STOCK EXCHANGE PRACTICES

WEDNESDAY, MARCH 7, 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), Adams, Goldsborough, Walcott, Townsend, 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; and R. E. Desvernine, counsel to Association of Stock Exchange Firms.

The CHAIRMAN. The committee will come to order, please. Mr. Leonard, we will hear you now.

STATEMENT OF FRANKLIN LEONARD, NEW YORK CITY, A MEMBER OF THE FIRM OF LEONARD, CUSHMAN & SUYDAM

The CHAIRMAN. Mr. Leonard, will you state your name, place of residence, and occupation?

Mr. LEONARD. Senator Fletcher, my name is Franklin Leonard, of 25 Broad Street, New York City, a member of the firm of Leonard, Cushman & Suydam.

The CHAIRMAN. You may go ahead with your statement.

Mr. LEONARD. I received a telegram from the San Francisco Mining Exchange requesting me to appear here on their behalf, I suppose, because some years ago I was a member of that exchange.

I find that a letter has been placed in the record written by the president of the San Francisco Mining Exchange, in which he referred to mining as mentioned in Mark Twain's Roughing It, and in which he spoke of the possibility of a mine becoming a hole in the ground and a hole in the ground becoming a mine.

Now, all that would not be pertinent here were it not for the fact that my investments in mines, which are traded in at San Francisco, are exceedingly great and mine operations out there will be tremendously affected if the stock exchanges engaged in dealing in mining stocks in San Francisco and others are interfered with to the extent that they may not be able to continue business.

Kindly permit me to point out that in States like California the corporation commissioner's office has proceeded with regulatory

measures, and our exchange in San Francisco fully cooperates with the office of the corporation commissioner of the State and proceeds to do business.

It seems to me, point one, that regulation of exchanges should be left to the States rather than to be made national.

It seems to me, point two, that under the circumstances it is quite ridiculous to talk about a $500,000 penalty, or something of that kind, on exchanges when there are many small exchanges in this country which actually could not pay a very small proportion of such fine.

Now, will you permit me to state that for 13 years I was counsel for the second largest exchange in this country, namely, the New York Curb Exchange; that prior to that time I had been counsel for a large number of mines and mining companies. At the present time I am the president of the Sutro Tunnel Coalition, which owns 30 or more mines upon the Comstock Lode, and which is endeavoring to obtain financial assistance for the purpose of development operations on many of its various properties.

Now, in going before the Federal Trade Commission it has come to my notice that that Commission in its fact-finding studies has found it necessary to take 7, 8, or 9 weeks continually asking additional questions in order to bring about a situation under which the Federal Trade Commission may proceed intelligently to act.

I assure you that at the present time there are two or three hearings proceeding down there, one of which has just been completed, and I assure you that it would be of great interest to this committee, or I believe so at any rate, I mean this Banking and Currency Committee of the United States Senate, if you would permit me to file as a part of my statement, a certified copy of the testimony taken and some of the proceedings which took place down there in that connection.

Please understand that I am not in any way criticizing or attacking the Federal Trade Commission. I am merely pointing out that a vast amount of time is lost on the part of these small people who are attemting to obtain, from speculators if you will, or by borrowing, promotion money for the purpose of developing their properties. And these small people are not able to proceed and to obtain funds within any reasonable period of time.

And, mind you, gentlemen of the committee, they could not do it at all without the general assistance of the exchanges.

Now, there has been a new exchange formed in the State of New Jersey, and I wish to say one word about that, because it so happens that my son was made vice president of it, and he asked me, if the opportunity presented, to suggest that that exchange can only deal in securities listed upon other exchanges. It cannot proceed to list stocks itself for the reason that it is only a small exchange, an exchange which is just starting out, and——

Senator TOWNSEND (interposing). Where is that exchange located.

Mr. LEONARD. It is located in Jersey City, in the State of New Jersey. Now, there are a great many reasons why there must be a mining exchange in the State of New Jersey. The principal reason, however, is the fact that the State of New York has placed a transfer tax upon sales, transfers, or deliveries of stock, which tax absolutely precludes the low-priced stocks from being dealt in.

To illustrate: Take the stock of a company in which I have invested upwards of $200,000. The stock of that company was selling at par in the month of May and also of June of this year, and at one eighth and one fourth over par, and then——

The CHAIRMAN (interposing). You mean last year.

Mr. LEONARD. Last year, I meant; yes. But when this State tax became effective the result of the situation was that the market for those stocks could not be continued in the State of New York, and it became necessary for the directors of the company to list its stock in San Francisco. That stock had been listed upon the New York Curb Exchange, regularly listed there, for 14 years, and all of its stock was outstanding, and the stock was then enjoying an excellent market. But——

Senator TOWNSEND (interposing). What was the stock?

Mr. LEONARD. Do you want me to give the name of it?

Senator TOWNSEND. Yes.

Mr. LEONARD It was the stock of the Comstock Tunnel & Drainage Co. The stock of that company was formerly listed upon the New York Stock Exchange, I mean years ago, the stock of its predecessor company. But the point that I want to bring to your attention is, that the market for the stock having been destroyed in New York, and this little mining exchange having been started in Jersey City, they placed our stock on their list. We did not ask to have the stock listed, that is, we did not request them to list the stock, but they began trading in it there because it was listed in San Francisco, and had been listed upon the New York Curb Exchange. Am I speaking too loudly, Mr. Chairman?

The CHAIRMAN. No. Go ahead just as you are.

Senator WALCOTT. I think you might very well keep you voice down. We can hear you very easily. Do not raise you voice so high.

The CHAIRMAN You do not talk too loud for me. I can hear you very well when you are talking just as you are now.

Mr. LEONARD. Now, under those circumstances, Senator Fletcher, you can see the necessity for these small exchanges. And I want to say that before allowing my son to join that exchange in Jersey City I inquired about it, and I found upon their board of governors seven men in whom I had entire confidence. They did not have money but they had moral credit. They were the men who started that little exchange in Jersey City.

Furthermore, at the present time the securities department of the attorney general's office is checking up to ascertain that it is being conducted properly. And I contend that under the general supervision of the securities department of the attorney general's office of the State of New Jersey there can be no danger to the public in speculating or investing in the small stocks that are traded in there, in the event they are approved.

Now, at former times I have represented the Salt Lake Exchange, and I have represented other exchanges.

And I want to say right here, Mr. Chairman, that I had hoped Mr. Pecora would be present when I appeared, because I expected he might ask me some questions. But he was absolutely familiar with the work which I conducted as counsel of the New York Curb

Exchange, during its formative period, for 13 years, and during 8 of those years Mr. Pecora was in the district attorney's office in New York. Judge Swann, as district attorney, and Mr. Banton, as district attorney, with Mr. Pecora in the office, knew that during all of that period not one member of the New York Curb Exchange was ever under indictment. The whole situation was a development of a small and new exchange from the rabble in the street until it resulted in exchange memberships having a price placed upon them amounting to $253,000.

Now, there is another instance where a situation develops which makes it absolutely dangerous to an exchange to be compelled to proceed——

The CHAIRMAN (interposing). I do not quite understand that statement, Mr. Leonard. You say the New York Curb Exchange developed to the point where it was worth $253,000. What do you mean by that statement?

Mr. LEONARD. I meant to say that when we first organized the New York Curb Exchange and obtained a charter by that name the formation was made by signing the constitution but with no payment. Eighty-six men signed the constitution of the New York Curb Exchange. Afterward seats on that exchange sold at $100 in 1911, and at $250 in 1912; and then when the financing took place and the building was constructed a price was placed upon seats of $5,000. And then during the past 10 years, up to 1929, the advance in the price of memberships of the New York Curb Exchange proceeded from that point of $5,000 until they had sold as high as $253,000.

The CHAIRMAN. I see. And before that Curb was organized it had done business out in the open, as I understand.

Mr. LEONARD. Yes; out in the open; in the street. And I was one of the original persons connected with it; in fact, I was the attorney that held the street, if you will permit me to say that. The Curb remained in the streets of New York for 17 years due to a decision made by Mr. Justice Guy, of the Supreme Court, which was affirmed in the appellate division, and afterward in the court of appeals. But I do not wish to go into that matter now, or to take up the time of the committee with it.

The CHAIRMAN. That is not necessary here.

Mr. LEONARD. But the whole thing shows that the development of a legitimate exchange is made very often from small beginnings.

Senator KEAN. Mr. Leonard, I should like to ask you some questions right there: I remember very well when the curb exchange was started. It was started by clerks of a few brokers meeting out on Broad Street and exchanging whatever they had to buy or sell. Isn't that right?

Mr. LEONARD. Yes. That would be beginning about in the nineties, do you mean?

Senator KEAN. Yes.

Mr. LEONARD. Yes; that was in the '90s.

Senator KEAN. And from that point it gradually grew so that there was a crowd out there in the middle of the street.

Mr. LEONARD. Yes.

Senator KEAN. Blocking traffic, but at the same time trading in various unlisted stocks.

Mr. LEONARD. Well, Senator Kean, we were able to prove that we were not blocking traffic when we came to court. [Laughter.]

Senator KEAN. Perhaps so. Next, I remember very well standing before a window in my office in New York and looking down at the curb exchange, and also down Wall Street, and suddenly I heard a great explosion. And I saw the people go down that way [indicating], and I saw the people from the curb exchange rush up to Wall Street, and then they turned and rushed back again. That was the explosion which occurred in front of the subtreasury and which killed a lot of people.

Mr. LEONARD. Killed 36 people, yes.

Senator KEAN. Killed 36 people, you say?

Mr. LEONARD. Yes, sir.

Senator KEAN. And injured many more. And the members of the curb exchange seemed to be very brave until they got up to the corner of Wall Street, and then they became afraid there would be another explosion, and they all ran away again.

The CHAIRMAN. What year was that?

Mr. LEONARD. I do not recall exactly. But, Senator Kean, I fear you are referring now to the curb boys very much as witnesses always did in court. If a fellow was arrested, for instance, for speeding he would give a fictitious name, and say he was a member of the curb market. [Laughter.] But there was something else there: We were trying to run a legitimate and well-organized market. So time having proceeded, from 1893, to which Senator Kean referred, on up, over a period of years, those clerks grew and finally it became an independent market, and 86 young men, who were of considerable standing, formed the curb exchange.

But I want to say to you gentlemen that before forming it they sent me to the New York Stock Exchange to ascertain if it would be entirely agreeable—and this is the first time that this point has ever been put on a public record—there was a gentlemen's agreement made by me with Frank K. Sturgis, the chairman of the law committee of the New York Stock Exchange, in which it was provided that the curb exchange might organize, that it might house itself, and that it might proceed with its business.

Now, under those circumstances, when I came in as secretary and counsel of the New York Curb Exchange—and I want to pause right there to mention that the first year of its organization there were 640 decisions rendered—at that time seats on the curb were $100, and I encouraged my friends, especially in the produce exchange and other exchanges, to join this curb exchange. And I might comment at this point just to say that the man who sold his seat for $253,000 was Frank Reinicke, who during the war, when the exchange was closed, sold his seat to me for $50 because he needed the money and did not have a cent. I then said to him, "Frank, these seats will be more valuable one of these days"——How do you do, Mr. Pecora.

Mr. PECORA. Good morning, Mr. Leonard.

Mr. LEONARD. And I turned it into a loan, and sold him back his seat in a short time, after getting him a job.

Now, gentlemen of the committee, that general policy was carried out right straight along in the matter of the New York Curb Exchange.

Mr. Pecora, I might explain to you that the reason I am mentioning the curb exchange when I am here testifying really on behalf of the San Francisco Mining Exchange, is that a man naturally goes back to his old love, to his first love, I suppose, and I want to make this point: More than half, I think more than 70 percent, of the stocks dealt in upon the New York Curb Exchange are not listed but they are admitted to trading under very careful supervision and management.

Now, supposing that this bill should make it impossible for any stocks upon a national-securities exchange that are not listed, to be dealt in. Eighty percent probably—and they will have to tell you how much, but probably 80 percent of all the trading on that exchange is in stocks which are not regularly listed.

Now, it seems to me that we ought to keep in mind the absolute advantages of an organized local exchange in the various cities in order to bring together those who wish to make a market in securities and help to develop the various properties which are promoted locally.

I do not propose to take up any more of your time, or to go into detail upon the objections we have to offer. I believe I could offer 21 quite serious objections to the bill, but believe I have heard nearly all of them stated and covered here already.

But I want to urge upon you Senators that if you are to have a body which is to supervise exchanges, that such body should not be a commission of the United States, no matter how high and wonderful its standing, which is overloaded now with a tremendous amount of work which it is not able to swing into action without additional help, and which if made a fact-finding body without review by the courts is bound to result in terrific injustice, not only to all the exchanges but particularly to the small exchanges.

My experience is that mining is Greek to them, and yet the great mining industry of this country is entitled to the utmost consideration here in Washington. It was the output of the Comstock lode, from mines which I now own and control through our various operations and companies, that made it possible for the Government to resume specie payments. It is a matter of history that the Comstock lode is entitled to a tremendous amount of credit for the recovery from the previous great panic.

Now, I want to point out that gold and silver properties are the ones which now must receive attention from one end of the country to the other. I bought gold stocks in 1929. I bought gold properties in 1926 and 1927, but all those properties were purchased pursuant to the advice of engineers, and I want to assure you that one of the reasons why I am not active in Wall Street, and one of the reasons why I have retired from the practice of law after 40 years at the bar in New York, is that I want to devote the rest of my life to the development of legitimate gold and silver mining properties through legitimate small exchanges of the West and the East.

I thank you, gentlemen of the committee, for hearing me.

The CHAIRMAN. Now, Mr. Leonard, in reference to the operation of these small exchanges, how do you account, for instance, for stock listed on the Chicago exchange and having no bid and no offer,

with no market there at all, being able to find a market developed on the Curb in New York? Does that happen very often, and if so, what is the cause of it?

Mr. LEONARD. That happens sometimes, Mr. Chairman. But it will be the other way round if they continue these taxes and the price of a stock is low; you will find bids and offers in Chicago but not on the Curb. But I wish to answer your question more directly, Mr. Chairman, if I may?

The CHAIRMAN. Yes, I wish you would please do so.

Mr. LEONARD. It is very often the case, Senator Fletcher, that the market may not be found where the bid may be. Now, suppose that the people who are interested in the stock live in New York, and the most of those interested in my stock do live in New York. Therefore, if they decide they want to sell, the offerings are made in New York, or the bids come there, and are shipped to Jersey City now because they are on the Jersey City Exchange. Say that the selling in New York day before yesterday was at the price of 50, but that the buying in San Francisco, or the price there was 56. Now, that was not a fair and proper market. But that will readjust itself because they will have arbitrage. Some smart broker will buy the stock in New York and sell it in San Francisco and make the difference in arbitrage. It just happened that there were no selling orders on the San Francisco Exchange, and no buying orders in New York at that moment. That occurred on Monday of this week. Does that answer your question, Mr. Chairman?

The CHAIRMAN. Yes. The suggestion to my mind was that it would be better to have Federal control over, or supervision over that situation, which would correct such differences.

Mr. LEONARD. Well, Senator Fletcher, you do not mean to say that you think you could by Federal control fix prices of stocks in the different parts of the country, do you?

The CHAIRMAN. No; I do not think that. But with all exchanges subject to the same regulation it would help, as I thought.

Mr. LEONARD. Well, it would help in some ways. And I wish you to understand that I am not opposed to regulation, that I am not opposed to anything that will interfere with wrongful manipulation of stocks. In fact, that is one thing I have had to fight all my life. However, if you will permit me to say this, Senator Fletcher, a thing I have said to many legislative committees before this: The boys of the curb market were the most honest men in the world as a coterie. Now, I admit that they had just the opposite reputation, but it was not justified. And there was good reason for their conduct and action: All of those young men on the curb hoped some day to have enough money so that they might buy memberships on the stock exchange. Therefore, they were very particular to keep their record clear and to make their contracts good. And there was never one single thing done by any of the rank and file of the curb membership that could be criticized in any way as irregular or improper.

Now, gentlemen of the committee, there is the situation.

Senator ADAMS. Then if the curb exchange was the most honest group, of course, that puts the New York Stock Exchange on a little lower level.

Mr. LEONARD. Now, Senator Adams, I think you are trying to be a little facetious. But the point is that so many members of the New York Curb Exchange have gone into the New York Stock Exchange that I am one of those that say that the curb exchange is running the stock exchange instead of the stock exchange running the curb

If you gentlemen want to check up on it you will find a great many members of the board of governors of the old Curb Exchange now on the stock exchange. I am not trying to be facetious, either, Senator Adams, but I want to say that the strong men, the active traders, the men who know how to trade, are very apt to have been those who have had their experience for a period of years upon the Curb Exchange. They go there as young men and if they are able they go to the stock exchange.

The CHAIRMAN. Here is a situation it would be well to call to the attention of the committee as well as to yourself, Mr. Leonard. I have a letter from the vice president of the Chicago Stock Exchange, written to the president of the Tri Utilities Corporation, in which he says:

> One of the things the Chicago Stock Exchange expects when securities are listed here is that those applying for the listing will keep up a market By keeping a market we mean to keep bids in those securities at all times on the exchange

Now, in reply to that letter the Tri Utilities Corporation stated that there had not been any trading in the stock for some time, but that those who had those securities could find a market for them on the Curb in New York. He says, for instance:

> We note your statement that there have been no sales of this stock for several months We call your attention to the fact that transactions in this stock occur frequently on the New York Curb Exchange, and that anyone wishing to dispose of stock can do so in New York The fact that sales occur in the New York market also make the stock available for use as collateral

Well, now, without going into details, the ultimate result of all this, of keeping up a market and operations in stock exchanges and on the curb in New York, finally culminated in a receivership for the Tri Utilities Co., and the final result was a dividend of the receivership issued in January of 1933 of less than $9,000, which was paid to creditors with aggregate claims of about $20,000,000, exclusive of the common and preferred stockholders. And the amount of the common and preferred stock outstanding was in excess of $15,000,000, which amount was a total loss. That was the result of the operations in the Tri Utilities Co.'s stock. The effort was to keep up a market on the Chicago Stock Exchange, and they were not able to do that, and a market developed on the New York Curb Exchange, and those stocks were sold in that way. But the stockholders lost $15,000,000, being every dollar they had put into the stock; and the creditors only got $9,000 out of $20,000,000 of claims.

Mr. LEONARD. Well, Mr. Chairman, that is one of those extreme utilities cases. I have been contending right straight along that people should look to the gold stocks rather than to some of these utilities.

The CHAIRMAN. Mr. Pecora, have you any questions to ask Mr. Leonard?

Senator ADAMS. Just one minute. To what extent do the mining exchanges with which you are directly connected, contribute to the furnishing of money for mining development; and to what extent are they merely places of speculation?

Mr. LEONARD. They do not definitely and personally as exchanges contribute anything and never have, but——

Senator ADAMS (interposing). I meant indirectly, of course.

Mr. LEONARD. The exchanges are merely markets for the trading in securities. Now, I can illustrate that by pointing out that when we first began to list stocks upon the curb exchange, when it first began to operate, three certain mining companies from Porcupine, Canada, were brought there. They were prospects, but I pointed out that if the exchange showed, by what was filed in its archives, and which are always open to the public, that they were only prospects, then the public had notice that they were prospects and could obtain the information. Therefore those Porcupine stocks, which today of course are out of existence, yet that camp has produced upwards of 30 million dollars since that time.

Now, anyone who had bought those original stocks and had carried them along through the different reorganizations, might have had a great fortune in proportion to the amount of his original investment.

Now, gentlemen of the committee, Tom, Dick, and Harry can not buy portions of companies. In the old days they used to buy so many feet of a mine. On the Comstock lode a man would buy 1 foot, or 2 feet, or 5 feet, along the lode in the mines. But when the stock of companies was possible of purchase, that is, when stock companies were formed, it became possible to distribute holdings of a mine in the form of stock.

Now, the peculiar end of it so far as I am concerned is, that I stepped into a company where the stock was all outstanding. I was not coming into the company for the purpose of selling its stock. I bought into a company where all of the stock was outstanding, and had been dealt in upon the stock exchange and the curb exchange for years. Therefore, if I can make it clear to you, I believe that every new company which is capitalized, of course if it is capitalized reasonably and is properly regulated, as is the case in California by the corporation commission of that State, and is not allowed to sell any stock unless the stock is deposited first in escrow, I mean the promotion stock is placed in escrow, why, then everybody is protected, and then trading can take place upon an exchange, men may buy and sell the stock, and there becomes considerable distribution, and it enables the promoters or holders of the ground which they want to develop, to obtain the necessary funds for putting on development.

May I illustrate that just once more in this way? There has been developed in the case of one of the properties which I purchased, as I stated before, an ore body in which the United States Bureau of Mines has just completed an investigation, and they have stated that we have in the matter of blocked-out ore ready for milling, $1,294,000 worth in the case of that one property, which is one of the properties belonging to the company that I have mentioned.

Now, we haven't any funds with which to build a mill. We haven't any funds with which to move the railroad off the ore body.

And it so happens that Mr. Mills' railroad crosses our ore body and we cannot mine it because if we mined it the railroad might cave in on the mines, or we might throw the railroad off grade, and therefore we have not been able for a number of years to improve that ground. We tried to get Mr. Mills to cooperate with us, but the best we could do with him was to agree to move the railroad off, and we would have to run it around the ore body at a cost of $55,000. Therefore it becomes a project of paying for the building of a mill, and paying for the moving of the railroad. Now, that is a project that, as shown by the United States Bureau of Mines, will pay 10 for 1, absolutely.

I am not here to talk about that project particularly, but if you gentlemen had tried for the last 3 years to raise any money for the building of a mill, or for any other purpose during that depression period, you would know what we have been up against. Why, you could not sell diamonds at half price. You could not sell anybody the idea of buying some stock in your company no matter how good it was.

But now, with the new development that has come about, with the change in the prices of gold and silver, a great number of projects which were not able to make any showing before now offer opportunities to sell some stock to get money for development operations.

And I want to say to you gentlemen that I think these development operations are just as legitimate—in fact, I believe more legitimate—than many others, and I could quote from a statement made by the public works commissioner of our State, the State of Nevada, that projects of that kind have the greatest economic value, and those are the projects which should receive consideration. And I expect that they will receive consideration after the examinations which are now being conducted by the United States Bureau of Mines. We are asking that the United States Bureau of Mines will come into that camp and make a complete report on all of the properties there.

The CHAIRMAN. Mr. Leonard, do you think you can now sell gold-mining stocks all right?

Mr. LEONARD. Well, Mr. Chairman, I will say to you that I have had an opportunity to sell gold-mining stocks, but I am a buyer and not a seller. As a matter of fact, a member of the New York Stock Exchange today, who has two sons who are both members of that stock exchange, will arrive on the Comstock lode next Monday. I am not going to talk about him particularly, but if you wish me to answer that question—and you asked me whether we could sell gold-mining stocks—he is going out there as a buyer and not as a seller.

Now, I can show you tickets on 10,000 shares of Tunnel stock which were bought by a stock-exchange member whose name is pretty well known from one end of the country to the other, and he sent it in for transfer with $4 Federal taxes and $300 State taxes on it, and I said to him: "Why do you pay this great State tax? Why don't you transfer it in Jersey City or San Francisco, where there is no State tax?" He said: "Well, I am making a sale of it because I am putting that stock in a trust as a hedge against declines in money." [Laughter.] This was last fall.

Now, I am telling you, if you want to hear about it, that you can sell gold stocks now if they are properly sponsored and if they will

show the absolute liquidation ability that other stocks can show, following, you understand, the most careful investigation by engineers.

But I also want to say to you gentlemen that there is a stock over here before the Federal Trade Commission right now in which they have five different prominent engineers in this country testifying, and they have not only a signed statement but have sworn to it in court, that there is $11,000,000 of ore in sight in that property. Yet those people down there are very doubtful whether they ought to give their O.K. to sell any stock in that property right now; and it has taken them 7 weeks, or perhaps 9 weeks, and they are not by yet.

The CHAIRMAN. All right, Mr. Leonard, if you have finished your statement.

Senator KEAN. Mr. Leonard, you were talking about arbitrage. If this bill should be enacted into law, it would rather interfere than otherwise with the adjustment of prices as between the different exchanges, would it not? I mean, with all the restrictions that are contained in this bill, wouldn't it rather interfere with the leveling of markets?

Mr. LEONARD. Well, perhaps so, but I had not thought of that as at all detrimental or objectionable.

Senator KEAN. You were speaking of the San Francisco market having temporarily been higher than the curb in New York.

Mr. LEONARD. Yes.

Senator KEAN. Now, of course, there is no doubt about it that since that quotation is known to some broker he will offer to buy in New York or to sell in New York, or to buy or to sell in San Francisco, so as to level up that quotation.

Mr. LEONARD. During the Goldfield period there was a great deal of that. Many hundreds of thousands of shares were in and out of the markets. That was arbitrage.

Senator KEAN. Yes; I have seen a good deal of it. But what I am getting at is this: If this bill should be enacted into law as is, it would interfere very largely, don't you think, considering all the restrictions that are placed upon the broker, and all the restrictions that are placed upon trading, that this bill would largely prevent equalization of markets?

Mr. LEONARD. Well, I would not be worried about that. I do not think it would do any harm from that standpoint. I do not think the bill would mean the slightest damage. It might interfere with a few small traders, from their getting in between prices in two different markets.

Senator KEAN. Well, that would interfere with a leveling of markets, wouldn't it? For instance, if you are a broker in New York, or in San Francisco, and you see that the quotation in New York is 1 percent above the quotation in San Francisco, why, you would sell in New York and buy in San Francisco, wouldn't you?

Mr. LEONARD. Yes.

Senator KEAN. Now, any restrictions would interfere with that, wouldn't they?

Mr. LEONARD. Well, I do not understand that there are any restrictions in the bill on trading in New York or in San Francisco, are there?

Senator KEAN. Oh, yes; surely there are.

Mr. LEONARD. You mean that the stock could not be traded in except where it is listed?

Senator KEAN. No. I mean to say that with the restrictions which are placed upon a broker, that he must do this, or that, and the other; the quotations would be so wide apart owing to the resulting market, that in that way it would restrict a leveling of the markets as between two places.

Mr. LEONARD. I think it would.

Senator KEAN. That is all that I wished to ask.

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

Mr. PECORA. Mr. Leonard, are you familiar with the letter that was addressed to counsel for this committee by Mr. Hudson, president of the San Francisco Mining Exchange, under date of November 27, last, and which was placed in the record of this committee?

Mr. LEONARD. Yes. It was shown to me last night for the first time. I did not know that you had it, Mr. Pecora.

Mr. PECORA. It has just been produced for me here now.

Mr. LEONARD. I think it would be nice to read it again, if you will.

Mr. PECORA. I will be glad to do it. It is on the letterhead of the San Francisco Mining Exchange, and is dated November 27, 1933, addressed to me as counsel to the committee:

> Complying with your request, we are enclosing herewith today's quotation sheet, which gives bids and offers and sales of stock listed in this exchange, together with the names and addresses of the members of the exchange
>
> In this connection, I wish to remark that our exchange may be termed a "white chip trading rendezvous for stock" Mining and oil stocks are necessarily of a speculative character, and we do not attempt to make the public think they are anything else A hole in the ground today may be a mine of value tomorrow, and the mine of immense development may run out of its ore and be a tremendous hole in the ground the next day Our stocks, for that reason, as I said before, are speculative and do not have the immense quantity of water that many of the industrial stocks contain The fact is we have to supply water from the desert area while the industrialists are usually organized by promoters and supplied with water with great hydraulic pumps from the Atlantic Ocean
>
> If we can be of further service, we are at your command.
>
> Yours very truly,
>
> CHARLES E HUDSON, *President.*
>
> P S—The bankers generally don't help us because our activities interefere with their game.

Mr. LEONARD. Well, Mr. Pecora, you can appreciate that that is a letter from a man some eighty-odd years of age, who has the reputation of being perfectly and squarely honest during his whole life. That gentleman invited me to make a few remarks before the exchange in San Francisco last summer when I was out there, and I began by saying: "I see a number of the brokers present who were here 25 years ago when I made my first visit to the exchange. I thought that they were old men. I looked upon them as elderly. But I see them here as young and as chipper as ever. Here is Charlie Hudson, 84. Here is Coffin, 94. Here is"—and I named about 8 or 10.

But I thought that the explanation would be, no doubt, the climate of California, and they all said "'Ray!"—a great yell for the New York speaker who would agree that the California climate was O.K.

But remember, Charlie Hudson is just as conservative, just as square, just as honest, and just as able in his field as any of us are

in our fields. He inspires confidence and is asked day by day by a large clientele to advise them with regard to investments in mining stocks. And I know that he always takes the same position that he has in the letter: If you are going to speculate, if you are going to gamble in mining stocks, it is your own guess.

The CHAIRMAN. Do you agree with that?

Mr. LEONARD. I agree that anybody that gambles in mining stocks without looking them up is not deserving of any particular protection from any committee anywhere. I do not think anyone who walks into a broker's office and is one of the chair warmers in one of these wonderful stock exchange houses that has a translux crossing, and sits there guessing on the red or the black, as to whether it is going up or down, and does not take the trouble to go over to the New York Stock Exchange and get the record and find out what he is buying and what he is selling, is not deserving of any particular protection.

I subscribe to everything our President has said from beginning to end, and from way back. But when he says, "Let the seller beware", and changes the situation which I have understood in legal procedure during my whole life, which was "Let the buyer beware", it seems to me that it is a pretty long step. And so far as I am concerned, when I speculate or gamble, or guess, or invest in stock, I have a pretty fair reason for it.

On the curb exchange during the period of my curb market experience, I thought everybody ought to know that stocks that were brought out on the curb were brought out there for distribution purposes, and therefore, if they were going to sell stock and get a distribution, there had to be an advance. Therefore, all I wished to know was that the stock was properly sponsored by a good market maker. Therefore, I proceeded to go in on all the underwritings. It did not make any difference what the company was, if the people were high class and had the underwritings right. Now, that is gambling. That is guessing. If I lost once out of 19 times or once out of 4 times, I was perfectly satisfied.

I want to tell you gentlemen that we put on a record in the curb exchange when I was there enough information on every company that was listed and every company that was not listed but only admitted to trading, so that any member of the public who wished to come there could go into the office and look at it and see exactly what he was buying.

But the average person that trades in stock—and you are talking about protecting the average person that trades in stock—does not care a continental what the company is. He wants some customer's man to tell him, or some other friend who lives next door to tell him, whether the stock is going up or not. Now, those people are of no value as stockholders in a company. They do not help any.

The CHAIRMAN. You mean to say the curb exchange has information as to the issue of stock, for instance, as to its assets and liabilities and its earnings? Is that all shown on your records there?

Mr. LEONARD. Yes; but, Senator, please make it clear, I am not connected with the curb exchange. I am not counsel for them now. I was counsel during all of the formative period and for 13 years. Any references I have made to the curb exchange are

unofficial, and I haven't any right to refer to them, but I am only speaking of them by way of illustration of points.

The CHAIRMAN. You said that anyone buying stock on the curb could go into their office and ascertain full information.

Mr. LEONARD. Yes; because they do keep a complete record of everything.

Mr. PECORA Even of the securities that are only admitted to the floor for trading privileges?

Mr. LEONARD. Yes; but will you please get that from their representative?

Mr PECORA. I mean you are not making that statement based upon any knowledge you have of conditions at the present time, are you?

Mr. LEONARD. No; I am not. I am making it upon the knowledge of conditions up to the time that I retired as counsel and the general information we had.

Mr. PECORA. How long ago was that, Mr. Leonard?

Mr. LEONARD. Six or seven years.

Senator ADAMS. Was that information available to the individual stock purchasers or just to the members of the exchange?

Mr. LEONARD. It was always and is now available to the public, any individual; he does not even have to be identified. He can come in there and see the whole record on any company. Didn't you know that? Yes; they do. They keep everything wide open. So do these mining exchanges and all these small exchanges. They keep the record for the benefit of the public. They can find out all that information.

The CHAIRMAN. Very well. Any other questions?

Mr. PECORA. In view of the last statement you made, I want to remind you, Mr. Leonard, of this statement that appeared on the document that accompanied the letter from Mr. Hudson, president of the San Francisco Mining Exchange, which I read a few minutes, and which was put into the record before this committee as exhibit no. 114 on February 26, 1934. Accompanying that letter was a printed sheet giving the names and addresses of members of the exchange and also the securities listed on the exchange, together with quotations. There also appears on that printed sheet this statement:

Facilities for investigating securities are available for everyone Investigate before investing Stocks listed on a recognized exchange are safer than unlisted issues Trade only in listed stocks The data on these sheets are collected with care, but neither the completeness nor the accuracy of the information is guaranteed No responsibility is assumed for any of the statements herein contained nor for any omissions or inaccuracies therein

Mr. LEONARD. But that is all available to the public.

Mr. PECORA. What percentage of the investing or trading public do you think takes advantage of that facility?

Mr. LEONARD. Very, very slight; not more than 2 or 3 percent.

Mr. PECORA. If that much?

Mr. LEONARD. Probably less. They do not inquire. They just buy and sell blindly. And they are to blame themselves, and the members of the exchange are not to blame. The members execute orders. Of course, when there is chicanery or when there is conniving or when there is manipulation of markets, that is another matter, but I am speaking of the fact that my son, my son-in-law, every man

that I have represented as an attorney for brokers for years—and many of them are now members of the New York Stock Exchange—every man absolutely executed his orders in the interest of his customer right through from the beginning. I have never caught one of them doing it otherwise.

Now, there is trading; there is manipulation. May I touch upon the most dangerous thing that brings about this situation? The exchanges are not to blame. They list a stock. A bunch of high-pressure salesmen proceed to buy a block of stock. Then they, through their connections in various offices, begin——

Mr. PECORA (interposing). What kind of offices?

Mr. LEONARD. Well, maybe the son of the corporation commissioner of Massachusetts might have an account with a brokerage house in New York—it actually did occur—and gave orders, and afterward, when it was found that that stock was thrown off the exchange for irregularities of the worst kind, it was found that the orders had all been sent in to perfectly good, legitimate stock exchange and curb houses through customers whom they thought they knew, and the manipulation took place by buying at the close every day enough to take all the stock that was offered and close it an eighth higher each day, and as they manipulated the stock up they had their employees and high-pressure men out through the country distributing stock on the strength of the quotations that were made on these legitimate exchanges. It took place many times on the stock exchange. It has taken place a number of times on the curb exchange, and we have to watch all the time or they will do it on the mining exchanges Now, those are the men that are dangerous. Suppose they bought a block of stock——

Mr. PECORA (interposing). They cannot be reached, can they, by any regulations which the exchanges might adopt?

Mr. LEONARD. What?

Mr. PECORA. Those operators could not be reached by any rules or regulations adopted and enforced by the stock exchanges, could they?

Mr. LEONARD. They can only be reached by compelling the brokers to know their customers, and they do that now; the exchanges do that now.

Mr. PECORA. And despite the fact they do that now, you say those operations are possible?

Mr. LEONARD. Have been done, and have been possible, and I say that there are Government instrumentalities that can reach those men. There is not any reason why those men should buy a block of stock and then proceed outside the exchanges to make deals which bring discredit upon the company. Sometimes the company themselves have no connection with it at all.

Mr. PECORA. And sometimes officers of the company acting as individuals give options on stock which they themselves own?

Mr. LEONARD. Yes.

Mr. PECORA. To operators who operate in the way that you have indicated?

Mr. LEONARD. Yes; they have done that. And the exchanges are not to blame for that. They cannot help that.

Mr. PECORA. The point I am making, Mr. Leonard, is that the rules and regulations adopted by stock exchanges, well meaning though

they be, cannot reach persons who are not members of the exchanges. So there must be some other power set in motion to curb the activities of market operators who are not members of exchanges and whose operations tend to mulct the public. Isn't that so?

Mr. LEONARD. I think that would be a great thing to accomplish, and I am in favor of it, absolutely, and have been at all times. But when in doing so you regulate the exchanges out of business, perhaps, when you——

Mr. PECORA (interposing). I am glad you added that "perhaps."

Mr. LEONARD. Yes—see. [Laughter.] Well, so far as the little mining exchange in San Francisco is concerned, gentlemen, we have had plenty of regulation in the last 2 or 3 years, and still worked and are doing a perfectly good and legitimate business in cooperation with the commissioner of California's office, and no matter what may be the result of this legislation, we expect to be able to conform in all respects with whatever it may be.

The CHAIRMAN. That may be a rash statement.

Mr. LEONARD. That is our attitude, but we will be without a large portion of our business, I think. We will conform and go through with it, but every exchange and every brokerage house will find that there is a lesser market. Too many restrictions will reach out, not alone to the exchanges, but will reach all the development operations in this country. Mining, if you please, I am talking about, but industries and every other promotion. I would rather see the Securities Act amended, perhaps, in some important particulars a little later than to argue the matter here.

The CHAIRMAN. Very well; we are much obliged to you, Mr. Leonard.

Senator KEAN. Mr. Chairman, I have here a letter from the New York Airbrake Co., a corporation organized in the State of New Jersey, and written to me protesting against the bill. May I put it in the record?

The CHAIRMAN. It may go in the record. That is not "air mail" but "airbrakes"?

Senator KEAN. Yes; airbrakes. [Reading:]

NEW YORK AIRBRAKE CO.,
February 27, 1934.

HON. HAMILTON F. KEAN,
United States Senate, Washington, D C.

DEAR SENATOR KEAN: The undersigned desires to file through you its vehement protest against the passage of the so-called "National Securities Exchange Act of 1934", being S. 2693, Seventy-third Congress, second session, introduced in the Senate on February 9, 1934.

We invite your attention to the fact that this act now only purports to regulate exchanges, but through various provisions directly affects the business and management of all corporations whose securities may be dealt in or listed on an exchange It is to this phase of the proposed act that we direct our protest.

In the first place, the attempt to regulate the internal management of State corporations seems to be in derogation of the rights of the several States to deal with such matters, and with respect to the provisions referred to, the act appears to us to be of doubtful constitutionality.

Section 11 (a) prohibits any person from selling or buying any security on a national securities exchange unless a registration is effective as to such security.

Section 11 (b) provides for registration upon application by the corporation issuing the securities, and requires the filing with the exchange and the Federal Trade Commission of various undertakings, information, and documents The Commission is to require an undertaking by the corporation to comply

with and, so far as it is within its power, enforce compliance by its officers, directors, and stockholders with the provisions of the act and the rules and regulations thereunder and, except in the case of Federal Reserve banks, not to lend any funds in the money market of any exchange or to any member thereof or to any person who transacts a business in securities through the medium of a member, except in accordance with rules and regulations to be prescribed by the Commission

The information which the issuer must file includes the organization, financial structure, nature of the business, particulars as to its different classes of securities and as to the terms on which they have been or are to be offered to the public, particulars regarding directors, officers, and principal security holders and underwriters, their remuneration and other interest in the securities, particulars as to the remuneration to others than directors and officers exceeding a stated amount and as to bonus and profit-sharing arrangements, and various other particulars, including material contracts and patents, balance sheets, profit-and-loss statements, and such other information as the Commission may require, also copies of articles of incorporation, bylaws, and similar documents, underwriting arrangements, and other documents which may be required by the Commission

By section 12 every corporation whose securities are listed, which means most of the larger industries of the country, would be required to file, in such form and detail as the Federal Trade Commission may require, annual quarterly and monthly reports (the latter including a statement of gross sales or gross income) with the Commission, and such other reports as the Commission may require

In view of the reports and returns now required by law and by the rules of the New York Stock Exchange, this requirement of new forms is simply adding a useless burden upon those who must compile them

By section 18 the Commission may prescribe the forms which are to be used, and may also require consolidated statements of accounts with any person directly or indirectly controlling or controlled by the listed corporation or with any person under direct or indirect common control

By section 13 the solicitation of proxies by the use of the mails, or an instrumentality of interstate commerce or any facility of an exchange or otherwise, is prohibited unless a statement shall have been filed with the Commission setting forth the purpose of the proxy, the persons to exercise it, their relations to and interest in the listed securities, and the names and addresses of the persons from whom similar proxies are being solicited. It must contain such further information as the Commission may require

This would necessitate in practice the filing of a complete list of stockholders, as it is common practice for the management to solicit proxies for stockholders' meetings

By section 15, every director, officer, or owner of more than 5 percent of any class of a listed security must file with the exchange and the Federal Trade Commission, at the time of registration of the security or when he becomes such director, officer, or owner, and also within 10 days after the close of each calendar month in which there has been any change in the amount of such securities owned by him, a statement showing the extent of his ownership and of all changes therein during the calendar month There are also various prohibitions against and regulation of the purchase and sale of securities by the individual, including taking his profit on certain transactions and giving it to the corporation

Section 17 imposes a very wide liability, the extent of which it is impossible to define, upon any person who makes or is responsible for making a statement in any document filed with the Commission which is false or misleading in the light of the circumstances under which it was made in respect of a matter sufficiently important to influence the judgment of an average investor Apparently he may be sued by anyone who has purchased or sold the security affected, whether or not he relied upon or even saw or heard of the alleged false statement The burden of proof of good faith is placed upon the defendant

Section 18 confer very extensive powers on the Federal Trade Commission

In addition to the authority to make rules to carry out, administer, and enforce the provisions of the act, and to prescribe the form or forms in which information shall be set forth, the items or details to be shown in the balance sheet and earnings statement, methods to be followed in the preparation of accounts and in the appraisal or valuation of assets and liabilities, etc, and

in the preparation, where the commission deems it necessary or desirable, of consolidated balance sheets or income accounts of any person directly or indirectly controlling or controlled by the corporation, or any person under direct or indirect common control with the corporation, and in addition to the authority given to the commission to prescribe rules and regulations for the transaction of business upon an exchange, set forth in great detail in section 18 (*c*) of the act, the Commission is given very broad powers of investigation and inquiry by section 18 (*e*) which apparently would permit it to investigate the internal management of any corporation whose securities are listed

This section contains a provision that any officer participating in such inquiry and any person examined as a witness upon such inquiry who shall disclose to any person other than a member or officer of the Commission the name of any witness examined, or any other information obtained upon such inquiry, except as directed by the Commission or an officer thereof, shall be guilty of a misdemeanor

This interference with the responsibility of the management is particularly obnoxious and will simply serve to break down that sense of obligation and responsibility which has been abundantly shown by the vast majority of the business men in this country and without which no enterprise can succeed

Section 19 contains clauses imputing liability for the acts of so-called "controlled" persons, including not only those controlled by stock ownership or agency, but also a spouse, child, or parent residing with the person to whom liability is to be imputed in the absence of proof of nonapproval or that the transaction was not for the purpose of evading a provision of the act

It may be noted in passing that so far as wives are concerned, the provision is a departure from the principle of the married women's separate property acts and the whole course of legislation in favor of equal rights for women, which has been the distinguishing mark for the last quarter century

Sections 21 and 22, relating to publicity of all hearings, records, reports, and documents, will be welcomed by thousands of competitors of those whose success has depended upon legitimate business secrets, such as secret processes, ideas, etc This may well destroy the property right of every corporation in its good will, its method of doing business, the development of ideas for its benefit, and similar intangible property It will also be welcomed by all who engage in the bringing of strike suits against corporations

The criminal penalties provided by section 24, which may amount to a fine of $25,000 or imprisonment of 10 years, or both, for a violation of any provision of the act or of any rule or regulation of the Federal Trade Commission, is so out of proportion to many of the possible violations that it is revolting to the sense of justice and fair play of all of us

By section 26 it is provided that the act shall supersede such laws of any State as are inconsistent with its provisions or purposes, and it is thus a direct interference with the rights of the State to legislate on questions of the management of State corporations

Section 28 makes it unlawful for a broker or dealer to use the mails or an instrumentality in interstate commerce to effect a transaction on a foreign exchange in a security of an American corporation, except in accordance with rules and regulations to be prescribed by the Commission

This is a direct interference with foreign business and with imports and exports

By section 30 the Federal Trade Commission is authorized to select and employ employees, attorneys, and agents and fix their compensation without regard to the provisions of other laws applicable to the employment and compensation of officers or employees of the United States.

This appears to be a violation of the principles of the civil-service laws

To sum up: The provisions relating to private corporations and individuals appear to place various features of the management of corporations chartered by the States in the hands of the Federal Trade Commission, which is neither equipped nor designed for the vast undertakings there suggested

They involve the breakdown of the authority of the several States over corporations chartered by them, the destruction of corporate responsibility and initiative, the substitution for private industry of the dictates of a bureaucracy, and the deprivation of private property without due process of law

The undersigned, whose stock is listed on the New York Stock Exchange, is a corporation organized and existing under the laws of the State of New Jersey,

by whose laws its franchises were granted and its management is governed. As such, it requests you to oppose the provisions referred to as being burdensome, unfair, and un-American.

Yours very sincerely,

LOWELL R. BURCH, *President.*

The CHAIRMAN. Mr. Reyburn.

STATEMENT OF SAMUEL W. REYBURN, NEW YORK CITY, PRESIDENT ASSOCIATED DRY GOODS CORPORATION

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

Mr. REYBURN. Samuel W. Reyburn, New York City, president of the Associated Dry Goods Corporation, a holding company that operates 8 department stores located: In New York City 2 of the stores, in Baltimore 1, in Newark 1, in Buffalo 2, in Minneapolis 1 store, and in Louisville, Ky., 1 store.

The CHAIRMAN. You wrote, Mr. Reyburn, that you had some views you would like to express on this bill to the committee. You may proceed.

Mr. REYBURN. Mr. Chairman, the members of the Committee on Banking and Currency of the Senate, I want to thank you for this hearing. I regret that the pressure on this committee made it impossible for them to allow me more than 20 minutes. I would like to have this corrected copy of the request for appearance before your committee put in the record, as follows [reading]:

[Day letter]

NEW YORK, N Y., *February 28, 1934.*

Senator DUNCAN U. FLETCHER,
Senate Office Building, Washington, D.C.

DEAR SENATOR: In Virginia, in Missouri, and in Arkansas, for generations, my forebears owned and operated farms and were prosperous I was reared on a farm in Arkansas, but taught by my parents and others that, in view of the policy of the Federal Government to subsidize industry with privilege through the tariff adopted during the last years of the Civil War, and consistently followed, which worked against the farmer, though I would inherit a good farm, I could achieve greater success and a more useful life in some other vocation. I graduated at a little law school, practiced law for a while and then got into the real-estate and mortgage-loan business While I had accumulated no money, I had acquired sufficient reputation to organize a trust company and get other people to put up the capital by buying stock This was successful and gave me the time to hold several public elective offices as well as to become chairman of the Democratic county central committee in my county. Through the use of corporations I raised capital for several other enterprises. Twenty years ago, at the age of 42, I came to New York to act on a reorganization committee of an important business that was financially embarrassed. Subsequently I became chief executive and the leader in the management of this corporation with major activities in 6 States

With the experience gained in these years of active work in the field of economic activities I would like to have you and your committee know that I believe the proposed legislation cited as the National Securities Exchange Act of 1934 will not be helpful to either the economic, social, or political orders of this country. I recognize that reasonable regulation and supervision is a proper function of Government activities of this kind but I do not think that any political body can assume authority or place restrictions that impose upon such body the management problems of business. From such information as I have gotten from the press and heard from other sources it would seem that so far the whole discussion hase been about governmental and stock

exchange rights and duties. As far as I know little attention has been paid to the rights and duties of industry, including investors, management, worker, and final consumer. Naturally, not holding political office or being a member of an exchange or operating as a speculator, my approach is entirely from the point of view of industry, including investors, management, and workers, and of a citizen who is also a consumer. I have known Senator Robinson over 40 years. It is my expectation to leave here for Florida for a much-needed vacation next Saturday. If it is convenient, I would be glad to appear before your committee and give my views for whatever they are worth sometime on Friday. Wire answer my expense, 270 Madison Avenue.

SAMUEL W. REYBURN.

WASHINGTON, D. C., *February 28, 1934.*

SAMUEL W. REYBURN,
New York, N.Y.:

Re telegram this date. We have every hour assigned for this week. If you will submit written statement I will put it in the record of the hearings.

DUNCAN U. FLETCHER

MARCH 1, 1934.

Senator DUNCAN U. FLETCHER,
United States Senate, Washington, D.C.:

Appreciate your prompt reply. Believe personal appearance would be more helpful than brief. If you can give me place on calendar Tuesday or Wednesday will delay vacation.

SAMUEL W. RAYBURN.

MARCH 2, 1934.

SAMUEL W. REYBURN:

Can give you 20 minutes Wednesday morning March 7.

R. H. SPARKMAN,
Acting Clerk Senate Committee on Banking and Currency.

MARCH 2, 1934.

R. H. SPARKMAN,
Acting Clerk Senate Committee on Banking and Currency,
Senate Office Building, Washington, D.C.:

Thanks for the courtesy. Will be there Wednesday morning.

SAMUEL W. REYBURN.

My belief in governmental regulation and supervision of all dealers and business in credit is of long standing. I do not believe in a control on the part of Government that undertakes the responsibility of determining and discharging duties of management.

The bill in present form with its provisions and restricting and arbitrarily fixing amounts and terms of capital and capital security credit should not be enacted. I believe that the Securities Act of 1933, similar in many respects, does serious injury to industry, commerce, and trade, and if not amended will also cause great harm to both labor and the consumer.

Credit cannot be supplied to industrial and commercial trade and financial transactions for either capital or operating needs safely and economically under the re idem directions of a general law. In my opinion it cannot be economically provided or compelled by governmental bureaus.

With regulations and supervision to prevent the unfair use of credit and capital, freedom of judgment on the part of banks and bankers who take the risk would reduce costs, facilitate movement

of goods, and thereby render the greatest and most permanent benefit to both workers and consumers.

The spirit of the "new deal" is to get rid of new-fangled notions, known failures, and return to old-fashioned ideals of proven worth. Toleration and justice is what we are after. Pardon me for putting into this record some old truths with which you gentlemen are familiar but which you probably do not discuss in public often enough.

What is credit but the plans and promises that grow out of the exchange of goods and services? The tremendous expansion of trade in the past hundred years, which has made a great contribution to the lifting of men and women to higher levels of accomplishment and greater opportunities to enjoy life and liberty, would have been impossible without use of the three time- and effort-conserving factors in modern business: Transportation, communication, credit.

The growth of means for quick and cheap transportation which facilitate the movement of goods and passengers from one place to another.

The development of communication through which, at small cost, information and knowledge are so promptly conveyed and widely disseminated.

The physical agents of these two factors, so frequently seen—railroads, steamships, motor cars, telephone, telegraph, radio, newspapers—have made their use and value well known to most people.

The third factor—in many ways the most important—has been the increase in the use of credit in exchanging goods and services, in securing capital requirements and operation needs for business of all kinds, and in financing governmental enterprises in advance of collection of taxes. Its use has eliminated the need and risk of actual transfer of money to cover individual transactions, thus materially decreasing the time and expense of transferring title to property from one person to another. It has supplied capital that in no other way could be secured by able and courageous men in management to enable them to employ their talents in a large way for the benefit of the public and themselves. And its use has enabled nations to protect and maintain themselves.

Credit, however, has no very obvious physical agent. It is abstract, a concept born within the mind out of our knowledge of other things and our feelings and beliefs, plus our faith, confidence, courage, and judgment. Ignorance of its laws are general. It is fully comprehended only through reflection; demonstrated only through its effects. There are not many people who train their minds in the habit of research, analysis, and reflection to the point where they are quick in grasping effects or abstract ideas. Many people regard money and securities objectively as an end; they are only a means to an end. The principles of credit should be understood and used by every leader in business on statecraft who has financial responsibilities. While you and I are informed on the subject, we do not describe it to the public as often as we should. Hence, in times of widespread distress, be a mystery to so many it is unjustly blamed.

The "credit" of man, a corporation, or a nation is the faith and confidence inspired in others in the intention and ability of that man, corporation or nation to keep promises. Contracts, currency,

bills, notes, checks, bonds, stocks, and mortgages are only promises of one kind or another.

There is also another highly important basis in the free functioning of the credit factor. It is a prime influence also in the encouragement of industry, thrift, and self-denial on the part of individuals. It is the faith in the stability and efficiency of the Government, the belief that life, liberty, property will be protected, lawful contracts enforced, and justice administered.

The good business leader, the statesman, knows that a wise use of credit builds the character and enhances the reputation of an individual or a private or public corporation; but a foolish use of it undermines character and destroys good reputation. While there should be a constant endeavor to maintain a record which will quickly secure the loan of needed sums, such power should be used sparingly.

The banker, a dealer in credit, merely buys and sells "promises", which are undertakings of future performance in regard to exchange of goods and services. He does not deal in money but, like the merchant, keeps enough of it on hand to make change. The banker's task is to judge accurately the ability of those who borrow to meet their promises and to know markets of commodities and investment securities and probably future trends, so that he in turn may be in a position to meet his own "promises" at the proper time.

It is obvious that credit cannot be handled and controlled in the manner that it is possible to control physical property. Promises cannot be appraised by statute or even by the comprehensive regulations of a Government bureau. It requires experience, constant watchfulness, a keen and seasoned judgment, quick and accurate decisions. The ordinary practical judgments that successfully guide so many men in business will not do. Neither will the faithful following of statutory requirements by a loyal and diligent governmental employee. His administration naturally will consistently follow his changing moods, and actions may with the best intention vary from a liberal to a strict and possibly a severe interpretation of the act.

To meet the unusual vicissitudes encountered in supplying demands that grow out of the varying mass moods of consumers, with competition sharp, the business manager must have an open and inquiring mind. He cannot be content to see a thing happen without trying to learn why and how it happened. He must cling tenaciously to a problem until it is studied in every phase, yet decisions must be made in time and with a high degree of accuracy. It is this capacity for concentrated attention, classification, and analysis, with prompt and effective action which distinguishes the superior man from the mediocre and the good from the poor leader.

In times of optimism, when prosperity runs into expansion, and expansion into inflation, when practically everybody has ceased to use forethought and judgment and is dependent entirely on hopes for the future, and on hunches, all of us, even leaders, get the contagion and become demoralized. Some in any line of business may succeed on chance or by luck alone. But in difficult times when all are distressed by economic depression, when we have given up the

hope that "Prosperity is around the corner", or that some governmental agency will do the whole job of pulling us out, with our backs against the wall, the first law of nature, self-preservation, asserts itself and we begin to fight. Then industry, forethought, and judgment return.

Practical judgment is based on accurate observation and memory of facts. In a long steady trend of business affairs it is often sufficient to enable the leader to achieve a considerable success. Reflective judgment is based on both experience and orderly classification of facts. When confronted with an unusual situation a man with reflective judgment draws not only upon his memory of specific cases that are analogous, but upon all that precept, example, and experience have taught him, from which he has been able to establish certain basic principles.

There are many men who possess these rare qualities of reflective judgment heading our commercial and investment banking institutions. We need them. We should help them and make them help us. We should not let our anger and impatience with the foolish and crooked banker, the speculator, or the broker who may exaggerate and falsify, lead us to put obstacles in the way of good sound leadership in financial and credit affairs.

We are all familiar with the classification under the three heads of the basic elements which make up a normal man: His physical, mental, and moral qualities. In a well-balanced individual who gets the most out of life these three forces must be fairly well integrated and work together. With great competition in the laws of nature, the three seem never to be able long at a time to render balanced performance. Adjustments between these forces are constantly being made within all of us. The body is instinctively self-indulgent and hard to control, but all important. The physical is the soil in which the mental and moral qualities of man flower or fade.

Civilization, cooperative effort of mankind, motivated by mass thoughts, feelings, and beliefs of the individuals composing it, has aspects quite similar to those ascribed to men. It has political aspects, social aspects, and economical aspects, all of them important, all of them partners, which theoretically should be well integrated and cooperative, but which in fact are in constant conflict. It is only through an efficient economic order, the soil which sustains the other two, that a just and effective political order and a sound social order can be maintained.

To plan and carry on a progressive future civilization constantly consumes wealth. For continued progress this wealth must be replenished. While both the political order and the social order should help in the plans, the actual work of replenishing this wealth falls back on the economic order.

In our lifetime we can see the constant change and conflict of these forces. We can all remember when a part of the economic forces dominated both the political and social forces, not to their benefit and also to the great injury of a part of the other economic forces. Perhaps the only happy circumstance growing out of this great depression is that so many people now realize the truth and are bent on correcting it. Our great care now should be not to destroy or impair any of the economic forces. They have been the goose, but remember they laid the golden egg.

It seems to me that this proposed measure and the Securities Act of 1933, unless it is amended, are going too far. To carry out the far-reaching program of the administration the errors of the industrial economic life and the errors of the financial economic life must be corrected, but these great agencies so essential to a sound civilization should not be destroyed.

Government and its bureaus are just another lot of men, some able and some not, some with courage and some without. But in appointive places public servants are most conservative, with no incentive to stimulate imagination, vision, and the spirit of adventure that makes one unafraid of losing. Yet these are qualities that are needed in business to insure progress.

With that general statement, gentlemen, I want to add that I am here representing my business myself. I have been a leader in management, I have been an investor, I have been a worker, and I think I am a consumer and a common, ordinary citizen.

Now, I am not going to talk from the stock exchange viewpoint. I think there are objections from my viewpoint to sections 5, 6, 7, 11, 12, 14, 15, and 18.

My objections to 11, 12, and 18 are very well detailed by the opening statement I have made. I think there is too much interference. I feel quite sure if that law is put into effect men like myself will have great difficulty in getting the capital that they need to conduct their business. I am already having trouble. My corporation has four representatives from four of the leading investment banking houses of New York all either members of or they deal through the stock exchange, and I want to say for that class of the directors they are the best ones I have ever found. The other directors are men that are operating in business. Those houses are the Morgan & Co., Lazard Freres, Blake Brothers, and Lehman Brothers.

Those men have their statistical departments, their economists, and their analysts, and you cannot imagine how thorough they are in going into your statements and asking questions, and you cannot appreciate, unless you have lived it and experienced it, what a wonderful moral influence it is to have someone who knows how to answer intelligent questions, to go into your plans and your operations. That moral influence is of tremendous value.

I just want to say for respectable men in the investment banking houses I think every large corporation needs a considerable number of them on its board. One good thing in having a considerable number is they are hardly ever, on a very important thing, all agreed at first. Sometimes some of them never agree with the others, but it brings about discussion and investigation.

My objection to section 5 is that we cannot withdraw if we go in there without the permission of the Commission. I think that ought to be changed.

In 12, the margin requirements that you set up there in a statutory way are a great mistake from the point of view that I am representing here.

Then I do not think any man in any business ought to be limited in using his reputation for keeping his promises. He should be permitted to use that finest thing about him, as far as the rest of man-

kind is concerned, his character and his reputation, to borrow money.

As to the proxy requirements, they are very onerous, and I do not think will do us a bit of good. I think that ought to be changed.

I do not think the freedom of the over-counter trading ought to be interfered with too much, and I do not think good directors ought to be driven off of our boards.

Mr. PECORA. How would good directors be driven off the board of any corporation through this bill?

Mr. REYBURN. It limits their use of their discretion and judgment.

Mr. PECORA. With regard to their own tradings in the stock of their company?

Mr. REYBURN. In regard to the operations of that company.

Mr. PECORA. In what way, Mr. Reyburn?

Mr. REYBURN. Well, I think in the registration requirements you ought to put that right up to a small committee, not the directors.

Mr. PECORA. What committee—committee of directors?

Mr. REYBURN. Say the executive committee or the president or the treasurer.

Mr. PECORA. What is the difference between putting it up to a small group of the board of directors or the entire board? If they are all directors, they all should have equal knowledge of the affairs of the company.

Mr. REYBURN. No; you cannot expect that.

Mr. PECORA. Because that is the responsibility that goes with the duty of directorship.

Mr. REYBURN. No. That is a general impression, but it is not possible for all directors to have an intimate knowledge of the business or an absolutely personal, intimate knowledge of the value of the assets of the business. They cannot do it. They select the best agents they can to operate that business. Sometimes they are mistaken. Sometimes the morals of the agents change. And you will destroy, I think, good corporate management by requiring the executives to take these great responsibilities.

The CHAIRMAN. It is important to do away with window-dressing directors, scenic directors, and have real directors, isn't it?

Mr. REYBURN. Oh, you bet it is, but they are directors with their own business to look after and cannot devote the necessary time to it.

Mr. PECORA. Then what good are they as directors?

Mr. REYBURN. The law and the public impression as to what a director's duties are—that is, all the board of directors—is based on a misconception of the need of corporate activity.

Mr. PECORA. A corporation must have a board of directors?

Mr. REYBURN. A corporation must have a board of directors. Then the board of directors——

Mr. PECORA (interposing). Under the law and in theory the directors manage the corporation. They have the voice of authority with regard to corporation activities and are responsible to the public for the exercise of their duties as directors, are they not?

Mr. REYBURN. Directors should be elected by stockholders.

Mr. PECORA. Well, they are.

Mr. REYBURN. As their representatives to conduct that business in accordance with the law and ethics of the business. Those directors then exercise their authority. They first should select a group from

their number who have the time to give more attention to it than a director ordinarily can, as an executive committee. Then that executive committee, with the aid and approval of all the directors, should select the officers, the management. That is the way it actually runs, and that is the way the law ought to read. Now, of that group, the management——

Mr. PECORA (interposing). You mean to say that executive committees and boards of directors select the officers, or do you mean to say that the entire board of directors select the officers of the corporation?

Mr. REYBURN. It should be a good deal like the executive and the Senate here. The executive committee should investigate and recommend. The board then should elect the officers. Now, the officers ought to be held to the very highest degree of responsibility, and they ought to be, when they do wrong, prosecuted and sent to the penitentiary, and so ought some members of the executive committee. Now, this other board that knows and has time to investigate its executive committee and investigate its officers, stands for the stockholders. They must use judgment in doing that.

Mr. PECORA. You may say that many members of boards of directors have not the time to meet the responsibilities of their positions as directors. If that is the case, what use are they to a corporation's board of directors?

Mr. REYBURN. They would be and can be of tremendous value without being on the executive committee. They get your statements, they put you on the stand, they examine into your plans, they give you good advice, they help you in many ways.

Then the executive committee, men who have greater knowledge or more time, work very much closer to the management. They watch it from week to week. The board of directors may meet only once a month or once a quarter and yet may be a splendid board of directors.

The CHAIRMAN. Any further questions of Mr. Reyburn?

Senator KEAN. I would like to ask what representative—Mr. Lehman is on your board?

Mr. REYBURN. Yes; Robert.

Senator KEAN. That is a brother of the governor, is it not?

Mr. REYBURN. I think a nephew. I am not sure.

Mr. PECORA. Nephew.

Mr. REYBURN. Is he a nephew?

Mr. PECORA. Yes.

Senator KEAN. Lehman Brothers were two brothers that started the firm, and then they had children and they are all in the firm. So he was a partner of the governor's, wasn't he?

Mr. REYBURN. Oh, yes; I think he was a partner in the firm before the governor withdrew from it.

The CHAIRMAN. Is there anything more, Mr. Reyburn?

Mr. REYBURN. Yes; I have written a little closing here which I would like to submit.

The CHAIRMAN. Very well.

Mr. REYBURN. Before closing, in addition to the reasons heretofore given as to my objections to clothing a governmental bureau with so much power over credit markets, there is another very good

one. It is very doubtful to my mind as to whether it is a wise policy for the Government to assume such a responsibility to investors. This is particularly true in a matter that requires a well-developed judgment that only long and intimate experience could bring—which would be difficult indeed for the Government to secure—as well as wide sources of information and quick decisions.

The power to regulate, like the power to tax, gives the power to impair and to destroy. The right to regulate does not give the right to destroy, but imposes the duty to improve and to build stronger, sounder, and more useful policies and methods of administration. While, if this proposed bill is enacted into law it will not destroy the stock exchange, it will impair its usefulness, and will destroy much of the value of many, and perhaps all the value of some, of the investments that have already been made in good faith. It will destroy or seriously impair the credit of many industries in the country, cause a decrease of employment and wages and dividends, production, distribution, and consumption.

The reasoning processes of investors are fallible just as those of all the rest of us. Whether we like it or not, whether or not it is sound for them to hold such beliefs, a great many of them watch the sale prices of securities every day and are tremendously interested in having a broad market in what they call "liquid" securities, and they do not necessarily mean by that a "watered" stock.

With quick marketability removed from anything of value—be it a farm, factory, bond, or stock certificate—fewer people are interested and its price inevitably is seriously affected and decreased. Desires of customers are what makes this business. They come from all over the world. The exchange is only the place where their agents execute the orders.

For the past 20 years I have lived within a few miles of Wall Street, the greatest credit market in the world. On the scale we now live, with a vast volume of production and consumption and the efforts to take care of the future, such a credit market performs a great service. It should be regulated, of course, but at the same time, in holding it to a high degree of responsibility, it should have the freedom to make it most useful and constructive in local, national, and international credit transactions.

The stock exchange is here. It is the auction block where every day the promises of men, corporations, and nations are bought and sold. Like everything in nature, our credit system and this piece of market machinery are not perfect. Along with a vast amount of good work, so beneficial to society, conscientiously and courageously done, there are exploitations of questionable and even crooked jobs. Human hopes are easily overstimulated, and it is easy for those who want to exaggerate and misrepresent to induce many people to carelessly buy poor and often false promises.

Let a bill be drafted that eliminates the misuse of the exchanges and it will have the support of every honest-minded man in the country. The opposition to the present bill is wide-spread because the proposed legislation does not attack the problem from this simple and constructive point of view, and because it strikes a vital blow at those investors and those industries who are so necessary to the agriculture, commerce, industry, education, and charities of the country.

All of these things can be safeguarded by legislation which instead of destroying, in the guise of regulation, preserves industrial and investment values through the medium of regulation which prevents or severely punishes abuse.

Thank you, gentlemen, for your patience. If the law is redrafted and you think I could be of any help to you, I would be glad to have you call upon me.

The CHAIRMAN. We are very much obliged to you, Mr. Reyburn. I hope you have a pleasant vacation in Florida.

Mr. REYBURN. Thank you, sir.

The CHAIRMAN. Mr. George Rich, secretary of the Boston Stock Exchange. We will be glad to hear from you now, Mr. Rich.

STATEMENT OF GEORGE A. RICH, SECRETARY AND TREASURER OF THE BOSTON STOCK EXCHANGE, BOSTON, MASS.

The CHAIRMAN. State your name and place of residence and occupation, Mr. Rich.

Mr. RICH. Mr. Chairman and gentlemen of the committee, my name is George A. Rich. I am secretary and treasurer of the Boston Stock Exchange. I have been secretary since 1916, and have been connected with the exchange since 1898. I speak, however, in behalf of the Committee on New England, representing both brokers and dealers.

It is not my purpose to discuss the details of the proposed bill, as this has already been adequately covered by others. I should, however, like to address myself to some general aspects of the subject which seem to us important. They are in brief as follows: First, the control of credit from the standpoint of stock-market operations; second, the question of segregating broker and dealer activities, and, third, the regulation of exchanges and their practices.

Before discussing these details, may I say just a word regarding the Boston Stock Exchange and its position in New England? The Boston Stock Exchange was organized 100 years ago. It has been in continuous operation since that time, with the single exception of a closed period during the great war. At the present time the membership is limited to 139, of which approximately 100 are active. Forty of our registered firms are also registered firms on the New York Stock Exchange.

At the present time there are listed upon the exchange the bonds of over 260 different corporations, representing 300 separate issues, and common and preferred shares of over 300 corporations. All of these corporations represent either New England industries or industries in whose issues there is a present substantial local ownership.

Now, to proceed to the points suggested at the beginning. First, the control of credit from the standpoint of stock-market operations.

Fundamentally we all agree that extreme speculation, whether in securities, land, or commodities, is bad from an economic standpoint. On the other hand, from an economic standpoint it is of the utmost importance that securities should remain liquid and at all times readily marketable. We feel that any attempt to restrict credit by any inflexible rule made in the light of the present circumstances is

undesirable. In my opinion it would be most unfortunate to write in law specific rules as to credit, because conditions are fluid and laws are static. The sound way would appear to be to leave it in the hands of those who, by reason of their position and their connection with the financial and economic conditions of the country, from their experience in extending credit, can best judge as to the proper flow into securities in order to maintain their liquidity and marketability in the light of circumstances as they exist, not only throughout the whole country but in special local sections.

In the last analysis credit is dependent upon both the individual and upon the character of the securities upon which the loan is based. If this is a true statement, there then can be no uniformity applicable to the whole country or to all securities. For this reason my associates are convinced that any limitation, either on the amount the individual should borrow or that banks may loan, should be left to the control of the Federal Reserve Board.

Now, if it be said that the control of the Federal Reserve Board failed in 1929, it should be borne in mind that not only have banks and bankers learned by that experience, but by the passage of the Banking Act of 1933 the powers of the Federal Reserve Board have been greatly increased for the express purpose of preventing the undue diversion of funds into speculative operations. What I have in mind are these powers: The power to deny credit facilities of the Federal Reserve System to any bank making undue use of bank credit for speculative purposes; the power of the Federal Reserve Board to fix for each district the percentage of capital and surplus which may be represented by loans secured by stock or bond collateral; the power of the Federal Reserve Board to remove any director or officer of a member bank guilty of unsafe or unsound practices; the power to increase or decrease the reserve balances required to be maintained against either demand or time deposits; the elimination of all banking affiliates engaged in the securities business; the forbidding of any member bank to act as agent or medium for others making loans on securities. In my opinion and in that of my associates, if further protection or power is needed to control credit in market operations, it should be done through the amplification of that act.

Now, to the second point, the question of segregating broker and dealer activities.

With respect to section 10, which separates the activities of the broker and dealer, I would respectfully submit that such a separation would work a hardship on New England people as a whole, and on the security houses serving New England, particularly on the smaller holders of securities in comparatively small cities and communities. By forcing segregation we New England people believe that the act would force our local securities houses to withdraw from the small cities and communities, to withdraw both their services as brokers and their services as dealers. The effect on the listed holdings of such investors would be to make them less readily marketable. The small holder, if the securities houses in the small communities are forced to withdraw, would not be likely to have established connections with securities houses in the large cities. This being the fact, he would find it difficult, in case of necessity, to

dispose of his listed holdings promptly, or to make arrangements for quick execution of an order to sell. A similar difficulty would obtain in case he desired immediate execution of an order to purchase listed securities. The general effect, therefore, on the small holder in the smaller towns would be to his decided disadvantage. It would make his listed securities less readily marketable.

In addition to this, individuals in small places holding unlisted securities would be deprived entirely of services and financial advice from dealers if the segregation section forced, as we believe it would, the withdrawal of securities houses from the small cities and towns.

Moreover, this section would, I believe—and when I say I, I mean my associates too—would produce the following additional unfortunate results: First, a radical curtailment of our established organizations. Second, the discharge of members of the personnel of our organizations who have labored long and faithfully and have established recognized reputations for honesty and fair dealings with the customers. I may say that in the State of Massachusetts alone there are something more than 10,000 employed by our organizations. Third, the forced separation and perhaps the loss of a clientele built up over a period of many years. Fourth, an increased cost to industry for financing and consequently a decreased valuation of the securities sold to the investor. Fifth, the entire elimination from the dealer business of the most financially responsible firms and individuals in our district.

It is my personal belief, based on the local situation, that this will result in the driving of purely local financing to other fields, particularly to New York, where alone I believe could dealers be found of sufficient means to absorb and distribute the securities necessary for current financing. This is due to the fact that the majority of the houses of substantial financial resources in our district are members of the stock exchanges.

The criticism which has been directed at brokers occupying this dual position, it would seem, has been largely, if not entirely, overcome by the passage of the Federal Securities Act, which appears to have eliminated the opportunity for unfair advantage, not only under section 12, imposing civil liabilities upon the seller, but by section 11, imposing even greater responsibilities upon an underwriter. Furthermore, under our New England laws, both statutory and common law, full disclosure as to his relations to the transaction is required on the part of any broker who is selling as a principal. I am also advised that the Investment Bankers' Association Code of Fair Practices, about to be adopted, makes further requirements in this type of transaction.

Now, third, the regulation of exchanges and their practices.

As to the prohibition and regulation of practices of exchanges, it seems to me that there are two considerations. Certain practices are condemned by exchanges as well as public opinion. As to such practices, there can be no objection to the enactment of a law prohibiting them. There is a distinct difference, however, between such practices and many other matters covered by the proposed bill as to which there is a sincere and honest difference of opinion.

As to such things, if Congress feels that certain Federal regulations should be imposed upon the activities of the stock exchanges, we

should not oppose it, provided that the authority is placed in the hands of a capable independent group of men, not bound in advance by specific prohibitions and requirements, before whom we could appear and discuss our local conditions and our local practices. Before such a body we should feel that, if any of our practices were regarded as ill-advised or not in the interests of the public and we could not convince them otherwise, then there really was some question as to the soundness of our own position. In other words, a body with flexible authority, sitting in conference with the exchanges, studying their problems, and both interested in the same ends, the public good and the sound interest of the security holders, is without objection. We believe under those conditions a sounder practice and procedure can be worked out than is possible in any other manner.

The CHAIRMAN. Are there any questions of Mr. Rich?

Mr. PECORA. I would like to ask a few questions, Mr. Chairman.

Mr. Rich, you said that certain practices are condemned by exchanges as well as public opinion. As to such practices there can be no objection to the enactment of a law prohibiting them. Would you be good enough to enumerate the practices you have in mind?

Mr. RICH. What I had particularly in mind, Mr. Pecora, was the wash sales, and so forth, some extreme types of pool operations. Those were the particular things I had in mind.

Mr. PECORA. In the concluding part of your statement you said that "as to such things, if Congress feels that certain Federal regulations should be imposed upon the activities of the stock exchanges, we should not oppose it, provided that the authority is placed in the hands of a capable, independent group of men, not bound in advance by specific prohibitions and requirements, before whom we could appear and discuss our local conditions and our local practices."

As to that, Mr. Rich, do you have any notion that the Federal Trade Commission would shut its ears to any suggestions made by representatives or officers of stock exchanges when it devoted itself to the task of formulating rules and regulations?

Mr. RICH. I had no thought, and I have none, that the Federal Trade Commission, if it were given this authority, would not give every member of the present exchange, broker, or dealer, the opportunity to present their cases to the Commission and get their hearing. What I would suggest and what runs in my mind is that whether or no the organization, the form in which it could best handle this problem, should be more diversified and have more opportunity to attend to the particular problems than perhaps such a commission would have. In one of the reports—I think, the Dickinson report—they made two suggestions, did they not? One, that there could be a remaking of the Federal Trade Commission, setting up certain commissioners who would give all their time, or to an independent stock exchange authority. What we have in mind is a group of men of diversified contacts and of wide experience to whom we could present matters, because we feel very strongly that a uniform law imposed on every exchange would, in certain instances, work injustice to many of these purely local markets. We are trying to preserve our local market.

Mr. PECORA. The matter of preservation of local markets with regard to elements that apply only to localities could easily be taken

up with the Federal Trade Commission when that body formulates its rules and regulations, could it not?

Mr. RICH. I agree that it probably could. I just tried to express my thought and that of my associates as to the particular type of body that we felt properly could handle it better. It is not said in criticism.

Senator KEAN. I would like to ask you a few questions. If this law "as is" is enacted, the Federal Trade Commission would be bound, of course, by all the requirements of the law, would it not?

Mr. RICH. Yes.

Senator KEAN. And if they are bound by all the requirements of this law, that would so cripple your exchange that probably it could not do business?

Mr. RICH. This bill that is before us now; yes. Our suggestion is that there should be great flexibility in the law in order that that body might function better.

Senator KEAN. I understand; but we have had testimony here that it would perhaps close most of the exchanges.

Mr. RICH. Section 10 would hit our district terribly hard, because, as I have stated, a substantial part of our long-term local business is done with those who happen to be members of the stock exchange.

Senator KEAN. Do you have about the same rules as the stock exchange in New York has?

Mr. RICH. Pretty generally the same.

Senator KEAN. Do you have a right to question your members as to whom they bought for and whom they sold for?

Mr. RICH. Yes, sir; we do.

Senator KEAN. Have you questioned them on air stocks?

Mr. RICH. We have no air stocks listed.

Senator KEAN. None of them are listed?

Mr. RICH. No, sir.

Senator KEAN. If this bill is enacted into law it would interfere very much with the sale or financing of all municipal bonds, would it not?

Mr. RICH. It would, in our district. It would have to be done outside of our district.

Senator KEAN. In other words, it would drive municipals and other bonds off the market, and they are regarded as the highest type bonds in the market today. Bonds of the State of Massachusetts and towns in Massachusetts are selling on a better basis than those of other States and cities in the United States, are they not?

Mr. RICH. They are selling, yes; I would not like to go as far as that.

Senator KEAN. It would practically deprive those cities and towns of the ability of marketing their securities?

Mr. RICH. They would have to go outside of our district where they now operate.

Senator GOLDSBOROUGH. I understand, Mr. Rich, that it is your judgment that there should be set up an independent commission to carry out and effectuate the provisions of this bill?

Mr. RICH. My judgment, as I tried to express it, is that; yes, sir.

Senator GOLDSBOROUGH. Rather than the Federal Trade Commission?

Mr. RICH. Rather than the Federal Trade Commission.

Senator GOLDSBOROUGH. Is that based upon the fact that you think the Commission would be carrying burdens already placed upon it, plus those imposed by this act, which would be such a stupendous task that it would be difficult for them to carry out the provisions of this bill?

Mr. RICH. There are two answers to that, Senator. First, I think it would be a stupendous task for them; and personally I am not clear in my mind but that a different type of personnel, a more diversified personnel, with broader contacts with economic and business conditions, would not be more serviceable. I am not criticizing in that suggestion, but am simply giving my reaction as to the most competent way of handling it.

The CHAIRMAN. Would you recommend that municipals be exempted from this act?

Mr. RICH. Frankly, I do not see why they should not, Senator. It covers the country over. I am not very familiar with municipals outside of my own district, and just what might be involved by giving that general exemption I do not know.

The CHAIRMAN. Are there any further questions? If not, we are very much obliged to you.

Mr. RICH. I thank you very much, gentlemen.

The CHAIRMAN. We will now hear from Mr. Archibald Roosevelt, who is accompanied by Mr. George B. Gibbons.

STATEMENTS OF ARCHIBALD B. ROOSEVELT, PRESIDENT OF ROOSEVELT & WEIGOLD, INC., DEALERS IN MUNICIPAL SECURITIES, NEW YORK, N.Y., AND GEORGE B. GIBBONS, PRESIDENT GEORGE B. GIBBONS & CO., INC., MUNICIPAL BOND DEALERS, NEW YORK, N.Y.

The CHAIRMAN. State your name, place of residence, and occupation, Mr. Roosevelt.

Mr. ROOSEVELT. My name is Archibald B. Roosevelt. I am president of Roosevelt & Weigold, Inc., dealers in municipal securities. By municipals I mean those of States and subdivisions of States.

The CHAIRMAN. And your residence?

Mr. ROOSEVELT. New York City.

The CHAIRMAN. Mr. Gibbons, you may state your name.

Mr. GIBBONS. My name is George B. Gibbons. I am president of Geo. B. Gibbons & Co., Inc., municipal bond dealers, New York City.

The CHAIRMAN. Proceed, Mr. Roosevelt.

Mr. ROOSEVELT. Mr. Chairman and Senators of the committee, last week the Municipal Bond Club of New York had a meeting and appointed a committee to study the National Securities Exchange Act of 1934, of which committee Mr. George B. Gibbons is chairman. After some study of the bill we were asked to come down here and explain to the committee just how we thought that this bill would affect municipal bonds and municipal securities. Neither Mr. Gibbons nor myself are members of any exchange that deals in securities. We deal solely in municipal bonds.

We have made a study of this bill and have come to certain conclusions. We feel that it is pretty definite that if the bill goes through

"as is", we will be out of business. Of course, that is very painful for us. Perhaps some people do not care about it. But we do not believe that the Federal Government has any idea of putting a legitimate type of business out of the picture entirely.

Secondly, we believe we can show that municipalities and States will find it difficult and expensive, if not impossible, to finance through the issuance of bonds, on account of this bill.

Mr. Gibbons has prepared an analysis of the bill, paragraph by paragraph, such paragraphs as we believe affect municipal bonds. We have copies of his analysis here, and Mr. Gibbons would like to explain it and comment on the various paragraphs, and we would like to answer any questions and hear any suggestions that any of the committee or counsel for the committee may have.

The CHAIRMAN. You may proceed, Mr. Gibbons.

Mr. GIBBONS. In going over this bill we did so without the aid of counsel. A number of the bond dealers in New York City made a study of it and arrived at certain conclusions. These we would like to place before you.

It seemed to us that the bill, from its very wording, was not intended to cover State or municipal bonds, although it specifically exempted bonds of the Federal Government and therefore by implication included all municipal bonds, we assume. It seemed to be particularly injurious in some cases to States and municipalities.

To put it briefly, it makes many bonds unsalable, not only bonds already outstanding in the hands of their owners, but it eliminates competition in the purchase of new issues sold by municipalities or when sold out by their present owners, life-insurance companies, banks, or estates. It very largely destroys the desirability of municipal bonds as an investment. Of course there are hundreds of millions of them outstanding. It reduces their availability as collateral; in fact, it makes it almost nil, and it destroys their salability.

The CHAIRMAN. Will you explain those points of objection as you go along?

Mr. GIBBONS. I will gladly do that, Mr. Chairman.

As to section 3, we have not gone over all the paragraphs, because some of them apparently do not apply to the subject; but by section 3 municipal bonds are apparently included. Municipalities, States, districts, and political subdivisions are classed as issuers.

Section 6, paragraph (a). This paragraph prevents banks, if they buy or sell securities from or to a member of an exchange, as practically all banks do, from lending money on State or municipal bonds unless they are registered on some exchange. That means that an issue already outstanding cannot be taken to a bank and used as collateral. The reason they were purchased for, in many cases, was that they would be available as collateral when occasion arose.

Section 6, paragraph (b), makes it impossible to borrow more than 40 percent of the value of any State or municipal security, and only then if the security is listed on an exchange. This would seriously and adversely affect insurance companies, savings banks, postal-savings funds, pension funds, corporations, and individuals, as well as dealers in municipal securities, by making it impossible for them to borrow on State and municipal securities in times of stress, or, in the case of dealers, after they have purchased them and pending their

sale to their customers. It would practically make it impossible for a group of municipal dealers to join together to purchase and finance a large issue of municipal bonds. It would require too much cash. Recently Pennsylvania sold some 30 millions of bonds, and some 40 dealers joined hands to buy them; but if they could only borrow $12,000,000 on the 30 millions of bonds and put up $18,000,000 in cash it would have been an impossible thing for many of them to do.

Paragraph (c) of section 6 apparently is not intended to apply to a dealer in municipal bonds, but it nevertheless would hamper the sale of municipal securities. Many people buy a new issue and turn in as part payment other bonds, especially short maturities. This section prevents making a loan, so they would have to have all cash for the new bonds. Bonds which might be maturing within a month or two months would not be available to be taken as part payment or to make a loan on——

Mr. PECORA. Mr. Gibbons, pardon me for interrupting at this point, but have you overlooked the provisions of the bill which would enable holders of bonds of this character to borrow as much as a lender is willing to give, provided that the transaction whereby the bonds had been acquired by the borrower had not been effected within 30 days?

Mr. GIBBONS. I saw that. On new issues that 30 days' provision would not apply, because they might buy bonds today and sell them to you tomorrow, and you might want to borrow something on them right away and you could not use those bonds as collateral. You must pay for them in full.

Section 7, paragraph (a), provides that all borrowing should be from a member of the Federal Reserve System; so that if a bank refused to lend on municipal bonds, possibly because it did not like the bonds, or for any other reason within its own discretion, the owner of those bonds would have to go to another member of the Federal Reserve System to borrow the money. It might force him to sell the bonds. Today he can go to anybody with money, who is willing to lend it to him, and borrow it. A great deal of money is borrowed from people other than banks. A dealer buys many municipals and feels that they are perfectly good, but the bank may feel that they may be a slow thing to sell and may prefer not to loan on them. Other people who may have no immediate use for their money are perfectly willing to tie it up for a while and loan on those bonds. A dealer would be prevented from going to them to borrow the money. In fact, you could not even go to a member of your own family and get him temporarily to loan you some money. If the banks would not loan you the money, you would have to throw the bonds overboard.

Mr. PECORA. That also would not apply to a borrower who owned the securities for more than 30 days.

Mr. GIBBONS. You might buy some bonds at a public sale and be required to pay for them within 5 or 10 days. You might have made a mistake in buying them; you might have paid too much, but nevertheless you must borrow on them at once.

Mr. PECORA. But those provisions would not apply to a borrower who had owned the bonds for more than 30 days.

Mr. GIBBONS. But there is a period when you do not own them 30 days. When you ae buying a new issue you only have them 1 day, and must borrow that day to pay for them.

Mr. PECORA. Your argument contains principles which would be applicable to new issues.

Mr. GIBBONS. Yes; and old outstanding issues, also; many a man buys an old issue and borrows on it immediately—an issue that has been outstanding. There is probably as much trading in old issues as there is in new issues. People seek to improve their holdings and sell one and buy another. So there is a continual turnover.

Paragraph (b) of section 7 limits a dealer very strictly in his commitments. It limits his obligations to not more than 10 times his capital. There are many municipal bonds sold at public sale, and in the average course of business no one dealer gets a very large percentage of the bonds he bids for. I have bid for as many as five or six millions of bonds in 1 day, and did not get any. At another time I bought five or six issues. I would not dare to run the risk of bidding for bonds if the aggregate amount of my bids totaled more than 10 times my capital, because if by a turn of fortune I should get all the bonds I bid for, my obligations would exceed the limits set by this bill. Even if I got them all and could turn them over very readily, I still could not assume the responsibility, even if it was temporary.

Paragraph (c) of section 7 presumes the segregation of business. That is not very practical in the municipal bond business, for the reason that most municipal bond dealers act in both the capacity of dealer and broker. I will explain to you how that is. If the city of Albany sells some bonds a syndicate may bid and secure the bonds. Other syndicates do not get them. The syndicate that does buy them is a dealer in those bonds. They have put their own money in it and are reselling them. The syndicate that bid for them and did not get them may have orders for those bonds. They talked to their customers about them to see if they would buy from them in case they secured the issue. They were unsuccessful, but nevertheless the customers want the bonds. Even though I individually did not secure them at the sale, they say, "We will take 25 thousand, anyway." I go to the syndicate that did get the bonds and buy them. In that case I am a broker. If I could only sell bonds where I acted as dealer I would have to be successful in every sale in order to make any money. I simply cannot afford to do business on that basis. Neither could I afford to act only as broker, because I could not then bid for them on my own account in cases where I had no immediate customer. That would apply to all dealers. That is true in New York City in the municipal bond business, and in smaller places it would not leave enough business for a municipal bond man to live on. Whether he be a dealer or broker, he would not get enough. They have very few bonds that they buy as a dealer, and a great deal they sell as a broker. Yet their dealer business is a very substantial part of their total business.

Mr. PECORA. Does your firm hold any stock exchange membership?

Mr. GIBBONS. Oh, no; we are incorporated. When we were a firm we were never members of any exchange at all. But we are members of the Investment Bankers Association, and they have a code, the

Investment Bankers Code; and that code requires that the dealer disclose to his customer the capacity in which he acts, whether as a broker or as a dealer. That would presumably safeguard the customer. As a matter of fact, my customers do not care whether I act as a broker or dealer. If they see bonds offered in the paper and my name is not among them, they give me an order for them. They know that I do not own the bonds, and they do not care. They get them at the same price.

In other words, whether I own city of Albany bonds or whether I deal in them as a broker makes absolutely no difference to my customers. I am not trying to hide the fact that I do not own the bonds, and the customer does not care whether I own them or not.

Mr. PECORA. It might make a difference if a customer came to you and sought your advice about a particular issue, and you at the time had some bonds and you recommended those in preference to others, which might appear to have a greater security and greater yield.

Mr. GIBBONS. But he would know whether I was an owner or dealer. Under the code I would have to tell him.

Senator KEAN. Is it not true, also, that you would submit a list of municipal bonds for him to pick from?

Mr. GIBBONS. That is correct. Some I would own and some I would not. He would not care one way or the other. But I would have to tell him, under the code, whether I was acting as broker or as dealer.

The CHAIRMAN. That code may be changed or abolished or modified at any time, may it not?

Mr. GIBBONS. Yes; so I understand.

Senator KEAN. But the practice is there, is it not, that that is the way the business is done?

Mr. GIBBONS. That is the way the business is done.

Senator KEAN. And you submit to your client a list, and he wants to invest $100,000 in some bonds. You submit to him a list of municipal bonds?

Mr. GIBBONS. He usually wants a large list to choose from, and he chooses a bond from the point of view of the desirability of the bond to him, irrespective of whether you own it or not. For instance, if I own bonds it is particularly exasperating to have a man pass over every bond I would like to sell him to buy a bond that someone else owned and on which I make one fourth of one percent, but that of course is his privilege—he buys the bond he prefers.

Mr. PECORA. Evidence before this committee shows that one of the biggest bond houses of the country did not follow the practice you have alluded to. Rather they pushed on their customers their own securities, particularly at times when they knew those securities were souring.

Mr. GIBBONS. Municipals or corporation bonds?

Mr. PECORA. There were some foreign issues which are comparable to municipals. They were selling industrial corporation bonds. I refer to the National City Co.

Mr. GIBBONS. They are large bond dealers, but in my own business and that of Mr. Roosevelt, and a good many other businesses, it is 99.9 percent municipal bonds. We very seldom handle anything else.

Senator GOLDSBOROUGH. I gather that under section 10, especially in small centers, it would be pretty difficult to separate the dealer and broker business. In other words, you could not make a living?

Mr. GIBBONS. No; you would not, even in the large centers. In the recent past, as you know, the municipal bond market has been very much depressed. High grade 6-percent bonds in Westchester County have sold under par, and bonds of many cities were unsalable. Then they worked back until they were worth about par. But no dealer would be willing at that time to assume the liability of actually purchasing those bonds. The same held true in other States. But they were willing to handle those bonds as brokers for anybody who wished to buy them. A great many people thought they were a good purchase and did buy them. They were right, because now they are selling at the equivalent of 110. At the same time no dealer felt justified in buying a large block of those bonds. He had to do the business on a brokerage basis. He did not know whether they were going down to 80 or not. New York City bonds went to 65.

Mr. PECORA. You are familiar with the legislation that is proposed in Congress of extending to municipalities the principles of bankruptcy laws, are you not?

Mr. GIBBONS. I have head part of it.

Mr. PECORA. Have you taken any position with regard to that?

Mr. GIBBONS. I have not.

Mr. PECORA. Apparently, from the demand that has been presented to Congress for the enactment of that legislation, any municipality can issue bonds and sell them to the public, and some have issued those bonds on an unsound basis. So the mere fact that an issue is of municipal bonds does not carry with it any sanctity, so far as its soundness or secureness is concerned.

The CHAIRMAN. They have back of them the taxing power to make them good.

Mr. GIBBONS. That is just the remark I wanted to make, Senator.

Senator GOLDSBOROUGH. Then you regard as a great hindrance the limitations of section 10?

Mr. GIBBONS. It would very seriously tend to eliminate competition at sales. Competition at sales is tremendously desirable from the point of view of the municipality.

I have a point on that that I would like to bring out, but I will go over the other points, if I may, first.

In section 11 we simply suggest the impracticability of registering all municipal bonds. Many small places have sold their bonds and are no longer interested, or may not be; and if they do not register their bonds, the bonds already outstanding would not be available as collateral nor would they be salable. In New York State alone there are 57 counties, 60 cities, 543 villages, 932 towns, and some 8,550 school districts, each of which would require to be registered in order that their bonds may be available as collateral. They bear different rates of interest. It would be a colossal task to even get them to do it. Not being registered, these bonds would suffer a severe depreciation in price, and the use for which they were bought by many people, in order to have them available in times of stress, would be utterly destroyed.

Section 12 compels municipalities to have an outside audit in order to have their bonds listed.

The only comment I have on that is that it is pretty costly. Many States have systems of audit which they think are fairly satisfactory. Even an audit would not help particularly. It would not cure their credit. What they really need is a balanced budget and somebody to make a survey to be sure they are not spending more money than they are getting from taxes. That is what makes a municipal bond good, and not the accuracy of their accounts. As a matter of fact, the safety and the security of a municipal bond do not depend upon the integrity or the good business ability of the officials; that may be helpful, but they depend upon the taxpaying ability of the taxpayers in the town. If they depended upon the good business ability and the integrity of the officials, even though the latter were the best in the world when the bond was sold, the next administration might have less capable and honest officials; and if the value of the bond depended upon that it would be very unstable.

An audit of a municipality would simply certify as to the honesty of the officials and the correctness of their accounts. A municipality, for instance, might require a million dollars for its operating expenses and only levy half a million dollars to meet these expenditures, and thereby ruin their credit, but still be perfectly honest. Another municipality might levy a million dollars; some official might steal $100,000, but, if they only needed the remaining $900,000 to meet all their operating expenses, they would balance their budget in spite of the theft, and the bonds would be much more salable and at better prices than those of the municipality previously cited.

Section 14 seems to make it unlawful to sell, and practically prohibits the sale of, any State or municipal bonds which did not comply with the Commission's ruling, which probably includes a provision for registration with the Federal Trade Commission. In view of the vast number of political subdivisions in the country, this is hardly feasible. This paragraph would prevent the sale of new bonds and would seem to prevent the sale, or the use as collateral for loans in times of stress, of any bonds now outstanding which might be held by insurance companies, savings banks, Postal Savings funds, pension funds, individuals, and corporations. Many of the institutions just specified and many corporations own municipal bonds which they hold as a reserve against the time when they may need to sell them or borrow money on them. Unless the issuers of these bonds register them, the bonds would not be available for this purpose and would be nonsalable.

Section 17——

Senator GOLDSBOROUGH. What about section 16?

Mr. GIBBONS. I omitted that because that simply requires the bond dealer to keep certain books subject to examination by the Commission. We have all had income-tax people in from the State and from the Federal Government. The only objection I make to that is paying for it. I cannot pay my own employees sometimes. The representatives of the Government are welcome to anything they want to come down and see. Our books are perfectly open. My firm, and I guess many others, have kept their books in permanent form and not loose leaves. They run right back to the

time when we started in business. I know mine do, and I think most people's do. Any properly constituted officials are not only entitled to see them, but are perfectly welcome to see them at any time; and they have been seen several times. But it would be costly to place a charge of $100 a day for a couple of auditors to go over the books and possibly spend a couple of weeks at it, when a man is having a hard time paying his own employees. Most of us have had a hard time in the last few years.

Section 17 (a). This paragraph and the subsequent paragraphs in this section would, apparently, render a municipality, which I believe is responsible for the acts of its officials, liable for any false statement. That sounds perfectly reasonable. I do not care whether they are liable or not, but it would be pretty tough on them, and I will tell you how it might happen.

A village in my State sold some bonds to me on an absolutely false statement made by the treasurer of the village. He absolutely lied and made false affidavits right through. He deceived the village officials; he deceived the attorneys for the village who were outside attorneys; he deceived the purchaser of the bonds. I sold those bonds under those false statements. I cannot guarantee the bonds I sell. All I can do is to be honest, myself, and make statements which I have investigated and believe to be true. If a municipal officer makes a false statement I cannot help it. That man did make such a false statement, and he was just released from jail the other day. By the way: Those bonds were sold in the fall of 1931 or the fall of 1932, I have forgotten which; but the market immediately after took a very severe drop until bonds of a similar character were selling at 90 cents on the dollar.

Under this bill, if I sold those bonds to you and they went down to 90 because of the general decline, you nevertheless having bought the bonds on a false statement can sue that municipality and make them pay you the difference. In this case it would cost them $86,000, under this bill. The mere fact that the village treasurer lied and stole a few thousand dollars did not affect the legality or security of those bonds one atom.

The CHAIRMAN. Then there was no loss or no damage?

Mr. GIBBONS. Suppose a man had bought them at par and they had sold afterward at 90. He could claim that he paid par within 90 days for bonds that now sold at 90 and could show he bought them on a false statement and he could sue the village for damages. There are so many things in there that it seems to me that possibly this bill is not drawn particularly with regard to municipal bonds or State bonds——

Mr. PECORA. If the bill were to confer power on the Federal Trade Commission to exempt municipal bonds from the operations of its provisions, which you have criticized, such action would meet your criticisms, would it not?

Mr. GIBBONS. No; for instance, we would not be interested in whether they had exempted a certain bond of a certain village in Pennsylvania or Connecticut or New York, but before we could buy that bond we would have to be sure it was exempted. So long as it is required to exempt all municipal bonds there would be a delay. A man who needed money quickly could not use his bonds

before he found out they were exempt. People would wait until the emergency arose and then try to sell their bonds and could not.

Mr. PECORA. When you submit a bid for a new issue of municipal bonds do you make an independent investigation?

Mr. GIBBONS. To what exent do you mean—send an auditor up there?

Mr. PECORA. In order to form your judgment as to the soundness of the securities?

Mr. GIBBONS. Yes. We consider that we have investigated sufficiently to arrive at an opinion so that we are satisfied about the bonds. We take the sworn statements of the officials as to their financial status, their tax collections, their debt, their population, and we act on that.

Mr. PECORA. Then you do not make an independent investigation, if that is all you do.

Mr. GIBBONS. We do not send an auditor.

Mr. PECORA. Do you make any kind of an independent investigation?

Mr. GIBBONS. I have just explained what we do.

Mr. PECORA. You take the sworn statements of somebody else?

Mr. GIBBONS. Correct.

Mr. PECORA. Of the officers of the issuing municipality?

Mr. GIBBONS. Yes. That is precisely what we do. In the first place, it would be impossible for us to make an independent investigation of New York City, for instance. The task would be too great. Nobody would undertake it; or in Albany or Yonkers or any other place.

Mr. PECORA. I did not mean an independent investigation of that kind; but do you merely rely upon the data and information furnished by the officers of the issuing municipality?

Mr. GIBBONS. We rely on the officers of the municipality to furnish us an accurate statement of their financial status—their debt, their bonds, their tax collections. We rely on the attorneys, who are usually New York attorneys retained by different municipalities. There are several firms that specialize in that. We rely on their opinion as to the legality of the issuance of the bonds, that the proceedings authorizing them are legal and that the sale is legal.

Senator KEAN. But further than that, you require that the municipality shall furnish you with certain statements and affidavits?

Mr. GIBBONS. Correct.

The CHAIRMAN. You do not check up the assessment to see whether there is an overassessment or an underassessment on the property, and how it compares?

Mr. GIBBONS. We do, Senator, but not by going to the place. For instance, we take the tables of equalization in New York State and find out whether or not the State board of equalization assess property in a certain way. Albany, for instance, may assess its property on 80 percent or 70 percent. Some counties assess at 40 percent, so they would apparently have $10,000 of market value of property for every $4,000 assessed. In paying their taxes they pay on $10,000 for State tax, and in their local taxes they pay on $4,000. Some counties are assessed at a higher percentage than others. They also have county boards of equalization. We have all those tables and can check them all up.

The CHAIRMAN. You can tell whether property is coming down year after year or going up?

Mr. GIBBONS. You can do that by seeing whether there is a change in the assessed valuation and also the amount of new building which is added. The only change in any place would be the removal of old buildings and the addition of new buildings plus or minus the change in values. The real estate would be the same. A house and lot are usually assessed as one. We have all those records.

The CHAIRMAN. Are there any further questions of Mr. Gibbons or Mr. Roosevelt? If not, that is all. We are very much obliged to you gentlemen.

Mr. PECORA. Are municipal bonds speculated in?

Mr. GIBBONS. They do not speculate much in municipal bonds, because once they are sold they are gone. If you had them on an exchange you would be able to pick up some pretty cheap bonds.

The CHAIRMAN. The committee will take a recess at this time until 2:30 this afternoon.

(Whereupon, at 1:12 p.m., a recess was taken until 2:30 p.m. of the same day.)

AFTERNOON SESSION

The committee resumed at 2:30 p.m., on the expiration of the recess.

The CHAIRMAN. The committee will come to order, please. Mr. Fletcher, we will now hear you.

STATEMENT OF R. V. FLETCHER, WASHINGTON, D.C., GENERAL COUNSEL FOR THE ASSOCIATION OF RAILWAY EXECUTIVES

Now, Mr. Fletcher, you have examined the bill we are now considering, S. 2693, have you?

Mr. FLETCHER. Yes, Mr. Chairman. And I want to submit just a few observations about two or three sections of the bill without discussing the general features of the proposed legislation at all.

The CHAIRMAN. You may proceed in your own way.

Mr. FLETCHER. I might say that I have no views to express at all with reference to the regulation of stock exchanges. I am concerned in behalf of the railroads, which I represent, with regard to a few features of the bill which seem to us to call for unnecessary expense, labor, and trouble. For instance, section 11, which is the registration clause of the bill; section 12, which deals with information that may be called for by the Federal Trade Commission; and one observation as to section 18 of the bill; as well as a very brief reference to section 13 in connection with proxies.

The CHAIRMAN. Very well. The committee will be glad to hear whatever you have to present in regard to this bill.

Mr. FLETCHER. So far as section 11 is concerned, that being the registration section, the point I wish to make is, that in that section, in connection with the obligation placed upon companies issuing securities dealt with on the exchanges, to have to register them, they are required particularly in the second portion of that section, which is (II) to furnish information to the Federal Trade Commission with respect to 11 different itemized matters.

As you no doubt know, in the railroad industry it is a highly regulated industry now. It is required to make reports to the Interstate Commerce Commission; to keep all records and accounts in conformity with the rules of the Interstate Commerce Commission; and, generally, to conform to the supervising authority of that body in great detail.

I have no purpose to delay the committee unduly, but would like to call attention to some items in section 11, more particulary paragraph (II) where it is provided that companies that issue securities listed on stock exchanges shall furnish the Federal Trade Commission, first, with information in regard to the organization, financial structure, and nature of the business. All that is reported regularly by the railroads in their annual reports to the Interstate Commerce Commission.

Second. They must furnish particulars regarding the terms, position, rights, and privileges of the different classes of securities outstanding. That information is not contained in the annual reports made by carriers to the Interstate Commerce Commission, but you will recall that before a railroad company can issue any security or reissue any of its securities, it must make application to the Interstate Commerce Commission under the provisions of section 20 (a) of the act, and secure the permission of the Interstate Commerce Commission to do anything about such securities; and the rules of the Interstate Commerce Commission which govern procedure in matters of that sort, require railroads to give all the particulars which are mentioned here in the second item of this subsection which I am now discussing.

It is true, of course, that there are securities listed on exchanges so old that they have not been issued under the authority of the Interstate Commerce Commission, since that portion of the Interstate Commerce Act requiring railroads to secure such authority from the Commission, was enacted in 1920. But I dare say there is scarcely a railroad of consequence in the United States that at some time or other since 1920 has not made application to the Interstate Commerce Commission for permission to issue or reissue a security of some kind. And the rules of the Commission require that there shall be reported to that body upon such application not only the particulars about the issue sought to be made then, but all particulars about all outstanding issues of stocks and bonds. So that without having checked the matter up carefully, I am quite convinced there is not a railroad in the country which has not filed with the Interstate Commerce Commission in connection with its application for authority to issue securities, all the material covered by the second section of that part I am now discussing.

The CHAIRMAN. This bill would not interfere with that in any way, would it?

Mr. FLETCHER. It would require railroads to give all this information again to the Federal Trade Commission, as I read the bill.

Mr. PECORA. Well, inasmuch as such information is given to the Interstate Commerce Commission, couldn't duplicate copies thereof be made and filed with the Federal Trade Commission?

Mr. FLETCHER. Do you mean from time to time as they are currently submitted to the Interstate Commerce Commission?

Mr. PECORA. Yes.

Mr. FLETCHER. That might be done, Mr. Pecora, but with all the labor involved in going back and reviewing the history for 20 years; no, not for 20 years but for 13 years, since section 20(a) was enacted, and filing such reports again with the Federal Trade Commission.

Now, Mr. Chairman, inasmuch as the Interstate Commerce Commission, which is a branch of the Government, has all that information, it could be readily obtained by the Federal Trade Commission upon application to the Interstate Commerce Commission, and therefore why should the railroads be required to go to the expense and the trouble of doing that again?

I will not take up your time to elaborate on that point, but will content myself by saying, Mr. Chairman, that as to every one of the items in section 11, and comprising 11 items, all except item (8) are exactly in that same category. The information here required is either on file with the Interstate Commerce Commission as a part of the annual reports of the carriers or else it has been filed with the Interstate Commerce Commission in connection with finance applications made to the Commission.

And that is true with reference to subsection (6), particulars regarding bonus and profit-sharing arrangements. It is also true in regard to subsection (7), particulars regarding management and service contracts; also as to subsection (8), particulars regarding material contracts not made in the ordinary course of business, and material patents; and also as to subsection (10), balance sheets; and also as to subsection (11), profit and loss statements for preceding years certified by independent public accountants. I could give you specific reference to the rules of the Interstate Commerce Commission along this line, but I do not want to burden the record unnecessarily. I am perfectly willing to have my statement checked on that, however.

Now, as to subsection (8), particulars of options in respect of securities existing or to be created, I do not think that information is with the Interstate Commerce Commission, but I doubt if it is very important in connection with the marketing of railroad securities, although you gentlemen are better judges of that than I am.

Mr. PECORA. Such information could be given in regard to options, I take it.

Mr. FLETCHER. I presume so, Mr. Pecora.

Mr. PECORA. That would not impose any particular burden or expense on the carriers, would it?

Mr. FLETCHER. I would not think so, as to that particular single item. Now, Mr. Chairman, in subsection (11) on page 24 of the bill, particularly along about lines 20 and 21, it is proposed to require that profit-and-loss statements for preceding years certified by independent public accountants, shall be furnished. I dare say that is a clause to which your attention has already been directed by other interests, and arguments made against it, but in the case of the railroads, some of which are nearly 100 years old, you can understand what an expense that would be, and what a burden it would be for such a railroad to have to go back to the beginning of its activities and furnish statements made by independent public accountants. And I think that is especially inapplicable to railroads, or rather it

is inapropos, if I may use a better word, so far as the railroads are concerned, because all accounts of railroads are kept in accordance with the regulations of the Interstate Commerce Commission, and they are fully regulated. I should like to respectfully suggest that that clause of the bill be made not applicable to railroads.

Mr. PECORA. You interpret paragraph (2) of section 12 (a) as requiring railroad corporations to furnish to the Federal Trade Commission annual and quarterly reports as of times prior to the effectiveness of this enactment, do you?

Mr. FLETCHER. Well, I had not really gotten to section 12 of the bill yet, but of course I am there since you ask me the question. I should say that that rather refers to the future, or at least it seems so to me, that particular section that you now call my attention to.

Mr. PECORA. Yes.

Mr. FLETCHER. I need not long detain you as to section 12 of the bill, because that is of the same general nature as section 11, and deals with information which shall be furnished to the Federal Trade Commission by the carriers, and among other things, annual and quarterly reports, including balance sheets and profit-and-loss statements certified by independent public accountants; and, Mr. Pecora, as counsel for the committee, I think you correctly suggested as I see it that that would probably apply to the future. There would not be any great amount of expense or labor involved in making duplicates of such reports as the Interstate Commerce Commission requires, and filing them with the Federal Trade Commission; except that I would want to make the same objection in that case as in the other as to the provision requiring certification by independent public accountants. The Interstate Commerce Commission very closely supervises all these accounts. Inspectors of the Interstate Commerce Commission visit the offices of the carriers insofar as their funds will permit them to do so, to see that those accounts are kept correctly. But, I doubt whether any great amount of good could be accomplished in the case of railroad accounts by making it necessary to file that sort of independent report.

Mr. PECORA. How frequently do railroad companies file audited reports with the Interstate Commerce Commission?

Mr. FLETCHER. They have to file various reports. Some have to be filed monthly, some have to be filed quarterly, and all have to be filed annually. The rules of the Interstate Commerce Commission make some distinction between what must be contained in the monthly report, and ordinarily that is a report of revenues and expenses.

Mr. PECORA. Somewhat like the provision of subsection (3) of section 12 (a).

Mr. FLETCHER. Somewhat like that; yes.

The CHAIRMAN. You may proceed.

Mr. FLETCHER. Just to give the committee an idea of the number of reports that have to be filed with the Interstate Commerce Commission and other branches of the Government by the railroads I will enumerate them:

They make 90 separate types of periodic reports to the Interstate Commerce Commission.

They make 13 reports to the Post Office Department.

They make 18 reports to the Treasury Department.
They make 4 reports to the Commerce Department.
They make 14 reports to the Geological Survey.
They make 28 reports to the United States Railroad Administration, what is left of it.
They make 8 reports to the United States Department of Agriculture.
They make 5 reports to the Board of Mediation and Conciliation, which administers the Railroad Labor Act.
They make 2 reports to the United States Bureau of Mines.
They make 4 reports to the War Department.
They make 1 report to the Alien Property Custodian.

Now, gentlemen of the committee, out of that mass of information thus contained it would seem to us the Federal Trade Commission could find out everything they might want to know about the railroads.

The CHAIRMAN. Railroad companies and their securities are exempt under the securities act.

Mr. FLETCHER. From the registration provision of that act. And in a general way that is what I seek here. But they are not exempt from the police part of the act if I may use such an inapt phrase. Those who are responsible for the issuance of securities, that is, to see that they are making correct statements, the railroads are not exempt from that. They are not exempt from liability for making full disclosure, but they are exempt from the registration provisions of the securities act.

Now may I mention in passing a provision of section 18 of the bill which to us seems unsatisfactory. That is the provision which gives to the Federal Trade Commission the right to direct the accounting methods and practices of carriers, with the proviso that rules or regulations so adopted by the Federal Trade Commission shall not be inconsistent with the requirements of the Interstate Commerce Commission.

I have had some little uneasiness about the term "inconsistent" because as I see it they could go beyond what the Interstate Commerce Commission has done. They cannot make a requirement which is contrary to what the Interstate Commerce Commission requires, but they could go far beyond that. And it seems to me that provision ought to be amended, if I may respectfully so suggest, to say that the power of the Federal Trade Commission shall not extend at all over accounts of carriers in view of the fact that they are now so fully regulated by the Interstate Commerce Commission.

May I say this about section 13 of the bill, and then I think that will be all I have to say. This is the provision about proxies. I dare say the committee has heard a good deal about that, and I do not want to repeat what some other and better-informed witness than myself may have submitted to the committee, but, without taking the time to read the section, you will note that when proxies are solicited for a meeting of stockholders it is necessary to give information as to the purposes of the meeting, and, more particularly—and this is the thing I want to lay stress on—they must send to each stockholder a list of all other stockholders from whom they are soliciting proxies.

In the case of the Pennsylvania Railroad—and I simply take that carrier as an illustration because it is the largest railroad—they have 250,000 stockholders. To assemble that number of stockholders together in an annual meeting, which may be only for the purpose of electing directors or of performing some other necessary but rather perfunctory task, is not possible. In other words, it would be impossible to get 250,000 people together, scattered as they are throughout the country and beyond, and therefore it is absolutely essential, if the law is to be applied, that stockholders may be asked to send their proxies in to a proxy committee. But, further, if the Pennsylvania Railroad has a print a book with the names and addresses of 250,000 stockholders, and print 250,000 copies of it, and send a copy of that book to each and every stockholder, why, gentlemen of the committee, it would be almost impossible to hold an ordinary meeting of stockholders of that great railroad.

Mr. PECORA. Objection has been made to that section, and the suggestion given that merely one copy of the list of stockholders and their addresses be filed with the Federal Trade Commission.

Mr. FLETCHER. Well, you see the point I am making about that.

Mr. PECORA. Yes.

Mr. FLETCHER. And this all leads me, Mr. Chairman, to make this suggestion. That the committee give consideration to adding to paragraph 10 of section 3 the following words:

> Nor any security issued by a common carrier which is subject to the provisions of section 20 (a) of the Interstate Commerce Act as amended

That is the section which exempts Federal issues from the obligation here.

I thank you very much for permitting me to appear before you.

The CHAIRMAN. Do you want railroad issues put on the same basis as Federal issues?

Mr. FLETCHER. I think so far as registration, issuing, accounting, and reporting are concerned; yes. I am very much obliged to you gentlemen.

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

(Thereupon Mr. Fletcher left the committee table.)

The CHAIRMAN. Is Mr. Comstock present?

Mr. COMSTOCK. Yes, sir.

The CHAIRMAN. Please come forward to the committee table.

STATEMENT OF LOUIS K. COMSTOCK, NEW YORK CITY, PRESIDENT OF THE MERCHANTS' ASSOCIATION OF NEW YORK

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

Mr. COMSTOCK. My name is Louis K. Comstock, New York City. I appear here, Mr. Chairman, on behalf of the Merchants' Association of New York, of which I am president.

The CHAIRMAN. Well, do you wish to offer some views regarding the bill the committee has under consideration, S. 2693?

Mr. COMSTOCK. Yes, Mr. Chairman.

The CHAIRMAN. You may proceed in your own way.

Mr. COMSTOCK. The Merchants' Association of New York, representing some 4,500 business enterprises and touching almost every

branch of business and industry in the Nation, is profoundly disturbed by some of the provisions of the Fletcher-Rayburn bill to regulate security exchanges.

It is disturbed primarily by the extent to which the terms of these bills would subject all business and industry, both large and small, in this country to arbitrary bureaucratic control, and secondarily to the restrictions which would be placed upon the open market for corporate securities.

The association frankly recognizes that the period of economic depression, which we are now experiencing, has emphasized faults and abuses in the financial system under which we were operating in the preceding period of prosperity. It has no desire to condone the abuses nor to perpetuate the faults, but it does insist that in the effort to remedy these faults and abuses we should not cripple legitimate business, stifle initiative, destroy the liquidity of securities or place our private business at the mercy of bureaucratic inquisitors operating under blanket authority.

As business men, we believe that under any sound, advanced form of financial organization we are entitled to a market to supply our needs for long-period capital and to an organization capable of transferring ownership rights in already existing securities promptly and efficiently.

The Federal Securities Act, through its too drastic restrictions, liabilities, and penalties, has to a dangerous extent deprived us of the opportunity to obtain new long-period capital on reasonable terms. The Federal Banking Act of 1933, by requiring the divorce of banking affiliates from our large commercial banks, has greatly restricted the organizations engaged in or capable of carrying on investment banking. This association approves of the divorce of banking affiliates, but it desires to point out that this proper act, taken in connection with the restrictions of the Federal Securities Act and the provisions of the Fletcher-Rayburn bill prohibiting the exercise of the functions of broker and underwriter by the same persons or companies, will so greatly restrict the capacity to perform the functions of investment banking as to make unnecessarily difficult the supply of long-period capital which is absolutely essential for the return and maintenance of industrial and business prosperity.

We are also mindful of the fact that labor is indirectly concerned with this aspect of the matter because when there is insufficient capital available to a company it cannot employ as many workers as it otherwise would.

Lodging the control over the securities market in the hands of the Federal Trade Commission is open to very serious objections. Since its creation over 20 years ago the Federal Trade Commission has been given various duties from time to time. The most important of these duties were imposed by the Federal Securities Act of 1933. These duties are sufficiently important to require all the time and ability which the members of the Commission may possess without adding thereto the task of supervising and preparing regulations for the conduct of an extremely technical, delicately adjusted, business with manifold ramifications into every part of the world.

We respectfully submit that if a Federal regulatory body is to be set up at all it should be set up for the sole and specific purpose

of regulating security exchanges and that a large majority of its members be men thoroughly familiar with the problems of security markets.

We also urge, inasmuch as by far the greater part of the securities exchange business is concentrated in New York City, that the office of whatever regulatory body is set up should be located in New York City, the business capital of the country, in order to relieve business men from the expense and delay inseparable from transacting business with a regulatory body located in Washington.

It is common knowledge that the reports required by the Interstate Commerce Commission impose a tremendous cost upon the public utilities now under its regulation. It is also common knowledge that the Federal Trade Commission has from time to time required corporations to expend huge sums gathering information for that body from which little or no constructive results are discernible.

We are fearful that if the body charged with the regulation of security exchanges, and of securities listed thereon, is given the blanket authority proposed in the Fletcher-Rayburn bill to require information of the issuers of all securities listed on exchanges, it will result in great waste and extravagance for the compilation of information which will have little or no real value when submitted.

Our great railroad corporations find the expense of filing information for the Interstate Commerce Commission a serious item. Compilation of similar records for the Federal Trade Commission would be a very serious burden upon businesses of ordinary size and might be particularly burdensome if called for in periods of seasonal activity. The tendency to require too voluminous and repetitious information would be particularly strong if the regulatory body were made the Federal Trade Commission and the Commissioners themselves were so preoccupied with their many other duties that the actual work of investigating and analyzing reports on business organizations was left to subordinates.

We therefore strongly urge that the power of the regulatory body to demand information be sharply restricted.

The very broad definitions of "member", "broker", and "dealer" contained in section 3 make the requirements of section 6 unnecessarily restrictive of credit on the securities of companies not listed on an exchange.

While New York is, of course, the headquarters for very many large companies as the most important center of commercial business, and is the largest manufacturing center in the country, it is also the home of an even greater number of comparatively small and medium-sized companies whose securities are not listed on any exchange, but which are thoroughly sound and profitable. Their securities are certainly entitled to some credit facilities from persons who are acquainted with their worth. This criticism is even more pertinent if the definition of a "member" includes a bank buying or selling securities for its own account or as agent for its customers.

The weaknesses and limitations of the margin requirements proposes in subdivision (b) of section 6 have been thoroughly discussed by others, and the Merchants' Association, in this respect, will merely record its concurrence in the objections already raised, except that

it particularly objects to the adoption of any restriction which would lead to a wave of deflation through forced liquidation of loans.

We are strongly inclined to believe that the present margin restrictions of the New York Stock Exchange are sound and reasonable and that the control of margin requirements should be left in the hands of this body on the ground that it is thoroughly conversant with past experiences in this field and able to act quickly and effectively to remedy faults in the situation as they arise because of its intimate acquaintance with daily developments. Certainly, if any margin requirements are to be written into law, they should only be of the most flexible nature.

The provisions of sections 7 (c) and 10, which prohibit a broker from acting as a principal, apparently would so restrict his activities as to make impractical the odd-lot business which is the only means by which many thousands of legitimate investments can be made. We cannot see any legitimate objection to a man investing in less than 100 shares of high-grade stocks nor any reason for penalizing him, other than the small premium required by the rules of the New York Stock Exchange for purchasing less than a round lot. A purchase of 90 shares of American Telephone & Telegraph Co. stock, for example, involves over $10,000, but if the odd-lot business is practically destroyed, as is reasonably argued it would be under the terms of this bill, a man would be practically prohibited from making use of such an investment to finance his business and he would be thereby encouraged to invest in lower-grade stock. We are firmly of the opinion that any advantage which may be gained by separating completely the operations of a broker and of a dealer would be more than offset by the penalty placed upon millions of legitimate investments, particularly those of men and women of small means or businesses of moderate size.

We believe that the provisions of section 13, which require any person soliciting a proxy to send to the person solicited, the names and addresses of persons from whom similar proxies are being solicited, is another instance in which the disadvantages outweigh the possible advantages. The necessity for printing a stockholders' list every time a stockholders' meeting was held would be a considerable item of expense without compensating advantage in a great majority of cases. We recommend that this provision be eliminated.

Mr. PECORA. Suppose that provision were modified so as to require the filing of a list of all stockholders of record and their addresses with the Federal Trade Commission, and would not require the sending of a copy of such list to every stockholder of the company when any proxies are sought?

Mr. COMSTOCK. That would decrease the objection considerably.

Mr. PECORA. It would practically cause the objection to disappear, would it not?

Mr. COMSTOCK. No; I do not think it would cause it to disappear, but it would decrease it.

Mr. PECORA. What would be the objection to filing a list of stockholders and their addresses with the Federal Trade Commission, if their proxies are sought?

Mr. COMSTOCK. Stockholders' lists are constantly changing.

Mr. PECORA. At the time that stockholders' lists are used for the obtaining of proxies, usually the stockholders of record as of a given date are those whose proxies are sought; isn't that so?

Mr. COMSTOCK. Yes; that is correct.

Mr. PECORA. Could not that date be the date fixed for making up the list?

Mr. COMSTOCK. I suppose that is so; yes.

Mr. PECORA. Would not that cause your objection, then, to disappear?

Mr. COMSTOCK. No; I do not think it would cause it to disappear. It would decrease it a good deal.

Mr. PECORA. What would be the objection?

Mr. COMSTOCK. I would like to put that the other way around. What could be the purpose of filing it with the Federal Trade Commission? I mean, what beneficial purpose would it serve?

Mr. PECORA. Conceivably the management of a corporation, through seeking proxies, which proxies they may readily seek because they have available to them at all times the list of the stockholders and their addresses, might, through that exclusive information which they have, be able to effectuate a purpose that might be selfish and might be inimical to the best interests of all the stockholders. If another stockholder or group of stockholders also wanted to seek proxies they would not have the list of stockholders available. The insiders in the corporation would have a decided advantage.

Senator KEAN. Would it not be much better to file it with the exchange where the stock is listed, and therefore where the stock is traded in, and therefore where the majority of stockholders would have ready access to it?

Mr. COMSTOCK. I should think so.

Mr. PECORA. Why not file it in an office of public record?

Senator KEAN. That would be an office of public record so far as the stockholders are concerned.

Mr. COMSTOCK. I think it is fair to say that if it would serve a beneficial purpose I do not think there would be any reasonable objection to it.

Senator KEAN. In the one case the stockholders, or body of the stockholders, would have to come down here to Washington and look it up, and in the other case they would go to the exchange where they bought the stock, and where the thing was readily available, and they could look at it there.

Mr. PECORA. File it in both places then.

Senator KEAN. It seems to me common sense would dictate——

Mr. PECORA. I should think the stock exchanges would prefer to have it filed with the Federal Trade Commission, rather than to have their own offices made the sole depositories for such lists, thereby subjecting themselves to whatever annoyance might ensue from having hordes of stockholders flock to their offices with a view of consulting the records.

Senator KEAN. Of course, under nearly every law I know anything about, any stockholder has a right to go and examine that list at the office of the company.

Mr. COMSTOCK. That is correct.

Senator KEAN. But, in addition, I think it would be a good thing to have that list on file where the stock is traded in, so that it would be available immediately to any stockholder.

Mr. PECORA. Don't you think, Senator, such a list should be in a public place?

Senator KEAN. Yes, Mr. Pecora; but I think that a public place would be a place where that was open to the public. If the stock exchange had that list, and everybody knew it was open to the public, it would be more convenient for the public to have it where the stock is dealt in, rather than with the public officials here. It is not as handy in the public offices here to get any information—at least I have not found it so—as it is in the stock exchange.

Mr. COMSTOCK. Suppose such a list were filed with the Federal Trade Commission or with the New York Stock Exchange, or some other stock exchange. Presumably the purpose of filing it is to confer some benefit on the other stockholders. Now, suppose you have a stockholder in London, or in Tokyo, or San Francisco, or Valparaiso. What good will it do them?

Mr. PECORA. I do not know, but it might do a lot of good to stockholders who were not in Tokyo or Valparaiso or anywhere else, and I imagine that that would include nearly all the stockholders.

Mr. COMSTOCK. That is true in a good many cases, but there are a good many cases where that is not true.

Mr. PECORA. The greatest good to the greatest number should be the fundamental principle of all legislation.

The CHAIRMAN. These foreign stockholders would probably have representatives or friends here to look after their interests.

Mr. COMSTOCK. They might have.

The CHAIRMAN. All right. Proceed with your statement.

Mr. COMSTOCK. The Merchants' Association objects, on behalf of the many small companies which are not listed on any exchange, but which within narrow circles are well known, to the provisions of section 14 insofar as they would prohibit dealing in unlisted securities without complying with all the rules and regulations which the Commission might see fit to prescribe.

Mr. PECORA. What is the reason for that objection? What is the argument in support of your objection there?

Mr. COMSTOCK. Well, it unnecessarily hampers the dealing in securities which are not listed anywhere, as between individuals.

Mr. PECORA. It would make available to all individuals an assurance that the trading, which is now more or less practically unregulated in the over-the-counter market, would be subject to some definite, uniform regulation. I should think that would be beneficial to all investors who deal in unlisted securities.

Mr. COMSTOCK. There are many securities that are not even traded in over the counter, which would be affected by this.

Mr. PECORA. The statement has been made here that there are thousands of such corporations whose securities are not listed, and are subject to trading in the over-the-counter market. The statement has been made that their number vastly exceeds the number of issues that are listed on stock exchanges.

Mr. COMSTOCK. That is very likely true.

Mr. PECORA. You say there are not very many. The opinion expressed here by persons, apparently, with competent knowledge on

the subject, is that the number of unlisted security issues vastly exceeds the listed issues.

Mr. COMSTOCK. I do not think we have any accurate information on that subject.

Mr. PECORA. I am merely giving you the opinion expressed to the committee by persons whose business and experience, apparently, endow them with some form of authentic knowledge on the subject.

Mr. COMSTOCK. The Merchant's Association questions the desirability of the provisions of section 16, which would permit the Federal Trade Commission to require the preparation of any accounts and records which it sees fit, and to assess the expense of any examinations made by its order against the company examined. This is very broad inquisitorial power bordering closely on deprivation of property without due process of law. It is obviously open to great abuse at the hands of subordinates and could be carried to an extent which would make a given business unprofitable through too great an increase in its overhead.

Mr. PECORA. Why would not that objection apply also to banks that are now subject to the inquisitorial powers of the Comptroller of the Currency, and, in the case of State banks, of State banking commissioners?

Mr. COMSTOCK. It might apply there. I am not thinking of that. I am not saying anything about that.

Mr. PECORA. Would you then advocate the repeal of the statutory provisions for such examinations of banks?

Mr. COMSTOCK. I do not think it is so much a question of the principle of the thing as it is in the abuse of the principle.

Mr. PECORA. That same abuse is possible in the case of bank examinations, is it not?

Mr. COMSTOCK. It probably is.

Mr. PECORA. The principle has not been abused there. What reason is there for believing that it would be abused by the Federal Trade Commission?

Mr. COMSTOCK. It may have been abused there.

Mr. PECORA. There has not been any great agitation about any such abuse that I have ever heard.

Mr. COMSTOCK. If these charges were reasonable, if the periodicity of the examinations were reasonable, it might be something that business could bear all right, but the point is, nobody knows how unreasonable they might become.

Mr. PECORA. What is the use of assuming that any legislation would be unwise merely because an abuse is possible under it? Measured by that standard or test, every piece of legislation, conceivably, could be branded as unwise, because it is possible to abuse any power, however wholesome the power might be.

Mr. COMSTOCK. Still, there is nothing here——

Mr PECORA. The directors of a corporation conceivably could abuse the power they have in directing the affairs of the corporation, but merely because of that you would not deprive the directors of any power at all, would you?

Mr. COMSTOCK. Oh, no.

Senator KEAN. Is it not true that a bank is in quite a different situation, because a bank has to have, at the present time, at least,

$100,000 capital, and it is supposed to have over $1,000,000 in deposits if it has $100,000 capital, and therefore it is a much larger concern, and therefore it is much easier to examine than an industrial company with, say, $50,000 capital and inventories all over the place that have to be checked. It would be a much easier thing to check the bank than it would be to check an industrial company. The cost of checking an industrial company would be much greater than the cost of checking a bank.

Mr. COMSTOCK. Its percentage of the general overhead would be much greater, without doubt.

Mr. PECORA. Are we not assuming a lot?

Senator KEAN. No; I do not think we are assuming very much, Mr. Pecora.

Mr. PECORA. We are assuming that an abuse of power is possible, and hence the power itself should not be granted. As I said before, by that test you could condemn any piece of legislation which gave power to any public officer or board.

Senator KEAN. Yes; but by having too many requirements for examination you could kill any business.

Mr. PECORA. Any and all power, whether vested in a public officer or exercised by a private individual, is capable of abuse. You are going to destroy the entire fabric of civilization if, for that reason, you are going to deprive all persons of the exercise of all power. You have to lodge it somewhere. We must assume that the power will be exercised with sense and discretion, or, as the United States Supreme Court said in a famous case many years ago, the rule of reason would prevail. I think that is a fair assumption.

Mr. COMSTOCK. Of course, there is quite a decided difference between examinations by public authority of banks and examinations by public authority of a private business. Banks are fiduciary establishments. A private business is not.

Mr. PECORA. Where the business or the corporation, through offering its shares to the public, invites the public to become part owners of the business or partners in the business enterprise, do you not think the public is entitled to have some detailed and authentic knowledge concerning the busiess in which it is invited to participate as a partner? Would you, for instance, think of entertaining a proposition made to you in your individual capacity to become a part owner of a private business, unless you were given some information or permitted to have access to records which would enable you to reach a judgment as to whether or not you wanted to invest?

Mr. COMSTOCK. I could get that kind of information from which to make a judgment myself, probably better than the Government could.

Mr. PECORA. In the case of corporations which invite the public generally, through the offer of their securities to the public, do you not think the general public should have the information?

Senator KEAN. Mr. Comstock, are we not talking about——

Mr. PECORA. Do you think a corporation would prefer to have every investor flock to its offices and make a lot of inquiries concerning its business, rather than to file statements at regular intervals with a public body?

Mr. COMSTOCK. The objection to this provision applies more to the small corporations than it does to the big corporations.

Senator KEAN. We are talking about unlisted securities.

Mr. COMSTOCK. Absolutely.

Senator KEAN. We are talking about the little $25,000 or $50,000 corporations in the little towns.

Mr. PECORA. But, Senator, this provision here does not apply only to corporations whose securities are unlisted.

Senator KEAN. But the majority of corporations in the United States are little corporations which are locally owned, and they are not offering their securities to the public. They are owned by a few people that know each other, that have access to the books. They do not care to have outsiders buy them, as a rule.

Mr. COMSTOCK. And the expense of a governmental supervision——

Mr. PECORA. Conceivably, then, no situation would arise where the Federal Trade Commission would make unreasonable requests for examination of the records of such a corporation. The Federal Trade Commission, I imagine, would act only in cases where there was evidence of an active public interest.

Mr. COMSTOCK. Still, the way is open here in this bill for them to do it.

Mr. PECORA. As I said before, we ought to assume that powers vested in a public body are going to be exercised with sense and discretion.

We apply that rule in our business affairs. Even in an unincorporated business we put persons in charge of departments and leave it to the discretion and judgment of those subordinates with regard to the actual daily operation. That power can be abused, but you would not for one moment think that the ideal form of operating a business is for the owner to attend to every detail himself and make every decision in the routine operation. It is unreasonable. It is contrary to every-day experience.

Mr. COMSTOCK. The point we desire to make here is that there is provided in this bill an inquisitorial power over the small corporation that is not balanced by any good that could come from it.

Mr. PECORA. You are assuming that the inquisitorial power is going to be harshly and unreasonably exercised, and at an undue expense to the corporation.

Mr. COMSTOCK. May we not be justified in that assumption?

Mr. PECORA. I do not know why. What basis have you for the assumption? What greater basis have you for such an assumption than you have for the assumption that the power would be reasonably and wisely exercised?

Mr. COMSTOCK. That is a question of opinion, I think.

Mr. PECORA. I am asking you for experience that you might cite to support your view.

Mr. COMSTOCK. Of course, we have no experience as yet on the application of this law.

Mr. PECORA. But I mean in the past, with regard to the unreasonable exercise of corresponding powers.

Mr. COMSTOCK. I think I could cite some cases there—not at the moment, but I am perfectly certain that they are available.

Mr. PECORA. I think you would have to search your mind pretty carefully.

Mr. COMSTOCK. I do not know. I do not think so.

The CHAIRMAN. Proceed, Mr. Comstock.

Mr. COMSTOCK. This association further objects to the exemption of the employees of the Federal Trade Commission from the requirements of the Federal civil service law as provided in section 30. Past experience with newly created Federal agencies has proven that such an exemption provides a large amount of political patronage and that the efficiency of any agency staffed in this manner is greatly reduced. We respectfully submit that any regulatory body set up with broad powers over security exchanges and general business must be as free from political influence and the inevitable inefficiency which goes with political patronage as possible. We therefore strongly urge that this section be amended to require that all of the employees of the regulatory body, with the possible exception of a few technically qualified chief subordinates, be recruited under the restrictions of the Federal civil service law.

In conclusion the association believes that unless this bill is substantially modified in the directions outlined above, its enactment would do more harm than good both to the business community and the investing public by causing deflation of sound loans, by unduly restricting the investment market for long-term capital, by unwarranted restrictions upon credit facilities for the securities of small companies and small investments, and in the laudable endeavor to protect the investing public against fraud, will so cramp that same public with bureaucratic methods and control as to destroy or reduce the value of sound securities far more than the sum which may be saved by reducing fraud.

We most earnestly urge that the importance of the question involved is such as to warrant the most careful consideration for every proposed phase of this subject and the enactment of legislation after mature deliberation. Above all whatever statute is enacted should not be punitive in spirit nor intended to substitute Government supervision and control for the initiative and detailed knowledge which can only come from long and intimate acquaintance with the manifold forms of business organization and needs.

Mr. PECORA. Might I ask a question or two? In the second paragraph of your statement you say that your association is disturbed primarily by the extent to which the terms of this bill would subject all business and industry, both large and small, in this country to arbitrary, bureaucratic control. What is the arbitrary bureaucratic control that you refer to there?

Mr. COMSTOCK. I think it has been rather more or less explained all the way through the paper. It is that control which places under constant examination, at the will of the Federal Trade Commission, the accounting, and the ways of doing business of thousands of small corporations.

Mr. PECORA. What is there here which gives power to the Federal Trade Commission to determine the ways by which a corporation would have to do its business?

Mr. COMSTOCK. Well, the whole bill does that

Mr. PECORA. I think that is a very broad statement. Can you point to a single instance of any provision of this bill which would operate to give the Federal Trade Commission control and the

power to determine the way in which any corporation must do its business—conduct its actual, corporate business?

Mr. COMSTOCK. I do not think the use of the word "control" here is used in the sense you have just used it.

Mr. PECORA. You say that this bill would subject all business and industry, both large and small, in this country to arbitrary bureaucratic control. That is a very broad statement and I wondered if you really meant it to be as broad as its terms imply.

Mr. COMSTOCK. It may be broader than we meant to have it, but at that, the control there is pretty broad, even so.

Mr. PECORA. Does not the control, so-called, given by the bill to the Federal Trade Commission relate almost entirely, if not entirely, to the requiring of corporations to make reports?

Mr. COMSTOCK. Yes. That is what this word "control" means here.

Mr. PECORA. And also to prescribe the form and content of those reports.

Mr. COMSTOCK. Yes, sir. That is what we mean by control.

Mr. PECORA. That is not control of the business.

Mr. COMSTOCK. No. I do not think it is so intended here. That is not the meaning of that phrase.

Mr. PECORA. The language is capable of that interpretation.

Mr. COMSTOCK. That is possible; yes.

Mr. PECORA. Do you favor the adoption of a uniform system of accounting for corporations?

Mr. COMSTOCK. It depends on what you mean by a uniform system. If you mean the same system that the United States Steel Corporation employs and the A.B.C. Grocery Stores employ, then I am not in favor of uniform accounting, because you cannot make the systems apply.

Mr. PECORA. But there are certain uniform principles of accounting that might be made general to the accounting of all corporations. At the same time there are perhaps certain kinds of corporations with details or features that would not be common to all. But insofar as it would be possible to establish certain fundamental principles of uniformity, would you favor that?

Mr. COMSTOCK. Yes; I would. But I would make this qualification. I would favor it within competitive circles. Where businesses are competitive with each other, then I think the uniform accounting is a fine thing, a splendid thing.

Senator KEAN. I would like to ask you, after reading this bill and studying it, with regard to these smaller corporations, whether this, in your opinion, is not an attempt on the part of the Government of the United States to seize the rights of the States in the control of corporations which do not do an interstate business. The Constitution applies to corporations doing an interstate business; that is, the Constitution applies to companies engaged in interstate commerce. This is attempting to regulate corporations that do not do an interstate business, is it not?

Mr. COMSTOCK. Yes, sir.

Senator KEAN. That is one of your objections to it?

Mr. COMSTOCK. Yes.

Mr. PECORA. Have you made a study of the bill for the purpose of arriving at an opinion as to whether or not the bill is constitutional?

Mr. COMSTOCK. No, sir; I have not.

Mr. PECORA. Then, how can you answer Senator Kean's question in the absence of such a study?

Mr. COMSTOCK. I think it is perfectly easy to do that.

Mr. PECORA. You can do something more than most individuals.

Mr. COMSTOCK. I do not know of anybody who can pass upon the constitutionality of this bill, or any bill, except the United States Supreme Court.

Mr. PECORA. That has the power of making the final decision.

Mr. COMSTOCK. Yes.

Mr. PECORA. But it is open for anyone who is qualified by education, training, and experience, and who makes a study or research on the question of constitutionality, to reach an opinion.

Mr. COMSTOCK. That is an academic opinion, is it not?

Mr. PECORA. You say you have not made such a study of this bill.

Mr. COMSTOCK. That is an academic opinion.

Mr. PECORA. You have not made such a study of this bill?

Mr. COMSTOCK. Not from that point of view.

Mr. PECORA. Then how could you say whether or not the bill is constitutional?

Mr. COMSTOCK. I do not think I made that statement. I did not say the bill was unconstitutional.

Mr. PECORA. Your answer to Senator Kean's question was such that it could only, intelligently, be based upon an opinion as to its constitutionality.

Mr. COMSTOCK. He asked a certain question, which did not refer particularly to the Constitution, and I answered it in a perfectly proper way, from my point of view.

The CHAIRMAN. Have you anything further to say, Mr. Comstock?

Mr. COMSTOCK. No, sir. That is all. Thank you.

The CHAIRMAN. We are very much obliged to you.

Mr. COMSTOCK. Thank you very much, Mr. Chairman.

STATEMENT OF HERBERT FILER, NEW YORK CITY, DEALER IN PUTS AND CALLS, 39 BROADWAY, NEW YORK CITY

Mr. FILER. Mr. Chairman and gentlemen of the committee, my name is Herbert Filer. I am a broker and dealer in puts and calls, and I represent the put-and-call brokers and dealers of New York City.

The CHAIRMAN. We will be glad to have your views about this bill.

Mr. FILER. I should like to present a statement in reference to section 8, subsection 9 of the proposed bill, which abolishes all puts and calls.

On behalf of the committee of put-and-call brokers and dealers, may I present to you this brief, the intention of which is to show that puts and calls, which are to be prohibited under the present proposed legislation, should be divided into two classes—those which are handled by the legitimate put-and-call brokers and dealers, whom we represent, and those which are granted by corporations or companies for manipulative purposes.

I wish to prove that the put-and-call contracts which we handle have great economic value and submit that in the proposed legisla-

tion a clear distinction should be made between the two kinds of options.

In setting forth the economic importance of the puts and calls which we deal in in the securities markets, we wish to emphasize three major elements: First, their value for insurance against loss; second, their stabilizing quality; third, the opportunity afforded the operator to protect a position in the market at minimum risk.

The CHAIRMAN. You are a member of the New York Stock Exchange?

Mr. FILER. No, sir; a member of no exchange.

Mr. PECORA. You are in the put-and-call business?

Mr. FILER. Yes, sir.

A call is a negotiable contract giving the holder the right to purchase from the maker, for a specified length of time, a given number of shares of a certain stock, at a price fixed in the contract. The maker of the call agrees to deliver to the holder, at the holder's demand, a definite number of shares of a given stock at a stipulated price when the demand is made, before the expiration of the stipulated period of time.

A put is a negotiable contract giving the holder the privilege to deliver to the maker, for a specified length of time, a given number of shares of a particular stock, at a price stipulated in the contract. The maker of the put agrees to receive from the holder, at his demand, a fixed number of shares of a particular stock at a fixed price, if the demand is made before the expiration of the fixed period of time.

In appendix no. 1 will be found specimens of standard forms for put and call contracts employed by brokers and dealers in these contracts.

We wish to make it clear that this presentation refers entirely to privileges—puts and calls—sold on a competitive basis at a fixed premium and publicly offered, as distinguished from so-called corporation or company options frequently privately offered in large blocks for manipulative purposes.

Possibly it would be in the interest of clarity if a brief historical summary of puts and calls were presented to the committee. These contracts have been developed and sanctioned by business practice over a period of 2 to 3 centuries. Undoubtedly, they had their origin in transactions involving the merchandising of commodities, and in this respect are closely akin to the future contract system now in vogue and such an indispensable part of the marketing of all great staple commodities. As a matter of fact, the future contract system was devised entirely for the purpose of insurance against injurious price changes. The put and call system is in the same category, for it insures the investor in securities against violent fluctuations due to unexpected developments.

In the business world options are used every day in one form or other.

An instance of the use of the option contract in a business that probably is familiar to every member of your committee is its protective use in real estate transactions.

A manufacturer wishes to extend his factory space, provided business conditions in the near future make this advisable. To do so he has to acquire a large parcel of real estate.

In order to insure that he can buy the property when he needs it, without committing himself definitely to the payment of a large sum of money for the same, he is perfectly willing to pay a relatively small sum of money to the owner of the land for an option or call for a certain period of time.

It is true that if he should not go through with his plans he will lose the cost of the option, but it is equally true that the amount which he paid for the insurance was very well worth while.

In connection with put and call contracts it might be pointed out that John Houghton, in 1694, described how puts and calls were used in connection with dealings on the London Stock Exchange. In 1816 the transactions in puts and calls already had reached considerable volume on the Berlin Stock Exchange. Today there is no important financial center where puts and calls are not dealt in and where they are not known as an important adjunct to security dealings. At present, New York has developed into a large market for puts and calls, and financial interests all over the world are buyers of these contracts in New York.

Probably the most important function of puts and calls is the protection against unlimited loss they afford to the owner of stocks. The best method of illustrating the insurance feature of puts and calls would be to employ specific examples.

Let us take the case of United States Steel selling, say, at 55. An investor may have bought the stock at 53. He feels reasonably confident that his judgment has been sound, but he wishes to guard against any unforeseen contingencies. He consequently pays $137.50 for a put, this charge being in the nature of an insurance premium. The put price is 51. If, during the 30-day period, the market should decline and Steel, let us say, sells at 45 at the end of the 30-day period, he will deliver 100 shares to the writer of the put at 51. In other words, while the best price he can obtain on the stock exchange is 45, he has been able to dispose of his stock at 51 through the medium of the protection of his put contract.

An investor holds 100 shares of Steel at 53. He buys a call at 57 good for 30 days feeling that if he should sell his long stock, he can by reason of his call contract, recapture the stock at 57, if it is to his advantage to do so.

Thus far this memorandum has referred entirely to the buyer of these contracts. It should be interesting to describe the position of the seller of these contracts.

The maker of the put in the case of Steel, selling at 55, is willing to accumulate the stock at 51, if it should decline. In the event that the stock is put to him by reason of the premium of $137.50, less the commission charge, which he has received, the cost to him is reduced to that extent. In case the put is not exercised, the maker of the contract has received substantial compensation for the insurance contract.

As the seller of the call usually is the owner of stock, he is perfectly willing to sell the amount of shares represented by the call contract at the advance plus the premium he received.

It can be seen that in both the cases of the buyer of the put or call and the maker of these contracts that there may be in the majority of cases a mutual advantage.

In the opening paragraph reference is made to the stabilizing influence of the put-and-call contracts. The owner of a stock without put protection in a market that is unsettled and weak in many cases would be inclined to liquidate his holdings and add to the pressure on the market. With his courage fortified by the put he is completely immune from the panic psychology that besets other holders not similarly protected. The reverse would be the case in a boiling bull market when an investor who had previously disposed of his stock might be inclined to rebuy at an inflated price but is restrained from such impetuous action by owning a call which enables him to participate in the rise.

It is not the purpose of this memorandum to contend that puts and calls are free from speculative possibilities. The individual who buys the call pays a premium for the privilege of participating in the rise in the stock above the call limit, without actually owning stock. In the case of a strong, rising market, he may be able to reap a considerable profit before the expiration of the 30-day contract call period.

The buyer of a put may not be long of a stock and may wish to participate in any profits resulting from a sharp decline. Please bear in mind that this individual is not a short seller and that when he buys his stock against his put he is fully protected from loss and thus becomes a supporter of a falling market.

In the earlier part of this memorandum reference was made to the similarity between the put and call contracts in securities and the hedging operations in the case of commodities. Essentially they are the same. Numerous legislative decisions have sanctioned their validity, but it seems undesirable to take up the time of the committee by reciting these in detail. A typical instance should suffice, and the occasion is taken to cite the case of the *Board of Trade* v. *Christie Co.* (198 U.S. 236). In delivering his opinion Mr Justice Holmes, of the Supreme Court of the United States, said:

> Purchases made with the understanding that the contract will be settled by paying the difference between the contract and the market price at a certain time stand on different ground from purchases made merely with the expectation that they will be satisfied by set-off * * *. Hedging * * * is a means by which collectors and exporters of grain or other products and manufacturers who make contracts for the sale of goods secure themselves against the fluctuations of the market by counter contracts for the purchase or sale, as the case may be, of an equal quantity of the product or of the material of manufacture. It is none the less a serious business contract for a legitimate and useful purpose that it may be offset before the time of delivery in case delivery should not be needed or desired.

The foregoing completes our presentation of the modus operandi and merits of the put-and-call operations on the various security exchanges, except to mention that the United States Government derives a substantial income from the tax on call contracts under the 1932 Revenue Act.

Before we conclude we wish to emphasize to the utmost the sharp distinction between the two kinds of put-and-call contracts. The class we sponsor is competitively sold, openly offered for a stipulated sum, guaranteed by stock-exchange firms, and protected by margins as in the case of purchase and sale of stocks. These contracts have no kinship with options privately or secretly issued by individuals, groups, corporations, or companies who, seeing speculative opportu-

nities in a particular security, offer these options for manipulative purposes, usually in conjunction with pool operations. It is our understanding that such operations recently have come under the ban of the New York Stock Exchange.

We trust your committee will recognize the economic relation of these put-and-call contracts to the security markets not only of the United States but the entire world. In fact, the London Stock Exchange, the oldest institution of this kind, places only one restriction upon these transactions, namely, that they are not permitted to run over a period exceeding approximately 105 days.

We are firmly convinced that these contracts serve the useful purposes of providing insurance, of stabilizing the market, and limiting losses to the public.

In conclusion, may we respectfully call the attention of the committee to the fact that every form of property can be insured against partial or total loss, whereas put and call contracts furnish the only known form of insurance against unlimited loss in securities.

The CHAIRMAN. What is your responsibility to the holder? Suppose for one reason or another you are unable to carry out the contract. Are you liable in any way?

Mr. FILER. No, sir; and it says so on the face of the contract.

The CHAIRMAN. You are simply agent?

Mr. FILER. Yes, sir; but if I buy a man a contract I will deliver it to him.

In the appendix, too, Mr. Chairman, are some various court decisions. If they will go in the record I would rather not bother to read them.

The CHAIRMAN. Yes; that is not necessary. They may be incorporated in the record.

(The matter submitted by Mr. Filer as an appendix to his statement will be found in the printed record at the end of today's proceedings.)

The CHAIRMAN Are there any questions?

Senator KEAN. I would like to ask some questions. That is something I do not know much about, but I would like to ask you, is it not true that there is a tremendous business in puts and calls in London? That is true, isn't it?

Mr. FILER. Yes, sir.

Senator KEAN. And that a large part of the speculation in stocks in London is carried on by put and call?

Mr. FILER. So I have read.

The CHAIRMAN. In the case of puts and calls the parties do not own the stock at all; they just put up the difference, do they? There is no stock passed?

Mr. FILER. Oh, there is stock passed, absolutely.

Mr. PECORA. That is where the option is exercised?

Mr. FILER. That is where the option is exercised. It is my impression that in drawing up this bill these two classes of options were not recognized as being so totally different.

Mr. PECORA. Would you say, broadly speaking, a put or call is an option for a price and given at a price? That is, one pays for the option?

Mr. FILER. In buying or selling stock at a price.

Mr. PECORA. Yes.

Mr. FILER. Within a period of time.

Mr. PECORA. One pays for the option to buy and sell the stock at a price in the option?

Mr. FILER. That is right, within a period of time.

Mr. PECORA. Are there any statistics available to which you could refer us showing what proportion of cases puts and calls are exercised by the holders?

Mr. FILER. Well, of course, it is according to the activity of the market.

Mr. PECORA. Are there any figures or statistics available on that?

Mr. FILER. No. I could just say this, Mr. Pecora: I have been in the business about 15 years, and if you want to take my estimate I will be glad to give it.

Mr. PECORA. What would it be?

Mr. FILER. I would say that about 12½ percent of the options that are written are exercised. But because they are not exercised does not say they do not serve a valuable purpose in the meantime.

Mr. PECORA. I merely wanted to get whatever figures were available, and now you have given us some idea based upon your own personal business.

Mr. FILER. That is right.

Mr. PECORA. In dealing in puts and calls. You say that about one eighth of them are exercised?

Mr. FILER. About 12½ percent are actually exercised at expiration time. That is over a period of time in a normal market.

Mr. PECORA. Yes, sir; and the other seven eights, the persons who buy these puts and calls, do not exercise them, and what they have paid for them is lost to them?

Mr. FILER. It is not lost. It is similar to an insurance premium that a man pays for——

Mr. PECORA. Yes. I mean they do not get it back; they pay that for an option to buy or to sell the stock at a fixed price?

Mr. FILER. It is not lost. It is not a case of not getting it back. They may have received that insurance. It may be that because a man holding a put through a falling market does not sell his stock out at a loss, and before the 30 days are over can sell that stock out at a profit. Now, he may not exercise the option, but the option has served a very valuable purpose.

Mr. PECORA. It has served a potential purpose.

Mr. FILER. Served a real purpose.

Mr. PECORA. In other words, it gave him a certain amount of what you call insurance.

Mr. FILER. Actual insurance.

Mr. PECORA. Actual insurance. But if he does not exercise his option under the put or call, why, what he has paid, let us say by premiums, by way of that insurance, he is out of pocket?

Mr. FILER. He is out of pocket. I would not call it a loss, any more than I would call a loss when I pay a premium on fire insurance and my house does not burn down.

Mr. PECORA. You say, based upon your experience in this business that about seven eighths of the options are not exercised?

Mr. FILER. That is right.

The CHAIRMAN. I understand these put-and-call contracts are very much alike in their nature to hedging contracts on commodities.

Mr. FILER. Yes, sir; so Justice Holmes ruled.

The CHAIRMAN. Any other questions?

Senator KEAN. The really big business in this thing is in London, isn't it?

Mr. FILER. London. Amsterdam has been very big in that market—Paris—in fact, there is quite a bit of business——

Senator KEAN (interposing). A large part of the speculation in London, as I understand it, is in puts and calls.

Mr. FILER. I understand that most of their transactions are done through puts and calls.

The CHAIRMAN. That is all, Mr. Filer. We are much obliged to you.

Mr. FILER. Thank you.

The CHAIRMAN. Mr. Oliver J. Troster.

STATEMENT OF OLIVER J. TROSTER, NEW YORK CITY, A MEMBER OF THE FIRM OF HOIT, ROSE & TROSTER

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

Mr. TROSTER. My name is Oliver J. Troster, of the firm of Hoit, Rose & Troster, 74 Trinity Place, New York City.

The CHAIRMAN. You appear for whom, Mr. Troster?

Mr. TROSTER. I appear for the New York Security Dealers' Association.

The CHAIRMAN. How many members in that association?

Mr. TROSTER. Fifty-five.

The CHAIRMAN. Dealers in what?

Mr. TROSTER. Over-the-counter securities, sir.

The CHAIRMAN. All right; you may proceed, Mr. Troster.

Mr. TROSTER. I am also secretary of the New York Security Dealers' Association, which is, so far as I know, the only organized association of over-the-counter dealers in New York City. I am appearing at the invitation by your chairman to that association to send a representative to this hearing. I am submitting herewith a list of our members and a copy of our constitution; but I will not take the time of the committee to read either of these.

(The list of members of the New York Security Dealers' Association, submitted by Mr. Troster, will be found in the printed record at the close of today's proceedings.)

Most of the members of our association are not members of any stock exchange. The typical business of an over-the-counter securities dealer consists of buying and selling as a principal, and not as a broker or agent, securities which are not listed on any exchange. We deal in a very wide range of securities, including among others Liberty bonds, Federal farm loan bonds, home owners loan bonds, bank stocks, insurance stocks, municipal bonds, public-utility stocks and bonds, guaranteed railroad stocks, real estate, industrial and railroad bonds, baby bonds, and so forth.

In general, we serve two principal functions, the first being to provide a market for investors in securities in which there are not

enough buyers and sellers for investment for the stock exchanges to provide a really free market; and, second, a function of an entirely different character—to provide a market for dealings by insurance companies and other large institutions which deal in such large blocks that their purchases and sales would frequently swamp the market on an exchange.

This latter function is of particular importance in dealing with Liberty bonds, Federal farm loan bonds, and other Government and State and municipal bonds. Although some of these are listed on stock exchanges, the trading in them on stock exchanges is of very small volume and by far the greater volume of sales are made off the exchanges. This does not necessarily mean that the greater number of sales take place off the exchanges. In these issues the small investor may customarily use these exchanges.

The purposes of the bill appear to us to be met, therefore, by regulating the exchanges. It is there that the credit system of the country will be protected against undue price fluctuations. In this, our function is supplementary. By handling the sales in large blocks by large institutions and large investors, we prevent the devastating fluctuation in price which would really result if these securities were all thrown onto the exchange.

One of the Senators asked the other day if there were any reason why all this trading in bonds should not take place on the exchanges. The "social reason", as Mr. Corcoran expressed it, is the one that I have given.

I now come to the service which we render in providing a market for securities which otherwise would not have one. These are the securities which cannot wisely be listed or dealt in on a stock exchange, because they have one or more of the following characteristics: Lack of speculative interest; small capitalization, or limited number of shares or bonds; limited distribution, or small number of shareholders; or comparatively high price.

These are the types of security which, if they were listed on an exchange, would be subject to wide fluctuations in price due to the comparative scarcity of dealings.

Securities vary greatly in their availability for this purpose. At one extreme stand securities like the common stock of the American Telephone & Telegraph Co. or the General Electric Co., with millions of shares distributed among tens of thousands of different shareholders. Such a stock will generally find a ready and active market between active investors willing to buy or sell. The function of the exchange which makes a business of trading in securities is simple in such a case—being merely to provide a place where buying and selling orders can be matched at one price at a fixed rate of commission.

The normal over-the-counter security does not belong to this class. It is ordinarily of a type which could not be successfully listed or dealt in on an exchange. Recent attempts by the exchanges to deal in the slower-moving securities prove that they were not adaptable to this purpose. The attempt to deal on the New York Real Estate Exchange in bond issues of limited distribution affords an example. This exchange, created some 4 years back by well-intentioned people who apparently did not understand the economies of the situation, and

since which time there has been intense change in real-estate values, has been virtually nonfunctioning. Other unfortunate examples have been the attempt to deal in unlisted securities by the securities division of the New York Produce Exchange and the so-called "unlisted" section of the New York Curb Exchange.

In the progress of marketability from the slowest to the most active type of security, it is the function of the over-the-counter dealer to provide a market for as many securities as he may, excluding those which enjoy a wide enough distribution to be properly listed on an exchange. Natural desire for profit will make him extend the range of his activities as widely as possible, and this urge on his part makes a very real contribution to the public welfare in extending as widely as possible the list of securities in which the public can find a market. At the same time it promotes business development and employment by extending the number of corporations in which the public will be willing to invest.

Now let us see this picture in its full perspective. It is estimated that there are 180,000 industrial corporations in the United States alone. The number of corporations of all types—industrial, rails, public utilities, and so forth, whose stocks are listed on the New York Stock Exchange has been stated to be 788.

Mr. PECORA. Mr. Troster, I wonder if Mr. Comstock is in the room, because those figures would be interesting to him.

Mr. TROSTER. I noticed that, and this is quoted, I believe, from Mr. Whitney's report; at least, a part of it is

Here we have the fundamental and vital difficulty with this bill from our point of view.

Based, as the bill appears to be, on a desire to regulate the large exchanges of the country, and drafted with an eye to their peculiar problems, it has wholly overlooked the infinite diversity of the over-the-counter business and of the problems of that business. After devoting section after section to regulation of the stock exchanges and of the corporations whose securities are listed on the stock exchanges, it finally lumps the over-the-counter business in one comprehensive catch-all section, section 14, and leaves its entire regulation to the unfettered discretion of the same Commission which is to regulate the stock exchanges and which will necessarily be principally occupied with their problems.

As the very name of this act implies, it is designed primarily for the regulation of national securities exchanges. Whether or not its provisions are well or ill adapted to meet these purposes, and whether or not the Federal Trade Commission is well adapted or ill adapted for this function, has been and is likely to be the subject of much testimony and thoughtful consideration here. We do not come to speak on that subject, except insofar as the over-the-counter business is affected thereby.

We come for what may be termed the "forgotten man" of the securities business—not the man whose large-scale dealings in the securities of a few great corporations fill the popular imagination, but the man who day in and day out provides a market for the infinitely larger number of smaller corporations which make up the backbone of the business of this country.

It is true that our New York Security Dealers Association represents only a small fraction of the business of this character in the

United States. We do not presume to speak for all the dealers in that business. They are scattered through all the smaller cities of the land. Wherever there is a group of small companies in a community whose securities are dealt in locally, there will be a local dealer or dealers who will strive to supply a market for that purpose.

We speak only because we have been invited to do so, and in confidence that our business is typical and representative of that of the many other cities of the United States. Nor does our association, of course, represent all or nearly all of the dealers in New York.

There are necessarily some people engaged in the business who are unfitted by character and experience to assume the very real responsibilities of this business. This group will attempt to avoid regulatory supervision, just as the bootlegger did under prohibition, and particularly where the supervision comes from so remote a source as Washington. There may well be prosecutions of a few offenders, but a few prosecutions and convictions will not stamp out the evil, particularly where the prosecution will be as slow and cumbersome as must inevitably be the case where it emanates from a single huge Government bureau in a distant central point. The real hope lies in constant vigilance and self-regulation in the locality.

I rather expect that the stringent regulations proposed in this bill in regard to lending on securities will result in the creation of a great bootleg lending market. If a man can no longer borrow from a respectable dealer or broker more than $400 on a $1,000 bond, the pawnshops will soon provide him with an opportunity to pledge the same bond together with one stickpin, and to borrow $800 on the two of them, marking $400 against the bond and $400 against the stickpin. If the prohibition law has any lesson for us, I venture the suggestion that that lesson is that the Federal Government will not, as a practical matter, be able to reach this kind of business.

Mr. PECORA. Do you think that that kind of an evasion that you refer to there, the stickpin which is of only nominal value, would enable a person attempting it to escape from the penal provisions of the bill?

Mr. TROSTER. From the real provision?

Mr. PECORA. From the penal provisions of the bill. In other words, that such a subterfuge as you suggest here, if adopted by a so-called "bootlegger" in the securities market, will enable him to escape the consequences of the law?

Mr. TROSTER. I do not see how you could very easily find those cases. I do not know how you could find them.

Mr. PECORA. Where they exist they can be found.

Mr. TROSTER. Would there be anything to prove, any way to prove, that the diamond stickpin and so forth was not worth $400, or that he did not think it was worth it? My point is that it will be a bootleg market.

Mr. PECORA. My point is that the sort of evasion or circumvention that you refer to here, assuming that the stickpin in this supposititious transaction is a stickpin of nominal value, would not operate to enable the person adopting this subterfuge to escape the penal provisions of this act.

Mr. TROSTER. You mean the lender?

Mr. PECORA. Yes.

Mr. TROSTER. Well, undoubtedly, if there would be just as many of those shops as there were bootleg establishments in New York during prohibition, it would be rather difficult, I imagine, to find all of them.

Mr. PECORA. Oh, I think they could be found. The trouble with bootlegging in liquor was there was not much of a disposition, apparently to really enforce the law.

Mr. TROSTER. I will not argue with you on that point.

The respectable and honest dealers—and I confidently state that they are in the great majority—are as much opposed to the dishonest dealer as are the members of this committee. We suffer daily from his competition. What we really fear is that this bill will encourage and promote his business and not discourage him. By constant vigilance we have in the last decade gone far in the elimination of what might be called the "underworld" of traders in securities. That has been the prime cause for the creation of our association. At this moment our members have been advised to subscribe to the proposed draft of Code of Fair Competition for Investment Bankers, which upon its adoption will provide stringent regulations on the same subject matter. These regulations will, of course, like those under all codes, be enforced in the first instance by others engaged in the same business in the respective localities, and only the appropriate power of supervision and review will be required from the Federal Government itself. This seems to us to be a constructive step forward. But a proposed statute simply throwing this whole great subject under the general jurisdiction of the Federal Trade Commission seems to us a step backward which can only lead to the encouragement, and not the discouragement, of dishonest and bootleg practices throughout the country.

I come now to particular provisions of the act.

Under section 3 exchanges are defined to include:

> Any board or market place, whether organized or unorganized, however managed or conducted, and whether incorporated or unincorporated, where or by means of any facility of which, contracts or offers for the purchase or sale of securities or other transactions in such securities are made

It appears to me as a layman that these words may be broad enough to cover every place of business of an over-the-counter dealer. Purchases and sales are certainly made there and by the use of its facilities. In a broad sense it is itself a board or market place. Yet we feel certain that the Congress cannot intend the absurd result that every little over-the-counter dealer's place of business is itself to be an "exchange" for all purposes of the act.

To insure that the intent will be clear, we suggest that the definition of exchanges be confined to regularly organized exchanges as is done in the draft of Investment Bankers' Code.

We now come to section 6. The problem here is whether the average over-the-counter dealer is "a person who transacts a business in securities through the medium of a member" of an exchange.

Here dealers divide into many classes. Most of them also act as brokers in varying degrees. Why is this? The reason is simple—that the customers demand it. The average investor regards brokers and dealers as really the same. He uses the broad term "broker" to apply to both classes, and to him his broker is the man through

whom he can sell the security he doesn't want to hold any longer and can buy the one he wants.

The average investor has no necessity to catalog in his own mind the house with which he does business definitely as broker or dealer, because of the general nature of the activities of the house. His requirements are that he know on every particular transaction what the relationship of the house is to him—whether it is as broker or agent on a commission basis or whether the house is a dealer acting on a net basis.

Now, in my firm, for example, if a man wants us to sell for him 100 shares of a listed stock we pass the business on to a stock-exchange firm and take no additional commission above that charged us by the stock-exchange firm. This is the customary practice among over-the-counter dealers in New York. We cannot understand the economic benefit in upsetting the habit of our customer which may be of years standing and based on mutual trust of going to a single broker or dealer for his financial advice and his financial transactions. In effect, you would be requiring us to tell him: "No; we will handle your Home Owners' Loan Corporation and your municipal bonds or your public-utility preferred and insurance stocks for you, but we won't handle your A. T. & T. or your General Electric or your General Motors."

The customer is baffled. To him they are securities—they are all one, and he wants us to handle them for him.

In my judgment, the principal effect of this will be to deprive the customer of the benefit of the knowledge of the dealer, which is the result of years of experience and accumulation of records. The knowledge acquired by the sum total of the dealers throughout the country of all classes of securities, including those in which they do not themselves personally deal, is a real asset to the investors of the country.

This bill proposes to kill that asset at one blow.

Many members of the Congress are lawyers. They understand well the difference between office lawyers and court lawyers, for example. Yet the layman speaks only of "his lawyer." Most likely, his lawyer does not go into court; yet the layman goes to him with his court case, if he has one, and trusts to his lawyer to pass it on to the proper specialist if he need one, whether it be a divorce lawyer, a patent lawyer, a corporation lawyer, or one specially qualified in bankruptcy law, railroad law, radio law, criminal law, or any other of the innumerable classes in which lawyers are specializing today.

So in the securities business there is an infinite variety of specialists. The lay investor cannot know them all. He comes to me and I take care of him, calling in the proper specialist where he has a security of the type I do not personally handle. But under the proposed bill I must turn him away whenever he comes with a type of security which is not what I myself directly handle; and I must do this under penalty of never being able to make a loan to him or arrange a loan for him on the very type of security which I do handle—the over-the-counter security not listed on any stock or securities exchange.

We submit that this sort of division into rigid classes or castes of the different types of dealers or brokers is arbitrary, unnecessary, and fundamentally un-American.

I should suppose that these considerations are even more important to investors outside of New York than to investors in New York. The New York investor can perhaps educate himself as to the different types of available brokers and dealers. But the man in the smaller city or town will only have a few brokers or dealers available. Far more than the New Yorker even, he wants to deal with the broker whom he has confidence in, whom he knows. Indeed, in many places he has hardly any choice. Yet if that broker does any business through the medium of any member of any exchange he will be debarred from taking any orders for his customer in baby bonds, guaranteed railroad stock, real-estate bonds, municipal bonds, and all the other types of securities not dealt in on an exchange. He will be debarred even from loaning or arranging for a loan on any of the stocks or bonds in local companies owned by his customer.

We therefore believe it to be extremely important that the same loan privileges be granted to unlisted securities as are finally granted to listed securities.

Indeed, the effect of requiring brokers and those dealing with brokers to get rid of the unlisted collateral in their accounts will, in my opinion, result in a great amount of dumping, the effect of which will be definitely deflationary.

This is more important outside of New York, as we in New York do our over-the-counter business almost entirely on a cash basis, whereas in other cities customers' securities are very frequently carried by the dealers, who are in many cases members of at least one exchange.

We further believe that the phrase "any person who transacts a business in securities through the medium of any such member" should be replaced by a phrase which would be limited to persons habitually and primarily engaged in a brokerage business on an exchange.

The same considerations apply to the term in section 10: "any person who as a broker transacts a business in securities through the medium of any such member."

We come finally to section 14. Placing all over-the-counter trading and dealing under the jurisdiction of a commission is not objectionable per se. No honest security dealer is afraid to be under supervision, any more than anyone else conducting an honest business. There is a belief among us, however, that a national commission, if not fully acquainted with the nature of the over-the-counter business, might attempt to regulate it along lines which follow strictly the regulation of exchanges. The over-the-counter business differs in so many ways from exchange business that it plainly needs rules of its own, which, though similar in general scope and purpose to those applying to the listed business, must of necessity differ from them in details, many of which are essential to the survival of the business.

Trading in securities over the counter is the oldest form of dealing in securities. It antedates all exchanges and is essentially one of barter or negotiation.

There can be no argument against the pure theory of an exchange, a central meeting place where the orders of buyers and sellers of active securities meet at a central place and are executed at one price at a fixed rate of commission. The trouble comes when it is attempted to stretch this theory to cover securities and situations to which it cannot apply.

Our recommendation is that, inasmuch as the Investment Bankers' Code when approved by the President will itself become a law regulating the activities of dealers in securities, and inasmuch as that code contains stringent and enforceable regulations, there is no necessity, at least at this time, for the enactment of section 14 of the proposed national exchange act.

Before closing, may I express my thanks to the chairman and members of this committee for giving me this patient hearing. This concludes my formal statement. I would like to submit for the record a brief statement with regard to the practice of dealing in unlisted securities on exchanges, with particular reference to the document submitted by the New York Curb Exchange on this same matter, and I would be happy to answer any questions which any member of the committee may wish to ask.

Mr. Chairman, I have this document that I would like to read, if you have the time; or I will summarize it if you have not the time.

The CHAIRMAN. I think you might summarize it. Could you not put it into the record?

Mr. TROSTER. I would like to summarize it or read one or two paragraphs from it, inasmuch as it has to do with dealing in unlisted securities on exchanges. This statement sets forth the fact that merely listing a security on an exchange does not in itself guarantee a good and active market in that stock. Also that the matter of investigation by Government authorities of trading in unlisted securities on an exchange is not a new one. This was done a quarter of a century ago by the present Chief Justice of the Supreme Court, Charles Evans Hughes, in connection with the investigation of the insurance scandals in New York City, with the result that the previously existing unlisted department of the New York Stock Exchange was voluntarily abolished in 1909.

It also develops our understanding of the simon-pure theory of a stock exchange. If I can read just the three paragraphs which I have mentioned, I will be through. [Reading:]

The matter of investigation by Government authorities of trading in unlisted securities on an exchange is not a new one This was done a quarter of a century ago by the present Chief Justice of the Supreme Court, Charles Evans Hughes, in connection with the investigation of the insurance scandals in New York City. As a result of this, there came out the so-called "Hughes' report", which, in speaking of dealing in unlisted securities on the New York Stock Exchange, among other things recommended that "the unlisted department except for temporary issues, should be abolished" As a result of this, the previously existing unlisted department of the New York Stock Exchange was voluntarily abolished in 1909

"The theory of the exchange in the maintenance of its unlisted department may be stated as follows When an active market in a security which meets the qualifications exists in New York, the public is better served by having that security dealt in on an exchange The purchaser or seller on an exchange deals through a broker member acting as agent, who makes contracts for his customer with other members likewise acting as agents A specified commission only is charged, the transaction is immediately made public by means of

the ticker; purchases and sales appear throughout the country in the daily papers; each transaction is open to investigation and verification; each member is subject to the rules and discipline embodied in the constitution and rules of the exchange"

This is what we would term the "simon-pure theory" of an exchange with which we would be the last ones to quarrel This picture does not take into consideration the activities of the specialist who buys and sells for his own account and whose activities notoriously can become pernicious and contrary to public policy when applied to inactive securities

When an order is put on the telephone through the machinery of an exchange, the buyer or the seller loses all power of direct negotiation If he gets back more than he gives up in terms of an equitable execution at a fixed commission rate, the public good is served But if he gives up his power of negotiation and does not get back the benefits of an execution by the matching up of buying and selling orders that are extant, but is subject only to the good nature of the specialist, it would seem that he is worse off

As to the spread being notoriously wide over the counter, we submit that the spread between the bid and asked prices of any security is based on the nature of the particular security rather than upon the market in which it is traded. In general, securities fully listed on, say, the New York Stock Exchange, have a better market than unlisted securities On the other side of the picture there are securities in the over-the-counter market that day in and day out have a ready market Putting it a different way, the listing of a security does not necessarily make a better market. The market is determined by characteristics of the particular security listed; that is, distribution, speculative interest, etc The inference that listed securities uniformly have good markets and those dealt in over the counter have poor markets, is not in accord with the facts

Looking at this morning's New York Times in the column recording bid and asked prices of stocks not traded in the day before on the New York Stock Exchange, we find 39 which have either no bid or no offering, and 211 which have a spread between bid and asked prices of 2 points or more and run as high as 262 points.

For example, the American Express Co. was quoted at 88 bid, 350 asked; American Agricultural Chemical Co. preferred, 27 bid, 44 asked; Chicago, Indianapolis & Louisville Railway, preferred, 2⅝ bid, 7 asked; Mackay Cos. preferred, 25 bid, 79 asked; Federal Mining & Smelting Co., 90 bid, 105 asked; Texas & Pacific Land Trust (old), 750 bid, 950 asked. Many more examples could be given, but that is all that I will take the time to read.

Mr. PECORA. In your statement, on the first page thereof, you say that the typical business of an over-the-counter securities dealer consists of buying and selling as principal, but not as broker or agent, securities which are not listed on any exchange. Does that mean that if the customer comes to you and asks you to sell for him, say, 100 shares of securities not listed, your firm would buy them from him with a view of selling them to some other customer who might want to buy them.

Mr. TROSTER. You mean one of our regular customers would walk into the office with a hundred shares of stock?

Mr. PECORA Is that a typical example of a transaction over the counter that securities dealers engage in?

Mr. TROSTER. No; our business is mainly in dealing with other brokers, members of the stock exchange, members of the curb, and other houses.

Mr. PECORA. Suppose someone came in and asked you to sell for him a hundred shares of a security that is usually traded in in the over-the-counter market and which is not listed on any exchange, would you buy them with a view of selling to someone else who might want to buy that particular security?

Mr. TROSTER. Yes.

Mr. PECORA. Would you sell it both as a broker and as an agent?

Mr. TROSTER. We could do either, if he desired. We always ask him which he would rather have us do.

Mr. PECORA. Where you buy for your own account from him, you are acting as principal?

Mr. TROSTER. Yes.

Mr. PECORA. Do you charge him a commission?

Mr. TROSTER. No, sir. We buy it directly from him and sell it at a net price. We cannot charge him a commission.

Mr. PECORA. How is the customer to know whether the purchase is being made by your firm for its own account?

Mr. TROSTER. From the confirmation which he receives. He receives a confirmation from us the following day, saying, "We have this day sold for your account and risk"—if we have sold it for his account and charged him a commission for it, or it will say, "We have this day bought from you." He will receive one or the other, depending on whether we have acted as broker in the first case and as principal in the second.

Mr. PECORA. Suppose you had an order from a customer to buy a hundred shares of X stock, an unlisted security, at, we will say, 95, and you have another customer come in who asks you to sell for him 100 shares of X stock at 90—what do you do?

Mr. TROSTER. We make a profit.

Mr. PECORA. You mean, you——

Mr. TROSTER. Would buy from one and sell to the other.

Mr. PECORA. You make a spread?

Mr. TROSTER. Yes.

Mr. PECORA. Would you also charge a commission to either the purchaser or the seller?

Mr. TROSTER. I am a layman, but I have always understood, in my dealings, that I could not be a principal and a broker at the same time. I think that is the law.

Mr. PECORA. When the customer that wants you to sell for him 100 shares of that stock at 90 comes to you with his order, and you have an order in your office from another customer to buy a hundred shares of the same stock at 95, would you tell the customer who wants you to sell that you have an order at 95?

Mr. TROSTER. If I could survive the shock of such a thing as that happening, I would undoubtedly do this. We are in the business of dealing in securities. We hope to be in that business for years to come. We jealously guard our reputation, and we would take only such an amount of spread between those two as we thought was absolutely fair and honest, depending on the nature of the stock, upon the amount of effort that we had to put in on one or the other order, and upon the fact that we are regulated by competition from other dealers; that one of these customers may be a customer of another house, and if we took too much of a profit from him, if it was discovered, the matter would be reported to the district attorney in the State of New York or to the stock exchange or to the Better Business Bureau, and our reputation would be gone. In other words, it would depend entirely upon those factors which I mentioned. We would undoubtedly make a spread on a stock of that much—I could not answer offhand as to how much there would

be, but it certainly would not be five points if they just happened to walk into the office.

Mr. PECORA. Suppose such a situation to arise where you had an order from a customer to buy 100 shares of X stock, and another customer came in and gave you a certificate for 100 shares of X stock to sell, and he told you he was willing to take 90. Would you tell the customer that wanted you to sell at 90 that you had another customer who would buy it at 95, or would you deal as principal with both?

Mr. TROSTER. That is not done among reputable dealers. Before giving you an order to buy or sell something a customer asks, "What is the market?"

Mr. PECORA. Is there any way by which the customer could check up on your statements as to what the market might be?

Mr. TROSTER. There are 1,600 dealers in New York City in unlisted securities.

Mr. PECORA. And your association is composed of how many?

Mr. TROSTER. Of 55 to 60 of the best-known names.

Mr. PECORA. Do you know what the other 1,550 do, who are not members of your association?

Mr. TROSTER. There are a good many good names outside of our association, and I have no doubt they would live strictly up to any principles that we might live up to. On the other hand, as I mentioned in my brief, there are those who do not qualify in undertaking to deal in unlisted securities, and they should be regulated in some way, and we are the ones that will certainly root for that harder than anybody else.

Mr. PECORA. If the provisions of section 14 are carried into effect by the adoption of suitable rules and regulations by the Federal Trade Commission, might they not take care of that situation?

Mr. TROSTER. They might; but on March 15 there is a hearing on the American Institute of Banking code of fair practices, I understand, and that is a law which is going to be administered by people who are now engaged in that business, and we think the business should be run or managed and supervised by that group, and can be, better than it could at least in the initial stages by the Federal Trade Commission.

Mr. PECORA. Is there not a much greater opportunity for unfair and unscrupulous dealings by unscrupulous over-the-counter securities dealers with the public than there is in the case of transactions in securities that are listed on the exchange?

Mr. TROSTER. Yes; there are. It comes in in the inactive securities. That is where the chances come in, I assume, for any irregularities on an exchange.

Mr. PECORA. For instance, in the over-the-counter market the public has not the advantage of ticker quotations to get the current prices and quotations?

Mr. TROSTER. No, sir.

Mr. PECORA. That are being effected in transactions on the exchange?

Mr. TROSTER. Mainly because the transactions are so few and far between. These unlisted securities are not dealt in, as you undoubtedly know, every day. Some are dealt in once in a year.

Mr. PECORA. There are various opinions that have been expressed here in regard to the relative importance of the over-the-counter market and the securities market as represented by exchange transactions.

Mr. TROSTER. We have no quarrel whatsoever with the trading on an exchange on active securities. Where a security is active we have no desire whatsoever to have any quarrel with an exchange. Inactive securities of the kind typified by one of these four things that I have mentioned in my brief, where there are high prices, where they are closely held, where there is lack of distribution—any of the characteristics that we have mentioned—they are not susceptible to being traded in. Otherwise you would have them selling at 22 one day and 35 the next, and up and down the scale.

Mr. PECORA. In the over-the-counter market where the security dealt in is an unlisted security, is not the public at a disadvantage in trading in that market because of the absence of current quotations on the buying and selling side?

Mr. TROSTER. There are quotations in the newspapers.

Mr. PECORA. But they are published at the end of the day.

Mr. TROSTER. Yes.

Mr. PECORA. I mean current quotations in the course of the day's trading.

Mr. TROSTER. They might never change in the course of a day. There might not be any transactions.

Mr. PECORA. But where there are such transactions, what would be the public's source of knowledge of them?

Mr. TROSTER. They can get it from any of the dealers at any time. Most all of the stock exchange houses have departments that deal in unlisted securities.

Mr. PECORA. How could the customer desiring to trade in such securities through an over-the-counter security dealer check up on the information that the dealer gives him? He would have to go shopping around to the offices of different dealers to find out, would he not?

Mr. TROSTER. He does; but the number of people who would actively want to trade in any inactive security that is dealt in over the counter are few and far between.

Mr. PECORA. You frequently get orders from customers to purchase securities for them. You also receive orders to sell from other persons, do you not?

Mr. TROSTER. Yes.

Mr. PECORA. And there is usually a spread between the two prices?

Mr. TROSTER. Yes.

Mr. PECORA. The customer who wants to buy has no knowledge, except that which is vouchsafed to him by the dealer, of the price at which a customer wants to sell?

Mr. TROSTER. My associate just remarked that orders of that kind that we get are very few and far between. It is rarely that these two orders come in simultaneously.

Mr. PECORA. I do not mean simultaneously.

Mr. TROSTER. Or in the course of the day.

Mr. PECORA. You get orders both to buy and sell from different customers in the same security, do you not?

Mr. TROSTER. But at a price enabling you to make a profit.

Mr. PECORA. Enabling who to make a profit?

Mr. TROSTER. The dealer.

Mr. PECORA. That is what I wanted to find out. If a customer who wants to sell a security which is unlisted and which is traded in in the over-the-counter market goes to a dealer who specializes in that market and tells the dealer he wants to sell a hundred shares of that stock at a certain price, is the customer told whether or not the dealer has at that time an order to buy the same kind of security at a higher price?

Mr. TROSTER. No.

Mr. PECORA. The dealer then is in position to take advantage of the spread, and usually does it for his own benefit and profit, does he not?

Mr. TROSTER. The first man that——

Mr. PECORA. Can you not answer that?

Mr. TROSTER. In a case of that kind, the first man coming in wanting to buy a hundred shares of stock—to give an example, it might be, say, Remington Arms stock which is quoted at 6 bid, offered at 6⅜. He will ask what the market is before he will give you an order. If he gives you an order it will be some place, say, about 6⅛ or 6¼. It will not be 6⅜. If I quote him the market he will say, "I will take 100 shares"; and I have traded with him on a net basis I have sold him 100 shares. No commission is mentioned by me. I have sold him 100 shares of Remington Arms stock. If he bids 6¼ and I am long on stock that cost me 6⅛, I will undoubtedly sell him 100 shares at 6¼, in which case I have not yet had any order from him. He has made me a bid and I have executed the order and it is through with. I have no order unless he would get it at 6⅛. If a man should come in and offer to buy G.T.C. (good till countermanded) 100 shares at 6⅛, if I am willing to sell it at 6¼, I quote the next man 6 bid, offered at 6¼. If he says, "I want to sell 100 shares", I quote him the market and I can buy his hundred shares and make ⅛ of a point in between the bid and the offered price. But I have not had an order from the customer at any time.

Mr. PECORA. Suppose a customer comes to you and says—and let us assume that this is an unlisted security—"I want you to sell this stock for me at 90, or the nearest price thereto that is obtainable", and at that time you have an order from another customer to buy for him, say, 100 shares of the same stock, and he says he would be willing to pay as high as 92. What would you do in such a situation?

(The witness consulted his associate.)

Mr. PECORA. Can you not tell us without consulting?

Mr. TROSTER. It was on something else. The amount of profit I would take on a transaction of that kind would undoubtedly be half a point.

Mr. PECORA. What do you mean? Do you mean that you would tell the customer who asked you to sell for 90 or as close to that as possible that you would sell that stock to the customer who has indicated that he is willing to buy at 92, and give the seller the benefit of the difference?

Mr. TROSTER. You could deal on one point, giving the benefit of a better execution to both people, making two perfectly good cus-

tomers for years to come, improve your reputation and make, as I say, good customers for the future.

Mr. PECORA. Is it not a fact that firms or dealers in the over-the-counter market who specialize in bank stock will send out to persons who they regard as potential customers an announcement to the effect that they will buy so many shares of X bank stock at 20 or sell so many shares of X bank stock at 21? That is a frequent practice, is it not, among dealers like your house?

Mr. TROSTER. Yes.

Mr. PECORA. And members of your association?

Mr. TROSTER. Yes, sir.

Mr. PECORA. If a house gets orders from customers to both buy and sell at prices which show a spread, would the dealer take advantage of that situation and make that spread for himself by acting as principal in transactions both with the buyer and with the seller?

Mr. TROSTER. He would make a profit. We act as dealers on all occasions. We are dealers in unlisted securities We would therefore make a profit. We feel we are entitled to a profit. The number of orders of that kind are very limited. We spend much money in circularizing, on pastage, on telegrams, on advertising, and so forth. We figure that we are entitled to a profit on a trade that was put through our organization. We have to match up isolated cases of this kind against the times when we sell out of inventory that we may have on hand with the possibility of buying it back, or times when we buy stock against the possibility of reselling it later In the average of those cases you will find that the margin of profit or loss is extremely small.

Mr. PECORA. Can you tell the committee in what proportion of the transactions that you effect you charge commission?

Mr. TROSTER. Speaking for my own firm, I imagine it is half of 1 percent.

Mr. PECORA. Only half of 1 percent?

Mr. TROSTER. On listed business we take no commission

Mr. PECORA. I am referring, of course, to transactions in unlisted securities.

The CHAIRMAN. Do you do business with parties outside of New York?

Mr. TROSTER. Yes, sir.

Senator KEAN. You have read this bill, have you not?

Mr. TROSTER. Yes, sir.

Senator KEAN. It is claimed by some people that if this bill were enacted into law it would shut up the stock exchanges. Other people, even its proponents, claim that it would reduce the volume very much. If it reduced the volume of trading very much, then you are going to have the same kind of spread that you illustrated?

Mr. TROSTER. The number of securities would certainly increase——

Senator KEAN. And you would have such a wide spread between the prices of securities that a person who wanted to buy or wanted to sell would be subject to buying at very large differences and selling at very large differences?

Mr. TROSTER. Yes, sir.

Senator KEAN. If you get 100 shares of an unlisted security to sell, the first thing you do is to call up traders and ask them for a bid; is that right?

Mr. TROSTER. Not necessarily if it is a semi-active stock.

Senator KEAN. I am talking about an unlisted stock that is very dull. The first thing you do is to call up the traders, is it not?

Mr. TROSTER. Yes.

Senator KEAN. Then you try to get a bid from the traders; and, under this bill, if the traders did not give you all the information, you would have a suit against you, would you not?

Mr. TROSTER. So I am informed.

Senator KEAN. So that the traders undoubtedly are practically the only market for a lot of these unlisted securities, and therefore they would have to refuse to make a bid?

Mr. TROSTER. Yes.

Senator KEAN. Because they would be subject to this law, and therefore you would lose that market entirely.

Mr. TROSTER. That very slow moving type of security would have a very poor market; yes, sir.

Senator KEAN. That is all.

The CHAIRMAN. That is all, Mr. Troster.

We will now hear from Mr. Chinlund.

STATEMENT OF EDWIN F. CHINLUND, NEW YORK CITY, REPRESENTING THE CONTROLLERS INSTITUTE OF AMERICA

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

Mr. CHINLUND. My name is Edwin F. Chinlund; residence, New York City; I am representing the Controllers Institute of America.

The CHAIRMAN. Do you want to be heard on the bill?

Mr. CHINLUND. Yes, sir; I have a statement, Mr. Chairman.

The CHAIRMAN. Proceed.

Mr. CHINLUND. The Controllers Institute of America has considered the provisions of S. 2693 and H.R. 7852, to be known as the "National Securities Exchange Act of 1934", and has requested me to submit this statement and to appear before you to present the views of the Controllers Institute on the bill.

The Controllers Institute is in sympathy with necessary actions taken to protect the investing public by the elimination of abuses in the security business, and to prevent abuses of credit caused by the diversion of credit into speculative channels to the injury of general business. This statement is principally confined to the accounting and financial aspects of the bill since those aspects are the ones in which our membership is primarily interested.

The membership of the Controllers Institute of America consists of over 300 controllers and other executives who are responsible for the accounting and financial policies of many of the corporations whose securities are listed on exchanges. This statement has the approval of our board of directors and based upon that approval and the many communications received from members, we feel safe in stating that it represents the opinion of the majority of our members even though we have not had time to obtain their vote.

In this connection it is appropriate to refer to the Declaration of Principles of the Controllers Institute of America, adopted shortly after foundation of the institute, which expresses our point of view on this subject and which, as will be seen, harmonizes with the avowed purposes of the bill (reading):

The Controllers Institute of America stands for the observance of the highest ethical standards in corporate accounting practice and in the preparation of reports of financial and operating conditions of corporations to their directors, stockholders, and other parties at interest, in such manner that all concerned may know the actual conditions insofar as such reports may assist in the determination thereof. To that end, the Controllers Institute of America offers its advice and assistance in connection with any movement which has for its purpose the establishment of better safeguards for the protection of the investor.

We submit the following as to the accounting and financial features of the bill.

The provision of section 12, which provides for the filing of quarterly balance sheets and income accounts, and further provides that such balance sheets and income accounts shall be certified by independent auditors, is, in our opinion, too burdensome to business and is unnecessary to secure the protection to investors for which the law is intended.

The present listing requirements of the New York Stock Exchange provide that corporations shall publish an annual balance sheet and income account, and quarterly income accounts. The variation of balance sheet items during a quarter is usually not great enough to justify spending the investors' money to set up the elaborate accounting machinery necessary to prepare a balance sheet sufficiently accurate to permit the officers of the corporation to assume responsibility for its correctness. Furthermore, quarterly audits would multiply the cost of the present annual audits and would be too heavy a burden for the corporation to bear. It is well recognized in accounting and business circles that quarterly statements of many corporations, although reasonably correct, are based upon estimates to a larger degree than annual statements, and therefore without greatly elaborating the present accounting methods they cannot be as accurate as the annual statements. Furthermore, if a corporation were to publish a certified quarterly balance sheet, it would be necessary in many cases to take physical inventories quarterly whereas now physical inventories are, in most cases, only taken once a year.

What the investor requires mainly to pass judgment on his investment is the trend of earnings, and most corporations whose securities are listed on the New York Stock Exchange are meeting this requirement by issuing quarterly income accounts. It is true that some corporations are not submitting quarterly reports because their agreements with the exchange were made before the exchange instituted the provision making this a requirement for new listings. However, the efforts of the exchange through its committee on stock list have been devoted for a long time to having corporations agree voluntarily to modifications of their listing agreements, so as to provide for quarterly earnings reports.

In this connection it should be pointed out that when the New York Stock Exchange made the publication of quarterly earnings statements a listing requirement, it was found that in certain industries quarterly statements were wholly misleading by reason of wide seasonal variations. Furthermore, in some cases it was found to be impossible to ascertain with any reasonable degree of accuracy certain basic data necessary for the preparation of such statements. In such cases, the stock exchange decided to permit the publication

quarterly of earnings statements covering the 12 months' period immediately preceding such publication, instead of 3 months figures, thus eliminating the seasonal factor.

We suggest, therefore, that 12 months earnings statements, published 4 times yearly, be permitted in place of quarterly statements where the latter would be misleading to the investing public. We suggest also, that permission be granted to publish semiannual earnings statements in cases where it appears that such statements present the picture more fairly than quarterly statements. Furthermore, in cases where it is obvious that an investment policy can be determined most satisfactorily from annual statements, such annual statements should be permitted.

The point we wish to make is that greater flexibility should be permitted, to conform to the diversity of conditions found in the various industries. It is our considered opinion that the appropriate earnings statements, as prescribed above, issued with the necessary qualifications as to approximation, should become a requirement, that the publication of certified balance sheets quarterly is unnecessary and much too costly, and that the present practice of annual balance sheets is preferable.

The provision as to monthly reports of sales or gross earnings is probably not too onerous for some corporations, although for others it would be very impractical. If a regulatory bill should be passed by Congress the provision for monthly reports should be flexible enough to authorize the Federal Trade Commission to waive this requirement in justifiable cases.

The provision of section 11 covering registration requirements, which provides that the Federal Trade Commission may modify the rules and regulations for the information to be filed with it before or at registration, together with the penalty provisions of section 17 (a), which apply if the information if "false or misleading in respect of any matter sufficiently important to influence the judgment of an average investor", may easily work out to be an invitation to unscrupulous traders to attempt to profit unjustly. Such traders might trade recklessly in any security in whose registration statement the slightest flaw may be detected, on the assumption that if a profit is made, well and good, while if the speculative transaction results in a loss, such loss may be recovered from the officers, directors, or accountants of the issuing corporation. It is even possible, as the bill is written, for damages to be assessed much in excess of the loss actually sustained.

The possibility of slight clerical errors among the thousands of figures and statements which must be contained in the voluminous reports required under this bill is so great as to raise serious question as to whether or not any corporation official or public accountant of responsibility could run the risk of possible penalties.

The provision of section 11 as to audit of balance sheets and profit and loss statements for preceding years does not specify the number of preceding years. It would seem to the Controllers Institute that if specific control of registration of securities is to be undertaken by the Government, it should be done either under much more clearly defined rules and regulations, incorporated into the law, which can

only be done after adequate time to study the question or left to the discretion of the regulating commission.

Under section 11, for all securities now listed on exchanges, a registration statement as defined by that section, and as further amplified by rules and regulations of the Commission, must be filed prior to October 1, 1934. Such registration statements include certificates of audit by independent public accountants. Therefore not only would it be necessary for audits to be made of previously unaudited companies but also new audit certificates would be required of companies at present audited, all to be filed prior to October 1, 1934. This large number of audits could not possibly be completed prior to that date by the public-accounting profession of this country.

As now written, the bill would include all railroads which desire listing on an exchange for one or more of their securities. This includes most of the class I railroads, which number about 180. To complete audits of all of these extensive properties by October 1, even if the work were commenced today, would be a physical impossibility.

An alternative method of accomplishing the purposes of the law would be to have the regulatory body supervise the actions and policies of the listing committees of the exchanges and the general requirements for listing within maximum limits to be stated in the law. Thus the Commission would not be given the burden of detailed approval of each individual listing. This procedure would also remove the possibility of investors assuming endorsement of soundness of issues by the Federal Trade Commission, if the Commission does not disapprove the listing within the 30 days specified in the bill.

The Controllers Institute wishes to express its concern over the serious situation in which each corporation's directors and executive officers will be placed if this bill becomes law. They will have to decide whether to comply with the law in order to secure listing and have marketability for their corporation's securities or to suffer loss of listing to avoid incurring the excessive expense and terrific liabilities imposed by the law. Officials have already been placed in the position of having to decide whether to incur the serious obligations required by the Securities Act of 1933 in order to secure new financing or even refunding. In most cases, however, it has been possible to postpone decision on this question by delaying new expenditures, with the resulting harmful effect on business recovery and unemployment, in the hope and expectation that the Securities Act would be modified in the near future.

In the legislation now proposed the situation is much more serious since a decision will have to be made immediately on passage of the bill in order to complete the tremendous amount of work required for securities to remain listed on October 1, 1934. Should it be decided that either the cost, the liability involved in complying with the listing requirements, or the difficulties arising from the undefined future regulation is too great, the only recourse would be to permit the corporation's securities to become unlisted, thus driving trading in the securities into a bootleg market, which this law would probably create. The results thereof would be:

(*a*) The investor would be unable to borrow on his security.

(*b*) If obliged to sell, the investor could do so only on a market in which a wide spread would very likely exist between the bid and asked prices.

(*c*) The corporation would find it extremely difficult to finance, even if the obstacles raised by the Securities Act of 1933 could be overcome.

(*d*) The National Government and the States in which exchanges are located would lose large tax receipts.

(*e*) Business recovery would be retarded.

Section 18, subsections (*a*), (*b*), and (*e*) in particular, granting special powers to the Federal Trade Commission, also directly affect corporations. These powers are expressed in such a broad way that the cost and volume of the information might be excessive. The broad powers granted would compel corporations to use such accounting methods and prepare such reports as may be demanded, although they might not meet the needs of the directors and officers of corporations in the regular management of the business. Duplicate records and reports would, therefore, be necessary. The methods to be prescribed for the valuation of assets, determination of recurring and nonrecurring income, and so forth, also are placed under the jurisdiction of the Federal Trade Commission, and would take the operation of business matters out of the hands of those professionally expert who have responsibility of performance. Subsection (*e*) also gives the Federal Trade Commission power to require corporations to bring their corporate records for secret investigation "from any place in the United States or any State at any designated place of hearing." On account of the great volume of records which might be involved, this hardly seems practical.

The Controllers Institute believes that the methods of accounting are internal matters for the controllers of each corporation to prescribe based upon recognized accounting principles and practices designed to meet the particular requirements of the business, and that the accounting methods and the accounts resulting from them should be approved by independent public accountants auditing the corporation's accounts. We believe that if it is to be the policy of the Federal Government to regulate all corporations, such regulations should be confined to major principles and not details.

The two countries of the world in which it is generally recognized that accounting has had the greatest development are England and the United States. The procedure under which this improvement in correct presentation of balance sheets and income accounts has been developed has been by selection of trained expert accountants as financial officers of companies, supplemented by an annual audit of the methods and accounting principles put into effect through such officers by independent public accountants. The intimate knowledge of the particular type of business and the kind of transactions it carries on, necessary to determine proper accounting policies for such business, requires detailed and recurring investigation which, in our opinion, no regulatory body could undertake and carry out as a substitute for the well-developed procedure now in existence. Anyone who has made a study of the development of the presentation of corporate financial statements is convinced that its entire history

shows an improvement in the direction of conservative and accurate statements of financial position and earnings.

The foregoing covers the principal difficulties which would arise from the accounting features of the proposed bill. There are other objections to the bill which have been covered by previous witnesses, such as—

(1) The deflationary effect of the ineligibility of unlisted securities and the margin requirements.

(2) The indefinite and almost unlimited control of corporate activities placed in the Federal Trade Commission.

(3) The possibilities of driving the security business into the hands of security bootleggers by the heavy restrictions placed on exchange members; and

(4) The difficulties arising from liability of directors, officers, accountants, and others under the provisions of section 17.

Section 13 of the bill relating to proxies imposes an undue burden and an excessive cost which must be borne in the last analysis by the stockholders. It should be pointed out that in the vast majority of cases proxies are solicites only to insure a quorum so that necessary corporate business may be transacted at annual meetings, thereby saving stockholders expense and time of attending meetings.

Reform of certain phases of the security business is necessary. Reform is always necessary in a dynamic nation like ours. The only question is how to reform without creating more evils than are remedied.

We feel that the greater benefits to the American people can be secured through a continuation of the evolutionary process of reform through education—education of the public, of security dealers and brokers and issuing corporations—rather than by such a process as is represented by this bill as written. Distinct progress along constructive lines has been made by the development of local blue sky regulation, by the activities of better business bureaus and similar organizations, through the initiative of the leading organized security exchanges, and through the growth of a more public-spirited point of view on the part of the leading corporations, especially since their securities have become distributed so widely among the general public.

To interrupt the evolution of reform through education and public opinion, by suddenly setting up stringent regulations impossible of enforcement, without driving the security business underground, would result in a set-back to the real progress which has been made so far. The Controllers Institute therefore respectfully recommends deferment of regulation of the securities business until a more thorough study of the subject has been made. The Securities Act of 1933 insofar as it covers issues which would be listed, duplicates to a large extent the listing requirements of the national securities exchange act.

We believe that many of the provisions in the proposed bill, if enacted into law at the present time, would counteract to a large extent much of the moral and economic benefit that has resulted from the aggressive leadership provided by the present administration and much of the legislation passed since March 4, 1933.

It is also our opinion that the Securities Act of 1933 in its present form is a definite deterrent to economic recovery and to the flow of private capital into industry, and unless substantially modified is bound to bring many serious evils in its wake. This in our opinion is equally true of the proposed national securities exchange act reviewed by this statement, and we believe therefore that not only should the proposed law not be passed but that it would be wise legislation to make drastic revisions of the Securities Act of 1933.

Since such revisions can probably not be worked out quickly, it would, in our opinion, be desirable to repeal that law now and, in lieu of both of those acts, appoint a commission for the purpose of studying the question thoroughly and reporting to the next session of Congress with proposed legislation to accomplish such reforms as might appear advisable after such study. As a suggestion, the make-up of such a commission of study, in addition to representatives of the legislative authority and appropriate Government departments, might well include men selected from the stock exchanges, investment banking business, banks, insurance companies, legal profession, public-accounting profession, and corporate executive and accounting officers.

It is worth noting that the Federal Reserve Act, our most important piece of financial legislation, as finally enacted in December 1913, effecting a vast improvement in our whole banking and currency system, was incubated and perfected only over a period of several years.

We are very appreciative of the courtesy extended to us in permitting us to be heard on our reactions to the bill as presented. We offer to place our services at the disposal of the committee for any elaboration of the above or any study which it desires to obtain.

The CHAIRMAN. All right, Mr. Chinlund. Are there any questions by members of the committee?

Senator KEAN. I think you have outlined it would be almost impossible in the accounting business to require accounts, for instance, if you take a great international company today, and they ship their goods all over the world, and, say, they get paid in the currencies of other countries, when they get paid in the moneys of other countries, some countries prevent that money from being remitted out of the country, don't they?

Mr. CHINLUND. That is right.

Senator KEAN. And therefore such a company would have to maintain a deposit in that country, and they might report that as earnings whereas the exchange might vary very much, and they might suffer a big loss on it, is that right?

Mr. CHINLUND. That is right.

Senator KEAN. So that the earnings would not really be reflected in what they were doing.

Mr. CHINLUND. The proper procedure in that case, in event they had funds in another country, would be to value their receivables at the amount the balance sheet would take, whatever it happened to be.

Senator KEAN. Yes; and that would be very doubtful, because they could not get their funds out of the country, isn't that so?

Mr. CHINLUND. Yes, sir. And they certainly ought to state that fact.

The CHAIRMAN. Very well, Mr. Chinlund, we are very much obliged to you.

(Thereupon Mr. Chinlund left the committee table.)

The CHAIRMAN. I now want to make a part of the record a communication received from the Federal Trade Commission today, being dated March 6, 1934, which bears on matters that I have referred to and that I think are important. I now ask the committee reporter to enter these on the record and I want them returned to me.

FEDERAL TRADE COMMISSION,
Washington, March 6, 1934

Hon DUNCAN U FLETCHER,
Chairman Senate Committee on Banking and Currency.

MY DEAR SENATOR FLETCHER. There is enclosed a copy of Commission's exhibit 5666, consisting of copies of correspondence between officials of the Chicago Stock Exchange and officials of Tri-Utilities Corporation. These letters were written during 1930 and 1931.

Tri-Utilities Corporation went into receivership August 31, 1931. The assets of Tri-Utilities were sold and the receiver was discharged the latter part of January 1933

As you will note, the subject of the correspondence related to support of the market for the common stock of Tri-Utilities Corporation The final liquidation dividend of the receivership estate in January 1933 was less than $9,000, which was paid to creditors, with aggregate claims of about $20,000,000, exclusive of common and preferred stockholders The amount of common and preferred stock outstanding was in excess of $15,000,000 which amount was a total loss.

Very truly yours,

GARLAND S FERGUSON, *Chairman*

FEDERAL TRADE COMMISSION EXHIBIT No. 5666

THE CHICAGO STOCK EXCHANGE,
November 3, 1930.

Mr G. L OHRSTROM,
President Tri-Utilities Corporation,
Jersey City, N J.

MY DEAR MR OHRSTROM:

One of the understandings the Chicago Stock Exchange asks, when securities are listed here, is that those applying for the listing will keep up a market. By keeping a market we mean keeping a bid in these securities at all times on the exchange.

The public, which has purchased the securities listed on any stock exchange, is under the impression that they will always be able to sell such securities in the future at the exchange where they are listed.

When a security listed here has no market—in other words, when a listed security cannot be sold at any price—the situation brings criticism from the owners of such stocks and bonds, as well as from the commercial banks that are asked to place loan values on these securities In fact, our banks take the attitude that any listed security with no bid is worthless as collateral

I mention these facts because I believe they are of enough importance for you to make every effort to keep a market for your securities listed here. Our records show there has been no bid in your common stock for several months and the last sale was on March 28, 1930

I am sure you will see the importance, not only to the Stock Exchange but to your own company as well, in cooperating with us along the lines suggested. I will appreciate it if you will let me know what your plans will be in this connection

Very sincerely yours,

HARVEY T. HILL,
Executive vice president

NOVEMBER 21, 1930.

Mr HARVEY T HILL,
Executive vice president Chicago Stock Exchange,
120 South La Salle Street, Chicago, Illinois

DEAR SIR We have your recent letter addressed to Mr Ohrstrom on the subject of market transactions in Tri-Utilities Corporation common stock on the Chicago Stock Exchange

We note your statement that there have been no sales of this stock for several months We call your attention to the fact that transactions in this stock occur frequently on the New York Curb Exchange, and that anyone wishing to dispose of this stock can do so in New York The fact that sales occur in the New York market also makes the stock available for use for collateral . It is a fact over which the corporation has no control that the market for its stock has developed in New York rather than in Chicago

We need not tell you that over the past year diminished public interest in common stocks has resulted in rather thin and inactive markets in many stocks in which there would otherwise be considerable trading We believe that when a different condition exists in security markets generally a more active market will develop in Chicago as well as in New York

We wish to cooperate with the Chicago Stock Exchange and will do everything which we reasonably and properly can to facilitate transactions on the Chicago exchange

Yours very truly,

TRI-UTILITIES CORPORATION,
By F S SPRING, *Treasurer.*

THE CHICAGO STOCK EXCHANGE,
120 South La Salle Street, December 20, 1930.

Mr F S SPRING,
Treasurer, Corporation, One Exchange Place, Jersey City, N J

DEAR SIR: Referring to your letter of November 21st, will state that it is the obligation of every company whose securities are listed on our Exchange to maintain a bid for said securities or to see that a bid is maintained by its bankers Failure of any company to carry out its obligations in this respect will, at the very least, have a bearing upon the consideration of other issues of the corporation which may be submitted for listing or sponsored by the same bankers.

By reason of the listing of our stock on this exchange, your company has the benefit of exemptions under the securities laws of a considerable number of States which do not exempt curb securities Most of these exemptions require that the securities be not only listed but dealt in The purpose of such provision is undoubtedly that the investor may be guided by the record of actual sales on the recognized exchange, and it might be possible for a litigant to allege that the exemption did not apply where transactions did not take place at reasonably frequent intervals

I discussed this situation with Mr Massey before his recent illness, and if he is now back at his desk I would suggest that you talk the matter over with him There is a great deal of interest in this section in your company and affiliates, and with a reasonable amount of cooperation from the company and the bankers an active market can be developed.

Very truly yours,

E. W. FEDDERSON, *Chief Examiner*

DECEMBER 23, 1930

Mr R R MASSEY,
Care of G L Ohrstrom & Co, Inc, 231 South La Salle Street,
Chicago, Ill

DEAR MR MASSEY We received a letter from E W Fedderson, copy of which is attached in answer to our letter to the Chicago Stock Exchange dated November 21, copy of which is also attached

We should be glad if you will give us your comment on this situation in the light of your conversation with Mr Fedderson

Yours very truly,

F. S SPRING, *Treasurer.*

JANUARY 13, 1931.

MR M. E SIMOND,
New York Office

DEAR MAYNARD A few days ago I had a long talk with Mr E W Fedderson, statistician of the listing committee of the Chicago Stock Exchange, with reference to the markets on our securities listed on that exchange

Mr Fedderson stated that the feeling of the exchange that we were not properly supporting our markets had become very definite They have always considered our situations as among the more sound and stable issues listed, and have been particularly disappointed with the market on Tri-Utilities common, which they feel should be in much better condition since it is our top holding corporation They do not seem to be so seriously concerned over the lack of activity as they are over the fact that for some period of time there has not even been a bid of any sort for the stock They are aware of the general problems which arise in running a market but feel that there should be some point at which we could bid for the stock which would not involve taking back very much of it

Mr Fedderson's attitude towards us has been and still is very friendly His attitude is that while serious consideration has been given by the exchange to taking some of our securities off the list, at the present time there is no action of that sort contemplated He feels that the exchange would certainly give us a chance to work on the situation before doing anything further, but that they would be looking for some improvement in the situation—particularly with respect to Tri-Utilities—sometime within the near future

As I suspected before talking to Mr Fedderson, one of the factors which has caused a definite drive on the part of the exchange for increased activity in listed stocks has been severe criticism on the part of middle western securities commissions of the markets maintained Action has now been taken in Wisconsin to remove the Chicago Stock Exchange from the list of exchanges whose listed securities are exempt under the Wisconsin securities act It seems fairly definite that this action will be successful and the Chicago exchange expects to be stricken from that list Apparently similar action is contemplated in other Middle Western States

In view of the fact that business seems to be a little bit better than it has been recently, and that plans are being made to better the condition of the Tricommon market, is there not some way that we can within the near future at least place some sort of a bid with the Chicago Stock Exchange? They are naturally quite interested in seeing some activity in the stock, but I feel that a bid of any sort would go a long way toward curing what has become a very sore situation

Very truly yours,

R R MASSEY

G L OHRSTROM & CO, INC, NEW YORK,
BOARD OF TRADE BUILDING,
Chicago, Ill, January 14, 1931

MR F S SPRING,
Tri-Utilities Corporation,
1 Exchange Place, Jersey City, N J

DEAR FRANK In accordance with our conversation while I was in New York, I have discussed with Mr Fedderson of the Chicago Stock Exchange the complaints which he made to you concerning the market on Tri-Utilities common

Attached you will find a copy of a memorandum written to Mr Simond concerning my visit with Mr Fedderson

While we are apparently to be given further leeway in the matter, I feel that in order to avoid trouble with the exchange, we are soon going to be forced to put some sort of a bid on the Chicago Exchange

Yours very truly,

R R MASSEY

JANUARY 13, 1931

Mr R R MASSEY,
Care of G. L Ohrstrom & Co, Inc,
231 South La Salle Street, Chicago, Ill.

DEAR MR MASSEY: You will recall our conversation with you on the subject of maintaining a market in Tri-Utilities Corporation common on the Chicago Stock Exchange

I am wondering if you have discussed this matter any further with anyone connected with the Chicago Stock Exchange.

You will recall that we suggested that the letter from Mr. Fedderson might be answered by saying that you or Mr. Pitner would call on him and discuss this general subject, and explain the present situation with respect to the market.

Yours very truly,

H D MCHENRY

G. L. OHRSTROM & CO, INCORPORATED

NEW YORK

BOARD OF TRADE BUILDING,
CHICAGO, ILLINOIS,
January 16, 1931

Mr. H. D. MCHENRY,
Tri-Utilities Corporation,
1 Exchange Place,
Jersey City, New Jersey.

DEAR MR MCHENRY: I have your letter of January 13th with reference to our conversation on the subject of maintaining a market in Tri-Utilities Corporation Common Stock on the Chicago Stock Exchange

I discussed this matter with Mr. Fedderson of the Stock Exchange upon my return to Chicago the first of the year. I wrote Mr. Simond of our New York office a memorandum concerning this and forwarded a copy of this memorandum to Mr Frank Spring, which you can undoubtedly obtain in your office.

Through the cooperation of our New York office a bid has now been entered and we feel that matters can be satisfactorily adjusted with the Exchange.

Yours very truly,

RRM: R R. R MASSEY,

The CHAIRMAN. The committee will now stand in recess until 10:30 o'clock tomorrow morning.

(Thereupon, at 5:10 p.m., Wednesday, Mar. 7, 1934, the committee adjourned until 10:30 o'clock the following morning.)

APPENDIX No. 1

(*a*) A call, which gives the right in consideration of a premium paid, to buy and receive delivery of a specified quantity of a named security at a fixed price, on or before a stated date, reads as follows:

CALL

This contract must be presented to the cashier of the firm it is endorsed by, before the expiration of the exact time limit. It will not be accepted after it has expired and cannot be exercised by telephone

NEW YORK, *March 7th, 1934.*

For value received, the Bearer may call on endorser on one day's notice except last day when notice is not required for one hundred_____ (100) shares of the common stock of the U S Steel Corp_____at fifty-seven_____dollars per share ($57 00), any time in thirty_____ days from date.

All dividends for which transfer books close during said time, go with the stock

Expires April 6th, 1934
2:45 p.m.

A. BLANK, *Broker.*

Delivery on C. H Sheet of N. Y S. E. or next day according to S. E. usage.

Endorsed by a New York Stock Exchange firm

PUT

(*b*) A put entitles the purchaser to deliver a specified amount of stock at a stipulated price on or before a specified date

This contract must be presented to the cashier of the firm it is endorsed by, before the expiration of the exact time limit It will not be accepted after it has expired and cannot be exercised by telephone.

NEW YORK, *March 7, 1934.*

For value received, the bearer may deliver me on one day's notice except last day when notice is not required one hundred_____(100) shares of the common stock of the U.S. Steel Corp_____at fifty-one_____ dollars per share ($51 00), any time in thirty_____days from date.

All dividends for which transfer books close during said time, go with the stock.

Expires April 6th, 1934
2:45 p m.

A BLANK, *Broker.*

Delivery on C. H. Sheet of N. Y. S. E. or next day according to S. E. usage.

Guaranteed by a New York Stock Exchange firm

APPENDIX No. 2

COURT DECISIONS

The attitude of the courts towards put and call transactions is shown in the following court decisions·

In *Biglow* v. *Benedict*, 70 N.Y. 202, the defendant, in consideration of a payment of $250, agreed to receive from the plaintiff at any time within six months a certain quantity of gold coin at a specified price The defendant refused to carry out the contract and set up the claim that the transaction was a gamble. The court held that the contract was legal in spite of the element of hazard involved. It was pointed out that the same element of chance occurred in every optional contract when one of the parties binds himself to sell or receive property at a future time at the election of the other. The court said:

* * * * * * *

"Mercantile contracts of this character are not infrequent and they are consistent with the *bona fide* intention on the part of both parties to perform them. The vendor of goods may expect to purchase or acquire them in time for a future delivery, and while wishing to make a market for them is unwilling to enter into an absolute obligation to deliver, and therefore bargains for an option, which, while it relieves him from liability and assured him of a sale in case he is able to deliver, and the purchaser may in the same way guard himself against loss beyond the consideration paid for the option in case of his inability to take the goods There is no inherent vice in such a contract."

Story v. *Solomon*, 71 N Y 420, involved the question of a double option where the seller agreed either to receive or deliver 100 shares of Western Union stock within a certain time at a certain price. The court said:

"There is always an element of speculation and uncertainty as to that, and yet it had never been supposed that there is any betting by such contracts. Here the option to buy or sell was put in the same contract. On the face of the contract the plaintiff provided for the contingency that on that day he might desire to purchase the stock, or he might desire to sell it, and in either case there would have to be a delivery of the stock or payment of damages in lieu thereof. We should not infer an illegal intent unless obliged to. Such a

transaction, unless intended as a mere cover for a bet or wager on the future price of the stock, is legitimate and condemned by no statute, and that it was so intended was not proved If it had been shown that neither party intended to deliver or accept the shares, but merely to pay differences according to the rise or fall of the market, the contract would have been illegal."

In *Irwin* v. *Willear*, 110 U S 499, the question arose as to whether a contract covering grain futures was a gambling contract The defendant contended that he never intended to take delivery The court said:

"It makes no difference that a bet or wager is made to assume the form of a contract Gambling is none the less such because it is carried on in the form or guise of legitimate trade It might therefore be the case that a series of transactions such as that described in the present record might present a succession of contracts perfectly valid in form, but which on the face of the whole taken together and in connection with all the attending circumstances, might disclose indubitable evidence that they were mere wagers"

It was held, however, that it was not sufficient to show that one party intended that delivery should not be made "The proof must go further and show that this understanding was mutual—that both parties so understood the transaction"

To the same effect:

Hentz v *Miner*, 58 Hun 428,
Zeller v *Leiter*, 189 N Y 361,
Springs v *James*, 137 App Div 110, affd 202 N Y 603;
Cohen v *Rothschild*, 182 App Div 408

In *Lewis* v *Wilson*, 50 Hun 166, the plaintiff sought to enjoin his suspension by the Consolidated Exchange where a claim was made that he failed to perform an agreement to accept stock under a put contract The defendant claimed the contract was illegal The court said:

"* * * to render agreements of this description illegal and void, it must appear affirmatively that they were entered into as gaming contracts and not as real transactions for the purchase and sale of property * * *"

Embrey v *Jemison*, 131 U S 236,
Watson v *Blossom*, 2 N Y S 551,
West v *Wright*, 86 Hun 436

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Munds, Winslow & Potter, Frank S Thomas, 40 Wall Street, New York, N Y.
William Morris & Co, William Morris, 44 Pine Street, New York, N Y
G M. P Murphy & Co, Prescott Eiskine Wood, 52 Broadway, New York, N Y
National Quotation Bureau, L E Walker, 48 Front Street, New York, N Y
George Nelson & Co, George Nelson, 74 Trinity Place, New York, N Y
Mark Noble & Co, Mark A Noble, 30 Broad Street, New York, N Y
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Wm J Ryan & Co, William J Ryan, 44 Wall Street, New York, N Y
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