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INVESTMENT BANKERS ASSOCIATION of AMERICA

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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-exempts is being pushed with utmost vigor; (2) envisions 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 IBA's 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. Further, he announces intent to establish as eligible for bank investing any security ruled "eligible" by the Comptroller of the Currency.

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

James J. Saxon

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 meantime there have been great 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 Nardan 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.; Delmont Pfeffer, First National City Bank, New York City, Lockett Shelton, of Republic National Bank, Dallas, Texas; and Franklin Stockridge, of Security First National Bank, Los Angeles.

I do not want to suggest that any one 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 a time—adopt some form, and 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 fears expressed as to the competitive aspects of the adoption of such a bill will not prove to have been overstressed.

We do also, however, strongly believe that in view of the growing volume of revenue bond financing in relation to the total obligational 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 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

Up-Dating Underwriting Practices and Procedures

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

Profoundly realistic paper on correcting self-defeating syndicate practices gnawing away at the successful operation of a large syndicate reflects 35 years of experience ranging from yesterday's simple underwriting to today's complicated, large syndications. Mr. Hassman probes such practices and procedures as: fallacy of taking for granted and automatically convening historic syndicate members; proxy arrangements; allocation procedures; designated sales; cut price sales; and advertising that does not reach principal investors. The writer is proud of the contribution Inderwriting has made, is making and can continue to make with necessary corrections. He notes that it took one small, unknown dealer who bought two king-sized issues to make the municipal fraternity realize how badly it has been underestimating 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 some repetition in subjects 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.

Elmer G. Hassman

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 topics 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 16 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 bonus issue that was going to require financing of $300 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 procedure devised at that time was so successful that it was to become the pattern for most future king-sized issues. As a result, underwriters began to look forward to subsequent large issues with keen anticipation and confidence. In the years that followed, large issues became more frequent; and today are almost commonplace. Interestingly enough, it wasn't until a comparatively unknown small dealer bought a couple of king-size 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 proof demonstrated by consumers that investable funds are available in size on all occasions, provided yields are satisfactory, We now have more underwriters of substantial means than ever before; and because capital is the life blood of our business, it is comforting to know that investment dealers and banks today can provide collective capital greatly in excess of what would be required to underwrite the largest volume of municipals 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 expediency, 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 reformation of historical syndicates. The industry has by practice tended toward rigidity in historical accounts, probably for the sake of convenience, as it makes an account easily available to the manager on most names and because members automatically will have a group with which to bid. This practice, however, can act as a hindrance in the flexibility and maneuverability of the manager in being able to reward good producers and to weed out non-producers. Certainly, in light of today's underwriting volume, managers should not have to be bound by a system that fails 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 rather 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 preceding issues have failed to perform commensurate with their participation. It would seem logical and reasonable that if a member has the important ingredients that make for a good underwriter, such as willingness to make a strong bid, loyalty to the account, 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 participant with these qualifications should be penalized by an antiquated practice of historical accounts that says he can't be moved up because he must hold the same position that he had in the last issue. 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 or accomplishments of an underwriter through the years; so he probably does that which comes most naturally—namely, sets up the account exactly as it was. Thus, everyone falls into the same position he held in the previous deal, even though that 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 letter, to ascertain first if members want to bid at all, and secondly, if the position indicated is satisfactory. If this were done, it might eliminate those who 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 on 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 it concerns a problem 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 giving of his time and efforts; and, for this reason, he should be given all the cooperation possible to make his task as easy as possible. One of the simplest ways to do this is to adhere to the Manager's written instructions, by having price ideas in the hands of the proxy in ample time prior to the first meeting, so as to make it unnecessary for the proxy to call for this information.

Obviously, if the member has conviction about a scale and good reasons for his views, then his ideas will be important and beneficial to the account; but if he is merely accommodating the Manager's request for price ideas and turns in low views because he feels he should, he is contributing little to the price meeting. I might add here that 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 whenever anyone is not in that frame of mind, he should get out early and gracefully, without allowing his unduly low price views to influence other members.

There are numerous times that a firm is asked to proxy for several members on a particular deal. On those occasions, should everyone elect to do what the proxy does, which is usually the case on the tough ones, it places the proxy in a most unenviable position. If he controls a good percentage of the vote in an account, and should his views conflict with those of the manager, his decision to drop or to go along can have an important bearing on the account's bid and is a responsibility that the majority who proxy would just as soon avoid, I'm certain.

Further, if the proxy has specific reasons of his own for going along with the account regardless of scale, and the scale may not be to the liking of the people for whom he is acting, he can't help but incur some eyebrow-raising if the deal turns up a dud. So it would seem that in fairness to all concerned it would make the proxies' and the managers' life much simpler if every member would use his own judgment on scale and reflect only that scale and his specific decisions on limits to his proxy.

Syndicate Allocation Procedures

Because of the tremendous post-war growth in our industry, a number of changes have occurred in distribution and allocation practices in major account. The take-down meeting, for those who can remember it, is a thing of the past. Designated orders and bank priority orders are commonplace; and the group buyer has become a dominant factor in the distribution process. As a result, there are many who feel an uneasiness at what the allocation processes in our syndicates have evolved into. Some of the prime points of concern center around the following:

(A) The practice of dealer banks in a group asking for and being granted takedown or dealer's concession on a priority basis for orders that involve bonds for portfolio and retail. This practice seems inconsistent. Theoretically, the priority granted by the account is granted to the bank as an institutional buyer, not as a competing dealer. If all other insti-

Continued on page 30

Meaning of Firm Policy to a Municipal Bond Organization

By John W. de Milhau,* *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 Milhau underscores the importance of clearly defining maximum underwriting and trading total dollar commitments, and of pinpointing particular area of municipal activity on which to focus operations. He similarly stresses the importance of adequate compensation of personnel and automatic review for upgrading, and of retirement security program to attract and keep a superior organization.

When it was first suggested that my topic for discussion should be "Firm Policy" I was concerned on 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 yourselves, assembled here for this Second Municipal Conference. I was also greatly concerned because it was my feeling that, because of my banking background, what little I might find worthy of discussion would apply solely to institutions 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.

John W. de Milhau

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 my 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 each 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 proprietor or a senior management group. It can be written and formally approved and 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 possessed 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 confidential 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 best prevent our losing it and to have our firm continue in business.

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 in the field of municipal finance. To others the maintenance of a municipal business may be desired to complement a stock or corporate bond operation and to broaden the line of services offered.

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 borrowing to capital, but in many other cases 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 adjustments for short-term bonds and notes as well as for securities of greater than normal risk or with restricted marketability.

Good policy would also call for sound and efficient operating procedure as well as 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 its 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 todays markets even a minor participant bidding cautiously, in his 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 Milner,* *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. Milner 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 not letting local markets revert 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, all these bonds are not yet out of syndicate. But they're getting there, friends, they're getting there.

Henry Milner

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 diversified as 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 new issues or engaged in setting firm policy.

Institutions Dealing Directly With Trading Desk

(6) In the past few years, we have found that institutional buyers have found it more practical to discuss business 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 expedience, especially when negotiating purchase or sale prices. Nowadays, institutions are constantly changing their portfolios. In a great many cases, a sale to an institution involves the purchase from them of a like amount of face value or principal in order to provide 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 alert dealer might do well to prepare his secondary desk to be capable of handling efficiently this potentially rewarding source of business. Once again, I repeat that this development does not decrease the area of effort on the part of the salesman. Rather, it provides the sales force with greater incentive to search out these potentials. Intelligent institutional men are becoming constantly receptive to ideas which will improve their portfolios. Salesmen are needed for this 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. And with it, a favorite subject—education in the Municipal Bond Business.

With very few exceptions, the Municipal Bond community has drawn its executives from the trading desks. Most of the partners, officers, heads of syndicate and sales departments started their careers as position clerks, odd lot traders and dollar traders. Over a period of many years they developed that priceless ingredient of experience which even today transcends the efforts of the most modern computers. The secondary desk should be staffed not only with career traders, but also with additional personnel of the junior executive type. While operating at the trading desk, these executives-in-training can develop not only a knowledge of issued bonds, but also an ever-increasing knowledge of their counterparts at other firms; men of similar stature with whom they some day may be sharing syndicate commitments.

There isn't a university in the country that can offer a course in the practical knowledge of what constitutes a solid municipal value. You must trade a bond, that is, actually buy it and then retail it before its true value can be assessed. Remember, the customer still makes the market. By his purchase, he makes a theoretical value a practical fact. Where is there a better place, then, to train a man who may be pricing entire new issues someday! After all, we may not always have a Regulation Q and may even be faced with pricing the issues once more for the retail trade. Nowhere else in the business does a man so often have to be his own analyst as does the secondary trader. Anybody can recite a quotation from an efficient broker. But the satisfaction gained from analyzing, buying, and profitably merchandising a parcel of seldom-seen bonds is as much a work of art as that of a painter with his brush, or a writer with his pen, and the successful creation of a previously non-existent market transcends the material gains (that is, assuming there are some).

The education of a trader is the education of a fully qualified bond man, ready, if need be, to analyze, sell, underwrite or trade. In other words, qualified to perform any productive function of the firm.

Educating Ethical and Efficient Trading

If these thoughts are valid, it also follows that the use of the secondary market effort as an educational media must be contingent upon the competence of the instruction disseminated by those charged with the responsibility of the development of this department. Ethical practices taught at an early age on the trading desk will result in ethical practice in all areas of the industry, including syndicate operations. Sloppy, lazy and inefficient executions at the apprentice level will result in a downgrading of the high standards which the entire industry is fighting to maintain. A current trend toward the dependency on other sources for sanctuary when trouble develops, is deplored and should be discouraged. The old contract rule of "caveat emptor" should be encouraged. A trader worth his salt should know thoroughly for what he is committing his firm's money. His market judgment should be encouraged, even at the expense of an occasional loss through overbidding. Dependency on brokers to bail him out of a market judgment error can only lead to irresponsibility. The professional trader is a proud career bond man. The philosophy of the Golden Rule is still his basis for ethical practices. Common sense, and common decency and strict adherence to sound market fundamentals make up the rest of his tool kit.

Secondary Trading Must Grow With Municipals' Growth

The secondary market for municipals must grow in volume and geographic scope as the country develops its internal frontiers and rebuilds its cities. The dealer who attempts to underwrite new issues without operating a competent secondary market is walking on one leg. The dealer bank who expects to be worthy of the title of dealer would do well to develop his secondary position in the industry to the extent that its reputation 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 tremendous importance, and that educational efforts instituted at this time might be helpful as a limited substitute for experience.

The dealer in the smaller cities might well look to developing his own local market secondary operations, and further season his personnel with secondary trading in nationally known issues. So many new districts, authorities and other local political subdivisions have come to the market in the past few years, that the local dealer may now go ahead and assume leadership in the secondary market in his geographic area, if he is willing to establish an active trading department and let it be known nationally that he is in this part of the business. I am confident that the future will see a return of the local specialist. I enthusiastically endorse this. The industry will benefit greatly by such action. It is true that a good many dealers are already profitably engaged in these local efforts. And as a result, the local names handled become more widely known and distributed. I congratulate those dealers who refuse to permit their local markets

Continued on page 22

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 syndicate practices provide invaluable advice and guidance. Realistic discussion deals with procedural responsibilities resting with the manager and the way to settle problems before and after a successful bid. Dealt with also are the "moral" responsibilities where differences of opinion easily arise and lead to misunderstandings. The latter include the annoying problems of an outside dealer confirming bonds to members' customers in oversubscribed maturities, of allotting bonds in the face of priority orders, and of meeting the opposite challenge of a sizable balance in a falling market. Mr. Fulkerson chides some managers for considerably undercutting list prices on bonds to the disadvantage of the small buyer and for failing to keep a list of group sales. All in all, syndicate operations today are given a favorable verdict and the industry is alerted to newer oncoming developments.

Our first Municipal Conference last September provided an excellent opportunity to focus attention on some syndicate practices which have evolved in our industry and it was obvious that there exist real differences of opinion regarding many of the procedures currently employed. I think it is a tribute to the Municipal industry that the criticisms, while unquestionably deserving of our best attention, are concerned mostly with details and do not strike at the fundamentals of our business. Considering the complexities of our profession we should be proud of the fact that we are able to carry on an enormous volume of day-to-day business throughout the country with a minimum of disagreements. This will be an attempt to outline briefly my thoughts on some aspects of syndicate practices. Limiting the discussion solely to the managers' responsibilities to the syndicate is rather confining since I am sure that every manager could at times speak with greater feeling on the equally important subject of "syndicate members' responsibilities." However, I know that this part of the problem will be covered very capably by Elmer Hassman. Since it is obvious that every syndicate functions with its own cast of characters to deal with a particular issue of bonds in the market environment of a relatively short period of time it is most difficult to suggest specific ground rules that might be applied universally to all accounts. This discussion is concerned with what we may imagine but never really encounter; namely, a typical competitive deal with no unusual circumstances involved.

W. N. Fulkerson, Jr.

Syndication Has Changed

Perhaps we can agree that many of our problems are the result of the rapid growth in both number and volume of new municipal issues which is placing an increasingly heavy burden on all underwriters but in particular upon those firms which usually manage a large percentage of their accounts. Years ago syndicate members had ample time in which to prepare thoroughly for bidding on a new loan and most problems were settled in a rather democratic manner with all hands participating. For example, the old-fashioned "take-down" meeting, where bonds were alloted within full view of all who were able to attend, had many advantages. At least the screams of the injured were more effective during the actual carving than after the horrible affair is an accomplished fact. But under today's conditions when we are apt to have on occasions very large syndicates and when on any given day a dealer may bid on half a dozen or more different issues it has come about that the manager is entrusted with many responsibilities that formerly were shared at least to some extent by the whole group. It is my belief that many syndicate members who have had little or no experience in the actual management, particularly of the larger accounts, are unaware of the amount of time and effort required to organize and service such an undertaking.

Syndicate Manager's Procedural Duties

I believe that we can group a syndicate manager's responsibilities in two general categories—"Procedural" and "Moral." If he is deficient in either area it is most likely that the joint venture will not achieve the best possible results. Most of the "Procedural" duties assigned to be performed by the manager are recognized by all account members but it might be well to review some of the more important decisions he is usually expected to make. They begin as soon as the issue is known to be scheduled for sale; or even before, since in many cases early knowledge of a forthcoming sale will give an account a distinct competitive advantage. The formation of the syndicate itself requires many decisions.

Some of the more basic questions will involve the membership of the account and initial participants. If it is a so-called "historical" account does the coming issue seem to call for changes in or additions to the group? Do sales performance records for past deals indicate adjustments in relative underwriting positions among the members? Will the suggested participations result in a potentially strong competitive account and at the same time provide worthwhile commitments for the members or does a "stand-by" agreement or immediate merger with another account seem advisable; and if so, what other group appears to offer the best opportunity for a satisfactory merger? What form of syndicate seems most suitable for the loan — an "undivided" or "divided" liability account?

Estimating Potential Business

In preparation for bidding on the bonds it is the manager's responsibility to have available accurate and current information about the issuer, its future plans and any legal points concerning the bonds that merit consideration. The manager must also obtain for the account the best possible estimate of potential business that may be expected if they should be the successful bidders. He should also know the probable competition to be encountered at the sale. Since many loans attract extremely close bids it is essential that the manager do a thorough job of pre-sale mathematics so that his account will have the opportunity to be fully competitive from this standpoint.

In recent years it has been customary, particularly for the larger new issues, to supplement the syndicate agreement with a letter of instructions to the members giving in detail the times of price meetings, the manner in which proxies are to act for out-of-town members, and the conditions under which members may drop from the account prior to the submission of the bid. In this connection I feel that all members should be permitted if they so desire to attend or be represented at the final meeting so as to have an equal opportunity with the price committee to evaluate conditions at the last minute and to withdraw from the account if, in their opinion, the bid does not represent a good risk.

Serious Source of Conflict

How is the machinery of the account to function if the group should purchase the issue? For one thing there should have been determined in advance the classifications of orders according to priorities. This is a potential source of serious conflict unless the matter is clearly defined and the orders handled with great care. It is my opinion that the priority classifications should be determined by majority consent when the other release terms are agreed upon. In the case of very large issues it is sometimes thought advisable by the manager to notify the members of the priority classifications well in advance of the sale. While there are undoubtedly sound reasons for this, I would prefer that for the average issue the majority interest in the account make the decision. Since nearly every sale is surrounded by circumstances peculiar to that issue and is subject to the environment of that particular market it does not seem desirable for the industry to adopt regulations designed as a blue print for the treatment of orders on all new issues. Let us consider, for example, the highly controversial subject of "designated" orders. I am sure that some firms would like to see them abolished and perhaps some time this will happen. After all we did carry on our business for years without them. Still I have seen many occasions when even the strongest opponents of such orders preferred to accept them rather than risk the possible loss of business when they felt that their account had made a particularly strong bid for the bonds. Therefore, I think that this should be a decision arrived at by majority preference in each deal.

Other procedural responsibilities resting with the manager following a successful bid are generally recognized and will include:

a. Group sale coverage.
b. Processing of orders.
c. Preparation of ads and circulars.
d. Examination of bonds and closing documents and payment to issuer.

Continued on page 21

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 those bonds depend more on managerial skill than upon their income-earning 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 investor 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 revenue 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.

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 industry, 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:

William F. Morgan

(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 of certain Pennsylvania School Authority issues).

(c) It appears as good business for the users or beneficiaries of such improvement to provide revenues to retire the debt on such project.

The varied nature of such projects being considered today is making the revenue bond business more complicated and technical than ever before—if that is possible. The difficulties of putting together bond resolutions and trust indentures with appropriate provisions which can be lived with by the issuer of the bonds, without undue difficulties, and still provide proper safeguards to the investors (and of course the investment bankers) have increased along with the other new complexities of our business which you will learn about at this Conference. These complexities also lead up to my next point, which I cannot emphasize too strongly to my fellow practitioners in the revenue bond business. . . .

"Hire the bond attorney in whom you have faith early during the period of setting up a bond issue." All too often we hear from interested citizens, municipal authorities and others as to the desirability and need of a new project. All this discussion is wasted if the community does not have the legal basis for issuing revenue debt for such a project. Perhaps the new facility (such as a toll bridge) will conflict with limitations which protect a facility already built upon which debt has heretofore been issued. Usually a quick check with a knowledgeable bond attorney will clarify the situation and point out the steps which must be taken to finance the desired facility.

Increasing Importance of Revenue Bonds Secured by Contracts

The bulk of the revenue bonds for a number of years was secured by water, light, sewers, turnpike and similar facilities. Security for these bonds is 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 bonds is derived from a specific contractual source. For example, during the first 10 days of May we had some $237,000,000 bonds scheduled for issuance to construct electric generating facilities secured primarily by contracts to take power by public utilities. 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 a contract between a newly formed Authority and the State of Michigan. Similar financing has become common with the various Authorities of the State of Georgia, and the trend has spread to other states, not the least of which has been the many School Authorities of Pennsylvania heretofore mentioned.

It is not the intent of these remarks to decry such a trend, but I do think that the use of such contracts call for increased vigilance of bond men, attorneys and issuing bodies. The contracts for such facilities as port authorities, and public power generating facilities such as the P. U. Ds of Washington, to mention only two examples, have become increasingly complex and require many hours not only in reading, but in developing of the various terms. It seems that increasing vigilance is necessary on the part of our industry to make sure that 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 talent becomes a necessity.

Increasing Number of Bonds Dependent Upon Management Skills

Each year as we develop new types of revenue bonds, it seems 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 on the basis of engineering estimates, and when no trends or operating experience for particular communities is available. In such facilities it appears that the conservatism and care with which the revenue bond underwriter puts together his deal is most important. Of course, to some extent the professional investor such as the life insurance or casualty insurance buyer will protect his policyholders by assuring himself that on the basis of estimates that a higher than average degree of coverage is available. In other words, if the estimates of revenues are incorrect to a reasonable degree, coverage of debt service would still be available. But more will be said about such coverage requirements later.

Advance Refunding Bonds Are Now With Us

One would be remiss in discussing recent revenue bond trends if he did not mention the advance refunding situation. There is probably nothing more controversial that we are working upon these days than this subject. It became so important for awhile that many of the revenue bond firms in New York were wearing out their calculating machines figuring out various plans for refunding bonds which are not callable for refunding for quite a period of years. I have to say at the outset that my firm has been involved in several such refundings, including the well-known Memphis Electric Plant issue, where an advanced refunding issue was necessary in order to release the lien securing the outstanding 4.40% bonds which are not callable until 1967.

Before discussing the merits of such refundings, let it be said at the outset that the best plan of the underwriter, before he gets all excited on the prospects of saving via an advanced refunding, is to check with the appropriate bond attorney as to whether he can get a legal opinion for such refunding. On this subject I have seen varied opinions of the gentry who write legal opinions. I know one instance where a bond attorney would give an approving opinion for a bond issue callable in 1968 but the same attorney felt that on an issue first callable in 1971 that he could not provide an unqualified legal opinion. One other attorney is asking that legislation be secured in certain other states, or else a court case upholding the proposed advance refunding is necessary. In the case of another situation where the bonds are callable for refunding in 1964, much work was done by many underwriters before the approving attorneys said there was no authority for any refunding prior to the 1964 refunding date. All I am trying to bring out is the all important point — check with the bond attorney before you try to line up Government Bonds, Certificates of Deposit, or work out in final detailed form the prospective savings of an advanced refunding.

Refers to Frank Carr's Letter

Advanced refundings have become most important in this period and likely will again when we have low interest rates as compared to earlier periods. In this respect, I sincerely believe an opinion expressed by Frank Carr of John Nuveen & Co. in a recent Bond Buyer letter to the editor is appropriate. He stated that the advance refunding is serving to some extent to do a piece of financing today which would normally be the bond man's business of tomorrow. However, it is most difficult for many of us to put off until tomorrow what appears today as a sure thing when if we waited until the bonds could be refundable under normal redemp-

tion provisions such a market opportunity might not exist.

Tax-Exemption of Refunding Bond

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 of 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 rest 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 lessees 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 recision 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 covenant 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 ratios 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 history; 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.

I realize including this tabulation 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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*An address by Mr. Morgan at the Second Annual Municipal Conference sponsored by the Investment Bankers Association, Chicago, Ill., June 20, 1963.

Solving the Bond Coupon Problem With Magnetic Ink

By John W. Agnew,* *Vice-President, The First National Bank of Boston, Boston, Mass.*

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.

John W. Agnew

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 at the First in having two men—namely, Harold Randall and Herb Corey —who participated in the first studies concerning the need for a common 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, first 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" x 6" dimension. Coupons are printed three-up, and the thickness of the bonds 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 2¾"—the same size as a pocket sized check. Incidentally, this is the minimum size of a piece of paper which can be handled in automated equipment. Compared to present coupons measuring 3½" x 1½", the surface area is admittedly larger than present coupons. However, the bonds stack easily and compactly, and the overall storage area corresponds to 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 bankers call the routing-transit area and identifies the bank the coupon is payable at. The next nine characters — including the "dash" and 'on us" symbol—is a number assigned by us at the bank to represent the company (or municipality) and the purpose of the bond. For example, a particular city may have a dozen issues outstanding—one for school, sewer, public works, etc. — and each will be assigned a different number. 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 any report can be preprinted in magnetic ink. Through the miracle of the magnetic ink reader-sorter, **every** number printed at the bottom of the coupon can be read onto magnetic tape in **one** pass. Once the information is on magnetic tape, the computer 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 amount of the coupons entered, sort the information down by company, issue, and maturity, post to the 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 random order in which they were entered into the reader-sorter, and eventually will be cremated.

Reviews Present Cumbersome 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 draw upon 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 account for which we act as sole paying agent. Right away I come to a point which should be elaborated on. Corporate bonds and coupons are much easier to handle from an efficiency point of view 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 relatively small 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 municipalities, we come to our first "short-cutting" procedure, and that is, to disregard the distinction between "issues" and group municipal bonds by maturity only.

During our paying procedure a municipal coupon may be counted as many as four times before being returned to a treasurer. If we were performing a cremation 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 treasurers, and proving the work each time, the coupons end up being counted four times. You 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 audit unit and serves to verify the work of the first count.

A third count is made at the end of the month to group each day's work into a consolidated package for the convenience of treasurers.

Finally, a fourth count (which is modified at times) is made 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 maturities for the most recent two-year period.

No Human Hand Need Touch The Coupon

Again, let me quickly review how this picture can be changed by MICR. No human sorting or grouping will be necessary. In fact, depending on the final system, it may be possible to eliminate even the machine sorting of the paper itself. The posting operation will be eliminated, since the computer will post the records. Month-end summary statements will no longer have to be prepared by hand. 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 and cremated and cross the numbers off a control sheet. Thus, we could tell the actual coupon number of any outstanding 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 "paying" 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 of improved procedures in the collection process of these coupons. A considerable amount of time was spent by the subcommittee on collections of the Federal Reserve System, the Technical Committee on mechanization of check handling of the American Bankers Association, and the Office Equipment Manufacturers in designing a routing-transit number for these coupons that would permit the separation of any of these items that inadvertently got into the cash collection system. As a result of this coordinated study, a new routing-transit num-

Continued on page 16

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 promoting the change which reflects progress made, and being made, since 1956 when he chaired the catalytic New York State Bankers Trust Operative Committee. Mr. Johnson sums up in this paper the "pro" and "con" arguments regarding the switch to, and issuance of, registered bonds; takes heartening note of the June 19th Firestone Tire & Rubber Co. $75 million debenture offering initially made in fully registered form; realistically examines what can be done to meet problems posed by municipal issues; and answers price 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" sort of thinking.

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 19, 1963 sale of the Firestone issue, which is to be delivered in registered form, exchangeable for coupons at the option of the holder.† This was a major step forward in our program towards fully registered bonds only.

Russell H. Johnson

The Problem

There are, in this country, some 283 million coupons cut each year at a cost of 452 man years of effort annually. The use of fully registered bonds is minute 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 283 million coupons, municipal bonds about 112 million and corporate bonds about 156 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.

†*Ed. Note:* 80% of the offering was finally sold in registered form.

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 bonds or counterfeits for loan collateral.

(4) Interest is received by mail.

(5) Call notices are received by mail.

(6) Permits direct communication for any reason.

(7) Closes tax loopholes.

(8) Increases safety in the event of a disaster.

(9) Decreases unproductive effort.

(10) Reduces space requirements substantially.

(11) Permits bondholder relations.

(12) 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 Fears

If one were to ask why our program hasn't been able to promote widespread public issuance of fully registered issues by major corporations, I think we would have to say that it is due to fear—fear that the issue won't sell. Or, to say the same thing another way, fear that the institutional buyers won't buy the registered bonds and fear that the bid for the fully registered issue might not be as good a bid as one for a coupon issue or an issue that had some of both. The Firestone issue I mentioned earlier proves these fears to be unwarranted. We have carefully investigated 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 declaring emphatically that they favor registered bonds. We have a resolution signed 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) Adequate provision is made for handling partial calls."

We are asking for similar resolutions from New York banks and from Chicago banks. There is, of course, no question that the trust departments of banks highly favor 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 storage problems and of the task of cutting coupons. I cannot get enthusiastic about this plan because all it really 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. The waste of manpower continues. The coupons still have to be cut, counted, audited, cremated, etc. The end result of this does not help to solve the major problems:

(1) Elimination of some 300 million pieces of paper annually in the form of coupons.

(2) Get bondholders to experience all of the advantages of fully registered bonds.

The Individual Investor

Corporations and institutional buyers are important, but I'd like to take a moment to consider the individual investor. About 85% of most quality issues are purchased by so-called professional investors, that is, banks, insurance companies, etc., and the other 15% 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 $5,000 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. I 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 plea also be 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 their 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

Is Competition Pushing Profits Over the Brink?

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

The profit-plight 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 curing what ails 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 competitive drive pushes us on to do things our better judgment tells us not to do.

John M. Maxwell

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 problems 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 definitive 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 have some hard knocks. But if we know this is going to be the unpleasant consequence of pushing the market too far, why do we persist in pushing it over the brink? It isn't as if there were not going to be 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 not be ridiculous.

Problems Affecting Profits

Some of the problems that we might look at are:

(1) What 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 syndicate 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' concession? 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 whole-heartedly with many of the views he expresses in this speech.[1]

(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 their own selling organizations and their own list of customers and not depend upon the standard list of institutional buyers to extinguish their liability.

(2) Mr. Reilly believes that the fellow who sells the bonds should get paid for it. In my opinion at least half of the gross spread should be allowed as selling commission to the members who do the selling.

(3) He recommends the divided form of account. I too think the standard form of account should be the divided or western form. Of course, most of us in Chicago have always preferred the divided account. I feel that a dealer who has distribution does a much more aggressive job when he can see the end of his liability by selling a certain number of bonds. If a dealer has no confidence that he can uphold his end of the selling, why should he be in the account? The argument is advanced that you don't get the best bid out of a divided account. But haven't many of our problems come from accounts over-bidding? It seems to me that, if all accounts were divided, the bidding competition would be more realistic and more in line with where bonds could be readily sold.

Serial maturities have often been cited as a difficult obstacle to divided accounts. Bracketing of maturities seems a simple solution to this problem. True, the divided form gives managers much more work in keeping track of liabilities, etc., but perhaps adequate takedowns and possibly oversales commissions could take care of these extra chores.

There are many more excellent ideas in Mr. Reilly's address, but these are the ones that impressed me most. And he has been kind enough to give me permission to emphasize them again.

In conclusion, I repeat, our industry is doing a great job in financing ever-expanding public improvements at a very small cost to the borrowers. But why don't we adopt a more enlightened approach that will permit us to do a more efficient job for all concerned, including ourselves?

*A talk by Mr. Maxwell at the Second Annual Municipal Conference sponsored by the IBA, Chicago, Ill., June 20, 1963.

William A. Noonan, Jr., *Continental Illinois National Bank & Trust Company,* Chicago

Gordon W. Pfau, *Woodcock, Moyer, Fricke & French, Incorporated,* Philadelphia

[1] Full text of Mr. Reilly's address appeared in the April 25, 1963, issue of the *Chronicle*.—Ed.

Beware of Legal Pitfalls in The Municipal Business

By Russell McInnes,* *Partner, Wood, King, Dawson & Logan, New York City*

Telling observations regarding problems posed by phenomenal growth and complexity of municipal offerings comments on: divergence of issues from the narrow confines of the legal basis for their existence; pitfalls in advanced refundings; possible financial advisor's conflict of interest when submitting a bid on bonds he had advised upon; need for a law to eliminate third party nuisance suits, to allow trustee to represent composite bondholders' claims against issuer in default, and validation for proposed bond issue; and existing applicability of SEC laws to sale of municipal bonds. Mr. McInnes hits hard at the need for increased vigilance in deciding to enter a bid, and for greater cooperation and understanding between issuers, underwriters and municipal attorneys in order to create marketable, fairly priced, and legally defensible new issues. He, also, notes difficulties as a result of Supreme Court decision placing bondholders' suit in State Courts.

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.

Russell McInnes

It has been said 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 coupon rates of interest, the use or attempted use of split or supplemental coupons, 100-page official statements containing detailed statistical charts, graphs and aerial photographs, free luncheon and cocktail information meetings, on-the-site inspection tours of the proposed project, approving legal 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 accounting 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 untried 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 station identification.

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, especially in the case of the issuance of municipal refunding bonds. Unlike the matter of the issuance of corporate securities in which anything can be done which is not expressly prohibited by law, the issuance of municipal securities necessitates the existence of legal authority for the procedure and the form of the securities proposed to be issued. For this reason, among others, the trend toward what is popularly known as "advance refunding" has caused a certain 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 realtionship 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 93 So. 2d. 371, 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 dismal view of this device on the theory that the fundamental public purpose in issuing municipal or revenue bonds is to provide funds for capital improvements 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 criticising 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 time deposits pending the issuance of municipal bonds.

Investment Advisor's Possible Conflicting Role

With the great complexity of the matters to be considered in the origination and issuance of municipal securities, the role of Financial Advisor has become one of increasing importance. As a general rule, the state legislatures have ignored the problem of a possible conflict of interest when a Financial Advisor submits a bid for the bonds and is also compensated for his services as Financial Advisor. The Supreme Court of Florida has ruled that a contract for a private negotiated sale of bonds which also provided for the services of the bidder as Financial Advisor was void as contrary to the public policy of the state (See 63 So. 2d 916, Florida.) The court was careful to point out, however, that it was passing only on that particular contract and in a later decision the court held that Financial Advisors could bid for municipal 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 even at public sale. In this case the court took the view that the Financial Advisor was the agent of the municipality. (See 55 N. W. 2d. 905.) In the absence of legislation generally or a body of favorable court decisions, it would seem 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 which they have assisted in originating.

One of the more troublesome problems faced by the industry today is caused by litigation which is brought by one or more individuals after the award of the bonds to the successful bidder but prior to the delivery of and payment for the bonds. The object of such law suits is, of course, to prevent the delivery of the bonds and in practically every instance it has been found that there is no merit in such law suits. Under present state law, there is nothing to prevent the repetition of such an action following the dismissal

Continued on page 17

W. W. Lewis, *Blyth & Co., Inc.*, Chicago; Carl H. Ollman, *Dean Witter & Co.*, Chicago

John F. Gerity, Jr., *Goodbody & Co.*, Detroit; W. G. Inman, *John Nuveen & Co.*, Chicago; Jack R. Boney, *Ryan, Sutherland & Co.*, Toledo; Lawrence H. Brown, *Northern Trust Company*, Chicago

J. C. Tripp, *Tripp & Co., Inc.*, New York; Ray Robinson, *Hornblower & Weeks*, Denver

Lawrence E. Shaughnessy, *Shaughnessy & Co., Inc.*, St. Paul; Edward F. Wrightsman, *Ira Haupt & Co.*, New York

Gilbert Hattier, Jr., *Hattier & Sanford*, New Orleans, La.; George W. Hall, *Wm. E. Pollock & Co.*, New York; R. J. Cook, *Ball, Burge & Kraus*, Cleveland; J. C. Fitterer, *Wertheim and Company*, New York

Lloyd B. Hatcher, *White, Weld & Co.*, New York; Donald C. Patterson, *Chemical Bank New York Trust Company*, New York

Paul H. Berghoff, *Mullaney, Wells & Company*, Chicago; De Witt Davis, *Mullaney, Wells & Company*, Chicago

Stuart D. Stevenson, *Bankers Trust Company*, New York; Julius M. Caccapola, *Bankers Trust Company*, New York; Robert Sturla, *Hallgarten & Co.*, New York; Charlie E. James, *Valley National Bank of Arizona*, Phoenix

George L. Hamilton, *Dominick & Dominick*, New York; Kenneth K. Mackey, *Stone & Webster Securities Corp.*, New York

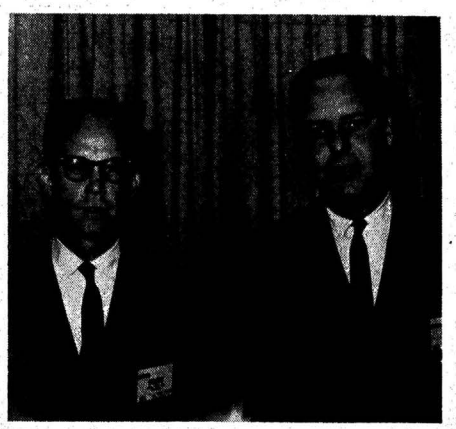
Paul E. Uhl, *United California Bank*, Los Angeles; W. G. Schalke, *Seattle First National Bank*, Seattle

Cecil L. Schultz, *Trust Company of Georgia*, New York; John P. Toolan, *Hornblower & Weeks*, New York; C. P. Anderson, *Goodbody & Co.*, Chicago; James F. Reilly, *Goodbody & Co.*, New York

W. F. Morgan, *Blyth & Co., Inc.*, New York; Miles Pelikan, *John Nuveen & Co.*, New York

T. Ward Phillips, *Central National Bank & Trust Company*, Des Moines, Iowa; Richard Phillips, *White-Phillips Company, Inc.*, Davenport, Iowa

Daniel P. Whitlock, *Ladenburg, Thalmann & Co.*, New York; Bill Simon, *Weeden & Co.*, New York; Dick Rand, *Rand & Co.*, New York; T. Anthony Coculo, *Fidelity Philadelphia Trust Company*, Philadelphia



Richard O'Brien, *Baker, Watts & Co.*, Baltimore; Norman E. Reed, Jr., *Curtiss, House & Co.*, Cleveland

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 fallacy 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 a float 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 beat 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 bond certificates with 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 really don't have any 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 bank note companies tells us that while printing coupon bonds in volume costs approximately 40c per bond, registered bonds, if fully engraved and ordered in volume, would be about 20c per bond. If the engraving were reduced, and some flat printing was introduced, the cost per registered bond could get down to about 12½c 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 counterfeitor, or thief, would have to add forgery to his crimes to make it work. This is another reason why municipals need registered bonds.

Technical Problems

Two technical problems that have been discussed in New York cover the matter of denominations and record date. As to denominations, we suggest that a fully registered issue be originally printed in denominations of $1,000, $5,000, and unlimited. We further suggest that a unit of trading would perhaps best be $5,000 and that someone wishing to buy or sell less than $5,000 could do so on an odd lot basis. In the same sense, denominations of over $5,000 would be split back to pieces of $5,000 to meet this unit of trading suggestion. All of this is in line with the rules covering stocks in which 100 shares is a normal trading unit, less than 100 is an odd lot, and more than 100 must be broken down. We refer more and more to the thought "why can't registered bonds be traded, transferred and delivered in the same manner as stocks?"

I would like to comment here on the very successful campaign waged by Mr. Felix T. Davis, Assistant Vice-President of the Federal Reserve Bank of New York, to promote the use of coupon bonds in $5,000 denominations. Issues of municipal bonds during January, February and March of

Continued on page 16

Ellwood S. Robinson, *Penington, Colket & Co.*, Philadelphia; Robert C. Brussat, *The Milwaukee Company*, Milwaukee

Walter W. Niebling, *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, New York; Edward J. Meyers, *Baxter & Co.*, New York; Harvey Franklin, *Merrill Lynch, Pierce, Fenner & Smith Incorporated*, San Francisco; Bob Sturla, *Hallgarten & Co.*, New York

John W. de Milhau, *The Chase Manhattan Bank*, New York; Russell M. Ergood, Jr., *Stroud & Company Incorporated*, Philadelphia

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 counterfeiting 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. Johnson before the Investment Bankers Association of America, Second Municipal Conference, Chicago, Ill., June 21, 1963.

Solving the Bond Coupon Problem With Magnetic Ink

Continued from page 10

ber system was developed for these coupons. However, the format of the number is the same as that used by banks on checks for cash items and thereby permits present reading - sorting equipment to sort these coupons at high speed.

Another long-range potential that should accrue when a large volume of these new style bonds are in the hands of the public is the elimination of the use of coupon envelopes. To make this possible each coupon was designed with an area on the reverse side for endorsement, so that the depositor of the item can be immediately identified by his endorsement on the document itself. Not only does the elimination of the envelope help the collecting banks and paying agents, but it saves the customer the job of preparing these envelopes. As soon as there is a large volume of the new style bonds in use, we should obtain great efficiencies in the clearing and paying of coupons.

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 reconciliation of coupons than ever before. We shall be able to put back into the coupon paying cremation 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 IBA, Chicago, Ill., June 20, 1963.

Edwin L. Beck, *Commercial & Financial Chronicle*, New York; Sherman Ellsworth, *Wm. P. Harper & Son & Co.*, Seattle

Richard O'Brien, *Baker, Watts & Co.*, Baltimore; Christopher P. Sweeny, *John Nuveen & Co.*, New York; Richard F. Mulligan, *Robert Garrett & Sons*, Baltimore; Charles J. Martin, *Folger, Nolan, Fleming & Co.*, Washington, D. C.; Henry J. King, Jr., *Robert Garrett & Sons*, Baltimore

George E. Barnett, Jr., *First National City Bank*, New York; John Kelsey, *William R. Staats & Co.*, Los Angeles

James F. Rose, *Howard, Weil, Labouisse, Friedrichs & Co.*, New Orleans; Richard J. Franke, *John Nuveen & Co.*, Chicago; Clarke J. Robertson, *Chapman, Howe & Co.*, Chicago; D. Dean Kaylor, *National Bank of Detroit*, Detroit, Mich.

Elmer G. Hassman, *A. G. Becker & Co., Incorporated*, Chicago; J. M. Maxwell, *The Northern Trust Company*, Chicago; W. Neal Fulkerson, *Bankers Trust Company*, New York

Lloyd B. Hatcher, *White, Weld & Co.*, New York; Robert C. Tengdin, *Allison-Williams Company*, Minneapolis; Floyd W. Sanders, *White, Weld & Co.*, New York

Beware of Legal Pitfalls in The Municipal Business

Continued from page 13

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, such 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 Municipals are exempt from the Securities Act"! True, exempt from the requirement of preparation 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 used 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 ignorance of the law or avail himself of a short statute of limitations to relieve himself of the 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

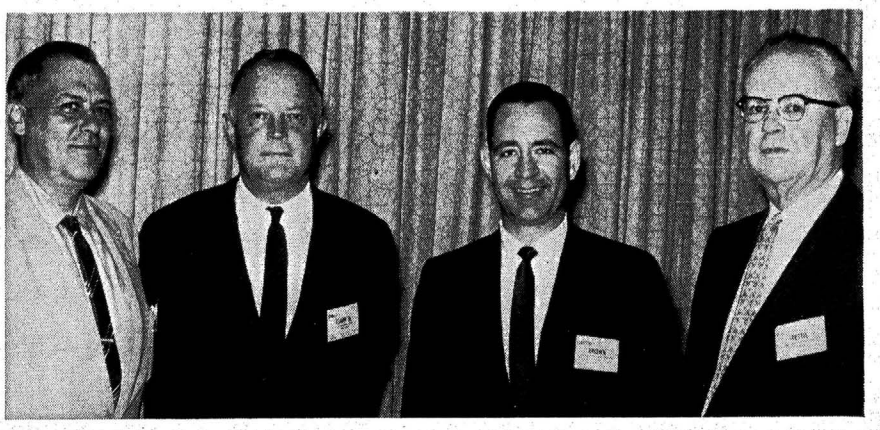
It is suggested that in the light of the foregoing, it would appear that not only increased vigilance in determining whether or not to submit a bid at public sale or to lend one's name to a negotiated issue but even more than merely ordinary diligence in the investigation and preparation of all prospective underwritings of municipal ond 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

Continued on page 18

Tom W. Masterson, *Underwood, Neuhaus & Co., Inc.*, Houston, Texas; Donald L. Gumbiner, *Stern Bros. & Co.*, Kansas City, Mo.



James E. Klingel, *Juran & Moody*, St. Paul, Minn.; John J. Clapp, Jr., *R. W. Pressprich & Co.*, New York; Clayton F. Brown, *The Northern Trust Company*, Chicago; D. L. Pettis, *Kirkpatrick-Pettis Co.*, Omaha

James J. Saxon, *Comptroller of the Currency*, Washington, D. C.; George Wendt, *First National Bank of Chicago*

Richard C. Swagler, *First Alabama Securities, Inc.*, Birmingham; William J. Riley, *E. F. Hutton & Company, Inc.*, New York

Francis X. Coleman, *Dempsey-Tegeler & Co., Inc.*, New York; F. E. Carter, Jr., *Equitable Securities Corporation*, New York; Daniel E. Fitzpatrick, *Fitzpatrick, Sullivan & Co.*, New York; Ellsworth M. Shafto, *Geo. B. Gibbons & Co.*, New York

Herman J. Eckrich, *Mullaney, Wells & Company*, Chicago; Richard G. Muench, *Mullaney, Wells & Company*, Chicago

Legal Pitfalls in The Municipal Bond Business

Continued from page 17

problem of trying to collect and enforce defaulted municipal bonds was the order of the day, little thought has since been given to the problem. By and large, tax collections have been satisfactory and tax supported bonds have been paid when due. As far as any history of enforcement is concerned, revenue bonds constitute a new type of security and they have been relatively untouched to date by default in payment. It would seem, however, that we would be lax, indeed, if we did not attempt to prevent difficulties from arising in the future by keeping abreast of these changing times.

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 place 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.

Current and Proposed Federal Financing Programs

By Gordon L. Calvert,* *Municipal Director and Assistant General Counsel, Investment Bankers Association of America, Washington, D. C.*

Up-to-date compact summary of Federal programs involving the financing of municipalities covers ten different areas where such financing is taking place and two programs now pending in Congress. Handy pocket outline details dollar volume authorized, interest rate conditions, purposes and amount expended so far. The net effect of this succinct presentation makes one want to pause and reflect upon the extent of Federal financing participation in municipal activities.

I

Public Works Acceleration Act

Adopted in 1962, the act authorizes the President to initiate and accelerate in eligible areas (i) direct Federal public works projects which have been authorized by Congress and (ii) public works projects of states and local governments for which Federal financial assistance is authorized under existing programs. Eligible areas are those designated (i) as an area of substantial unemployment for at least nine of the preceding 12 months by the Secretary of Labor or (ii) as a "redevelopment area" under Section 5(a) or (b) of the Area Redevelopment Act.

The President delegated to the Secretary of Commerce the responsibility for prescribing rules and procedures which will insure that consideration is given to the relative needs of eligible areas.

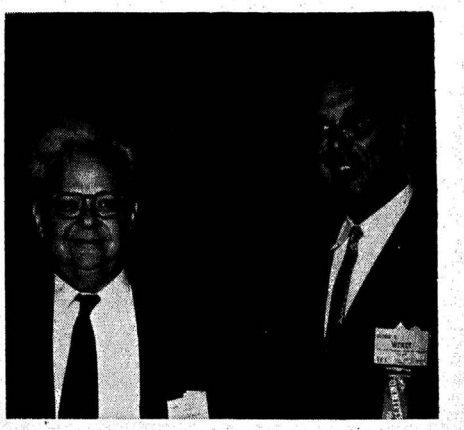
The Act authorized an aggregate of $900 million. Congress in 1962 appropriated $400 million and in May, 1963 appropriated an additional $450 million.

Under the Act the Community Facilities Administration of the Housing and Home Finance

*A talk by Mr. McInnes before the Second Annual IBA Municipal Conference, Chicago, Ill., June 20, 1963.

George Partlow, *J. J. B. Hilliard & Sons,* Louisville; A. J. Warner, *Stein Bros. & Boyce,* Louisville

John K. Clauson, *Goldman, Sachs & Co.,* Chicago; William C. Glasser, *Goldman, Sachs & Co.,* St. Louis; John N. Faust, *Kidder, Peabody & Co.,* Chicago; Bill Armstrong, *Kidder, Peabody & Co.,* Chicago



Walter Trohan, *Chicago Tribune,* Chicago; George B. Wendt, *First National Bank of Chicago*

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 1955. Administered by Community Facilities Administration of Housing and Home Finance Agency.

Authorizes Federal loans with maturities up to 40 years for public facilities at interest rate determined each fiscal year, currently 3¾% to municipalities with population up to 50,000 (or in redevelopment areas at 3½% 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: $198,690,000.

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 ⅛ of 1% less for each five years shorter maximum maturity, but not less than 3¾% (¼ or 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.H.F.A. Authorizes Federal loans at an interest rate determined annually (presently 3½%) to colleges for dormitories and certain related educational and hospital facilities (but not classrooms) if the financing is not available from other sources "upon terms and conditions equally as favorable." Authorization through fiscal year 1961 aggregated $1.675 billion. 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 65% 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 3½% if financing is not otherwise available on 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 $58 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 purpose, to pay debt service. Bonds sold under such contracts through December, 1962 aggregated over $3.8 billion.

VII
Urban Renewal

Planning advances. Loans. Capital grants. Relocation payments.

VIII
Federal Highway Act of 1956

Administered by Bureau of Public Roads.

(a) Interestate system: Federal grants for 90% of project cost. Originally authorized aggregate of $25 billion Federal funds for fiscal years 1957 through 1969. Federal aid Highway Act of 1961 increased authorization $11.56 billion to total of $37 billion. Interstate system planned to include 41,000 miles. President Kennedy in budget message in 1963 stated that over 13,000 miles of system are completed and another 15,700 miles are in various stages of development.

(b) Federal-aid primary, secondary, urban highway systems; Federal grants for 50%, require 50% matching funds by state. Authorized $925 million annual rate for fiscal years 1962 and 1963.

IX
Federal Airport Act

Administered by Federal Aviation Agency. Authorizes Federal grants, limited to 50% of the allowable project cost, except that grant may be 75% in some states containing large areas of public lands. Airport development project, to be eligible for grant, must be included in the national airport plan. From adoption in 1954 through fiscal year 1961 total grant agreements aggregated $573 million. 1961 amendments authorized extension with $75 million for each of three fiscal years ending June 30, 1964.

X
Water Pollution Control Grants

Administered by the Surgeon General.

(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 30% of estimated reasonable cost or $600,000, 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 for fiscal years $80 million in 1962, $90 million in

Continued on page 20

Sampson Rogers, Jr., *McMaster Hutchinson & Co.*, Chicago; Newman L. Dunn, *Robert W. Baird & Co., Inc.*, Milwaukee

Malvern Hill, *Malvern Hill & Co., Inc.*, New York; T. Anthony Coculo, *Fidelity-Philadelphia Trust Company*, Philadelphia; Edmund G. O'Leary, *Eastman Dillon, Union Securities & Co.*, New York; Steve Brown, *Barret, Fitch, North & Co.*, Kansas City, Mo.

Charles A. Urick, *Continental Illinois National Bank & Trust Company*, Chicago; Henry W. Peters, *Peters, Writer & Christensen, Inc.*, Denver

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.

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.

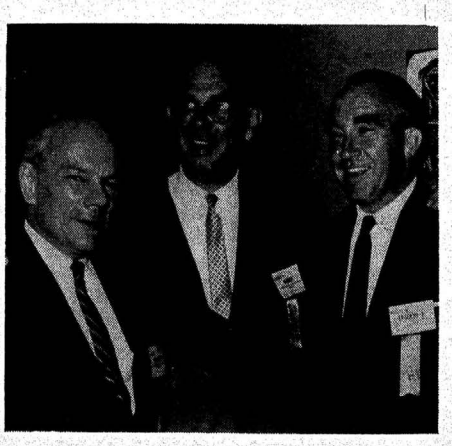
(b) $1 billion in low interest rate Federal loans over the next three fiscal years for academic facilities for higher education (colleges and universities), requiring that at least one-quarter of the cost of the construction be financed from non-Federal sources.

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 guarantee of an aggregate of $375 million of transit revenue bonds issued by states or local public bodies, with a proviso that to be eligible for such a guarantee any revenue bond shall expressly state on its face that the issuer has waived the Federal tax exemption for the interest on such bonds. The House Banking and Currency Committee on April 9 reported favorably a bill (H. R. 3881) similar to the proposal recommended by the President, but the bill as not yet cleared the House Rules Committee for consideration in the House.

*Outline used by Mr. Calvert in speaking at the Second Annual Municipal Conference sponsored by the IBA, Chicago, Illinois, June 21, 1963.



Donald C. Patterson, *Chemical Bank New York Trust Company;* George B. Wendt, *First National Bank,* Chicago; Russell M. Edgood, Jr., *Stroud & Company Incorporated,* Philadelphia

Frank P. Magoun, III, *National Shawmut Bank,* Boston; Robert J. Mullens, *J. J. Kenny Co.,* New York; George C. Sarris, *White, Weld & Co.,* New York; James A. Hurley, *L. F. Rothschild & Co.,* Chicago

Walter A. Hintz, *A. G. Becker & Co., Incorporated,* Chicago; Alan N. Weeden, *Weeden & Co.,* New York

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 adequate and well-trained personnel who are capable of providing the necessary leadership and service for the group. Since this is a joint venture I believe that the manager should be as frank as possible in disclosing to the account at the proper time the extent and nature of the presale interest as he sees it. I believe that it is an obligation of the manager to treat priority orders in the manner that has been agreed upon and to resist any temptation to retain business for his own account that properly belongs in a different classification. Needless to say, the manager has a strict obligation to allot bonds against members' subscriptions, including his own, in an unbiased manner, and his knowledge of orders filed by other members should not influence the amount or character of his own subscriptions. Most certainly his own sales organization should not have access to the detailed record of members' orders.

There are few things more annoying than to find a dealer outside the account confirming bonds to members' customers in maturities that have been oversubscribed. While this is impossible to control entirely, an alert manager can minimize the possibilities of this occurring.

In allotting bonds a problem is sometimes presented when priority orders are likely to exhaust available bonds without considering members' orders at all. It seems to me that generally speaking it is poor policy not to reserve a fair percentage of bonds for individual retail demand through members' subscriptions. I do not mean, however, that a fixed percentage of each maturity should necessarily be available. This is basically an account problem but it usually falls upon the manager to solve it.

Sticking to the Terms of the Agreement

It should certainly be the duty of the manager to see that the terms of the syndicate agreement are adhered to. At last year's conference one of the panelists stated that the usual contracts have remained essentially unchanged over the years. I believe that this is so and that they will still serve satisfactorily if all parties carry out the respective obligations which they have assumed under these agreements. Unfortunately, some of the basic provisions of these contracts are not always adhered to and because of this the door is left open to complaints which in many cases are entirely justified. The severest tests which can be placed upon a manager occur when the account has a sizable balance in a falling market.

These circumstances focus the spotlight on his resourcefulness and his integrity. He is, of course, anxious to reduce the balance but unfortunately on occasions is prone to ignore the usual provision of the syndicate agreement that calls for majority approval of all price changes. Except for the rare cases where time pressure may be a key factor it is seldom that any valid excuse exists for the manager to confirm bonds at special prices without majority approval. In my opinion, over the long run nothing of value is gained by failing to discuss mutual problems with the account members; and in fact much valuable information is often acquired during the tedious process of polling a group. Of course, in many instances the account may have authorized the manager to negotiate business within certain limits and this in effect gives him the necessary majority consent.

Censures the Industry

I should like to comment on one procedure for which I think our industry could on occasions be properly censured. This is the practice of maintaining list prices on bonds but giving the manager authority to negotiate sales considerably under published offerings. I am not referring to instances of volume sales slightly below list but to spreads of 20 or more basis points. Under these circumstances the small buyer may not receive the consideration due him. In this connection I believe that all members should be advised of special sales that the account has made as soon as the details can be conveniently communicated to them.

At times the manager has a problem when a bid has been made for bonds which he himself does not feel is worth considering. Granted that it is a matter of judgment and that the account would not expect him to report a ridiculous proposition, still in doubtful cases I believe the manager has an obligation to seek other opinion rather than assume that he always knows what is best for the group. Nothing is more irritating than for an account to sell bonds at a level below a bid which had been made previously but which the manager failed to report.

Other Responsibilities

Among other moral responsibilities the following seem worthy of mention:

a. The protection of members' interest in the event of legal problems affecting the issue.
b. The *prompt* redelivery of bond to members and group customers after settlement with the issuer.
c. Holding expenses within reasonable limits and to items

Continued on page 22

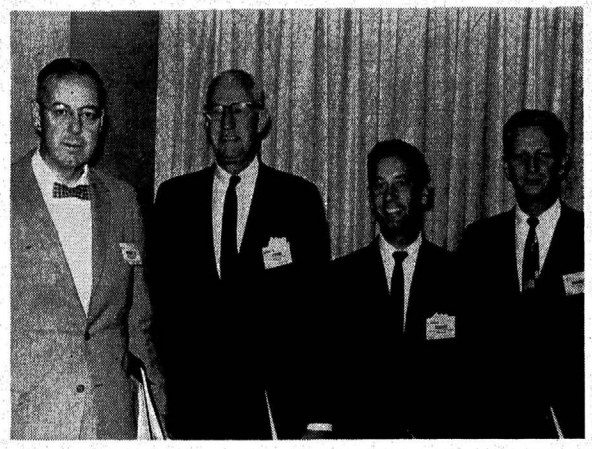
E. H. Davis, *John Nuveen & Co.*, Chicago; Edward J. Dempsey, *Bacon, Whipple & Co.*, Chicago; W. F. Morgan, *Blyth & Co., Inc.*, New York; D. M. Ellinwood, *Moody's Investors Service*, New York

Arthur Gorman, *First National Bank*, Chicago; John J. Ward, *Chase Manhattan Bank*, New York; William M. Durkin, *First National Bank of Chicago*, New York

Leland E. Tanner, *American Fletcher National Bank & Trust Co.*, Indianapolis; Saralyn B. Marcum, *Bache & Co.*, Chicago; Jerry K. Pickell, *Continental Illinois National Bank & Trust Company*, Chicago

Murray Mumma, *Warren W. York & Co.*, Allentown, Pa.; Norman B. Ward, Jr., *Singer, Deane & Scribner*, Pittsburgh; Harvey L. Zeve, *Singer, Deane & Scribner*, Youngstown, Ohio; Edwin F. Scheetz, Jr., *Moore, Leonard & Lynch*, Pittsburgh

Charles L. Ledger, *Schwabacher & Co.*, San Francisco; B. Newton Barber, *W. H. Newbold's Son & Co.*, Philadelphia; Richard Murphy, *B. J. Van Ingen & Co., Inc.*, New York; G. Philip Whitman, *Hartford National Bank & Trust Company*, Hartford, Conn.



W. M. Wright, Jr., *Kidder, Peabody & Co.*, Philadelphia; Robert W. Ewing, *A. E. Masten & Co.*, Wheeling, W. Va.; R. Gerald Coghill, *Wachovia Bank & Trust Company*, Winston-Salem, N. C.; J. B. Shumate, *First National Bank*, Miami, Fla.

Continued from page 21

properly chargeable to the account.

d. The *prompt* settlement of syndicate accounts, with 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 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 that basis. 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 amazing 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 interests in the spirit of fair play.

*An address by Mr. Fulkerson at the Second Annual Municipal Conference sponsored by the Investment Bankers Association of America, Chicago, Ill., June 21, 1963.

Trading Desk and Secondary Market

Continued from page 6

to revert by default to the active traders in the larger cities.

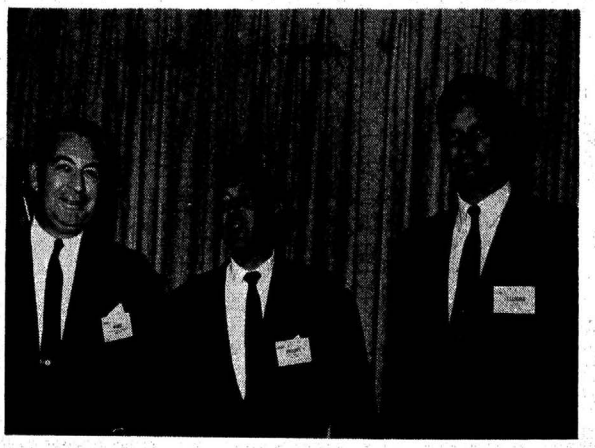
Promoting Better Public Relations

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. Milner at the Second Investment Bankers Association Municipal Conference, Chicago, Illinois, June 20, 1963.

Winston L. Molander, *Northwestern National Bank,* Minneapolis; Henry J. Kieper, *New York Hanseatic Corporation,* New York; Walter H. Stohl, *Fidelity Union Trust Company,* Newark, N. J.

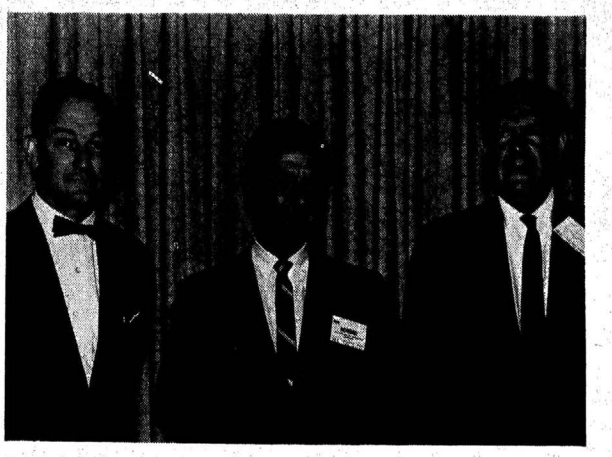


John J. Ward, *The Chase Manhattan Bank,* New York; George H. Brooks, *Dick & Merle-Smith,* New York; John E. Stalford, *The Chase Manhattan Bank,* New York

Ed Jones, *The Columbian Securities Corp.,* Topeka, Kansas; John D. Cleland, *Seltsam-Hanni & Co.,* Topeka, Kansas; Bob Schaeffer, *The Columbian Securities Corp.,* Topeka, Kansas

Rowland A. Radford, Jr., *The Robinson-Humphrey Company, Inc.,* Atlanta; Walter E. Knowles, III, *First Boston Corporation,* Chicago; Alan C. Snodgrass, *First National Bank,* Fort Worth, Texas

Robert C. Winfield, *A. G. Becker & Co. Incorporated,* New York; Albert Stortz, *National Boulevard Bank,* Chicago; R. C. Garraway, *Deposit Guaranty Bank & Trust Co.,* Jackson, Miss.



Paul L. Sipp, Jr., *Stern, Lauer & Co.,* New York; John Howard, *Industrial National Bank of Rhode Island,* Providence, R. I.; Art Pickard, *Burns, Corbett & Pickard, Inc.,* Chicago

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 regulation as we here propose it. It has been filed in the "Federal Register" and will appear officially on June 21.[1]

What we have here proposed mainly is to make a more workable 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, prohibitions, 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 appear 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 eight or nine months reached a 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 comments, criticisms and recommendations for change as they may see warranted or necessary.

5% Investment Limit

Substantively we have made a certain number of changes here which would enlarge, to some extent, 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 modestly enlarged, scope for investment for 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 having 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" investment 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 here there would exist certainly a group of professionals on their own able to appraise, from engineering and other investment standpoints, the

Continued on page 24

Sherman Ellsworth, *Wm. P. Harper & Son & Co.*, Seattle; David J. Barry, *Manufacturers Hanover Trust Company*, New York; Louis A. Hauptfleisch, *Goldman, Sachs & Co.*, New York

Newell S. Knight, *First National Bank of St. Louis;* Charles E. James, *Valley National Bank of Arizona*, Phoenix; Joseph E. Refsnes, *Refsnes, Ely, Beck & Co.*, Phoenix

Paul E. Uhl, *United California Bank*, Los Angeles; Thomas E. Morris, *United California Bank*, Los Angeles; Claude C. Richards, *R. H. Moulton & Co.*, Los Angeles

W. G. Schelke, *Seattle First National Bank*, Seattle; T. Russell McConchie, *Virginia National Bank*, Charlottesville, Va.; Jack D. Howe, *F. W. Craigie & Co.*, Richmond, Va.

Joseph M. Luby, *Paine, Webber, Jackson & Curtis*, New York; T. Norris Hitchman, *Kenower, MacArthur & Co.*, Detroit; Parks B. Pedrick, Jr., *Howard, Weil, Labouisse, Friedrichs & Co.*, New Orleans

Thomas W. Hanlon, *First National Bank of Denver*, Denver; Aaron W. Pleasants, *First National Bank of Denver*, Denver; Arthur P. Quinn, *Quinn & Co.*, Albuquerque, New Mexico

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 affording 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 a 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 underlying 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 established a new test with respect to all securities, whatever their character: namely, that investment or underwriting of any is subject to the exercise of a

William H. Thayer, *Woodard-Elwood Co.*, Minneapolis; James M. Kinsman, Jr., *The Kentucky Company*, Louisville; Ralph M. Pierce, *McDougal & Condon, Inc.*, Chicago

James G. Couffer, Jr., *United California Bank*, New York; William W. Crawford, *W. L. Lyons & Co.*, Louisville; John S. Haertel, *Northwestern National Bank*, Minneapolis

Thomas L. Carter, *Loewi & Co. Incorporated*, Milwaukee; Philip W. K. Sweet, Jr., *The Northern Trust Company*, Chicago; Thomas J. O'Connor, *Hammill & Co.*, Chicago

Paul Stephens, *Paine, Webber, Jackson & Curtis*, Chicago; George Johnston, *Paine, Webber, Jackson & Curtis*, Chicago; Phillip W. Davis, *Paine, Webber, Jackson & Curtis*, Chicago

P. Alden Bergquist, *First National Bank of Chicago;* Theodore A. Griffinger, *Bank of America, N. T. & S. A.*, San Francisco; Lewis F. Lyne, *Mercantile National Bank*, Dallas

James H. Kerley, Jr., *First Southwest Company*, Dallas; William G. Chestnut, Jr., *Eppler, Guerin & Turner, Inc.*, Dallas; Dan A. Almon, *Almon, McKinney & Dudley*, Dallas

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 generally underwriting and dealing in revenue bonds by the banks.

Text of Proposed New Regulations

ED. NOTE: 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 26

Parks B. Pedrick, Jr., *Howard, Weil, Labouisse, Friedrichs & Co.*, New Orleans; George W. Hall, *Wm. E. Pollock & Co., Inc.*, New York; John C. Fitterer, Jr., *Wertheim & Co.*, New York; R. J. Cook, *Ball, Burge & Kraus*, Cleveland

Walter A. Hintz, *A. G. Becker & Co., Incorporated*, Chicago; George H. C. Green, Jr., *Liberty National Bank & Trust Company*, Oklahoma City; Albert G. Langer, *Girard Trust Corn Exchange Bank*, Philadelphia

Arthur Kirtley, *First Boston Corporation*, Chicago; George H. C. Green, III, *The Liberty National Bank & Trust Company*, Oklahoma City; Fred D. Stone, Jr., *Marine Trust Company of Western New York*, New York City

Joseph Valeriano, *Eastman Dillon, Union Securities & Co.*, New York; Arthur G. Hageman, *Childs Securities Corporation*, New York; Frank S. Du Bell, *Granbery, Marache & Co., Inc.*, New York

Robert Morrison, *J. H. Hilsman & Co., Inc.*, Atlanta; Ladd Dinkins, *Ladd Dinkins & Co.*, New Orleans, La.; Frank C. Carr, *John Nuveen & Co.*, Chicago; James T. Stewart, *John Nuveen & Co.*, Chicago

William N. Murray, Jr., *The Illinois Company, Inc.*, Chicago; J. H. Kramer, *Braun, Bosworth & Co., Inc.*, New York; Bert Nelson, *The Illinois Company, Inc.*, Chicago

Broadening the Municipal Investment Areas of Banks

Continued from page 25

State member banks to engage in securities transactions. Banks may, 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, provisos, 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 Courthouse, 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. 335, 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-

Gordon L. Calvert, *Investment Bankers Association of America,* Washington, D. C.—Speaking on Accelerated Public Works Programs for Eligible Areas in connection with Federal Financing of Municipalities

George B. Wendt, *First National Bank of Chicago;* Russell M. Ergood, Jr., *Stroud & Company, Incorporated,* Philadelphia—A star performance in arranging the IBA Municipal Conference

ing §§1.5 - 1.21 and by revising §§1.1 - 1.4 to read as follows:

PART 1 — Investment Securities Regulation

Sec.
1.1 Authority.
1.2 Scope and application.
1.3 Definitions.
1.4 Limitations and restrictions on purchase and sale of a public security.
1.5 Limitations and restrictions on purchase of an investment security.
1.6 Limitations and restrictions on holding investment securities.
1.7 Limitations and restrictions on purchase, sale and holding of specified obligations.
1.8 Prudent banking judgment; credit information required.
1.9 Requests for rulings.
1.10 Convertible securities.
1.11 Amortization of premiums.
1.12 Exceptions.

AUTHORITY: §§ 1.1 to 1.12 issued under paragraph Seventh of R.S. 5136 as amended, 12 U.S.C. 24.

§1.1 **Authority.** This part is issued by the Comptroller of the Currency under the authority of paragraph Seventh of 12 U.S.C. 24.

§1.2 **Scope and Application.** This part applies to the purchase, sale, underwriting, and holding of investment securities by National banks and pursuant to 12 U.S.C. 335 by state member banks.

§1.3 **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. 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.** A 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

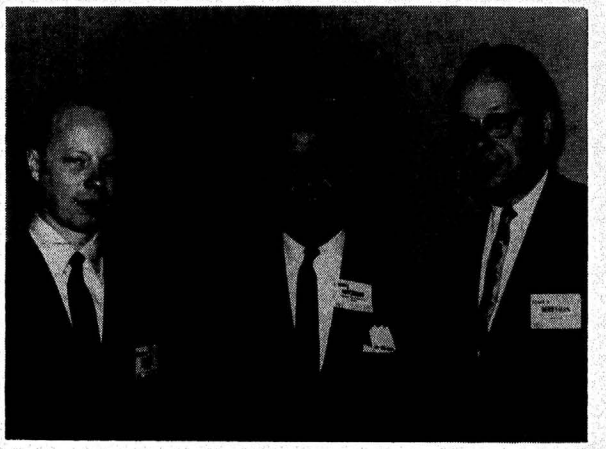
Frederick G. Leech, *Arthurs, Lestrange & Co.*, Pittsburgh; G. Robert Brooks, *Schmidt, Roberts & Parke*, Philadelphia; George G. Harrison, *Harrison & Austin*, South Bend, Ind.

John W. de Milhau, *Chase Manhattan Bank*, New York; Salvador Rodriguez, *Government Development Bank for Puerto Rico*, New York; Henry Milner, *R. S. Dickson & Co., Inc.*, New York

Kenneth C. Ebbitt, *Shelby Cullom Davis & Co.*, New York; William T. Brown, *C. J. Devine & Co.*, Chicago; Joseph G. Cross, Jr., *C. J. Devine & Co.*, New York

Gene Marx, *Bear, Stearns & Co.*, New York; William F. Fuller, *White, Weld & Co.*, New York; Ellsworth M. Shafto, *Geo. B. Gibbons & Co.*, New York

Norman K. Foley, *Continental Illinois National Bank & Trust Co.*, New York; Charles Gerken, *Salomon Brothers & Hutzler*, Chicago; E. William Darmstatter, *Stifel, Nicolaus & Co. Incorporated*, St. Louis



Theodore A. Gaskell, *Hayden, Miller & Co.*, Cleveland; T. Norris Hitchman, *Kenower, MacArthur & Co.*, Detroit; Homer Berryman, *The Marine Trust Company of Western New York*, Buffalo, New York

Continued from page 27

the basis of the par or face value of the security.

(b) **Obligations purchased on the basis of reliable estimates.** A bank may not hold at any time investment securities purchased 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 not at any time thereafter 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.

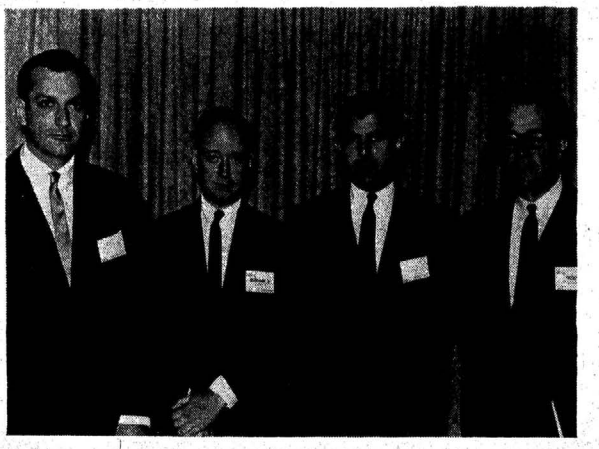
§1.9 **Requests for rulings.** Any bank may request the Comptroller of the Currency to rule on the application of this part, or paragraph Seventh of 12 U.S.C. 24, to any security which it holds, or desires to purchase for its own account as an investment security; or which it holds, or desires to deal 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

Ladd Dinkins, *Ladd Dinkins & Co.*, New Orleans; Lee F. Murphy, *Ladd Dinkins & Co.*, New Orleans; John J. Kenny, *J. J. Kenny & Co.*, New York



Tom Rife, *Blewer, Glynn & Co.*, St. Louis; Elzey G. Burkham, Jr., *G. H. Walker & Co.*, St. Louis; Robert W. Holland, *Rotan, Mosle & Co.*, Houston; Arthur Tresch, *A. E. Masten & Company*, Pittsburgh

P. Alden Bergquist, *First National Bank*, Chicago; Thomas A. Griffinger, *Bank of America N. T. & S. A.*, San Francisco; W. Neal Fulkerson, *Bankers Trust Company*, New York

remaining after the charge to undivided profits required by §1.10 so that such premium or portion thereof shall be entirely extinguished at or before the maturity of the security, and the security, including premium, shall at no intervening date be carried at an amount in excess of that at which the obligor may redeem such security; or

(b) Set up a reserve account to amortize the premium or portion thereof, said account to be credited periodically with an amount not less than the amount required for amortization under paragraph (a) of this section.

§1.12 **Exceptions.** The restrictions and limitations of this part do not apply to securities acquired through foreclosure on collateral, or acquired in good faith by way of compromise of a doubtful claim or to avoid a loss in connection with a debt previously contracted.

JAMES J. SAXON
Comptroller of the Currency

*Remarks of Mr. Saxon before the Second Annual Municipal Conference of the Investment Bankers Association of America, Chicago, Ill., June 20, 1963.

Meaning of Firm Policy to a Municipal Bond Organization

Continued from page 5

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 confine 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 firms 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 guideposts 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.

Let us be alert, venturesome and self-confident but let us never be greedy.

Let us take a lesson from these famous words of Patrick Henry—

"I have but one lamp by which my feet are guided, and that is the lamp of experience. I know of no way of judging of the future but by the past."

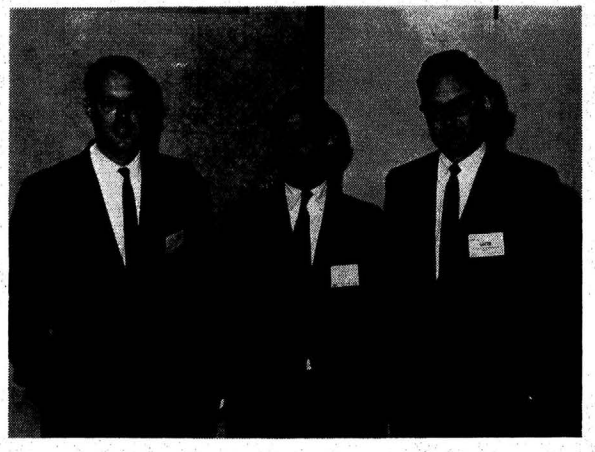
*An address by Mr. de Milhau before the Second Annual Municipal Conference of the Investment Bankers Association of America, Chicago, Ill., June 20, 1963.

J. Jay Cavanaugh, *Philadelphia National Bank,* Philadelphia; Haven L. Zebold, *Prescott & Co.,* Cleveland; Alex R. Beard, *Philadelphia National Bank,* Philadelphia

"Bob" Faath, Jr., *A. C. Allyn & Co.,* New York; William S. Magnus, *Magnus & Co.,* Cincinnati, Ohio; E. M. Bancroft, *Stranahan, Harris & Co.,* Toledo

Frank B. Hutchinson, *Hutchinson, Shockey & Co.,* Chicago; Frank A. Toplikar, *Zahner & Company,* Kansas City, Mo.; Felix N. Porter, *First National Bank & Trust Company,* Oklahoma City

Duane T. Smith, *Stockyards National Bank,* Wichita, Kansas; Bill T. Wall, *Parker/Eisen/Waeckerle/Adams & Purcell,* Kansas City, Mo.; Victor H. Zahner, *Zahner and Company,* Kansas City, Mo.



Walter E. Knowles, III, *First Boston Corporation,* Chicago; Robert W. Holland, *Rotan, Mosle & Co.,* Houston, John M. Greer, *McClung & Knickerbocker, Inc.,* Houston

William M. Marlin, *Bache & Co.,* New York; Alfred J. Bianchetti, *J. A. Hogle & Co.,* New York; Gerry MacLeod, *Pacific Northwest Company,* Seattle; Willys P. Jones, *Allison-Williams Company,* Minneapolis

Up-Dating Underwriting Practices and Procedures

Continued from page 4

tutions who buy bonds on a priority basis pay a net price, then it seems logical that dealer-banks in the group should also. The practice also appears unfair to competing commercial bank buyers without bond departments and could be indirectly a contributing cause for the sudden surge by commercial banks to open bond departments which in many instances 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 underwriter 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 takedown with the right of reoffering immediately but agreeing to resell to members of the account at the dealer's concession. This is a means of simply taking away merchandise that should be rightfully available to all members of an account at the full profit. The argument most generally advanced for its justification is that it helps the bid, although there are numerous people who will debate this, because, in all likelihood, it involves maturities that are the most saleable. Besides being unfair, it can prove embarrassing 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 members 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 deserves or merits in this era of big bank and casualty company buying. 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 distribution 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 matter 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 practice, we could make some progress in correcting some of the abuses. Obviously, designated sales are wonderful for those designated, but not for those who are slighted. In an undivided account, probably the only hardship on those not designated, other 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 elsewhere. However, in a divided account, there are more serious disadvantages. 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 deprived of getting bonds because of the precedence rule over member 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 industry who would like to see designated orders eliminated entirely. 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 in fairness to all members of an account, if a buyer wishes to designate, 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 commission to the designees. Much has been written and said on this subject; but if we are really sincere in trying to protect minority as well as majority interests, more flexibility in our thinking is called for.

Cut Price Sales

One of the unpleasantries 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 acceptance. 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-

ployed by accounts to move bonds, particularly in a weak market, is to hit bids. The account either waits for bids to come in or actively solicits them. I would say that more often than not managers make a conscientious effort to do the best job possible when these situations occur and are governed by majority consent when a bid is received for a block of bonds below list price. However, when a bid comes into the account unsolicited, then, certainly, it would seem that the manager should not request or expect to get a commission on the sale. On the other hand, if the account has decided 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 manager 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 by no means 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 in direct violation of the syndicate agreement and assumes a right over another participant's liability which he does not possess. Because this can cause erosion in the price structure of any account, the manager should have the right to not only turn a bid down but also severely criticize the action.

Advertising

We are all too well aware of the constant rising cost of doing business, but there are many who feel that the expenses incurred in some underwriting groups are all out of proportion to the over-all spread. Certainly, we would all 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 through the medium 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 $.00 to $.71 per bond for an average of $.26 per bond. Certainly, it would seem to me that this money could be employed to more productive advantage by dealers and banks if applied to their own house advertising programs.

All of this, of course, must lead to only one thing and that is profit margins. I appreciate that in the competitive market in which we operate, there is no way possible to lay down any ground rules or, for that matter, even to get a gentlemen's agreement on profit margins; but we can all be guided by the rule of common sense. We have all been guilty at various times of being willing to buy a deal just for the glory!—the recent two Treasury deals are good examples of this; but the glory has never yet been known to pay overhead!

I suppose that to a certain group of underwriters who distribute bonds in large blocks to somewhat restrictive accounts, the small spread is compensated for by volume. However, there is another group, and they are by no means a minority from the standpoint of numbers, who must depend to a large degree on the assistance of a sales force to distribute bonds. I'm sure you all are familiar with the way a salesman's mind works—he can sell most anything if the profit is good; but he is the first to give you a curbstone opinion in words of one syllable of what he thinks of small profit deals. It is for this reason that many underwriters who must pay salesmen's commissions are being denied more and more the support of their sales forces on many deals, because of the meager spreads. Certainly, this is not a healthy condition, when we consider that we need all the distribution we can get not only now but in the future, if we are to successfully get through the volume of new issues that are in store for us.

In closing, I would like to make this observation: our field of endeavor, which a short time back was considered the step-child of the security business, has reached maturity and today makes a most vital contribution in the field of investments and to the country as well. We have, by necessity, made many changes in our methods of doing business and will have to make many more as we continue our future progress. Because we represent the only unregulated segment of our business, we must all, therefore, assume a greater responsibility than ever before, that the practices we develop be sound of principle, fair to all, and above reproach.

*An address by Mr. Hassman before the Second IBA Municipal Conference, Chicago, Ill., June 21, 1963.