

October 24, 1933.

Hon. John Dickinson,  
Assistant Secretary of Commerce,  
Washington, D. C.

Dear John:

Enclosed are the memoranda I promised you.

You will note a first-class crack in the eye from the New Republic this week. In itself it means little, except that it probably adds to the political difficulties. I have been trying to figure out a line of handling that, and when I get a chance to talk to you I will be glad to go over it.

With kind regards,

Very truly yours,

Enclosures

Memorandum to the Committee

on Stock Exchange Regulation

The attached memorandum divides into three phases.

The first has to do with certain obvious matters which I think have to occur, and indeed will be done anyway, intelligently or unintelligently.

The second goes into more elaborate details, likewise, I think, both within the range of possibility and probability. As to these, however, there will be more dispute.

The third proposes what I regard as the fundamental solution without at the moment being able to say whether it is politically possible. If the thing cannot be done now, some kind of commission ought to be set up for the purpose of study and report. Such a commission could be done within the frame of present administrative machinery,--that is, without creating a new body.

A. A. B., Jr.

(October 24, 1933)

I. Obvious regulatory action.

Corporations whose securities are listed on an exchange (suitably defined) should:

(1) Publish and file with the Federal Trade Commission or with a bureau in the

Department of Commerce:

(a) An annual balance sheet

(b) Quarterly income accounts.

(2) The agency receiving these reports and making them public should have the power to prescribe from time to time rules of accounting, the power being flexible enough to permit variation in the rules as between different types of business, and the statute should be so drawn as to make uniformity of accounts in uniform businesses the objective to the extent possible.

(Note:- The New York Stock Exchange has been attempting to reach this result, but is encountering difficulties. I am informed that several members of the Committee would prefer to see this function taken over by the government, feeling that the Stock Exchange has not adequate staff to handle the matter.)

Certain exceptions should be made in the case of corporations whose accounting is already standardized, e.g., railroads, in which case the filing should be merely that of the account required to be filed by the supervisory commission. I should not, myself, trust any account supervision I have yet seen, except that of the Federal Interstate Commerce Commission.)

(3) The agency designated should have the power to investigate into and set up investigations in the event of a complaint as to false accounts; and might have the power to require independent audit by certified public accountants admitted to practice before it under rules not dissimilar from the rules affecting the Treasury (Internal Revenue Department) Bar.

There should also be required:

Reports of the stock transactions of

(1) Directors and principal officers of the corporation;  
(2) Of any stockholder holding more than, say, 10% of the stock of the corporation,  
such reports to be filed every thirty days.

(3) Reports by the corporation of any Option given upon its stock;

Agreement to which it is a party, or of which it has knowledge, looking towards  
“pegging” the price of the stock or towards any manipulation thereof.

(Note:- The normal pool operation presupposes an option by or for someone making available an adequate supply of the stock to be carried through the operation. The arrangement by which stock is “pegged” may or may not be vicious; but if it is closed it is not easy to see that it can do anyone any great damage. The type case will probably be the “pegged” price of the bankers’ syndicate when an issue of stock is floated and the market is being “made” for a period of sixty or ninety days thereafter. But there are other cases of options given to pool operators.)

Reports of the stock operations of officers and directors should be made, say, every thirty days; reports of options or price fixing or pegging arrangements by the corporation should be made within forty-eight hours after the arrangement is made.

The words “stockholder” and “stock-holdings” would have to be so defined as to catch the dummy corporation, dummy individual and dummy brokerage account. This becomes a political necessity since the disclosure of the Wiggin transactions in the Chase National Bank; but it ought to exist anyhow.

Possibly, though this is debatable, some liability to the corporation should be attached for profits of an officer or a director of a corporation who speculates in its stock, though this is more questionable. Certainly such liability might be attached where he does so without making, or causing the corporation to make, the reports required by the Act.

II. Certain requirements relating to markets and credit.

There is no real reason why credit should be involved in the stock market to the extent that it is now. Further, the free use of credit encourages the wild fluctuations. Such credits are largely bound up with marginal trading requirements.

I suggest

- (1) That stock exchanges be licensed where their operations have a discernible effect upon interstate commerce;
- (2) That the President designate an appropriate agency as the licensing authority;
- (3) That such licensing authority be given the power to make rules and regulations in connection with

- (a) Margin Trading.

(Note:- My thought is that margin trading ought not to be permitted. If the trader is able to make his own arrangements at the bank, there is no reason why he should not do so; his credit will be limited by the means of the bank, and his own standing will have to be pretty secure. The little fellow who is usually the lamb in the transaction does not have access to bank credit. Further, the credit risk will cease to be passed on by a customer's man in a brokerage house on the basis of market quotations.)

- (b) Power to suspend short selling.

(Note:- I have never been too much impressed by the arguments in favor of short selling. The danger in wiping out short selling is more a danger of transition than a permanent danger. The bond market, for example, worries along pretty well with a minimum of short selling.)

- (c) The power to issue regulations from time to time in respect of specialists.

(d) The power to regulate the publicity, the activities of solicitors and customers and of the wires and mails.

(Note:- A good deal of this is ardently desired by a considerable group of brokers on the New York Stock Exchange. For instance, many of them do not like to send out market tips and market letters and go through the customers racket, but consider they have to in order to meet competition. The effect of a drastic limitation on all these functions would be to cut down overhead, which is all to the good.)

(4) There should be, in some proper form, a flat prohibition against brokerage houses trading for their own account.

(Note:- I have never been able to satisfy myself why a brokerage house, handling orders for customers, should also be able to trade on its own account, using the information which it had to vary the market.)

(5) No brokerage house should be allowed to carry a trading account for

- (a) The corporation whose stock is traded in, or
- (b) An officer or director thereof, or
- (c) A subsidiary therefor and affiliate thereof, or individual or group so connected therewith as to be, in substance, under its control or operating with its funds either directly or indirectly, except under regulations provided by the licensing authority, and reported to the licensing authority.

(Note:- Certain open market operations by corporations are, of course, legitimate, as where securities are being purchased for retirement. But the kind of manipulation which went on by H. L. Doherty for Cities Service, by Trans-America for its affiliated bank shares, by the Chase Securities Corporation in Chase National Bank stock, by National City Company in National City Bank stock, etc., ought not to be permitted. In essence, it is always the corporation gambling in the market against its own shareholders. In rare cases, a limited amount of "company trading" may be necessary to insure liquidity, and there ought to be a loophole for this kind of activity.)

(6) Wherever a corporation or a group is about to

- (a) Sell securities at original issue to the public, or

(b) Distribute to the public all or part of an authorized issue not theretofore distributed (though some of it may have been distributed) -- publicity should be given to that fact.

(Note:- In a good many instances, after a small amount of stock has been distributed to the public, a much larger amount is then sold to the public through the stock exchange, by means of a brokerage campaign. The vice is that people do not know what is being done.)

(7) Nothing ought to be done which will interfere with the existing action of the Listing Committees and the Business Conduct Committees, so far as they now go. It is essential in any scheme to preserve their swift action without legal review. At best, any licensing or regulative authority can only pick up the situation after the Business Conduct Committees have failed. In other words, the licensing group should consider its job as filling in, leaving the responsibility in the first instance to the Governors and Listing Committees and the Business Conduct Committees.

### III. A Federal Incorporation Law.

It will be seen that most of the foregoing regulations affect corporations quite as much as they affect the exchanges.

In fact, the exchanges are primarily a symptom, rather than a cause.

Gambling, as gambling, we shall never eradicate by any process of law. We may restrict the class of gamblers to a group which can afford to lose, and the total volume of gambling to a point where it will not involve the whole financial structure.

The main issue consists in having

(a) Honest shares,

(b) In the hands of a reasonably effective management whose acts are, in market respects as in other respects, public, and which is prohibited from using the corporation either as a spring-board device towards power or as a means of securing inside information on gambling transactions with the added ability to throw the funds of the corporation into the breach to support the gamble where necessary.

Since it is manifestly out of the question to draw a Federal Incorporation Law in time for the next Congress, I think that the Committee should recommend the creation of a Commission composed of, say, a representative of the Department of Justice, the Department of Commerce, and the House and Senate Committees on Judiciary, with the power to employ counsel, for the purpose of drafting a Federal Incorporation Law for submission within a stated period of time.

A. A. Berle, Jr.