Looking for the Answer to Your Investment Problem?

Look to tax-exempt municipal bonds. These bonds provide the investor with a simple method of reducing his tax burden. How? Interest on municipal bonds under present law is exempt from all federal income taxes and generally from state and local taxes in the state where issued. This provides the individual in the 38 per cent tax bracket who buys municipal bonds yielding 3½ per cent with an equivalent of a taxable interest yield of 5.65 per cent. This is only part of the story. Municipal bonds afford great investment flexibility. Redemption dates range from one to twenty years or more, enabling the investor to plan for his future financial needs. Not to be overlooked is the security of these bonds, generally considered second only to U.S. Government Bonds. For a sound and beneficial investment, look to tax-exempt municipal bonds.

Second Municipal Conference

INVESTMENT BANKERS ASSOCIATION of AMERICA

PICK-CONGRESS HOTEL
CHICAGO, ILLINOIS

JUNE 19-21, 1963
The members of this group account, led by Chase Manhattan Municipal Bond men, have just set the bid for a city bond issue. As the meeting breaks up, the bid is immediately phoned to a Chase correspondent bank who then presents it to the city's officials.

The members have blended a mass of information with imagination to arrive at a competitive bid calculated to produce the best possible interest cost for the borrower and satisfactory acceptance by value-conscious investors. Chase Manhattan continues to combine full measures of experience, organization and informed market judgment with its role as one of the nation's leading underwriters, distributors and dealers of:

STATE, COUNTY, MUNICIPAL BONDS AND NOTES
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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (WORLD BANK)

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FEDERAL INTERMEDIATE CREDIT BANKS
FEDERAL HOME LOAN BANKS
BANKS FOR COOPERATIVES

THE CHASE MANHATTAN BANK
MUNICIPAL BOND DIVISION
Head Office: 1 Chase Manhattan Plaza, New York 15, New York
Broadening the Municipal Investment Areas of Banks

By Hon. James J. Saxon,* Comptroller of the Currency, Washington, D. C.

The burgeoning role of commercial banks in securities underwriting and dealing is frankly endorsed by government's top official on the subject. Mr. Saxon: (1) admits commercial bank underwriting of revenue tax-exempt in being pushed with utmost vigor; (2) envisages joint participation of investment and commercial bankers in growing volume of state-local financing which would use the distributive talents and capital resources of each; (3) answers BAA fears of, and arguments against, liberalization of banks investment regulations; and (4) invites critical examination of recently revised ruling on investments enlarging banks' flexibility in investing for their own account with a 5% limit on buying certain securities. Mr. Saxon also explains revised meaning of "political subdivisions" which encompasses municipal corporations, public authorities, etc.

We have been engaged in this office on a broad program of revision of the rules, practices, procedures and administrative machinery at this important organization. This has been an extensive and highly consuming job, one which should have been done over the years gradually.

Much of the structure of this system had been left untouched for as much as 40 years, affecting such areas as the rules and opinions governing one of the most essential activities in the country—commercial lending activities by national banks.

Complete Revision

We have completely revised these manuals affecting lending, corporate practices, corporate procedures, our own personnel machinery, administrative operation generally, an entirely new revised set of trust regulations, now in effect, a whole new examination form, manual of instructions, both commercial and trust, and many, many other changes.

Now we have come to one of the more pleasant segments of the investment area, I hope, which is a subject of extreme importance to the investment banking and commercial banking fraternity, and with respect to our office—particularly the latter—as it affects the national banks and state member banks.

We have been studying for a period of eight or nine months the necessary revision of the investment regulation. The regulation has been unchanged since 1936. In the mean time there have been, and substantial changes in the economy and the methods of financing, as all of you are most aware particularly.

The committee which we have had to advise us in the technical and procedural aspects of investment operation was headed by Norden Hawes of the Harris Trust and Savings Bank, Chicago, and consisted of four other men, who were John Clark of Wachovia Bank and Trust Co., Winston-Salem, N. C.; Del monte Pfeiffer, First National City Bank, New York City; Lockett Shelton, of Republic National Bank, Dallas, Texas; and Franklin Stockbridge, of Security First National Bank, Los Angeles.

I do not want to suggest that anyone or all of these men should be held responsible for what we here propose in case anyone might disagree with any aspect of it. I am sure we should not be so sanguine as to expect unanimous endorsement or enthusiastic reception of all of it. We do think, however, that we have done here in the matter of a proposed regulation the best possible job we could do, with the aid of what we all consider to be a top-flight group of technicians in this field.

Before getting into that, I would like to touch briefly on the other subject relating to the investment area. I know this is of strong interest to the investment members of the municipal bond fraternity.

Aggressively Pushing Revenue Bond Underwriting

We have been, very frankly—and I want to speak very frankly about this—vigorously pushing the underwriting of revenue bonds. Last year we did get a favorable report through the administrative, the Executive end, to the Congress. This year we are very hopeful and indeed expect that a favorable report will be presented to the Congress.

There is increasing interest in this area, in my opinion. In fact, the bill sponsored by Senator Clark of Pennsylvania bears the support, on the bill itself, of five or six other Senators, all prominent; and I think generally there is increasing support for this.

I personally believe that it is inevitable that the Congress will in time—and I hope not too long time—affect, adopt a substantial form, of authority in national and state member banks to underwrite and deal in revenue bonds generally.

I realize this is not an area which will be pleasing to the investment banking fraternity. I am not so sure, however, that in the long run the objection is to the competitive aspects of the adoption of such a bill will not prove to have been overstressed.

I do so, however, strongly believe that in view of the growing volume of revenue bond financing in relation to the total obligatory financing in this country, the great capital resources available to banks, and their capacity and the need for all to participate in financing the growth of state and local facilities, that the entrance through underwriting and dealing into this area by the national and state member banks is important.

Using the Best That Commercial Banks and Investment Banks Have to Offer

I would hope that if this bill should be adopted there is a fair chance, I expect, we would work out the enormous distributional facilities of the investment banking fraternity and its great talents, combined with the talents of the bond pros and the capital of the commercial banks, to combine in this area.

The first question is: What is the need for it? This question arises from the investment banking members. And this is an understandable question.

I do not want to get too seriously into the competitive aspects, but I do think there is a need, that the effectiveness of such financing will be improved, both as to distribution and cost, with the joint participation of commercial banks and the investment area of banking fraternity.

I am obliged to state in all frankness that I will continue to promote this bill with all of the vigor I possess, and can bring to bear in this area, this being the major proposition legislatively.

Continued on page 23

Our business thrives on ideas...

Here at Continental, our Municipal Bond people are always looking for new and better ways to do things. We are convinced that creativity and the free exchange of ideas and experiences, as well as prompt, efficient service, are responsible for the position we hold in the Municipal Bond field.

Last year alone, Continental headed or participated in 100 Municipal offerings with a total value of more than $1,300,000,000. We are always interested in Municipal underwriting and trading opportunities, anywhere in the country. We'd be most happy to work with you.

CONTINENTAL ILLINOIS NATIONAL BANK
AND TRUST COMPANY OF CHICAGO
231 South LaSalle Street, Chicago 90
Representative Office: 71 Broadway, New York 6
Up-Dating Underwriting Practices and Procedures

By Elmer G. Hassman,* Vice-President, A. G. Becker & Co., Inc., Chicago, Ill.

Profusely revealing paper on correcting self-defeating syndicate practices growing away at the successful operation of a large syndicate reflects 35 years of experience ranging from yesterday's simple undertaking to today's complicated, large syndications. Mr. Hassman probes such practices and procedures as: failure of taking for granted and automatically convening historic syndicate members; proxy arrangements; allocation procedures; designated sales; open price sales; and advertising that does not reach principal investors.

The writer is proud of the contribution Underwriting has made, is deepening and can continue to make with necessary corrections. He notes that it took one small, unknown dealer who bought two kingsized issues to make the municipal fraternity realize how badly it has been underwriting its underwriting and distributing ability because of anachronistic procedures.

Certainly any discussions on the problems confronting the Municipal business must, by their very nature, be of concern to both Managers and Participants; so it would follow that the resolution in subject as between groups would have to occur. It is my hope that when this happens, the two viewpoints might be beneficial toward a possible solution of some of our problems.

Since my subject—"Members' Responsibilities"—has so many facets and because the problems in one group or segment of the industry may not necessarily be those of another, I found it somewhat difficult to approach the topic in too technical a manner. I have tried, however, whenever possible to get the views of other persons on some of these subjects, so as to preclude too biased an opinion to which my 35 years' experience in the business might feel entitled.

Since there may be many in this profession who have not been members of this honorable fraternity too long, I thought I might begin by going back some years, so they will be better able to judge the progress we have made in underwriting issues and also become cognizant of areas where we might do some up-dating.

When Underwriting Was Simple

To Syndicates

Prior to the advent of the large bonus issues about the year 1947, municipal underwriting was a comparatively simple procedure; for it was seldom we had to concern ourselves with issues that ran in excess of $25 million. However, when the State of Illinois announced a bond issue that was going to require financing of $800 million, the industry showed justifiable concern, not only because of the risk involved in underwriting, but also in the matter of distribution. The logical approach seemed to be in the formation of one large syndicate, which would include practically all underwriting banks and dealers throughout the country. How successful this idea proved to be in reality is now history. It was a pleasant surprise and relief to learn that the procedures taken at that time was so successful that it was to become the pattern for most future king-size issues. As a result, underwriters began to look forward to subsequent large issues with keen anxiety and confidence. In the years that followed, large issues became less frequent, and today are almost commonplace. Interestingly enough, it wasn't until a comparatively unknown small dealer bought a couple of kingsize California deals that the municipal fraternity suddenly realized how badly it had been underestimating its underwriting and distributing ability by continuing a procedure conceived many years ago in a climate of unwarranted fear and conservatism.

Today, as we all know, our industry is geared to handle the ever-increasing volume of new financing which is currently running at an annual rate in excess of $8 billion. More important and gratifying has been the consistent record demonstrated by consumers of investable funds, which is available in size on all occasions, provided yields are satisfactory. We now have more underwriters of substantial size, far in advance of what we had before; and because capital is the life blood of our business, it is comforting to know that the most progressive dealers and banks today can provide collective capital greatly in excess of what would be required to underwrite the largest volume of municipal and corporate issues that it is possible to visualize in the foreseeable future.

With this brief background, I would now like to examine a few of our present practices and procedures with a view of trying to determine whether they represent the best that our industry is capable of producing, or if, for the sake of expedience, we have not devised some methods that, while they benefit a few, cannot really be considered good for all those who must labor in the vineyard.

Historical Accounts

A logical starting point would seem to be the subject of the reformulation of historical syndicates. The industry has been criticized and it makes an account easily available to the many members. Many people, and because members automatically will have a group with which to bid, more small syndicate members, in so far as the accounts are concerned, will be able to reduce good work and to weed out non-producers. Today, the tug-of-war underwriting volume, managers should not have to be bound by a system that is set up to keep up with the tempo of the times. Participants that have developed underwriting and financial stature through the years should be welcomed by managers into a higher bracket than have to fight for it. By the same token, managers should have the right to reduce a member's position, or even to drop those who on more than one occasion have failed to perform commensurate with their position. One would seem logical and reasonable that if a member has the important items which make for a good underwriter, such as willingness to make a strong bid, loyalty, ability to account for experience and record in distributing bonds, plus financial responsibility, his position in future accounts should be determined by these factors; and it does not seem right that a very important factor such as these values and positions should be penalized by an antiquated practice of historical accounts that have been moved up because he must hold up his past performance in the last time. Too often these accounts probably are reactivated by personnel in the department whose limited experience does not qualify them to properly evaluate the relative merits of accomplishments of an underwriter through the years; so he probably does not have any position most naturally—necessarily, sets up the account exactly as it was. Therefore, everyone who holds a position in the previous deal, even though it might have been five years ago. I would like to make the observation that many of the troubles of the manager might be eliminated if a consistent practice were developed by all managers, as is now done by some, of contacting members of an old account before sending out the account. This is certainly first if members want to bid at all, and secondly, if the position indicated is certain then this is the position he held in the previous deal. If this were done, it might eliminate those who have for one reason or another prefer not to bid on the particular issue and would only drop later at the price meeting.

Proxy Arrangements

We move now to the matter of proxy arrangements and practices. This particular subject was adequately discussed and reported on by a sub-committee on syndicate operations of the IBA in 1961. However, because of the problems with which certain underwriters are confronted almost daily, it deserves some additional thought. There can be no question that when someone is requested to act as proxy and generally expresses a willingness to do so, he is willing of his own accord and effort; and, for this reason, he should be given all the operation possible to make his task as easy as possible. One of the simplest ways to do this is to give him the underwriter's written instructions, by having price ideas in the hands of the proxy in advance of the first meeting, so as to make it unnecessary for the proxy to call for them in advance.

Obviously, if the member has conviction about a scale and good ideas, then his ideas will be important and beneficial to all, but if he is merely accommodating the Manager's request for price ideas and does not have enough control, because he feels he should be contributing little to the price meeting. However, if the practice of participants who deliberately tender low price ideas at a meeting because of the lack of desire to submit a competitive bid is unfair, not only to the managers but also to the account as a whole. I think it might be well for everyone to keep in mind that the basic reason an account is formed is to try and buy the issue; so it would not be in the frame of mind, he should get out early and gracefully, without alienating other members through the price views to influence other members.

There are numerous things that a firm or proxy can do to protect several members on a particular deal. On those occasions, should the member who knows what the proxy does, which is usually the Manager, call for more than one or two places; he takes a strong position. If he controls a good scale, he can write in the account, and should view conflict with those of the managers. As a general rule, any proxy so arranged can have an important bearing on the account's bid and structure. If the Manager were to employ his own judgment on scale and reflect only that scale and his personal decisions on limits to his proxy.

Syndicate Allocation Procedures

Because of the tremendous postwar growth in our industry, a situation may have occurred in distribution and allocation practices in major account. The take-down of the important account may not be to the liking of the people for whom the Manager can't help but incur some eybrow-raise if the deal turns up a dod. So it would seem in fairness to all concerned it would make the syndicate's and the Manager's life much easier if every member would use his own judgment on scale and reflect only that scale and his personal decisions on limits to his proxy.

*Exbrook 2-8054
Meaning of Firm Policy to a Municipal Bond Organization

By John W. de Milhan, Senior Vice-President, The Chase Manhattan Bank, New York City

There's more to establishing a policy than meets the eye if a municipal underwriting and distributing firm is to be successful. Valuable insight on determining and flexibly executing objectives is provided. Mr. de Milhan underscores the importance of clearly defining maximum dollar limits and trading in a particular area of municipal activity on which to focus operations. He similarly stresses the importance of adequate compensation, formal and automatic review for upgrading, and of maintaining a strong posture to attract and keep a superior organization.

When it was first suggested that my topic for discussion should be "Firm Policy," it brought to mind several counts. I was concerned because at first glance it seemed to be a vague and nebulous subject. It appeared to be difficult to interpret and of little general interest to a group such as you yourselves assembled here for this Second Municipal Conference. I was also greatly concerned because it was my feeling that there was an insular banking background, little which might tend to discourage discussion and the sharing of the insights such as my own and would not be an integral part of the operation of any other type of firm underwriting and distributing municipal bonds.

What Is Firm Policy?

As I tried to undertake some sort of an analysis of what might constitute Firm Policy I began to find that many fears were unfounded. I could see that in many respects it was a plan, a guide, a road map, and a very necessary one.

If we had to define firm policy as it applies to our business I suppose we could say that it is the result of decisions as to the objectives to be sought, the type of operation to be undertaken, the manner in which it will be conducted and the extent of the maximum financial commitments which will be permitted. In a few moments we shall take a more detailed look at this part of this definition and try to see what it can mean to us.

Who Determines It?

Firm policy can be determined at any level of management, starting of course at the top where the decisions are made by a board of directors, a committee or senior management group. It can be written and formally approved or acknowledged or it can be of a verbal and informal nature. Each succeeding management level may further define firm policy in greater detail but, of course, must do so within the framework passed on to it.

Why Is It Necessary?

Is firm policy just as necessary in a small well-knit organization as it is in a large complex one? Of course it is. It is necessary so that an organization, no matter how large it is or how small, may function with unit of action and accomplish in the most efficient, proper and profitable manner the purpose for which it was formed.

It permits delegation of authority

and, if desired, divisional operation.

How Flexible Should It Be?

To be efficient and to achieve the results desired, firm policy should, in many instances, be adaptable and permitted of sufficient flexibility to take advantage of the frequent changes taking place in this business world of ours today.

But there should never be any deviation from ethical standards of the highest order. The confidant character of customer relationships and the fulfillment of all legal requirements should be maintained at all times.

In other cases, because of changing conditions, an alteration of some phase of firm policy is sometimes not only desirable but also frequently very necessary. Any policy changes must be funneled through the proper channels so that all affected parties are kept informed.

Possible happenings which would induce changes in some areas of firm policy are many.

Substantial changes in the market level will definitely affect the immediate operating outlook. An increase or decrease in the capital account can greatly change the overall scope of operation. New legislation may open new avenues of diversification and there will be times when an alteration in operating procedures will be called for to meet changes in competition.

Objectives

Now what are some of the policy decisions to be considered? What are the objectives of a particular organization? Why are we in business?

I think that without question the number one reason for being in business is the simplest of all—to make a profit.

Yes, of course we want to make money, but how should we do it and what can we do to do it effectively and not hurt our firm in the process?

In our own particular case we consider it also necessary for us to be in a position to service our customers in a professional manner and to be able to take care of any demands they may make upon us without totally compromising our financial position. To others the maintenance of a municipal business may be maintained to concentrate upon our underwriting and trading in the line of services offered.

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Commitments and Working Capital

Today I can think of no area of firm policy as important and yet, in some instances, as overlooked as that of the relationship of overall commitments to available capital. For some firms Exchange regulations define the ratios of certain items and the like. However, in other matters there are no adequate limitations. Certainly lenders can and do demand what margin they believe will protect them, but unless limited by firm policy to a reasonable amount, there is frequently an over exposure to risk caused by unbridled operation in the "When Issued" market or the excessive use of repurchase agreements. This can be dangerous.

The amount and availability of Capital should determine the maximum volume of commitments to be undertaken as well as the extent of the firm's fixed operating costs.

Regardless of the immediate outlook it must be kept in mind that any commitment represents a risk and experience has shown us frequently that a loss situation can develop most unexpectedly and to a far greater degree than anticipated.

Firm policies in this respect should be conservative and should be directed to permit continuous underwriting and trading in declining as well as in rising markets. This policy would clearly define the maximum total dollar commitments, new issues as well as old, to be undertaken at any one time, with appropriate adjustment for short-term bonds and notes as well as for securities of greater than normal risk or with unusual requirements.

Good policy would also call for sound and efficient operating procedures as well as for sufficient controls so that the makeup of the full liability position is available at all times.

Type of Securities Operation to Be Undertaken

Once the extent of capital and the limitations on commitments has been determined we are then in a position to more adequately determine the particular area of municipal activity upon which to focus our operations.

Those with the greatest resources may well take an active part in all the underwriting and trading areas of our business although they may choose to place more emphasis on certain types of issues than others.

For those with more limited capital the choice, of course, must be made that will fit in most appropriately with the background of experience of the principals and with the kind of customers they intend to cultivate and which will provide the best return on the invested capital.

The choices available are numerous.

Perhaps, in many cases, more than usual thought should be expended before a decision is reached to participate at all in new issue bidding as a member of an underwriting syndicate.

I would like to place particular emphasis on this point for in today's markets even a minor participant bidding cautiously, in my opinion, can very easily and quickly find himself committed to a greater degree than anticipated. If a number of the issues are slow to sell his hands are tied and there is nothing that he can do to free himself until the managers take some action or the account is terminated.

The secondary market offers the great advantage of freedom to act at any time. You all know how broad and active it is. It also provides the opportunity to limit activity to the exact maturities or coupons in which a house has interest rather than in the entire maturity range of a new issue.

Banking law rather than firm policy has dictated that banks should restrict their dealer activities to general obligation bonds. However, for those who participate in the busy area of revenue bonds there are decisions to be made. Will you try to specialize and run active trading markets in

Continuing on page 29
Trading Desk Is the Heart of the Secondary Market

By Henry Miller, Vice-President, R. S. Dickson & Co., Inc., New York City

Just as it is the responsibility of the municipal industry to provide the investing public with a growing, orderly secondary market, it is incumbent upon each and every dealer—no matter how small—to make his trading desk the heart of his activities. In elaborating on this central point, Mr. Miller outlines the dealer's function in the secondary municipal market and the vital functions of his trading desk. He sees this operations center as a training ground for future traders, and contends that direct contact between institutional buyers and the trading desk aids rather than lessens the salesman's efforts. Stressed is the need to promote investor education, and the importance of setting local market rates by default to larger city dealers.

Those of us who are actively engaged in the municipal bond business do not need to be reminded of the magnitude of our secondary efforts. With $600,000,000 in the Blue List, who can forget it? True, there are bonds not yet out of syndicate, but they're getting there, friends. They're getting there.

It should be a matter of pride throughout the industry that we have developed today such a highly competitive and financially responsible arena for secondary activity. And what is an even greater source of satisfaction to us is the fact that some dealers have been known to make an occasional dollar while providing this service.

It is the responsibility of our industry which devotes so much energy to the underwriting of new issues, to provide the investing public with a secondary market capable at all times of insuring the orderly redistribution of these securities. It is the function of the dealer to provide the capital and the facilities, which, in conjunction with the efforts of the municipal brokers and, of course, the investors, constitute the secondary market.

The Heart of the Secondary Market Is the Trading Desk

The heart of these secondary dealer activities is the trading desk. Let us examine this operating center. By so doing, we may discover some way we can improve our value to our firms and our service to our customers.

(1) First, the secondary trading department should provide a diversified inventory from which salesmen can answer current inquiries. The new issue calendar does not always offer such choice. An inventory conditioned to quality, maturity, general obligation and revenue, can catch the pulse of the current investor interest. Turnover should be rapid and prices kept current in order to be effective.

(2) The Trading Department furnishes up-to-date markets on active issues and regular quotations on the so-called "dollar" bonds. A constant flow of information from the desk out to the organization is essential. The desk is the liaison between the retail effort and the entire market. Some organizations detail a man to the specific task of alerting the organization, particularly the Sales Department, with any new purchases, sales, or other vital market news. It's a good idea if personnel is available.

(3) The desk provides an inventory control center for all operations—syndicate, secondary and agency. Open orders, options, confirmations, under the direction of one individual on the desk is necessary to avoid duplication of effort and effective control.

(4) The trading desk acts as a service center for the other departments. Portfolio appraisal, statistics on open accounts, compilation of list against inquiries, wholesale, out-of-town dealer liaison. In fact, care should be taken not to saddle up the boys on the desk with irrelevant chores.

(5) As a result of constant street contact and through inventory operations, the secondary trading personnel can provide the firm with up-to-date intelligence for organizational information exchange. Such information can be vital to those charged with buying and selling in their respective setting in firm policy.

Institutions Dealing Directly With Trading Desk

In the past few years, we have found that institutional buyers can be taught to deal directly with the man on the trading desk, rather than through the salesman assigned to the account. This is no reflection on the ability of the salesman concerned. It is simply a matter of convenience, especially when negotiating purchase or resale prices. Nowadays, institutions are constantly changing their portfolio and a sale to an institution involves the purchase of them from a like number of accounts rather than the funds for the new acquisition. At this point negotiation often can be effected more efficiently from the desk. Of course, this type of operation will not be valid for every firm, but I strongly believe that the direct trader-buyer relationship will increase greatly in the coming years.

I offer the suggestion that the dealer, in order to provide his secondary desk to be capable of handling efficiently this new trend, provides the personnel and practice. Once again, I repeat that this development does not necessarily mean a reduction in the contributions of the salesman. Rather, it provides the sales force with another increment of the potential of these entitled. Intelligent institutional men are becoming conversant with the market, and will improve their portfolio. We shall be needed for the groundwork. But the dealer with the competitive secondary desk will usually be the one to write the tickets.

Training Junior Desk Traders

(7) This brings me to the final function of the secondary trading desk. There are, with very few exceptions, the Municipal Bond community has drawn its executives from the trading desk. Most of the partners, officers, heads of syndicate and sales departments started their career in the position clerks of odd lot traders and dollar traders. Over a period of many years, they developed, and to a degree, the feeling of control which the concept of a Golden Rule is still his basis for ethical practices. Common sense, a common decency and strict adherence to sound market fundamentals make up the rest of his training.

Secondary Trading Must Grow With Municipal's Growth

The secondary market for municipals must grow in volume and geographical scope as the country develops its national and local fronts. The dealer who attempts to underwrite new issues without operating a complete secondary department is walking on one leg. The dealer bank who expects to be worthy of the title "dealer" must develop his secondary position in the industry to the extent that its regulation as a distributor is not confused with that of an investor with dealer privileges. It has been indicated by authoritative sources that one of these days the dealer banks may be fishing in the deeper, more mysterious waters of the revenue bond streams. I respectfully submit that qualified secondary trading departments in this specialized field could be of the greatest service to dealers and to the educational efforts instituted at this time might be helpful as a learning and experience.

The dealer in the smaller cities might well look to developing his secondary market, to develop the secondary, and further season his personnel with secondary trading nationally and locally. So many new districts, authorities and other local political subdivisions are continually appearing on the market in the past few years, that the local dealers in this city and in the rest of the country are known nationally that he is in this part of the business. I am confident that the future will see a larger and more specialized. I enthusiastically endorse this. The industry will benefit greatly by such action. It is true that a good many dealers are already taking advantage of these local efforts. And as a result, the local names handled bec more widely known and distributed. I congratulate those dealers who re to permit their local markets

UNDERWRITERS and DISTRIBUTORS

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STATE, MUNICIPAL and REVENUE BONDS

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"Members New York Stock Exchange"

NEW YORK

The Commercial and Financial Chronicle — Thursday, July 11, 1963

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Running a Municipal Syndicate Properly

By W. Neal Fulkerson, Jr.* Vice-President, Bankers Trust Company, New York City

Managing the municipal syndicate today is hardly what it was like years ago. Mr. Fulkerson's thoughts on some of the changes that have occurred in the industry will provide invaluable advice and guidance. Realistic decision making should be a major concern of all members. Over the years there has been a trend toward greater cooperation among brokers and the underwriting syndicate. A group of approximately 15 brokers is the typical syndicate today. In the past, it was common for a syndicate to consist of as many as 40 or 50 brokers. This change is due in part to the increased complexity of underwriting syndicates and the greater volume of business being handled.

Estimating Potential Business

In preparation for bidding on the bonds in the market, the manager must consider the amount of business the syndicate can handle. A number of factors must be taken into account. For example, the size of the syndicate, the number of members, the amount of business the syndicate can handle, and the amount of business the syndicate is currently engaged in. The manager must also consider the amount of business that will be covered by the syndicate's underwriting. The amount of business that will be covered by the syndicate's underwriting is determined by the size of the syndicate and the amount of business that the syndicate is currently engaged in.

Our first Municipal Conference last September provided an excellent opportunity to focus on some of the changes that have occurred in the industry. Our second Conference held this March-We plan to continue these discussions in our future conferences.

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Complexities in Today's Revenue Bond Business

By William F. Morgan, Vice-President, Blyth & Co., Inc., New York City

Revenue bonds have gone far beyond their traditional scope into newer and newer areas and have become more complicated and technical. Many of these bonds depend more on managerial skill than upon their measurable base. Hence, Mr. Morgan advises, it behooves all parties concerned to make certain that top legal counsel is used so that bond provisions safeguard the issuer and permit the issuer to live with them. Also scrutinized by Mr. Morgan is the growing trend of advanced refunding and industrial aid bonds and the controversial problems they generate; the lack of identification behind some industrial aid bonds; and the need to improve the coverage of bond provisions which would permit better bond ratings.

The investment banker, further, gives a breakdown as to what he believes are reasonable coverage ratios for revenue bonds.

William F. Morgan

It seems to be the fashion these days, when a community needs a new improvement, be it a parking garage, a swimming pool, a port facility, an improved transit system, an office building, or even new industrial use, to turn to municipal bond men or bond attorneys and ask the question, "Can we finance this improvement through issuance of revenue bonds?" The reason for considering revenue bonds to finance the needed— or if not needed at least desired—improvement is fairly obvious and can be summarized as:

(a) To the extent possible the community wishes to keep the cost of such improvement off the tax rolls, thereby avoiding a general tax increase.

(b) Perhaps the debt limit provides a deterrent to further general obligation debt, so the community turns to revenue bond financing (this was the case in certain Pennsylvania School Authority issues).

(c) It appears as good business for the users or beneficiaries of such improvement to provide revenue for the issuance of revenue bonds. The reason for considering revenue bonds to finance the needed—or if not needed at least desired—improvement is fairly obvious and can be summarized as:

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Increasing Importance of Revenue Bonds Secured by Contracts

The bulk of the revenue bonds for a number of years was secured by water, light, sewer, turnpike, and similar facilities. Security for these bonds was based upon a general class of users. Today we find more and more revenue bonds secured by contracts between the issuers and the users or recipients of the output of the facility. In this case, security for the bond is derived from a specific contract, and it is only after the first 10 days of May we had some $237,000,000 bond's scheduled to construct electric generating facilities secured primarily by contracts to take power. In Detroit a new stadium is scheduled to be built if the 1968 Olympics are secured by that City, and the prime security of such bonds will be the agreement between a newly formed Authority and the State of Michigan. Similar financing has become commonplace with the various Authorities of the State of Georgia, and the trend has spread to states that least of which has been the many School Authorities of Pennsylvania heretofore mentioned.

It is not the intent of these remarks to denigrate such a trend, but I do think that the use of such contracts call for increased vigilance of bond men, attorneys and issuing underwriters. It is my opinion that such facilities as port authorities, and public power generating facilities constitute an extremely complex and require many hours not only in reading, but in understanding of the various trends. It seems that increasing vigilance is necessary on the part of our industry to guard against the interests of bondholders and users alike are properly safeguarded by the ultimately developed documents. In this respect it appears that further reliance upon high grade legal opinions is necessarily.

Increasing Number of Bonds Dependent Upon Management Skills

Each year as we develop new types of revenue bonds it will be seen that more and more of the new bond issues to some degree are dependent upon a relatively high degree of management. Of course, the classic example of revenue bonds is the issue secured by earnings of a water revenue system. Water, a necessity, is involved, and if revenues are not sufficient rates can be increased. If people do not pay their water bills, it is usually provided that the water can be turned off, and depression experience proves this threat is more than enough to keep such bills paid promptly. However, it is to be noted that such types of facilities as parking garages and natural gas systems, to mention only two examples, require a very high type of management skill. This is especially true when such facilities are financed as an element of the engineering, and others as to the desirability and need of a new project. In this discussion is wasted if the revenue bond has not the legal basis for issuing the revenue bond for such a project. Perhaps the new facility (such as a toll bridge) will conflict with regulations which protect a facility already built upon which debt has herefore been issued. Usually a quirk with a knowledgeable bond attorney will clarify the situation and point out the steps which must be taken to finance the desired facility.

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tion provisions such a market opportunity might not exist.

Tax-Exemption of Revenue Bonds

Before leaving this subject let me say that my firm recently participated in the advance refunding of the bonds of the Tulsa Municipal Airport Trust. In this instance it was deemed advisable by house counsel to secure an IRS ruling that the interest on the new bond issue was tax exempt. As these remarks are prepared prior to securing such ruling, one can only conjecture as to the action of the IRS. If it is secured on a favorable basis, as bond attorneys feel it will, it should put to a considerable degree the controversy surrounding whether interest is tax exempt when there are two bond issues outstanding and ostensibly secured by only one property.

This is such a controversial subject that I believe that further thoughts on it might better be brought out in open discussion later.

Industrial Revenue Bonds

In any discussion of recent revenue trends probably something should be said about industrial revenue bonds. The subject is controversial; however, one thought which stands out in my mind is the matter of full disclosure of information concerning the company looked to as the backer of such bonds. Most industrial revenue bond circulars which I have read are woefully deficient as respects information on the companies who are issuers of the property. A similar lack of such information was partially responsible, at least, for getting the SEC into the corporate securities business some years ago.

I am not advocating that the writer of the industrial revenue bond circular go as far as is required by SEC prospectus rules. However, I do feel that unless more information is included in such circulars that sellers of such bonds are asking for trouble in the form of refunding suits. Whatever we think of industrial revenue bonds, may I say I hope that those of us practicing in this field will protect themselves—and our industry—by having at least reasonable information in their circulars concerning the companies looked to for debt service requirements on such bonds.

Improvement of Bond Provisions And Ordinances Would Be Desirable

In the preparation of bond issues for competitive bidding, we see from time to time failure on the part of financial advisors to include provisions which would not be onerous to the issuer but if included would help improve the bond ratings. For example, we have noted bond issues with additional bond provision clauses which are so liberal that the rating agencies refuse to rate the issues. All too often if such provisions had been written properly in the first place, a bank rating would have been possible and the additional bond provisions could have been workable so far as the issuing body was concerned.

In the field of reporting information to bondholders, the bond ordinance in many instances is too brief. With the many bond issues held by institutions these days they all would appreciate it, I am sure, if each and every revenue bond indenture would provide for at least annual audit reports to be sent to a mailing list of bondholders. The indenture should also state that such audit reports would contain a statement from the auditor to the effect that he had read and was aware of certain protective covenants of the indenture and would include his opinion as to whether such covenants were (or were not) being observed by the issuer of such revenue bonds.

There are other provisions which might also be improved, but I believe these two indicate certain of my pet objections found all too often when reading revenue bond resolutions.

Estimates of Coverage Ratios

Before closing I would like to give some indication as to what appears as reasonable coverage ratios for revenue bonds. Often the question is asked, "What minimum coverage should a bondholder expect on a water, sewer, electric or gas revenue bond?" I am perfectly aware that experts can disagree with each of the ratio shown below with logical justification. However, here goes:

Water—1.20 coverage of debt service, if rates are low and a demonstrated record of management is shown.

Sewer—1.30 coverage, again if rates are reasonable, management good, and protective covenants for collection are adequate.

Electric—1.30 coverage, if based on estimates, coverage should vary based on nature of territory and management.

Gas—1.75 coverage, if based on history; if based on estimates coverage should vary based on nature of territory and management.

This is far from the tabulation which may be stepping over into Dave Ellinwood's (Moody's Investors Service) field. However, such ratios are basic and usually are the first item looked to by the experienced analyst when he considers the purchase of a revenue bond issue.

Summary

If any summary can be made of the preceding remarks, it can be stated succinctly as "More complexities in the revenue bond business." As further use has been made of the revenue bond vehicle for financing, additional complications and more complex bond provisions have been devised and included in bond indenture by ingenious bond men and attorneys. This trend, if the recent techniques illustrated by advance refundings and lease financing are a guide, is continuing. The buyers and sellers of revenue bonds thus will have to continue and if possible improve their vigilance in order to safeguard the interests of the bond buyer and issuer alike.


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Solving the Bond Coupon Problem With Magnetic Ink


Boston banker suggests the use of magnetic ink character recognition impressions as the way to settle the controversy between those who do and do not favor replacing coupon bonds with registered ones, and those who urge larger denomination bonds. Mr. Agnew points out that all necessary information can be preprinted which will eventually lead to complete automation. Paper details why proposal made is believed to be more practical and efficient than those advanced by others, and why, just as importantly, it can easily lend itself to many long-range potential uses which have, so far, stayed out of reach until magnetic ink came along to make the impossible possible.

As we all know, there has been much controversy lately over the most efficient method of processing coupons. One solution proposed was to increase the use of registered bonds; another, the use of larger denomination bonds.

The First National Bank of Boston has recently come up with still another solution—one which we feel is practical as well as efficient. The principle is simple: It utilizes MICR (Magnetic Ink Character Recognition) characters, with which we are becoming so familiar every day on our own checks.

We have been fortunate in the First in having two men—namely, Harold Randall and Herb Corey—who participated in the first studies concerning the need for a machine language and who were familiar with all the advantages and disadvantages of magnetic ink. Thus, the fundamentals of our coupon processing system have been appraised carefully by experts from all angles. Before going into the rather complicated details of how coupons are handled today, let me explain what the new style bond and coupon look like. The complete bond is compact in appearance and measures 6" wide and just under 9" high. The bond itself is on the last page and covers the entire 9"x6" dimension. Coupons are printed three-up on the third of these bonds, and depends, of course, on the maturity or number of coupons. For example: A 20-coupon bond contains seven pages of coupons. Each individual coupon measures 6" x 2.5"—the same size as a pocket sized check. Incidentally, this is the size of a sheet of a piece of paper which can be handled in automated equipment. Compared to the plastic coupon measuring 3 1/2"x 1 1/4", the surface area is admittedly larger than the MICR coupon and the bond stack easily and compactly, and the overall storage area is one and a half times present storage requirements.

Preprints All Necessary Information

Now let us examine the information that each coupon contains in magnetic ink, which will permit eventual automatic processing. From left to right, the first 11 characters represent what we shall call the routing transit area and identifies the bank the coupon is payable at. The next five characters—excluding the "dash" and "on" symbol—are a number assigned by us at the bank to represent the company (or municipality) and the purpose of the bond. For example, a particular type of expenditure, such as "issues outstanding—one for school, sewer, public works, etc.—and a lot of others." The next two characters represent the coupon number, and since we can determine beforehand the exact maturity date of each coupon, these two digits are useful in classifying by due dates.
The next six characters represent the number of the bond itself. Finally, the last ten characters, bracketed by two "amount" symbols, represent the amount of the coupon. Thus, every possible bit of information needed for proper report on the coupon can be preprinted in magnetic ink. Through the miracle of the magnetic ink, every number printed at the bottom of the coupon can be read onto magnetic tape. From this the information is on magnetic tape, the coupon can sort by any group of numbers, and prepare reports in any manner desired.

I would like to emphasize the concept at this point of "information processing," rather than "paper handling." I can visualize the day when there will be no need to actually sort the coupons down by company, issue, and maturity. In other words, the initial entry to a reader-sorter will be used to prove the accuracy of the coupons entered, sort the information down by company, issue, and maturity, and produce a proper "magnetic tape ledger card," and prepare periodic statements showing unpaid coupons by issue and maturity. The coupons themselves can be stored in a vault in the same manner that they were entered into the reader-sorter, eventually they will be cremated.

Reviews Present Cumberbatch System

Now let us go back and take a look at the system presently used by many banks. Actually, systems vary considerably from bank to bank, so I will follow our own procedure for an example. The differences from bank to bank depend on the amount of "short-cutting" each bank will do.

I know from experience that many banks have eliminated some of the steps which we continue to feel are essential; at the same time, there are other banks which are still maintaining procedures that we now feel are unnecessary. To illustrate: Let us take the situation of a municipal bond for which we act as sole paying agent. Right away I come to a point which should be emphasized on. Corporate bonds and coupons are much easier to handle from an efficiency standpoint, because of the larger number of bonds contained in any one issue. Municipal bonds tend to cause problems because of need for designating bonds for a specific purpose and issuing a gross number of bonds for any one issue. Thus, it is virtually impossible to group a particular maturity, of a particular issue, of a particular municipality in large enough batches to justify an efficient operation. It is our customary practice to sort corporate issues down to issue and maturity, and post accordingly. However, when handling bonds, our procedure is to come to our first "short-cutting" procedure, and that is to disregard the distinction between "issues" and group municipal bonds by maturity only. Thus, we are utilizing our grouping procedure a municipal coupon may be counted as many as four times before being returned to a treasurer. If we were performing a creation function also, the coupons would be counted a fifth time. Actually, we feel that two good counts would be sufficient, but in the process of grouping these coupons into a form suitable for return at the end of the month to the treasurers, and proving the work each time, the coupons end up being counted maybe six or seven. We may wonder how this happens: The first count is made as the coupons enter our paying unit and are proved to incoming totals.
The second count is made by the computer unit to verify the work of the first count.
A third count is made at the end of the month's work into a consolidated package for the convenience of the treasurers.
Finally, a fourth count (which is modified at times) is made to account when the coupons are packaged for return.
Besides the counting procedures, the amount of coupons paid each day is posted on a ledger card for each municipality. At the end of the month when the coupons are grouped by maturity, a summary statement is prepared which shows a breakdown by maturity for the most recent two year period.

No Human Hand Touch The Coupon

Let me quickly review how this picture can be changed by MICR. No human sorting or counting will be necessary. In fact, the last step in the final system, it may be possible to eliminate even the sorting of the paper itself. The posting operation will be eliminated, since the magnetic ink will post the records. Month-end summary statements will no longer have to be prepared. If we reach a point where coupons can be retained at the bank for eventual cremation, the usual peak load at the end of the month will be eliminated.

So far, I have not mentioned too much about cremation, since it seems to be a practice of municipalities not to let the banks cremate. In those cases where we do "cremate," another count is necessary. In fact, it is less than 10 years ago that we used to keep a numerical record of those coupons paid off and cremated and cross the numbers off a control sheet. Thus, we could tell the actual coupon number of any standing coupons. This is a step which has since been "short-cut." Some banks have cut this step even further by not re-counting the coupons before cremation. In other words, they rely on the second count performed during the "accounting" function. Through MICR, it will be possible again to be in a position to prepare a report of outstanding coupons by bond number.

Long Range Potentials

One last point I would like to touch upon is the long-range possibilities which were suggested in the collection process of these coupons. A considerable amount of time and effort have been spent by the subcommittee on collections of the Federal Reserve System, the Technical Committee of the National Monetary Association, and the Federal Reserve banks in designing a routing-transit number for these coupons that would permit the posting of any of these items that inadvertently got into the cash collection system. As a result of this coordinated study, a new routing-transit number...
Toward a More Widespread Use of Registered Bonds

By Russell H. Johnson,* Executive Vice-President, United States Trust Company of New York

Mr. Johnson is one of the pioneers in the campaign to replace coupon issues with registered bonds. He is Chairman of the American Bankers Association’s Special Committee on Bonds and has seen that organization go from the study stage to propose the change which reflects progress made, and being made, since 1956 when he chaired the catalytic New York State Bankers Trust Organizing Committee. Mr. Johnson says up in the air of the "free" and "cash" arguments regarding the switch to, and issuance of, registered bonds; takes heartening note of the June 19th Firestone Tire & Rubber Co. $75 million denture offering initially made in fully registered form; realistically examines what can be done to meet problems posed by municipal issues; and answers prior differential, cost, and other technical problems; and recommends underwriters, both corporate and municipal, should take a hard look at the issue instead of leaning on tradition and the "we have always done it this way"

The title of this presentation was chosen because we no longer seek a first issue primarily of registered bonds. This is now a reality with the June 19th sale of the Firestone issue, which is to be delivered in registered form, exchangeable for coupons at the option of the holder.

Russell H. Johnson

This was a major step forward in our program towards fully registered bonds only.

The Problem

There are, in this country, some 285 million coupons outstanding at a cost of 452 man years of effort, annually. The use of fully registered bonds is a major step by comparison with volume coupon bonds. Very few people, financial or otherwise, are aware of the many advantages that accrue to the holder of fully registered bonds.

Treasury bonds throw off about 15 million of the 225 million coupons, municipal bonds about 112 million and corporate bonds about 166 million.

Recognizing this as a problem, the American Bankers Association appointed a Special Committee, of which I am chairman, to promote the use of fully registered bonds.

The committee decided early in the game to tackle the corporate issues first and we have made some progress.

Advantages

Let’s look at the advantages that registered bonds have over coupon bonds. These apply to corporates, municipals, and governments for the most part:

(1) Eliminates cutting, counting, auditing and cremating of coupons.
(2) Reduces insurance and mailing costs by five to one or 80%.
(3) Protects against the use of stolen or counterfeit coupons for loan collateral.
(4) Interest is received by mail.
(5) Call notices are received by mail.
(6) Permits direct communication for any reason.
(7) Increases safety in the event of a disaster.
(8) Decreases unproductive effort.
(9) Reduces space requirements substantially.
(10) Permits bondholder relations.
(11) Tends to eliminate the price differential.

Disadvantages

In order to be completely objective, my committee tried to determine the disadvantages of fully registered bonds. These were not easy to find:

(1) Issue possibly harder to sell because of a departure from accepted practice.
(2) Probable lessened interest on the part of the foreign buyers because identity could not be concealed as easily.
(3) The possibility of delayed deliveries due to transfer requirements.
(4) Closings could not be handled in the usual manner.

The Fear

If one were to ask why our program hasn’t been able to promote widespread public issuance of fully registered bonds by major corporations, I think we would have to say that it is due to fear that the issue won’t sell. Or, to say the same thing another way, with some institutional buyers won’t buy the registered bonds and fear that the bid for the bond won’t be there. It is not as if the bond is not as good a bid as one for a coupon issue or an issue that had some of the problems I mentioned earlier. These fears are not unwarranted. We have recently examined this question. The first two fears really ask “how can we be sure that the buyers will buy registered bonds?” Our committee has letters from over fifty major insurance companies denouncing emphatically that they favor registered bonds. We have a representation by the major Philadelphia banks which reads as follows:

"We state that we would be willing to buy new issue Corporate Bonds appropriate for our purposes, fully registered, not interchangeable for coupons, with no concession in market price on that account, provided that:

(a) The issuing Company arranges for authentication and transfer of its Registered Bonds within the 4-day settlement period.
(b) The seller receives interest to date of settlement.
(c) A provision is made for handling partial calls."

We are asking for similar resolutions from many banks. We have, of course, no question that the trust departments of banks favor highly registered bonds.

The Philadelphia Plan

The Philadelphia Plan is one I’d like to review. This Plan permits holders of coupon bonds of the City of Philadelphia to send these to the City and exchange them for registered bonds at no cost. It also provides an exchange in reverse at a later date. This certainly was a step in the right direction in many ways, because it relieved coupon bondholders of the storage of and the task of the cutting of coupons. I cannot express enough about this plan because all it did was to take coupon bonds out of one bank’s vault and put them in another bank in Philadelphia. The overall storage problem remained the same, etc. The end result of this does not help to solve the major problem.

(1) Elimination of some 300 million pieces of paper annually in the form of coupons.
(2) To experience all of the advantages of fully registered bonds.

The Individual Investor

Corporations and individual buyers are important, but I’d like to take a moment to consider the individual investor. About 80% of most quality issues are purchased by so-called professional investors, that is, banks, insurance companies, etc., and the other 15% or so by the public. Merrill Lynch, Pierce, Fenner & Smith’s publication, the “Investor’s Reader,” published our story a couple of months ago. One woman with $3,000 worth of bonds wrote to say that she brought coupons to her bank for collection on the first of January and was told that the bonds had been called for redemption the previous July. This meant that she had $5,000 not earning interest for six months. She acknowledged her letter and asked if I could quote her. She gave me that permission, and added that an elderly widow friend had asked that her plans be also included because the same thing had happened to her. The letter closed by saying thank you for thinking of the “little fellow.”

Logically, it is so beneficial for an individual to own a registered bond, as opposed to a coupon bond, that I don’t think we have to send out a million questionnaires to satisfy ourselves on this point.

The Price Differential

Let’s examine the three segments that make up the market for bonds: the seller, the underwriter, and the buyer. The buyer should be first because surely he should have something to say about the package he is buying. It seems to me that the size, shape, and content of any other product that is sold in this country, result from the buyer making known what he wants, and I conclude from the voluminous correspondence that I have had with professional buyers that they prefer registered bonds. Are you aware that the first thing many insurance companies do upon receiving their massive pile of coupon bonds on a new issue is to exchange them for registered bonds? They ask, however, for a letter from the corporation permitting them to exchange back to coupon again at no charge. Now this is an interesting point. They want that letter permitting a free exchange back to coupon because it is the only defense against the price differential that traditionally has existed between coupon and registered bonds of the same issue. The price differential is caused by three conditions that have been dogmatically accepted:

(1) Common practice has dictated that only a coupon bond is a good delivery, although this is not actually the case under the

Continued on page 15

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Volume 198
Is Competition Pushing Profits Over the Brink?

By John M. Maxwell,* Vice-President, The Northern Trust Company, Chicago, Ill.

The profit-p inflict of municipal underwriters who competitively have pushed themselves to a perilous point receives not a sympathetic bemoaning but a vigorous assessment of the problem and a practical outline on what should be done about it. The Chicago bank's municipal securities' expert endorses Jim Reilly's suggestions on ceding what all the municipal industry which he recapitulates.

There always seem to be some problems with us, big or little. But in recent months there has been a greater and greater buildup of conditions in our business which have made it more and more difficult to carry on a profitable operation. Now, we all know that many types of business have been experiencing a profit squeeze, so that the municipal business is in no way unique. In my opinion, we have more leeway to correct our difficulties than many industries confronted with labor problems and other conditions more or less beyond their control. We are doing it to ourselves. We know perfectly well that many of our current practices are bound to result in smaller profits, or even losses, but the competition continues to drive us on to do things our better judgment tells us not to do.

Most of these ill-considered operations could be eliminated in a very simple way. All that is required is the use of a little "common sense." I looked up the meaning of this phrase in one of my daughter's school dictionaries. It read: "Common sense—normal intelligence; sound, practical judgment." The solution of our problem doesn't require genius, merely "normal intelligence" which produces "sound, practical judgment."

Now, when we get down to analyzing our specific problems, I want to be the first to admit that difficulties and solutions are often beyond me. I keep asking my friends in the business, "How can we get an adequate profit margin?" and the usual answer is that the situation will correct itself as soon as we hit a hard knock. But if we know this is going to be the unpleasant condition of pushing the market too far, why do we persist in pushing it over the brink? It isn't as if there were not enough bonds to bid on, with the volume of financing growing year by year. Our industry has performed a great service for our national economy in underwriting the ever-growing financing needs of our states and municipalities at the narrowest of profit spreads. And we can continue to do so, but let's be realistic.

Problems Affecting Profits

Some of the problems that we might look at are:

1. Should be the proper makeup of our underwriting syndicate? Should more consideration be given to including only members who normally should have real distribution for the name in question?

2. What can be done about some members making offerings at cut prices during the life of the joint account? Shouldn't all special offerings be made by the syndicate manager, or with his permission, after majority vote has approved the cut? Should an account member be paid a selling commission on a cut-price sale?

3. Who is entitled to the dealers' concessions? I will venture an answer to this one. Only dealers or dealer banks with bona fide bond departments.

4. What can be done to control or reduce expenses? This applies to the operation of our individual shops as well as joint ventures. This is the realm where automation could play a more and more important role.

5. Syndicate managers often experience annoying delays in getting bidding views from members in time to make a thorough appraisal of an account's strength. Members are as fully aware as the managers as to when a sale is taking place and should be willing to volunteer their views at the proper time, without making it necessary to drag them out of them. Also, it greatly facilitates operations if the person expressing the views is prepared to make the commitment for his firm.

6. Shouldn't an underwriter check his historical alignments before joining a syndicate? As manager we follow the practice of confirming an historical account on a given credit when the size doesn't require reducing or expanding the number of members. Anyone should feel free to change syndicate associations but it would simplify the manager's job if he were notified promptly of a change before the letters go out.

Endorses Jim Reilly's Suggestions

I expect some of you heard and many of you have read Jim Reilly's excellent address at the Texas Group Meeting in April. If you haven't read it, I recommend that you do. I agree wholeheartedly with many of the views he expresses in this speech.

(1) He makes the point that selling and distribution are all-important. Where would General Motors be if they merely manufactured their cars and pushed them off the assembly line? The way to broaden the distribution of municipal securities is to have more and more houses develop

* A talk by Mr. Maxwell at the Second Annual Municipal Conference sponsored by the IBA, Chicago, III., June 25, 1963.

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[Odd Lot Municipal Bonds]
The relatively simple municipal business of the 1930 period has grown rapidly into a complex and complicated big business today, with an output of securities in excess of $8,000,000,000 annually. This figure as predicted by some experts is expected to reach $15,000,000,000 annually by the early 1970 period. It has been predicted that in the so-called good old days all one needed was a basis book and an affinity for Lady Luck and he was in the municipal business. Volume, of course, present and anticipated, together with the increasing pressures resulting from competition has radically changed that simple and perhaps nostalgic picture. As of today, the business of originating and issuing municipal securities appears to be characterized by the use of multiple banking and credit union, the use or attempted use of split or supplemental coupons, 100-page offertory books, containing detailed statistical charts, graphs and aerial photographs, free lunches or cocktail parties, information meetings, on-the-site inspection tours of the proposed project, approved underwriters opinions printed on the bonds, with the securities issued in denominations of $5,000 each, Madison Avenue executives, public relations experts, bond counsel, corporate counsel, local counsel, consulting engineers and accountants firms, to say nothing of the highly specialized staffs of at least the managers of the prospective underwriting syndicates. Undoubtedly, at least one New Frontier has really been attained.

With all of this necessary emphasis on presentation, some, however, are beginning to wonder whether the industry is not in fact in danger of losing sight of the fundamental legal principle on which the business of underwriting and distributing municipal and revenue obligations has been established. In the face of this rapidly increasing volume of new issues and the desire on the part of some members in the business to originate untied and sometimes questionable types of issues in order, it is argued, to meet the demands on government at all levels for new services resulting in part from our most recent population explosion, it is perhaps the better part of wisdom at this time to pause briefly for a recitation of the legal principles.

Are We Forgetting the Legal Basis? As a fundamental legal principle underlying the conduct of the industry, it cannot be stressed too strongly that the authority to issue municipal and revenue bonds must be directly expressed in the law or necessarily implied within the strictest legal limits from some express power. It is important to note that our courts in the several states have consistently frowned on a liberal interpretation of the use of any implied power in the issuance of municipal bonds to carry out the purpose of the issuance of municipal refunding bonds. Unlike the matter of the perfection of complete securities in which anything can be done which is not expressly prohibited by the law, the perfection of municipal securities necessitates the existence of legal authority for the proceeds and indicates a form of the securities proposed to be issued. For security reasons, among others, the trend toward what is popularly known as "advance refunding" is the potential amount of eye raising among the more sophisticated in the industry, and it is submitted that each proposed issue should be examined and determined as to feasibility as well as legality under present law. It should be pointed out that at the present time there is a real lack of authorizing legislation in a great many of the states and few court decisions in the majority of the states which would appear to support the general use of this device. No definitive answer to such fundamental questions as the relationship between the date of the proposed refunding bonds and the maturity date or redemption date of the outstanding bonds proposed to be refunded can be given except to say that in the language of the few decisions certain time periods have been held to be "reasonable," the longest of these being five years. (See 38 So. 2d 711, Florida.) Certain other questions, such as the power to invest the proceeds of a refunding issue in Government securities, the discharge of the lien possessed by the outstanding bonds and the possible abrogation of the defeasance clause in a trust indenture have yet to be judicially determined and it may well be that the courts would take, in at least some cases, a dim view of this device on the theory that the fundamental public purpose of the municipal or revenue bonds is to provide funds for capital improvement and not to make money for the general fund of the issuer. It is significant that the Comptroller of the State of New York has taken a similar view in a fairly recent opinion criticizing the issuance of non-callable Bond Anticipation Notes as a money making device for the issuer through an investment of the proceeds in Government securities or in the purchase of the municipal bonds.

Bonds at Competitive Public Sale. (See 77 So. 2d 788, Florida.) In an earlier case in Wisconsin, however, the court took the opposite view, holding that Financial Advisors could not bid at a public sale. In this case the court took the view that the Financial Advisor was the agent of the municipality, that is "(55 N. W. 2d, 905.). In the absence of legislation generally or a body of favorable court decisions, it would be seen in the light of the foregoing to be good business judgment for those employed as Financial Advisors not to attempt to act as underwriters of the bond issue.
Toward a More Widespread Use of Registered Bonds

Continued from page 11

rules of the New York Stock Exchange.

(2) There is usually a charge to exchange coupon for registered or registered for coupon, particularly in the latter case.

(3) There is potentially a time lag in effecting a transfer of registered bonds from one name to another.

The falacy of number one is obvious and I don’t think it needs any further discussion.

The committee is combating the second condition with a campaign to persuade large corporations to waive charges for exchanges in either direction. Already 27 major corporations have agreed to waive all charges, thus creating afloat of registered bonds and educating the holders of registered bonds to the many advantages that they create. This activity is instilling in the corporate mind, particularly since they agreed to waive charges, the interesting thought that perhaps the next time they issue they should consider issuing bonds only in fully registered form—NO COUPONS AT ALL. I stress “no coupons at all” because the real way to best the price differential is to have only one price.

As to the third condition, it is simply a problem of having corporate transfer agents get into the habit of processing registered bonds at the same speed that they presently process stock certificates.

Costs

Naturally, one of the factors of particular interest to an issuer is that of cost. Since the only existing fully registered issues we know of are very small corporate issues, we can only by personal experience to guarantee whether it costs more or less. We do, however, have two major corporations that have stated that costs are lower with registered bonds. The American Telephone and Telegraph Company tells us that it costs them 50% less to process registered bonds than coupon bonds. The Pacific Gas and Electric Company states that because of the number of their fully registered bonds outstanding, the interest processing costs are $30,500 a year less than they would be if all bonds were coupon bearing.

In fact, Pacific Gas and Electric is so enthusiastic about the use of registered bonds that they have offered to send a man to the Trust Company to cancel the coupon bonds in our vault and issue registered bonds right on the spot.

To continue with costs and to be as factual as possible, one of the major bond note companies tells us that while printing coupon bonds in volume costs approximately 40 cents per bond, registered bonds, if fully engraved and ordered in volume, would be about 20 cents per bond. If the engraving were reduced, and some flat printing was introduced, the price per registered bond could go down to about 12½ cents per bond. It is not for me to suggest whether or not the bonds should be fully engraved, engraved on the face and lithographed or any other arrangement. This is something for the municipal industry to settle on its own. Perhaps this would be a good subject for the Municipal Securities Committee of the Investment Bankers Association to consider and discuss with the American Bar Association, the Municipal Forum of New York, and the Municipal Finance Officers Association.

The use of fully registered bonds would protect against counterfeiting of bonds and the use of stolen bonds as collateral, because the counterfeiter, or thief, would have to add forgery to his crimes to make it work. This is another reason why municipals need registered bonds.

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Toward a More Widespread Use of Registered Bonds

Continued from page 15

This year indicated wide acceptance of this principle.

The second technical problem has to do with the record date. My committee suggests that consideration be given to the advantages of a uniform record date. One might say, for example, the record date for a registered bond interest payment should always be the tenth business day prior to the due date of interest.

I am aware that many of the thoughts I have expressed seem to apply to corporate bonds, and municipal people rightly would like a little more comment about what our thoughts are concerning municipal bonds. In the first place, I want to make it abundantly clear that we do not think that fully registered bonds are ideal for all municipalities. To go a step further, I would say that registered bonds are probably only practical for the large municipalities. What do we mean by large? It would seem to me that if the issuer is large enough to require a corporate paying agent in a major financial center, or if there is a central fiscal office within the state of issue, then we believe benefits would accrue, such as possible lower costs and less counterfitting problems, to name but two, to make the use of registered bonds logical.

We are very much aware, too, that certain state statutes prohibit the use of anything other than coupon bonds. It would seem to me that if others begin to share any of the optimism that I have in this project, they will conclude that the registered bond is eventually going to become the standard thing and that, instead of selling at a discount when compared to a coupon bond, it has a good chance of selling at a premium at some future date because of the sheer logic favoring its use. It is not too early, in my opinion, to start examining local finance laws and discussing with municipal officials and attorneys, the steps that are necessary to open the door to the use of fully registered bonds for communities you are called upon to finance.

Summary

Let's sum up what I have said:

1. We have established that there are no losers in this plan, that this plan is not just for banks and brokers, and that the issuer and the investor both benefit. The investor should have something to say about the product he is buying and I believe he is going to make himself heard before long.
2. We have established that the professional buyers, the ones that buy 85% of the issues, want registered bonds.
3. We have established that important corporate issuers believe in this project and indicate their belief by their willingness to waive charges.
4. We believe that, from a safety point of view, it is of national interest to promote the wider use of fully registered bonds.

Let me conclude by saying that all this program needs to put it over is for people to get together and look hard at the many cogent logical reasons for the wider use of fully registered bonds—and stop leaning on tradition and apathy and the "we have always done it this way" sort of thinking.

*An address by Mr. Agnew at the Second Annual Municipal Conference sponsored by the IRA, Chicago, III., June 20, 1963.

Solving the Bond Coupon Problem With Magnetic Ink

Continued from page 10

There are several additional advantages from the new size coupon which are semi-related to automation. One is that the size is more conducive to human counting rather than the present small, awkward size. (Have any of you ever tried counting large quantities of small coupons?) Furthermore, the small size is difficult to use with such counting machines as a "tickometer."

Summary

In summary, we feel the new MICR coupon will enable banks to perform a more accurate and efficient reclamation of coupons than ever before. We shall be able to put back into the coupon paying creation functions, procedures which have been eliminated as being impractical under present systems, limited by time-consuming human labor.

*An address by Mr. Agnew at the Second Annual Municipal Conference sponsored by the IRA, Chicago, III., June 20, 1963.
Beware of Legal Pitfalls in The Municipal Business

Continued from page 12

of a suit and there are instances where the financing has been abandoned or indefinitely postponed because of these tactics. There is a real danger that severe damage will be suffered by underwriting groups in the future because of these unreasonable delays in the delivery of bonds unless an adequate remedy is established. It is suggested for your consideration that legislation be introduced in the various state legislatures making it a crime for a third party to interfere in any way with a contract entered into between two parties, in this case the issuer and the underwriter. In the opinion of this observer, a law, which would make it extremely costly to interfere with such contracts, would go a long way toward the elimination of the risk of nuisance suits. One further legislative step should also be considered, to wit, the enactment of a law in the various states authorizing the issuer to bring a proceeding for the validation of a proposed bond issue. The validation decree could be made conclusive and such a decree would also constitute an injunction, as provided in the law, preventing the bringing of any suit to contest the validity of the bonds.

SEC Law's Applicability to Municipal Sales

In the light of the anticipated increase in volume in the coming years, it is also suggested that the relationship between the Federal Securities and Exchange Act of 1934 and the origination and issuance of municipal and revenue securities will take on an increasing significance. How often have we heard some ambitious bond salesman declaim over the telephone: "But Municipalities are exempt from the Securities Act!" True, exempt from the requirement of public offering and filing of a registration statement but our salesman friend forgot to remind his customer that Municipal Bonds are subject to the so-called "Fraud" Section of the Securities Act and that misrepresentation of a material fact or the failure to state a material fact in an offering prospectus or other document in connection with the offering of securities subjects the underwriter to severe risks and possible penalties. Nor does the fact that the document was prepared by the issuer and delivered to the underwriter relieve the latter from liability. It is well settled that upon acceptance of such a document the underwriter adopts the document as his own and assumes responsibility for all of the representations contained in the prospectus or official offering statement. Nor can the sometimes ignorant underwriter plead reliance of the law or avail himself of a short statute of limitations to reassert his own liability for misrepresentation. Moreover, by availing himself of the remedy afforded by a court of equity the investor has 10 years from the time he discovers the misrepresentation—not 10 years from the offering of the bonds—to bring suit to rescind the contract of sale and to recover damages in the event that he has sustained any loss through the sale. In other words, the possible liability of the underwriter is not removed upon the sale and delivery of the bonds and the profit check deposited, but it will remain with him until the last bond of the issue is retired or redeemed.

Need for Greater Vigilance

It is suggested that in the light of the foregoing, it would appear that not only increased vigilance in determining whether or not to submit a bid at public sale or to lend one's name to a negotiated issue but even more than merely ordinary diligence in the investigation and preparation of all prospective underwritings of municipal and revenue bond issues will be required in the coming years, if the industry is to live up to its responsibilities to both institutional and individual investors. It would seem also that greater understanding and cooperation will be necessary between issuers, underwriters and municipal attorneys in order to create new issues that will be not only marketable at a fair and reasonable price but those in which the purpose of issue is truly a public purpose in the best interests of the people and not for private benefit.

Problem of State Jurisdiction

Since the experiences of the "Great Depression" when the

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Legal Pitfalls in The Municipal Bond Business

Continued from page 17

We should keep in mind that in the decision in the case of Erie Railroad v. Tompkins (304 U. S. 64), the United States Supreme Court has held that a Federal court exercising jurisdiction on the grounds of diversity of citizenship must apply the state law as declared by the highest state court. In overruling the decision in the case of Swift v. Tyson (16 Pet. 1), which had been the law of the land for generations, the distinct advantage of bringing suit in a Federal court formerly enjoyed by bondholders has to a great extent disappeared. It is important to note that most of the favorable results obtained by bondholders in and after the depression period were gained in Federal courts sitting without a jury and not in state courts, where the bondholders too often were regarded by the members of the jury as foreigners and capitalists whose rights, if any, were distinctly questionable in the minds of the jury. It is submitted that in places of costly and long drawn out litigation, with results that in many cases in the past were not too satisfactory financially to the bondholders because of the expense involved in prosecuting the claim, the Trustee for the bondholders and bondholders' committees be empowered to effect a composition of the claims of the bondholder creditors with the issuer in default and to work out a refunding program in the best interest of both in order to avoid protracted and costly litigation. This remedy would, of course, require remedial legislation in many of the states as well as modifications in trust indentures to empower the Trustee to act in his new capacity, but it is believed that this procedure would in the long run work to the definite advantage of the bondholder.

In conclusion, it is rumored that there are some who would provide a new look to the municipal business by eliminating the use of coupon bonds and substituting registered bonds to be initially issued and later traded in the secondary market. While the problem is still in the preliminary stage of discussion and will require a great deal of investigation by qualified market and financial experts, there is one legal aspect of the problem which should not be ignored. It should be pointed out that under the provisions of the Uniform Negotiable Instruments Law and court decisions an instrument, to be negotiable, must be payable to bearer. Thus a bond payable to a registered holder would not be a negotiable instrument per se. It is suggested, therefore, that a careful study be made as to the effect that the law of negotiable instruments would have on the marketability of municipal bonds in registered form.

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Agency is making grants to municipalities for 50% of the cost of construction of public works (except educational facilities and housing projects) which can be initiated or accelerated within a reasonably short time in an eligible area (in a few cases the grants may be made for up to 75%). If municipalities receiving such grants are unable to finance the balance of the project cost in the private market on "reasonable terms," they are technically eligible for loans from the CFA under the Community Facilities Loan Program described below.

II
Community Facilities Loan Program

Authorized by Housing Amendments of 1953, administered by Community Facilities Administration of Housing and Home Finance Agency.

Authorizes Federal loans to municipalities up to 40 years for public facilities at interest rate determined each fiscal year, currently 3 1/2% to municipalities with population up to 50,000 and in redevelopment areas at 3 1/2% to municipalities with population up to 150,000, provided that no loan shall be made "unless the financial assistance applied for is not otherwise available on reasonable terms."

Amendments in 1961 also authorized loans to states, municipalities or public agencies to finance facilities and equipment for use by operation or lease in mass transportation service in urban areas and for use in coordinating highway, bus, surface-rail, underground, parking and other transportation facilities in such areas, with $50 million of the total authorization ear-marked for this type of assistance.

Total authorized: $650 million.
Total net commitments as of Dec. 31, 1962: $189,090,000.

Key to applicability of program is condition that no loan be made unless the financial assistance is not available from other sources on "reasonable terms." The "reasonable" rate of interest, determined administratively, at present is (for general obligations and revenue bonds) 4% for a maximum maturity of 30 years or more, or 1 1/2% less for each five years shorter maximum maturity, but not less than 3 1/2% (1/4% to 1% lower in each case in redevelopment areas).

III
College Housing Loan Program

Authorized in Housing Act of 1950, administered by Community Facilities Administration of H.E.F.A. Authorizes Federal loans at an interest rate determined annually (presently 3 1/2%) to colleges for dormitories and certain related educational and hospital facilities (but not classroom) if the financing is not available from other sources "upon terms and conditions equally as favorable." Authorization through fiscal year 1961 aggregated $1,675.000. Housing Amendments of 1961 authorized an additional $300 million on July 1 in each of the years 1961 through 1964.

IV
Area Redevelopment Act of 1961

Assistance available only in areas which qualify as "redevelopment areas" on the basis of unemployment.

(a) $200 million in Federal loans for industrial or commercial usage projects, up to 60% of project cost if financial assistance applied for is not otherwise available at reasonable terms.

(b) $100 million for Federal loans for public facilities at 3 1/2% if financing is not otherwise available at reasonable terms.

(c) $75 million in Federal grants for public facilities if there is little probability that the project could be undertaken without the assistance of such a grant.

V
Public Works Planning Grants

Administered by Community Facilities Administration of Housing and Home Finance Agency. Authorizes advances for public works planning, to be repaid without interest if contract is started. Authorized funds increased in Housing Amendments of 1961 by $10 million to a total of $38 million.

VI
Public Housing Program

Administered by Public Housing Administration. Local public housing authority issues bonds. PHA contracts to pay contributions necessary, with other funds of the local public housing authority available for such purposes, to pay debt service. Bonds sold under such contracts through December, 1962 aggregated $3.4 billion.

VII
Urban Renewal


(a) Matching grants to state and interstate agencies to assist in establishing and maintaining adequate water pollution control programs. Amendments of 1961 authorized $5 million for each fiscal year 1962 through 1968.

(b) Grants for construction to any state, municipality or inter-municipal or inter-state agency. Grant for any project limited to 50% of estimated reasonable cost between $900,000, whichever is smaller (except that in the case of a project which will serve more than one municipality the maximum may be as high as $2.4 million). 1961 amendments authorized fiscal years $80 million in 1962, $90 million in 1963.

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Current and Proposed Federal Financing Programs

Continued from page 19

1963, $100 million in each year 1964-1967; provided at least 50% of the funds shall be used for grants for construction of treatment works serving municipalities of 125,000 population or under.

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New Programs Pending in Congress

Proposed "National Education Improvement Act of 1963"

Numerous proposed programs for Federal aid to education this year were lumped into a single bill, H.R. 3000 in the House and S. 580 in the Senate. The IBA submitted statements at hearings in the House and Senate opposing those parts of the proposed Act which would authorize:

(a) $1.5 billion in Federal grants over the next four years for teachers’ salaries or 50% of the cost of construction of elementary and secondary school facilities.

(b) $1 billion in low interest rate Federal loans over the next three fiscal years for academic facilities for higher education (colleges and universities), requiring that at least one-quarter of the cost of the construction be financed from non-Federal sources.

Proposed "Urban Mass Transportation Act of 1963"

President Kennedy recommended adoption of an Act to authorize Federal grants aggregating $500 million over the next three fiscal years to assist states and local public bodies and agencies thereof in financing facilities and equipment for use, by operation or lease or otherwise, in mass transportation service in urban areas and in coordinating such service with highway and other transportation in such areas. The IBA submitted statements at hearings in the Senate and the House opposing the proposed Act.

On April 4 the Senate passed S. 6 which would authorize (a) an aggregate of $375 million in Federal grants over the next three fiscal years for up to two-thirds of the net project cost which cannot be reasonably financed from revenues and (b) Federal guar¬
Running a Municipal Syndicate Properly

Continued from page 7.

e. Redelivery to customers and members.
f. Carry arrangements.
g. Settlement of account—closing statements.

Let us consider now briefly the "moral" responsibilities of the manager. It is in this area that important differences of opinion can arise which lead to many misunderstandings.

"Moral" Responsibilities

In the first place the manager should have available and be willing to commit to the account all bonds paying interest and principal according to the acts of the board of directors. This information should be available to all parties interested, but it is his duty to ensure that the board does not exceed its authority. In the second place, the manager should have access to all bonds which are available for sale by his own members. As a general rule, the manager should be allowed to conduct his own business in all respects. The manager should also be allowed to conduct his own business in all respects. The manager should be allowed to conduct his own business in all respects.

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properly chargeable to the account.
d. The prompt settlement of syndicate accounts, with taking some of each member's proper statements of expenses, sales performance records and list of group sales.

Listing Group Sales
I believe the last point about group sales deserves emphasis. It seems to me that since in effect a group sale is accomplished by a group sale, with taking some of each member's bonds every participant in the account is entitled to know what happened to them. This should also apply to designated sales except where the customer refuses to allow his name to be given up and the order was accepted on the same. In recent years there have been great technological changes in our business, many of them stemming from the rapid increase in state and local borrowing. For instance, the 5,000 denomination bond is now accepted without question and this is probably just the forerunner of other developments which will lead to more efficient means of handling our merchandise. We are apparently on the threshold of an era where remarkable computing machines will play a major role in our business. In these areas where great improvements are bound to evolve, I believe the syndicate manager should be alert to sponsor sound new ideas which will benefit the entire investment field.

In conclusion, I would say that the present machinery of our syndicate operations is functioning pretty well, particularly when it is realized that a typical account will bring together many different kinds of dealers with diverse geographical interests and local customs. There are, of course, understandable differences of opinion regarding some practices and we should welcome any informed opinion or recommendations which might result in more efficient or fairer operations of our syndicates. Still it seems to me that most problems can be settled within each account rather than through industry-wide rules which would tend to remove the flexibility which is so essential in meeting constantly changing conditions. Our present procedures evolved as the best means of meeting specific problems and I am confident that the industry will, as usual, meet the future challenges of a highly mechanized age. I believe that most of our current methods can work quite well if the syndicate manager and the members recognize their respective obligations to work together for their common interest in the spirit of fair play.

Trading Desk and Secondary Market
Continued from page 6
revert to default by the active traders in the larger cities.

Promoting Better Public Relations
Before closing, I offer the suggestion that the dealers can improve their functions in the secondary market by promoting better public relations through the local press. Publications such as 'The Bond Buyer' now carry excellent coverage of secondary activities. The financial writers in New York have expressed greater interest in our activities, and as a result of better cooperation between the traders and the press, the public is beginning to get the idea that the municipal market is no longer what one writer called it a few days ago. He likened it to a municipal mortgage market. Don't blame the writers. Let's help them to do a better reporting job. After all, customers read newspapers.

*From an address by Mr. Miller at the Second Investment Bankers Association Municipal Conference, Chicago, Illinois, June 20, 1963.

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Broadening the Municipal Investment Areas of Banks

Continued from page 3

which I seek to accomplish or have accomplished.

I know this is not very pleasing to all members of IBA municipal fraternity but I might as well
tell you this frankly; I hope you will appreciate that much.

There are other matters of course, legislatively, in which we
are interested, on which we hope to
secure some action. But this is
a very important one.

Proposed Investment Regulation

Now, if I may, I would like to
get over to the investment regu-
lization as we here propose it.
It has been filed in the "Federal
Register" and will appear offi-
cially on June 21.

What we have here proposed mainly is to make a more work-
able and intelligible regulation. This is no easy task.
We did start with a regulation which, from
our standpoint and that of the
banks, has been very difficult to
grapple with. It amounts to and has amounted to for all these
years a confusing collection of
rulings, interpretations, prohibi-
tions, limitations, as well as a
lack of useful standards. It has
been extremely difficult for this
office through the years to grapple
with it in its present form.

1 Full text of proposed new regulations appears at end of Mr. Saxon's remarks. Editor.

In line with the efforts we have made in the year and a half I have been in this office, this being
the last major area, we have after
nine months of study has reached the
point of publishing this ruling for
review as proposed rule making.
We would hope that affected
banks, lawyers, members of the
investment banking fraternity, all
will examine it with the utmost
care and will submit such com-
ments, criticisms and recommenda-
tions for change as they may see
warranted or necessary.

5% Investment Limit

Substantially we have made a
certain number of changes here
which would enlarge, to some ex-
tent, the flexibility of commercial
banks in dealing with this area,
and I do not here refer in this
aspect to underwriting. What I do
refer to is the enlarged, the
modesty enlarged, scope for in-
vestment for our own account by such
banks in securities up to a limited
percentage, the first time this has
been employed generally, a 5% limitation of certain securities.

We have done this on the basis of
limiting it to those banks hav-
ing qualified and established
investment departments or bond
departments. This is a terminology
which we have struggled hard
to frame in an understandable form,
and what we here mean by
"qualified" and "established" in-
vestment department is reflected
best, illustratively, by the bond
department of the Northern, the
Harris, the Continental, the Chase,
Wells Fargo, United California, or
banks of this order, and on the
ground that there would exist certain a group of profes-
sionals on their own able to ap-
proach, from engineering and other investment standpoint.
the

Continued on page 24
Broadening the Municipal Investment Areas of Banks

Continued from page 23 quality of securities and afford it, as proposed here, this flexibility.

Defines Public and Investment Security

We have also made a revision of the meaning of the term "political subdivision" by including within the definition of that term municipal corporations and public authorities. This is, in fact, simply a recognition of what we have been doing basically, a recognition in this regulation, thus according to the securities issued by such organizations, corporations or authorities the status of public security, a new term which we are here using to embrace general obligations of the United States, states and municipalities, and including within the latter the term "subdivision of municipal corporations or other publicly owned authorities." We are here, of course, referring only to public securities.

We have made a number of other revisions in this regulation dealing with the investment area, which I now should like to point out. We first reorganized it to give it a more suitable and understandable form, as we hope—and I think this will be—will be observed on examination.

We have here defined the term "investment security." We define the term "public security" to mean an obligation "... not subject to limitations and restrictions as to dealing, underwriting and purchasing." We define "public securities" to mean (a) an obligation of the United States; (b) any general obligation of any state or political subdivision thereof; and (c) other obligations listed in paragraph 7 of 12 U.S.C. 24. These are the securities specifically exempt by statute.

Then we define the term "political subdivision" of a state, as I noted earlier, to include municipal corporation, a public authority and generally any publicly owned entity which is an instrumentality of the state or any subdivision thereof.

In defining the general obligation of any state or any subdivision thereof, we have heretofore defined it to mean to fulfill an obligation supported by the full faith and credit of the obligor in terms of certain securities issued by municipal corporations or public authorities. This would include general obligation securities issued by such authorities.

Prudent Banking Test For All Securities

We get promptly, therefore, into the matter of the principal underwriting recent rulings of this office in the Georgia Securities and certain others that there can be, and, in fact, is an indirect commitment of a full faith and credit. This is the essential basis in principle of a decision underlying some of the recent issues, with which there may not be total agreement; but which on the whole, so far as we are advised, are found legally acceptable.

We have for the first time set up a new test with respect to all securities, whatever their character: namely, that investment or underwriting of any investment or underwriting of any...
prudent banking judgment. And this we also have defined.

That Ruled Eligible by the Comptroller

There is one other category, and of course I am not trying to deal with this in great detail here. We further establish a class of investment security eligible for investment by national and state member banks, being any security, investment security, ruled eligible by the Comptroller of the Currency.

We have retained, with some changes, previous provisions relating to convertible securities, amortization of premium and certain other matters. We have provided for the first time a procedure whereby a bank may request a ruling from this office. We are also providing the machinery now for prompt disposition of a request for ruling.

I would like to point out here that it would be a serious misunderstanding of this proposed regulation if it were taken to mean that it would authorize underwriting and dealing in revenue bonds generally. This is not the case. This must be obvious to all; otherwise, we would not be promoting so vigorously the legislation which would authorize underwriting and dealing in revenue bonds generally. This is not the case. This must be obvious to all; otherwise, we would not be promoting so vigorously the legislation which would authorize underwriting and dealing in revenue bonds generally. This is not the case. This must be obvious to all; otherwise, we would not be promoting so vigorously the legislation which would authorize generally underwriting and dealing in revenue bonds by the banks.

Text of Proposed New Regulations

End Date: Mr. Saxon's letter addressed to "Presidents of all National and State Member Banks" along with text of proposed revision in their investment powers, appears herewith:

"There is attached for your information, consideration and comment, a proposed revision of the Investment Securities Regulation which was published June 21 in the Federal Register. The banking laws limit the authority of National Banks and

Continued on page 25

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Underwriters, distributors and dealers in corporate and municipal securities.
Broadening the Municipal Investment Areas of Banks

Continued from page 25

State member banks to engage in securities transactions. Banks, however, purchase investment securities for their own account to a limited extent. In addition, the limitations on their authority to purchase and hold investment securities and the prohibitions against dealing in, or underwriting such securities are not applicable to public securities such as the obligations of the United States and the general obligations of state and local governments.

"There has long been a need for a simple interpretation of the legal effect of the authorizations, prohibitions, limitations, restrictions, provisions, exceptions and exemptions contained in the banking laws relating to these securities transactions by banks. The proposed regulation attempts to meet this need. To a large extent it restates the statutory requirements in simplified form and provides useful standards for their application to particular securities.

"The proposed regulation defines investment securities and some of the terms used in the law with respect to public securities. The term 'political subdivision,' for example, is defined to include public authorities and the publicly owned instrumentalities of state and local governments.

The term 'general obligation' has been defined so as to permit the inclusion of obligations indirectly supported by the full faith and credit of a state or local government. The definitions relating to public securities represent a statement of the principles which were applied in such rulings as the Georgia State Authorities, the Chicago Civic Center Courhouse, and the Virginia Public School Authority.

"The authority of a bank to deal in, underwrite, purchase, hold without limit and sell a public security is recognized. The proposed regulation requires, however, that this authority as well as the authority to purchase other investment securities must be exercised in accordance with prudent banking judgment and certain investment standards which are set forth.

"Special provision is made to permit a bank with a qualified investment department a somewhat broader range of judgment with respect to a limited portion of its investment portfolio. Provisions are also included relating to (a) requests for rulings by the Comptroller (b) purchase of convertible securities and (c) amortization of premiums.

"Your comments on the proposed regulation should be submitted to the Comptroller of the Currency, Washington 25, D.C., prior to July 21, 1963. It would be helpful if the outside of the envelope were marked 'Investment Security Comments.'"

"JAMES J. SAXON"
"Comptroller of the Currency"

Department of the Treasury
Comptroller of the Currency
[12 CFR Part 1]
Investment Securities Regulation
NOTICE OF PROPOSED RULE MAKING

Notice is hereby given that the Comptroller of the Currency pursuant to the authority contained in paragraph Seventh of R.S. 5136, as amended, 12 U.S.C. 24, is considering the adoption of a revision of Part I relating to the purchase, sale, underwriting and holding of investment securities by National Banks. Pursuant to 12 U.S.C. 333, the proposed regulation would also be applicable to state member banks.

Prior to the adoption thereof, consideration will be given to written comments pertaining thereto which are submitted to the Comptroller of the Currency, Washington 25, D. C., within 30 days after the date of the publication of this notice. All National Banks and state member banks and other interested parties are invited to submit such comments. It is contemplated that the proposed revision will enter into effect on or about Aug. 10, 1963, with such revisions thereof as may be deemed appropriate in the light of comments submitted.

The proposed revision would amend Part I of Title 12 of the Code of Federal Regulations of the United States by remember-
PART 1

Application of Paragraph 5136 R.S. and Sued under 1.11

Amortization Exceptions.

L. Gordon

Limitations

Scope

Authority.

1.1 Prudent

Limitations

Requests

§1.2 Definitions. (a) The term “bank” includes National banks and state member banks.

(b) The term “investment security” means a marketable obligation in the form of a bond, note or debenture which is commonly regarded as an investment security. It does not include investments which are predominantly speculative in nature.

(c) The term “public security” means an obligation described in 12 U.S.C. 24 as not subject to the limitations and restrictions contained therein “as to dealing in, underwriting and purchasing for its own account, investment securities.” Public securities include:

(1) Any obligation of the United States.

(2) Any general obligation of any State of the United States or of any political subdivision thereof.

(3) Other obligations listed in paragraph Seventh of 12 U.S.C. 24.

(d) The term “political subdivision of any State” includes a municipal corporation, a public authority and generally any publicly owned entity which is an instrumentality of the State or of a municipal corporation.

(e) The phrase “general obligation of any State or of any political subdivision thereof” means an obligation supported by the full faith and credit of the obligor. A bank it includes an obligation payable from a special fund when the full faith and credit of a State or any political subdivision thereof is obligated for payments into the fund of amounts which will be sufficient to provide for all required payments in connection with the obligation.

§1.4 Limitations and restrictions on purchase and sale of a public security.

A bank may deal in, underwrite, purchase and sell for its own account a public security subject only to the exercise of prudent banking judgment. In the case of an obligation of a State or a political subdivision thereof prudent banking judgment will require a determination that the obligation is payable from a source or source of funds sufficient to provide for all required payments in connection with the obligation and all other obligations payable from the same source or sources.

§1.5 Limitations and restrictions on purchase of an investment security.

(a) Evidence of obligor’s ability to perform. A bank may purchase an investment security for its own account when in its prudent banking judgment it determines that there is adequate evidence that the obligor is able to perform all that it undertakes to perform in connection with the security, including all debt service requirements, and that the security may be sold with reasonable promptness at a price which corresponds reasonably to its fair value.

(b) Reliable estimates of obligor’s ability to perform. Bank which maintains a qualified investment department may purchase an investment security for its own account when, in its prudent banking judgment based upon reliable estimates, it determines that the obligor is able to perform all that it undertakes to perform in connection with the security, including all debt service requirements and that the security may be sold with reasonable promptness at a price which corresponds reasonably to its fair value.

(c) Securities ruled eligible by the Comptroller of the Currency. A bank may purchase any investment security ruled eligible for purchase in a published ruling of the Comptroller of the Currency.

§1.6 Limitations and restrictions on holding investment securities.

(a) Obligations of any one obligor. A bank may not hold at any time investment securities of any one obligor in a total amount in excess of 10% of the bank’s capital and surplus. For this purpose the amount of an investment security is to be determined on

Continued on page 28
Continued from page 27

the basis of reliable estimates. A bank may not hold at any time investment securities purchased

(b) Obligations purchased on pursuant to paragraph (b) of §1.5

in a total amount in excess of 5% of the bank's investment account.

c) Limitations prescribed in eligibility rulings. When the Comptroller of the Currency has in a published ruling ruled an investment security eligible for purchase subject to a specified limitation, a bank may hold such security in an amount in excess of the specified limitation.

§1.7 Limitations and restrictions on purchase, sale and holding of specified obligations. A bank may deal in and underwrite the obligations of the International Bank for Reconstruction and Development and the Inter-American Development Bank and all bonds, notes and other obligations of the Tennessee Valley Authority but it may not hold at any one time the obligations of any one of such obligors in a total amount in excess of 10% of the bank's capital and surplus.

§1.8 Prudent banking judgment; credit information required. Every bank shall maintain in its files credit information adequate to demonstrate that it has exercised prudent banking judgment in making the determinations and carrying out the transactions described in §§1.4 and 1.5.

§1.9 Requests for rulings. Any bank may request the Comptroller of the Currency to rule on the application of this part, or paragraph Seventh of 12 U.S.C. 24, to any security which it holds, or desires to purchase for its own account as an investment security; or which it holds, or desires to deal in, underwrite, purchase, hold or sell as a public security. Such a request for a ruling should be supported by (1) information sufficient to enable the Comptroller to make the necessary determination and (2) the bank's appraisal of the information furnished.

§1.10 Convertible securities.

When a bank purchases an investment security convertible into stock or with stock purchase warrants attached, a charge to undivided profits must be made by the bank at the time of purchase to write down the cost of such security to a price level representing a yield which reflects the investment value of the security considered independently of the conversion feature or attached stock purchase warrants. Purchase of securities convertible into stock at the option of the issuer is prohibited.

§1.11 Amortization of premiums. When an investment security is purchased at a price exceeding par or face value, the bank shall:

(a) Provide for the regular amortization of the premium paid or of that portion of premiums...
Meaning of Firm Policy to a Municipal Bond Organization

Continued from page 3

A number of dollar bond issues? Do you have the time, the ability and the personnel to seek out and place whole issues privately? What is your Firm Policy on industrial aid revenue bonds and should it be changed?

Will you confined your operations to those issues having a national market or will you specialize in securities confined to a particular geographic area? And not to be overlooked is the important decision as to the minimum quality security which you will offer and recommend to your clients.

Organizational Development

It is not possible at this time to discuss more than just a few of the important points which should make up Firm Policy. However, I would not wish to conclude my observations without some thoughts about the vital area of Firm Policy which should be concerned with personnel.

Our industry is composed of firms which in effect are but groups of people. If steps are not taken to provide adequate talent for the future a firm will gradually shrivel away and in time, die. Much can be done to prevent anything as drastic as this from happening. For example, in the case of a larger organization, a well defined training program would be set up which would not only indoctrinate new employees but would also prepare older ones for more important assignments.

Personnel Compensation

Firm Policy concerning personnel should be clear as to the possibilities of promotion to management levels and also as to compensation to be paid. It is to most firms definite advantage to do as much as possible to retain experienced associates. Where a salary is the main basis of compensation, care should be taken that it is at least competitive with that paid outside for similar work. It is important that the salary be reviewed on a regular basis and that adjustments be made from time to time both for merit as well as length of service.

Retirement benefits today have become very important in reducing turnover of those with substantial years of service behind them, but care must be taken that they will not be a drain on a firm's assets.

In many instances a bonus or a profit sharing plan or a combination of the two could provide adequate incentive. The compensation of salesmen is a most interesting subject in itself and will be covered by another speaker.

Conclusion

If all these comments concerning Firm Policy were to be summarized briefly, I think that it could be said that it is a way of life. It should represent keen and aggressive forward planning which does not overlook the lessons to be learned from the past. If properly formulated and thoroughly understood, Firm Policy should be a series of guidelines that will keep us on the right track. If it is inadequate in its scope or disregarded in times of stress, just when adherence to it should be most important, nothing but trouble can lie ahead. The records are filled with names that paid little heed to many of these points of policy and which are no longer with us.
Up-Dating Underwriting Practices and Procedures

Continued from page 4

Continued from page 4

as a result of

transactions that buy bonds on a prior-

It appears unfair to com-

peting commercial bank buyers

Without bond departments and

would be indirectly a contributing

cause for the sudden surge by com-

mercial banks to open bond de-

partments which in many in-

stances is for no other purpose

than to avail themselves of the

privilege of buying bonds for

portfolio at some concession. If

bonds taken on a priority basis

are for retail purposes, it can only

follow that it gives the bank un-

derwriter an unfair advantage

over his fellow members, in that

he is assured of certain bonds that

other members are deprived of

getting. The fair practice would

seem to be that bonds be left in

account, giving all the members

an equal opportunity to get bonds

to fill orders.

(B) The most recent practice of

an account that is formed within

an account getting priority on a

strip of maturities at the take-
down with the right of reoffering

immediately but agreeing to re-

sell to members of the account at

the dealer's discretion. This is a

means of simply taking away mer-

chandise that should be rightfully

available to all members of an

account at the full profit. The

argument most generally ad-

vanced for its justification is that

it helps the bid, although there

are numerous people who will de-

bate this, because, in all likeli-

hood, it involves maturities that

are the most salable. Besides be-

ing unfair, it can prove embar-

rassing to other firms when a

salesman contacts a buyer and,

after he informs his account that

a certain strip of maturities is out,

is told by that account that such-

and-such a bank or dealer had

just offered them the bonds. This,

in my opinion, is probably the

quickest and surest way that has

as yet been devised of losing the

support of your sales force.

It would seem to me that if for

any reason it is felt that priority

should be granted to such a group

on such a basis, then other mem-

bers should either have the right

to participate in that group, should

they so desire, or be allowed to

taken down their pro-rata share

of the bonds. One of the vital

cogs in our business is the dealer

who can distribute bonds in small

amounts, in good times and bad.

Unfortunately, however, he does

not get the recognition he de-

serves or merits in this era of big

bank and casualty company buy-

ing. Because of this, he is more

times than not the forgotten man

when the allocation machine

grinds out its product. It would

be well for us to constantly try

to keep this fellow in mind, for

his importance in the future,

when we will again be compelled

to rely on his method of distribu-

tion to put over deals, cannot be

over-emphasized.

Designated Sales

In regard to designated sales, I

believe the last open discussion

took place here at the September

Forum. While the arguments pro

and con seemed valid enough, I

believe many will agree that mat-

ter was not quite resolved; and I

question that it will be in the near

future. Possibly, if we approached

the subject with the idea that we

can do little to eliminate the prac-

tice, we could make some prog-

ress in correcting some of the

abuses. Obviously, designated

sales are wonderful for those

designated, but not for those who

are slighted. In an undivided ac-

count, probably the only hardship

on those not designated, othe-

r than that of hurt pride, is the loss

of the takedown that might have

accrued to them had they been

able to get bonds for sale else-

where. However, in a divided ac-

count, there are more serious dis-

advantages. If the bonds are taken

out at the takedown and the

designees are allowed to reduce

liability in the bracket, then those

not designated are not only de-

prived of getting bonds because

of the precedence rule over mem-

ber orders; but they retain full

liability in the bracket, but in less

desirable maturities. Because of

this and other practices that are

good for a few but unfair to many,

there is a large group in our in-

dustry who would like to see des-

ignated orders eliminated en-

tirely. It certainly would simplify

our allotment system considerably

if this were done. Unfortunately,

however, it runs counter to the

wishes of most group buyers.

Therefore, it would seem that it

is unfair to all members of an ac-

count, if a buyer wishes to desig-

nate, his order should be accepted

but with the understanding that

if a conflict exists in any maturity,

all orders in that maturity will be

filled at a net price, with no com-

mission to the designees. Much

has been written and said on this

subject; but if we are really sin-

cere in trying to protect minority

as well as majority interests, more

flexibility in our thinking is

called for.

Cut Price Sales

One of the unpleasantities in our

business, of course, is what to do

about a deal that, shall we say for

lack of more descriptive terms,

has not met with buyer accept-

ance. Cutting price is a painful

process; and when it becomes

necessary to do so while bonds

are still in account, it becomes a

problem as well. I doubt if a

pain-proof method can ever be

devised for doing this. The usual

and most common method em-

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played by accounts to move bonds, particularly solicited, is to provide a market for bids to hit bids. The account either waits for bids to come in or actively solicits them. I would venture to say that in many instances account managers are providing a conscientious effort to do the best job possible when these situations occur and are governed by majority consent when a bid is the correct block of bonds below list price. However, when a bid comes into the account unsolicited, it is unnecessary to state that it is quite possible that the manager should not request or expect the seller to have to accept the sale. On the other hand, if the account decides to actively solicit bids at a down price, then all members should be apprised of this and those successful in obtaining orders should be entitled to some compensation. Further, I believe that when bonds have been sold at a special price and a member is unaware of this fact and goes into the market to take down a smaller amount of bonds at the original terms, he should be informed that sales were made at a down price. This will allow the member to determine if he feels his customer should pay the price penalty because he does not classify as a large buyer. This is indeed dangerous ground on which we tread when this is not done, because it can put a member's relationship in jeopardy with his client if he fails to disclose to him that other buyers have bought bonds at cheaper price. Last, but not least, for a group member to go out and solicit and encourage bids for bonds at a down price expecting to make a commission on the sale, without having obtained explicit permission to do so from the manager, is indeed dangerous ground on which we tread. Therefore, members should always agree that it is an impossibility to cut some of the built-in costs on a deal. However, there is an ever-growing group of people who believe it is possible to curtail some of the lavishly expensive advertising that is indulged in at times. Other than the fact that it gives managers a sort of "pride of accomplishment," it is felt that it produces little in the way of actual business. Quite frankly, I know of no other business that is willing to assume such high advertising "cost-to-profit ratios" on a product that is next to impossible to sell to the masses employed. To give you some idea of how these costs have run, the Committee on Municipal Practices made an analysis of 100 settlement letters chosen at random, dating back to 1960. This survey showed that advertising expenses ranged from $0.60 to $7.11 per bond for an average of $2.06 per bond. Certainly, it would seem to me that this money could be em-

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