

NEW YORK STOCK EXCHANGE

Eleven Wall Street

New York 5, N. Y.

EMIL SCHRAM

President

December 27, 1946

Dear Marriner:

Over eleven months have passed since the Federal Reserve Board amended Regulation T to provide that all purchases of registered securities be made on a "cash" basis, and I feel that the time has come for the Board to review those amendments in the light of present conditions.

The securities registered and listed on the national securities exchanges are by and large the securities of companies which are outstanding in their respective fields of industry, are securities which have the greatest intrinsic values, whose prices and markets are publicly known daily and in connection with which most data are available as to the company's financial affairs upon which the prospective purchaser can exercise informed judgment. It is such securities which have been deprived by the Federal Reserve Board's regulations of collateral value with brokers and banks for the purpose of purchasing or carrying registered securities. On the other hand, less well-known non-registered or unlisted securities which generally do not have such data available to the public have collateral value with the banks for the purpose of purchasing non-registered securities. It is the considered opinion of the Exchange that this results in gross inequity and discrimination against registered securities.

The regulations have in the opinion of many tended to drive prospective purchasers from the better regulated field to less regulated or unregulated ones, such as into non-registered or unlisted securities, commodities, real estate, etc.

The flow toward the less regulated field since collateral or loan values of registered stocks were eliminated is noticeable in the predominance of non-refunding primary offerings of stocks which are unlisted.

In the five-month period when registered securities had a 50% loan value, listed stock offerings accounted for 21.7% of the number of issues and 53.5% of the money amounts involved.

In the six-month period during which registered securities had a loan value of 25%, listed stock offerings represented 24% of the number of issues and 55.9% of the money amounts involved.

However, in the period since registered securities have had no loan value (February through October, 1946) listed stock offerings accounted for only 15.6% of the number of issues and for only 48.9% of the money amounts involved.

The credit regulations may well have tended to make it easier for an unseasoned company to sell to the public low-priced shares which are largely speculative in character and will not be listed on a national securities exchange than it is for a seasoned company to sell new shares of possible investment merit which it then lists on such an exchange.

The regulations have had the effect of making it more attractive for a company to keep its securities unlisted than to list the securities on a national securities exchange and by so doing not disclosing vital information to the stockholders, which was one of the principal objectives of the Congress in passing the Securities Acts.

Signs of the trend from the regulated to the much less regulated field are also discernible in the commodities futures markets, especially in eggs and potatoes.

A comparison of the average monthly volume of trading in egg futures in the period when registered stocks had a loan value of 25% with the average monthly volume in the period when such stocks had a 50% loan value shows an increase of about 40%. The average monthly volume in the eleven-month period following the elimination of loan value rose 183% over the average monthly volume in the period when registered stocks had a 25% loan value.

The tendency is even more pronounced in potato futures. Average monthly volume in those futures in the 25% loan value period increased 264% over average monthly volume in the 50% loan value period. The average monthly trading volume in the no-loan-value period rose 1625% over the average monthly volume in the 25% loan value period.

In cotton futures the average monthly volume in the 25% period increased approximately 28.5% over the average volume in the 50% period, while the average monthly trading volume in eleven months of the no-loan-value period showed an increase of about 108%.

Another direction in which the reduction in and then the elimination of collateral or loan values of registered stocks may well have turned is into unregulated field of farm lands. Average values are up at least 70% over the 1935-1939 period, accompanied by considerable increase in the voluntary sales of farms, a fairly large number of which occurred after a short term holding.

The stringent regulations have apparently resulted in their circumvention through the guise of "non-purpose" loans by banks. There are many who feel that the use of such "non-purpose" loans has been quite extensive. That this condition exists is cited by the Controller of the Currency in his annual report in which he pointed out that the national bank examiners had noted a tendency on the part of some national banks to accept without question borrowers' statements that loans were not for the purpose of purchasing listed stocks in circumstances which should have put the banks on notice that in reality this was the function of the loans.

When the Federal Reserve Board had an initial margin requirement banks had a standard to guide them in making their securities loans. However, since the elimination of that guide banks have set their own requirements which in certain instances are said to have been none too conservative.

The drastic requirements with respect to the extension of credit on registered securities, particularly as they apply to brokers, have had, in the opinion of many observers, adverse effect on the securities markets.

In the primary market, the predominance of unlisted stock offerings, as I have mentioned earlier, may well be an indication that largely because of the credit restrictions the public is more willing to buy highly speculative unlisted securities rather than seasoned listed securities.

The large number of proposed securities offerings which have been delayed since September is attributable in great part to the severe break in the secondary securities market. The severity of that break has been ascribed to the thinness of the secondary markets which in turn is attributed to a great extent to the prohibition against extending credit on registered stocks. The thinness of the market on this Exchange since January is discernible in the wider spreads

between bids and offers and in the wider fluctuations between sales.

In the secondary distribution and "special offerings" of listed stocks there has been an increase in the percentage of unsold shares, again indicating resistance on the part of security purchasers to securities without loan value.

In the period when listed stocks had a 50% loan value, the number of unsold shares represented three-tenths of 1% (.3%), while in the 25% loan value period, the unsold portion was 3.8%, and in the period since loan value was eliminated the unsold portion has been 5.3%.

In reviewing this subject, I would suggest that the Board obtain from the Chairman of the Securities and Exchange Commission the views of the Commission which is vitally interested in the present condition of the securities markets, including the exchange markets.

Another penalty which the revised credit regulation has imposed on securities holders is the prohibition against selling one listed security against which credit is being extended and the purchase of another listed security, with no increase in the amount of credit being used. The effect has been to discourage an investor from selling one security concerning which his opinion has changed due to the situation affecting that security and purchasing another security which the investor believes would be more advantageous for him to hold.

I should like to point out that the Exchange has done and continues to do everything in its power in the way of directing the public toward making purchases of securities only after obtaining the facts and evaluating them. These efforts have been in two directions: first, through the Exchange's own initial margin requirements, and, second, through its advertising program.

With respect to the Exchange's margin requirements, you will recall that as of April 1, 1943, the Exchange ruled that securities selling below 5 should be given no value in computing the condition of an account. Then in February, 1944, this ruling was broadened to exclude valuing such securities for the purpose of making new commitments or withdrawals of cash and securities selling below 5. The Exchange drastically increased its requirements in March, 1945, by imposing a minimum equity requirement of \$1,000, ruling that no value be given to securities selling under 10 and that a minimum margin of \$10 a share be obtained on stocks selling above 10. The latter pro-

vision was dispensed with in July, 1945, when it lost much of its force upon the Federal Reserve Board decreasing the initial loan value from 50% to 25% of the market value. In putting these requirements into effect the Exchange was endeavoring forcibly to bring to the attention of prospective purchasers the need to select securities not because they were low in price but because of their intrinsic value.

Concerning the Exchange's advertising program, which has been nation-wide in scope, its main objective has been directed toward educating the public to obtain all the facts possible with respect to a security and the company which had issued the security before making a decision to buy that security.

The Board's authority to place collateral or loan value on registered securities stems from the Securities and Exchange Act, which empowers the Board to prescribe regulations "for the purpose of preventing the excessive use of credit for the purchase or carrying of securities."

One yardstick in measuring the amount of credit which is being employed for that purpose is the amount of debit balances of customers of New York Stock Exchange member firms carrying margin accounts.

Since 1934, when the Securities and Exchange Act was passed, the highest total of debit balances was in February, 1937, (when the loan value of registered stocks was 45%) and was.....\$1,559,000,000

The lowest total of such balances was in August, 1942, (when the loan value was 60%) and was..... 490,000,000

When the Board decreased the loan value from 50% to 25% in July, 1945, the total of such debit balances was..... 1,065,000,000

At the beginning of 1946, when the Board eliminated the loan value, the total of the debits was..... 942,000,000

Today's total is only about..... 491,000,000

At the present time the total of customers' debit balances is 68% less than the highest total of such balances since 1934, 54% less than they were when the Board reduced the loan value from 50% to 25%, and 48% less than when the Board eliminated the loan value.

The Exchange is of the very strong opinion that there is no excessive use of credit for the purchase or carrying of securities.

The Exchange believes that the federal credit requirements should be changed to restore collateral or loan value to registered securities for the following reasons:

- (1) It will be in the public interest for prospective purchasers of securities to buy securities which are or will be listed on national securities exchanges inasmuch as most information is available in respect to such securities.
- (2) It will eliminate the inequity and discrimination resulting from the continuance of bank credit on unregistered stock issues of companies many of which are not the leaders in American industry, while eliminating the loan value of registered stock issues of companies among which are numbered the best managed, the most productive and the greatest man-power users.
- (3) There is no excessive use of credit for the purchase or carrying of securities.
- (4) It will remove a material factor which has contributed to the lack of digestion in the primary securities market and it will also facilitate the sale by companies whose securities are regularly listed on a national securities exchange of additional issues which also will be so listed following distribution.
- (5) It will tend to improve and make more stable and orderly the auction market.
- (6) It will tend to bring back prospective purchasers from the unregulated or less regulated fields into the most regulated field, i. e., the broker. It will foster the use of the regular rigidly controlled channels of credit rather than the less controlled in which so-called "non-purpose" loans are made by banks and other lending agencies inexperienced with this type of loan. It will tend to reduce the diversion of prospective purchasers into the less controlled commodity field or the uncontrolled real estate field.

- (7) It will reestablish a standard which banks will tend to follow in making securities loans.

We do not believe that the restoration of collateral or loan value to registered securities will result in a sudden, precipitous or excessive increase in the amount of credit for purchasing or carrying of registered securities. The return of collateral or loan value to registered securities will bring about a much improved secondary market having greater liquidity, continuity and stability. Under such conditions it will again be possible to go forward with the flotation of new securities the proceeds of which are vitally needed to aid industry in its vast expansion program so necessary for increased production and full employment.

Accordingly, the Exchange strongly urges the Board of Governors of the Federal Reserve System to amend Regulation T to restore a reasonable collateral or loan value to registered securities.

It is our suggestion that the initial collateral or loan value be set at 50% of the market value. Also, the Board might consider setting the date of such a change effective at a reasonable time after its announcement, so that no implication as to the Board's opinion of the nation's economic condition or of the level of security prices may be drawn therefrom.

Sincerely,

(Signed) Emil

Hon. Marriner S. Eccles, Chairman  
Board of Governors  
Federal Reserve System  
Washington 25, D. C.

January 20, 1947.

Dear Emil:

Your letter of December 27 would have had an earlier acknowledgment but for the fact that I did not return from Utah, where I spent the holidays with my family, until after the New Year and since then we have had under consideration the reduction in margin requirements which we announced last Friday afternoon.

I was interested to have your comments, even though it does not seem to me that they are relevant as reasons for action by the Board. I recognize, of course, the so-called discrimination in that the regulation does not apply to unlisted securities, but as I am sure you must be aware, there is nothing the Board can do about this because Congress, in enacting the Securities and Exchange law, required us to fix margins for listed securities but provided no authority covering unlisted issues. I understand that the subject was carefully considered before the law was passed and apparently Congress had some doubts about the constitutionality of applying the law to unregistered issues. In any case, your letter gives the erroneous impression that it is the Board and not the law which discriminates.

Similarly, the uninformed reader would, I think, gain the impression from your letter that the 100 per cent rule deprived securities of their loan value. Of course the fact is that the rule only deprived them of loan value for the purpose of buying more listed stocks. For every other purpose they have had loan value all along. Accordingly, it seems to me that most of the criticisms in your letter relate to the law rather than to the Board's discharge of its responsibility under that law.

I realize, of course, that the entire subject is a highly controversial one. There are three general schools of thought about margin trading, judging by the large volume of correspondence which has come to my office. One group opposes margin trading at any time. Another group is for public regulation of it. The third group appears to be opposed to any public regulation.



Likewise, there is room for differences of opinion as to how the obligation placed by Congress on this Board should be discharged. You and I know that a good deal of margin trading is purely speculative and contributes nothing of value to the economic progress of the country, unless possibly it might be argued that the speculative activity creates a ready market for the investor and thus helps to draw funds through this medium into production and employment. I know, of course, that as President of the New York Stock Exchange, it is your duty to present the views of the brokerage community, and I think you do so earnestly and ably. Nevertheless, I think it is an ex parte presentation. It seems to me the Board's duty is to consider all relevant aspects of the subject and to the best of its ability determine margin requirements on the basis of what it feels to be in the broad public interest.

I was glad to have your opinion of the advisability of setting the effective date ahead in changing the margin requirements, and I always welcome your frank expression of your views.

With kindest personal regards,

Sincerely yours,

Mr. Emil Schram, President,  
New York Stock Exchange,  
11 Wall Street,  
New York 5, New York.

ET:b

Miss Benton

March 10, 1947.

Dear Emil:

This is to acknowledge your letter of February 27 with further reference to margin requirements. As you know, I am always glad to have your comments, and making allowance for the fact that we view the problem from different angles, the area of our differences of opinion on the margin question comes down largely to a matter of timing. As I said in the statement I gave out when we reduced the requirements to 75 per cent, "further action will depend upon the course of economic events."

I would agree with you, of course, that the investing public and the American public are not synonymous. Nevertheless, I think it is evident from the volume of underwriting that there is no lack of funds available to absorb worthwhile, new issues. At this juncture I cannot see any justification for further action either on the level of margins or on the so-called "incidental squeeze."

Decisions on the question of loan values should be based, in my judgment, on a general broad consideration of economic conditions and prospects. The amount of credit in the market is only one factor, even though it is referred to specifically in the law.

With kind personal regards,

Sincerely yours,

(Signed) Marriner

Mr. Emil Schram, President,  
New York Stock Exchange,  
11 Wall Street,  
New York 5, New York.

ET:b

March 27, 1947.

Dear Emil:

Your letter of March 15 with regard to economic conditions that would justify a further reduction of margin requirements raises very broad questions that I would be glad to discuss informally with you sometime when you are in Washington and possibly can come over and take luncheon with me.

As you know, I indicated publicly in the talk I gave in Boston last fall and in the statement I issued when margin requirements were reduced to 75 per cent my own general views on this subject.

With kindest personal regards,

Sincerely yours,

Mr. Emil Schram, President,  
New York Stock Exchange,  
11 Wall Street,  
New York 5, New York.

ET:b