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Mr. Anderson: I think that would be an evil that would result from competitive bidding, don't you?

Mr. Spencer: I don't think so.

Mr. Anderson: If you are going to put me in competition with these big buyers and underwriters on the small issues of securities and have them come into my market and take them away from me, that is going to be the result, isn't it?

Mr. Spencer: Aren't you now?

Mr. Anderson: I cannot say about public utilities--

Chairman Frank (interposing): That is all we are talking about is public utilities, you understand. We are not talking about anything but public utilities, and the question Mr. Spencer is asking you is whether ^{if} that competition exists, it has nothing to do with competitive bidding. If it exists, it exists.

Mr. Anderson: I don't know that I quite understand the point that he is making. As I understood him, he wanted to know whether we would feel able to bid under competitive bidding on small issues of public utilities offered in our state. I would say that we would not be. At the present time we have no opportunities to buy those issues because none of them have come up. I will say with respect to the Virginia Public Utilities Company, that we were interested in that and we were members of a group that were considering making a proposal. But it never got down to the point where we were able to do

that.

Mr. Weiner: Where the company was proposing to purchase some property?

Mr. Anderson: Yes.

Mr. Weiner: You never got a chance at those bonds competitively or otherwise?

Mr. Anderson: That is right.

Chairman Frank: Thank you.

Mr. Stewart: Next is Mr. Estes, of Topeka, Kansas.

STATEMENT OF WAYNE J. ESTES

Estes, Snyder & Co.

Topeka, Kansas

Mr. Estes: I want to say in advance that my only interest is that of the small dealer. We are a very small dealer. The evidence introduced here yesterday proved to me only one thing, and that is that the small dealer will be the one to suffer. The large underwriters, whether they be for or against competitive bidding, do not care much what happens to us. The ones that are for it hope to get more business; the ones that are against it think that they can do better under the present system.

We know that it has been your Commission that has helped the little fellow by their policy of broadening distribution on all securities and don't think that the small dealer does not appreciate it.

Chairman Frank: Then you might suspect that we would not be likely to embark on a course unless there were some other compelling reasons that would do what we thought was an injury to the small dealer.

Mr. Estes: Yes, but I disagree with you as I will show you later. But I think it is your motive to help the small dealer.

Mr. Stanley has never had anybody out in Kansas nor has Mr. Stuart nor Mr. Eaton, but your Commission has. Mr. Eicher has been out and talked over our problems with us.

Our firm has been able to participate in both underwritings and the selling of securities since this Commission was created. I don't believe we would ever have done it otherwise. What we are afraid of now is if you put this rule into effect is that it will undo all the good that your Commission has already accomplished. The testimony here yesterday indicates that what the big insurance companies do not buy will go to the large underwriters who will attempt to do their own retailing, and it will be just like it used to be when the large houses had retail organizations traveling all over the country right into our own community.

Chairman Frank: Is it true--Mr. Stanley is here--was it true that Morgan, Stanley & Company and its predecessor, J. P. Morgan & Company, had salesmen throughout the country?

Mr. Hall: J. P. Morgan & Company did not have, but I

presume he refers to the organizations like the National City and Halsey Stuart.

Chairman Frank: Fortunately or unfortunately, the market conditions are very different. We have a very different kind of a buying situation.

Mr. Estes: But their spreads will probably be closer and they will be able or they won't use the smaller dealer.

Chairman Frank: That goes on a great many assumptions-- first, that there will be overpricing and their own margin of profit will be so small that they cannot afford to give any of it to you. I would like to ask you a question, the question that I asked yesterday. Would you think--assuming the Commission had the statutory power to inquire into the proportion of the spread allotted to the dealers by the originating underwriter and it found that the originating underwriter was getting a very handsome profit but giving a niggardly amount to the small dealer, that the Commission ought to do something about it?

think
Mr. Estes: I certainly/they should.

Chairman Frank: I think I may say that we asked the National Association of Security Dealers last May, I believe, to advise us, (a) whether we had that power in their opinion, and (b) whether we should do anything about it, and we have not heard to date from them.

Mr. Estes: I do think that that rule would react more

unfavorably on the small dealer than any one else.

Commissioner Eicher: What proportion of your income over the last five years has been derived from commissions or from the sale of public utility securities?

Mr. Estes: This last year it meant the difference between a profit and a loss.

Commissioner Eicher: So that apparently you have made a profit?

Mr. Estes: That is right. That is what we are there for.

Mr. Weiner: Considering the overall effect upon you, have you taken into account what possibilities of business you may have lost through the private placement? Our figures show that approximately 40 per cent of public utility issues in the past have gone by that route.

Mr. Estes: I think that should be done away with.

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Mr. Weiner: On balance, assuming that the result of such a rule as proposed here would curtail very sharply the amount of private placements, do you think it likely that the small dealer can perhaps come out even?

Mr. Estes: No, I don't think so. I think what you ought to do is to eliminate private placements and leave the system as it is.

Mr. Weiner: That is quite an order.

Mr. Estes: That is my opinion.

Mr. Nevil Ford: You made a remark just a moment ago that

the Association had not replied to an inquiry of the Commission. I should like to state for the record that we are prepared to make a reply and will ask our counsel to speak on that subject.

Chairman Frank: Very well.

STATEMENT OF PAUL W. LOUDON

Piper-Jaffray & Hopwood

Minneapolis, Minn.

Mr. Loudon: I am another small dealer from the sticks, and I am not representing the I.B.A. or the N.A.S.D., although I am a member of both. I do not think that you have gotten a lot of letters from dealers in Minneapolis and St. Paul, although you may have because I am frank to state that they all felt it was just love's labor lost, that the die was cast, and yet we thought that some one ought to come down here and be the goat and register, and I am the goat. (Laughter)

I am perfectly serious about this--I mean it--they thought it was just a waste of time.

Commissioner Healy: There are people that do not go to the polls on election day for the same reason.

Mr. Loudon: Yes, I know that, but I had a father and mother that did until they were over 90, if that is any interest to you.

Commissioner Healy: You are living up to the family tradition.

Mr. Loudon: I sort of resent the remarks you made about the blandishments of the bond salesmen in the 1920's. I remember when the Government was pretty damn glad to have us go out and sell bonds, if that is of any interest. (Laughter)

But to get back to this--

Commissioner Healy (interposing): I was selling war stamps, war saving stamps, so we are on a par in that.

Mr. Loudon: I was glad to hear Mr. Franklin say yesterday that he was open minded on this question, and I hope that he meant it; I take his word for it.

I think there is a lot to be said for us little fellows because that is what we are. I don't want to repeat, and I will just simply say that Mr. Whipple and some other small dealers, but bigger than us, have stated it here before, and it is repetition and I don't want to go into it.

There are one or two that have not been brought out that I might enlarge on from our angle, and it may help the cause. Our interest is definitely selfish; there is no use fooling ourselves or anybody else, so I won't try to.

Chairman Frank: It should be selfish.

Mr. Loudon: We have been in business out there for 20 years. I have been in the investment business since 1926, and I studied it before I went into it. I did not fall into it out of Yale or anywhere else just as a white shirt and collar business. I thought it was a good one and I studied it and

I went into it. I thought I had a business, and I raised a family and five children and I still would like to have pride in my business, but it has come to^a pass through circumstances in the last few years that whereas we for about 20 or 21 years have had small local underwritings in not only municipalities but small corporation deals such as might come along, we have only got one that we are a little bit ashamed of. The rest of them weathered the gale pretty well.

I think that is pretty well borne out by the fact that we have still got friends and clients that are still willing to do business with us, and we try to do business with them on a list of which a good part are in the public utility bonds if we can get them. We do not always get what we want, and I hold no brief for the eastern underwriters, but they have treated us pretty well and we have helped to make our bread and butter out of it and we would like to see the thing continue, because we cannot see how what is suggested here is going to help us.

I disagree pointedly with the fact that competition and auction block sale of public utilities is going to help eliminate private sales. I think Mr. Ecker said yesterday that they were going to go in and bid, and certainly if the insurance companies will do that, they can bid on a much smaller margin of profit than we can.

Chairman Frank: But you understand that today there is a

very large volume of utility bonds at which the investment banker never gets a crack.

Mr. Loudon: That is true. I understand over a billion in the last three or four years.

Chairman Frank: The pretty obvious reason is, as Mr. Rogers has said, and he boastfully says, that the insurance companies, including the one that he represents, are in a position to put the money on the table and make a firm commitment, as the investment bankers are not. Now, one of the effects of the proposed rule, if it did not contain the exception that Mr. Ecker and Mr. Rogers suggest, one of the effects of the proposed rule would be that that advantage of the insurance companies would disappear. They would no longer be able to grab that issue at an early date as they can today. Most of us have observed this trend, and if I were in your business, I would want to see anything that would stop that trend be tried. The trend is such that if it goes on at the present rate, there are going to be fewer and fewer and fewer issues that are offered publicly. This will put the insurance company and the investment banker on the line together. The insurance company will lose any advantage except one, the fact of having more money to bid.

Mr. Loudon: And they can bid on a lesser spread.

Chairman Frank: Yes, and they can today privately, that is what they are doing.

Mr. Loudon: All right, but they are also getting bonds privately.

Chairman Frank: Yes.

Mr. Loudon: And they are getting enough bonds from the underwriters where they do not feel it is worth their while to go in there.

Chairman Frank: But Mr. Rogers' appetite does not seem to be at all satiated, and if I recall Mr. Ecker's testimony yesterday, he stated that through the combination of their ability to bid competitively and with private placements, they would acquire a larger number of bonds.

Mr. Loudon: Then they are getting it.

Chairman Frank: And he also said something that was strangely inconsistent. It was brought out by Mr. Fournier that the effect of competitive bidding would be overpricing. He then said that the effect of overpricing would be—he was asked if he would not buy them in and he said he would, and then the obvious question was put to him, which I do not think he answered, which was, why should he buy them if he thought they were overpriced, when all he had to do was not to enter and wait until they got to a price which he thought was the right price. He did not answer that question.

Mr. Rogers: I don't know that the question was answerable when put in that form, but I think what Mr. Eckert meant was that the non-necessity of considering any necessary spread or

any immediate profit such as the bankers would have to consider, that because of that we would be in a very good position to bid slightly above what they were able to bid.

Chairman Frank: But if they were bidding a price that you thought was too high, why would you bid?

Mr. Dean: How would you know it was too high with sealed bids?

Chairman Frank: Why would the Metropolitan Life Insurance bid a price that it thought was too high? The assumption that has been reiterated here, I think, until--I will not say until I am persuaded, but I am certainly familiar with the argument-- is that competitive bidding must lead to overpricing, and by dint of repetition if that were proved, we would now have it as an axiom.

Mr. Rogers: Not in every case.

Chairman Frank: If it were so, then the Metropolitan, if well advised, would only bid a price which it thought was the right price, and if it did so, and if the effect of competitive bidding were to lead to a higher price, then the Metropolitan would not get a bid, and then the competition between the Metropolitan and the investment banker would all go in favor of the investment banker.

Mr. Loudon: Mr. Frank, I would like to say a word there.

Chairman Frank: It is your floor.

Mr. Loudon: Assuming that a sizeable underwriter goes in

there and bids against the Metropolitan or anybody else, isn't it going to tend to make them bid closer, and that would eliminate us little fellows?

Chairman Frank: I am assuming that Mr. Ecker meant what he said, and I am sure that he did, and that Mr. Rogers meant what he said, and I am sure that he does, that they would not bid a price--

Mr. Rogers(interrupting): I would like to state what we mean.

Chairman Frank: If you will let me finish, you may correct me, where I have misstated your postulates--that they would not bid a price that they thought was too high and, to be sure, because of the amount of money they have and what they can save, they are able to shave, but they would not bid a price, and as Mr. Dean said, since they are field bids, they would not know what the price was going to be. But they would bid a price that they thought was right and not too high. We start with that assumption, and if it is true, that inevitable effect of competitive bidding would be that persons bidding other than well-advised persons who were going to be long-range investors like the insurance companies--the investment bankers eager to get the business and get rid of it in a hurry--if the tendency of competitive bidding would be to make them bid it high, then their bid would be higher than the bid of the Metropolitan or any other insurance company and the

Matropolitan would not get the business, and therefore it would eliminate private placement. That would mean what? According to this argument--I am not saying I am convinced by it or that it is accurate--private placement would go out and the investors might pay more because they would get over-priced bonds--that would be one of the arguments to be sure--but certainly in the competitive race between the underwriters and the insurance companies, the insurance companies would bid their price and the investment bankers would bid a higher price and the investment bankers thought they should to take the bonds out.

Mr. Loudon: But the underwriters would be in there and they are these big underwriters.

Chairman Frank: Aren't they now?

Mr. Loudon: Yes, but they have got a reasonable spread.

Chairman Frank: Have the big underwriters ever disclosed their profits to you?

Mr. Loudon: No.

Chairman Frank: Your assumption is that today they are making a certain profit, and that the resulting underwriting spread will be so markedly to reduce their profit that they will have to reduce the amount that they allot to you. That is the question of fact, isn't it?

Mr. Loudon: Yes.

Chairman Frank: I am going to follow your assumption

for a moment that this spread will be less. But how do you know that it still won't be large, and so large that they still ought to give you as much as or perhaps more than they are giving to you today? You don't know anything about that today, do you?

Mr. Loudon: No.

Chairman Frank: They give you exactly what they want to?

Mr. Loudon: That is right.

Chairman Frank: They--you are completely at their sufferance?

Mr. Loudon: Yes.

Chairman Frank: You are working for them?

Mr. Loudon: No, I am working for myself.

Chairman Frank: But you take whatever they want to give you?

Mr. Loudon: That is true; anything they hand out.

Chairman Frank: You don't know whether what they are giving to you is a fair proportion?

Mr. Loudon: No, but I have heard them state that if that comes to a pass, it will make the margin less and they will go into retailing themselves. We have seen six of those big underwriters go out of Minneapolis in the last seven or eight years, and I don't want to see them come back, and I believe that it is just as true as I stand here that if that thing goes on, we will have them all back on a retail basis.

Chairman Frank: But all of your arguments are predicated on statements made to you without any detailed statements of their profits. You don't know and I don't know what their profits are.

Mr. Loudon: I will take their word for it, or yours, when I think you are giving your word as a gentleman.

Chairman Frank: You won't take my word for something that I don't know?

Mr. Loudon: No. I don't believe they are going to come up here and tell a different story that is not a true one.

Mr. Whipple: Isn't it fair to point out that the insurance company will have an important advantage over the underwriter or dealer in purchasing securities by the fact that he requires no spread or no profit?

Chairman Frank: He has that advantage today. Unquestionably, that is why they are having private placements.

Mr. Whipple: Isn't it going to continue the same way?

Chairman Frank: The advantage that he has, he has. That advantage will be eliminated to the extent that you take away the advantage of his being able to make a firm commitment weeks in advance. All I am addressing myself to is the remark that there is going to be overpricing by competing underwriting who are going to come in, and I say that the insurance company in those circumstances would be very foolish to go in and bid a high price if they saw it was going to be overpricing,

because from Mr. Ecker's statement I understood that the consequence of overpricing is that the securities come back on the market, and they can buy them up at a lower price.

Mr. Rogers: Mr. Ecker mentioned the possibility of bidding a quarter of a point lower than the banker did. A quarter of a point on a 30-year bond would amount to very little over the term. The security may very well be worth that to us, and it would be a fair price to us to bid a quarter or a half a point lower than the bankers. That is what he meant.

Chairman Frank: That is a factor in the market today, and that is why you are going in on private placements.

Mr. Rogers: No private placements would split the economies or attempt to between the issuer and the investors and those economies are very substantial. As to the possibility of our just waiting around and buying later, as you well know, we do very little of that, and this is one of the reasons--this is one of the answers to ^{the} private placement point when it is stated by the small investor.

Chairman Frank: If that were true--it seems to me the logic is inescapable--if it is true that competition and competitive bidding is going to lead to overpricing, and if by overpricing you mean a price of such a character that the persons who purchase will not hold for because
there will be within a short period stabilizing
starts a drop in the price and the bonds will come back in

the market at a lower price, there is no reason why the insurance companies should bother to go into private placement.

Mr. Dean: In the spring of 1935, the first time that the public utility companies were issuing securities below 4 per cent, the large insurance companies at that time quite properly decided that they were not interested in the securities that were being offered. They had, however, in their portfolios fairly substantial blocks of the securities which were being refunded. They did not buy any of the issues which were being offered. That meant that they had a substantial number of bonds in their portfolios that were refunded, and those funds were idle and seeking investment. Those utilities at the time had their large refunding programs. They went to the market again, and again the insurance companies thought the prices were too high and again some of the securities that they had were refunded. That happened the third time. Again, some of the insurance companies did not invest until some of the insurance companies became very much worried about the very large percentage of the securities of those companies which were being refunded but for which they had no investment outlet, and they then went to those companies and offered them a higher price than the investment bankers could meet. I think you will find that if the insurance companies should decide to bid on a particular issue, and that the price was too high, although in a sealed bid, I don't see how they would know what the price

would be--

Chairman Frank (interrupting): Everybody in this room has predicted that the prices are going to be high. Everybody has said so. If it has become a dogma that requires no proof, a self-evident truth so that no one needs to inquire into it--

Mr. Rogers (interrupting): Mr. Eaton also pointed out that in a rising bond market, they bid $101\frac{1}{2}$ for a certain issue, and the issue could not be sold at that price, and that they held the security for about nine months and then sold it at 105.

Chairman Frank: Therefore, one of the two arguments is sound and the other is not. If overpricing has been pictured as an evil to the investor and if it is going to be, and if that evil is going to lead to the investor quickly returning the bonds to the market, and you know, as you seem to know without any demonstration, because it has not been operated, but if you know that it must happen that way, then I say I cannot understand why the insurance companies need to have the anxiety that they had in the instances that you cited, because in those instances, the bonds apparently were not overpriced and did not get back, and they were not able to pick them up, but if it be a dogma as it seems to have become judging by the utterances of many persons in the room, and apparently is taken for granted that competitive bidding is bound to lead to overpricing, and not in the sense which Mr. Eaton was talking

about, where the investment banker holds them and later sells them at a higher price, but where he disposes of them at an excessive price and they come back on the market, which is the sequence of events which has been predicted here--that is what we have heard again and again and again, and then I say that I do not see why the insurance companies should bother to go in and bid privately, because all they would have to do would be to sit down, and five or six weeks the bonds would be back and they could get them at what they thought would be the right price.

Mr. Dean: There have been a great many statements made here. You may have a rising or a falling bond market. Obviously if you had bid too high in a rising market, you would be able to sell them even if you did hold them.

Chairman Frank: Then the evils of overpricing are absent, because the evil was supposed to be an investor getting the bonds at an excessive price.

Mr. Dean: The investment banker at the particular moment paid a higher price than the investment market at that particular time would stand, but due to a rising bond market he was able to sell them in a period of four or five or six weeks later. If there were a falling bond market, on the other hand, and you had a complete 100 per cent competitive bidding, I should think that the natural tendency would be that if you had one or two issues that were overpriced, that you would then have a tendency

to have those issues greatly underpriced.

Chairman Frank: Now, it is the issuer that is going to be hurt.

Mr. Dean: Then I think in a falling price, you would have an overstocked inventory, your investment banker would be overstocked and the market clogged--

Chairman Frank (interrupting): Just what Commissioner Pike said yesterday.

Mr. Stanley: I do not pretend to speak for the insurance companies, but I would say that today the insurance companies can pay a point more for a large issue and would, than he would for a smaller amount, because of the volume.

Mr. Bollare: I should like to say--

Mr. Loudon (interrupting): How about me?

Chairman Frank: I was thinking of you. My elementary canal is beginning to assert itself, and I think that we had better recess.

Mr. Loudon: I will finish in two minutes here. I want to say one other thing from the small dealers' standpoint, and I say it in all good spirit. I don't want any personalities here, but I have listened to Mr. Eaton, and from our standpoint, and again I want to say that I am fighting nobody's battles but my own, but when we offer securities, we have a great majority of our people who are smart enough or think they are wise enough to ask who is underwriting them. It is just like the example of the name "sterling" on silver -- it may not mean anything on the silver, but just the same people look for it, and I think that has a big bearing as to whether these underwriters earn their money. And Otis & Company in our country is not as well known as somebody else. It may be too well known on other accounts. We have a lot of Continental Shares up there, and people might think regardless of what is the situation if they would follow it through, and we might not be able to sell a security that was underwritten by Otis & Company although we might by Halsey, Stuart or someone else.

Now, that is a matter of fact. Whether it is fair or not, it is true. And I think that that should have some bearing on this question.

My only other point is that I read one little piece at least out of Mr. Weiner's brief -- I tried to digest all of it and I did not even get started -- but there was one point that the issuer should receive the most favorable terms obtainable rather than

the maintenance of a living wage for investment bankers, and I would just like to ask Mr. Weiner if us forgotten men should come into the discard of big business -- if they can not look out for themselves better than the smaller people out in the sticks, then I don't understand the game of living. I don't believe it is the will and the desire of the industry or of Congress in establishing the S.E.C. to just simply put the emphasis on the big shots and leave us wherever we may fall in the general run of the thing.

Chairman Frank: I don't think that you have found the S.E.C. doing that by their attitude generally.

Mr. Loudon: I don't think so, and I don't believe it, Mr. Frank, and I can not believe it. If you obtain what you are after, which is the elimination of private placements, I wish to God you would, but I think that you should drop competitive bidding and go to some other attack.

Mr. Daley: May I rise on a point of privilege? I think good taste will stop us from talking about the issues of other issuers which have been any more fortunate than some that we have put out. I do not think that is an issue here, but if it is an issue, we are always glad of course to sit down and go over the whole situation.

Chairman Frank: We will recess now until 2.30 p.m.

(Whereupon, at 1.15 p.m., a recess was taken until 2.30 p.m. of the same day.)

Grover
Shaw

AFTERNOON SESSION

(Whereupon, the conference was resumed at 2:30 p.m.)

Chairman Frank: Let us proceed, gentlemen.

Colonel Scott, would you care to be heard?

Colonel Scott: Yes, sir.

STATEMENT OF COLONEL FRANK A. SCOTT

Chairman, Finance Committee, Western Reserve University

and

University Hospital, Cleveland, Ohio

Colonel Scott: Well, I am interested in your hearing and your desire for opinions and information on this general subject. I have no personal interest in it, in the profit sense. I happen to be the Chairman of two rather important investment committees in our community, one, of our University, and the other of a great group of hospitals which we have in Cleveland, that are united, and together have about \$20,000,000 of securities.

I--when the Securities and Exchange Act was passed, and I presume I have this in common with many citizens--approached it with the thought that their chief interest was the interest of the investor, and therefore I have tried to apply this idea in that direction--to what extent, if at all, would this competitive bidding on this type of security aid the investor as against the system which we have been pursuing?

I have been unable to see that it would be of advantage to the investor. It seems to me, from such experience as I have had, that it would rather work to the disadvantage of the investor.

I think the existing system has certainly built up in the mind of the investor a reliance upon the issuing house, growing out of that relationship which has often existed between the issuing house, or rather the purchasing house, and the issuing corporation, a banker and customer, so that the investor has come to rely upon the judgment of the banking firm, and has assumed that if the banking firm was willing to lend its facilities to the distribution of the security, it had first satisfied itself with the probability that the security was sound, and that its ultimate history would not be a reflection upon the banking firm involved.

This may be naive, and it may merely be old-fashioned, Mr. Chairman, but my observation of that kind of thing has been that there has existed in the normal operations the relationship between the investing banking firm and the corporation issuing securities, that normally exist between a banking house and its customer, a mutual knowledge of the character and ability of the other party, and a mutual confidence arising from that knowledge.

It seems to me that what is under consideration now lessens, to a very great degree, the building up of that kind of knowledge and confidence, and lessens it to a degree that in the ultimate would be harmful to the investing public.

I don't know but what I have said right there about all I can say. That is my impression of it from years of contact

with it.

I should be glad, Mr. Chairman, if you wish to question me, to make such comments as I am able.

Chairman Frank: Thank you very much.

Mr. Stewart: May I proceed, then?

Chairman Frank: Yes.

Mr. Ford: May I interrupt a moment, Mr. Chairman, before we leave the subject of the small dealer?

I should just like to state, as a representative of the National Association of Securities Dealers, that our Board concurs most heartily in the statements such as have been made by the small dealers appearing here this morning. From inquiries which we made among our own membership, which you know consists of some 2,900 houses in this country, the expressions given here reflect very strongly the feelings of the majority so far as we can determine, of the small dealers, that the institution of a competitive bidding rule will be followed by far-reaching effects upon the small dealer, and we believe in many instances will lead to his elimination, and further, that it will lead to the concentration of the security business in the hands of a few.

Thank you.

A Voice: Before we leave the subject of the small dealer, I would like not over three or four minutes.

Mr. Stewart: Might I say that we haven't left that subject

yet. There are still small dealers who haven't put in an appearance, and we think they will testify further if that is agreeable.

May I proceed, Mr. Chairman?

Chairman Frank: Yes.

STATEMENT OF ROBERT McLEAN STEWART

Chairman, Securities Acts Committee, I. B. A.

Mr. Stewart: As Mr. Chamberlain said yesterday in his testimony, the most important consideration put forward by the staff relates to the question of whether there is or is not competition, and we would like to turn our attention for the time being to the exploration of that question, the question of competition.

The staff says in its report, at page 11, that one of the criteria of competition is whether or not a new dealer can enter the business and make his livelihood in that business.

As we have said in our brief filed with you, the history of the last 25 years shows that great numbers, a very large number of new firms, have been formed throughout the country as well as in the large cities.

Chairman Frank: That originates underwriting of utility issues?

Mr. Stewart: No, they do not necessarily originate underwriting of utility issues.

If I may be permitted, Mr. Chairman, to address myself to

the general subject, in view of the fact that the staff report apparently is concerned with the broad question and has been based, to a considerable extent, upon the testimony given before the Temporary National Economic Committee. Our sole reason for referring to the general subject is that the staff report itself seems to be general.

As we proceed, there are here a number of representatives who will give evidence showing that they have been able to enter the investment banking business and to achieve a moderate success as great a success as economic conditions prevailing in the field have permitted.

Chairman Frank: Mr. Stewart, I would assume that what would be germane--if we are to go outside of the utility field--would be issues of a comparable size. Now do I take it that you are going to endeavor to demonstrate that there have been a considerable number of new investment banking houses that have originated issues of considerable size?

Mr. Stewart: I wouldn't suggest that we could prove that.

Chairman Frank: It would scarcely be germane to our subject, I would think, to go into a discussion of small issues, particularly of a local character, which wouldn't furnish us with any yardstick for our discussion of the underwriting of utility issues, which is the only subject with which we are directly concerned here.

Mr. Stewart: It would, of course, be our view that no

underwriter originates issues, the issues originate with the issuer.

Chairman Frank: I won't quarrel with you about the terminology. You know what, in my stupid way, I am referring to.

Mr. Stewart: I think that before we talk about whether there is or is not competition in investment banking, we might explore to some extent what is the nature of the competition.

As we said in our brief, we think it unnecessary that competition should be an affair of noise and clamor in the streets; that competition can exist, and exist effectively, without that development.

This morning several of the witnesses here were talking about the status of professional people, as to whether or not there is competition among them. I suppose that the competition which has developed there is the kind that experience throughout the centuries has shown to be the wise kind of competition. I would doubt that there is an absence of competition.

I have in my own family many professional people and I know that they have always been keen for success and have not neglected the proper means of assuring that success.

Some time ago Professor Frank A. Fetter, of Princeton, said, in a book which he wrote:

"The broad definition of competition is wide enough to include a physical fight to the death, and those of any and

every form of weapon of fraud, deceit and destruction. We must recognize the distinctions between fair and unfair, legal and illegal, social and anti-social competition--"

Chairman Frank: I don't happen to know, but do you happen to know whether Professor Fetter thinks that the kind of competition between investment bankers that now exists is adequate?

Mr. Stewart: I am sorry that I don't know what his views are.

Chairman Frank: I would be surprised if he did, knowing his general attitude. He happens to be far more zealous about the stimulation of competition than I am, I know, and I would be surprised if he would agree with the views that your report expresses.

Mr. Stewart: Our view, of course, Mr. Chairman, is adequate. As a matter of fact, we think there is too much competition for the social good.

Chairman Frank: Is there the same kind of competition between underwriters for large issues, that there is between shoe manufacturers for the shoe business?

Mr. Stewart: I would say not, and I should think it improper that there would be. It seems to me that one of the fundamental errors made here in our consideration of this problem is that we liken securities to shoes or bread and butter, or other consumers' goods. There I think the problem

is very different. Certainly, the consumer is not injured by the subsequent variation in the price of a local bread which he buys. The local bread is bought for immediate consumption. If it is not immediately consumed, the laws of several dynamics get to work, and it decays very rapidly indeed. But that is not true of the security. The security is something which must exist throughout its whole life, and it is greatly affected by its price throughout its whole existence.

Chairman Frank: It is true of real estate, isn't it? I mean, real estate doesn't decay, and I gather that people who deal in real estate compete pretty actively, don't they?

Mr. Stewart: I wouldn't regard acreage of land as consumers' goods.

Chairman Frank: Not exactly. I was trying to take an analogy of the purchase by people of things which they have some notion of possibly disposing of thereafter, and where the price has some effect, I mean taking that aspect of your argument, there seems to be pretty lively competition between men engaged in selling real estate. They do not adhere to the rule that was indicated as existing among investment bankers this morning, of not going after each others' customers.

Mr. Stewart: I didn't interpret the testimony given this morning as indicating that investment bankers were not prepared to go after each others' customers. On the contrary, I thought they indicated that they were ready to employ every effective

means of competition.

Chairman Frank: I understood Mr. Stanley to make the following statement--he will correct me if I am incorrect--that as long as he thought a rival was doing the business well and creditably, he would not seek to get his business away from him.

Mr. Stanley: That is true, Mr. Chairman, but I said that if I thought he was not doing well, I would try.

Chairman Frank: Yes. But is that true in the real estate business?

Mr. Stewart: I am not an authority on the real estate business.

Chairman Frank: You know in general. Do you think Broker Jones says, "Well, now, Smith seems to be handling that estate account, and it is a credit to the business, so I am not going to try to take it away from him"?

Mr. Stewart: I really can't speak for the real estate brokers.

3 Mr. Dean: I think they did have such a provision in the Realtors' Code, adopted in 1929.

Chairman Frank: That is my understanding, but that is no longer in existence. That was in the NRA Code, and that is interesting because they were severely criticized because they had so much competition.

Mr. Dean: I don't believe competitive bidding is used

in the sale of real estate except seaside lots, or lots--

Chairman Frank (interposing): I am not talking about competitive bidding, I am talking about the real estate business as distinguished from the investment banking business. Mr. Stewart was addressing himself to the question of whether there was competition, as we know it, in ordinary walks of life.

Mr. Dean: I would doubt very much that William A. White & Company would go out and try to take, actively, Brown, Wheelock's business away from them, as far as the management of buildings is concerned. We handle a good many buildings in our own office, and those real estate brokers come in to see us all the time, but if William A. White & Company were to come in and actively pester us, we would regard them as a nuisance.

Chairman Frank: There is always a point beyond which salesmanship becomes self-defeat.

I happened to have lived for many years in Chicago. Mr. Harry Stuart and I come from a woolier part of the country, and we may not always agree on certain things; but my experience in the real estate business was that I was pestered to death whenever I had any real estate business to handle, by competing real estate brokers, and they didn't say, "Jones is handling this well and I wouldn't think of interfering because it would hurt our profession by him having me barge

in".

I never heard that in the real estate business; whether it was small business or large, the competition was very keen.

Mr. Dean: If you are the executor of an estate, and you have a large block of securities to sell, I can assure you that every single investment banker in the country, practically, will call you up about it.

Chairman Frank: By the way, before we have finished with this session, we would like to have you address yourself to the sale of portfolio securities, because that does not involve questions of fixing up trust indentures and the like.

Mr. Stewart: And I can say this about the investment banking business, that I had a good many years in the selling end of the investment banking business. I found it one of the most highly competitive of all businesses.

Chairman Frank: But surely that has nothing to do with our subject today.

Mr. Stewart: I think it has.

Chairman Frank: Let me understand this. What we are talking about is whether there is competition between investment bankers trying to procure issues which they can sell. Now, that once they have procured the issue, and then go out to sell it, they find themselves in competition, they or their retailers find themselves in competition with

others who are also endeavoring to go to the ultimate consumer, is of course an interesting subject, but I don't think it will be very fruitful for purposes of our inquiry. The question is whether at this particular point at which this proposed rule is directed, which has nothing to do with the sale to the ultimate consumer, but whether there should be competition and whether there is competition today, and whether there should be and whether the competitive bidding rule is the way to procure it; and whether there should be and is competition in the procurement of the business of the issuer.

Now, the fact that there is competition at a later point has no bearing on that subject, and while I always like to hear whatever you have to say on anything, because it is informative, maybe my colleague care to hear from you on that subject, but I personally don't think it is germane, and we have so much to do I would rather not hear about it.

Mr. Stewart: I had only a very brief statement to make, and it was that a man who is accustomed to be actively in competition is not likely to change his spots or to change his character merely because he moves his desk.

Chairman Frank: We needn't discuss it a priori, about what he is likely to do. The question is--is there today competition between investment bankers for issues or is there not? Now that there is likely to be, it might be interesting

if we couldn't get at the facts, but there is such competition.

Mr. Stewart: Well, there are men who are competitive in nature, and employ all the devices of competition to the best of their ability. It happens to be my job--

Chairman Frank (interposing): I will ask you the direct question. If Morgan, Stanley & Company have an account that they have done business with in a certain enterprise, or if Dillon Read has, if they have a company whose bonds they have disposed of, do you call upon that issuer and endeavor, without first consulting Dillon Read, to get that business?

Mr. Stewart: I have never consulted any one as to what I should do in endeavoring to get business.

Chairman Frank: Do you do that?

Mr. Stewart: I do my best to get business.

Chairman Frank: You go to the issuer and say, "We think we can do the job better than Dillon Read"?

Mr. Stewart: I don't think that would be an effective technique.

Chairman Frank: Have you tried it?

Mr. Stewart: I have tried it in other activities. In selling bonds, for example, I never found that it helped me at all to say, to go to any one and say, "We can do a better job".

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Chairman Frank: Have you ever approached the issuer, where Dillon Read has theretofore handled the account of an issuer, and tried to get the business away by any gentlemanly means or any other appropriate means?

Mr. Stewart: It has been my business to do that.

Chairman Frank: And you do that regularly?

Mr. Stewart: To the best of my ability, when I am not down here before the Commission on the securities law. As a matter of fact, that is true.

Chairman Frank: Then your process is different from Mr. Stanley's. As I understand it, he wouldn't do it, he would not try to get an issue away from you if he thought you were doing the business satisfactorily.

Mr. Stewart: That is what he said this morning, yes.

Chairman Frank: Do you doubt it?

Mr. Stewart: If you will forgive me, I would like to say that he reserved to himself the right to judge whether or not we were doing the business satisfactorily.

Chairman Frank: Oh, yes.

Mr. Stewart: I don't wish to push that point too much, sir.

There is one other aspect of competition in investment banking we referred yesterday. I haven't finished reading Professor Fetter's statement, but I think you understand what it is.

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I might say that I have some specific examples of changes in business which I will introduce in a few minutes if I may.

I would like to refer again to the competition in private placements because I think that is an important matter to consider here because it does directly relate to the contention of the staff that there is banker domination of utility issues. We say that it is established beyond any question that no such domination exists.

I assure you that any of us who could get an issue away on reasonable terms from an insurance company or a group of insurance companies which was attempting to make a direct purchase would most certainly do so.

The private placement trouble has been one of the troubles of which we have been most acutely conscious for these last several years. Mr. Ecker, in his testimony yesterday, said that there was no banker domination of the issuers who securities they had purchased, and the record of the staff shows, I think, that more than a billion dollars of public utility securities were so purchased in the last period of four or five years, - I forget the precise length of time.

We have ourselves compiled a record of 502 issuers. It is true they are not all utilities, although the bulk of them are, utility issuers. They account for something in excess of \$4,000,000,000 of securities.

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So that in the utility field, and outside the utility field, issuers apparently are wholly free to choose whatever means they wish to select for the placement of their securities. Our records show 502 issuers.

Yesterday, Mr. Howard Sachs spoke about the competition of the market. We wish particularly to emphasize the reality of that competition. It may well be, and it perhaps is true, that prior to 1933 there were evils in the business which required the attention of Congress, and which needed to be remedied.

We contend that they have been remedied.

Chairman Frank: When was the Trust Indenture Act?

Mr. Stewart: According to my memory, 1939, but the Public Utility Holding Company Act in 1935, and the administration of the Public Utility Holding Company Act has been under your control since then. We think that with the great mass of information which is available to the public now, with the great control which this Commission exercises under the Act of 1935, and the disclosure requirement both in the 1933 Act and in the Trust Indenture Act, that there is no possibility for evils which could be injurious to the public to exist.

That being so, we think that the conditions which may have existed prior to passage of these Acts have no bearing upon the situation as it exists today.

The competition of the markets by the way, to quote

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Professor Fetter, again, he says:

"Market-competition is a peaceful and constructive process of rivalry in efficient production and service; and it is neither an immense legalized gamble for capital prizes for the strong and successful few, nor a duel to the death for the unsuccessful many."

The record which we have, of competitive bidding to date, show that it operates in securities to bring the bulk of the business to the highly successful few.

So, Gentlemen of the Commission, in the paper of the staff reference is made to what is called "propriety rights", and that is quoted on several occasions in the staff report.

I think it only proper to say that the use of that term apparently originated in Boston. It is reported at 11865 of the testimony by Mr. Chapin of Kidder, Peabody & Company. But the staff did not say in their report that Mr. Gordon of Kidder, Peabody & Company, also in the report at page 11943, denied any knowledge whatever of the use of that term, or of the existence of the paper therein referred to.

I can, at page 11875 of the proceedings of the Temporary National Economic Committee, Mr. Whitney, who was then appearing, said:

"If I may be permitted, I should like to say a word on that 'proprietary interests'. That memorandum does not speak

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of proprietary interests, it speaks of original terms. I was very glad to learn a few minutes ago where the word started because I had never heard of it used before until the other day."

To the best of my knowledge, no one in the investment banking business had ever heard of it until it appeared before the Temporary National Economic Committee, and I wish to say very clearly that I have been unable to find, anywhere in my experience, any use of the term or any belief on the part of those concerned that such things as "proprietary rights" existed. I think it is a term that we could drop because it does not relate to reality, in our judgment. It appears so many times in the staff report that we thought it necessary to make mention of it.

Incidentally, the staff report refers to 29 contracts, and again I would like to point out that those 29 contracts -- all have somewhat ancient history, but no one of them relates to any of the leading underwriters whose leadership or business was under consideration in the staff report.

As a matter of fact, I have an abstract of the 29 documents here, and as we say, eight of them were, I think, Halsey Stuart contracts which had been cancelled before the date of the staff report, and others were contracts with the Federal Securities Corporation which was not in existence and hadn't been for a good many years.

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It does seem to us that to turn back to that history to prove a case against investment banking isn't really very sound proceeding.

Mr. Weiner: May I interrupt to ask Mr. Stewart one question?

Chairman Frank: Yes.

Mr. Weiner: In referring to the TNEC testimony and the use of the term of "proprietary interest", I want to ask you whether you noted this passage. Mr. Henderson was examining or asking some questions of Mr. Chapin, who was a partner of the old firm of Kidder, Peabody & Company, and at page 11865 there is this inquiry:

"Mr. Henderson: Was it customary to refer to these percentage participations as 'proprietary interests'?"

"Mr. Chapin: Yes."

Mr. Stewart: I noticed that you quoted that, referred to it directly in the report, yes. I think that it is perhaps a fact ---

Mr. Dean: (Interposing) May I say something there as counsel for Kidder, Peabody & Company. I have been counsel for that firm since 1931, and the first time I heard the word used was the time that a man from the TNEC got those papers out of Mr. Robert Windsor's files. I never had heard the term used in the firm of Kidder, Peabody until the TNEC testimony.

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Mr. Weiner: Of course no member of the staff, Mr. Dean, ever heard those terms used directly by participating investment banking houses, but so far as I understood Mr. Stewart's statement, the impression was that this was a term which was created by somebody outside of the business, and then sort of foisted upon the people in the business. And apparently, from Mr. Chapin's testimony, he recognized it as a term that the people in the business had used during that time. I don't know to what extent it was used, but it pretty evidently was current in the business.

Chairman Frank: Let the record note that Mr. Dean never heard anybody in that firm use the term, and that therefore he apparently thinks that Mr. Chapin, who was his client ^{is} or his client, is in error.

Mr. Dean: No, Mr. Chairman. Those agreements were very peculiar agreements. They related to the financing of the American Telephone & Telegraph, and they were two separate syndicate agreements. In those old agreements, the firm of Kidder, Peabody & Company syndicated approximately 30 percent of each issue, separate and apart from the syndication of J. P. Morgan & Company. At that time -- I think it is unique so far as I know -- Kidder, Peabody & Company had a separate syndicate and marketed their securities completely separate and apart from J. P. Morgan & Company. J. P. Morgan & Company took down their securities and marketed their securi-

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ties separate and apart from Kidder Peabody.

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In order to distinguish the interests of Kidder Peabody and of J. P. Morgan & Company from the other members in the group, Boston counsel called the people who had 30 percent participation and the 70 percent participation the "proprietors", and therefore they referred to it as a "proprietary interest".

But I think it was a purely technical drafting term, I don't think it was ever actually used in the business.

Mr. Stewart: It seems to have been a strange misuse of English.

Chairman Frank: I have been accustomed to think of New England as a well of pure English undefiled, but being a mere westerner, I probably make undue obeisance as to New England.

I do want to say that I think Mr. Weiner has correctly quoted from the testimony, that Mr. Chapin was asked if it was customary to refer to these percentage participations as "proprietary interests", and Mr. Chapin said yes. And the photostat of the agreement called to the attention of the witness expressly uses the term "American Telephone proprietary interests".

Mr. Stewart: I don't wish to say that the staff invented the term, and if I created that impression I am sorry. I wished to say that they made a discovery and treated it as a very happy discovery, and employed the term very frequently there-

after, although Mr. Gordon denied any knowledge of it. Mr.
Chapin at the time was a partner in Kidder Peabody.

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Chairman Frank: The document itself uses that term.

Mr. Stewart: It was a private document, and it became a part of the file. I merely wish to say that it is not a term in use in the business, not a term that any one uses, it is not a claim that any one in underwriting makes, and I think therefore that perhaps it should not be used to refer to the existing transactions in business.

Chairman Frank: Well, it is obvious that you don't like the term?

Mr. Stewart: That is right, sir.

Now, without belaboring the point of the 29 contracts, I should particularly like to call attention to the fact that most of them, or many of them, let me say, the majority, had no relation whatever to utility financing. Many of them were corporate ones. There are some which relate to utility financing, but they are certainly not the majority.

Now, as to instances of corporations changing over, I call your attention to our report, our brief, at pages 9 and 10, where we cite certain examples. We say that the records of recent periods provide important illustrations of issuers who, for one reason or another, have terminated their underwriting agreements and taken their business to other underwriters. Among these corporations, as mentioned by us, are Bethlehem Steel Corporation, Shell Union Oil Corporation, and the Republic Steel Corporation.

Among the public utilities, there is the Pacific Gas & Electric Company, Commonwealth Edison Company, the Public Service Company of Northern Illinois, and various subsidiaries of the Middlewest Corporation.

I might add one small example from our own experience, the Lockhart Power Company. I believe that the financing of the Lockhart Power Company at one time was done by the Chase, Harris, Forbes, or by Harris Forbes, I am not sure which. None the less, we in my own firm did handle an issue of their bonds not very long ago, in 1935 or 1936; but quite recently, much against our will, the business was taken away from us by another house which acted as agent for an insurance company, and placed the issue privately. We regretted losing the business, but I mention it as an additional illustration of the fact that competition is always at work in the business,

The statistics placed in the record of the T.W.E.C. by Professor Altman, which appear in the staff report at page 10, are very interesting and I wouldn't for a moment dispute their mathematical accuracy. They point out that six of the leading firms managed, I think the figure is 62 per cent, of all registered managed bond issues.

In compiling those statistics Dr. Altman, of course, used his own formula. He decided that if there was a joint management, half the issue was managed by one house, and the other half was managed by another house, as if two people were

attempting to drive a car at the same time or a team of horses--an impossibility in real life, but it may serve for statistical purposes.

The point is, however, that if one applies Dr. Altman's statistics to the few public utility issues which have been sold by compulsory competitive bidding, one finds that 94 per cent of them are managed by a few large underwriters.

Now, if we turn from that field to the field of equipment trust financing, or municipal financing, we find an even greater degree of concentration existing.

I would like to point out that while 62 per cent of these issues may have been managed by the large firms named, the fact is that hundreds of underwriters participated in that business, and that fact is, I think, not being sufficiently brought to your attention by the staff, nor has the staff report brought out the more important fact that in current practice some 40 to 50 per cent at least in principal amount of all these securities, so managed, are distributed among selling groups throughout the country.

Chairman Frank: What is the bearing of that on the question of competition for the issues themselves? In other words, if a house gets an issue, it then uses a large number of persons for public distribution, but that has nothing to do with whether there is competition between the underwriters for the business of the issuer, has it?

Mr. Stewart: This section of the staff report seems to have been very largely concerned with the whole general practice of underwriting. That being so, it seemed necessary to address attention to it in that respect.

Mr. Weiner: I just wasn't aware that it was so concerned with the general question.

Chairman Frank: Nor was I, and if it was, I should say that as far as I am concerned, if it comes to action on the question of whether or not to adopt the rule, I would ignore that part of it because it would seem to me to be totally irrelevant.

Mr. Stewart: Well, I think I share that view, Mr. Chairman, and I think it is unfortunate that the staff introduced the subject in the report.

Chairman Frank: The subject that you were going to address yourself to was whether there was competition between underwriters for the business of issuers. Now, what happens after an underwriter obtains the issue, and wants to distribute it, doesn't seem to me to be relevant as bearing on that question.

Mr. Weiner: Might I say, Mr. Chairman, that we have had numerous intimations about what was introduced in this report, and in the subject matter. I would appreciate it if Mr. Stewart would point out just what portion of the report he is referring to.

Mr. Stewart: Well, I am referring at the moment to the figures given by Dr. Altman which appear in your report at pages 9 and 10.

Mr. Weiner: I thought you were criticizing those figures for not having brought in the question of how many underwriters and dealers participated in the actual distribution, rather than for any failure to limit the discussion of the origination or management of issues?

Mr. Stewart: Are you limiting your attention solely to the management of issues?

Mr. Weiner: On the question of whether there is competition, very definitely.

Mr. Stewart: I would say that there is probably nothing in the Act, and there is certainly nothing in the maintenance of competitive conditions--I have said before that there is competition between underwriters--but aside from that, I would say the maintenance of competitive conditions does not mean in the Act that there must be warlike competition between underwriters themselves.

Chairman Frank: Unquestionably it might be a matter of concern to us if there were lack of competition in the distribution end of the business. Obviously, that could not be affected by a competitive bidding rule. Therefore, ^{even} /if there were such a lack of competition--and I don't think there is-- it wouldn't be germane to our discussion today.

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Let's confine ourselves to the question of whether there is or is not competition between underwriters for issues, and not as to the distribution, because that seems to me to be irrelevant, and I didn't think the staff discussed it, and if they did, as I say, as far as I am concerned, it seems to me it oughtn't to be in the report.

Mr. Stewart: I am glad you mentioned that, Mr. Chairman, because it brings to mind a subject I meant to speak of. The title of the report says that it relates to the problem of arm's-length bargaining and maintenance of competitive conditions in the sale and distribution of securities. I was wondering what the word "distribution" in the title meant.

Mr. Weiner: You have several situations here. We have both the sale of the portfolio securities by the same jobber, as distributor; we have the original issues which we, for convenience, call "sale".

Now, the whole function is selling and distribution, but no one could read the report without seeing that the points that were here made with respect to the bigger problem that was posed, namely, Rule U-12F-2, and possible substitutes for it, had to deal with the people who did the bargaining.

Now, so far as the bargaining is concerned, that is done, as we understand it--we haven't heard anything yet to the contrary--directly with the originating underwriter,

and perhaps a few of his associated underwriters, and it is at that end of the business, that is, the question of who can go and deal with the issuer for an original issue, to which this report is solely directed, as to that phase of the transaction.

Chairman Frank: I think, Mr. Stewart, you will acknowledge that we have been pretty patient with you.

Mr. Stewart: Very.

Chairman Frank: And we want to get through with all the persons present here today if we can, and I wish, therefore, as a favor to us, you would confine your discussion to what seems to us to be germane.

Mr. Stewart: I have been attempting to do that, and I am sorry if I wandered afield. I think perhaps if I paused at this point and allowed some of those in the room who themselves have made efforts to get other business, to say so, it might help facilitate matters.

If it please you, I will do that.

Is there any one here who wishes to take the floor on this matter? Would you, Mr. Stanley?

Mr. Stanley: I will be glad to, but I would rather continue until I finish, when I start. Is this on just one point?

Mr. Stewart: I will have finished what I have here in a very few minutes, if you wish me to go ahead, and I think

that point can then be taken up.

Chairman Frank: Very well.

Mr. Stewart: I have certain figures here on municipal issues which I think have a bearing from the standpoint of what competitive bidding does, and I think for that reason they are definitely germane to the point, to the subject.

We rather hurriedly compiled certain statistics here which show that over 40 per cent of all municipal financing in the last six years has been handled by ten of the leading underwriters of municipal securities. That includes, of course, banks as well as dealer houses.

I call your attention also to the figures which we included in the Harriman Ripley booklet on this subject, which show the high degree of concentration which takes place in municipal issues.

Mr. Fournier: Are you now referring to the management of the issues?

Mr. Stewart: Yes, definitely to the management of the issues.

We show in this booklet at page 21 of the booklet, that about 35 per cent of the total principal amount of new municipal issues represented business transacted by only 16 of the largest dealers in the country. That is a high degree of concentration, and that is the way in which competitive bidding works in that field. That is at page 21 of the printed book.

I will also call your attention to the fact which was brought out at page 9 of the booklet, that of 6,374 issues of long-term serial state or municipal bonds offered in 1936, only 176 issues, or 3 per cent of the total number, had a principal amount of \$1,000,000 or more. Now, these small issues were, of course, taken up by dealers in the local community, and when consideration is given to that fact, it seems to me the degree of concentration in the municipal business, which operates under competitive bidding, is much greater than the bare statistics which I have just given you, show.

In the railroad equipment trust field, we find an even greater degree of concentration. I have gone through our records which we compiled with great effort, covering the last period of years. They are incomplete for 1934, but are complete from 1935 up to the end of 1940.

We find that of the total \$629,838,000 principal amount of railroad equipment trust certificates, 74 per cent, or \$466,513,000 was handled by six firms. That is 74 per cent of the total.

But more alarming still, from the standpoint of what it may mean if competitive bidding is required for public utility issues, is the fact that 42 per cent of that total was handled by one firm. So that we think we are right in saying that if there is, under existing practice, an undue amount of concentration in the handling of public utility securities, there is

likely to be a vastly greater degree of concentration in the handling of that business if you leave it to the devices of competitive bidding.

I am very grateful to you for your patience, Mr. Chairman.

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Harry L. Stewart

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Chairman Frank: I was wondering whether we could get a little relief from the tedious monotony of agreement, by having Mr. Harry Stuart - since this might be "Stuart Hour"- now give us his views on the subject.

STATEMENT OF HARRY L. STUART
of
Halsey, Stuart & Company

Mr. Stuart: Mr. Chairman, I came down here really as an observer, to see if I could learn anything new on the subject, and thus far it has been a total loss.

I am very pleased to see that the Chairman of the Commission has a very keen sense of an organization that apparently has been built up to keep things as they are and make no change.

I have been in the business a great many years, and I have learned something new today, which was the great love of the big issuing house for the small dealer. I never knew that existed before, and it doesn't really exist in any event.

The small dealer is useful to the big house only as a means of assisting it to distribute securities. That is inherent in the business, it is bound to remain so.

I am a believer in competitive bidding. I think the only way to break up the so-called proprietary interest in securities is in competitive bidding. I think that it will work exactly as the equipment trust competitive bidding worked; when that started in 1925 or 1926, there were very few

bidders for equipment trust certificates. For one reason or another, they didn't want to bid. Now they are very freely sold and there are very many people who participate in equipment trust issues.

As to the small dealer, I thoroughly sympathize with the small dealer's position. My own firm's desire and intent has always been to play with the small dealer, but in recent years, in trying to organize syndicates to bid, where we have had an opportunity or where we have sought to have an opportunity to bid, we have had great trouble in getting the small dealers to participate. For one reason or another they have declined. They give various reasons, but they do not participate, and we have had, even a year ago, for instance, in connection with the \$16,000,000 Chicago Union Depot bonds that were brought out - we had very great difficulty in organizing a syndicate of small dealers to bid. Some of them gave the reason that they would be shut out of New York syndicates if they attempted to put in a bid. So we did bid and had to take about half of them for ourselves in order to make it possible. I think the thing will work.

Now then, there is another angle to it that also concerns the small dealer, and that is that the issues that have been brought out mostly to date are large issues simply because they are a consolidation of many issues that were put out before, and all refunded at one time.

Now one day that will be over, all those big issues will have been refunded or re-refunded, and new capital will be, as it has been in the past, of relatively small amounts.

Under those conditions, I think you will find a great many bids for the small issues that come out.

As to the competition with insurance companies, I am pleased that the form of the staff's suggestion of an order is that there won't be any private sales, that private sales will be stopped and dealers will have a chance to compete for it all. I think that gives all of us a chance at the bonds that are now going at private sale, and which we couldn't hope to have a chance at.

Now as to real competition between the ultimate consumer, the insurance company or other big aggregate of funds, and the dealer who has to work on a profit in order to live, we are absolutely on our own then. If the insurance companies and other big aggregates of funds are aggressive, and decide they want to buy, and they have the money to do it, that is just too bad for the rest of us who are in business and have to make a profit.

Now in that connection, I have heard a good deal of talk today about the fact that you didn't have private sales before the passage of the Securities Act, and the intimation seemed to me to be that it was a result of something in the Act, that that was the reason why private sales took place.

Nothing could be further from the truth. It is simply an economic matter. The truth is that the insurance companies who used to buy large mortgages and railroad bonds quit buying mortgages, partly because the Government went into the mortgage business. They quit buying railroad bonds because they had such a large number of defaults.

There were two fields open, - one was industrial securities, and the other was public utilities.

The pressure of money forced them to get that money working. So it is entirely an economic matter, and not at all a legal matter, and has nothing to do with the passage of the Act, and if there had been no such thing as the Securities Commission, and economic conditions had been as they are, the same thing, in my opinion, would have resulted.

I think those are all the observations that I would like to make, Mr. Chairman.

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Mr. Dean: Could I ask Mr. Stuart one or two questions?

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Chairman Frank: Yes.

Mr. Dean: Mr. Stuart, on the average how many people participate in bidding for equipment trust issues?

Mr. Stuart: I can't answer that, I am sorry.

Mr. Dean: In your opinion, have the protective provisions of the agreements under which equipment trust certificates are issued deteriorated under competitive bidding?

Mr. Stuart: No.

Mr. Dean: Are you aware that in recent issues the covenants requiring lessees to acquire additional equipment or to make other adjustments to maintain the agreed ratio between the cost and the equipment certificates, if the original estimate of costs proves too high, have been omitted?

Mr. Stuart: Yes, that is true, but that has nothing to do with your question. Your question is - Have they deteriorated? The test is - Are they paying, not what was in the agreement, but are they paying?

Mr. Dean: Well, the ones that have recently been issued serially are paying, but we don't know about the ones outstanding.

Are you aware that the covenant requiring that lost, worn out or destroyed equipment should be replaced by new equipment has been omitted in several issues recently?

Mr. Stuart: The answer to me would be - Are they any good?

Mr. Dean: Are you aware that in cases where the value of the equipment is concentrated in a few items of specialized equipment, such as Diesel streamlined trains, insurance covenants have been omitted, with one or two exceptions?

Mr. Stuart: No, I am not.

Mr. Dean: Are you aware that the release provisions which might disqualify certificates as legal investments for trusts and savings banks under such statutes as those in Massachusetts have been become very common?

Mr. Stuart: Well, there is a good, big market for them.

Mr. Dean: Are you aware that covenants permitting the investment in securities of the cash deposited in lieu of lost, destroyed or released equipment, have appeared in several recent equipment certificates?

Mr. Stuart: I am afraid you are asking me a lot of questions that I might be able to answer as a lawyer, that I do not know as a layman. I do know that they have been successful, and so far they have been paid.

Mr. Dean: There was one recent issue, was there not, where there was a defect in the security, and after the issue was offered it had to be withdrawn?

Mr. Stuart: I am not familiar with that.

Chairman Frank: Mr. Dean, has that never occurred with respect to securities of industrials, where there was no competitive bidding?

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Mr. Dean: I am not aware; I am may be wrong, but I am not aware of any situation where there has been such a defect in the issue that it had to be withdrawn.

Chairman Frank: I think we had a case here - I don't know whether your firm was in or not - where an issue was completely divergent from the selling literature that the company -- this was a utility issue -- felt it incumbent upon itself to, as a moral obligation, take over the offering that had been advertised, and that prior to the Securities Act, I may say. That came before us. I remember now that it was a Columbia Gas subsidiary. I am not sure whether Columbia Gas owned it at the time the issue was put out.

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I can name one - but I won't - of a conspicuously large issue put out around 1929 or 1930 by one of our major underwriting houses, in which the indenture was at variance with the selling literature. A law suit ensued, and thereupon the indenture was amended.

I mean I don't think that is idiosyncratic with respect to equipment trust certificates.

Mr. Dean: I was simply trying to point out, Mr. Chairman, that it would seem to us that this is occurring with marked frequency in these equipment trust certificates.

Chairman Frank: Are you prepared to say it is more frequent? I am speaking of the last point you made.

Mr. Dean: I know of two instances where there are been

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very marked effects. In the Pennsylvania Railroad equipment issue, their attention was called about fifteen minutes before it was let to a very serious defect.

In the recent Chicago, Burlington and Quincy financing, the railroad was supposed to turn in certain axles, and they had completely forgotten about the "after acquired property" clause in their general mortgage.

Mr. Weiner: Mr. Chairman, might I make an observation at this point? We have heard, although we have not been directly concerned with it, this comment about the deterioration of equipment trusts. From time to time we have asked various persons who have made that statement if they would be good enough to furnish an analysis of that fact. We have never received one. We have had the same point brought up, as I recall it, at a conference we had last May with the NASD, but no one --

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Chairman Frank: (Interposing) As I recall that conference last May, we were told that we would be given, in a short time, a study on the subject, and that has never been received.

Mr. Weiner: I might also add that since these are, as we understand them to be, regulated securities, we are a little astonished that they are becoming notoriously bad, as this description of them would seem to indicate.

Chairman Frank: Does the Interstate Commerce Commission have power to determine the characteristics of the instruments securing, or pursuant to which the equipment trusts are issued?

Mr. Dean: That is my understanding. I wouldn't want to make that statement specific, because I haven't looked at that.

Mr. Howard: I am from the Interstate Commerce Commission, I am Assistant Chief of the Bureau of Securities. I don't want to testify except to straighten this record out, and state that the Commission passes on nothing, and the law gives them no authority except over the issuance of securities.

Chairman Frank: You have no --

Mr. Howard: (Interposing) Authority on mortgages whatsoever.

Chairman Frank: It is scarcely a comparable situation, then, Mr. Dean, since so far as utility issues are concerned

this Commission would have jurisdiction as to all cognate questions, would it not?

Mr. Dean: Yes, sir; you have a right to pass upon the entire terms and provisions of all indentures.

Chairman Frank: And is it not true from your own knowledge and experience, Mr. Dean, that the Commission on frequent occasions has insisted upon provisions, both with respect to the trustee and the character and the percentage and the ratio of bonds to stocks, and the like, has insisted upon conditions protecting the investor that were far stricter than the investment banker had required?

Mr. Dean: Yes, sir; but may I say this on that point. I believe that the work of the Commission in that field is very helpful and very desirable. When the situation is put up to the Commission, however, I think that this much must be said, that the issuer and his counsel have very often spent a great many months with underwriters and their counsel in working out the terms and provisions of the issue.

Now it is quite possible that the provision with respect to maintenance, and the provision with respect to depreciation, or the covenant with respect to the amount of dividends which can be paid, is not, in the opinion of the Commission, sufficiently strict.

Commissioner Healy: Insert the bondability of additions from depreciation.

Mr. Dean: Yes, sir.

I believe that the work of the Commission along those lines is excellent. On the other hand, I think the Chairman will agree with me that within certain areas, that falls within the realm of judgment.

Chairman Frank: Yes, but if anything comparable to what you pointed out concerning equipment trusts were to appear in an issue of utilities coming before this Commission, I can assure you that the appropriate provisions would be contained therein, and my point is that we have exacted higher standards than the investment bankers have thought necessary in many instances, and to their great annoyance.

The criticism of this Commission has not been that it has been too lax. We have been charged with usurping authority because we have asserted that the conditions weren't adequate. And here the suggestion is made that a deterioration - that must be the import of your remarks - will take place if there is competitive bidding.

I can't follow it, because the same standards will be required by this Commission that have been required in negotiated issues, and if we have found it necessary to jack up the conditions that bankers have required in the case of negotiated issues, why should we suddenly blind ourselves to defects, as you assume we would, if the issues were sold through competitive bidding?

Mr. Dean: If the investment bankers were to accept the report of the staff in toto, - let's assume for argument that they would, - then if I understand the report of the staff, the investment banker would be under no duty whatsoever, in setting up the covenants, and as a matter of fact the investment banker would be insulated from the issuer, and all of the professional work in connection with the setting up of indentures and security terms should be done by an independent professional group retained by the issuer for that purpose.

The investment bankers then would be solely in the position of bidding for the securities competitively, and selling them after the Commission had set up the terms and conditions of the issuer. The investment banker then would have absolutely nothing to do, under those circumstances, or rather, it would seem that he would have absolutely no responsibility with respect to what happened to those securities subsequently.

Mr. Weiner: Mr. Chairman, might I say that I think that is a misconstruction of the report. There is nothing in the report to prevent - in fact, I don't know why it shouldn't be encouraged - that persons who assist in setting up the securities might well be investment bankers who themselves anticipate that they will bid and hope to get and sell to their own clients the securities that are so set up.

The difference between that situation and the one that largely prevails today is that no one else gets an opportunity

to approach those securities. It is the same distinction that I believe was made in connection with the engineer who might well design the plant, and then be one of a number of people who were given an opportunity to bid upon the construction.

Mr. Dean: Suppose you had to have 25 or 35 engineering firms coming in and going over your data in order to help them design the plant?

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Chairman Frank: Where is the suggestion made that 25 or 30 persons should come in and look at the specifications?

Mr. Dean: How are you going to come in and familiarize yourself with all of the past capital structure of the issuer, read all of the past indentures of the issuer, read all the material contracts of the issuer, read all of the franchises, familiarize yourself with its territory, its working capital position, make the investigation required by both the common law and Section 11, unless you are prepared to bid? You are either going to make no investigation at all, and have a very small amount of capital, I should think, so that you hope to be able to stay in business and hope that the work of the Commission and the registration division under the 1933 Act was such that you wouldn't get caught, or otherwise, you would have to make the investigation yourself; or, as an alternative, you would have to give up your buying staff entirely, in order to be able to sell the issues on a much narrower spread, not have any overhead, and transfer all of the professional work now done by the buying departments of the underwriters to these new professional firms who would be retained by the issuers.

Chairman Frank: Well, everything that you say isn't germane to the remark I am about to make. I am amazed that securities sold through competitive bidding in New England have found a market, because you made it appear as if it were virtually impossible to do that business.

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Mr. Dean: In every one of those cases, Mr. Chairman, the issuer has asked some one investment banker to work with him at great length.

Chairman Frank: That is exactly what the statute contemplates may happen here.

Mr. Dean: Yes, but bear in mind that the entire work of the buying departments of these investment bankers today is paid for in very large part out of their negotiated issues.

Chairman Frank: I wasn't referring to that part of your remarks, I was referring to the part of your remarks that indicated that it would be almost an impossible task for an issuer to get an issue set up for competitive bidding purposes and sell it. I am not now talking of the difficulties that you anticipate would ensue to the investment banker, I am talking from the issuer's point of view.

Now, if it is going to be so difficult, then I just don't understand how the numerous issues listed in the staff report, sold through leading investment bankers, many of whom are here today, could have been sold, because according to you if the State of Massachusetts were today proposing competitive bidding you would be appearing before its appropriate legislative committee and saying, "You just can't do this, because if you do it is going to be impossible to sell these issues". Well, they have been sold, gentlemen in this room have sold them, and some of them have amounted to millions of dollars -- and that,

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since the enactment of the Securities Act of 1933. So it can't be just such an impossible undertaking as your remarks would indicate.

Mr. Dean: In those cases, and I have worked on a number of those issues, one house has been called in and has done a major portion of the work. In some of the cases I am informed, -- I don't know this on my personal knowledge -- people have bid upon those issues who have not spent a half an hour conferring with the officers and directors of the issuer. How they can sustain the reasonableness of their investigation under the Securities Act of 1933, I don't know.

Chairman Frank: Well, the staff report indicates that they are rather responsive houses ---

Mr. Dean: (Interposing) A jocose remark was made to me by one underwriter that inasmuch as he knew the extent to which another underwriter had been in there, and the great lengths to which he had gone; and inasmuch as he knew that a very responsible law firm in Boston had been over the registration statement, that they really didn't think that they were taking any risk.

But supposing that that didn't happen. An underwriter can afford to risk the time of several people in his buying department for a period of five or six weeks if they have had such a past connection with that particular issuer that they reasonably sure, because of their market and their connections

with it, that they probably can bid the highest price and get it. But that is not necessarily true if you had universal competitive bidding, and it would seem to me that inevitably your particular investigations would have to decline, or you would have to give your staffs completely in order to take up these narrower spreads.

In the Otis & Company booklet, the statement is made that First Boston in the Boston-Edison issue accepted the papers of the company without change. Permit me to say that in 1934 the First Boston Corporation and their counsel --of which at that time I happened to one-- spent a period of three or four months completely revising trust agreements and indentures of the Edison Electric Illuminating Company, and spent several months on the registration statement. Since that time, unfortunately for me, the matter has been entirely carried on by Boston counsel.

But in the last issue, several people from the First Boston Corporation spent a period of four or five weeks working with the Edison Illuminating Company on that statement.

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Mr. Ford: To divert attention from Mr. Dean's loss of employment, might it be pertinent if I place in the record here portions of a letter from counsel of the Boston Edison Company, written on this subject. This is a letter written by counsel for the Boston Edison Company under date of January 3, 1941.

(At this point Mr. Ford read excerpts from the letter above referred to.)

Mr. Weiner: May we have that letter in the record?

Mr. Ford: Yes.

(The letter referred to will be found at the conclusion of the testimony on Wednesday, January 29, 1941.)

Chairman Frank: Mr. Ford, I think the Boston Edison issue was not an issue that came under the 1935 Act?

Mr. Ford: Correct.

Chairman Frank: Consequently, there is a very substantial difference, isn't there? In other words, where an issue - and that is the only issue we are talking about today - comes under the 1935 Act, then the Commission has given permission to issue the securities, and that means, in fact, leaving out the law, in fact it means, and you well know that to be true, that the Commission has gone over the documents on hands and feet, it has crawled all over those instruments, and it has looked at them through a magnifying glass.

I know that you must have a considerable sense of

assurance, when our staff has gone over an issue, that it is likely to be a pretty good issue, if it is a utility issue. Whereas, the Boston Edison issue was something we had nothing to do with, and we simply looked at it under the Securities Act to see that the truth had been told; but whether the issue is one that measures up, from the point of view of security values and the like, we had nothing to do with that; isn't that correct?

Mr. Ford: That is quite true. My firm has the greatest respect for you and your staff. Nevertheless, the fact remains that there is a connection between the two, because underwriters are subject to Sections 11 and 12, and it is against those liabilities that my firm, at least, feels it must protect itself.

Chairman Frank: But your firm has dealt in New England issues since 1933, and so have most of the responsible houses. They run up to a good many millions of dollars, and it is strange the trepidation about the effect of the 1933 Act on competitive bidding should suddenly arise at this moment when, for six years, nothing has been said about it.

Mr. Ford: I think you will find, Mr. Chairman, that the issues which were mentioned are issues of companies with which we have been connected for a great many years, and in most cases - and I think in all, as Mr. Dean has already said - we set those issues up ourselves in the same way we

would have done if they had been negotiated issues, the only difference being, from the procedure proposed here, that we were not paid for them.

Chairman Frank: I don't suppose you would object to that.

Mr. Ford: We are always glad to work in the public interest.

Chairman Frank: I meant, I didn't suppose you would object to getting paid.

Mr. Ford: No, not at all.

Mr. Bollard: May I speak to this point, for a moment?

Chairman Frank: Yes.

STATEMENT OF R. H. BOLLARD
of
Dillon Read & Company

Mr. Bollard: We happen to have been the investment banking firm which bought one of the 16 issues to which reference has been made, a \$15,000,000 issue of the Potomac Electric Power Company.

Now that is the only issue of these 16 for which we made a bid, and the only reason we made it there was that we were thoroughly familiar with the Potomac Electric property. We had, previous to making that bid, sent a staff down to the Washington offices of the company, we had employed engineers who had gone over that property and made a report to us, and we felt thoroughly competent to bid for that issue in the same

way as if it had been a negotiated issue from the standpoint of our complete investigation and familiarity with it.

Chairman Frank: Was there anybody else that bid for that issue?

Mr. Bollard: I don't recall whether there was.

Chairman Frank: Mr. Fournier, do you know who else bid for that issue?

Mr. Fournier: Yes, sir. On the PEPCO issue that came out in June of 1936, if I remember right, on page C-32 of the report, it shows that the bidders were headed by the following firms: Dillon Read & Company were the successful bidders; Blythe & Company, Inc.; Kidder, Peabody & Co.; and Brown, Harriman & Co.

Mr. Bollard: I would like to make this point, Mr. Frank, that the staff has compiled figures here on 16 competitive issues which I suppose comprise the entire amount for the 5-year period. The aggregate to which you referred as running into many millions of dollars, is \$133,000,000, and five of those issues constitute \$103,000,000. In other words, there were five issues for \$103,000,000, and there were 11 issues for an aggregate of \$28,000,000.

Chairman Frank: The only purpose in making the reference was to indicate, not that there had been a large volume as compared with what there would be if this rule were going into effect, but to show that a very ponderable amount of

bonds had been issued through competitive bidding that have qualified under the Securities Act, and that it has been possible to do the job.

Now up to the time that competitive bidding under the Utilities Act was mentioned, the Commission had heard of no great difficulty in the sale of these New England issues because of the 1933 Act. Suddenly we hear about it. I didn't say it was comparable in volume to the amount of utility securities sold otherwise. The only point is that responsible banking houses have been willing to bid on these issues.

Mr. Bollard: And as far as Dillon Read & Company are concerned, the only reason we were willing to bid on one of those was that there was one with which we were thoroughly familiar, and we felt that we could satisfy the requirements of the Securities Act as to "investigation and disclosure" because of that familiarity.

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The others we did not have such an investigation made on, nor such familiarity with, and we declined to make a bid because we felt that we could not satisfy the requirements of the Act as to investigation and disclosure.

Chairman Frank: There were other responsible underwriters however that were ready to bid?

Mr. Bollard: In five years, a total of eleven issues for \$28,000,000 and five more for \$103,000,000.

Chairman Frank: But whatever issues there have been, there have been bidders, have there not, bids by responsible houses?

Mr. Bollard: There have, Mr. Chairman, and I should like to make this one point, that that is a situation superimposed upon a vastly greater base of negotiated issues.

Now if we have competitive bidding, there is not going to be that base upon which you can impose this small amount of competitive bidding issues which is the basis of the reference throughout a large part of this report.

Chairman Frank: My only point was at this juncture that reference was made apparently to the tremendous difficulties which arise under the Securities Act with respect to competitive bidding, and I say that that apparently has not deterred responsible banking houses from bidding on these issues?

Mr. Bollard: There is one point that was made this morning, to which I should like to address myself, and that is the

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matter of the effect which competitive bidding is apt to have on the small dealer, and the extent to which his business may - quite possibly and I believe probably - be damaged if competitive bidding is to prevail on public utility issues.

I think perhaps we may best understand the situation if I take the concrete illustration, say, of a comparatively small issue.

Mr. Stewart, I believe, referred to the fact that if an issue were of a small amount, the small dealer might be expected to have a participation in that. Now in my humble judgment, if this rule is put into effect, I don't believe it is going to work out that way, and I should like to assume, if I may, that the Cleveland Electric Illuminating Company proposes to put out an issue for, say, \$10,000,000, just a modest sum. It is not a big refunding job, but for its requirements for expansion of business.

And I should like to contemplate what conceivably may occur under those conditions. That is a choice issue, I think it is not inconceivable that if the Commission puts this rule into effect, and makes no exception in favor of the life insurance companies, such as was advocated by Mr. Ecker, that what is likely to happen will be that various of the large institutions will bid for that issue, various firms of banking houses may bid for it. I think very probably my firm would bid for it, because we have a thorough familiarity with that property, having

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3 Now if there is competitive bidding I believe the insurance companies are likely to make such a price as they think will make that an attractive investment for their account. The investment banking houses, knowing that those companies are bidding for that issue, will realize that they have got to pay a very high price if they hope to be a successful bidder for it. If the insurance companies are successful in buying the issue, of course the smaller dealer is eliminated. If the banker is successful, one of the banking groups is successful, it is going to follow, I think without much question, that their price will be high, and in order to dispose of that issue successfully they will be forced to make a very narrow mark-up on the price at which they can offer it publicly. Let's say they might put the retail price a half a point or three quarters of a point above the price which they had paid for the issue. They will endeavor to dispose of that issue in places where they can handle it at the least cost to themselves, and if that is a small amount above what they have paid for it, conceivably they can hand it along to a few institutions and of necessity the small dealer will be eliminated.

Now on the Cleveland Electric Illuminating bond issues, which our firm has handled on a negotiated basis, one point which the North American has always made, and which we have always been glad to comply with, is to give the dealers in the territory

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4 the maximum amount which we can pass along to them, which they can sell in that territory. There has been enough of a spread in a negotiated issue to do that. Under this kind of a situation, I think that will not be the case, and it seems to me that the thing is apt to work out in much the same way as some of the evils of this private placement procedure.

Now my firm made an analysis of private placements for the five years ended 1939, and we made rather a detailed analysis of the private placements for the year 1938.

There were \$802,000,000 of private placements -- I am speaking now not only of public utilities but of all classes of issues in excess of \$1,000,000, which were financed by private placement in the year 1938.

Thirty six investors acquired 98 percent of that \$802,000,000.

Now by contrast, there were public issues registered with the Commission in the year 1938 aggregating \$1,346,000,000, and we were able to ascertain the holders of those securities only to an aggregate extent of \$560,000,000 out of the \$1,300,000,000.

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But that \$560,000,000 was acquired by 700 institutional purchasers. There is no record of who acquired the additional \$783,000,000, but an analysis of those institutions shows that they were purchased, these public issues, by 534 different insurance companies, one foundation, 37 colleges and universities, 7 pension funds, 121 savings banks --

Chairman Frank: (Interposing) That is very interesting, and what you are saying is --

Mr. Bollard: (Interposing) I think it is fair to say that competitive bidding is likely to work the same way in concentration with the large institutional purchasers as the private placement has worked in the past.

Chairman Frank: Of course, private placement means, as we have seen it, that the large companies are going -- the large insurance companies are going to get most of the issues, and the small ones aren't. But you say that that competition that is going to occur in competitive bidding is going to increase that private placement. Aren't you now in competition with the insurance companies, and if the issuer knows that it can get a better price of the kind you indicated, and you have got that keen competition, doesn't the trend show that you are facing that today?

Mr. Bollard: Yes, sir; it does.

Chairman Frank: So that is happening right now. Now you say it is likely to happen under competitive bidding.

Perhaps it will, but we do know this much, at least, that it is going to make it possible for you to avoid one advantage that the insurance company has today, namely, that they can make a firm commitment weeks in advance which they won't be able to do under competitive bidding arrangements.

Mr. Bollard: I would like to have you cure private placements without giving us a worse evil.

Chairman Frank: I think we are going to have great difficulty in doing it any other way. Here we are with a Utilities Act that requires our approval, and takes a certain period of time. Forget the Securities Act completely. If there weren't any Securities Act, or if the Securities Act required that issues purchased by an insurance company should be registered, so that that discrepancy between the insurance company and the investment banker disappeared, you would still have the time lag necessary to put a utility issue through the Utilities Act, and if the insurance company can say to the company on January 5th, "We will take this issue whenever it comes out within a reasonable period after its approval by the Utilities Division of the Commission, we will take it at a fixed price" - you can't compete with them.

Now the only way you can get rid of that tremendous advantage that the insurance company has is to put up the same barrier, namely, that none of you can take it except on competitive bidding. Then their advance commitment will be

eliminated.

Mr. Rodgers thinks we oughtn't to do that, that we oughtn't to take away that advantage. He thinks that is unfortunate, but it is the only way that it can be taken away. They have got the money, the ability to make the commitment; they don't have to regard the fluctuations in the market price as you must, and they have that advantage. Now this is going to obviate or take away from them that tremendous advantage they have over you.

Mr. Bollard: I think there was one significant figure brought out this morning, Mr. Frank, that whereas there have been an aggregate of \$3,500,000,000 of private placements purchased, in this compilation which Mr. Rodgers made only \$450,000,000 out of that \$3,500,000,000 were registered. I believe that is very significant.

Chairman Frank: It is, indeed.

Mr. Weiner: May I ask Mr. Bollard a question?

Chairman Frank: Yes.

Mr. Weiner: If I recall properly, in the last two pieces of financing by the Potomac Electric Power Company those were private placements, were they not?

Mr. Bollard: They may have been, Mr. Weiner, I personally have not handled the Potomac Electric financing subsequent to the time I was one of the group which came down here on behalf of my group to make the investigation. I know there

has been the one issue, and there may have been the second, I wouldn't be sure.

Mr. Weiner: In those two instances, or perhaps only one that you may recall, there was paid to your firm a so-called finders' fee, was there not?

Mr. Bollard: There again, I am sorry to say that my familiarity with the transaction is such that I can not testify on that, I do not know.

Mr. Weiner: Do you recall some of the other private placements with North American subsidiaries in which your company acted as an agent or finder?

Mr. Bollard: I do not, Mr. Weiner, I don't know that there have been other private placements on behalf of North American. I do not handle the North American account personally.

Mr. Weiner: Do you handle any of the accounts of public utilities which are subsidiaries of registered holding companies?

Mr. Bollard: Personally, now, it doesn't happen to be in my field.

Mr. Weiner: Then you are not very familiar with this particular subject on which we are talking today?

Mr. Bollard: Not on the private placement of utility issues, no, sir.

Mr. Weiner: Well, are you familiar --

Mr. Bollard: (Interposing) Not on the details of the transactions.

Mr. Weiner: Are you familiar with the public financing of those utility companies?

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Mr. Bollard: Well, such familiarity as being a member of the firm which has handled them would give me.

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Chairman Frank: You weren't the person in the firm that handled them?

Mr. Bollard: No, sir.

Mr. Weiner: Is there any representative of your firm here who is familiar with the public utility issues?

Mr. Bollard: I happen to be the only representative of our firm here.

Mr. Weiner: I do want to call your attention to the fact that in the private placements of the Potomac Electric Power Company there were finders' fees paid to your firm. This same was true in the Wisconsin Electric Power case. In other words, so far as this private placement thing is concerned, it bears far more heavily upon the small dealers than upon most of your originating underwriters who get the equivalent through a finders' fee.

Mr. Bollard: I quite agree, and yet I am anxious that the private placement evil should be eliminated. I think any system which concentrates its highest issues in the hands of those of great financial strength is contrary to social entity.

Mr. Weiner: But it might also eventually result in the elimination of finders' fees?

Mr. Bollard: Conceivably.

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Chairman Frank: May I say that the Commission wants to get through with all the persons here today, and to that end I think we will gird up our loins and stay here as late this evening as is necessary. If necessary, we will come back after dinner.

END

We will next hear from Mr. Stanley.

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