STOCK-EXCHANGE PRACTICES

THURSDAY, APRIL 5, 1934

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

The committee met at 10:30 a.m., following adjournment on Tuesday, April 3, 1934, in room 301 of the Senate Office Building, Senator Duncan U. Fletcher (chairman) presiding.

Present: Senators Fletcher (chairman), Wagner, Bulkley, Gore, Costigan, Reynolds, Bankhead, McAdoo, Adams, Norbeck, Goldsborough, Townsend, and Carey.

Present also: Senator King, of Utah; 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.

The CHAIRMAN. The committee will come to order, please. Mr. Untermyer is able to be present this morning. The members of the committee know very well, I think, about his great interest in this subject. He has been active more or less, and certainly concerned, about the subject for over 20 years. We know of his services with the Pujo Committee; we know of his services here when we had a bill pending in 1914; and he has a thorough understanding of this whole situation.

Now, Mr. Untermyer, we will be very glad for you to just discuss this bill. Have you examined the revised bill and the bills that are pending before this committee?

Mr. UNTERMYER. I have examined the revised bill after a fashion, within the limited time at my disposal. I have examined the original bill very fully.

The CHAIRMAN. All right. We will now be very glad to have your views.

STATEMENT OF SAMUEL UNTERMYER, ATTORNEY AT LAW, NEW YORK CITY

Mr. UNTERMYER. Mr. Chairman and gentlemen of the committee, I tried to fix up something on the way over. I trust that the committee will not get the impression from anything I may say by way of criticism of the pending bill that I am lacking in enthusiasm or appreciation of the necessity for the enactment of comprehensive legislation for Federal regulation of stock exchanges.

Perhaps I may be pardoned in that connection——

(Thereupon Senator Bulkley, of Ohio, came into the committee room and was congratulated by members of the committee.)

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Senator KING. Mr. Untermyer, here is the new bridegroom, and we have to interrupt your statement in order to congratulate him.

Mr. UNTERMYER. Well, Senator Bulkley, I also congratulate you.

Senator BULKLEY. I thank you.

Mr. UNTERMYER. Now shall I resume?

The CHAIRMAN. Yes.

Mr. UNTERMYER. Perhaps I may be pardoned in that connection for referring to the fact that I have been for at least a quarter of a century actively agitating for such legislation, both in the Congress of the United States and in the State of New York, and am the author of a number of bills looking to that end, beginning with the bill recommended in the Pujo Committee report, and followed in 1913 by a bill which was before the Senate Committee on Banking and Currency, of which Senator Owen, of Oklahoma, was then chairman, and known as the "Owen bill", and ending with the submission of a bill last year that was prepared by me at the request of the President.

I am profoundly imbued with the necessity for such legislation and deeply interested in the subject.

Before outlining my objections to the present bill, permit me to refer to the omission of a number of particulars that may be regarded in a sense as of comparative minor importance but which seem to me of considerable importance. In what I have to say on this subject I have more particularly in mind the form of the constitution and the regulations of the New York Stock Exchange, after which the others are largely patterned.

First. For 40 or 50 years the membership of the New York Stock Exchange was limited to 1,150 members. At least I think that was the number. That was true, alth ough the business of the exchange had increased, perhaps, fiftyfold. It was not until after the boom of 1929 or thereabouts that it was increased by 25 percent, or 375 seats. Those were issued as in the nature of membership dividends, the sale and distribution of which was vested in the board of governors of the New York Stock Exchange, so that the present membership is about 1,450.

Those seats, I understand, were sold at an average price of approximately $500,000 each, yielding enormous cash dividends of over $175,000,000 to the members of the exchange as a result of their monopoly of the right to sell securities thus built up and for which the public has had to pay in the form of commissions.

I suggest that the Federal Trade Commission be given supervisory control over the exchange membership, and that the proceeds from the sale of future seats be treated as a trust fund for the public benefit instead of a sinecure for the members.

One of the regulations of the exchange that has been very drastically enforced has given to exchange members on the insolvency of a member or firm a priority over all other creditors to the extent of the value of that seat, and every member to whom the insolvent member is indebted will get 100 cents on the dollar, although defrauded creditors may not get more than 1 cent or 5 cents on the dollar, which has frequently been the case. It seems to me that rather runs up against the law of the land, and that upon bankruptcy, and many of them have become bankrupt, the seat should be an asset of the estate and all creditors should share in the value or the realized

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sum from that seat. The members should not be preferred creditors to the extent of the value of the seat.

Second. The commission rates on the purchase and sale of securities have been practically doubled in recent years. They now range, I believe, from $20 per 100 shares to $50 per 100 shares, of which one half is payable by the seller and the other half by the buyer.

While section 46, page 18, of your bill would give the Federal Trade Commission the right to prescribe uniform rates of commission, it does not otherwise authorize the Commission to fix rates, which it seems to me it should do and would do by striking out the word "uniform." That would permit the Commission to fix rates.

The volume of the business transacted on the exchange has increased manyfold. Great fortunes have been made by brokers through this monopoly. The public has no access to the exchange by way of membership except by buying a seat and paying a very large sum for it. Therefore it is a monopoly. Probably it has to be something of a monopoly. But after all it is essentially a public institution. It is the greatest financial agency in the world, and should be not only controlled by the public but it seems to me its membership and the commissions charged should either be fixed by some governmental authority or be supervised by such authority. As matters now stand, the exchange can charge all that the traffic will bear, and that is a burden upon commerce.

Third. The power of the exchange to expel and suspend members is now supreme, and so remains under the terms of this bill. A former president of the stock exchange testified as long as 22 years ago before the Pujo committee that the most grievous offense a member could commit would be to split commissions or to reduce the prescribed commissions. Although many of the great capitalists of the country who deal largely on the exchange in the purchase and sale of securities never act as brokers, yet they are able to have their orders executed at less than 10 percent per share of the cost to the public by reason of holding a membership.

Senator COSTIGAN. Mr. Untermyer, is it your suggestion that the prices at which seats on the exchange are sold should be fixed by an external governing authority?

Mr. UNTERMYER. No. My suggestion is that the proceeds from such monopoly, and the increase of seats, should go into some sort of trust fund and not into the pockets of members of the exchange. This $175,000,000 I referred to was simply distributed among the members of the New York Stock Exchange.

Senator MCADOO. Mr. Untermyer, you would suggest that it go into a trust fund for whose benefit?

Mr. UNTERMYER. Well, I suppose it could be used to some extent toward the administration of the act.

Senator GOLDSBOROUGH. Mr. Untermyer, did I understand you correctly that if a deed of trust be filed or a petition in bankruptcy by a member of the New York Stock Exchange, the proceeds arising from the sale of his seat on the exchange would not go to his general creditors?

Mr. UNTERMYER. It would not. It goes to the members of the New York Stock Exchange.

Senator MCADOO. Well, they have a prior claim on it under the rules of the New York Stock Exchange; is that it?

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Mr. UNTERMYER. Yes. Under the rules of the New York Stock Exchange they have a prior claim on it. But is there any reason for such a rule?

Senator GOLDSBOROUGH. I quite agree with you, but my understanding was that the situation was quite the contrary. I am glad to be advised of the true situation, and now understand from you that it is the other way.

Mr. UNTERMYER. Yes.

Senator MCADOO. It has always been as Mr. Untermyer suggests. They have always had a preference, and I think Mr. Untermyer is right in saying that no such preference should be given.

Senator GOLDSBOROUGH. Well, I did not know that that was the situation, and I am glad to be set right on it.

Mr. UNTERMYER. I happen to know because I have had many experiences along that line.

Senator GOLDSBOROUGH. Oh, I have no doubt of your knowledge. I am quite sure that you are right about it.

Mr. UNTERMYER. And I know of instances in which the estate has yielded 1 percent to other creditors, while stock exchange members have received 100 cents on the dollar.

The CHAIRMAN. You may proceed with your statement, Mr. Untermyer.

Mr. UNTERMYER The expulsion or suspension of a member not only exterminates him in a business sense but destroys his reputation. It seems to me such a decree should be subject to judicial review. I do not mean by this that the operation of the judgment of expulsion or suspension should be stayed pending such review, but that the right to appeal to the courts should exist. It is an arbitrary and undemocratic power that should not be vested in any body of individuals. It is likened unto a private club, and for many years they took the position in the courts that they were in effect a private club. The courts have sustained that contention, or practically have sustained that contention, so that no member could get a review. A member cannot get a review as things now stand.

Senator COSTIGAN. In other words, the consequences are in effect those of disbarment of any member of the legal profession.

Mr. UNTERMYER. Oh! They are worse almost, it seems to me, and there is no opportunity for a judicial hearing anywhere. Now, it would disrupt the business of the exchange if a man could operate, could stay the operation of such a judgment. I do not think that should be permitted, and while I think the judgment should go into effect, yet if the man should feel that he wants to clear his reputation he ought to be given the opportunity to do so.

Senator GORE. If he were allowed to stay in the exchange as a member. I mean after a judicial proceeding, could the rest of the members boycott him so that it would be in the end equivalent to expulsion even though he were cleared?

Mr. UNTERMYER. Well, I don't know about that. I should say not if you have a regulatory power over the exchanges, such as I have been contending for now for a quarter of a century.

Senator GORE. I thought the other brokers might, out of respect for the decree of the management or the board of governors, even though a court held a man should not be expelled, just refuse to trade with him.

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Mr. UNTERMYER. Well, he would still have his customers, would have the people who believed in him, after a court should vindicate him. My idea was that he should not remain in the exchange and continue to deal pending his appeal, but that if he should be vindicated by a court then I think he should be reinstated.

Senator MCADOO. Is it your idea that, in case of vindication by the courts, he would have an action against the exchange for the damages he had suffered?

Mr. UNTERMYER. No. I do not think so.

Senator GORE. Wouldn't his orders have to be executed by some other broker, I mean on the other side of the transaction?

Mr. UNTERMYER. Yes; they would have to be executed by a broker on the other side of the transaction, but so long as you have a regulatory body, why, its duty would be to see that orders are executed if they are bona-fide orders.

Senator GORE. What I was wondering about was this: If John Doe were a member who, it was undertaken, should be expelled, and if he gave an order to Richard Roe, would Richard Roe execute that order?

Mr. UNTERMYER. Well, Senator Gore, sufficient unto the day is the evil thereof. The question is whether a man should have his day in court on a subject of that kind. Many of these expulsions in years gone by have simply been because of reducing the commissions to a large customer, or splitting commissions. They have not been, as a rule, for fraud.

Senator MCADOO. Nor for moral turpitude, I take it?

Mr. UNTERMYER. No. Some of them, I should say many of them, have not been cases of members guilty of moral turpitude. And others who have been guilty of moral turpitude have stayed in the exchange until they were sent to prison, such as this man Booth, who kept no books. The exchange told him he should keep books, but he kept none. He got rid of millions of dollars of the people's money. Now, I believe, he is up in prison.

Mr. PECORA. I think he is out by this time.

Mr. UNTERMYER. Is he out by this time?

Mr. PECORA. Yes! I think so.

Mr. UNTERMYER. Well, he ought to go back.

Senator WAGNER. Well, I believe there is a review in a case where the board of governors may act arbitrarily in the matter of expulsion.

Mr. UNTERMYER. No, sir.

Senator WAGNER. Well, then, I did an illegal thing when I attempted to review, as a judge, the famous Miller case.

Mr. UNTERMYER. I remember the Miller case very well. But after you had reviewed it and examined the authorities you found there was nothing you could do, didn't you? You did not reinstate him.

Senator WAGNER. No; but I declined on the ground that there was evidence to sustain the action of the board of governors in expelling him. There the charge was a very serious one.

Mr. UNTERMYER. But the precedents are all against that. I do not know of any case in all the history of the New York Stock Exchange where a fiat of the board of governors has been reviewed and reversed, or the courts have taken any jurisdiction. I have had some of those cases myself.

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The CHAIRMAN. I think we have spent enough time on that angle. That is a matter of practice or of the internal operations of the exchange among its members. I do not see the relation to the public interest there as being so vital.

Mr. UNTERMYER. It has the relation of the rights of individuals.

The CHAIRMAN. Yes.

Mr. UNTERMYER. It is not everything that people agree by contract to do in a public body of that kind that ought to be enforced, because they have been more solicitous for their commissions and for maintaining their standard of commissions, in which I think they are perhaps right, than they have been about any other subject.

The CHAIRMAN. I am glad to have the point, but I do not think we need to take much more time on it.

Mr. UNTERMYER. All right; the next suggestion I make is this: I urge that there be included in the bill the necessary machinery to enable holders of bonds and debentures that are listed on the exchange, to communicate with one another for mutual protection, and that no such security should be listed or should be retained on the list that does not provide for such protection.

As matters now stand, the trustee for the bonds through which the interest coupons are paid is the only one who has the means of ascertaining the real owners where they are bearer bonds, as most of them are, and bearer coupons. The trustees should be required to furnish the company with these lists from time to time, and the latter in turn should be under the duty of supplying them to the bondholder. The result of the present situation is that it is well-nigh impossible for protective committees on defaulted bonds or other contesting bodies of bondholders to communicate with one another, and their protection against the powers that be in the corporation is almost impossible.

We have recently had the last of many object lessons in this connection, one in which I am concerned, or was concerned, for the protective committees in the case of Kreuger and Toll, and the International Match Co., where there were two protective committees, of which Messrs. Bainbridge Colby and ex-Governor Silsby, of New Jersey, are the respective chairmen.

The firm of Lee, Higginson & Co., of Boston, and the issuing houses, great trust companies and banking houses connected with them, were responsible for the perpetration of colossal swindles on the securityholders of these companies. I do not mean to say that they perpetrated these swindles. I do not mean to say that they knew of the swindles. But they were so grossly negligent in not examining into the affairs of those companies and their names were so great that people relied so implicitly upon them, that I regard them as responsible for those swindles. And yet the issuing houses connected with that banking firm, or their representatives, were able to corral the bulk of the bonds almost to the exclusion of the committees organized to protect the holders, because of the inability of the protective committees to ascertain the names and addresses of securityholders; whereas the inner circle had access to that information There was $350,000,000 lost to the securityholders of this country in that transaction. They are going to get practically nothing.

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Senator GORE. You think much of that could have been saved to the security holders by the plan you suggest?

Mr. UNTERMYER. Well, I don't know that the plan I suggest could have saved them, but the plan I suggest would have given them a chance to get together and endeavor to protect themselves.

Senator GORE. And make an effort?

Mr. UNTERMYER. Yes. Instead of which these security houses had the access to the lists of bondholders and nobody else could get them. I think out of 150 million dollars of bonds our protective committees were able to get by advertisment less than 10 million dollars in bonds, because we could not reach these people, did not know where they were. They were in every corner of the earth. The average investor or the people of this country in those securities had as an investment less than $2,000 apiece. Every little hamlet in the country, the supersalesmen all over the country, just scouring the country and selling these bonds, whilst they worked on the stock exchange, manipulated the prices there so as to keep these bonds up a little above par until their hundreds of supersalesmen that floated them on the public got through and then they took the pegs from under them, and I think they are about $5 a bond now.

We will come to that later when we talk about this provision about allowing these syndicates to peg securities with the consent of the Commission. That is just another form of manipulation.

There is another effect that prevents stockholders of nondividend-paying corporations from joining for their protection. As counsel for the Transit Commission of New York I called this to the attention of the transit commission and the stock exchange a few years ago. It arose while we were endeavoring to get in touch with the stockholders of the Interborough Road, which had not paid dividends on its stock for some years.

Senator TOWNSEND. Mr. Untermyer, would you mind being interrupted there?

Mr. UNTERMYER. Not at all.

Senator TOWNSEND. You spoke of the pegging of the price of those bonds. Would you mind elaborating on that?

Mr. UNTERMYER. I am coming to that a little later.

Senator TOWNSEND. All right.

Mr. UNTERMYER. The stock of the Inter-Borough was being kicked around the street, as is usual in such cases, in the names of brokers who had at one time or another held it as collateral for loans, many of whom had not for years owned or had any interest whatever in the stock and in the certificates that stood in their names, and had no idea where they were. They used to give proxies on that stock until I had the exchange pass a regulation somewhat ameliorating that condition.

In such cases there was and is no way of ascertaining the names of those who own this stock or of the brokers who at the time may hold it as collateral. The brokers have been in the habit of issuing proxies on this stock that stood in their names, but as to the ownership of which they had no idea. The great banking houses in New York and in other cities have been in the habit of controlling publicly owned corporations through such practices, although in most cases they have little or no interest of their own in the corporation. I tried to induce the stock exchange to pass a regulation requiring

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every brokerage house that held such stock on margin to have it registered in its name within 10 days after it came into its possession, but the exchange refused that request on the ground that it would interfere with speculation in the stock.

Now, they did pass a regulation at my suggestion prohibiting brokers from giving any more proxies on stock that they did not have, although it stood in their names. But they did nothing to make it possible to find out for the city and the transit commission who owned this stock, and we cannot find out today.

All I can see is that it interferes not with speculation but with evading the transfer tax by passing the certificates from hand to hand. Its effect is to leave stockholders helpless in corporations that do not pay dividends. Of course, where they pay dividends is another situation. Then the books of the company show to whom the checks are mailed out. But a great preponderance of the common stock on the New York Stock Exchange I should say do not pay dividends. Every listed stock should be required to be registered in the name of the owner or of the broker who owns it, so that the stockholders can get together for mutual protection.

Now, my sixth suggestion: I respectfully submit that the provisions of section 13 (a) of your revised bill, page 52, line 21, with respect to proxies, they are the opposite of what they should be. The ability of security holders to join for their mutual protection against the management of corporations that are now largely controlled by those with no substantial financial interest in the corporation and to communicate freely with one another to that end and to protect one another should be encouraged rather than discouraged or made difficult.

Why should it be considered necessary or desirable in the public interest in the solicitation of proxies to continue or dislodge an existing management. Before being permitted so to do—I quote from the bill—to solicit or to permit the use of his name to solicit any proxy for consent or authorization in respect to any security, to apply to the Commission and to file with it a statement of his purpose or his relations to and interest in securities. The bill says "The names and addresses of the persons from whom similar proxies, consents, or authorizations are being solicited."

Senator ADAMS. Mr. Untermyer, what would be the effect of the section as it now stands on the corporate operations and contests over corporate control?

Mr. UNTERMYER. Well, as it now stands, anybody who wants to contest corporate control instead of being encouraged to do so and to have his voice heard, has got to go before the Commission and make a disclosure to the Commission and get the consent of the Commission to deal with his own property. Why? Who put that in and why was it put in? I am trying to find out some reason for it. It is difficult enough for people who want to buck up against these managements to do so. What is the purpose of making it more difficult? Why not leave the stockholders where they are. If they want to contest the management or an election or an act that is to be done by a corporation, why not permit them to do so?

The CHAIRMAN. I imagine the purpose was to prevent a group of stockholders from corralling all the stock by obtaining proxies secretly and quietly for that purpose.

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Mr. UNTERMYER. Well, in the first place, haven't the stockholders the same right to give them the stock, to vote to give it to the management? Why should the management have such an advantage as that over the ordinary stockholder that is trying to dislodge him?

The CHAIRMAN. The idea was to prevent that advantage to the management. The idea was to give the stockholders a chance.

Mr. UNTERMYER. It does not give him any chance at all. It does the contrary. It embarrasses him. It requires him to make a whole lot of disclosures to the Commission before he can go and approach his fellow stockholders and ask their authority to act.

Senator GORE. What is your suggestion as to facilitating this communication?

Mr. UNTERMYER. My suggestion is to facilitate the assertion of the rights of stockholders who are not controlled by the management, to give them a chance to come into their own.

Senator GORE. Yes.

Mr. UNTERMYER. Now, we all know that the bulk of the great corporations of the country are controlled by people who have not any interest in them.

Senator ADAMS. That is in line with your suggestion which you made just preceding this, that the lists of bondholders and stockholders be made available?

Mr. UNTERMYER. Yes; it is all in the same direction.

Senator GORE. Isn't that one of the fundamental troubles in our whole economic structure, that the management is divorced from ownership?

Mr. UNTERMYER. That is because the stockholders are willing to divorce management from ownership. If they choose to give their proxies to managements that have no ownership, that is their affair, but why embarrass people who want to change that sort of management?

Senator GORE. What is your concrete suggestion as to how to close the circuit and bring them into contact?

Mr. UNTERMYER. Well, my suggestion is to leave it alone as it is now; not to make it more difficult. That is all.

Senator MCADOO. You would eliminate this provision?

Mr. UNTERMYER. Yes; I would.

Senator GORE. You think that makes the present situation worse?

Mr. UNTERMYER. It does make it worse.

Senator GORE. And the present situation is bad enough?

Mr. UNTERMYER. Well, it is bad enough—very bad—because of the power of these brokers who have the stock registered in their names and these great corporations permit them to get these proxies. That is the way they get them. They get them through brokers.

Senator MCADOO. There is not any doubt there is a great abuse there, Mr. Untermyer, that ought to be corrected. I think the purpose of the bill was to correct them. Now, if it is to be made worse for the unprotected stockholders, I think we ought to have a concrete suggestion. We would be glad to have a concrete suggestion. You haven't any amendment prepared?

Mr. UNTERMYER. We do not need a concrete suggestion. Let them alone.

Senator GOLDSBOROUGH. You mean you would take out the entire section?

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Mr. UNTERMYER. I would take out the entire section.

Senator MCADOO. That is what I was getting at.

Mr. UNTERMYER. Unless you want to prevent brokers from giving proxies on stocks that stand in their names. You have tried to prevent it in other places, and we have tried to prevent it, and we have had some amendments passed to that end, looking in that direction, but they are not sufficient for the purpose. They do not accomplish the purpose.

Mr. PECORA. Mr. Untermyer, what is the objection in your mind to requiring anybody, whether it be a minority stockholder or a group of minor stockholders, or whether it be group of stockholders who may be minority stockholders in fact but who by virtue of their relationship to the corporation as officers and directors might manage or control the corporation—what would be the objection to any such person who desired to solicit proxies from their fellow stockholders setting forth in a statement to be filed with the Federal Trade Commission the specific purposes for which they are seeking those proxies? Doesn't that information acquaint every other stockholder with the avowed purpose or object for which his proxy is being sought?

Mr. UNTERMYER. Yes; it acquaints the management, too, and puts them on guard, so that the stockholders are much more embarrassed, and then it requires certain disclosures and it seems to me that it puts every stockholder who wants to protect his corporation and get a change of management in the position of a sort of a striker.

Now, somebody has evidently persuaded—someone connected with the drawing of this bill—that there are a lot of strikers around and that every fellow who wants to change a management is a striker.

Mr. PECORA. Speaking for myself and such others as I conferred with in the connection with the preparation of this bill with regard to section 13, what we had essentially in mind was putting every stockholder in a corporation, whether he was a large or small stockholder on an equal footing with every other, if such a stockholder desired to associate with him other stockholders for what purpose he had in mind, and making it thereby possible for every stockholder from whom a proxy is solicited by any other stockholder to know definitely what the purpose was of the person soliciting the proxy.

Mr. UNTERMYER. Why?

Mr. PECORA. Well, I think so a stockholder could intelligently decide whether or not to give his proxy.

Mr. UNTERMYER. He is not a babe in arms. He can decide.

Mr. PECORA. In the past stockholders have been solicited to give their proxies by other stockholders without really knowing what use was going to be made of their proxies.

Mr. UNTERMYER. They never did.

Mr. PECORA. What purposes were sought to be effectuated by those solicited proxies? Under this bill if enacted a stockholder whose proxy is solicited by any other stockholder would have specific information given to him concerning the purpose for which the proxy is sought and what use is intended to be made of it. Don't you think that that gives every stockholder an opportunity of better determining whether or not he shall give his proxy when it is solicited?

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Mr. UNTERMYER. No; because every committee of stockholders—and I have represented some hundreds of them at one time or another—every committee of stockholders explains in a circular to the stockholder why he wants his proxy. The proxy itself contains the particular features of the specified respects in which he wants to act. He has got all that information. What has the Commission got to do with it?

Mr. PECORA. Mr. Untermyer, very often the requests for these proxies specify the purpose that the solicitor seeks to effectuate in such very general language that the stockholder receiving it and sending in his proxy really does not know the extent of the grant and power that is given the attorney-in-fact named in the proxy.

I have at the moment specifically in mind an incident, proof of which was presented to this committee within the last two or three months, where the officers in control of the corporation had done certain acts during their year of administration and desired to get a blanket ratification of all of their acts from the stockholders. They sent out solicitations for proxies which in very general language contained a statement of that sort. The annual meeting or the special meeting of the stockholders that was called for the purpose of giving ratification to the acts of these officers, the only person attending the meeting was the representative of the officers who had all the proxies that had been turned in. No one else sought any proxies.

The result was that at this special meeting the officer of the corporation, the only stockholder present, voted nearly all the outstanding capital stock by virtue of these proxies in a resolution dictated by the officers who had done acts that well might have merited criticism, which was adopted ratifying those acts. And I venture to say that not a single one of the stockholders of that corporation who gave their proxies under those circumstances knew what acts they were going to be asked to ratify through the medium of the proxies that they gave.

Mr. UNTERMEYER. That abuse has existed from time immemorial, and it is an abuse by management, understand. This does not change it.

Mr. PECORA. It does to this extent, I believe, that this requires the management, or anyone—let us say the management—seeking proxies from fellow stockholders to state definitely what use they intend to make of the proxies, what purposes they have in mind to attain through the voting of the proxies; and when they do that, the moment they solicit proxies, it gives the right, this bill gives the right, to any other stockholder to go to the Federal Trade Commission, and by having access to the statement of purposes this Act requires the management to file, will be able to acquaint himself with those purposes and will in turn be thereby enabled to seek proxies from those same stockholders for the purpose of counteracting the aims and purposes of the management.

Mr. UNTERMYER. Mr. Pecora, you know and I know, from 50-odd years of practice of corporate law——

Mr. PECORA (interposing). Yours is an experience of 50 years. Mine is not.

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Mr. UNTERMYER. Yes. Well, at any rate, we know the abuses of this proxy system. You are adding to them by this provision. If you want to provide that every proxy shall state the specific purposes for which it is to be used, you understand, and it shall not be used for any other purpose applicable to all proxies, that is one thing, and that is what they have not done. They have had blanket clauses in their proxies under which all the acts, all the illegal acts of the directors and officers, have been ratified, and when we have gone to the court we have met those ratifications and they have been very difficult to overcome. We have not been able to overcome them.

But those are offenses of the management. Now, this law does not require anything of the management in that direction.

Mr. PECORA. It requires it of every one seeking proxies.

Mr. UNTERMYER. No; it does not require anybody. The statement of the purposes—why, that does not mean anything, unless you provide that the proxies—if you are going to go into that subject and have the commission deal with it instead of letting the security owners deal with it, as they can deal with it if you do not embarrass them, why that is one thing. This embarrasses them. I know it embarrasses them, because I have represented so many and I have represented so many corporations on the other end of this thing.

Mr. PECORA. You know, Mr. Untermyer, from your vast fund of experience, that persons constituting the management of a corporation in a great many instances in reality are very, very small stockholders.

Mr. UNTERMYER. Yes.

Mr. PECORA. This bill would require them to say in the statement to be filed with the Federal Trade Commission as a condition to their soliciting proxies from fellow stockholders not only the purposes for which those proxies are being sought and are to be used, but also to specify their actual individual interest in the corporation and their relation to it.

Now, I venture to say that in the past many stockholders who have given their proxies upon solicitation to the management of a corporation had been led to believe that the management seeking those proxies were large stockholders, and hence through their stockholding interests of a substantial volume could be regarded as being imbued with a desire to promote the best interests of the corporation; whereas, if those stockholders had known of the very slight interest which in many cases the managers of corporations actually have through the ownership of stock, they might not have been persuaded so easily and readily to send in their proxies.

Mr. UNTERMYER. That is all right theoretically, but that is not the way it works out in practice. The way it works out in practice——

Mr. PECORA (interposing). We do not know how this will work out in practice because the practice has not been initiated.

Mr. UNTERMYER. Well, yes; I can see how it will work out in practice, because the managements would come in, they would marshall all the stockholders they can get, and they would come in and they would say, "We represent so many stockholders and we are making this application in behalf of so many." Have you gone over it yet with the phraseology of this thing?

Mr. PECORA. We have, sir.

Mr. UNTERMYER. It is a burden upon the minority stockholder.

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Mr. PECORA. I think it makes the way open to every stockholder to be informed specifically the purposes for which his proxy is being solicited by any other stockholder, be the other stockholder connected with the management or merely acting as an individual.

Mr. UNTERMYER. Let us see if it does anything of the kind, Mr. Pecora. Let us see what page it is.

Mr. PECORA. Page 37 of the printed bill, H.R. 8720.

Mr. UNTERMYER (reading):

It shall be unlawful for any person, by the use of the mails, to permit the use of his name to solicit any proxy or consent or authorization with respect to any security registered on any national securities exchange unless (1) at such time prior to such solicitation as the Commission shall by rule or regulation prescribe the persons named to exercise such proxy, consent, or authorization shall file with the Commission a statement setting forth the purposes of the proxy, consent, or authorization

Now, then, that means you have got to tell your whole story in your circular.

Mr. PECORA. Isn't the stockholder entitled to that information when someone seeks his proxy?

Mr. UNTERMYER. Oh, they both ought to have to tell their story. The management should also tell its story.

Mr. PECORA. Neither one has to tell his story.

Mr. UNTERMYER. All the management says is "We are asking for a proxy to reelect our board." That is all. The man who is contesting, though, has got to show some reason why the board is not to be elected. He is the fellow who has got to make a disclosure, not the management. This does not impose anything upon the management.

Mr. PECORA. The management is required to conform to this section just as well as any other stockholder

Mr. UNTERMYER. Yes; but he is in control.

Mr. PECORA. And he wants to perpetuate or continue control

Mr. UNTERMYER. All this says is that he is asking for a proxy to reelect his board, that is all.

Mr. PECORA. Another stockholder desiring to bring about a defeat of that board may solicit proxies from the stockholders, from the other stockholders, and this would require him specifically to so state, and I think any stockholder is entitled as a matter of right, reason, and equity to know what uses are going to be made by anyone who solicits a proxy from him of that proxy.

Mr. UNTERMYER. He never gives a proxy against the management unless it is accompanied by a full explanation from a reputable committee.

Mr. PECORA. Then the explanation could be embodied in the statement.

Mr. UNTERMYER Now, but why should he? The management is going to send out a proxy. All they have got to do is to say that they want a proxy to reelect the board, and they want a proxy, if you please, to take care of all that has happened and have it all approved and ratified. That is all they say.

Mr. PECORA. He is trying to get proxies.

Mr. UNTERMYER. A man out of power has no chance of getting a proxy. Why should he apprise customers that he wants to go out with his proxies at the same time that the management goes out?

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He does not want to go out after the management. Most stockholders just sign their proxies, anyway, and send them in. They do not even know there is a row on. Why not let these people alone? They have got their rights now.

Mr. PECORA. I think all stockholders should be put in a position where, if anyone solicits their proxies, they must inform the stockholders what use is intended to be made of them, what purposes are intended to be effectuated by the use of the proxies

Mr. UNTERMYER. See how that lines up.

Mr. PECORA. I think it would line up by making it possible for every stockholder to learn in advance of his giving a proxy what the proxy is sought for, whether the request for the proxy comes from the management group or whether it comes from a minority group who want to use the proxy. It enables every stockholder to act intelligently with regard to the giving of his proxy, instead of putting him in position where he gives his proxy through the process of signing a blank check.

Mr. UNTERMYER. He does not give a proxy blindly. He gives his proxy to a broker.

Mr. PECORA. Under this bill he would not.

Mr. UNTERMYER. Yes; he would.

Mr. PECORA. Brokers are prohibited from doing it now, under this bill, without the written consent of the actual owner of the stock.

Mr. UNTERMYER. Yes; but they always get it. This bill does not add anything. That is so now. He has got to get the written consent of his customer now.

Mr. PECORA. Under a rule or regulation of the exchange.

Mr. UNTERMYER. Yes; which I had passed. He has got to get written consent; and where a man has a lot of stock on margin there is not much question about his consent He consents to whatever he is told to do.

Mr. PECORA. There is nothing to prevent the stock exchange from repealing or modifying its rules and regulations tomorrow.

Mr. UNTERMYER. I am not discussing that. I am going to discuss that a little later. I think it ought to be a little more specific; but that is the regulation as it exists today. The broker has got to have the written consent of his customer, and he never fails to get it. He gets it when he makes a loan. He gets two consents: he gets one by which he pockets the interest. Instead of the customer getting it, the broker grabs that, and the customer does not get the interest, nor does the customer get a proxy, because it is sort of a blanket proxy. I want to get that changed by a word or two so that there will have to be a written consent in each case.

But coming back to this question of proxy, I think you are embarrassing the rights of the minority stockholders by the proxy provision in the present bill. May I have just another minute or two on this? There is a regular stereotyped form that comes from the management. It provides as a rule for ratifying everything that the directors and officers have done. Now, suppose a minority stockholder or a committee of stockholders wants to contest that. The present system is ample and has worked very well. He goes to the stockholders, if he can get a list of them—and sometimes he cannot, because of the hocus-pocus that exists—he gets a list of stock-

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holders, and if he has a real grievance he has got to state his grievance in detail.

Mr. PECORA. He does now. Such a minority stockholder would have to state it now.

Mr. UNTERMYER. Yes; and he does state it in great detail.

Mr. PECORA. This bill would put him under no greater burden or obligation than exists now.

Mr. UNTERMYER. Yes; it would. He has got to show who is connected with him, who is associated with him, what other proxies he has got. He has got to uncover men who may not want to be uncovered in their fight for control——

Mr. PECORA. Not necessarily.

Mr. UNTERMYER. Yes. He has got to do it under this act. He has got to give all his cards away and the management sits by——

Mr. PECORA. Would he not have to do it anyway if he wanted successfully to combat the efforts of the management in the battle for proxies?

Mr. UNTERMYER. No; the man behind the scenes does not need to be disclosed; and if he thinks his financial life is of any value to him he generally does not disclose himself.

Mr. PECORA. You called attention to what you happily phrased as the present hocus-pocus that makes it sometimes impossible for a stockholder seeking to contest the continuation of a management group from getting a list of his fellow stockholders.

Mr. UNTERMYER. Yes.

Mr. PECORA. Under this bill, if the management group sought proxies in order to continue themselves in management and control as they always have, they would be required to file with the Federal Trade Commission a list of the names and addresses of the other stockholders whose proxies were solicited.

Mr. UNTERMYER. Where?

Mr. PECORA. With the Federal Trade Commission.

Mr. UNTERMYER. But where, in the bill? I do not see it.

Mr. PECORA. It provides for filing with the Commission a statement setting forth the purposes of the proxy, consent, or authorization, the persons to exercise it, their relations to and interest in the security, the names and addresses of the persons from whom similar proxies, consents, or authorizations are being solicited. Now management groups seeking proxies for the purpose of continuing their management or control would be required, under this bill, at the time they sought those proxies, to file with the Federal Trade Commission a statement which would include the names and addresses of the stockholders whose proxies were solicited, and that immediately makes that list available to any other stockholder who might seek to obtain proxies from stockholders in order to combat the management group.

Mr. UNTERMYER. But that list is available now, under the law. We need no law for that.

Mr. PECORA. You mentioned the hocus-pocus which has existed in the past and which has operated to prevent stockholders from getting access to such lists.

Mr. UNTERMYER. What I said was that these lists consist largely of brokerage houses who have long parted with the control of the stock that stands in their name, and if you get a list you get a list of

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these brokerage houses which have nothing to do with the stock except that they have been getting proxies on stock that they had nothing to do with at all. You would get no further information under this bill than you can get now and which is available to you at the moment. Not the slightest. You are just requiring people who are contesting the control of corporations to bring themselves under the jurisdiction of the Federal Trade Commission and such regulations as it may pass. That is just embarrassing. It does not help you in the control or the management. It is something tending to make it more difficult.

Senator GORE. It seems to me that both sides of this issue have been presented, if I might be allowed to say go.

Senator MCADOO. I think we might be allowed to proceed with the next point, Mr. Chairman.

The CHAIRMAN. Yes.

Mr. UNTERMYER. I say that subdivision (b) of section 13 is a mere reenactment of the existing regulation of the stock exchange which requires a written authorization from the customer before his broker can give a proxy; and I suggest, if written authorization of the customer is required as to each proxy thus given, the words "specific authorization from such customer" be substituted for the blank authorization such as is now in use.

The CHAIRMAN. Where is that?

Mr. PECORA. Lines 12 to 18, page 38 [reading]:

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

And so forth—

> to give a proxy, consent, or authorization in respect of any security registered on a national securities exchange and carried for the account of a customer without specific written authorization from such customer

Mr. UNTERMYER. "As to each such proxy."

Some of the above suggestions were called by me to the attention of Mr. Pecora in a communication to him on March 2, from California, before the revised bill was introduced. I have no disposition to discuss, and I am sure that you have no time to listen to any discussion of the question of the constitutionality of this bill in its present form. You and your counsel have doubtless given that subject the consideration to which its importance entitles it. That question was fully discussed in a brief submitted to the Senate Banking Committee by my deceased partner, Mr. Louis Marshall, and myself in 1913, for the committee, and by the late John G. Milburn for the stock exchange, in which I contended that regulation of the exchange could be accomplished under the post-office section of the Constitution and through the telephone and telegraph systems.

Senator GORE. To what committee was that brief submitted?

Mr. UNTERMYER. That was submitted to Senator Owens' committee. There was grave doubt as to whether it would be possible to regulate stock exchange transactions as within the purview of interstate commerce; but subsequent decisions of the United States Supreme Court in the cases of *Stafford* v. *Wallace*, *Board of Trade* v. *Olsen and Tagg Brothers and Morehead* (280 U.S.) have to a considerable extent strengthened the argument that these transactions may be regarded as interstate commerce, although the question is not free from doubt. Regulation under the post-offices section has, how-

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ever, always seem to me to be ample to insure the constitutionality of this legislation.

Addressing myself now to a friendly criticism of a more important provision of the bill, I beg respectfully to submit the following suggestions, which will be taken up in the order in which they appear in the bill:

On page 8, paragraph (13), and page 13, section 6 (a), the failure to include tax-exempt obligations of the States and political subdivisions among the exempted securities by specifying those of the United States Government——

Senator ADAMS. That has been done. This committee has already adopted an amendment of that kind.

Mr. PECORA. State and municipal bonds or bonds issued by any political subdivision.

Mr. UNTERMYER. I am very glad to hear that. It adds a great deal.

Senator MCADOO. That is already accomplished.

Mr. PECORA. After I received the letter from you that you were kind enough to send me last month, we discussed every suggestion of yours, and find that many of them have been adopted.

Mr. UNTERMYER. Some have not; and those are the ones that I am going to talk about.

Mr. PECORA. I mean, like the one you are now addressing yourself to.

Mr. UNTERMYER. I did not know that. It is not in the revised bill.

Mr. PECORA. No; it is not in printed form as yet.

Mr. UNTERMYER. That is very gratifying and it saves a lot of discussion. I felt that that would be a dangerous thing to do.

Senator MCADOO. It is not in the last print we received, Mr. Pecora.

Mr. PECORA. I beg your pardon, sir?

Senator MCADOO. That provision that we agreed on is not in the last print. It will be embodied subsequently.

Mr. PECORA. Yes.

Senator WAGNER. Is it not in the confidential print?

Senator ADAMS. No; that was adopted, Senator Wagner, when we were having a meeting over in the Capitol when we had the Chairman of the Federal Trade Commission present at a meeting of the committee. I think Mr. Pecora was not at that meeting.

Senator WAGNER. Do you also include securities of municipal agencies of one or more States?

Senator ADAMS. Yes; that is also included. That covers the port of New York.

Senator WAGNER. We have got to have a special provision for that.

Senator ADAMS. It is already in.

Senator WAGNER. We do not include it here. Using the words "political subdivision of a State" does not include the port authority, because that is an instrumentality of two States.

Senator ADAMS. That was specifically included in the amendment.

Senator WAGNER. I suggested that amendment; I remember that.

The CHAIRMAN. That was all threshed out over there.

Mr. UNTERMYER. In hurriedly going over this at about 1 o'clock this morning, I think I misread section 4 on page 10.

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The CHAIRMAN. Section 4 refers to transactions on unregistered exchanges.

Mr. UNTERMYER. I am not sure about this, Mr. Pecora. I may be mistaken, and you may correct me if I am. As I say, I dictated this hurriedly. Section 4 makes it unlawful for any broker or dealer, directly or indirectly, to buy, sell, or deal in any security on an unregistered exchange under the all-embracing definition of the word "exchange" as described in section 3 (a) of the bill. That seems to me to be a handicap upon the marketing of a vast proportion of the corporate securities of the country. There are many hundreds, probably thousands, of high-class bonds and stocks of companies privately owned that have not been and are not desired by the owners to be distributed to such an extent as to entitle them to listing, but which the owners may from time to time desire to sell through brokers. Why should that rule limiting distribution be denied to the owners of these properties? This is especially true as to bond issues. It happens about daily, or almost daily, that the owner of a comparatively small but perfectly sound property or business may want to market bonds or sell stock. The natural agency for such a transaction would be a banking house or a brokerage house. This provision seems to prevent him from using the mails to that end, does it not?

Senator GOLDSBOROUGH. What page is that, Mr. Untermyer?

Mr. UNTERMYER. Page 10.

Senator ADAMS. Mr. Untermyer is reading from page 10, section 4, H.R. 8720, the printed revised draft.

The CHAIRMAN. A modification of that was suggested. We propose now to leave that to the Federal Trade Commission.

Mr. UNTERMYER. I do not think so, Mr. Chairman. You mean under this bill as printed?

The CHAIRMAN. I think we have suggested a modification of that.

Mr. UNTERMYER. I do not see why there should be any interference whatever.

Senator GOLDSBOROUGH. I have a copy of the new draft here, Mr. Untemyer [handing document to the witness].

Mr. UNTERMYER. I understand that you have stricken that out and substituted something else for that.

Senator ADAMS. The House has made a suggestion which is in this new print.

The CHAIRMAN. Your point is well taken. I think it has been corrected.

Mr. UNTERMYER. I think that covers the situation. We might pass that, then. That seems to prevent the disbarring of sales of bonds.

Section 6 (a) makes it unlawful for any member of a national securities exchange, or any broker or dealer who transacts business through such a member, directly or indirectly, to lend on any securities not listed on the exchange. This I regard as one of the most serious prohibitions in the bill, especially with regard to loans on gilt-edge bonds, mortgages, and similar collateral. It seems to me to be an unnecessary restriction in the wrong direction, the effect of which will be to destroy the market value of many of the highest classes of securities, such as stocks of banks, insurance companies,

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and the like. If all unlisted securities are to be made unavailable as collateral, their marketability is wellnigh destroyed.

Has that been taken care of?

Mr. PECORA. It has; yes. The Commission is given the power, under the bill, to classify certain unlisted securities as exempt securities, taking them out of the operation of this prohibition. It has already been specifically done with regard to Government, State, and municipal bonds and bonds issued by any policial subdivision of a State or States or any agency or instrumentality of a political subdivision of a State or States.

Mr. UNTERMYER. Yes; but, Mr. Pecora, the question of whether or not they are going to be included rests with the Commission from day to day, and if it is uncertain whether they can be dealt in at all, there value is going to be affected.

Mr. PECORA. This prohibition does not run to banks making loans on such unlisted securities.

Mr. UNTERMYER. It did originally.

Mr. PECORA. The original draft was put out so long ago, and we have been working on so many different provisions, that I will not at this moment trust my recollection as to just what was in the original. I would rather charge my mind with what is now before us. But I think that has been taken care of. We had before us your letter at the time it was gone into.

The CHAIRMAN. That section has been modified.

Mr. PECORA. We gave most earnest consideration to it.

The CHAIRMAN. We have changed that entirely.

Mr. PECORA. I think you will find that that objection has been taken care of and met by revision.

The CHAIRMAN. The Federal Reserve Board now has charge of that matter.

Senator MCADOO. Are you talking about margin requirements?

Mr. UNTERMYER. No, sir.

Senator MCADOO. That is in this section.

Mr. UNTERMYER. But another subdivision.

Senator MCADOO. But that is the section that you are dealing with, is it not?

Mr. UNTERMYER. I am dealing with subsection (a).

Senator MCADOO. That is the 40-percent margin requirement?

Mr. UNTERMYER. No; that is not the one.

Senator MCADOO. That is subsection (a).

Mr. UNTERMYER. In other words, that prevents loans upon any collateral that is not listed—as it stood, I mean.

Mr. PECORA. By the broker only.

Mr. UNTERMYER. The broker makes a loan to his customer. He gets the money from the bank, but, after all, it is the broker's loan. He borrows it at a lesser rate as a rule because he adds his own responsibility But it is a broker's loan all the same. The banks never make loans on stock exchange collateral directly to the owner of the collateral. They make them to the broker and he carries the account and he goes to the bank.

Mr. PECORA. The broker is enabled to lend to his customer because he, in turn, gets credit from the bank.

Mr. UNTERMYER. But it is a loan from the broker to the customer.

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Mr. PECORA. But if the bars as to unlisted collateral were to be thrown down entirely and these margin provisions are to be made effective and enforceable, a broker could very easily evade the purpose and intent of the act, or that portion of the act relating to margin requirements, by assigning an arbitrary value to unlisted securities whose market value is a matter always of considerable doubt and uncertainty.

Mr. UNTERMYER. But his broker would not take it.

Mr. PECORA. The broker might take it in order to enable him to evade the provisions of section 6.

Mr. UNTERMYER. There is one thing that a broker never does: He never knowingly takes inadequate collateral. He sometimes hooks it and converts it, but he does not take inadequate collateral.

Mr. PECORA. Brokers as a class are today opposing this bill because, among other things, of its margin requirements which they think are too high; so that that is some evidence of the fact that legal evasion, if such a term is proper, could be effected I think it would be effected by throwing down the bars now found in section 6 (a) against brokers making loans on unlisted collateral unless such unlisted collateral be in exempt securities. The bank is left free; and a bank always has better knowledge and information about security and about a customer.

Mr. UNTERMYER. Suppose my margin has declined and I have got a piece of property that is free and clear and that is worth a million dollars——

Mr. PECORA. Provision has been made, but has not yet been brought to public notice, covering such a situation.

Mr. UNTERMYER. Then I am only too pleased. But as it stands in this revised bill I do not think it is a good thing.

Senator ADAMS. As to this matter there are some amendments to cover. The committee has not been advised of them as yet.

Mr. PECORA. They will be brought to the committee's notice.

Mr. UNTERMYER. I do not think it ought to be in that form. I hope it has been changed. But you gentlemen have something else to do than to listen to me.

The CHAIRMAN. What suggestion would you make as to a change, Mr. Untermyer?

Mr. UNTERMYER. As to subdivision 6 (a)?

The CHAIRMAN. Yes.

Mr. UNTERMYER. I should make it "or on any nonregistered collateral approved by the Federal Reserve Board" or "unlisted collateral deemed sufficient by the Federal Reserve Board." I do not know whether you realize the burden you are putting upon the Federal Reserve Board. They will not be able to do any other business for many years.

Senator MCADOO. We may have to consider having a special commission to deal with this whole problem here, this and the securities act. We have not acted on that yet.

Senator KING. Mr. Chairman, I wanted to ask Mr. Untermyer a question. I hope that Mr. Untermyer, before he leaves the stand, and before he leaves the city, will have an opportunity to express his views, if he cares to, on this interdepartmental report, which sets up an independent committee or commission for the purpose of handling

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all these questions, instead of leaving it with the Federal Trade Commission.

Mr. UNTERMYER. With representation of the stock exchanges on it? I am opposed to it. I do not know why they should have any representative on any board that is regulating them. It would be the first regulatory body I know of that had a representative on it from the interests that were being regulated.

Senator KING. That was not an essential in the bill.

Senator MCADOO. The committee might consider the point I suggested a moment ago, because the suggestion made during the discussions here is that an independent commission, not nominated by the stock exchange or anybody else, but appointed in the public interest, might be provided for, instead of conferring these powers upon the Federal Trade Commission or the Federal Reserve Board.

Mr. UNTERMYER. The Federal Reserve Board is the ideal agency, if it has the time, or if it could be enlarged, and have a couple of members added to it who would devote themselves to it, because it is a part of the financial business of the country.

Senator MCADOO. I do not say that the committee is going to adopt any such suggestion. I only mention the fact that the suggestion has been made to the committee, and it will be considered, of course.

Senator GORE. I introduced Senate bill 3234. It may not have come to your attention. It creates a board consisting of the Secretary of the Treasury and the Governor of the Federal Reserve Board as ex officio members, and three other commissioners to be nominated by the President, with the advice and consent of the Senate Your suggestion to add two members of the Federal Reserve Board would be just one less than the membership provided for in my proposal.

Senator MCADOO. That was Mr. Untermyer's suggestion.

Senator GORE. You probably have not seen that bill.

Mr. UNTERMYER. No; I have not.

Senator GORE. It is based upon the so-called "Dickinson report."

Mr. UNTERMYER. I do not favor the Dickinson report. I think that the Federal Reserve Board is the logical financial agency to take control of this situation, except as to the business end of it, and as to that I quite agree that the Federal Trade Commission is the right agency. In that respect I am in full accord with the bill.

Senator GORE. The bill I introduced follows, in a good many details, the bill submitted to the Pujo Committee by you.

Mr. UNTERMYER. I do not remember that.

Senator GORE. There was a bill included in their report.

Senator ADAMS. Mr. Chairman, may I suggest one inquiry? We have this confidential committee print. Have the parts in italics been adopted by the House committee or just submitted?

The CHAIRMAN. No; I do not think so. They have been trying to keep up with our hearings and they have suggested this printed form. The print shows the difference between the revised bill and the changes to be made in the revised bill. That is merely a matter to come before the committee for action.

Senator ADAMS. I was inquiring as to what action, if any, had been taken by the House committee.

The CHAIRMAN. They have not taken any action on it.

Mr. UNTERMYER. May we skip section 6 (a) on the theory that I will examine that and look at it?

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Senator WAGNER. In my absence you have discussed the margin feature of it?

Mr. UNTERMYER. No. I am going to now.

Section 6 (b) is, of course, the most widely discussed and highly controversial provision of the bill. That is the marginal provision. It prescribes a rigid, uniform percentage basis of the extent to which listed securities may be made available for stock-exchange loans, regardless of the character of the collateral. It is immaterial whether the security for the loan be high-grade bonds or nondividend paying common stocks, which are subject to wide fluctuations.

The margin of security in all cases must be the same minimum. I submit, with all due respect, that this is a false basis for determining the margin of safety for a loan. A loan secured by a 10-percent margin in bonds of the State of New York, which are unlisted, at their market value, may be, and is, far less subject to fluctuation, and has a wider market, and is far more conservative than a 60-percent margin on any number of listed common stocks. Every collateral loan on listed securities necessarily depends for its safety upon the character of the securities in that loan. No hard and fast rule can be laid down that will not take from the all-around security of such loan. On this proposition, strange to say, I find myself in agreement with the stock-exchange authorities, that the marginal requirements as to each class of security should be left to the determination of the Federal Reserve Board. Those requirements will necessarily be shifting from day to day. The desire that prompts this drastic requirement is one with which everyone outside of the financial district will sympathize, but it does not accomplish that purpose. It seems to me that it is bound to reduce and restrict speculation, which we would all like to see, within reasonable limits. But I am not in favor of preventing it. If you had no speculation in the market, either for the rise or the fall; if you had no short or long accounts, the differences in quotations would be wide and the market would be very much restricted. So that I feel that you have to have a certain amount of speculation. You have to encourage a certain amount There has been the grossest, most excessive, dishonest speculation There is no doubt about that. But I hope that is not going to mislead this committee into making unwise provisions in this law.

It seems to me that it is bound to have the contrary effect of deflating the market value of the highest class of securities by placing them on a par with the most speculative ones as to their availability as collateral, which is far from the purpose you have in mind.

I am aware that this view is contrary to that which you have well-nigh agreed upon, or are said to have well-nigh agreed upon, but I feel that notwithstanding that fact I should register a protest against what seems to me an unsound and unreasonable method. It is bound to militate against the very highest classes of securities, and in favor of the most speculative class.

In this connection I have not lost sight of the provision of subdivision (d) of section 6, on page 17, of the bill, which gives to the Federal Reserve Board a certain discretionary power to permit accounts to be carried for a limited period under specified conditions on different margins, but the board will naturally be reluctant to allow such exemptions, and the banks will be equally reluctant to loan in these exceptional cases, in view of the declaration that the

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specific marginal requirements are to be generally strictly adhered to, as the considered policy of Congress. If the law is passed in this form, it is reasonably certain that the requirements which are laid down will have to be followed in the making of most loans.

With all due respect, gentlemen, I think it is the wrong principle. As I have said, take a State bond of the State of New York. It has not fluctuated 2 points in price throughout all the depression.

Mr. PECORA. But, Mr. Untermyer, those bonds have been taken care of, as we indicated before, by putting them all in the exempt class.

Mr. UNTERMYER. I am only using using that as an illustration. Take certain first-mortgage railroad bonds——

Mr. PECORA. The Commission has the power, under the bill, to exempt those securities, too.

Mr. UNTERMYER. You mean the Federal Reserve Board has the power?

Mr. PECORA. The Federal Trade Commission.

Mr. UNTERMYER. That means that whenever a man has high-grade first-mortgage railroad bonds that are selling on a 4 or 4½-percent basis, before he can use them as collateral he has got to go to the Commission.

Mr. PECORA. It would also mean that the Commission itself would, in advance, make rules and regulations exempting securities of that class.

Mr. UNTERMYER. In the face of a declaration to the effect that it is the announced policy of Congress to adhere to this specific, rigid marginal requirement?

Mr. PECORA. That statement appears in connection with the powers given to the Federal Reserve Board over margins, but the power to exempt securities from the operation of the provisions of this bill is lodged in the Federal Trade Commission, and is a pretty broad power.

Mr. UNTERMYER. I am not speaking of the power to exempt them from the operation of the bill. I am speaking of the extent to which they are available as collateral.

Mr. PECORA. If they are made an exempt security, then they are not tied down by any of the restrictions of this bill as to their availability for purposes of collateral.

Mr. UNTERMYER. If that is so, it goes very far, but the principle is wrong all the same.

Senator MCADOO. You mean the fixing of any specific, rigid, marginal requirement by statute?

Mr. UNTERMYER. By statute; yes.

Senator ADAMS. If I get your theory, there may be securities which ought not to be exempted entirely from regulation, but as to which the margin requirements are too high.

Mr. UNTERMYER. There are so many thousands of securities on the list, and there are so many inactive securities that have, for 40 years, paid their interest, never defaulted, and there is no chance of it.

Senator COSTIGAN. Mr. Untermyer, what tests would you have the Federal Reserve Board apply in determining the appropriate margin requirement?

Mr. UNTERMYER. Its own judgment at the time, because times change.

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Senator COSTIGAN. Would the objection be to prevent excessive speculation?

Mr. UNTERMYER. Yes.

Senator COSTIGAN. Or would there be some other?

Mr. UNTERMEYER. No. The objective would be, first, to make loans absolutely secure and to prevent excessive speculation. Take the active stocks on the market. The active stocks are those of these great corporations. Sometimes, in active times, they go up to half a million shares in a week. Some times they fluctuate 10 or 20 or 30 points in a week. A great many of them do not pay any dividends. A lot of them are not worth 40 percent of what they were worth, and the margins would be exhausted as to those. I think it is much better to leave that to a body that has its hand on the throttle.

Senator MCADOO. You mean to subject them to regulatory power by a competent authority, either the Federal Reserve Board, the Federal Trade Commission, or whatever body may be constituted for that purpose?

Mr. UNTERMYER. Yes. That would check speculation.

Senator GORE. Is it not one of the infirmities of this sort of regulatory measure, where you commit to the hands of an administrative official control over such a wide field of activities, that you have to reduce those activities to routine? They must largely be committed to the hands of subordinate officers and employees, and the activities you commit to those people must be reduced to routine. You cannot give them any wide discretion.

Mr. UNTERMYER. There is a great deal in what you say. As long as you are going to try to control and prevent excessive speculation, you have to give the power to somebody. As soon as you start on a policy of a rigid marginal requirement and try to look into the future, with all its possibilities, you are going to break your neck before you get through.

Senator GORE. Montesquieu said that excessively good laws produce excessive mischief. I sometimes think there is a grain of truth in that.

Mr. UNTERMYER. When you try to be too specific.

Senator MCADOO. You are talking a lot about excessive speculation, which we want to restrain, and, of course, that is one of the objectives of this bill. What is troubling me a great deal about it is how you are going to define or determine what is excessive speculation. Have you any formula for it?

Mr. UNTERMYER. Nobody has a formula.

Senator MCADOO. Exactly. How are you going to interpret it?

Mr. UNTERMYER. But when the time comes we will have a formula. That is the function of the Federal Reserve Board, to determine when there is excessive speculation, when too much of the funds of the country are being directed toward Wall Street and the security markets. In 1929 everybody who had any sense at all knew that there was wild and excessive speculation. Every fellow who knew what he was about got out from under.

Senator MCADOO. Do you think that can be controlled effectively merely through the marginal requirements on loans?

Mr. UNTERMYER. That is one feature. That is a pretty good check.

Senator MCADOO. How are you going to reach those vast amounts of private and corporate funds which are lendable in the market at

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all times? You might restrain the banks, but one of the things that is troubling me is how you are going to reach those vast amounts of money that come into the market that are not subject to governmental jurisdiction.

Mr. UNTERMYER. That never comes in unless there is excessive speculation, because the rate does not attract it.

Senator MCADOO. How are you going to control it?

Mr. UNTERMYER. You are going as far as you can. You cannot control everything.

Senator MCADOO. We think we can.

Senator GORE. It seems to me that is the only point in favor of this specified margin.

Mr. UNTERMYER. But it will do untold harm.

Senator GORE. In 1929 could not the Federal Reserve Board, by raising the rediscount rate, probably have put some check or brake on the runaway market?

Mr. UNTERMYER. No. People would pay anything for money then. They did not care what they paid for money.

Senator GORE. I think you are right about that. It was just a stampede.

Senator MCADOO. The trouble about the rediscount rate, Senator Gore, is that many people are not touched by the rediscount rate. If you have ample resources without rediscounting in the bank, it is immaterial what the rediscount rate may be, and those who have funds that are not subject to regulation, as the banks are, are not affected by it one way or the other. But I do think that a provision which we put in the banking act last year, which gives the Federal Reserve Board, so far as banks are concerned, the right to increase the reserve requirements of the banks above the legal limit, is the most effective check that can be put upon it.

Mr. UNTERMYER. If I were drafting this legislation, and I felt that Congress had the power, I would not let these corporations put their money in Wall Street.

Senator MCADOO. How could you stop that?

Mr. PECORA. This bill contains a restriction along those lines.

Mr. UNTERMYER. There ought to be some restriction. They can put it in their banks. The banks got together in the biggest monopoly we have today, the Clearing House Association, and said, "We will not pay any interest. We collect interest, but we will not pay any." I tried to get the Clearing House Association regulated, just as I did the stock exchange, by a bill that is attached to the Pujo report. It needs it just as badly.

Mr. PECORA. I recall the effort you made before the New York State Legislature.

Mr. UNTERMYER. I tried there again, but I just did not get anywhere.

Senator ADAMS. In the matter of paying interest, you know there was a bill which went out of this committee and through Congress, which played right into the hands of this banking control by forbidding the payment of interest. That was done by a bill that went through this committee.

Mr. UNTERMYER. I wonder why.

Senator ADAMS. I wonder why myself.

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Mr. UNTERMYER. They are drawing interest. They are lending it out at interest. Why should they not pay interest. I remember when they paid as much as 3 percent.

Senator MCADOO. There are a good many reasons for it, which I have not time to present to the committee here. I do not think it is altogether germane, but if you will take the record of the hearings you will get the explanation of it.

Mr. UNTERMYER. I have yet to learn it.

The CHAIRMAN. Let us go on.

Mr. UNTERMYER. Let us go on with this business. The subject is so vast——

Senator WAGNER. Your final recommendation is to fix no limitations, but leave it to the Federal Reserve Board?

Mr. UNTERMYER. Yes. That is the one respect in which I agree with this document.

The CHAIRMAN. Proceed.

Senator WAGNER. I think you forget that I introduced that bill to which you referred in the State Legislature of New York.

Mr. UNTERMYER. I know you did.

Senator WAGNER. That was a good while ago. We tried then.

Mr. UNTERMYER. Yes; we tried, but the powers that be were too strong for us.

In subsection (e) of section 6, beginning on page 17, there is an exemption of a loan to a dealer to aid in the financing of the distribution of securities to customers not through the medium of an exchange. That seems to me unjust, in that it discriminates in favor of new and untried securities as against those that have been tested in the security market. There is greater danger in such loans, and more care should be required in the fixing of margins with respect to such securities than with respect to those that have undergone test on a free market.

I would like to know why that exemption has been made. I can not quite see that. That is just in order to assist in the distribution of securities, is it not? We will have something to say about that in a few minutes, if you have the patience to listen. They do not need any more encouragement in the distribution of securities. In fact, they have too much encouragement now. I do not see why they should be taken out from this bill.

Senator MCADOO. Excuse me a moment. How long are you going to be here? I have to leave.

Mr. UNTERMYER. I do not know how long these gentlemen will have the patience to listen to me.

Senator MCADOO. How long do you expect to be in town?

Mr. UNTERMYER. I wanted to take the 5 o'clock train.

Senator GORE. Mr. Chairman, I shall have to leave to go on the floor of the Senate. There is a matter coming up in which I am greatly interested.

The CHAIRMAN. We will proceed for a little while, and then, I think, when we adjourn we will meet in the Military Affairs Committee room in the Capitol.

Mr. UNTERMYER. I must say that I cannot see the reason for that exemption.

The CHAIRMAN. Let us finish the main statement, if we can.

Mr. UNTERMYER. Shall we pass on?

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The CHAIRMAN. I think so.

Mr. UNTERMYER. That is section 6 (e). I do not think there should be any exemption in favor of new securities against those that have been tried.

The CHAIRMAN. We will note that.

Mr. UNTERMYER. Section 6 (f) reads:

The provisions of this section shall not apply on or before January 31, 1939, to any loan, renewal, or extension thereof made on any security or securities prior to the enactment of this act.

And so forth.

Mr. Pecora, I think somebody must have put this over on you. Let us see if he did not.

Mr. PECORA. If anyone has, I would like to have the hoodwink removed from my eyes.

Mr. UNTERMYER (reading):

any loan, renewal, or extension thereof made on any security or securities prior to the enactment of this act

They are exempted from the effect of the bill for almost 5 years, until January 31, 1939. That would seem to exclude from the operation of the bill the many hundreds of millions of loans now outstanding on securities of pools and syndicates held in the banks. Some of them have already been carried along for years I regard this as a distinctly vicious exemption. It means that the banks may be cluttered up for another 5 years with this vast amount of unmarketable securities on which the margins have been exhausted or impaired, instead of forcing the banks either to demand additional collateral from the underwriter, as required by the bill, or to liquidate the loans within one year, which is ample time for the purpose, and thus release for commercial purposes the funds of the bank that are thus tied up in these loans.

Of course, all of us who live in the financial district, or who have lived in the financial district and had to do with it, know that in the great boom, up to 1933, they just ground out pools and syndicates. You have dealt with some of them yourself.

The CHAIRMAN. Some 250 of them, I think.

Mr. UNTERMYER. That does not cover all of them by any means.

Mr. PECORA. I have not dealt with any pool. I have merely brought evidence to the committee of pools.

Mr. UNTERMYER. You have dealt with them very effectively, in my opinion; and I am very much gratified to see it. There is no reason for tieing those unliquid loans up for 5 years.

Mr. PECORA. May I explain the reason for it?

Mr. UNTERMYER. Certainly.

Mr. PECORA. Considerable argument was heard by the committee with regard to the original provisions of subsection (f), section 6, the argument being, in substance, that were the bill to remain in its original form with regard to this provision it would require or compel a liquidation of all existing margin accounts where the margins were less than those fixed by this bill, by the time the bill went into effect, and that that would have a decidedly injurious deflationary effect.

Mr. UNTERMYER. That is true, too.

Mr. PECORA. This modification was made in order to meet that objection or criticism, which did seem to be reasonable. The condi-

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tion to which you refer, of banks being loaded up for some time with securities pledged with them by pools and syndicate accounts, is still within the control of the banks. There is nothing in this bill to prevent a bank from selling out or from liquidating any such loan accounts, or requiring the furnishing of additional collateral.

Mr. UNTERMYER. Except that they themselves are in it up to their necks.

Mr. PECORA. The banks may further be required to do it through the operation of the examiners, whether State or Federal. Their pressure is of no inconsiderable quality in such a situation, as you know.

Mr. UNTERMYER. But I do not see why, Mr. Pecora, 1 year is not ample time for them to call on the underwriters either to increase their margins, if they want to carry these unliquid loans indefinitely, or take them up. But why should there be 5 years allowed for it? That just excludes them from the operation of this bill and puts them in a favored class.

Mr. PECORA. There was no desire to do anything but afford a period of time for the liquidation of existing margin accounts that would enable such liquidation to be effected without producing any deflationary effects on the market.

Mr. UNTERMYER. I am sure that is so, so far as you are concerned. I know something about the inside of some of these loans. They are as rotten as they can be. They have not got any margin, and the banks themselves are interested in them.

The CHAIRMAN. Why not compel them to close out right now?

Mr. UNTERMYER. Not now. I suggested 1 year.

Mr. PECORA. The only question was whether the 5-year period was too long.

Mr. UNTERMYER. I think there ought to be 1 year, at least. But in the meantime they can call on their underwriters to take up these loans or to give them liquid collateral. This collateral is dead. A lot of it is upon ventures that could not come through because they were caught. A good deal of it is based upon most exaggerated values.

Mr. PECORA. The hope is that the banks will be prodded into taking proper and appropriate action with regard to furnishing additional collateral in those instances, through the examiners.

Mr. UNTERMYER. The way to do it is to give them a year in which to do it. Then they will find a way. But do not give them 5 years. Let me say this: I was somewhat concerned with the Federal Reserve bill which was the outgrowth of the Pujo investigation. We got all sorts of legislation, to do away with interlocking directorates, and a great many other things, but we gave them too much time, and they came down here, and the Federal Reserve Act today, as compared with what it was, is not a recognizable thing. It was lacerated to death. If you give these people 5 years, before you get through they will get 15 years. You will have a change of administration, and you will get them in the saddle. We have just now a people's government. We have had a high-finance government for a good many years. They run the country, with all due respect to some of the Republican members of this committee, and if you let them have 5 years for this thing, the banks will continue to carry them. There is no reason for it. If, at the end of 1 year,

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they can show some good reason, let them come to Congress and show it. I would not give the many more than 1 year.

Mr. PECORA. I might say that Mr. Redmond, who attended the meetings of this committee on behalf of the New York Stock Exchange, made the argument on this 5-year provision, that it would not do a customer any good anyway. I do not agree with his argument, but I am merely showing you the diversity of opinion.

Mr. UNTERMYER. It would not with a bank that was independent, but it would with a bank that was not—and most of them are.

The CHAIRMAN. The committee will stand in recess until 2 o'clock, at which time we will meet in the Military Affairs Committee room in the Capitol.

(Whereupon, at 12:30 p.m., Thursday, Apr. 5, 1934, a recess was taken until 2 p.m. of the same day.)

AFTERNOON SESSION

The committee resumed its session at the expiration of the recess.

STATEMENT OF SAMUEL UNTERMYER—Resumed

Mr. UNTERMYER Before I go on with this résumé of comments upon the revised bill, may I make a suggestion, Mr. Chairman?

The CHAIRMAN. We would be glad to have it.

Mr. UNTERMYER It is in connection with section 6 as to the rigid margin requirements and the substitution of the Federal Reserve Board. I know how busy the Board is, and my suggestion would be that the Board be increased by three members. I speak of the Federal Reserve Board because it is more properly delegated, to my mind, with power to pass upon these questions of margin requirements. My suggestion is that there should be an addition of three members to the Federal Reserve Board and that the President assign three members of that board to that part of the administration of the act with which they would be concerned under the bill, so as to give proper attention to that subject.

I know there is a good deal of difference of opinion as to the Federal Reserve Board, and that a great many people think that they are rather closely allied to high finance, which may or may not be true; but that would not be true of the new members appointed by the President. I do not say it is true of the present board. That would avoid any such suspicion in the public mind, and it would do away with what I regard as a very dangerous provision in this bill in endeavoring to fix margin requirements by act and to have a sort of uniform percentage of security values regardless of the character of the securities in the loans. As I said before, a loan on one class of securities is better secured at 30 percent than another would be at 70 percent, because one is upon purely speculative securities and the other is upon stable securities.

The CHAIRMAN. We will consider that suggestion.

Mr. PECORA In other words, you feel, Mr. Untermyer, that if section 6 is to be modified so as to give to the Federal Reserve Board discretionary power over margin requirements instead of fixing indefinite limitations upon margin requirements in the bill, the Federal Reserve Board should be increased by three members to be ap-

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pointed by the President, and that the President shall also be empowered to create a division of not less than three members from among the personnel of the Federal Reserve Board, with the special duty of administering the functions placed upon the Federal Reserve Board by this act?

Mr. UNTERMYER. Yes; that accurately sets forth my suggestion.

I refer now to section 7 (a) of the bill which I regard as one of the most novel and important and, I think, the most questionable revolutionary requirements of the bill. It prohibits any member of an exchange or any broker or dealer from borrowing on stock exchange collateral except from or through a member bank of the Federal Reserve System, subject to the power of the Federal Reserve Board to allow such loans to be negotiated in localities where there are no member banks to meet emergency needs.

Do I correctly understand that that has been changed so that State banks or institutions may be appealed to for these loans, or that it still rests with the Federal Reserve banks?

The CHAIRMAN. I think we modified that so as to allow leeway there for using other banks.

Mr. UNTERMYER. Why should not that be in the bill? Why should the bill be limited to Federal Reserve banks for the purpose of loans and the other be a mere matter of discretion? There must be some good reason, which I have been unable to visualize, why State banks and trust companies have thus been excluded from lending on securities listed on the stock exchange. There is no question that this drastic restriction will lessen speculation; but it will, on the other hand, create an exclusive haven in the Federal Reserve System of stock-exchange transactions and will affect the marketability of all listed securities, besides increasing the interest rate on stock-exchange loans and discriminate against the legitimate business of State institutions.

Take, for instance, the present situation in the city of New York where the bulk of these loans are made. The Clearing House Association, which is a rock-ribbed monopoly consisting of Federal Reserve banks, and State banks, and State trust companies and institutions—not all of them, but some of them have managed to do as they pleased with the borrowing public. If you are going to restrict borrowing through a certain clique or section, even of that association, you are going to let them charge any interest rate they choose and make loans or not make them as their own interests may require, and do a variety of other things that have brought discredit upon the whole financial system. I do not know whether you are familiar with the latest performance of the Clearing House Association in New York in connection with the Harriman Bank or not. Are you?

The CHAIRMAN. We have had some information about it.

Mr. UNTERMYER. It is a shocking situation.

Mr. PECORA. It is on the program to present some evidence about that, in detail, to the committee.

Mr. UNTERMYER. I hope so; the country is sadly in need of it.

Senator KEAN. The way this thing works in the clearing house is like this, that today I may have a credit of $8,000,000, and therefore I call so many brokers' loans. Tomorrow I may be debited at the clearing house $10,000,000. In one case I loan the money

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out; in the other case I call it back. That is about the system that the banks use, is it not, in New York?

Mr. UNTERMYER. Except where they are dominated by private selfish interests.

In the case of the Harriman Bank, the bank was in temporary trouble, as many other banks were. It was a member of the Clearing House Association. They were going to be thrown into insolvency; and being a clearing-house bank, that might have precipitated a run on other clearing-house banks. So, to protect themselves, they said to the Comptroller of the Currency, "We guarantee the payment of depositors if you will put our man in as president." And they put in Mr. Cooper, of the Guaranty Trust Co., which was an influential institution in the Clearing House Association. They put him in as president, but the thing did not work out very well, and they had to go into insolvency. The Comptroller of the Currency, upon like representation that they were going to make good every obligation and take care of the depositors, appointed this same Mr. Cooper as the conservator.

Mr. PECORA. I think Mr. Cooper had been connected with the Manufacturers' Trust Co. and not the Guaranty.

Mr. UNTERMYER. No; I think it was the Guaranty. I do not think it was the Manufacturers' Trust. At any rate, what happened was this——

The CHAIRMAN. That whole business was investigated by the Judiciary Committee.

Mr. UNTERMYER. Not very much, Mr. Chairman. At any rate, they repudiated that obligation and are now being sued upon it. They claim that their own executive committee did not have the power to commit them to the obligation on the faith of which the Comptroller of the Currency put them in control. What are you going to expect of institutions that deal with the Government in that way?

Mr. PECORA. Dealing with section 7 and your comment upon it, you undoubtedly notice that the prohibition there is upon a loan to a broker or dealer who is a member of a national securities exchange; and in order to enable the Federal Reserve Board the more effectively to have control of bank credit for stock-market purposes, it was deemed advisable to put in the restriction that you have called attention to. I am merely stating that as the purpose.

Mr. UNTERMYER. Yes; I understand. But I do not think the reason is at all persuasive. Take the rest of the country, where there are perhaps some communities in which there are only two banks. One may be a Federal Reserve bank and the other a State institution. Are you going to take all the business away from the State institution, the business of loaning on securities, and give it all to the Federal Reserve bank? If you want to destroy State banking and want to drive all such institutions into the Federal Reserve System, that might be a way of doing it. That probably will be the most efficient way of doing it.

Mr. PECORA. That was another thing that was in our minds.

Mr. UNTERMYER. I can conceive of its being done for that reason. If that is the reason I will have no more to say. But I believe that State institutions really ought to be preserved.

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The CHAIRMAN. One thought is that the Federal Reserve Board has some sort of supervision over Federal Reserve banks and member banks of the system, but they have not over State banks.

Mr. UNTERMYER. I know; but that is no reason why a man should not be able to go to a State bank and borrow money on listed securities.

Mr. PECORA. An ordinary borrower can. This bill only prohibits a broker from so doing.

Mr. UNTERMYER. Yes; but that is no reason why a broker should not be permitted to do so, because he is acting for a customer; he is not acting for himself.

Mr. PECORA. Then this might be, as you suggested, a persuasive force to induce State banks to come under the Federal Reserve System.

Mr. UNTERMYER. Yes.

Mr. PECORA. And help to bring about a unified banking system.

Mr. UNTERMYER. And it might be a blunderbuss.

Senator CAREY. What page is that?

Mr. PECORA. Subdivision (a), page 19, of the first revised bill.

The CHAIRMAN. It is page 30 in the other print.

Senator KEAN. Suppose a broker has been in business for many years and has accumulated quite a fortune, say, $100,000 or $150,000. This would prevent his using his capital or borrowing any money from a bank at all, would it not, outside of a Federal Reserve bank?

Mr. UNTERMYER. He could not borrow on this collateral, but I do not believe there would be anything to prevent him from personally lending money to a customer.

Senator KEAN. But if someone came in and wanted to borrow, he could not do it——

Mr. UNTERMYER. I think it is a little too rigid.

Senator CAREY. This would exclude borrowing from any bank but a Federal Reserve bank, would it not?

Mr. UNTERMYER. Yes; and why?

Senator CAREY. He could not borrow from a private bank?

Mr. UNTERMYER. No; a broker could not who is a member of the exchange when he is borrowing on stock-exchange collateral; and he cannot borrow on any other collateral. That is another thing.

Mr. PECORA. Unless it is exempted.

Mr. UNTERMYER. Yes; but the great body of securities are not exempted and are not going to be.

Senator GOLDSBOROUGH. It permits borrowing from a State bank which is a member of the Federal Reserve System?

The CHAIRMAN. Yes; any member bank.

Mr. UNTERMYER. Yes; but a State bank might have a good reason for not being a member of the Federal Reserve System.

Senator CAREY. He could not borrow from an individual either?

Mr. UNTERMYER. No, sir. Subdivisions (c), (d), and (e), section 7, relating to the hypothecation by exchange members of securities carried for customers' accounts, are similar to those prescribed by the New York State law, and now in practice on the stock exchange. Experience has proven that they do not accomplish their purpose.

Subdivision (c) prohibits the commingling of a customer's securities with those of any person other than a customer.

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Subdivision (d) prohibits the commingling of such securities of one person with those of another person without the written consent of the customer, while subdivision (e) forbids the lending of pledged securities without his consent. While subdivision (d)—will you take note of this, Mr. Pecora?—requires written consent, subdivision (e) rather significantly provides only for consent. But I imagine this is an oversight. Did you notice that?

Mr. PECORA. Yes, sir.

Mr. UNTERMYER. Neither of these safeguards has proven effective. The customer is always required to sign an omnibus consent. The consent required should be specific written consent that the broker is permitted to commingle the securities. The customer has not heretofore profited by or received any of the fees that come to the broker from the lending on any such securities and which have heretofore constituted a large part of the revenue of the broker. A real safeguard to the customer concerning the hypothecation of his securities and one that I have suggested to the stock exchange would be a provision requiring that on the outside of the so-called "loan" envelope—I suppose you know that the broker hands in a loan envelope to his bank and on the outside he lists the securities—on the outside of the so-called "loan" envelope containing the securities delivered to the lending bank the broker should be required to list the amounts for which he holds the several securities, and that the bank be prohibited from lending or holding securities for a sum on a basis in excess of that amount.

Mr. PECORA. Mr. Untermyer, we have had it in mind, and this is a method that might meet your comment, to change subdivision (d) in section 7—this is a new draft which you have not got before you—so it will make it unlawful for any member of a national securities exchange or a broker or dealer through the medium of any such practice directly or indirectly to hypothecate or arrange for the hypothecation of securities carried for customer's account under circumstances that will permit such securities to be commingled with the securities of any person other than a bona-fide customer or that will permit such securities to be hypothecated for or subjected to any lien or claim of the pledgee for a sum in excess of the aggregate in debtedness of such customers in respect of such securities.

Mr. UNTERMYER. That is all right, except that that would prohibit a bank from making such a loan——

Mr. PECORA. The broker is prohibited from making any such loan. That would operate on any lender, too.

Mr. UNTERMYER. If you will add to that that on the back of the loan envelop the amount for which the broker holds such securities should be noted and that the bank should not lend in excess of that amount, it would be better.

Mr. PECORA. We have sought to effectuate the principle you have in mind by this proposed modification that I have just read to you.

Mr. UNTERMYER. In all the many failures of brokerage houses of which I know it has been found that the broker has borrowed on the securities of his customer in excess of the sum owed, and the customers have either had to pay an excess over the sum owed the bank or lost all their securities. Tens of millions of dollars have been lost in that way. There is no occasion for continuing that abuse.

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It is a very simple matter to limit the amount that a broker may borrow to the sum owing him by the means above outlined.

Mr. PECORA. In this proposed modification we have also modified, or we propose to modify, subsection (e) so it would require the written consent of the customer.

Mr. UNTERMYER. As to each security?

Mr. PECORA. Yes. In other words, it would then read:

To lend or arrange for the lending of any securities carried for the account of any customer without the written consent of such customer

Mr. UNTERMYER (reading):

Without the specific written consent of such customer as to each security

Mr. PECORA. Yes.

Mr. UNTERMYER. Section 8, entitled "Prohibition against manipulation of security prices", is a virtual reenactment of existing laws of the State of New York and other States covering that subject. Except as hereinafter specified, they have never been sufficient to prevent manipulation and are not now adequate. There is constant syndicate manipulation by banking houses in marketing new securities. Subdivision (8) on pages 23 and 24, which authorizes the Commission to permit "pegging, fixing, or stabilizing the price of such property", which I assume is intended to permit of the distribution of new securities by syndicates, makes possible the continuation of this vicious form of manipulation. The operations of Lee, Higginson & Co. in the Kreuger & Toll International Match case fairly illustrate that method of distribution. Whilst they and their associate issuing houses were scattering their worthless securities broadcast over the country with the aid of many hundreds of high-pressure salesmen, they were pegging and lifting the prices of the securities on the exchanges through washing operations and creating an artificial appearance of activity to induce investors to buy the worthless stuff at around par. As soon as they had marketed the securities, the artificial pegs were pulled from under the market and the securities finally dropped to about 5 percent of the price at which they were sold to hundreds of thousands of victims who were led to believe that they were buying a high-grade, 5-percent investment bond vouched for by the most impressive list of great banking houses in the country. Such tactics are not necessary. They should be made impossible. Why that method of distributing securities should be encouraged with the concurrence of the Commission, as this bill provides, instead of being made a criminal offense, is a mystery to me.

Mr. PECORA. May I explain something about that?

Mr. UNTERMYER. Yes.

Mr. PECORA. When the original draft of the bill was before the House and Senate committees at public hearings there was considerable argument advanced to the committees by opponents of the bill with regard to this provision. It was pointed out that the Government in recent times, particularly, has resorted to stabilizing or pegging processes to stabilize the market in the issuance and distribution of Government securities, and the point was made that that proved that there is some benefit to the public in certain kinds of pegging processes or stabilizing processes. It was in deference to that argument, based upon the example of governmental activities, that this clause was written. You notice that it leaves it entirely

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within the discretion of the Federal Trade Commission to say what kind of pegging or stabilizing operations may be permitted as deemed to be in the public interest.

Mr. UNTERMYER. Yes; but now we know what they will do, and they will do the most vicious thing. They have been doing it. Pegging is nothing but manipulation.

Mr. PECORA. Yes; there is no question about that.

Mr. UNTERMYER. What the syndicate banking house does is this. It has, for instance, a hundred million dollars of bonds or stock to dispose of, and it makes daily transactions—one set of brokers to sell and another set of brokers to buy. At the end of the day they generally have no more than they had at the beginning. Sometimes they have and sometimes they have not. But I do not see any difference between that kind of manipulation and others. They justify it on the ground that that is the only way in which they can distribute securities. But that is not true. That is not the British system at all. The British system, which we ought to have in our country, just as we ought to have had the British Securities Act, as I urged upon these gentlemen, instead of this hodge-podge we have got here now—under the British system a prospectus, which is pretty rigid, is published. The British public is educated to buying securities on the basis of the prospectus. The prospectus is offered for subscription, and generally the subscriptions open at 10 o'clock in the morning and close at the end of the day, and the stock that is not subscribed is turned over to the underwriters where it belongs, instead of being foisted upon the public through these deceptive methods.

I do not believe that pegging, which is manipulation, should be encouraged at all. Because the big fellow can get away with it, why punish the small fellow for doing it?

Mr. PECORA. Your criticism is not that it is too drastic but that it is too liberal?

Mr. UNTERMYER. My criticism of the bill is that it should not be allowed.

Senator KEAN. Do you think it should be stopped as to United States bonds?

Mr. UNTERMYER. I do not think we should disturb that. There is not much of that done.

Senator KEAN. Oh, there is a great deal of it just now.

Mr. PECORA. I made the point at a prior hearing, with reference to that, that if the Government does it, it does it for the public interest. When anybody else resorts to it, they do it for their own private interests.

Mr. UNTERMYER. They do it to unload them on the public. What happens is that when they have, through their supersalesmen, marketed these securities, they withdraw the peg and you are stuck and the stuff goes to its own level. It is all wrong.

Senator KEAN. It is bound to go to its own level.

Mr. UNTERMYER. The point they make—and I have discussed it with them—is that the difference between pegging by a high-brow bank and pegging by a low-brow banking house is that one is manipulation and the other is not.

I am pretty nearly through, gentlemen. Your patience will not be required much longer.

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I will discuss next section 10 (e) with respect to specialists. These provisions should, in my judgment, be more drastic than those prescribed in section 10, subsection (e). It is an acute and long-standing evil.

No dealer or broker and no firm of which a dealer or broker is a member that registers as a specialist should be permitted, directly or indirectly, under any circumstances, to buy, sell, or deal in for his own account or for his firm any security in which he acts as a specialist. But I see no reason for restricting his dealings as a broker in other securities. That seems to me a sane and reasonable solution of the specialist proposition. He is a specialist every morning he gets from the other brokers their buying and their selling orders. He knows just how much stock he has got to buy and how much he has got to sell, and he has no right to deal in that security for his own account. In point of fact, they have made great fortunes by that corrupt method of dealing. I am not in favor of excluding the specialist from being a broker in anything except securities in which he is a specialist, because in normal times there is not enough business for a specialist purely as a specialist, and as long as he confines himself to other securities and does not try to be both a broker and a purchaser in the security it is all right.

Mr. PECORA. The original draft of the bill, as you probably will recall, provided for a complete segregation of the functions of broker and dealer, and would not have permitted any member of an exchange to trade for his own account. He could only be a broker.

Mr. UNTERMYER. That is the British system.

Mr. PECORA. Yes. That evoked very considerable opposition on the part of the exchanges all over the country. That is, perhaps, next to section 6, the section which has become the most controversial section of this bill. Special study was given to that particular question. We went to the floor of the stock exchange within the last 2 or 3 weeks. We were given the privilege of the floor, but not to trade—to observe and see and study—and we devoted a considerable part of 2 hours to the operations of the specialist.

The claim has been made that when the market is not active, if a specialist is deprived of the right to buy and sell for his own account you would have a much larger spread between the bid and asked prices of a given security, and that is to the detriment of the investor. We studied that and gave it very considerable attention and it seemed that there was some merit to that criticism.

Mr. UNTERMYER. I do not think so.

Mr. PECORA. The specialist argues that when the market is inactive he is under no inducement to make a market and keep the price range close or narrow, merely because he is enabled to execute orders on commission; that the only incentive to him to make a fair and orderly market with narrow quotations would be to trade for his own account, and that would be the only way in which he could make a narrow market or a fair and orderly market. With that in mind we thought that whatever benefits actually might accrue from the exercise by the specialist-broker of the right to trade for his own account could be preserved and the evils that you have called attention to could be eliminated by the adoption of rules and regulations by the Federal Trade Commission which would prescribe the extent to which a specialist-broker could trade for his own

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account. That is what we have sought to do by the present provisions of section 10.

Mr. UNTERMYER. I do not think that that is nearly as simple or effective a way as to say to the specialist, "You cannot be a broker to sell other people's securities, or to buy securities for other people, and at the same time deal in your own securities." It might create a little wider divergence in an inactive market, but that is inevitable to honest dealing, because this is a falsely stimulated market for the benefit of the man who holds the cards on both sides.

Mr. PECORA. We appreciate the advantage to the specialist in holding those cards. He is playing the cards with the knowledge of what is in the hands of the public.

Mr. UNTERMYER. I should say so. He is just playing with marked cards.

Mr. PECORA. But we thought we might be able to preserve whatever benefits may actually accrue to the public from a close and narrow market that would flow from the exercise by the specialist of the right to trade for his own account, if we confined the extent of that trading to such limits as appear to be, in the discretion of the Federal Trade Commission, in the public interest.

Mr. UNTERMYER. You cannot control that.

Senator KEAN. Mr. Untermyer, do you not realize that on the stock exchange in one department there is a very large number of listed securities that are very inactive?

Mr. UNTERMYER. Yes.

Senator KEAN. And if these brokers did not make a market, it would make a very wide difference—I mean to say, a difference of 25 or 30 percent.

Mr. UNTERMYER. No.

Senator KEAN. Yes.

Mr. UNTERMYER. In the first place, you do not have specialists in those securities.

Senator KEAN. Excuse me, sir. You do.

Mr. UNTERMYER. Almost all the securities of which I know——

Senator KEAN. Are active.

Mr. UNTERMYER. They are sufficiently active for a man to devote all his time to them as a specialist?

Senator KEAN. Yes.

Mr. PECORA. Not only for one man, but they have competing specialists holding books on the same securities.

Mr. UNTERMYER. But in inactive securities they do not usually have specialists.

Senator KEAN. They do.

Mr. PECORA. There are a few brokers who make a specialty of those inactive stocks. There are some 200 or 300 in number. They all trade around one post.

Mr. UNTERMYER. I know the posts, and I know the system, but they do it because there is a lot of graft in it.

Senator KEAN. They make a market which otherwise would not exist.

Mr. UNTERMYER. They make a market, and add on their profit.

Senator KEAN. The point is that they make a market which otherwise would not exist at all.

Mr. PECORA. And that has a tendency to keep the quotations closer.

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Mr. UNTERMYER. I do not believe they should be permitted to make a market——

Mr. PECORA. We have given some study to the English system, where they have the jobber in place of the specialist, and the evidence that has come to our notice with regard to the operation of the English system does tend to indicate that the market is much wider, and that the quotations are much wider under the jobber system.

Mr. UNTERMYER. I am very familiar with the British market. I have spent a good deal of time in England, and with the British system. The jobber and the broker there are absolutely divorced. The broker does not go on the exchange at all.

Mr. PECORA. We find that under the English system the jobber, when there is a period of public trading such that he cannot trade to his own advantage, just stays away from the floor. He will not function at all.

Mr. UNTERMYER. It would be better, I think——

Mr. PECORA. He runs away from the market, in other words, when perhaps his activities are the most needed for the public interest.

Mr. UNTERMYER. I think it would be better than to permit a specialist to take orders to buy and orders to sell, and then go and trade upon them for his own account. That is what he does. He says "I have an order here to buy a thousand shares of steel at 51, and I have an order to sell a thousand shares at 52. I will buy myself one thousand shares at 51." His customer will not get the shares at 51. He will probably get them at 51½ or 52, because he has absorbed the market.

Mr. PECORA. Under the present rules and regulations of the stock exchange, some of which have only recently been adopted, the specialist cannot do that.

Mr. UNTERMYER. He has to show his orders.

Mr. PECORA. Yes. I think the present rules of the stock exchange have gone forward in the right direction.

The CHAIRMAN. He has to offer the securities first to the public before he can buy.

Mr. UNTERMYER. Yes.

Mr. PECORA. I think that is a step in the right direction.

Mr. UNTERMYER. Yes. I think a better step would be if he could not deal at all in those in which he is a specialist. He has the rest of the market, in which he is on a par with everybody else.

Mr. PECORA. If he is a specialist he has to remain at his post. He cannot go around on the floor trading in other stocks. He would not have the opportunity to do it.

Mr. UNTERMYER. They do not remain all the time at their posts.

Mr. PECORA. I know it.

Senator KEAN. Pretty well.

Mr. PECORA. In the more active securities they have got to.

Mr. UNTERMYER. In the very active securities; but not in the comparatively inactive securities.

Senator KEAN. You mentioned Steel.

Mr. UNTERMYER. There are a number of specialists in Steel.

Senator KEAN. They have to be there all the time.

Mr. UNTERMYER. They have to be there all the time.

The CHAIRMAN. Mr. Untermyer, you spoke of the British system, and said that our Securities Act ought to follow that.

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Mr. UNTERMYER. Yes.

The CHAIRMAN. Do you not think that we did follow it about as far as we could? Under the British law all corporations are under one control. Here we have 48 different kinds of corporations, and you cannot make our law absolutely fit in with the British law.

Mr. UNTERMYER. Not absolutely. I have agitated that subject here in Congress for quite a number of years. I wanted the British companies' acts enacted, and I wanted interstate corporations to be under Federal regulation or a Federal law. I have had some experience with the British companies' acts. I have organized a good many companies under those acts.

Senator KEAN. As the organization is now under the Securities Act, it places so much responsibility on everybody that——

Mr. UNTERMYER. Nobody will act. I do not want to discuss that. I would rather not discuss it.

The CHAIRMAN. I just thought I would mention that difference.

Mr. UNTERMYER. Huston Thompson, I think, drew the first draft, and when it was first submitted to me I said I thought it was too severe to be workable.

Senator KEAN. You think it ought to be modified?

Mr. UNTERMYER. Yes; I do.

The CHAIRMAN. Very well. You may proceed.

Mr. UNTERMYER. Let us go on.

The next is section 15 (a), referring to the beneficial owner of more than 5 percent of any class of equity security.

Senator KEAN. That is only securities listed on the exchange, is it not—or does it apply to any securities?

Mr. UNTERMYER. No. I think it is only securities that are listed.

Senator KEAN. It is confined to listed securities.

Mr. UNTERMYER. That is on page 39, Mr. Pecora.

Mr. PECORA. That relates only to registered or listed securities.

Mr. UNTERMYER. I can understand its wisdom if it were limited to a person in practical control of the company by the ownership of, say, 20 percent of the stock.

Mr. PECORA. This section, Mr. Untermyer, has been colloquially termed the "anti-Wiggin" section, which, perhaps, will explain the purpose of it.

Mr. UNTERMYER. Yes. In extreme cases make bad laws.

Mr. PECORA. The theory was that the ownership of 5 percent of the stock would practically constitute him an insider, and by virtue of that position he could acquire confidential information which he might use for his own enrichment by trading in the open market, against the interests of the general body of the stockholders. That is the main purpose sought to be served.

Mr. UNTERMYER. I understand the purpose, and I understand the wisdom of it.

Mr. PECORA. You approve of the principle?

Mr. UNTERMYER. I approve of the principle, but I do not approve of its application to anybody who owns 5 percent, who is not an officer or director, and has no fiduciary relationship.

Mr. PECORA. If you were to raise that limitation to 20 percent of a listed or registered security, you probably would have difficulty in having it apply to any individual, because it is a grave question

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whether, in any listed security, there is any individual who owns 20 percent or more of the outstanding stock.

Mr. UNTERMYER. If he owns less, and is not an officer or director——

Senator KEAN. If he is a director or officer, I think it should apply.

Mr. UNTERMYER. I agree. I think it should apply. But if he is not—if he has no relation whatever to the corporation, except that he is an investor and owns that amount of security, I do not see why these penalties should be applied to him. They are too severe.

Mr. PECORA. We had evidence here last summer from Mr. Van Sweringen. He and his associates felt that if they could acquire a block of stock which amounted to around 10 or 15 percent of an important railroad line, they would thereby get a management control. He admitted that very blandly.

Mr. UNTERMYER. But with the prestige of Morgan. Otherwise they would not.

Mr. PECORA. I do not recall whether they succeeded in making that acquisition of that block of stock with the aid of J. P. Morgan & Co. As I recall the evidence, they financed it through some banks.

Mr. UNTERMYER. They were Morgan banks. I know the Van Sweringen outfit.

Mr. PECORA. The only point I want to make is that with that evidence in mind, that management control of an active stock could be obtained through control of 10 percent of the outstanding stock—and there was a large amount of stock outstanding—where an individual owned as much as 5 percent or more, he would be in a position, through that ownership of a block of stock of that size, to virtually be an insider, and he could very well dictate, with one or two others, elections to the board of directors.

Mr. UNTERMYER. So, you will not let anybody acquire over 5 percent.

Mr. PECORA. It is open to anybody to do it, but he cannot use the information to trade for his own account against the public interest.

Mr. UNTERMYER. But he cannot get any profit out of it. He is foreclosed from making anything out of it, and the result is that he will not buy it.

Mr. PECORA. He can profit from it provided his transactions are more than 6 months apart. It is designed avowedly to prevent insiders from utilizing their position to trade for their own account and against the interests of the general body of the stockholders. The only penalty against it, as you have observed, is that he has to disgorge his profits for the benefit of all the stockholders.

Mr. UNTERMYER. That is a penalty that will prevent him from buying any more stock, and you will hurt the market in the stock. He may have to buy to protect the stock.

Mr. PECORA. If he buys and does not sell again for another 6 months, he does not have to account.

Mr. UNTERMYER. But he may just buy for the purpose of protecting the sock, and he may want to sell it as soon as he can. He may not be an insider at all. There are many corporations owned or controlled by big banking houses that have not 1 percent of the stock. They know more about it. They have got more information than the follow who owns 30 percent of the stock. They know all about it because they are running it. To take one extreme case, like the

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Wiggin case, and predicate legislation of this kind upon it is very dangerous because, as you know, Mr. Pecora, hard cases make bad laws.

Mr. PECORA. We do not know how many other cases of Wiggins there might be.

Mr. UNTERMYER. There are plenty.

Mr. PECORA. I am afraid that is so.

Mr. UNTERMYER. There are plenty.

Mr. PECORA. That is why the section was written.

Mr. UNTERMYER. I must say it is likely to do more harm than good.

The CHAIRMAN. You think that that 5 percent ought to be made 20?

Mr. UNTERMYER. I think so—15 or 20; some substantial amount.

Senator KEAN. Mr. Untermyer, would it not be satisfactory if you made it apply to the officers or directors?

The CHAIRMAN. That is another provision.

Mr. UNTERMYER. I think that 5-percent provision should apply to the officers and directors, but I do not think it should apply to anybody who wants to accumulate a larger amount than 5 percent of the stock.

Senator KEAN. Suppose you believed some security was going to go up, and that you accumulated some of that stock, and you thought you were going to be elected a director, and then the United States came along and said, "You cannot be a director in that company." For instance, take a bank. They have told me I cannot be a director in a bank—several of them. I have a letter in my pocket from them, and I have to resign from every bank of which I am a director.

Mr. UNTERMYER. The last suggestion I have to make is with regard to section 17 (c). I think you put this back where it did not belong. The limitation in section 17 (c) of the time for the commencement of an action to enforce a liability to 2 years after the cause of action accrues is unduly restrictive. Frauds and misrepresentations are generally not discovered until after that length of time. I do not think the time limit for the operation of the statute should begin to run until after the discovery of the cause of action, and I am hoping that the provision in the original bill in that respect will be restored. Was not that in the original bill?

Mr. PECORA. In the original bill the limitation provided was 1 or 2 years after discovery.

Mr. UNTERMYER. That is what I said.

Mr. PECORA. It was argued here that the discovery might not be made for many years after the violation occurred.

Mr. UNTERMYER. That is so in all equity actions now.

Mr. PECORA. That was the argument that was advanced.

Senator KEAN. I am the one who advanced it, and I think it leads to blackmail. I have known of a great many such cases.

Mr. UNTERMYER. So have I; but I have known of many cases where the management blackmailed the outside stockholders.

Senator KEAN. That may be, but we are trying to protect the public.

Mr. UNTERMYER. We are talking about the public. I do not think we need have very great fear of blackmail.

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Mr. PECORA. Mr. Untermyer, what do you think of the suggestion of providing a statute limitation of 2 years after discovery, but in no event more than 6 years after the violation?

Mr. UNTERMYER. I would approve of that fully.

Those are the only suggestions, gentlemen, that occur to me at the moment. I want to say this, if I may, in closing, that I should consider it nothing short of a catastrophe if this bill were not enacted.

Senator MCADOO. I did not hear that.

Mr. UNTERMYER. I should consider it nothing short of a catastrophe if this bill were not enacted. I think it is so important that if I were a legislator, notwithstanding all the objections I have urged, I would take it as it is rather than see it fail. I would like to see it improved very much, but above all things, we have gone all these years with a great financial institution, the greatest in the world, absolutely a law unto itself, without any sort of control whatever, and it is time it was controlled. Nobody can have his own way about any piece of legislation of this kind. I know the influences that are pressing upon Congress to defeat this legislation. I have met them myself. I think it is the greatest propaganda that was ever tried upon any legislative body.

Senator KEAN. I think the committee wants to enact the bill, if they can get it in shape.

Mr. UNTERMYER. Then let us get it in the best possible shape, and then enact it. But do not let it fail, and do not let this vicious propaganda destroy it. I do not want anything I have said by way of criticism of this bill to be regarded as anything except in the way of helpful, constructive suggestions. Some may be right and some may be wrong. Even as to those that are right, I would rather see those go down than to see the bill fail.

Thank you, gentlemen.

The CHAIRMAN. With regard to this propaganda which you mention, I have a letter from a man out in California, who says that one concern there is issuing 20,000,000 circulars against this bill. They are being signed by clerks and other people. They have frightened all the employees and have told them that they were going to lose their jobs, that the exchange was going to be closed, and all that. They got them to sign these circulars in that way.

Mr. UNTERMYER. I have been up against it too often not to know what it means.

Senator MCADOO. Did you get the name of that constituent of mine? I would like to have it.

The CHAIRMAN. All right; I will show it to you.

Mr. UNTERMYER. When they get through with that, then they will begin by trying to frighten the Members of Congress.

The CHAIRMAN. That is what they are doing. I have had letters threatening me. They have told me, "You will never come back to the Senate", and all that; but that does not bother me.

Mr. PECORA. I have gotten letters, Mr. Chairman, saying that I will never come back to the Senate. They do not know that I have never been there.

Mr. UNTERMYER. They are not good propagandists. They are not well informed.

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The CHAIRMAN. They have come to this point, though, Mr. Untermyer—and it is quite effective. It is having its weight on Members of Congress and the public generally. They are claiming that this bill is going to check investments, is going to keep capital out of business, is going to disrupt business, is going to destroy the exchanges, and all that sort of thing. That, of course, is a serious thing, but that is the most effective point they have reached with their propaganda. The people do not want to destroy business.

Mr. UNTERMYER. Senator Fletcher, you remember what happened when the Federal Reserve Act was under consideration?

The CHAIRMAN. Yes.

Mr. UNTERMYER. You remember that every great banker, almost, in the United States went upon the witness stand and testified that its enactment would destroy the country.

The CHAIRMAN. Yes.

Mr. UNTERMYER. You remember that within a year or two after it was passed those same gentlemen said it was the salvation of the country—every one of them.

Senator MCADOO. Some of them even claimed credit for its enactment.

Mr. UNTERMYER. Yes, sir.

The CHAIRMAN. I remember that perfectly well.

Mr. UNTERMYER. I do not believe the public is going to take these gentlemen quite so seriously.

The CHAIRMAN. That is what I wanted to bring out. Can you see any such effect as destroying the exchanges, crippling business, and interfering with investments adversely?

Mr. UNTERMYER. I can see that the bill will restrict speculation. That is its purpose.

The CHAIRMAN. And that ought to be done.

Mr. UNTERMYER. It ought to be done.

Senator KEAN. Mr. Untermeyer, further than that——

The CHAIRMAN. Let me finish, please.

Senator KEAN. I beg your pardon.

Mr. UNTERMYER. No; you go on.

Senator KEAN. We had Mr. Potter, of the Guaranty, down here. He figured out these margins, and said that for his institution alone it would mean the liquidation of some $400,000,000 of market loans.

Mr. PECORA. Mr. Potter was addressing himself then to the original draft, Senator Kean.

Senator KEAN. Yes.

Mr. PECORA. I think much of his criticism would disappear if directed to the revised draft.

Mr. UNTERMYER. Frankly, I think that these specific, rigid marginal requirements are a great mistake, and that is the reason I have suggested the increase of the Federal Reserve Board and the allotting of three men to the execution of this law, and not endeavoring to deal with a delicate subject, such as this is, by hard and fast rules.

Senator KEAN. If anything like Mr. Potter's statement would be true, for his institution alone, that would mean the liquidation of over 1 billion dollars on the stock exchange.

Mr. UNTERMYER. He must have had in mind all the frozen loans he has there for syndicates and pools.

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Mr. PECORA. And which would have had to be liquidated by October 1.

Mr. UNTERMYER. The answer to Mr. Potter might be to let the underwriters take up those loans.

Senator KEAN. It might be. I do not know what he had in mind. I could not read his mind.

Mr. PECORA. Senator Kean, his objection was to the original draft, which has been considerably relaxed in respect of the provisions which bear upon the banks.

The CHAIRMAN. Giving those people who have the present margins time in which to carry their securities.

Senator MCADOO. I just want to ask Mr. Untermyer one question. I agree with what I understand to be your position, that it is unwise to fix a statutory requirement, or fix any statutory margin requirement for loans when all these things vary so materially in point of security and other conditions that no general formula can be made to apply with advantage or with safety, perhaps, to the general interest.

Mr. UNTERMYER. That is my position.

Senator MCADOO. That can be accomplished, however, through regulations by the authority which is empowered to deal with those questions.

Mr. UNTERMYER. Yes.

Senator MCADOO. And the fixing of these margin requirements should be relegated to regulation, and not be committed to a statute.

Mr. UNTERMYER. I would not put the rigid marginal requirements in the statute.

Senator MCADOO. That is what I mean. Leave it to regulation.

Mr. UNTERMYER. I would leave it to regulation.

Senator MCADOO. By the competent authority which is going to administer the act.

Mr. UNTERMYER. That is my idea; but I would be very careful not to leave it to the regulation of people who are under the domination or control of high finance in New York.

Senator MCADOO. Certainly not. It will be regulated by the Federal Reserve Board, or the Federal Trade Commission, or whatever authority is established by the Congress to deal with it.

Mr. UNTERMYER. I would rather see a new deal in the Federal Reserve Board.

Mr. PECORA. Through the appointment of three new members?

Mr. UNTERMYER. Yes. Is there anything else, gentlemen?

The CHAIRMAN. Any other questions to be asked? I do not know whether you need to bring that up, it is not very important, but as long as you are here and your opinion is so valuable to us, we have gotten as far as section 2 of this bill, and the question is as to the importance of section 2, which simply outlines the purpose.

Mr. UNTERMEYER. I don't see any harm in it. It is a stump speech.

Senator KEAN. That is the objection to it?

Mr. UNTERMEYER. No; I don't see that that is any objection to it. I think it may guide the courts in determining what Congress had in mind when it was passing this legislation as affecting interstate commerce.

Senator COSTIGAN. That was the case in the Grain Futures case.

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Mr. PECORA. Board of Trade against Olsen.

Mr. UNTERMYER. Yes.

Mr. PECORA. This section was somewhat based on that Grain Futures Act, which contained a recital of purposes, which also might be called a "stump speech", but was a statement of conclusions of fact.

Mr. UNTERMYER Yes.

Mr. PECORA. And which was of guidance and value to the court in construing the act and upholding its constitutionality.

Mr. UNTERMYER. Yes; stump speeches are sometimes very interesting when not delivered from the stump.

Senator KEAN. The motion, Mr. Untermyer, was to leave in everything, I think, that was constructive and to cut out the speech part of it.

Mr. UNTERMYER. Well, then there would not be anything left. [Laughter.]

Senator KEAN. I think that the finding of facts was all left in.

Mr. UNTERMYER. I read it two or three times, and I think pretty well of it myself.

Senator ADAMS. So do the authors.

Mr. UNTERMYER. Oh, yes; I am sure they do. I think it is pretty well constructed as that sort of a thing, and it may be a guide to the court. It cannot hurt. There is nothing about it that I have seen. I went through it to see if there is anything that might harm, if it contained any admissions against interest, and I could not find anything.

The CHAIRMAN. Any other questions you wish to ask Mr. Untermyer?

Mr. UNTERMYER. Gentlemen, I am obliged to you for your patience.

The CHAIRMAN. We are very much obliged to you for coming down.

Mr. PECORA. Might I make again the statement that the communication addressed to us by Mr. Untermyer and which contained many suggestions, most of which he has referred to in detail today, was very, very carefully and favorably considered, and I think it should be stated to Mr. Untermyer that many of them have been adopted.

Mr. UNTERMYER I am very intensely interested in this thing. The passage of this legislation I would regard as the culmination of one of my ambitions of a quarter of a century.

The CHAIRMAN. I am glad to hear you say that. I think it is very important, and I think now is the time to accomplish it if we are ever going to accomplish it.

Mr. UNTERMEYER Yes; I think so, too.

The CHAIRMAN. The country needs it We are very much obliged to you.

Is there anything else now? If not, we will meet again at 10:30 tomorrow morning.

(Accordingly, at 3:27 p.m., the committee adjourned until 10:30 on the following morning.)

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WASHINGTON, D C, *Saturday, March 24, 1934*

PETITION ON BEHALF OF THE SPECIALISTS OF THE NEW YORK STOCK EXCHANGE

The Honorable Committee on Banking and Currency of the United States Senate, Washington, D C.

GENTLEMEN The undersigned members of the New York Stock Exchange respectfully invite your attention to the far-reaching effect which we believe certain provisions of the pending Stock Exchange Regulation Bill would have on the fortunes of twenty million investors in the United States

We refer to the provisions in Section 10 of the Bill for the practical elimination of the present market "specialist", who, as he now operates, is an indispensable factor in assuring the liquidity of investments and, in turn, the liquidity of commercial banks and other financial institutions throughout the country

The specialist, as the members of the Committee are doubtless well aware, is a member of the Exchange who deals exclusively in one or more stocks and is thus able to execute with the utmost diligence all orders entrusted to him for the purchase or sale of such stocks Any member of the Exchange may become a specialist if he so desires

Because of the active and varied operations on the floor of the Exchange, it is physically impossible for the broker who directly represents the commission house to execute all transactions committed to him In line with the intensive specialization which has taken place in every field of modern activity, the vocation of the specialist has been developed over a period of years to fill the obvious need of a man of expert knowledge and financial and moral responsibility who can give instant execution to orders entrusted to him for the purchase or sale of specified stocks The specialist is primarily a broker's broker

The specialist, however, under the present practice, is more than a broker's broker. He is also a dealer, and his activity as a dealer is indispensable to his effective functioning as a broker It is our understanding that your Committee, while recognizing the useful services performed by the specialist, seeks to impose certain limitations upon his activities in accordance with the Committee's general purpose of regulating the Exchange on behalf of the public interest

The members of the Exchange, as already reported to your Committee, are heartily desirous of co-operating in any measure that would make the Exchange a more effective market for public securities We feel, however, that the present draft of the bill before your Committee would essentially alter the character of the specialist as he actually exists and, in so doing, greatly diminish the facilities of the Exchange in its service to the public

The specialist of today is the custodian or trustee of thousands of orders originating in this and many foreign countries With a market order in his possession a specialist is barred from trading for his own account until that order is filled He cannot give his personal interest precedence over that of his customer No business is more carefully supervised, and there are no penalties in any other line of business endeavor more drastic than those meted out to a specialist if he violates the law of the Exchange or if, as stated in the Constitution of the New York Stock Exchange, he indulges in any practice "inconsistent with just and equitable principles of trade"

There seems to be a common belief that, because of the possibility of his acting either as a broker or dealer, the specialist has an opportunity to act contrary to the interests of the regular brokers and their customers and that he actually does so Nothing could be further from the truth

The greatest criticism directed against the specialist is that he works in a dual capacity, either as a broker for his customers or as a dealer for his own interests As a matter of fact, he can never serve these two interests simultaneously. Were he to do so he would be expelled from the Exchange Further, the minute a specialist steps into the capacity of a dealer, any trades which he may effect for his own account are, by the rules of the New York Stock Exchange, not binding except with the consent and approval of a representative of the firm with whom he trades In other words, a specialist in trading for his own account buys from or sells to a broker who represents the seller or purchaser, as the case may be. It is the duty and interest of this other broker to see to it that *his* customer makes the best possible trade If at any time such a trade is seen to be "inconsistent with just and equitable principles of trade" that trade is cancelled

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The new Bill as now formulated provides two types of specialists. that of the dealer-specialist (one who trades for his own account and cannot accept commission orders) and broker-specialist (who executes orders for others and cannot trade for his own account) This means a division of the functions now performed by specialists If this dual capacity is broken up so that there are two categories, viz. dealer-specialists and broker-specialists, a situation will arise which will have a broker-specialist working for the interest of his customers and a dealer-specialist who has no responsibility except to himself.

The present specialist lives because of the fact that if he does not at all times make a just and ample market, the commission houses will speedily introduce a competing specialist in his field and his business will be cut down He, therefore, does everything in his power to make such a market. Let us assume for the moment that the broker-specialist operating as provided in the Bill cannot trade for his own account and a dealer-specialist may The dealer-specialist has no customers, is responsible to no one save himself, and it is inconceivable that he would have the same interest as the present specialist in the maintenance of a continuous fair market for securities

The specialist's success depends upon the efficiency and intelligence with which he serves his clientele, without that efficiency and intelligence he would shortly find himself without orders

The fact that the business of the specialist has been developed over a period of time and requires a high degree of alertness and specialized knowledge for its efficient functioning, and the fact that it involves the livelihood of several thousand people, including the necessary staffs, cannot, of course, be a primary concern of your Committee But your Committee is rightly concerned with the maintenance of a liquid, or immediately accessible, market to the investor, which in turn means an opportunity for the nation's industry to finance its development We believe that the specialist performs an essential function in that branch of national economy

If the liquidity of he market is at any time impaired it will unquestionably mean that collateral would necessarily be more difficult of disposal Banks would accordingly be reluctant to accept stocks as collateral for loans which might be needed for productive enterprise The effect, in truth, would be to impair a capital market on all exchanges in the United States where securities may now be either obtained or sold, with the inevitable consequence that other world markets would be utilized

The end and aim of commercial banks is, at all times, to have such a degree of liquidity that they may accommodate the short term needs of business Destroy the liquidity of the market and the ability of the banks so to function would be proportionately curtailed There are many examples today of the inability to liquidate in other lines of business

We believe the intricate and complex functions of the specialist should not be disturbed as they now exist, and we respectfully submit the suggestion that the members of your Committee visit the Exchange to observe these functions in actual operation

The corporate structure of American business has resulted in the issuance of hundreds of millions of shares of stock held, it is said, by over twenty million people These are the people who, in the last analysis, "make the market" If the prospective legislation is followed to its logical conclusion, the functions now performed by the New York Stock Exchange would be seriously curtailed This would not only impair the savings of millions of people but also throw many thousands into unemployment

Therefore, it is respectfully petitioned that Section 10 of the Bill be amended in accordance with the recommendation of Richard Whitney, Esq, President of the New York Stock Exchange, made to the Committee on Interstate and Foreign Commerce of the House of Representatives at a public hearing on Thursday, the 22nd of March, 1934

Section 10, as thus amended, would read as follows

"Section 10 (a) It shall be unlawful for a member of a national securities exchange while on the trading premises of such exchange to act as a dealer and broker in contravention of such rules and regulations as the commission may prescribe as necessary or appropriate in the public interest or for the protection of investors

(b) Subject to such rules and regulations as the commission may prescribe as necessary or appropriate in the public interest or for the protection of

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investors, to insure compliance with the provisions of this subsection, the rules of a national securities exchange may provide for the registration of members with the privilege of acting as dealers, and any member so registered shall have the privilege of acting as a dealer and as a broker within the limitations of this subsection It shall be unlawful for a member with the privilege of acting as a dealer who also acts as a broker to effect any transaction in a security by use of any facility of a national securities exchange or otherwise, (1) if in connection with any such transaction he directly or indirectly extends or maintains or arranges for the extension or maintenance of credit for a customer on any security (other than an exempted security) which was a part of a new issue offered to the public by him as a dealer or distributor within six months prior to such transaction, or (2) unless, if the transaction is with a customer, he discloses to such customer in writing any interest he may have in connection with the security which is the subject-matter of the transaction and offers the customer a reasonable time not exceeding ten days to refuse the transaction after the disclosure if the disclosure is not made at the time of the taking of the order and confirmed in writing substantially simultaneously therewith"

Respectfully,

BLAIR S WILLIAMS, 308 Lexington Ave, New York City
SIDNEY RHEINSTEIN, 941 Park Ave, New York City
THOMAS R COX, 343 Highview Road, Englewood, N J
PETER J MALONEY, 812 Park Ave, New York City
JOHN W WALTERS, 3 East 61st Street, New York City.
HENRY PICOLI, 14 Cathedral Ave, Garden City, N Y
ELI B SPRINGS, 2nd, Hillside Rd, Rye, N Y
JOHN H AUERBACH, 778 Park Ave, N Y
CHARLES K COOK, 40 Fifth Ave, New York City
BENJAMIN H BRINTON, Chestnut Street, Englewood, N. J.

N B The specialists of the New York Stock Exchange are assisted in their labors by 1,290 employees who support 2,481 dependents The annual salaries of the employees total $2,166,708 The specialists pay in real estate rentals and clearances $1,846,999 per annum.

WASHINGTON, D C, *Saturday, March 24, 1934.*

PETITION ON BEHALF OF THE FLOOR TRADERS OF THE NEW YORK STOCK EXCHANGE

The Honorable Committee on Banking and Currency of the United States Senate, Washington, D C

GENTLEMEN The undersigned members of the New York Stock Exchange, representing some sixty members engaged in trading exclusively for their own account on the floor of the Exchange, respectfully invite the attention of the Committee to a provision in Section 10 of the pending National Securities Exchange Bill, the effect of which would in our opinion be the virtual paralysis of the activities of floor traders and substantial injury to the interests of the entire investing public of the United States

The provision to which we refer is, in substance, that it shall be unlawful for any member of a stock exchange (except "odd-lot dealers" and "specialist dealers") to effect any transaction whatever for his own account while on the trading premises of the Exchange (Sub-section (c))

The exclusion of the floor trader from the privilege of trading on the premises would seem to indicate either that the language employed does not express the intention of the Committee or that the functions of the floor trader are imperfectly understood.

The floor trader is a member of the Exchange who acts exclusively as principal and, as a rule, only with his own capital He has no customers and accepts no commission orders He buys and sells securities for his own account, assuming the entire risk of profit or loss He is not restricted to a fixed post nor to a limited number of securities In the course of the day's trading the floor trader is to be found at various parts of the floor in competition with specialists and other traders, contributing in this manner to the maintenance of a fair market in all stocks If he has, on the one hand, as compared with the investor off the floor of the Exchange, the advantage of instant information concerning the technical position of

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the market, he is subject, on the other hand, to the disadvantage (in view of the exclusion of news tickers from the trading premises) of not being immediately apprised of developments in the outside world of industry, finance and politics

The floor trader performs indispensable services in the public interest by his contribution to the maintenance of a continuous and liquid market in which securities may be bought and sold at equitable prices

It is obviously in the interest of the investor that the securities which he holds, and which he may desire to use as collateral for the financing of productive enterprises, shall have a continuous fair market value On an Exchange which was limited to the execution of commission house orders, there would inevitably be many occasions on which the divergence between the price bid and the price asked would be so extreme as to result in wide fluctuations In the filling of the gap between bids and offers and the prevention of sudden and unreasonable fluctuations the interposition of the floor trader plays an outstanding part Without the constant personal presence of the floor trader, ready to buy or sell instantly for his own account and on his own responsibility for small profits, the market would be characterized by excessively sharp rises and declines

The initiative of the floor trader and his competition with specialists and other traders are at all times factors of the highest importance in the maintenance of fair market prices

His services in this respect are particularly conspicuous on occasions of stress, when there is a great preponderance of either buying or selling orders from all parts of this country or from abroad On such occasions the floor trader is pre-eminent in taking the initiative in buying or selling as the situation may require So highly are his services in this respect valued on the Exchange that floor traders are frequently informed of an abnormal market situation by a governor of the Exchange, acting in the public interest, with a view to assuring the execution of buying or selling orders at a fair price

In view of the indispensable services performed by the floor trader, as above indicated, we earnestly trust that it is not the intention of the Committee to eliminate the floor trader as such We respectfully submit that the floor trader should be allowed to continue his operations substantially in accordance with the present practice In this connection we wish to signify our hearty endorsement of the suggestion made to the Committee on Interstate and Foreign Commerce of the House of Representatives by Mr Richard Whitney, President of the New York Stock Exchange, with reference to the revision of Section 10 of the Bill

Respectfully,

HERBERT L CARLEBACH,
35 East 76th St, New York City
ARTHUR K HARRIS,
1125 Park Avenue, New York City
ROBERT CRAIG MONTGOMERY,
Bronxville, New York

DRAFT BILL FOR REGULATION OF NATIONAL STOCK EXCHANGE

This bill has been submitted to representatives of the following exchanges for criticisms and suggestion:

Boston Stock Exchange
Chicago Stock Exchange
Los Angeles Stock Exchange
Los Angeles Curb Exchange.
New York Stock Exchange.
New York Curb Exchange
Philadelphia Stock Exchange.
San Francisco Stock Exchange.
San Francisco Curb Exchange.
Associated Stock Exchanges representing:
Baltimore Stock Exchange.
Buffalo Stock Exchange.
Cincinnati Stock Exchange.
Cleveland Stock Exchange.
Columbus Stock Exchange.

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Detroit Stock Exchange
Hartford Stock Exchange
Minneapolis-St Paul Stock Exchange
New Orleans Stock Exchange.
Pittsburgh Stock Exchange.
St Louis Stock Exchange
Salt Lake Stock Exchange
Washington Stock Exchange.

and also, for the purpose of consideration of this bill, the following non-member exchanges

Louisville Stock Exchange
Richmond Stock Exchange.
Seattle Stock Exchange

73RD CONGRESS
2ND SESSION

H R —

IN THE HOUSE OF REPRESENTATIVES

A BILL

To provide for the regulation of National Stock Exchanges operating in interstate and foreign commerce or through the mails and to prevent unfair practices in security transactions and for the protection of investors, and other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1 This Act may be cited as the "National Stock Exchange Act of 1934"

DEFINITIONS

SEC 2 When used in this Act, unless the context otherwise requires—

(1) The term "exchange" means any board, market place, exchange, chamber of commerce or association, whether organized or unorganized, however managed or conducted, and whether incorporated or unincorporated, where contracts or offers for the purchase or sale of securities or other transactions in securities are customarily made

(2) The term "national stock exchange" means any exchange which has been duly licensed pursuant to the provisions of Sec 6 of this Act

(3) The phrase "facility of an exchange" includes its premises and tangible property whether on the premises or not, any right to the use of such premises or property or any service thereof, including any system for the distribution of quotations of transactions made on the exchange

(4) The term "person" means an individual, corporation, partnership, association, unincorporated association or exchange

(5) The term "member" means any person who is permitted to effect transactions on a national stock exchange without the services of another person acting as broker or to use the facilities of an exchange for transaction thereon without payment of a commission or fee or with the payment of a commission or fee which is less than that charged the general public, or any firm of which a member is a partner, or any partner of such firm

(6) The term "bank" means (a) a banking institution organized under the laws of the United States, (b) a person engaged in the business of banking pursuant to the laws of any State, who is subject to examination or regulation by Federal or State banking authorities, (c) a banking institution organized under the laws of a foreign country or any agency or branch thereof authorized to engage in business in a State and which is subject to the supervision of State banking authorities, or (d) a receiver, conservator or other liquidating agent of any institution included in clause (a), (b) or (c) of this paragraph.

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(7) The term "broker" means any person engaged in the business of effecting transactions in securities for the account of others and receiving commissions therefor

(8) The term "dealer" means any person engaged in the business of making purchases and sales of securities, or of distributing securities, for his own account through a broker or otherwise

(9) The term "broker" or "dealer" shall not include a bank and the term "member" shall include a bank which is a member of a national stock exchange only to the extent that it shall act as broker or dealer

(10) The terms "buy" and "purchase" shall include any contract to buy, purchase or otherwise acquire

(11) The terms "sale" and "sell" shall include any contract to sell or otherwise dispose of

(12) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, voting-trust certificate, certificate of interest in property tangible or intangible, or, in general, any instrument commonly known as a security, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase any of the foregoing.

(13) The term "State" means any State of the United States, the District of Columbia, Alaska, Hawaii, Puero Rico, the Philippine Islands, Canal Zone, the Virgin Islands, or any other possession of the United States

(14) The term "Commission" means the Federal Stock Exchange Commission as constituted pursuant to the provisions of Sec 5 of this Act

MANIPULATIVE PRACTICES PROHIBITED

SEC 3 (a) It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce or any facility of a national stock exchange—

(1) To effect any fictitious transaction in any security or any transaction which purports to be a purchase or a sale of a security but involves no change in the beneficial ownership thereof;

(2) To enter orders, by prearrangement with any other person or persons, for the purchase and sale of any security at substantially the same time at substantially the same price, for the purpose of creating a false or misleading appearance of the volume of trading in such security or of establishing price quotations therefor which do not truly reflect the market value of such security,

(3) To effect, either alone or in conjunction with one or more other persons, a series of transactions for the purchase and sale of any security for the purpose of creating a false or misleading appearance of the volume of trading in such security or of establishing price quotations therefor which do not truly reflect the market value of such security;

(4) To circulate or disseminate with intent to deceive any false or misleading information in regard to any security for the purpose of inducing the purchase or sale of any security;

(5) To pay or cause to be paid for the purpose of inducing any purchase or sale at prices which do not fairly reflect the market value of any security in which the person making such payment or causing the same to be made is directly or indirectly interested, any consideration to any person to circulate or disseminate as news or disinterested opinion any information intended to induce the purchase or sale of such security at such prices, or to receive knowingly any consideration for such circulation or dissemination

(b) Any person who wilfully violates any provisions of this section shall be liable to any person who shall suffer any injury by reason of such violation for any loss sustained thereby and may be sued therefor in law or in equity in any court of competent jurisdiction.

(c) No action shall be maintained to enforce any liability created under this section, unless brought within two years after the cause of action accrued and unless brought within six years after the violation upon which it is based.

REGULATION OF MARGIN REQUIREMENTS

SEC. 4 It shall be unlawful for any member of a national stock exchange or any broker or dealer transacting a business in securities through any such

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member, directly or indirectly, to extend or maintain credit to or for any person or to borrow any money, the repayment of which is secured by the pledge or hypothecation of any security, in contravention of such rules as may be established from time to time by the Federal Reserve Board for the purpose of preventing the excessive use of credit for speculation.

FEDERAL STOCK EXCHANGE COMMISSION

SEC 5 There is hereby established a Federal Stock Exchange Commission to be composed of five members to be appointed by the President, by and with the advice and consent of the Senate Not more than three of such appointed Commissioners shall be members of the same political party. No appointed Commissioner shall actively engage in any other business, vocation or employment than that of serving as Commissioner Each appointed Commissioner shall receive a salary at the rate of $10,000 a year, payable in the same manner as the judges of the courts of the United States, and shall hold office for a term of six years, except that (1) any Commissioner appointed to fill a vacancy occurring prior to the expiration of the term for which his predecessor was appointed shall be appointed for the remainder of such term, and (2) the first Commissioners appointed shall continue in office for terms of two, three, four, five and six years, respectively, from the date of the taking effect of this Act, the term of each to be designated by the President, but their successors shall be appointed for terms of six years The Commission shall choose a Chairman from its own membership Any Commissioner may be removed by the President for inefficiency, neglect of duty or malfeasance in office A vacancy on the Commission shall not impair the right of the remaining Commissioners to exercise all the powers of the Commission

The Commission shall have an official seal which shall be judicially noticed.

The Commission shall appoint a Secretary, who shall receive a salary payable in the same manner as the salaries of the Commissioners, and it shall have authority to employ and fix compensation of such attorneys, special experts, examiners, clerks and other employees as it may from time to time find necessary for the proper performance of its duties and as may from time to time be appropriated for by Congress With the exception of a secretary and a clerk to each Commissioner, the attorneys and such special experts and examiners as the Commission may from time to time find necessary for the conduct of its work, all employees of the Commission shall be part of the classified civil service and shall enter the service under such rules and regulations as may be prescribed by the Commission and by the Civil Service Commission

All of the expenses of the Commission, including all necessary expenses for transportation incurred by the Commissioners or by their employees under their orders, in making any investigation or upon official business in any other place than in the City of Washington shall be allowed and paid on presentation of itemized vouchers therefor approved by the Commission

Until otherwise provided by law, the Commission may rent suitable offices for its use

The general accounting office shall receive and examine all accounts of expenditures of the Commission

The principal office of the Commission shall be in the City of Washington but it may meet and exercise all its powers at any other place, and the Commission may, by one or more of its members, or by such examiners as it may designate prosecute any inquiry necessary to its duties in any part of the United States

LICENSING OF NATIONAL STOCK EXCHANGES

SEC 6 (a) Any exchange may be licensed as a national stock exchange by filing with the Commission an application in such form as the Commission may prescribe containing all relevant information in regard to the history, organization, membership, and the rules and regulations of such exchange and a list of the securities in which dealings are permitted on such exchange.

(b) Unless such application shall be withdrawn by such exchange, the Commission shall, within thirty days after the filing thereof or within such further period as may be agreed upon, grant a license to such exchange as a national stock exchange if it shall determine that the rules and regulations of such exchange are adequate to prevent unfair practices in security transactions and to protect investors; otherwise it shall enter an order, after appropriate notice

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and opportunity for hearing, denying such application and stating the reasons therefor

(c) Any national stock exchange may upon reasonable notice to the Commission surrender its license under this Act.

(d) Nothing in this Act shall be construed to prevent any national stock exchange from exercising any power vested in it by its constitution or its rules or regulations or from adopting and enforcing any rule or regulation not inconsistent with this Act or any effective order entered by the Commission thereunder.

TRANSACTIONS ON UNLICENSED EXCHANGES PROHIBITED

SEC 7 Unless an exchange is licensed as a national stock exchange under this Act, it shall be unlawful for any person, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce for the purpose of using any facility of such exchange to effect any transaction in a security on such exchange or to report any such transaction.

REQUIREMENTS FOR LISTING OF SECURITIES ON NATIONAL STOCK EXCHANGES

SEC 8 The Commission shall have power by order to direct any national stock exchange to adopt such requirements for the listing of securities or the admission of securities to trading thereon as the Commission may deem necessary to secure adequate information for the protection of investors.

UNFAIR PRACTICES UNLAWFUL, POWERS OF COMMISSION

SEC 9. Unfair practices in security transactions upon national stock exchanges and by members thereof or persons acting through such members are hereby declared unlawful For the purpose of preventing such unfair practices the Commission shall have power by order to require national stock exchanges to adopt such rules as the Commission may deem necessary for the protection of investors.

RIGHT OF COMMISSION TO INVESTIGATE

SEC 10 Whenever the Commission shall have reason to believe that any person has violated or is violating any provision of this Act or has been or is employing any unfair practice in security transactions upon any national stock exchange or that such an exchange has failed to adopt or to enforce any rule or regulation which it shall have been required to adopt pursuant to this Act, the Commission either directly or through its duly authorized representatives, may make such investigation as it deems necessary and proper For the purpose of any such investigation, the Commission may administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence and require the production of any books, papers or other records which the Commission deems relevant or material to the investigation If any person subpoenaed to attend any inquiry fails to comply with such subpoena without reasonable cause or shall, without reasonable cause, refuse to be sworn or to be examined or to answer a question or to produce any book, paper or other record when ordered so to do, he shall be guilty of a misdemeanor and punishable accordingly.

ORDERS OF COMMISSION

SEC 11 Whenever the Commission shall determine, as a result of investigation or otherwise, that it is necessary that any national stock exchange should adopt any rule or regulation to prevent unfair practices in security transactions or for the protection of investors, the Commission may enter an order requiring any national stock exchange to adopt such rule or regulation Any such order shall be effective on the tenth day after notice of the entry thereof shall have been mailed by registered mail to the national stock exchange affected thereby, provided, however, that if the Commission shall determine that an emergency exists requiring that such rule or regulation be adopted immediately, then such order shall become effective upon the entry thereof, provided telegraphic notice of the entry of such order shall be given to any national stock exchange affected thereby.

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ENFORCEMENT OF ORDERS OF COMMISSION

SEC 12 Whenever the Commission shall determine that any national stock exchange has violated or is violating any order or rule or regulation of the Commission, or has failed to exercise due diligence in enforcing compliance therewith by its members, the Commission may, in its discretion:

(1) After appropriate notice and opportunity for hearing, enter an order suspending for a period not exceeding twelve months or revoking altogether the license of any such national stock exchange; or

(2) After appropriate notice and opportunity for hearing, enter an order requiring any or all members of such national stock exchange to secure a license, on such terms and conditions as the Commission may reasonably deem necessary for the prevention of unfair practices in security transactions or for the protection of investors, as a condition of continuing to conduct business as a member of such national stock exchange.

APPLICATION FOR REVISION OF ORDERS OF COMMISSION

SEC 13 Any person aggrieved by any order entered by the Commission may, at any time within thirty days after the effective date of such order, apply to the Commission for a revision of such order The Commission shall fix a time for hearing on such application and shall afford such person a reasonable opportunity to show cause why such order should be modified or rescinded. The evidence in such proceeding shall be reduced to writing and the Commission, after due consideration, shall either affirm, modify or rescind such order

Any application for revision of an order entered by the Commission, other than an order made effective immediately because of an existing emergency, made by a national stock exchange before such order shall become effective, shall operate as a stay of such order No member of a national stock exchange shall be entitled to apply for the revision of an order of the Commission directing such national stock exchange to adopt any rule or regulation

COURT REVIEW OF ORDERS

SEC. 14 (a) Any person aggrieved by an order of the Commission who shall have applied for a revision thereof, as provided in Sec 13 of this Act, may, after such order shall have been affirmed or modified, or in the event that the Commission shall have made no determination on such application for revision within sixty days after such application, obtain a review of such order in the Circuit Court of Appeals of the United States, within any circuit wherein such person resides or has his principal place of business, or in the Court of Appeals of the District of Columbia, by filing in such court, within sixty days after such determination by the Commission or the expiration of such sixty-day period in which the Commission shall have made no determination on such application for revision, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall be forthwith served upon the Commission, and thereupon the Commission shall certify and file with the court a transcript of the record upon which the order complained of was entered and upon which such application for revision was determined No objection to an order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission. The finding of the Commission as to the facts, if supported by the evidence, shall be conclusive If either party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the hearing before the Commission, the court may order such additional evidence to be taken before the Commission or in such other manner as the court may direct and to be presented to the court, upon such terms and conditions as the court may deem proper The Commission may modify its findings as to the facts, by reason of the additional evidence so taken, and it shall file such modified or new findings, which if supported by the evidence shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The jurisdiction of the court shall be exclusive and its judgment and decree, affirming, modifying, or setting aside, in whole or in part, any order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided

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in Sections 239 and 240 of the Judicial Code, as amended (U S C, title 28, secs. 346 and 347).

(b) The commencement of proceedings under subsection (a) shall not, unless specifically ordered by the court, operate as a stay of the Commission's order.

JURISDICTION OF OFFENSES AND SUITS

SEC 15. (a) The district courts of the United States, the United States court of any Territory, and the Supreme Court of the District of Columbia shall have jurisdiction of offenses and violations under this Act and of all suits in equity and actions at law brought to enforce any liability or duty created by this Act Any such criminal proceeding may be brought in the district wherein any act or transaction constituting the offense or violation occurred. Any such civil suit or action may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cause may be served in any other district in which the defendant is an inhabitant or wherein the defendant may be found Judgments and decrees so rendered shall be subject to review as provided in Sections 128 and 240 of the Judicial Code, as amended (U S C, title 28, secs. 225 and 347) No costs shall be assessed for or against the Commission in any proceeding brought under this Act

(b) In case of contumacy or refusal to obey a subpœna issued to any person, any of the United States courts, within the jurisdiction of which said person guilty of contumacy or refusal to obey is found or resides, upon application by the Commission may issue to such person an order requiring such person to appear before the Commission, or one of its examiners designated by it, there to produce documentary evidence if so ordered, or there to give evidence touching the matter in question; and any failure to obey such order of such court may be punished by said court as a contempt thereof.

(c) No person, who shall have been subpœnaed by the Commission, shall be excused from attending and testifying or from producing any book, paper, contract, agreement, and other record before the Commission, or any member thereof or any officer designated by it, or in any cause or proceeding instituted by the Commission, on the ground that the testimony or evidence, documentary or otherwise, required of him, may tend to incriminate him or subject him to a penalty or forfeiture; but no individual shall be prosecuted or subjected to any penalty or forfeiture for or on account of any transaction, matter, or thing concerning which he is compelled, after having claimed his privilege against self-incrimination, to testify or produce evidence, documentary or otherwise, except that such individual so testifying shall not be exempt from prosecution and punishment for perjury committed in so testifying

PENALTIES

SEC 16 (a) Any person who wilfully violates any provision of section 3 or of section 7 of this Act, or who wilfully extends credit or borrows money in violation of section 4 of this Act, or who wilfully violates any order of the Commission entered pursuant to section 12 of this Act shall, upon conviction, be fined not more than $5,000 or imprisoned for not more than two years, or both;

(b) Any person who wilfully maintains credit for any person in violation of section 4 of this Act shall be liable to a penalty of not more than $1,000 for each such violation and in addition not more than $100 for each and every day of the continuance of such violation which shall accrue to the United States and may be recovered in a civil action brought by the United States.

SEPARABILITY OF PROVISIONS

SEC 17 If any provision of this Act or part thereof, shall be held invalid, the remainder of this Act shall not be affected thereby.

EFFECTIVE DATE

SEC 18 This Act shall become effective on October 1, 1934, except that applications for licenses by exchanges under this Act may be made to the Commission in accordance with its rules and regulations at any time on and after July 1, 1934: Provided that sections 3, 4 and 5 shall become effective immediately upon the enactment of this Act.

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NEW YORK STOCK EXCHANGE

ELEVEN WALL STREET

RICHARD WHITNEY,
President

THE WILLARD HOTEL,
Washington, D C , April 10, 1934.

Hon PHILLIPS LEE GOLDSBOROUGH,
Senate Office Buildings, Washington, D.C.

DEAR SENATOR GOLDSBOROUGH: In reading the testimony of Mr Samuel Untermyer on April 5, 1934, before the Committee on Banking and Currency I noticed on page 9 et seq of the stenographic transcript certain inaccuracies with respect to the disposition of the proceeds of a membership in the Exchange upon the insolvency of a member

Upon admission to membership, a member agrees that the proceeds from the sale of his seat, whether the sale results from his insolvency or otherwise, shall be available to satisfy the claims of members of the Exchange arising out of Exchange or Members' Contracts, as defined in Article XV of the Constitution of the Exchange and as allowed by the Committee on Admissions Mr. Untermyer stated that this agreement embodied in the Constitution of the Exchange "runs up against the law of the land". I am advised by counsel that such an agreement has been upheld by the Supreme Court of the United States as a valid equitable pledge.

In answer ot your question Mr Untermyer also stated that the proceeds from the sale of an insolvent's membership go to the members of the Exchange. Members have a preferred claim, as I have stated, only an Exchange and Members' Contracts allowed by the Committee on Admissions. Between July 1929 and the present date a total of seventeen Stock Exchange memberships were sold because their holders became insolvent The total proceeds of all memberships amounted to $2,980,181 76 The sum of $866,271 78 or 29 1 per cent of the total was paid to members of the Exchange upon claims allowed by the Committee on Admissions and $2,113,909 98 or 70 9 per cent was paid to trustees or receivers of the insolvents The Committee on Admissions disallowed members' claims totaling $1,394,494 49 Although a breakdown of these figures is not immediately available, I am quite confident that a substantial part of the 29 1 per cent paid to members of the Exchange went to the customers of members for whose accounts the claims were presented to the Committee on Admissions I am having prepared and shall forward to you when completed a breakdown of the figures with respect to two of the largest insolvencies, showing the proportion of allowed members' claims which were for the account of customers

Members in accepting contracts for the purchase or sale of securities upon the floor of the Exchange, although in most cases acting as agents for customers, under the rules of the Exchange assume the liability of principals. Furthermore, it is an unwritten law of the Exchange that members must accept the best bid or offer regardless of the financial standing of the member making such bid or offer. These so-called compulsory contracts between members of the Exchange are essential in order that their customers may receive the best available prices in the open market It, therefore, seems only fair that if members are forced to assume the liability of principals and are also forced to accept the financial responsibility of all other members of the Exchange, the business contracts entered into between members should be secured by the proceeds from the sale of the memberships The pledge of particular assets to secure the performance of particular contracts follows a universal business practice Upon this security rests the willingness of members to accept large commitments in security transactions for the accounts of their customers Without this security members would be unwilling to execute orders for the purchase and sale of securities at great financial risk to themselves The result would be to deprive investors of the free and open market which has preserved the liquidity of listed securities throughout the depression.

Faithfully yours,

RICHARD WHITNEY, *President.*

P S —I am enclosing copy of the Constitution of the Exchange, with particular reference to Article XV above referred to.

R. W.

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