

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON

OFFICE OF THE CHAIRMAN

July 15, 1938

Honorable M. S. Eccles, Chairman
Board of Governors of the
Federal Reserve System
Washington, D. C.

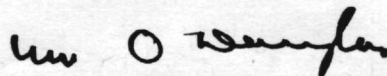
Dear Mr. Eccles:

I beg to acknowledge receipt of your letter of July 7, replying to mine of June 28 in which I inquired concerning the basis of your reported view that certain provisions of the Securities Act of 1933 operate to discourage or prevent new capital financing.

I am sure you are correct in your belief that you and I will find ourselves in agreement on all essential matters relating to control of the public distribution of securities. Likewise, I share the concern which you express for the capital requirements of business, particularly small or intermediate companies, (and for that reason I should like very much to know what facts lead you to consider the Securities Act among the factors which in your opinion have materially impeded the flow of investment funds into the capital market.)

May I also take this opportunity to thank you, on behalf of my associates and myself, for your kind offer of the assistance of members of your Board and its staff in connection with the Commission's continuing consideration of this problem.

Yours faithfully,



William O. Douglas,
Chairman.

Received in
Chairman's Office
JUL 19 1938
Board of Governors
Federal Reserve System

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date July 23, 1938To Mr. ClaytonSubject: Proposed letter to Mr. DouglasFrom Mr. Vest

For your consideration, I wish to suggest the following rewording of the third paragraph:

"As to the Securities Act of 1933 I do not hold any such definite conclusions, but on the basis of such information as we have on the subject it appears that the Securities Act or the regulations issued thereunder are one of the factors which has made it expensive for small business units to obtain capital funds through the issue of securities and compliance with the Act and regulations is regarded as a complicated and technical procedure."

I also suggest that the words "is almost prohibitive" in the first sentence of the fourth paragraph be changed to read: "is substantial and in some instances may be almost prohibitive".

As you know, the figures set forth in the table quoted in your letter represent, as I understand it, the total cost of issues and not merely the cost attributable to registration requirements. In this connection also, you may wish to reread the memorandum which Mr. Solomon prepared on this subject under date of April 13, 1938, before the amendments to the regulations of the Securities and Exchange Commission were adopted.

GB ✓

(first draft -
not used)

Honorable William O. Douglas, Chairman
Securities and Exchange Commission
Washington, D. C.

Dear Mr. Douglas:

This will acknowledge your letter of July 15 in reply to mine of July 7, ~~in which~~ (I endeavored to set forth in a general way some of the factors which in my opinion have in recent years impeded the ready flow of capital funds to business enterprise) (1) ~~investment funds into the capital market~~. As to the factors in the field of banking, I have heretofore arrived at some ~~general~~ ^{definite} conclusions and have done what I could to bring about changes in banking regulations so as to improve the functioning of the banking system as a supplier of capital and credit for business. As to what factors there may be in the field covered by the Securities Act of 1933, as stated in my ^{previous} letter, I would hesitate to come to any definite conclusions, feeling that you and your associates are best qualified to appraise the effect of legislation and regulations in that field. However, I cannot escape an opinion with reference to one aspect of the Securities Act of 1933 and the regulations of the Commission issued thereunder, namely the difficulty and expense encountered by smaller business units in issuing securities for public distribution.

(1) In your letter you ask what facts lead me to conclude that the Securities Act of 1933 is among these factors.

Drawing upon my experience both as a business man and as a banker, I recall that during the '20's it was a common thing for a local business needing from, say, \$100,000 up to \$500,000 to approach a local underwriter or banker and with *little* delay or expense, ~~to~~ arrange for an issue ~~and distribution~~ of bonds, debentures or notes, most of which would be placed with local banks and a few individual investors. It is my recollection that such issues were generally sound and resulted in good investments for the banks and a reasonable and prompt means of securing capital for the local businesses. I am not unmindful of the fact that there were also small issues of local securities that were peddled by unscrupulous underwriters and dealers to the public generally, and I therefore ~~do not share the opinion expressed~~ *appreciate that the problem cannot be solved by* ~~by some critics of the present restrictions that there should be~~ a complete exemption of all issues up to a certain size. It does seem, however, that a legitimate local business enterprise should be able to find an outlet for its obligations without too much disadvantage as compared with a large nationally-known enterprise. This would call for a separation of the sheep from the goats and I must frankly admit that I have no formula to suggest insofar as public distributions are concerned. *B* But I am wondering whether it would not be possible to permit local

businesses to sell their securities to a group of institutional investors, particularly banks, without the need of registration. At present, as I understand it, a local underwriter could not handle such an issue unless it was first registered, and, until the recent revision of the Comptroller's Regulation on Investment Securities, the local banks could not purchase all or part of such an issue unless it was not only registered but also widely distributed and highly rated. This latter change will, I hope, facilitate the issue of local securities, but I am not sure that the results will be satisfactory so long as the local enterprise is prevented from using an underwriter for the distribution of its obligations. After all, the average manager of a local business enterprise is not so familiar with the legal and financial technique of issuing and marketing securities that he could successfully place an issue with a group of local banks.

The foregoing will suggest some of the problems that come to my mind in connection with the capital financing of small business and as I understand it at present there is not only a serious problem in connection with the time element, but the cost of capital obtained through the issue of registered securities in small amounts is prohibitive. From a statistical survey by the Securities and Exchange Commission of the estimated costs involved in the issuance of new securities (bonds, notes and debentures) from January 1, 1936, to June 30, 1937, the following

percentages of cost as against gross cash realization from the securities illustrate the heavier burden on the smaller issues, particularly those under one million dollars:

(In thousands)	Under \$250	\$250-499	\$500-749	\$750-999	\$1,000-4,999	\$5,000-9,999	\$10,000-24,999	\$25,000 or more
Number of issues...	11	8	6	6	50	11	37	35
Commission and discount (per cent) ..	6.4	6.2	5.2	4.2	3.4	2.3	2.2	2.1
Other expenses (per cent)	2.2	2.0	2.5	2.0	1.4	1.1	0.9	0.6
Total (per cent) ..	8.6	8.2	7.7	6.2	4.8	3.4	3.1	2.7

2. I would not have you infer from the foregoing discussion that I am of the opinion that the indicated problems are not already known to you and your associates. That they are so known is evident from ~~a~~ ^{the} statement issued by the Commission under date of April 22, 1938, and it is my hope that the experience of the Commission under the liberalized rules respecting some classes of exempted issues will indicate some more permanent relaxations ^{that} may be safely made so as to improve the lot of ^{and medium-sized unit firms} ~~the~~ small business in its capital problems.

Yours sincerely,

M. S. Eccles
Chairman

July 28, 1938

Honorable William O. Douglas, Chairman
Securities and Exchange Commission
Washington, D. C.

Dear Mr. Douglas:

This will acknowledge your letter of July 15 in reply to mine of July 7. In your letter you ask what facts lead me to conclude that the Securities Act of 1933 is among the factors which in my opinion have impeded the flow of investment funds into the capital market.

In my letter of July 7 I endeavored to set forth in a general way some of the barriers which have been set up in recent years against the flow of capital funds to business enterprise. Very important barriers were erected in the banking system and since that is the field of my present activity, I have heretofore arrived at some definite conclusions and have succeeded in bringing about changes in banking regulations which I believe will improve the functioning of the banking system as a supplier of capital and credit for business.

As to the Securities Act of 1933, I do not hold any such definite conclusions, but I cannot escape the impression that that Act and the regulations issued thereunder have made it both involved and expensive for smaller business units to obtain capital funds through the issue of securities.

Without discussing the various technical requirements of registration which may not be onerous for a large business but which I am told are formidable for a small business, it is my understanding that the cost of obtaining capital through small issues of registered securities is relatively high and is considered by many to be almost prohibitive. From a statistical survey¹ by the Securities and Exchange Commission of the estimated costs involved in the issuance of new securities (bonds, notes and debentures) from January 1, 1936, to June 30, 1937, the following percentages of cost as against gross cash realization from the securities illustrate the heavier burden on the smaller issues, particularly those under one million dollars:

① Stat. Series Release 700.41 - Series 4, 11/29/37

Honorable William O. Douglas - 2

(In thousands)	Under \$250	\$250- 499	\$500- 749	\$750- 999	\$1,000- 4,999	\$5,000- 9,999	\$10,000- 24,999	\$25,000 or more
Number of issues...	11	8	6	6	50	11	37	35
Commission and dis- count (per cent)...	6.4	6.2	5.2	4.2	3.4	2.3	2.2	2.1
Other expenses (per cent).....	2.2	2.0	2.5	2.0	1.4	1.1	0.9	0.6
Total (per cent)...	8.6	8.2	7.7	6.2	4.8	3.4	3.1	2.7

As to what portion of these costs might be avoided by amendments to the Act and the regulations of the Commission, I am not advised but would welcome information thereon. I might add that there is no such disparity in interest rates on loans to prime commercial borrowers as between small and large amounts.

It may be that cost figures for the period subsequent to June 30, 1937, would show some variation from the above, but I should suspect that there would not be a great difference. I recognize also that it is entirely possible that under the liberalized rules announced by the Commission under date of April 22, 1938, smaller business units might obtain capital through issues of securities at a relatively less cost than heretofore. If you have data on this phase of the problem, I would be glad to have it.

I hope that the results of the trial period under the liberalized rules of the Commission referred to above will indicate some permanent relaxations that may be safely made so as to improve the lot of small and medium-sized business units in their capital problems. I am confident that the recent changes in bank examination policy and the revision of the Comptroller's Regulation on Investment Securities will be of material assistance in the same direction.

Yours sincerely,

(Signed) M. S. Eccles

M. S. Eccles
Chairman

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