that a buyer who advanced $7.50 a share as margin, or 33⅓ percent of the debit, on stock purchased at $30, was never in jeopardy. It would have been unnecessary, at any time, to deposit additional margin in order to protect his position in the stock. Continuing our illustration of "time element" being an essential factor, assume that 3 weeks later, when the stock rose at $90 a share, a purchase was made with a margin of 60 percent of the purchase price, or $54 a share. A debit balance of $36 a share would result with a margin of 150 percent of the debit. Within 4 days a decline more abrupt than the advance ensued, and the purchaser saw his $54

per share margin entirely dissipated. Meanwhile, the purchaser at $30 a share, with his $7.50 a share deposit, found his margin intact. This illustration is not based upon fancy or fiction, but upon actual facts involved in the market gyrations of this issue.

This case is presented to illustrate that, in itself, a percentage margin, if figured from a market price as a basis of computation, is an illusory protection. A study of the history of market fluctuations in various stocks confirms the view that the real problem is involved in marginal requirements which will prevent credit money from flowing into securities at too rapid a rate. The amount of credit money that enters the security market is not the supreme factor, but rather the rapidity with which securities loans are swelled. No one would presume to have the prescience to predict that a total volume of 8 billion dollars of brokers' loans would be too large a volume 25 years hence, but one would have no hesitancy in stating that the expansion of brokers' loans to such a figure in the next 12 months would represent a speculative bubble which should be prevented.

It may be stated as a fact that the public is attracted to unwise speculation by the rapidity of the upward movement in an issue, or a group of stocks. The psychology created by such a situation is the anxiety on the part of the public to participate in the profits of a speculative movement; the average person never feels sure that a fundamental advance is taking place in securities until a rapid movement in many issues has already taken place. Even presuming that the actual trader has made his commitment at a relatively low price, the rapidity of the movement engenders a desire to use his speculative profit, so quickly acquired, to enlarge his commitment, either in the same stock, or in other issues. It is by this method that "inverted pyramids" are created. This speculative furor is fomented by the fallacy that the market quotation at any specified time is a sound basis for computation of credit. The inescapable conclusion is reached that any system of marginal computation, founded upon percentage of the current price of an issue has, in a rapidly advancing market, the inherent weakness of encouraging pyramiding.

If a system is inaugurated which will limit the credit on an initial purchase to a reasonable loaning value, and prevent the unrestricted use of further credit now made available by the rapid advances, we will have eliminated a very large percentage of the untoward effects that inordinate speculation has on our economic system, because we will then have put under control the rapidity of the flow of credit money into securities markets.

The theory of the plan presented is that the maintenance of a specific level for a stock entitles it to a greater consideration in connection with its loan value. As an illustration:

Assume that an issue sells for 11 months at $10 a share, and then, in the next month, advances rapidly to $50 a share, the value therefore of the stock, for loan purposes, should not be more than the average price during the 12 months; that is, 11 months times $10 plus one month at $50, divided by 12, or $13 a share. Now suppose this stock maintains for another period of 1 month, a stability of

$50 a share, at the expiration of the second month's maintenance of a price of $50 a share, the computation for loanable value will be 200 divided by 12, or $16 a share; the 200 being 10 months at 10, plus 100, representing 2 months at 50. If it maintains its value at $50 a share for 1 month more, it will be 240 divided by 12, or 20, and if it maintains the value for another month, you will have 280 divided by 12, or $23 a share.

It will be noted that the buffer of safety on the initial rise to 50, will be approximately $37; in other words, on this initial rapid rise, the marginal requirements, at the advanced price, will be $37 a share. This will deter manipulation and unusually rapid upward movements with the danger not only to the specific stock, but also to the entire market fabric which is entailed thereby. It is to be noted that the $40 advance will be unusable for credit purposes in rapid pyramiding.

Referring once more to the action of American Commercial Alcohol, on the day before the rapid advance started, the market price was approximately 40. The loan value, under the proposed system, would have been $22 per share. A few days later, when the stock was selling at 90, the loan value would have increased to approximately $23 a share, and the purchaser, at a price of 90, would have had to advance a margin of $67. This marginal requirement would have had so prohibitive an effect on the advance that the issue would have been extremely unattractive as a speculative medium. It would have been practically impossible for the stock to have ever reached that price in so short a time, and the subsequent collapse, with the necessarily disastrous effect, would have been avoided

There are two distinct advantages to the plan herein discussed:

First The possibility of a rapid advance is minimized owing to the rapidly increasing marginal requirements. A trader would hesitate to purchase a stock at $50 a share which has advanced so rapidly that it requires 37 points to margin it and would, in preference desire to go into the market and buy a stock which is stabilized and requires less margin. It would remove the incentive to rapidly mark up stocks.

Second. The other advantage of this plan is that when general level of stocks is low the small operator would have the marginal ability to purchase a reasonable quantity of stocks, without exorbitant margin. Let us refer to 1914, when Europe dumped literally millions of shares of stock on our markets. Under the proposed bill the capitalist, who already has for over 30 days millions of securities in his safe-deposit vault, would be enabled to borrow on these securities, or even on his open paper, and purchase cheap securities in the open market to his heart's content, while the small man in America would be denied reasonable opportunity to take advantage of such a situation. To require the man of moderate means to pay 60 percent of the market price of a stock in cash, no matter what the level may be or what the occasion may be, is so prohibitive that it denies " an equal opportunity to all." It is putting a premium on large capital to the disadvantage of the man of ordinary means.

The plan proposed, in addition to automatically preventing a straight line move upward in the market, does not deny to the American public, as a whole, the opportunity to share in the development

of the United States and participate in a growing prosperity. The small man's opportunity to acquire capital should not be unduly circumscribed to the advantage of those who already have large means The more the public is denied the right to participate, on a sound basis, in the markets, the more generally large capitalists will be free from competition in acquiring the securities of the best railroads, public utilities, and industries of our country.

The question now arises how to translate this marginal plan into practical operation. It is submitted that an arrangement may be effected by which a code of conduct, together with a marginal plan, such as is here suggested, can be incorporated in the N R A codes, and the constitutions of all exchanges; with an additional provision that the marginal requirements, at all times, shall be subject to alteration and change by a special committee, composed of the Secretary of the Treasury, Chairman of the Federal Reserve Board, with the President of the United States as the third member of the Board, with the right of veto in addition to directing affirmative action

Under such a plan, American institutions would not be impeded in raising capital for new enterprises and expansion purposes; unbridled speculation would find itself in check, and, above all, the man of moderate means would have the same opportunity to participate in the advantageous development of the United States as would be afforded to the rich.

A flexible situation would be created, adaptable to the exigencies of any particular time

The adoption of a margin of 60 percent of the purchase price means the eventual concentration and control of all securities of public companies in a few hands.

The CHAIRMAN. I understand you are opposed to any law with reference to fixing margins.

Mr. STERN. No. I am definitely not, sir. I propose to put a loan limit upon securities beyond which a broker or a bank may not go.

The CHAIRMAN. What limit?

Mr. STERN. The average price for the preceding 12 months, or 6 months—whatever the study of it will indicate to be the best time limit

The CHAIRMAN. They can loan the full amount of the average price?

Mr. STERN. No; they may not loan more than the average price I believe in leaving the percentage part to the discretion of the individual lender, for his own protection I think you have one real object in all this marginal study, and that is to prevent credit flowing into the securities market at such a rate that it builds up a snowball.

The CHAIRMAN. Brokers generally do not object to a flow of credit, do they?

Mr. STERN. A lot of them do not, but they should.

The CHAIRMAN. I agree with you there, but generally their interest is the other way. With reference to the small man, the man of small means, do you know what proportion of small men, or men of moderate means, who deal in stocks on the exchanges come out winners?

Mr. STERN. I know a very small percentage of them come out winners, but that is no reason why they should have to continue to do that.

The CHAIRMAN. What percentage of men of moderate means dealing in margins on the stock exchange succeed?

Mr. STERN. As traders?

The CHAIRMAN. Yes.

Mr. STERN. Very few of them; but a lot of them as investors, Senator.

The CHAIRMAN. I mean, taking the average run throughout the country of small people, people of small capital, who want to go into the stock exchange and trade on small margins, how many of them lose out?

Mr. STERN. I should say by far the largest percentage of them lose out, but, if I may say so——

The CHAIRMAN. About 1 in 5 succeed?

Mr. STERN. I do not think that many.

The CHAIRMAN. Not that many?

Mr. STERN. No.

The CHAIRMAN. Then, what is the use of worrying ourselves to take care of those people, 1 in 5 of whom succeed, the rest of them lose all they have?

Mr. STERN. I believe you can fix the situation so that the other 4 out of that 5 are not going to lose all they have. You are going to protect them against themselves by not letting them get in on a rapidly advancing market on a small amount of margin. In other words, of you take 60 percent of the purchase price, as provided in this bill, in the case of a stock that is selling, we will say, at 50, he is entitled to 20 as a loan value. If that stock should double to 100 next week or next month, it will be entitled to twice as much as its loan value. My claim is that that method is entirely wrong, in that it allows credit to build up at the same rate at which the stock rises.

The CHAIRMAN. The suggestion I am offering is this. Would it not be pretty good legislation if we should save these four people out of five who are losing money all the while, from further losses?

Mr. STERN. I do not think that is the problem, Senator Fletcher. I think the problem is to stop credit expansion at a rapid rate. In other words, a man goes into the market and buys the stock, and next month it is up $20, and he goes to his broker and says, "Let me have a thousand dollars. I want to buy an automobile." That man is pyramiding just as surely as the man who buys more stock, because he is using credit and creating credit that goes into industry to stimulate enterprise on something that is very intangible.

The CHAIRMAN. How would you regulate this flow of credit?

Mr. STERN. By not permitting margins to rise as fast as stocks rise. I would penalize the rise in stocks. I think the down movement will take care of itself. Increase the margins in direct proportion to the rate at which the stock goes up.

The CHAIRMAN. We are very much obliged to you.

STATEMENT OF EUGENE E. THOMPSON, PRESIDENT OF ASSOCIATED STOCK EXCHANGES, WASHINGTON, D.C.

The CHAIRMAN. Mr. Thompson, please state your name, place of residence, occupation or business, and for whom you appear.

Mr. THOMPSON. Eugene E. Thompson; president Associated Stock Exchanges, Washington, D.C.

Mr. Chairman and gentlemen of the committee, I am here as the president of the Associated Stock Exchanges. Eighteen of the principal exchanges of the country outside the city of New York comprise the membership of this organization, as follows: Hartford Stock Exchange, Hartford, Conn.; Baltimore Stock Exchange, Baltimore, Md.; Philadelphia Stock Exchange, Philadelphia, Pa.; Washington Stock Exchange, Washington, D.C.; New Orleans Stock Exchange, New Orleans, La.; Buffalo Stock Exchange, Buffalo, N.Y.; Cleveland Stock Exchange, Cleveland, Ohio; Pittsburgh Stock Exchange, Pittsburgh, Pa.; Columbus Stock Exchange, Columbus, Ohio; Cincinnati Stock Exchange, Cincinnati, Ohio; St. Louis Stock Exchange, St. Louis, Mo.; Minneapolis-St. Paul Stock Exchange, Minneapolis, Minn.; Salt Lake Stock Exchange, Salt Lake City, Utah; Los Angeles Stock Exchange, Los Angeles, Calif.; Los Angeles Curb Exchange, Los Angeles, Calif.; San Francisco Stock Exchange, San Francisco, Calif.; San Francisco Curb Exchange, San Francisco, Calif.; Detroit Stock Exchange, Detroit, Mich.

We have been requested to represent, in addition to our own members, other exchanges as follows: Louisville Stock Exchange, Louisville, Ky.; Seattle Stock Exchange, Seattle, Wash.; Richmond Stock Exchange, Richmond, Va.

At the beginning, I should like to have the record show, because everything I shall say here will be based upon this premise, that the local stock exchanges represented in our group, individually and collectively, are receptive to rational and constructive criticism. If out of these hearings and deliberations there shall be evolved ideas or plans for strengthening the exchanges in their proper field and in their legitimate purposes, I can promise you that they will be cordially welcomed and will be given careful and conscientious treatment whether or not this or any other bill reaches the statute books finally.

I do not need to admonish you gentlemen that you cannot destroy and moreover, that you cannot restrict the primary and legitimate activities of the stock exchanges without interrupting very seriously and perhaps disastrously the gigantic work now in progress of reconstructing the business, industrial, and economic structure of the country. We have always had stock exchanges. There were stock exchanges, called market places, long before there was a United States. They are essential and vital to the business life of this or any other progressive nation, as much so in their particular sphere as are banks or other institutions of fiduciary responsibility to the public.

We are opposed to the pending bill in its present form because we have not been convinced that it meets the requirements of rational legislation. Undoubtedly there are many things in the bill which

are good, but as a whole the measure is built upon a foundation, except for the intentions it represents, which is so insecure and rickety, so hastily thrown together, that the results cannot be otherwise than futile and mischievous.

That which is offered in this bill is unworkable. Let it go to enactment, as now framed, and you will have wrecked the stock exchanges as institutions; but the damage will not have ended there, for you will have turned the corporate securities business of the greatest industrial country in the world out of orderly channels and into the keeping of securities racketeers and bootleggers; and I think you will agree with me when I say that we have had quite enough already of this gentry in the United States.

Your bill, gentlemen, whether you wish it or not, or whether you like it or not, is aimed at the heart of national recovery.

It is the solemn judgment of our group of local stock exchanges that this proposed legislation, if passed without drastic redrafting, will result in a law so restrictive that the market places for corporate capital, so necessary to the country's economic welfare at all times and so doubly necessary at the present time, will discover themselves so hampered and thwarted in their proper functions that it will be impossible for them to retain their vitally important position in the industrial and economic scheme and set-up of the United States. Business in this country cannot survive without market places for capital stock, and by market places I mean, of course, stock exchanges.

I am not here with a blanket defense of stock-exchange practices. The exchanges have to deal with conditions and circumstances as diverse and ramified as is human nature itself. They cannot always be right; but neither could a Federal governing agency always be right. The human equation in the situation will not permit of that under any circumstances. The practices—the basic practices, at least—of the exchanges should be understood before condemnation; but unfortunately this appears not possible in the midst of a clamor and onrush of public sentiment which seemingly has rallied around misunderstanding and fallacy, rather than around fact and logic.

The exchanges have been maligned far beyond their deserts in the agitation which has led up to the situation confronting us today. After all, the exchanges were and are, as I have said, mere market places for approved securities—nothing more than that. They exist for an important legitimate purpose. They are controlled by men of proved worth in their respective communities and in the country These men are actuated in their affairs by thoughts of the public interest as are all other patriotic citizens. I know of no other character of business in the country to which so much time is given and energy and effort exerted in the public interest as in the management and conduct of the business of the stock exchanges.

In those memorable days previous to the catastrophe of 1929 the exchanges—the market places—were open for business, and business came to them, as we all know, in avalanche proportions. That which occurred has been characterized as a speculative orgy. But were the exchanges responsible for this? I submit that they did not create the conditions in this country any more than they created

the conditions in foreign countries, which caused the banks, savings institutions, insurance and utility companies, and other large corporations to be loaded down with vast amount of unemployed money. An analysis of the conditions prevailing at that time will disclose that the cause of the economic misadventure cannot be rightfully laid on the doorstep of the exchanges The exchanges as such did nothing to create the desire on the part of the holders of money and credit everywhere to put to work the funds which were in their keeping. They were not responsible for the concentration of the financial resources of the country at places of availability for speculation They did not fix interest rates for brokers' loans. These things were of the nature of conditions precedent to anything of an unusual character that transpired within the exchanges themselves.

It is the opinion of our group that the provisions of this bill, as now drawn, will retard the free flow of corporate capital to such an extent that great and irreparable harm will be done. It must be obvious to all who have studied even superficially into the situation that the stock exchanges, under their own guidance and by their own rules and regulations, have constituted one of the mightiest of all the factors in the bringing out of funds for the corporate development of the country's industrial resources.

The growth of these resources has been due only in small part to private capital. The magnitude of many of the projects and enterprises requires that the capital for their creation and maintenance shall be raised in corporate form. There is no other way. It so happens, even as these deliberations are in progress, that corporate capital is needed in vast amounts for the refunding of maturing obligations. When the general business conditions have improved, even larger amounts will be required to continue the development of our industrial, agricultural, and commercial resources. If corporations are to be denied the advantages of an open public market for the raising of capital, it is very likely that the government itself will be compelled to set up an authority to care for maturing obligations, else there will be defaults in stupendous aggregates on maturing obligations during the coming twelve months. The stock exchanges heretofore have been a potent force in the enabling of corporations to raise capital; but there are grave fears that this bill will not be conducive to the maintenance of a free and open market for the flow of this needed capital. Instead of being a measure for the protection of the investor in corporate capital it may prove to be the most damaging legislation of its character that Congress has ever enacted.

Within recent years there have been wide-spread reactions reflected in public opinion against the Government engaging in private business or controlling the conduct of private business. This bill is another step in that direction. It has gained some friends and support because it purports to be a measure for the protection of the public against fluctuations in the values of securities; and in this respect, as in other respects, it strains at a futility if not at an impossibility.

The present reaching out by Congress to establish Government control of the Nation's industries, through legislation such as that now proposed, is a matter for the gravest concern. Practical and

accepted habits and customs, the outgrowth of the experience of the ages, are about to be discarded in the present instance to make way for the theories and experimentations of persons who rarely have been in personal contact with the exchanges and who know about the problems involved only through the fact that they are opposed to all things which are conventional or institutional and have a vague idea that the exchanges are within this category.

You may say, as has been said here, that the "sky did not fall" when other drastic regulatory ideas, vigorously opposed, were written into law by the Congress. That may be true. Nevertheless, legislation of this character tends to lead the country in a direction opposite to that which was contemplated by those who gave us our basic form of government. The evil is cumulative and pernicious. I do not recall that the sky fell in Russia when communism placed its grasp of steel upon the throats of the people of that country. Are there any of us here who would care to live in Russia?

There is much anxiety and unrest on the part of securities owners as to the next move that may be made; and if this bill should be passed and signed by the President, there will be certain to follow an avalanche of selling—or efforts to sell—such as we have never before witnessed. I hope the committee will not interpret this statement as being of the nature of a threat. It is not intended as such. It is merely a statement or a prediction or a warning as to a result which many of us, who have been students for years of the human tendencies in connection with securities markets, feel is inescapable.

Investigations of stock-exchange practices by Congress, lasting over a year, have brought to light only a comparatively small number of practices deserving of condemnation. We offer no defense for bad practices. The exchanges do not want them any more than you want them.

Since the beginning of the inquiry by the Senate Banking and Currency Committee, in my capacity as president of the Associated Stock Exchanges, I have visited the principal stock exchanges of the country. On these visits I conferred with the governing officers of the various organizations. Among these gentlemen I found a very earnest desire on the part of all to consider those things which have been intelligently and advisably criticized. But that is not all. The exchanges have recognized the desirability of uniform practices insofar as they can be made compatible with local conditions; and in this situation long and salutary strides also have been made. I tell you these things, so that you will know that we have not been standing still, nor have we drawn about us any cloak of pretended righteousness as a protection against just and constructive criticism.

We desire an opportunity to call attention to the several matters uppermost in our minds, and these, with your permission, we will deal with by sections.

Section 3, item 5, page 5: The term "dealer", meaning "any person engaged in a business of buying and selling securities for his own account, through a broker or otherwise", should be more clearly defined as to what is intended. Engaging in a business of buying and selling securities for one's own account is susceptible of various interpretations.

Mr. PECORA. I might interject here, Mr. Thompson, that consideration is being given to that very thing.

Mr. THOMPSON. Thank you.

Section 6, subsection (a): The prohibition designed to estop a member of a national securities exchange, or any person who transacts a business in securities through the medium of any such member, either directly or indirectly, from extending or arranging credit to or for any customer on any securities not registered upon a national securities exchange, would tend to restrict many transactions on the local exchanges. It should be borne in mind that there are stocks of numerous banking institutions, insurance companies, public utilities, and other high-grade corporations which are not listed upon any exchange. In addition, there are large numbers of Federal farm-loan bonds, joint-stock land bank bonds, Home Owners Loan Corporation bonds, and the obligations of States and their political subdivisions, as well as many others that are not or cannot be listed. Local exchange brokers would find the restrictions against loans on securities not listed upon an exchange to be very burdensome, and its effect would not only be harmful to the small broker, but the restriction would be a gratuitous discrimination against unregistered securities.

Mr. PECORA. May I interrupt you there?

Mr. THOMPSON. Certainly.

Mr. PECORA. Do you think that granting the Federal Trade Commission the right and power to exempt certain securities now unlisted in the operation of the present provision which you have referred to might meet the criticism you have just offered?

Mr. THOMPSON. In very large part.

Senator KEAN. Just before you go on—because I must leave very shortly—let me say that I have read over this list of stock exchanges that you have submitted here. Do those stock exchanges have the same rules and practices that the New York Stock Exchange has?

Mr. THOMPSON. I would not say, Senator, that they have the same rules. I think they follow the general line, as far as they can be adapted to their conditions.

Senator KEAN. Would you say that they have the right to call upon their members to say who had traded in air stocks during the period that we have been considering here?

Mr. THOMPSON. I think the governing committees of any of those exchanges could obtain that information.

Senator KEAN. Do you think you could obtain the information for this committee?

Mr. THOMPSON. I shall endeavor to do so. I do not know of any exchanges where air stocks are being traded in at the moment; not on the local exchanges.

Senator KEAN. I think they are traded in.

Mr. THOMPSON. I am sure if there are any particular ones we would be very glad to ask for them, Senator.

Senator KEAN. I would like the committee to ask by wire if air stocks are traded in on those exchanges and, if so, whether they will ask their members to submit to the committee the amount of trades.

Mr. PECORA. In other words, have the members of those exchanges responded to a questionnaire generally like the two questionnaires sent out by the New York Stock Exchange?

Senator KEAN. Yes; if air stocks are traded in on those exchanges.

Mr. THOMPSON. The same dates as requested of the New York Stock Exchange?

Senator KEAN. Yes.

Mr. THOMPSON. I will endeavor to obtain that for you.

Mr. PECORA. Have you copies of the questionnaire of the New York Stock Exchange?

Mr. THOMPSON. I have not.

Mr. REDMOND. I think I have extra copies down at the hotel.

Mr. PECORA. We probably can find some around here to give this gentleman.

Mr. THOMPSON. To deny the use of such issues for credit purposes manifestly would be not only a discrimination against the securities themselves, but it would be, if you will permit the expression, unfair and unsound legislation.

It would appear that a nonmember broker, if he were doing no listed business, could extend credit in full on unlisted securities, and this obviously would create an unfair and extremely dangerous practice by forcing holders of such securities to seek credit and trade with brokers who are not members of any exchange; and under these conditions, it hardly is necessary to point out, the country soon could be overrun by securities loan sharks and securities bootleggers.

Section 6, subsection (b): This subsection provides certain restrictions as to marginal transactions, and presumes to establish, at the moment the law becomes operative, a margin ratio which may be out of all proportion to the needful protective requirements under other conditions than those presently prevailing, or, for that matter, under any future conditions. True, the commission is given power, when deemed appropriate in the public interest, to establish lower loan values, which could mean only higher and not lower marginal requirements. We submit that the maker of the loan should be a better judge of the loan and the collateral than could be a disinterested person, or even a Government body empowered to establish at a specific time the values and ratios. Then, too, if it should be determined that a bank handling business for its customers comes under the classification of dealer, which is possible under the wording of the bill, the bank would be compelled to abide by the same marginal requirements as those provided for a broker.

Many insurance companies, industrial companies, and other organizations requiring liquidity of capital frequently enter the loan markets when they have surplus funds which they may not care to invest permanently. It is not uncommon for such funds to be placed through the medium of one who is a broker. Under this section it is not difficult to apprehend the likelihood of loans being diverted to Canada and other foreign countries.

There is also in this clause a discrimination definitely in favor of persons of wealth who may have paid for their securities in full more than 30 days prior to the making of loans; whereas the person of moderate means is denied these advantages because he has not the capital with which to pay for his securities 30 days prior to seeking a loan. A drastic deflation of accounts will take place if this becomes effective.

Section 6, subsection (d): It is provided here that the commission shall by rules and regulations prescribe the times and the specific

methods for calculating values for purposes of loans, the times at which initial and subsequent payments shall be made by the customer, the notice to be given to the customer, and the method to be followed in protecting the broker or dealer in closing out an account. Through operation of rules and regulations which have not yet been determined upon but which later are to be promulgated and made a part of the law itself, this section may prove harmful to a broker carrying accounts by barring him from taking the steps necessary to protect himself against loss; and also the customer might be injured by the creation of an additional indebtedness.

It would appear that there is a distinct conflict or inconsistency as between subsections (d) and (b), in that subsection (b) definitely says what the marginal requirements for a loan shall be, unless the commission shall prescribe a lower loan value. The relationship existing between customer and broker thereupon, under the provisions of this section, will be separated by a barrier which would make the broker a mere automat and give him no latitude in assisting his customer in the event of an active declining market; and thus many persons would be forced to suffer losses which otherwise could have been saved.

Section 7, subsection (a): This item apparently prohibits a broker from carrying accounts for dealers, a practice which at present is common among local exchange members.

Loans could not be obtained on registered securities except from member banks of the Federal Reserve System And here again we have a serious restriction against which the local exchanges strongly protest. The provision removes the opportunity which always has been open to brokers in the smaller centers to borrow from private sources.

Section 7, subsection (b). This subsection would operate unfairly against the smaller houses throughout the country, although they may be completely solvent, by automatically reducing the amount of business they can transact to accord with the amount of capital presently at their disposal In addition it restricts the growth of their businesses unless it be possible for them to raise additional capital, which is obviously difficult to do under existing conditions It accomplishes nothing except to put a premium on capital, and thus further centralize money power. The past records of brokers clearly show this subsection to be too drastic.

Section 7, subsection (f) · There should be amendments here to make it possible to handle routine business involved in the delivery of securities sold in order to cover the normal delay in deliveries due to distance from the exchange upon which the business is transacted Referring to lines 1, 2, and 3, page 15, there should be an explanation here as to what is meant by "crediting of interest on account of loan" The language now carried in the bill indicates that interest must be computed and credited by a broker when he has used certificates which he is carrying to make delivery against other certificates, of the same stock, which he has sold for a customer at a distant point and which certificates are in transit. The question arises as to whose stock was used or "loaned" and to whom the credit should be given. The door of confusion is opened here, and also the door of discrimination.

Section 8, subsection (a), item 3: In lines 5 and 6 the bill uses the words, "or a false or misleading appearance in respect of the market for such security or securities." We submit that the execution of an order for a customer in which the broker causes false or misleading appearances in respect of the market has no place in this bill. We cannot too vigorously oppose this entire section. The civil penalties which are intended to protect persons, who have been intentionally misled in the recovery of damages, opens the door wide not only to those who have suffered losses, but also to those who may claim to have suffered losses when in fact they have suffered no losses at all.

Section 8, subsection (a), item 7: There should be a clearer definition of what is meant by "pegging", "fixing", or "stabilizing." The language is susceptible of various interpretations There are times when stabilization is helpful. The Government itself believes in the principle of pegging or stabilizing. It may be found that, for example, an investor is ready to buy all of a certain stock or bonds obtainable at a fixed price—perhaps at a concession from the prevailing market. Under this section he could only do this by disclosing his intent to the exchange and to the commission, and by such disclosure he would run the risk of defeating the accomplishment of the investment. Other reasons could be cited for objecting to the language of this section.

Section 8, subsection (a), item 8. This item deals with the practice of acquiring the floating supply of any particular security for the purpose of causing its price to rise on the exchange, through control of the floating supply. The local exchanges strongly protest the language of this section. It is not uncommon for a member of a local exchange to buy all of a floating supply of a stock, in some cases causing the price to rise very perceptibly. It should be observed that the execution by a broker of an order to buy at the market on some of our local exchanges cannot result otherwise than to force a rise where there is only a limited amount of the stock for sale, which is frequently the case.

A broker may be given an order to buy, say, 100 shares of a certain bank stock, or an insurance stock, or a high-grade preferred stock, or an inactive high-grade industrial common stock, not knowing the intention of the customer, and then upon attempting to make the purchase find that only limited offerings are available; but the customer insists that he wants the stock, which compels the broker to bid up the stock or else take the offerings which are available, and this immediately causes the price to rise. The language of the bill mentions merely the acquisition of the "floating supply" for the purpose of causing the price to rise. There isn't a broker in the country who could ever know where he stands with language such as is used here.

Section 8, subsection (a), item 9 It appears that this provision was designed to put an end to trading in "puts", "calls", and other purely speculative options or privileges. But the language is such that it involves another very important matter in the affairs of members of local exchanges It has occurred frequently that a member of a local exchange, in the handling of large blocks of securities to close an estate, or being confronted with the necessity

for liquidating sizable loans or other holdings, has found it impossible to distribute the securities on the exchange and is required to find a private purchaser. The amount of work necessary to handle a transaction of this kind often goes far beyond the ordinary commission which is governed or fixed by the rules of the exchange upon which the security is listed An attempt to sell larger blocks of stock on an exchange than is warranted by the local market, without giving due consideration to local financial conditions, might prove not only a futile experiment but a very disastrous one When more securities are forced upon the market than it is capable of absorbing, there is just one answer—declining prices.

If we grant that "puts", "calls", etc., for speculative purposes are wrong, we submit that legitimate options or privileges are required and are necessary in most lines of business.

Mr. PECORA. Do you grant that puts and calls are wrong?

Mr THOMPSON. I say, if we do grant it.

Mr. PECORA Do you grant it, as a matter of fact?

Mr THOMPSON I am open-minded about it. I have explained it just a little later, so it probably will throw a little light on it.

Mr. PECORA. All right.

Mr. THOMPSON. It will be found that options are a necessary part of the work of a broker. It is a customary practice, and is just as legitimate and proper as any other branch of the brokerage business Therefore, this section should be revised so as to permit options under proper conditions Consideration should not be overlooked of the fact that corporations in raising new capital must frequently issue rights to their shareholders to purchase new securities, in order to provide the corporations with increased capital. Under the language of this provision it readily could be construed a violation of the law where corporations have engaged themselves only in the legitimate function of increasing their capital.

Section 8, subsections (b), (c), and (d): We are unalterably opposed to subsections (b), (c), and (d) of this section because they provide penalties, over and above fines for violations of the law, which we submit have no place in a regulatory measure. The liability for losses is too arbitrarily fixed to meet the demand of fair play and justice, and the opportunity for blackmail is too apparent for safety. That which is established by this wording will subject every broker to continued, unlimited, and unjust liabilities and will weaken the entire structure of the brokerage business.

Section 9, subsection (a): We believe that short selling occupies a proper and legitimate place in the securities market, and unless the commission shall be directed to prescribe rules and regulations that will permit short selling we are opposed to this subsection. Under any circumstances a short sale should be more clearly defined than at present in the bill. The powers given to the commission under the present wording of this subsection cannot but be the means of regulating the course of the market.

Section 9, subsection (b): Stop-loss orders are essential in order to limit losses and as a protection against further losses not only to the broker, who may be carrying an account under the required margin, but to banking institutions having loans upon stocks and bonds as collateral and wishing to protect themselves against a loss.

If the subsection is to remain in the bill, we suggest that in line 19, after the word "stop-loss", there be inserted the words "which does not close out an existing commitment."

Section 9, subsection (c): This subsection is so vague and inadequate for the purpose evidently intended to be accomplished that it should be stricken out in its entirety. To allow it to remain leaves in the hands of the commission a weapon with which that body might determine upon anything as being detrimental to the public interest or to the proper protection of investors.

Section 10: We particularly direct your attention to this section, because it will destroy the means of livelihood of hundreds of brokers, members of local exchanges, who now act both as a broker and as a dealer in, or underwriter, or distributor of securities. It will drive many brokers out of business. The amount of business done by many brokers on the local exchanges is not alone sufficient to enable them to maintain their organizations, and to deprive them of the privilege or right, which they have always enjoyed, of acting also as a dealer in, or underwriter, or distributor of securities would be treating them most unfairly with no compensating benefit to the public at large. Quite a few of the smaller stock exchanges undoubtedly will be forced to close if the harsh treatment provided in this section is meted out to their broker-members.

It is impossible to be a strictly local broker and not handle local investments. This section would paralyze the local markets. As brokers we insist that we have a right—an inherent right, a perfectly legitimate right—to operate as brokers and dealers. The regulations of all the local exchanges are, we believe, ample to prevent a broker from acting as a dealer in the execution of any orders wherein the broker is required to act as agent on a commission basis. The functions of dealers and brokers, respectively, are easily differentiated in the conduct of business Not only do the stock exchanges have stringent rules covering this matter, but most of the States have laws of agency and principal. This section, if enacted into law, will drive business in considerable volume away from the protection of the regulated national stock exchange member to the unregulated, unlisted dealer, with damage to the national stock exchange member and the investor alike.

Should the section be permitted to stand, we direct your attention to lines 14 to 16 inclusive on page 21 of the bill, wherein it is stated that it shall be unlawful for any members of a national securities exchange to act as a specialist unless registered as such. If it is possible to do business under this bill, we submit that it is essential to have specialists to conduct the business of brokers on the exchange. Specialists have a peculiar and particular function which, we believe, is not generally understood and is usually misunderstood. We fear that this prohibition against specialists was drawn without due consideration of the problems of local exchanges. In line 20 on page 21 it seems that the words "fixed price orders" should be more clearly defined as to what is actually meant. The language as now used would appear to require that after rules and regulations are prescribed by the Commission, specialists will then be prohibited from making a transaction except on an order giving a definite fixed price. Such a restriction as this will prevent the investor from

giving what is commonly known as a market order and will restrain him from making a purchase at anything other than a definite price. Also may I direct your attention to one of the important functions of a specialist, which is that he must execute stop-loss orders, such orders being usually for the purpose of preventing further losses.

Stock-exchange regulations covering the operations of specialists are very stringent and can be quickly invoked.

Section 11, subsection (a): This provision makes it unlawful for any person to effect transactions in any securities on a national stock exchange unless a registration is effective as to such issue in accordance with the provisions of this act and the rules and regulations made by the Commission thereunder and unless such security or securities have been issued.

Consideration should be given to the proposition that, as this subsection in requiring registered securities to be issued would of necessity force the initial trading in rights and additional issues of registered securities to be conducted on an unlisted basis, it would seem logical that they should be traded under the control of and on the national securities exchanges where the primary security is traded in. Provision should, therefore, be made for such trading under proper protective provisions.

The subsection provides certain requirements to be complied with by a corporation before the securities may be registered with a national securities' exchange. These requirements place upon the exchanges the burden of forcing compliance by corporations with this whole section. We submit that it is not fair to the exchanges to make them members of the policing authority of the Commission.

We further submit that this section will cause the delisting of many corporate issues, and as these delistings occur, the public will have no protection from unregulated markets such as they enjoy today, even though the Commission is empowered by section 14 to make rules and regulations governing unlisted trading.

In particular we direct your attention to article 2 of subsection (c), lines 19 to 23, page 24, of the bill. Corporations here are required to furnish certified independent public audits for preceding years (the number not stated). It may happen that corporations applying for listing on the local exchanges have not had certified public audits for previous years, and to obtain such audits the expense would be prohibitive. It may also be that in some cases the audits are not obtainable; and then, too, it may be a new corporation without audits.

Lines 21, 22, and 23, page 24, require that such other information be furnished as the Commission, by rules and regulations, may require as necessary or appropriate for the public interest or for the protection of investors. This language makes it impossible to know just what the Commission may or may not require. In this same subsection, line 5, page 25, attention is drawn to the authority vested in the Commission to make rules requiring the Commission's approval for the removal of any securities from listing. This might prove a detriment to the public interest in case the exchange itself should find it expedient to act forthwith in the suspension of trading in any securities listed thereon in order to prevent fraud, misrepresentation, or manipulation, or for various other causes that might

arise. The power of removal from trading or listing, or both, should inherently rest with the exchange.

Mr. PECORA. Don't you think the Commission might be in position to act promptly upon the request of the exchange to strike an issue from its list?

Mr. THOMPSON. It may. It is doubtful. I say it is doubtful in the sense that it might not look at it in the same light that the exchange would; that is all.

Section 12, subsection a, article 2: We doubt the ability of many corporations to furnish quarterly balance sheets and profit-and-loss statements by independent public accountants. Such requirements would mean that corporations whose securities are registered and listed on the exchanges would be compelled almost continuously to employ independent auditors, and thus there would be placed such a burden and expense upon the smaller corporations listed upon the local exchanges as to force them to withdraw their securities from listing. The expense for such work would hardly seem to be justified.

Mr. PECORA. By that you mean to suggest that there should be no regulation whatever for corporations whose securities are listed, to furnish auditors' statements?

Mr. THOMPSON. I am very strongly of the opinion that there should be audited statements at least once a year, and I have been an advocate and we have recommended to our local exchanges that they exact reports quarterly from the corporations; not insisting, however, that they be certified independent auditors' reports.

Mr. PECORA Would not independent audits be preferable?

Mr. THOMPSON. I hardly think it is fair to many of the small corporations. Some of them have very limited capital compared with the capital of larger corporations. The time required to get up these audits is very long in some cases.

Mr. PECORA. For small corporations?

Mr. THOMPSON. Not for small ones; but if we are going to furnish these independent audits of all corporations listed on the exchanges, there is going to be quite a big business in the auditor's line, and it would be difficult to get them to come in just when wanted, perhaps.

Mr. PECORA. This section is not intended to boom the auditors' business.

Mr. THOMPSON. It unfortunately will, I am afraid.

Mr. PECORA. It is intended to obtain more reliable information for stockholders and the investing public.

Mr. THOMPSON. I am heartily in favor of anything that will give the public more information, but at the same time I feel very strongly that if the small corporations listed are required to go to the expense of quarterly audits——

Mr. PECORA. What about semiannual audits?

Mr. THOMPSON. I heartily favor quarterly audits, but I do not think it is possible to get it done. I do not think they will stand the expense. As to semiannual audits, quite naturally the burden would be very much less. I would like to see it if it can be done.

Mr. PECORA. You do not mind these interruptions, do you?

Mr. THOMPSON. Not at all.

In article 3, of this subsection, we hold that "monthly reports, including, among other things, a statement of sales or gross income", may prove exceedingly misleading and the purpose for which the information was intended defeated by a wrong interpretation which could easily be placed upon such monthly figures. If this clause is enacted there should be a clear definition of what is required in the monthly reports besides sales or gross income.

Section 13, subsection (a): This requires that, before the solicitation of proxies "in respect of any security registered on any national securities exchange" there shall be filed with the Commission certain information among which shall be a list of the names and addresses of the persons from whom proxies are to be secured. This would mean, if the section is literally interpreted, that, whenever proxies are sent out by a corporation for the usual annual meeting, the corporation must furnish a list of its shareholders and their addresses to all stockholders. Attention is directed to the enormous expense burden that this will place upon some of the larger corporations.

Mr. PECORA. That criticism would be obviated, would it not, if the requirements were limited to the furnishing of a list of shareholders and their addresses to the regulatory body?

Mr. THOMPSON. Yes, sir.

Section 13, subsection (b), line 12, page 27: It might prove exceedingly difficult for corporations to obtain quorums for annual meetings if brokers carrying stock for customers are required to obtain specific authorization for each proxy. If this section should stand, could not the word "specific" be eliminated so that a general written authorization will cover all requests for proxies?

Mr. PECORA. Would not that keep the door open to most of the abuses now in existence?

Mr. THOMPSON. It may. I grant you it would not close it at all.

Section 14: Should this section stand, it becomes more than a possibility that the market for unlisted securities will be completely destroyed. The provision clothing the commission with power to prescribe whatever may be appropriate in the public interest for the protection of investors in what is known as "over-the-counter markets" is so vague, misleading, and lacking of definition that it should be removed from the bill.

This section also gives the commission power over brokers and dealers in State, county, and municipal bonds as well as Federal farm loan, joint-stock land bank, Home Owners' Loan Corporation bonds, and the stocks and bonds representing many other high-grade investments.

Mr. PECORA In preceding portions of your statement you call attention to what you claim to be provisions of the bill which discriminate against listed securities in favor of unlisted securities. When you reach the section of the bill which purports to give the Federal Trade Commission the power to deal with unlisted securities, you object to it.

Mr. THOMPSON. We do in this respect, Mr. Pecora. We feel that there are quite a number of unlisted securities which by their very nature cannot be listed. Let us take, for instance, as an illustration, the serial bonds of a city, and so on——

Mr. PECORA. Don't you think that that part of the objection might be met by a provision giving the Federal Trade Commission the power to exempt certain securities of the sort that you have referred to?

Mr. THOMPSON. Yes; in part, but there are many other securities. There are securities of very high grade, insurance stocks and bank stocks, and of many industrial concerns of exceptionally high grade, that are traded in today by brokers who are members of recognized exchanges.

Mr. PECORA. The power vested in the Federal Trade Commission to declare such exemption would meet that criticism, would it not?

Mr. THOMPSON. Yes.

Section 15, subsection (B), article 2, lines 20 and 21: In restricting the delivery of securities by directors, officers, or principal stockholders to within 5 days of sale the bill makes no allowance for Sundays or holidays. In the event of sales in the East from the Pacific coast, or on the Pacific coast from the East, or other remote places of the country, the 5 days' limit is too short. Also, should a holder of securities be out of the country and wish to sell on the prevailing market, under the 5-day clause he is barred from doing so.

Mr. PECORA. He would not be barred if he had his securities under the control and custody of someone in the community.

Mr. THOMPSON. But if he attempted to come home to obtain his safe-deposit box, he would.

Mr. PECORA. I mean, a person could very easily take some necessary precautions to protect himself from the harshness of any such provision.

Mr. THOMPSON. Ordinarily; but there are many cases that arise where a person is out of the country and who makes up his mind to act in a hurry.

Mr. PECORA. But he could leave his securities in such a custodianship as to make them easily available to the person in whose custody they are left to execute the order to sell.

Mr. THOMPSON. Ordinarily that would be true, but I do know of instances that have arisen where persons out of the country have desired to sell their securities held in their safe-deposit boxes. A very perceptible rise in the securities was made known to them after they had left the country, and it caused them to make up their minds that they wanted to dispose of them.

Mr. PECORA. You know the custom has grown up and developed of persons leaving their securities for safe-keeping in the hands of banks and trust companies?

Mr. THOMPSON. Yes; but there are a number of persons who keep them in safe-deposit boxes just the same.

Mr PECORA. If they contemplated going out of the country, they could make proper arrangements. It is open to every person to relieve himself of that so-called "hardship."

Mr. THOMPSON. Perhaps that would be a precaution that everyone would not take.

Mr. PECORA. If he would not take it, it is his own fault.

Mr. THOMPSON. It should also be taken into consideration that on the Pacific coast transactions are made in securities from Honolulu and Alaska where it is not possible to obtain delivery, to the place where the transactions are made, within the 5-day limit. San Fran-

cisco exchanges have a substantial volume of business in the pineapple and sugar stocks from Honolulu and canning stocks from Alaska and Honolulu.

Section 16: The expense of examination provided in this clause is unfair. Most of the exchanges and some of the States now conduct examinations. The securities business is subjected to a greater taxation on the character of business transacted than probably any other business in the country.

Section 17, subsection (a), page 32, line 2: The words, "influencing the judgment of an average investor", we submit, is language too vague and inadequate to determine just what is the judgment of the average investor. In the penalizing clause the door is wide open for those who are prone to blackmail, and the burden of proof is placed upon the broker.

Section 17, subsection (e): It would seem that the broker, by this subsection, must face a continuing liability, as either a purchaser or a seller of securities who has discovered a violation of this section of the law will have a right of action against the broker at any time within 2 years "after the discovery of the violation." What is meant by the word "discovery" as used in this connection? How can an ordinary citizen, may I ask, discover that a law has been violated in the sense that he, thereupon, will become both the judge and the jury in the matter? And if the citizen is to be authorized to exercise judiciary prerogatives, why not go the whole route and authorize him to assess punishment?

Mr. PECORA. Don't you think that argument is far-fetched?

Mr. THOMPSON. It may be. On the other hand, it is possible.

Mr. PECORA. The word "discovery" used here has its counterpart in many statutes involving civil remedies.

Mr. THOMPSON. It may be.

Mr. PECORA. I do not know of any cases in which courts have found difficulty in determining just what was meant by the term in a statute.

Mr. THOMPSON. You can readily see, Mr. Pecora, that 5 or 6 or 7 years from now you can discover that something has been violated.

Mr. PECORA. It has already been suggested, and as far as I know it has found favor, that there be a further limitation, that such an action must be brought within 6 years.

Mr. THOMPSON. There should be a time limit.

Section 18, subsection (A): The extending of authority to the commission to make "such rules and regulations as it may deem necessary or appropriate to carry out and to implement, administer, and enforce the provisions of this act, including the rules and regulations governing the form and content of registration statements and reports for various classes of exchanges, members, securities, and issuers, and defining accounting, technical, and trade terms used in this act" is a power which we feel Congress, even if constitutional to do so, which is doubtful, should not delegate to a commission of any kind or form. There is the power in the commission also to rescind and change its rules and regulations. To pass this authority on to a commission, in this instance, is to place those doing a brokerage business in a class by themselves where they shall have no rights whatever, not even the right to be heard when the commission is

formulating the rules and regulations which are to become part of this law. We protest the broad powers conferred upon the commission in this provision.

Subsection B of this same section, among other things, provides that the commission shall determine the method to be followed in the preparation of accounts, in the appraisal of assets, liabilities, and so forth, all of which can go a long way toward compelling corporations to give to their shareholders, and to the public, such statements as may be misleading and in serious conflict with previous practices. Under subsection A of this section the commission can step in and operate an exchange at any time. We submit that this subsection should be entirely eliminated.

Mr. PECORA. Are you not in favor of uniform systems or methods of accounting?

Mr. THOMPSON. Absolutely.

Section 20: This section provides, among other things, that whenever the commission shall be of the opinion that any person "is about to violate any provision of this act" and when any person is "about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this act, or of any rule or regulation prescribed under authority thereof", the commission may proceed against such person in any United States court to enjoin him and prosecute him for having an intention, which may be nothing more than a suspicion or an inference. We strongly protest the language contained in this section.

Mr. PECORA. Don't you think it is well to try to lock the stable door before the horse has been stolen sometimes?

Mr. THOMPSON. I think perhaps it might well to do so. That is an old saying and that is very well stated, but at the same time what an intention will be is pretty hard to determine. I may have some ideas about a matter, but I have no intention of doing anything whereby I would be forced to defend myself in the courts.

Mr. PECORA. Courts are every day called upon to determine with what intent an act is done.

Mr. THOMPSON. Let us not put anything more on the courts of that kind. I think we have too much of it now.

Mr PECORA. The courts are not complaining.

Mr. THOMPSON Section 22: If the information required by the commission is to be made available to the public, we believe the benefit to be derived by the public will be barred by the prohibitive cost of such information. This we base upon the cost of information available to the public by the Federal Trade Commission under the Securities Act, these costs varying, I understand, from $40 to $60 per issue of securities.

This in the event that the information is to be placed open and available for the public to see, in the commission.

Section 24: Lines 24 and 25, page 43, makes use of the words "false and misleading in any matter sufficiently important to influence the judgment of an average investor." The question of who is and what constitutes an average investor is one difficult of determination even by Congress. The liability under this clause is so unreasonable and the penalties so severe that instead of making the bill one of regulation it becomes an opening for persecution.

Section 27, subsection (b): Many exchanges today hold listing contracts and agreements with corporations. Some of these contracts covering the listing requirements and agreements between the exchanges and the corporations have been in force for years. Consideration should be given to such long-standing contracts and relations.

Section 28: This section discriminates against brokers and dealers in favor of the individual, enabling the individual to purchase securities direct from foreign countries but forbidding a broker or dealer from making such purchases. This section will encourage investors to place their orders direct in foreign markets.

Section 29: We vigorously protest against a tax of any kind whatsoever being levied upon the exchanges, or the brokers engaged in business thereon, for the purpose outlined in this section. The business of buying and selling securities is already bearing a greater proportion than is its share in the way of Federal taxes; and the revenue derived by the Government, if it is necessary to have a regulatory measure, is more than ample to bear any expense involved in the enforcement of the act.

Mr. PECORA. The tax that you refer to is one and five hundredths of 1 percent?

Mr. THOMPSON. Yes. I might say, in addition to the tax levied by the Federal Government, there are some of the States that also levy a tax equal to that of the Federal Government upon the securities business.

Section 30: The way is cleared by this provision for the employment by the Commission of persons either with or without the peculiar qualifications necessary to the handling of delicate relationships, who frequently no doubt will consider it necessary to step into situations involving the very confidential relationships or understandings already existing or to exist between brokers and customers. No protection is afforded here either in the development or the maintenance of relationships of this character, which are considered so valuable and are so highly prized by both brokers and customers. Yet an incompetent employee of the commission, who is in his position without sanction of the broker, but whose compensation is paid in part by the broker, may find himself in a position where he can either by ignorance or design wreck business associations of this kind which have lasted for years.

The burden of expense upon the broker, particularly the small house, provided for in this section is likely to prove prohibitive.

Then I have the figures showing the number of transactions in shares of stock on the local stock exchanges outside of New York from 1929 to 1933 by the year and the total.

(The tabulations submitted by Mr. Thompson appear in full at the conclusion of his statement in the printed record only.)

Mr. PECORA. Have you any statistics that you could include showing the market value of securities listed on these various exchanges?

Mr. THOMPSON. No; I have not, Mr. Pecora. One of these is the same information as to the par value of bonds. The next one gives as of February 19, 1934, the total numbers of shares and the total par values of bonds listed upon the local exchanges outside of New York.

The general impression is that the National Securities Exchange Act will only affect the New York Stock Exchange. Never was there a more erroneous impression. I submit herewith tables showing that there are listed on stock exchanges outside of the city of New York 2,140,015,288 shares of stock and $10,960,816,255 par value of bonds and that the volume of transactions for the past 5 years, as officially reported by the local exchanges, reached a total of 750,549,338 shares and $199,663,557 par value of bonds respectively.

Mr. PECORA. Mr. Thompson, where did you get the notion the general impression is this bill affects only the New York Stock Exchange?

Mr. THOMPSON. I do not get the notion, Mr. Pecora. It is the general impression that prevails. It was aimed at the New York Stock Exchange.

Mr. PECORA. There is nothing in the act that says that.

Mr. THOMPSON. I did not say so. I am talking about the general impression that prevails. I did not say the act said so.

Mr. PECORA. I have moved among different classes of persons, and this is the first time I have heard that thought advanced.

Mr. THOMPSON. Many of the provisions of the bill seem to be aimed more particularly at the operations on the larger markets, say the New York Stock Exchange.

Mr. PECORA. All the markets.

Mr. THOMPSON. Yes, sir; but many of the provisions of the bill are applying to the local conditions throughout the country, which are not in the same class as the larger national market in New York. The present bill would seem to be predicated upon the mistaken premise that corporations and stock brokers will somehow contrive to continue their normal functions despite the drastic regulations imposed by the measure. I respectfully submit, on the contrary, that corporations will immediately and in great numbers remove their securities from listed trading to avoid the burdens the act seeks to impose upon them, and the public thereby will not only fail to obtain the results hoped for from the act but automatically the market for these securities will be thrown upon the street or upon the over-the-counter market, thus depriving the corporations and their securities owners of the admitted and certain benefits of a regulated market.

Mr. PECORA. Mr. Thompson, aren't you mindful of the fact that under section 14 the Commission will have the power to prescribe rules and regulations governing transactions in the over-the-counter market?

Mr. THOMPSON. I am not unmindful of that, Mr. Pecora. I am rather of the opinion that if the bill is enacted in the present wording, corporations will simply remove the stock from listing and let it fall in whatever course it will.

Mr. PECORA. What reasons have you for that?

Mr. THOMPSON. Because of the expense involved in it.

Mr. PECORA. What expense?

Mr. THOMPSON. The expense upon the corporation and requirements of adhering to the regulations.

Mr. PECORA. What expense?

Mr. THOMPSON. Well, the expense, first, in the certified public audits.

Mr. PECORA. You have already indicated that you are in favor——

Mr. THOMPSON. I am.

Mr. PECORA. Of having audited statements.

Mr. THOMPSON. I am in favor of it, but I will grant you that corporations will not stand the expense.

Mr. PECORA. You think that they would forego the advantage of having their securities listed in order not to meet the expenses of the cost twice a year?

Mr. THOMPSON. On the local exchanges they would, I think.

Mr. PECORA. Do you think the stockholders would sanction such action?

Mr. THOMPSON. I do.

Mr. PECORA. And have them dealt in in the over-the-counter market?

Mr. THOMPSON. I am not talking about where they shall be dealt in, because if the Commission prescribes certain rules and regulations under this bill they may not be dealt in at all.

Mr. PECORA. Corporations then, in order to avoid the expense of an audited statement twice a year, would prefer to destroy the liquidity of their own securities by withdrawing them from a market entirely? Is that your fear?

Mr. THOMPSON. Our premise in this matter is based upon four quarterly audited reports and this memorandum is drawn upon that statement. Now, what will happen if there are only two, I do not know. Certainly the burden is much lighter.

But I do say that to comply with the matter of soliciting proxies, is another expense; I could not enumerate them all to you at the moment, but there are certain expenses in there that the corporation will have if its securities are listed.

The CHAIRMAN. And yet you think they ought to make these semiannual audited reports?

Mr. THOMPSON. I should like to see quarterly reports, Senator. I stated that several times. But I do not see how it is possible to force corporations to go to the expense of quarterly audits. There are many corporations on our local exchanges with a capitalization of three or four or five hundred thousand, or six hundred thousand, some of them a million, and a great deal more, but we have many small corporations.

In the same manner I am confident that many if not a majority of brokers, particularly those who are members of local exchanges, will be unable, if not unwilling, to comply with the provisions of the act and that as a result the local exchanges themselves will cease their existence.

We may presume that the members of the Federal Trade Commission, as at present organized, have been carefully selected and are wise and prudent in the execution of their duties and responsibilities Nevertheless, entirely too much power is placed in the hands of the commission by the terms of this measure. The stalking menace of bureaucracy is apparent in the bill's general purport and in

all its passages. The exchanges will have no equal voice in the conduct of their own affairs—the regulatory features are too rigid and too unwieldly to permit of that, even if the Commission were not vested, as it is under the bill, with authority so broad that it can regulate if it likes or it can take things into its own hands and actually administer the business of the exchanges. More than that. The Commission by the bill is given power to restrict and control the credit system and it is given control of corporations regardless of whether or not they are engaged in interstate commerce.

Mr. PECORA. How do you think the bill gives the Commission power to control corporations?

Mr. THOMPSON. It gives the Commission power to control the kind of statements that they shall issue, appraise the assets, the liabilities, and many other things that are mentioned there in the bill.

Mr. PECORA. Then you think that the provisions giving the Commission the right to call for certain statements, prescribing the form and content of such statements, is equivalent to the power to operate the business of the corporations?

Mr. THOMPSON. I cannot see how it would be possible for a corporation to go along and conduct its business the way we will assume it has been running if the Commission comes in and sets up certain rules and regulations that it must abide by in order to have its securities listed on the exchange.

Mr. PECORA. What are the rules and regulations that you have reference to that the Commission could adopt?

Mr THOMPSON. Well, we have already mentioned several of the expense matters that they go to. The bill goes further, Mr. Pecora, and states that they shall determine the appraisal of the assets, the liabilities.

Mr. PECORA That goes back to the determination or the adoption of a uniform system of accounting, doesn't it?

Mr. THOMPSON. Not necessarily.

Mr. PECORA. Well, I think it does.

Mr. THOMPSON. Not at all.

Mr. PECORA. I think that is exactly what is aimed at.

Mr. THOMPSON. I cannot agree with you on that.

Mr. PECORA. Merely because the Commission is given the power to determine what shall be the form and content of the statement of condition is, to my mind, rather a tenuous basis upon which to say the Commission is thereby given the right to control the corporation. You might just as well say that the bookkeeper or the person in charge of the bookkeeping of the corporation has a greater voice in the operation of the business than the president and other executive officers or the board of directors.

Mr. THOMPSON. Mr. Pecora, if you have a plant appraised at a million dollars and the Commission comes along and sets up a method by which you shall appraise that plant—they say that you cannot allow this and that—you may find that you have an appraisal of $250,000 before you are through.

Mr. PECORA. You know the kind of abuses that are indulged in because we have no uniform system of accounting?

Mr. THOMPSON. That is quite true. I agree with you.

Mr. PECORA. Don't you think those abuses should be eliminated?

Mr. THOMPSON. I think they should be, but I do not believe they should be blamed on the stock exchanges.

Mr. PECORA. Then let us see if they cannot be by the adoption of a uniform system of accounting. The Income Tax Department requires form of income-tax statements that corporations and individuals must make. Do you think that that puts the Internal Revenue Bureau in a position of running the business of those corporations and individuals?

Mr. THOMPSON. No; but the Federal Trade Commission is given very much broader power than the income tax department is in the administration of this measure.

Mr. PECORA. Not merely because it is given the right to determine the form and content of statements. I think that is a very far-fetched conclusion.

Mr. THOMPSON. It is a safe assumption that few if any among the country's population even so much as dreamed that the law which put the Reconstruction Finance Corporation into operation would some day give that body control over the banks. Yet that came about, as we all know. Was this an expectation of Congress when the R.F.C. legislation was under consideration? If the answer to this question is in the negative, as I think it must be, then another question might properly be asked: If the Congress itself doesn't know what it wants, why leave the matter to a Commission for experimentation?

A government by bureaucracy means a government removed from the people. It means regulating the spirit of incentive out of the lives of individuals. We have heard the statement made here that the bill allows for flexibility of action. If there is flexibility of action in this bill, then by all its earmarks it is flexibility for the regulators and not for the regulated.

It is not conceivable that Congress should pass a bill so drastic as this one is in its opposition to established business principles, and so destructive of established financial market.

The last several days in this room we have heard expounded a philosophy—a sort of applied philosophy—vague to most of us but eloquent nevertheless, which is designed seeming to put the business interests and the country itself on notice that the customs and practices in our particular line of endeavor, which of our knowledge were built upon the solid rocks of experience and common sense, are no longer to guide us in the future in the United States. Whence comes this philosophy? What is its genesis? Does it spring from the minds of the men of our Nation who make up the generations that have devoted lifetimes to the study of the problems related to the operation of the stock exchanges? Do these young gentlemen fresh from the colleges who have learned about the exchanges from their own theses, and by long distance, actually have a better insight of what is necessary and advantageous to the public welfare in this connection than do those who have gained their knowledge and wisdom through circumstances of close contact with the problems themselves?

Pass this bill, declared one of the measure's proponents in this presence, and the stock exchanges no longer will be private clubs.

Mr. PECORA. You have heard the argument made that the stock exchange is a private club and hence should be without the power of State or Federal regulation?

Mr. THOMPSON. I have heard it made right here in this room.

Mr. PECORA. You have heard it made by the representatives of stock exchanges, too?

Mr. THOMPSON. No; I have not.

Mr. PECORA. Well, I have; not only here, but before the New York State Legislature, when efforts were made to regulate the exchanges in New York.

Mr. THOMPSON. I think there is nothing in that kind of talk. At best it is a specious argument. How many times have you and I heard the United States Senate referred to as the most exclusive club in the world? There is a great deal about the bill itself and about the support of its provisions here and elsewhere that savors of amateurism. It strains hard at the unattainable. It seeks to carry us to a Utopia by heading us in the direction of the Tower of Babel.

I have said that the stock exchanges are merely market places. They are that, and they are much more than that. They are human institutions. Their dependence is the public itself. Their ears are always close to the ground. They are susceptible to public sentiment and public pressure in a peculiar sense and to a greater degree than is perhaps any other widespread business enterprise in the country with the possible exception of the United States Government itself.

True, as has been intimated in some quarters, we may not have all the knowledge and all the wisdom which is necessary in the conduct of our business; but this bill would indicate that that neither those of us who are now in temporary control of the exchanges nor those who have preceded us in this capacity have ever had or will ever have any knowledge, or wisdom, or decency, or patriotism. There is a trite old saying to the effect that the proof of the pudding is in the eating thereof. We might try out this bill on the American people. But I say to you solemnly that the outcome and the result will only be contemplated through the wreck of the stock exchanges as institutions and through further financial and industrial chaos everywhere in the United States.

As a final word, let me say that the stringent provisions of this bill as now written will operate to defeat the very purposes which are sought to be accomplished. It would without doubt seriously impair if not actually destroy the value of securities markets, and thereby deprive the Federal Government and some of the States of the enormous revenues now derived from taxation on sales and transfers of securities; it would throw thousands out of employment, and it would deprive the commercial life of the Nation of those essential functions of the stock exchanges which no less a person than the President of the United States recognized when, in his very recent message to the Congress he said, in part:

It is my belief that exchanges for dealing in securities and commodities are necessary and of definite value to our commercial and agricultural life

I have spoken, as you understand, for the local exchange. Pass this bill, and you will have destroyed not only the local exchanges but all stock exchanges.

Mr. PECORA. Mr. Thompson, you have been good enough to quote the President of the United States in his very recent message to the Congress. You might also bear in mind his suggestion that "speculation with other people's money should end."

Mr. THOMPSON. I am not unmindful of that, Mr. Pecora. I am in accord with you that speculation with other people's money should end.

That is all, Mr. Chairman.

The CHAIRMAN. Then you are opposed to any legislation looking to Federal supervision or regulation?

Mr. THOMPSON. I am opposed to any Federal legislation looking to the regulation of stock exchanges wherein the stock exchanges do not have some voice.

The CHAIRMAN. I do not understand that all voice of the stock exchanges would be eliminated under this bill.

Mr. THOMPSON. I would understand that the voice of the stock exchanges would be eliminated under this bill as to the regulation; yes, sir.

Mr. PECORA. On page 4 of your statement you say:

In those memorable days previous to the catastrophe of 1929 the exchanges, the market places, were open for business, and business came to them, as we all know, in avalanche proportions That which occurred has been characterized as a "speculative orgy"

Do you think that that characterization is wide of the fact?

Mr. THOMPSON. No; I do not.

Mr. PECORA. Then you ask the question:

But were the exchanges responsible for this?

In asking that question do you think the exchanges had no responsibility whatever for this "speculative orgy"?

Mr. THOMPSON. Mr. Pecora, that is a very difficult question to answer just in that way. I will say to you that I cannot lay to the doors of the exchanges the blame for the—just as you term it, "wild speculation", the large speculation.

Mr. PECORA. The reason I asked you the question was because later on, on that same page, you say:

An analysis of the conditions prevailing at that time will disclose that the cause of the economic misadventure cannot rightfully be laid on the doorstep of the exchanges

Mr. THOMPSON. Yes, sir; I maintain that position.

Mr. PECORA. In reading that I would gather the inference that your conclusion is that the exchanges had absolutely no responsibility for any part of this speculative orgy. That is why I asked you the specific question you now say is a difficult question to answer.

Mr. THOMPSON. Well, it is a difficult question to answer in that way, Mr. Pecora. I say the exchanges themselves had no responsi-

bility, if I had to answer your question directly. I should like to qualify it, however, if I were going to answer it in your way, and say that possibly more stringent regulations on the part of the exchanges might have operated to curtail the large amount of trading. I do not think it would have had anything to do with the question of the rise in prices.

Mr. PECORA. Then at least to the extent that those more stringent provisions were not adopted by the exchanges they were derelict?

Mr. THOMPSON. Well, I would not say that, because we are living in a day when we are learning year by year by experience.

Mr. PECORA. Well, it is because of the experience of 1929 and the time that has elapsed since then that the necessity seems to have arisen for a bill of this character.

Mr. THOMPSON. And may I say to you, Mr. Pecora, that I mentioned several times here that we are ready and willing to cooperate in anything that is constructive, where we will have some voice. But I am unalterably opposed, and I think my exchanges are opposed, to any bill of any kind, shape, or form which does not give us a voice.

Mr. PECORA. The exchanges all this while have had every voice and the sole voice.

Mr. THOMPSON. I cannot say that.

Mr. PECORA. And the result of that is evidenced by the shrinkage in security values that the chairman called attention to earlier today.

Mr. THOMPSON. I do not think that the exchanges can be blamed for the decline in securities values.

The CHAIRMAN. What you mean by saying the exchanges should have some voice is really the exchanges should control?

Mr. THOMPSON. I do not say that, altogether. If there is to be a public regulatory body, if that is decided upon by the Congress, I would feel that the exchanges should have some voice in the matter of their own regulation.

The CHAIRMAN. All right. We are very much obliged, Mr. Thompson. We will take a recess now till 10:30 tomorrow morning.

(Accordingly, at 4:47 p.m., an adjournment was taken until 10:30 the following morning.)

THE VOLUME OF TRANSACTIONS IN PAR VALUE OF BONDS LISTED ON EXCHANGES OUTSIDE OF NEW YORK CITY

	1929	1930	1931	1932	1933	Total
Baltimore	$8,001,200	$6,417,500	$3,048,100	$2,140,200	$2,137,500	$21,744,500
Boston	11,118,745	5,539,376	3,363,800	1,911,600	1,169,800	23,103,321
Buffalo	1,747,100	2,240,400	1,524,600	928,900	797,600	7,238,600
Chicago Stock	4,975,500	27,462,000	12,480,500	10,597,000	1,433,000	56,948,000
Chicago Board of Trade (Stock Dep't)		53,500	281,000	283,500	196,100	814,100
Chicago Curb	956,500	2,538,200	963,675	73,400	422,500	4,954,275
Cincinnati	30,000	68,000	220,000	134,500	168,500	621,000
Cleveland	1,490,100	883,050	222,250	71,900	84,000	2,751,300
Detroit	(1)					
Hartford	(1)					
Los Angeles Stock	779,500	2,800,500	623,500	148,000	151,000	4,502,500
Los Angeles Curb	(1)					
Louisville	44,000	22,000	19,000	4,000	8,000	97,000
Minneapolis-St Paul	778,500	110,000	127,400	18,950	15,600	1,050,550
New Orleans	2,834,000	2,941,000	2,075,000	1,661,000	2,438,000	11,949,000
Philadelphia	6,057,074	5,882,125	11,089,222	3,948,602	1,560,188	28,537,211
Pittsburgh	115,000	284,000	100,000	43,000	119,000	661,000
Richmond	265,100	527,500	847,300	502,100	519,500	2,661,500
St Louis	2,021,000	2,244,000	910,000	194,000	161,000	5,530,000
Salt Lake	(1)					
San Francisco Stock	3,384,500	2,457,500	2,381,000	1,530,000	854,500	10,607,500
San Francisco Curb	767,500	2,533,500	1,938,500	349,000	423,000	6,011,500
Seattle	1,151,200	800,400	170,200	3,000	(1)	2,124,800
Washington	2,395,200	1,603,200	1,624,200	1,011,200	1,122,100	7,755,900
Total	48,911,719	67,407,851	44,009,247	25,553,852	13,780,888	199,663,557

[1] No bonds

THE VOLUME OF TRANSACTIONS IN SHARES OF STOCK LISTED ON EXCHANGES OUTSIDE OF NEW YORK CITY

Baltimore	$1,312,270	$743,565	$510,773	$350,350	$635,753	$3,552,711
Boston	25,075,468	15,413,305	12,462,142	10,299,561	13,672,390	76,922,866
Buffalo	4,832,045	2,865,925	1,531,004	610,078	274,377	10,113,429
Chicago Stock	82,216,000	69,747,500	34,404,200	15,642,000	18,288,000	220,297,700
Chicago Board of Trade (Stock Dep't)	890,775	1,466,185	1,667,147	1,155,643	1,657,024	6,836,774
Chicago Curb	6,643,201	6,047,935	3,855,194	840,200	3,136,400	20,522,930
Cincinnati	1,643,130	762,533	527,392	321,867	288,127	3,543,049
Cleveland	2,007,110	779,056	519,460	407,463	488,281	4,201,370
Detroit	11,434,665	5,065,720	3,843,225	2,775,956	4,092,518	27,212,084
Hartford	3,250,000	2,300,000	1,680,000	1,100,000	1,800,000	10,130,000
Los Angeles Stock	15,406,993	9,171,442	5,450,543	3,068,749	3,228,819	36,326,546
Los Angeles Curb	37,775,806	11,082,275	8,310,729	3,106,501	5,922,176	66,197,487
Louisville	23,700	30,500	1,250	1,000	700	57,150
Minneapolis-St Paul	730,424	559,252	487,074	323,062	363,162	2,462,974
New Orleans	345,000	128,000	116,000	52,000	95,000	736,000
Philadelphia	35,520,785	27,234,794	10,589,837	6,592,342	7,614,522	87,552,280
Pittsburgh	5,328,923	3,542,446	1,625,014	1,551,958	2,409,566	14,457,907
Richmond	22,315	29,621	21,717	14,014	12,377	100,044
St Louis	1,318,000	543,000	390,000	165,000	145,000	2,556,000
Salt Lake	30,455,056	19,429,889	10,315,075	3,468,282	8,637,020	72,305,322
San Francisco Stock	19,188,822	15,262,932	9,875,057	7,058,715	8,129,554	59,515,080
San Francisco Curb	12,983,565	4,840,286	2,470,066	1,401,017	2,099,054	23,793,988
Seattle	431,718	293,955	145,231	15,393	415	936,712
Washington	99,831	57,093	41,543	9,035	11,433	218,935
Total	298,985,602	197,402,209	110,829,673	60,330,186	83,001,668	750,549,338

Number of shares of stock and par value of bonds listed on exchanges outside of New York City as of February 19, 1934

Exchange	Shares	Par-value bonds
Baltimore	14,397,097	$593,317,018
Boston	298,767,489	3,542,913,710
Buffalo	33,401,000	126,000,000
Chicago Stock	258,174,589	1,049,903,000
Chicago Board of Trade (stock department)	63,265,198	1,578,400
Chicago Curb	165,241,937	337,278,587
Cincinnati	39,224,286	140,353,000
Cleveland	28,299,810	26,937,650
Detroit [1]	118,691,000	
Hartford [1]	16,602,191	
Los Angeles Stock	180,549,744	396,500,000
Los Angeles Curb [1]	43,402,851	
Louisville	143,255,000	4,153,500
Minneapolis-St Paul	5,009,758	11,360,000
New Orleans	147,000	233,000,000
Philadelphia	134,377,531	2,224,328,626
Pittsburgh	60,213,161	74,925,000
Richmond	2,309,312	90,041,714
St Louis	10,761,000	122,774,000
Salt Lake [1]	118,482,946	
San Francisco Stock	156,150,366	990,814,500
San Francisco Curb	224,700,000	554,000,000
Seattle	4,686,682	27,454,600
Washington	19,905,340	143,182,950
Total	2,140,015,288	10,690,816,255

[1] No bonds listed