

**REGULATION OF OVER-THE-COUNTER
MARKETS**

HEARINGS
BEFORE A
SUBCOMMITTEE OF THE
COMMITTEE ON
INTERSTATE AND FOREIGN COMMERCE
HOUSE OF REPRESENTATIVES
SEVENTY-FIFTH CONGRESS
THIRD SESSION
ON
S. 3255, H. R. 9634

BILLS TO PROVIDE FOR THE ESTABLISHMENT OF A
MECHANISM OF REGULATION AMONG OVER-THE-COUNTER
BROKERS AND DEALERS OPERATING IN INTERSTATE
AND FOREIGN COMMERCE OR THROUGH THE MAILS,
COMPARABLE TO THAT PROVIDED BY NATIONAL SECURI-
TIES EXCHANGES UNDER THE SECURITIES EXCHANGE
ACT OF 1934, AND FOR OTHER PURPOSES

APRIL 11, 1938

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Committee on Interstate and Foreign Commerce



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REGULATION OF OVER-THE-COUNTER MARKETS

MONDAY, APRIL 11, 1938

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE OF THE COMMITTEE ON INTERSTATE
AND FOREIGN COMMERCE,
Washington, D. C.

The subcommittee met at 10 a. m., Hon. Edward C. Eicher (chairman) presiding.

Mr. EICHER. The committee will come to order. We are met here this morning to consider various bills that have been referred to our committee on the subject of over-the-counter trading; the Lea bill in the House, H. R. 9634; the Maloney bill in the Senate, S. 3255 being companion bills. There is also another bill that has been referred to our committee, the Sabbath bill, H. R. 9592.

To this subcommittee, of which Mr. Boren, Mr. Reece, and myself are members, has been assigned the duty to conduct the hearings on these matters and make a report to the full committee.

The Senate bill, S. 3255, has passed the Senate and in its final form has been referred to our House committee. It would be my idea, therefore, that in the progress of our hearings we direct our attention more specifically to the latter bill.

(S. 3255 is as follows:)

[S. 3255, 76th Cong., 3d sess.]

A BILL To provide for the establishment of a mechanism of regulation among over-the-counter brokers and dealers operating in interstate and foreign commerce or through the mails, comparable to that provided by national securities exchanges under the Securities Exchange Act of 1934, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Securities Exchange Act of 1934, as amended, is amended by inserting after section 15 thereof the following new section:

"SEC. 15A. (a) Any association of brokers or dealers may be registered with the Commission as a national securities association pursuant to subsection (b), or as an affiliated securities association pursuant to subsection (d), under the terms and conditions hereinafter provided in this section, by filing with the Commission a registration statement in such form as the Commission may prescribe, setting forth the information, and accompanied by the documents, below specified:

"(1) Such data as to its organization, membership, and rules of procedure, and such other information as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors; and

"(2) Copies of its constitution, charter, or articles of incorporation or association, with all amendments thereto, and of its existing bylaws, or of any rules or instruments corresponding to the foregoing, whatever the name, hereinafter in this title collectively referred to as the 'rules of the association'.

Such registration shall not be construed as a waiver of any constitutional right or of any right to contest the validity of any rule or regulation of the Commission under this title.

"(b) An applicant association shall not be registered as a national securities association unless it appears to the Commission that—

"(1) by reason of the number of its members, the scope of their transactions, and the geographical distribution of its members such association will be able to comply with the provisions of this title and the rules and regulations thereunder and to carry out the purposes of this section;

"(2) such association is so organized and is of such a character as to be able to comply with the provisions of this title and the rules and regulations thereunder, and to carry out the purposes of this section;

"(3) the rules of the association provide that any broker or dealer who makes use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security otherwise than on a national securities exchange, may become a member of such association, except such as are excluded pursuant to paragraph (4) of this subsection: *Provided*, That the rules of the association may restrict membership in such association on such specified geographical basis, or on such specified basis relating to the type of business done by its members, or on such other specified and appropriate basis, as appears to the Commission to be necessary or appropriate in the public interest or for the protection of investors and to carry out the purpose of this section;

"(4) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no broker or dealer shall be admitted to or continued in membership in such association, if (1) such broker or dealer, whether prior or subsequent to becoming such, or (2) any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), or any person directly or indirectly controlling or controlled by such broker or dealer, whether prior or subsequent to becoming such, (A) has been and is suspended or expelled from a registered securities association (whether national or affiliated) or from a national securities exchange, for violation of any rule of such association or exchange which prohibits any act or transaction constituting conduct inconsistent with just and equitable principles of trade, or requires any act the omission of which constitutes conduct inconsistent with just and equitable principles of trade, or (B) is subject to an order of the Commission denying or revoking his registration pursuant to section 15 of this title, or expelling or suspending him from membership in a registered securities association or a national securities exchange, or (C) is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security;

"(5) the rules of the association assure a fair representation of the membership in the adoption of any rule of the association or amendment thereof, the selection of its officers and directors, and in all other phases of the administration of its affairs;

"(6) the rules of the association provide for the equitable allocation of dues among the membership, to defray reasonable expenses of administration;

"(7) the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors, and to remove impediments to and perfect the mechanism of a free and open market; and are not designed to require or permit unfair discrimination between customers, or issuers, or brokers or dealers, nor to fix minimum profits or minimum rates of commission or other charges;

"(8) the rules of the association provide that members shall be appropriately disciplined by expulsion, suspension, fine, censure, or any other fitting penalty for any violation of its rules;

"(9) the rules of the association provide a fair and orderly procedure with respect to the disciplining of members and the denial of membership to any broker or dealer seeking membership therein. In any proceeding to determine whether any member shall be disciplined, such rules shall require that specific charges be brought; that such member shall be notified of, and be given an opportunity to defend against, such charges; that a record shall be kept; and that the determination shall include (A) a statement setting forth any act or practice in which such member may be found to have engaged, or which such member may be found to have omitted, (B) a state-

ment setting forth the specific rule or rules of the association of which any such act or practice, or omission to act, is deemed to be in violation, (C) a statement whether the acts or practice prohibited by such rule or rules, or the omission of an act required thereby, are deemed to constitute conduct inconsistent with just and equitable principles of trade, and (D) a statement setting forth the penalty imposed. In any proceeding to determine whether a broker or dealer shall be denied membership, such rules shall provide that the broker or dealer shall be notified of, and be given an opportunity to be heard upon, the specific grounds for denial which are under consideration; that a record shall be kept; and that the determination shall set forth the specific grounds upon which the denial is based; and

"(10) the requirements of subsection (c), insofar as these may be applicable, are satisfied.

"(c) The Commission may permit or require the rules of an association applying for registration pursuant to subsection (b), to provide for the admission of an association registered as an affiliated securities association pursuant to subsection (d), to participation in said applicant association as an affiliate thereof, under terms permitting such powers and responsibilities to such affiliate, and under such other appropriate terms and conditions, as may be provided by the rules of said applicant association, if such rules appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors and to carry out the purposes of this section. The duties and powers of the Commission with respect to any national securities association or any affiliated securities association shall in no way be limited by reason of any such affiliation.

"(d) An applicant association shall not be registered as an affiliated securities association unless it appears to the Commission that—

"(1) such association, notwithstanding that it does not satisfy the requirements set forth in paragraph (1) of subsection (b), will, forthwith upon the registration thereof, be admitted to affiliation with an association registered as a national securities association pursuant to said subsection (b), in the manner and under the terms and conditions provided by the rules of said national securities association in accordance with subsection (c); and

"(2) such association and its rules satisfy the requirements set forth in paragraphs (2) to (9), inclusive, of subsection (b); except that in the case of any such association any restrictions upon membership therein of the type authorized by paragraph (3) of subsection (b) shall not be less stringent than in the case of the national securities association with which such association is to be affiliated.

"(e) Upon the filing of an application for registration pursuant to subsection (b) or subsection (d), the Commission shall by order grant such registration if the requirements of this section are met. If, after appropriate notice and opportunity for hearing, it appears to the Commission that any requirement of this section is not satisfied, the Commission shall by order deny such registration. If any association granted registration as an affiliated securities association pursuant to subsection (d) shall fail to be admitted promptly thereafter to affiliation with a registered national securities association, the Commission shall revoke the registration of such affiliated securities association.

"(f) A registered securities association (whether national or affiliated) may, upon such reasonable notice and upon such terms and conditions relating to orderly liquidation as the Commission may deem necessary in the public interest or for the protection of investors, withdraw from registration by filing with the Commission a written notice of withdrawal in such form as the Commission may by rules and regulations prescribe. Upon the withdrawal of a national securities association from registration, the registration of any association affiliated therewith shall automatically terminate.

"(g) If any registered securities association (whether national or affiliated) shall take any disciplinary action against any member thereof, or shall deny admission to any broker or dealer seeking membership therein, such action shall be subject to review by the Commission, on its own motion, or upon application by any person aggrieved thereby filed within sixty days after such action has been taken or within such longer period as the Commission may determine. Application to the Commission for review, or the institution of review by the Commission on its own motion, shall not operate as a stay of such action, unless the Commission shall so order.

"(h) (1) In a proceeding to review disciplinary action taken by a registered securities association against a member thereof, if the Commission, after appropriate notice and opportunity for hearing, upon consideration of the record before the association and such other evidence as it may deem relevant, shall (A) find

that such member has engaged in such acts or practices, or has omitted such act, as the association has found him to have engaged in or omitted, and (B) shall determine that such acts or practices, or omission to act, are in violation of such rules of the association as have been designated in the determination of the association, the Commission shall by order dismiss the proceeding unless it appears to the Commission that such action should be modified in accordance with paragraph (2) of this subsection. The Commission shall likewise determine whether the acts or practices prohibited, or the omission of any act required, by any such rule constitute conduct inconsistent with just and equitable principles of trade, and shall so declare. If it appears to the Commission that the evidence does not warrant the finding required in clause (A), or if the Commission shall determine that such acts or practices as are found to have been engaged in are not prohibited by the designated rule or rules of the association, or that such act as is found to have been omitted is not required by such rule or rules, the Commission shall by order set aside the action of the association.

"(2) If, after appropriate notice and opportunity for hearing, the Commission finds that any penalty imposed upon a member is excessive or oppressive, having due regard to the public interest and the established practice of such association and of other registered securities associations with respect to penalties, the Commission shall by order cancel, reduce, or require the remission of such penalty.

"(3) In any proceeding to review the denial of membership in a registered securities association, if the Commission, after appropriate notice and hearing, and upon consideration of the record before the association and such other evidence as it may deem relevant, shall determine that the specific grounds on which such denial is based exist in fact and are valid under this section, the Commission shall by order dismiss the proceeding; otherwise, the Commission shall by order set aside the action of the association and require it to admit the applicant broker or dealer to membership therein.

"(i) (1) The rules of a registered securities association may provide that no member thereof shall deal with any nonmember broker or dealer (as defined in paragraph (2) of this subsection) except at the same price, for the same commissions or fees, and on the same terms and conditions as are by such member accorded to the general public.

"(2) For the purposes of this subsection, the term 'nonmember broker or dealer' shall include any broker or dealer who makes use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security otherwise than on a national securities exchange, who is not a member of any registered securities association, except a broker or dealer who deals exclusively in commercial paper, bankers' acceptances, or commercial bills.

"(3) Nothing in this subsection shall be so construed or applied as to prevent any member of a registered securities association from granting to any other member of any registered securities association any dealers' discount, allowance, commission, or special terms.

"(j) Every registered securities association shall file with the Commission in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, copies of any changes in or additions to the rules of the association, and such other information and documents as the Commission may require to keep current or to supplement the registration statement and documents filed pursuant to subsection (a). No change in or addition to the rules of a registered securities association shall take effect until thirty days after the filing of a copy thereof with the Commission, or until such earlier date as the Commission may determine.

"(k) (1) The Commission is authorized by order to abrogate any rule of a registered securities association, or to prevent any rule from taking effect, if after appropriate notice and opportunity for hearing, it appears to the Commission that such abrogation or prevention is necessary or appropriate to assure fair dealing by the members of such association, to assure a fair representation of the membership in the administration of its affairs or otherwise to protect investors or effectuate the purposes of this section.

"(2) The Commission may in writing request any registered securities association to adopt any specified alteration of or supplement to its rules with respect to any of the matters hereinafter enumerated. If such association fails to adopt such alteration or supplement within a reasonable time, the Commission is authorized by order to alter or supplement the rules of such association in the manner theretofore requested if, after appropriate notice and opportunity for hearing, it appears to the Commission that such alteration or supplement is necessary or appropriate in the public interest or for the protection of investors

or to effectuate the purposes of this section, with respect to: (1) The basis for, and procedure in connection with, the denial of membership or the disciplining of members; (2) the method for adoption of any change in or addition to the rules of the association; (3) the method of choosing officers and directors; (4) affiliation between registered securities associations; (5) the prevention of fictitious quotations; (6) the prevention of fraudulent or manipulative acts or practices; (7) safeguards against unreasonable profits or unreasonable rates of commissions or other charges; *Provided*, That nothing herein shall authorize the imposition of any schedule of minimum or maximum prices, discounts, commissions, allowances, or other charges; (8) safeguards against unfair discrimination between customers, or issuers, or brokers or dealers; (9) safeguards with respect to the financial responsibility of members and against the evasion of financial responsibility through the use of corporate forms, special partnerships, or other devices; (10) the manner, method, and place of soliciting business; (11) the time and the method of making settlements, payments, or deliveries; (12) the collection, recording, and dissemination of information relating to the over-the-counter markets; and (13) similar matters.

"(1) The Commission is authorized, if such action appears to it to be necessary or appropriate in the public interest or for the protection of investors and to carry out the purposes of this section—

"(1) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to revoke the registration of a registered securities association, if the Commission finds that such association has violated any provision of this title or the rules and regulations thereunder, or has failed to enforce compliance with its own rules, or has engaged in any other activity inconsistent with the purposes of this section;

"(2) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a registered securities association any member thereof who the Commission finds has violated any provision of the Securities Act of 1933 or of this title or the rules and regulations thereunder, or has effected any transaction for any other person who, he had reason to believe, was violating in respect of such transaction any provision of the Securities Act of 1933 or of this title or the rules and regulations thereunder;

"(3) after appropriate notice and opportunity for hearing, by order to remove from office any officer or director of a registered securities association who, the Commission finds, has failed to enforce the rules of the association, or has abused his authority.

"(m) If any provision of this section is in conflict with any provision of any law of the United States in force on the date this section takes effect, the provision of this section shall prevail."

Mr. EICHER. We have with us Commissioner Mathews, who I understand is willing to assume the burden of going on with the evidence. We would be glad to hear from Commissioner Mathews now.

STATEMENT OF HON. GEORGE C. MATHEWS, COMMISSIONER, SECURITIES AND EXCHANGE COMMISSION

Mr. MATHEWS. Mr. Chairman and gentlemen of the committee:

If the committee is agreeable to my reserving the right to discuss, possibly very briefly, some details of the bill after they may have been discussed by others, I think I can shorten my presentation at this time very materially.

I believe there is no need of making a statement to the committee at this point in as elaborate detail as was made to the Senate committee.

We would like to understand that you have before you, or will have before you, the statement which I made to the Senate committee, the testimony of the witnesses who appeared before the Senate committee, and the report of the Senate committee. If that is understood, as far as the Commission's case goes, we can shorten it very materially.

May I, therefore, offer for the record the statement which I made before the Senate committee, the testimony which was presented to the Senate committee by all of the witnesses on this bill, and the report of the Senate committee to the Senate? We will arrange to furnish copies, if the committee does not have them now.

Mr. EICHER. Without objection that may be considered as our procedure. Of course, you do not mean by that necessarily that they will be reprinted in full in the House hearings?

Mr. MATHEWS. I have no desire that they be reprinted.

This morning, then, I want to limit my discussion quite sharply, merely to round out the record that has been presented.

Mr. BOREN. Mr. Chairman, while we are just getting started, may I say that it is my impression that the most controversial question involved here is that in reference to dealers in municipal securities. I do not know whether the Commissioner, particularly, cares to emphasize that phase.

Mr. MATHEWS. I intend to touch on that, Mr. Chairman.

Mr. EICHER. I am quite sure the Commissioner recognizes that to be the fighting ground of the bill. Another proposition is one in which the investment bankers are concerned.

Mr. MATHEWS. What I propose to do this morning is merely to discuss those questions that are in controversy, rather briefly.

Senate bill 3255 amends the Securities Exchange Act of 1934, as amended, by inserting a new section, section 15 A, immediately after the present section 15; and by amending subsection (c) of section 15, subsection (a) of section 17, subsection (b) of section 29, and section 32. The general scope of the bill, the reasons which support it, and a section by section analysis of it are set forth in the report of the Senate Committee on Banking and Currency to accompany the bill. To avoid repetition, and to conserve time, I should like simply to present a copy of this report.

The bill in its present form has been strongly endorsed by representative leaders of the Investment Bankers Conference, Inc., an organization of investment bankers and over-the-counter dealers and brokers consisting of some 1,700 firms situated in all parts of the United States; by a substantial majority—23 out of 33—of the board of governors of the Investment Bankers' Association of America, an association which numbers some 700 members; and by the New York Security Dealers Association, which includes in its membership some 70 firms in the securities business in the city of New York. In addition, a group of about 20 dealers from Massachusetts and Rhode Island have indicated that they would endorse the bill if two changes in it were made, to which I shall revert below; and the dissenting minority within the board of governors of the Investment Bankers Association have indicated that they, too, would be in favor of the bill if three specified changes were made. I need hardly add that the Securities and Exchange Commission is, of course, in favor of the bill.

In view of this alignment of sentiment, and in view of the history of the bill, I shall confine the remainder of this statement to an analysis of the specific points of criticism of the bill which are advanced by the Massachusetts-Rhode Island group and by the minority of the board of governors of the Investment Bankers Association, and to a brief consideration of the application of the bill to trading in securities issued by the Federal Government, States, and municipalities.

1. The question of applicability of section 29 (b) of the Exchange Act to rules or regulations which may be prescribed pursuant to clause (3), (4), or (5) of the proposed new subsection (c) of section 15:

I should like to call the attention of the committee to section 3 of the bill, which appears on page 17. This section would amend section 29 (b) of the Exchange Act, which, in general, provides that contracts entered into in violation of that act or any rule or regulations thereunder shall be void. Under this proposed amendment, no contract entered into in violation of a rule or regulation prescribed pursuant to clause (3), (4), or (5) of the proposed new subsection (c) of section 15 would be void by reason of section 29 (b) except—and here I come to the point in issue—

Except in so far as the Commission, having determined that such action is necessary or appropriate for the protection of investors, shall have expressly provided in such rule or regulation that the provisions of this subsection shall apply in the case of any violation thereof.

(This clause appears in lines 7 to 11, inclusive, on p. 17.)

Mr. EICHER. Your references are all to the bill as it passed the Senate, as I understand it.

Mr. MATHEWS. That is correct.

The Massachusetts-Rhode Island group wish the quoted clause to be eliminated from the bill. This position is concurred in by the minority of 10 of the board of governors of the Investment Bankers Association—I do not think it is correct to say that the rest of the Investment Bankers Association would not be willing to have it eliminated, but the minority indicated their willingness to go along with the bill, only if it were eliminated—among whom, as we understand, were included members of the Massachusetts-Rhode Island group. These dealers point out that under clauses (3), (4), and (5) of the proposed new subsection (c) of section 15, the Commission may adopt rules and regulations which, rather than striking at abuses in the form of fraudulent or dishonest conduct, would be designed to promote orderly business practices in connection with matters falling within the scope of the standards set forth in those clauses. While not objecting to the inclusion of these clauses in the bill, these dealers contend that the injunctive remedy and the power to revoke the dealers' registration provided in the Exchange Act are sufficient and appropriate method of enforcement of rules and regulations adopted under these clauses. They insist that it is neither necessary nor fair that contracts entered into in violation of this technical sort of rule should be rendered void.

With this argument, the Commission was in sympathy to the extent that it actually had application to rules which might be adopted. The Commission pointed out, however, that, under clauses (3), (4), and (5), it might adopt not only rules and regulations of the technical sort which I have already referred to, but also rules and regulations striking at abuses in the form of dishonest or overreaching conduct within the scope of the standards set forth in those clauses. While agreeing that contracts entered into in violation of rules of the technical kind should not be made void by the Exchange Act, the Commission believed that it was desirable and appropriate that contracts entered into in violation of rules designed to check dishonest conduct should be void. In consequence, the Commission requested the Senate committee to draft the law in such a way as to allow for differentiation

between these two kinds of rules. The Commission's argument was accepted by the Senate committee and the Senate. Thus, as I have already pointed out above, section 3 of the bill would amend section 29 (b) of the act to provide that section 29 (b) should not apply to violations of rules and regulations adopted under clauses (3), (4), and (5) of the proposed new subsection (c) except in cases in which the Commission found that it was necessary for the protection of investors that such contracts should be void and expressly so provided in adopting the rule. The Senate committee report, in the light of which the bill will be interpreted, clearly sets forth the two types of rules which may be adopted, and makes it plain that section 29 (b) should apply only to rules designed to check forms of dishonest or overreaching practice and not to rules of the more technical kind.

Mr. BOREN. Mr. Chairman, may I interrupt?

Do I understand that you infer, Mr. Commissioner, that the report itself is the yardstick by which you propose to interpret this section?

Mr. MATHEWS. Yes.

Mr. BOREN. But it does not necessarily follow that there is anything binding on the Commission to interpret a piece of legislation in the light of the report?

Mr. MATHEWS. I do not understand that the report has the force of law. I think it would be very persuasive in an interpretation.

Mr. BOREN. What I wanted to get at was, are you inferring here that we should act on the presumption that the Commission will interpret this law in the light of the report?

Mr. MATHEWS. I think so, sir. I think you should act on that assumption, particularly in view of the requirement that the Commission can only make contracts of that nature void where it makes a finding that it is necessary for the protection of investors. Now, a finding of that sort can hardly be made capriciously. I do not think we can assume, or if it is to be assumed that findings of that sort are to be made capriciously, then there was not basis for any legislation granting power to the Commission, it seems to me. My experience with the interpretation of the acts under which we are working has been that the legislative committee reports have largely determined the interpretation, where they contained statements bearing on the subject.

Mr. BOREN. But what avenue would the dealer have in the event that he wanted to test the validity of such a rule as you might lay down to protect the investor?

Mr. MATHEWS. I would prefer to leave that to one of the members of our legal staff to answer. I find myself confronted with these legal questions, and not being a lawyer I think it is better for me not to attempt to answer. Mr. Katz is here and if you want to question him on it I am sure he would be glad to respond.

Mr. BOREN. I have nothing further, Mr. Chairman.

Mr. REECE. What do you understand gives rise to the apprehension of this group with reference to this provision?

Mr. MATHEWS. Mr. Withington, who is here representing the group, I believe, can state the case much more accurately than I can. But, in general, I understand that it grows out of experiences which dealers in Massachusetts have had with a series of rescission suits which have been very expensive to them, where rescission rights attached under the Massachusetts law. And they have a feeling

that they may be confronted with the same difficulties because of technical violations of this act.

I think it better for me to leave to Mr. Withington the more detailed explanation of that.

Mr. EICHER. Would the Commission have any objection to delimiting that general language a little further as contained in lines 8 and 9 of page 17, where you say "for the protection of investors", by saying "protection of investors from dishonest or overreaching practice", or something of that kind?

Mr. MATHEWS. I have not thought of just those words. I think I should consult with my colleagues before giving a response. I would be glad to take the suggestion back to them.

Mr. BOREN. Mr. Chairman, if this provision as it applies here more or less refers to the specific case and gives power to the Commission to lay down a specific rule, what objection could there be to making the language such that it would give the power only where it can be definitely shown that these practices exist?

Mr. MATHEWS. I am not sure but you are getting now beyond the scope of a rule under which the Commission would proceed, into the field of procedure by order; and I should question whether we would have the right to proceed by order to fix a liability in a particular case where really it is a matter to be fixed in accordance with the general statutory standard.

That is the way your suggestion appears to me offhand. I would like, if you want me to, to talk with my colleagues on the Commission as to your suggestion. I do not feel like responding offhand to a suggestion of that kind.

Mr. EICHER. I did not expect you to, but I wanted to make the suggestion.

Mr. MATHEWS. That is a sort of circumstance that we want to protect against.

The second question at issue is:

2. Question concerning insertion of the word "willful" before the word "violated" in clause (A) of subsection (1) (2) of the proposed new section 15A.

I should now like to call your attention to paragraph (2) of subsection (L) of the proposed new section 15A, which appears on page 15 of the bill. This paragraph authorizes the Commission, in any case in which such action appears to be necessary or appropriate in the public interest or for the protection of investors or to carry out the purposes of the section, after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding 12 months or to expel from a registered securities association any member of such association who the Commission finds (A) has violated any provision of the Exchange Act—that is the 1934 act—or any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe, was engaged in any such violation—you notice the word willfully is not used in connection with the right to expel for violations of the Exchange Act, or rules and regulations under that act. Then the section goes on—or (B) has willfully violated any provision of the Securities Act of 1933 or of any rule or regulation thereunder, or who has effected any transaction for any other person who, he had reason to believe, was engaging in such willful violation.

The minority of 10 of the board of governors of the Investment Bankers Association want clause (a) amended so as to condition the right of suspension or expulsion upon willful violations of the Exchange Act. We understand that the Massachusetts-Rhode Island group likewise want this change, although we have not understood that this change is considered as important by the Massachusetts-Rhode Island group as the one relating to section 29 (b), which we have already discussed.

The Commission strongly objects to this change. < Clause (a) is the counterpart of section 19 (a) (3) of the Exchange Act, which vests in the Commission a parallel power in regard to members of exchanges. That is, we have the right to suspend or expel members of exchanges for violation of the act or rules and regulations thereunder which need not be established to be a willful violation. > In our judgment, it is necessary in the interest of both fairness and practical administration that these parallel powers should be governed by parallel terms and conditions. Moreover, the Commission feels that critics of this provision have not taken due account of the fact that the Commission is authorized to exercise this power of suspension or removal only if it finds, not only that a violation has been committed, but also that the suspension or expulsion is "necessary or appropriate in the public interest or for the protection of investors or to carry out the purposes of this section."

That is, the punitive action does not follow automatically from the finding of the violation. We must further find that there is a purpose to be served by such punitive action.

< I do not see how an innocent and accidental violation could be made the basis of such a finding. >

Mr. BOREN. Is not the terminology of the bill "or" rather than "and"; that is, in connection with this second premise for your action. Will you specifically point out the provision so I can understand it?

Mr. MATHEWS. You are correct. It says in the public interest or for the protection of the investors. But one of those standards must be conjunctive with the finding of the violation.

Mr. BOREN. And the dealer has recourse to the courts after your action?

Mr. MATHEWS. After an order of expulsion.

Mr. BOREN. If his case is upheld by the court as against the Commission, does the Commission then have to recede from its position and maintain his registration?

Mr. MATHEWS. My understanding would be that the Commission does not even have to do that. That is done when the court upholds him.

Mr. BOREN. It is automatically done?

Mr. MATHEWS. Yes.

Mr. BOREN. As I understand this bill, all these cases are taken direct from the Commission to the circuit court of appeals.

Mr. MATHEWS. That is correct.

Mr. BOREN. Is there any particular reason in the mind of the Commission other than the fact that the original act provides for going straight to the circuit court of appeals—any particular reason why you should go to the circuit court of appeals and skip over the court of the first instance, rather than taking the regular route that all citizens of America have to take in going before our courts?

Mr. MATHEWS. I must say that I am not familiar with what the considerations were in the original draft of the 1934 act that provided an appeal directly to the circuit court of appeals.

Mr. BONES. I want to propound this question for your legal staff, Mr. Commissioner, if you do not want to answer it now, that is all right. Can there be a clause inserted in this bill, without disrupting the entire purport of the bill, which will so amend the original act that a finding of the Commission will be referred to the district court rather than the circuit courts hereafter?

I will leave that question for your legal staff to answer.

I might just as well state that I do not believe in any of the system which permits any Federal bureau or commission to circumvent courts of the first instance. I speak from my own viewpoint. I see no reason why a Federal body should carry a man engaged in a local business to a circuit court when all citizens of the United States are called upon to sue or to be sued in courts of the first instance.

Ever since I have been on this committee it has been my policy to attempt to alter that situation every time we met it, and it will be my policy in connection with this bill. If it cannot be done as to this particular bill, sooner or later, if I remain on the committee long enough, I hope to amend the original Securities Act so that it will provide for their going to the court of the first instance instead of to the circuit court of appeals.

I will pass that question now.

Mr. MATHEWS. Mr. Katz will give you a report on that.

I might add that one difficulty with the use of the word "willful" is that considerable confusion exists as to just what this word means as a matter of law. Some cases suggest that a grossly negligent violation of law is willful; others suggest that a violation cannot be considered willful unless it is deliberate and malicious.

The difficulty of proof of willfulness, if the second of those standards is the accepted standard, would in our minds make this provision of the bill practically useless, if the word "willful" is inserted.

Mr. REECE. Why do you make the provision different in the two instances; using "willful" in one case and leaving it out of the other?

Mr. MATHEWS. I am answering you now as to what is in my own mind about it.

Mr. REECE. Yes.

Mr. MATHEWS. There are so many opportunities, innumerable opportunities for technical violations of the Securities Act that if the right to discipline under the Securities Act were not related to willful conduct, I think you would have a great outcry against the Commission having that authority.

For instance, the failure of a salesman to deliver a prospectus, where every intention of his employer was that he should deliver it. A slip in the office by which a letter dealing with an issue goes out to a prospective customer before the prospectus; a great many of those minor technical violations.

It is true that a course of conduct continuing those violations would be serious. But I believe that to depart from the standard of willfulness in the act of 1933 would open the door to the possibility of discipline for minor violations, which would be very objectionable.

Now, we have not found that to be true under the Exchange act, under the 1934 act.

The next question I would like to discuss briefly is:

3. The question whether the language of clause (1) of the proposed new subsection (c) of section 15 should be rearranged:

The minority of 10 of the board of governors of the Investment Bankers Association have suggested that clause (1) of the proposed new subsection (c) of section 15, which appears in lines 13 and 16 of page 16, should be modified to read as follows: "to prevent transactions by means of manipulative, deceptive, or other fraudulent devices or contrivances;". We are under the impression that this suggestion reflects the sentiment of dealers in municipal securities within the Investment Bankers Association. In any event, this suggestion is one which likewise has been made in behalf of certain dealers who deal exclusively in municipal securities. In consequence, before taking up this suggestion, I should like to turn to a consideration of the position of dealers in municipal securities under this bill.

4. Transactions in municipal securities: In its original form, all provisions of this bill applied to transactions by brokers and dealers in "exempt securities," which are defined by section 3 (a) (12) of the Securities Exchange Act of 1934 to include securities issued by the Federal Government, States, and municipalities. Considerable protest was made by a group of dealers who deal exclusively in municipal securities. It is noteworthy that no such protest was made by the great number of dealers who deal both in corporate securities and in municipal securities. This is particularly striking, in view of the fact that such general dealers, according to such statistics as are available, do a considerably larger business in such public securities than the exclusively municipal dealers.

The chief argument advanced by these exclusively municipal dealers was that the bill would tend to interfere with the issuance of securities by States and cities. In fact, protests were received by the Senate committee from the fiscal officers of various States and cities on this account. We have good reason to believe that these protests were stirred up by propaganda circulated by certain municipal dealers. As an illustration of the nature of this propaganda, I should like to read into the record a letter sent to the fiscal officers of municipalities throughout Alabama by a prominent dealer in municipal securities doing business in Birmingham, Ala. This letter reads:

BIRMINGHAM, ALA., February 7, 1938.

DEAR SIR: There is now pending before Congress a bill of vital importance to all governmental units that issue bonds payable from taxation. It is known as the Maloney bill and the Senate Banking and Currency Committee is now having hearings on the measure.

Congress on two different occasions has attempted to do away with the tax-exempt feature of bonds and a great howl of protest from the issuers of such securities prevented such passage.

This time another course is being taken to gain this end. The Securities Exchange Commission means to get control of municipal finance through control of over-the-counter transactions. Succeeding in that, and without much delay, will not the next step of doing away with tax-exempt securities be quite simple? Senator John H. Bankhead is a member of this committee and we earnestly request that you wire or write him immediately your opposition to this bill. If this bill passes a great many cities, counties, and school districts that are now able to borrow, principally because of the tax-exempt feature, will have no market for their securities.

And that statement is false.

Do not delay to advise the committee of your feelings at once.

Very truly yours,

WATKINS, MORROW & Co.

Mr. REECE. I notice there was printed in the Senate hearings a reprint of an editorial from the Daily Bond Buyer of February 2, 1938. That editorial might also have inspired some communication, might it not?

Mr. MATHEWS. Yes. There have been quite a number of that sort of statements. The letter speaks for itself.

Mr. EICHEN. That writer must have anticipated Senator La Follette's amendment to the tax bill in the Senate.

Mr. MATHEWS. I am not prepared to discuss the tax-exempt feature of public securities, but the argument, if I may digress for just a moment, runs that the right of the Commission to impose rules may result in the imposition of such rules that the secondary market for these securities is frozen.

It is a peculiar thing that no such fear has been expressed as to the effect of those rules on other securities than municipal securities, although they would necessarily have the same incidence.

I want to call to your attention also the fact that as the bill now stands further elimination of dealers in municipal securities from this bill would have to eliminate them from rules to prevent fraud.

Mr. REECE. The changes which you indicate have been suggested would make this bill pretty much the same as the present law, the present section, would it not?

Mr. MATHEWS. Insofar as the effect upon municipal dealers goes, that is true, because municipal dealers are now out from the effect of rules under clauses (3), (4), and (5) of this bill.

Mr. REECE. Section 15 (c) at present reads:

No broker or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in or to induce the purchase or sale of any security (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, by means of any manipulative, deceptive, or other fraudulent device or contrivance. The Commission shall for the purpose of this subsection by rules and regulations define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent.

Mr. MATHEWS. Yes. I planned to come to that point very briefly.

Mr. REECE. I am, of course, not reading that for your information, but in order to have it appear in the record at this place.

Mr. MATHEWS. I want to say just a sentence or two dealing with that.

Senator Maloney has stated repeatedly that at no time was the bill intended to regulate, directly or indirectly, the issuance of securities by States and municipalities. And you cannot find any power for such regulation in this bill. It seems to us clear that the bill even in its original form could not and would not have had this effect. However, it is unnecessary for us to go into this question. The bill was amended to exclude transactions by brokers and dealers in exempted securities from the scope of all provisions of the bill except clauses (1) and (2) of the proposed new subsection (c), which appear in lines 15 and 16 on page 18 of the bill.

Now, coming to the point which you raised:

These clauses substantially reenact subsection (c) of the present section 15. The changes from the present subsection (c) are of a clarifying nature. In so clarifying this subsection, these changes broaden it by eliminating certain technical and legalistic ambiguities which may possibly exist in the present law. As a matter of fact, the

Commission has consistently interpreted subsection (c) in its present form to mean what clauses (1) and (2) now explicitly say—and I might say we think that is the correct interpretation—and, on the basis of that interpretation, has adopted rules and regulations which have withstood the test of experience and have met with the approval of representative groups of brokers and dealers subject thereto.

Mr. REECE. Now, referring to the hearings which were held by this committee in 1936 on Senate 4023, the provision of the then suggested 15 (c) reads this way:

* * * such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest to prevent fraud, concealment, unfair discrimination, or manipulative or deceptive practices or otherwise to insure to investors protection comparable to that provided by and under authority of this title in the case of National Securities Exchange.

That proposed section was changed, of course, so that it became the present section 15 (c). What is the difference between the comparable provision in the present bill and the provision that was in Senate 4023 and which was changed to become the present law?

Mr. MATHEWS. It seems to me that the original draft which you have read there was considerably broader, although that would be a matter of legal interpretation of it. I was not present at any of the hearings in connection with the bill, from which you have been reading.

Were you present at those hearings, Mr. Katz? Can you answer the question?

Mr. KATZ. The provision which you read is very much broader, Mr. Reece. There are two points at issue; one is the substantive scope and one is the method of statement. Now, clauses (1) and (2) in the pending bill in general substantive scope are substantially identical with the present section 15 (c) and are much narrower than the clause you read.

There still remains the question of method of statement which depends upon what you feel about certain legal and technical ambiguities to which Mr. Mathews has referred.

The provision you read contains references to concealment and unfair discrimination and also the general catch-all provision about protection comparable to that provided by and under this title in the case of exchanges.

Now, none of that is in the present bill.

Mr. REECE. I consider the provision in Senate 4023 to be broader, as you suggest.

Mr. KATZ. Very much.

Mr. REECE. Then the comparable provision in the pending bill. It is your feeling that the present bill contains no sound basis for the apprehensions which existed on the part of the municipal dealers to the provision in Senate 4023?

Mr. MATHEWS. Very definitely; assuming that there were sound bases for apprehension at that time.

Mr. REECE. It would appear from the hearings, as I read them, that Commissioner Landis felt that there probably was some basis for apprehension at that time or that he, in a way, could understand why the apprehension arose, although he did not indicate that he expected the Commission to administer the section in such a way as to bring about the conditions which the dealers were apprehensive of.

Mr. MATHEWS. Yes.

Mr. Chairman, that is all I have in the way of a prepared statement.

Mr. BOREN. Commissioner, I wanted to ask you about what I understand is a fundamental provision in the bill, recognizing the dealers' rights—and I use that term "rights" advisedly—to enter into a cooperative or corporate association for their activities; I might say setting up a sort of fictitious corporation in which, I presume, the corporate activity takes in the individual capitalist, if you can call him that, in this operation.

Has there been any particular objection on the part of individuals to being brought into a sort of corporate system into which their individual action—at least by implication—is absorbed?

Mr. MATHEWS. There has been objection come to our attention from a very limited number of sources, and that objection it seems to me, boils down to a fear, that the actions of this association might be dominated by business competitors who in some way will be in a position to injure other individuals.

Now, to meet that, we have, with the Senate committee, worked over very carefully the nature of the grant of powers to the association; the limitations on that grant of powers and the reserving of powers to the Commission. We believe that as the bill is drawn, and assuming that it is efficiently administered, the basis for that fear is not a sound one. But I would not be stating the matter correctly to you if I did not agree that from a few sources I have heard that fear expressed.

Mr. BOREN. It strikes me that we should be particularly cautious about the extent of the grant of theoretical rights to this fictitious set-up, in that the individual members of this set-up are undoubtedly in the future going to have to depend upon this corporate body for their own activity and security; and then, too, that same reasoning implies that the individual who might try to function in a little world of his own outside of this corporate system, is more or less in a position of attempting the impossible.

Mr. MATHEWS. As to certain very important types of the securities business, it is true, I think, that one could not operate successfully outside of this association, if the association gets organized on the scale that this bill visualizes. But it does emphasize the importance of being certain that the right to this association to act in such a way as to injure any of its members without fully protecting that member in his rights, is very carefully guarded.

Mr. BOREN. It strikes at the fundamentals of our American philosophy of government: I mean, it places an obligation on the Commission to carry out that fundamental, in that it becomes your obligation, if you set up this corporate body to absolutely assure equal rights to each corporate member, especially if you are giving them such a power as will more or less compel the individual to turn to the Corporation for his future operation and security.

I am not finding fault with the provision necessarily, but it seems to me that the Commission is recognizing in this act what the country at large has refused during the last 50 years to recognize, that capitalism, as an individual capitalistic system, no longer exists in this country, and that we are rather dependent, so far as security even as individuals, is concerned, upon a corporate system.

So your obligations are so great that I want to be certain, in passing over this act, that the security and safety of the individual within the corporate action is on a basis of equality comparable to the general philosophy of our form of government.

Mr. MATHEWS. We believe that is the fact. We have attempted very carefully to protect the rights of the individuals in here, realizing the dangers that you point out. And we are confirmed in that belief by the fact that we think that as a general thing, among the people in the industry, those who have studied the bill most carefully, agree with that conclusion.

Now, understand, there are a great many people—for instance, there are hundreds of dealers in the Investment Bankers Conference supporting this bill whose livelihood is just out the window if the powers under this bill are abused, if there is not a sufficient reservation of the power to protect, in the Government.

Mr. BOREN. And yet you presume they all recognize that those who try to function as individuals outside of this corporate system will be, in a sense, approaching, as individuals, an impossible situation.

Mr. MATHEWS. We have had some estimates made of the number of dealers who would come into this association. We have a record of some 6,700 dealers registered with the Commission. And that does not include dealers exclusively in municipal securities. Nobody knows how many people might come into this association. But the best estimates we have run from about 1,500 to about 2,500.

Those who take part in original distributions of securities are peculiarly subject to the necessity of coming into this situation—those who take part in large-scale distributions. Now, there are a great many people in the securities business—that is, in the securities business in the sense of being required to register as brokers or dealers with the Commission, probably some thousands of them—who will not come into these associations. That is, the type of business that they do is such that they will not see the importance of coming in.

In the aggregate, the amount of their business is, of course, relatively small. In number they are very large. I do not know how many will come into this thing. We have had a number of guesses from within the industry—and I am sure they have been made in good faith—of somewhere between from 1,500 to 2,500. That seems to be the best guess.

Mr. BOREN. It seems to me the general foundation for discussion that we have at this point strengthens the importance of caution, that there not be ill-defined grants of arbitrary power either to the Commission or to this new creation of your corporate system; and in going through the bill I hope that where there are any lines of ill-defined potentialities, that we might insert, in at least two or three controversial instances, more specific language.

It seems to me that this bill in itself, while relatively unimportant to the nation at large, perhaps is a recognition of almost a new, and definitely a progressive feature in our Government, that we will have to come to in our economic system. And it is so far reaching as a possible foundation, that we ought to be very cautious, both in the Commission and as representatives of the people, in delegating power.

Mr. MATHEWS. I think that is the spirit in which we have approached this thing. That is the result we have tried to secure. If there are any respects in which we have not succeeded in securing it, I am sure that we still want to try to secure them. So that we are not here in any sense with closed minds as to matters of that sort in the bill. The things that we are taking a definite position on are the questions of scope and principle.

Mr. BONES. My object here, Mr. Chairman, was to point out to the committee and to all interested parties, that we are creating this fictitious corporation—and all corporations are fictitious creations by the Government—

Mr. EICHER. Artificial, rather.

Mr. BONES. Yes, either way. But the point that I am making is that the individuals, if they attempt to function outside of this corporate existence are trying to meet an impossible situation.

I have finished, Mr. Chairman.

Mr. REECE. The first section of this bill dealing with the associations is not materially different from the provisions of the Stock Exchange Act, dealing with the stock exchange? That is, there is not any new principle here?

Mr. MATHEWS. No, sir. We have tried to run them parallel as closely as we could. Of course there is this fundamental distinction growing out of the nature of the business: The stock exchange is an exclusive organization. This cannot be exclusive. Anybody who will abide by the rules of the game, who has a decent character, can come into this association. There is not a property right in a seat in this association which could be transferred.

The aim has been not to narrow, but to spread out, to get into this association as many as we can of these people, and then if they come in and form the association, to parallel the stock-exchange situation as closely as the nature of things permit. But basically there is this difference in conception, that a stock exchange necessarily is an exclusive organization and this cannot be.

Mr. REECE. Yes; I understand that. Also the present act gives the Securities and Exchange Commission authority to regulate the over-the-counter market, and if you had the money and were disposed to set up an organization to do so, you could regulate the market insofar as you found it practicable. And, as I understand, in this bill you are suggesting voluntary regulation through these associations rather than direct regulation by the Commission.

Mr. MATHEWS. Yes. We are suggesting voluntary regulation so far as it can properly apply.

Now, there are certain features of the regulation, of course, that this association cannot do. They cannot prosecute a criminal case.

Mr. REECE. Would you mind saying just what you have in mind by clause (2) of section 15 (c), to prevent fictitious quotations?

Mr. MATHEWS. Well, we find this situation not infrequently. Quotations are published by a dealer which are not genuine at all. He won't buy, he won't sell, or, perhaps, he sends out generally a quotation that he will buy 10 shares of stock if they are offered to him. He will send out a quotation which bears no relation to the real market. The real market may be 40. He may send out a quotation far from that market.

I do not know that I think of other instances of it just at present. We find in the distribution of certain types of securities of new corporations instances of a sales campaign being put on, selling the stock we will say at 30 cents a share, and when we get into it, we find the market is maybe 8 cents a share. That is where there is over-the-counter trading in it. The price at which it is sold is not the market. It is a fictitious thing.

Mr. REECE. Just one other question, if I may. Is there any way by which the Commission could determine and explain in advance just what it anticipated might be done through this authority, that is giving cause for apprehension to the municipal dealers? That is, the section authorizing the Commission to prescribe such rules and regulations as may be necessary or appropriate in the public interest or for the protection of investors, to prevent fraudulent, deceptive, or manipulative acts or practices.

The municipal dealers seem to be very much concerned by that authority. It would seem as if there might be some way of reaching an understanding on that that would alleviate that apprehension. Is there any way by which it can be done?

Mr. MATHEWS. It is difficult for me to do, because I cannot understand the apprehension. I cannot understand why the municipal dealer has that apprehension where the corporate dealer does not have it.

Mr. REECE. After they have testified, you might then be able to do that, because I do not think the testimony which they gave before the Senate committee necessarily applies to this bill, because the bill to which they were speaking at that time is, as Mr. Katz remarked a while ago, considerably more far reaching on its face than the present bill. After they have addressed themselves to this particular section as now worded, it might be helpful if you have something more to say on that section.

Mr. MATHEWS. If we can do anything to be helpful, we will be glad to do it. We have not been able to so far, because we cannot understand it.

Mr. EICHER. As I perceive the focus of the controversy at the present time, the municipal dealers seem to think that they should be left just like private individuals, subject only to the statutory law defining fraud, manipulation, and deceptive practices; that is, that they feel there is no need for the setting up of a body of regulations with reference to what you might call, those well-recognized concepts of fraud.

Now, can you give us some specific examples of cases where there might need to be an expansion, you might say, by regulation, of the points driven at in subsections (1) and (2) of subsection (c) of section 15 as amended, namely (1) to prevent fraudulent, deceptive, or manipulative acts or practices; and (2) to prevent fictitious quotations?

Mr. MATHEWS. I think I might give an illustration by going back first to a case involving corporate issues. You are all familiar, of course, with what happened to the real estate securities market. We found, in administering our State statute a number of instances where dealers who were hard pressed sold bonds to customers without letting them know that taxes were in default on the properties securing those bonds. We found cases where dealers with securities on their shelves which were worth 40 and 50 cents on the dollar, created collateral trust issues and sold those same securities in indirect form at 100 cents on the dollar.

Now, as to the specific information with reference to what the exclusive municipal dealer has done, we have very little, for the reason that they are not required to register as brokers and dealers under our act. We know in general that they are about the same kind of human beings that the rest of us are. We know, for instance, in a case that

recently arose, it appears that a firm or a group of firms of dealers arranged for the wholesale forgery of municipal bonds, which they were selling. I do not know whether they are exclusively municipal dealers or not.

Mr. BOREN. Of course, that would be covered, Mr. Commissioner, without this provision.

Mr. MATHEWS. Yes. But what I am pointing out is that the business is not immune from the same sort of abuses that occur in the securities business generally.

We have heard a good deal about instances—and I cannot cite you an instance—but of instances where municipal bonds have been sold without calling to the attention of the purchaser the existence of a default. But as to specific information, the only way that very much of it could be gotten would be by an investigation in the field of the municipal bond business, to find out just what they are doing.

We are necessarily proceeding pretty much in the dark as to specific instances, in view of the fact that they are out from under the act as completely as they are now.

I do not think it is proper to suggest to the committee many of the rumors that we hear, because we have found so many instances where rumors have been circulated about what the Commission was doing or about to do, that we are inclined to discredit rumors that we hear about what other people are doing.

Mr. EICHER. They are looking for dictators under most every bed now, aren't they?

Mr. MATHEWS. Apparently so.

Mr. EICHER. Are there any further questions? If not, we thank you very much, Mr. Mathews.

The next witness is Mr. Frothingham. Mr. Frothingham, please give your name and the capacity in which you appear.

STATEMENT OF FRANCIS E. FROTHINGHAM, PRESIDENT OF THE INVESTMENT BANKERS ASSOCIATION OF AMERICA; VICE PRESIDENT OF COFFIN AND BURR, BOSTON, MASS.

Mr. FROTHINGHAM. Mr. Chairman and gentlemen, my name is Francis E. Frothingham. I am president of the Investment Bankers Association of America and vice president of Coffin & Burr, an investment bond house, Boston.

Mr. EICHER. Do you have a prepared statement you would like to leave with the committee?

Mr. FROTHINGHAM. What I have is in my head.

Mr. EICHER. We shall be very glad to listen.

Mr. FROTHINGHAM. Gentlemen, I am not going to take up any of the details of the bill. I am going to leave them to be discussed by Mr. Starkweather, whom I will speak of in a moment. What I particularly wanted to do was to give you, if you would allow me a few minutes to do so, a background of what the Investment Bankers Association is, the place that it fills, and what it is trying to do.

The Investment Bankers Association has now about 790 members scattered all over the country. Those members range from the largest to the smallest house.

Just over 100 of the members have less capital than \$50,000. About half of those have capital of less than \$25,000. Some 10 or a dozen have capital of less than \$10,000.

The association is managed by a board of governors, 32 being the governors proper and the balance being the officers of the association. These are scattered widely over the country, as I will show you in a moment.

The association has some 18, what might be called autonomous subdivisions, known as the groups, each with its separate chairman, its own officers, but working within the association.

The purpose of the association has been, ever since its inception, to raise the standards of practice and conduct in the business, to give attention to various forms of legislation, both State and National, that come up for its consideration and that affects its business and affects the public interest.

The association, through its then president, the late Mr. Christie, was primarily responsible for the development of the code in the times when we were developing codes in the country. And I think that is an exhibit of the earnestness and the purpose of the association. That code finally became the basis for the Investment Bankers Conference.

Now, if I may, in order to indicate to you the back-ground of this association, point out that of our governors, six are from New York; three from Chicago; two from Philadelphia; one from Detroit; two from Los Angeles; one from Montreal; one from Cleveland; two from St. Louis; one from Baltimore; one from Boston; one from Pittsburgh; one from San Francisco; one from Milwaukee; one from Washington; one from New Orleans; one from Cincinnati; one from Kansas City; one from Seattle; one from Denver; one from St. Paul; and one from Spokane.

That gives you the breadth of the background of the association. Now, I suppose that some five hundred members of this association are also members of what is called the Investment Bankers Conference. That Investment Bankers Conference has a board of governors, I think, of 21, of whom 17 are members of the Investment Bankers Association; four or five are also on the Investment Bankers Association Board of Governors. So that the I. B. C. cannot readily in these matters before you be distinguished from the Investments Bankers Association; so they do not in fact represent substantially separate points of view but are much more identical than a superficial consideration would lead one to think.

When this Maloney bill came up for consideration I appointed a special committee to consider and weigh the matter. That committee was made up of Mr. Starkweather, from New York, chairman of Starkwater & Co.; Mr. Perry Hall of Morgan, Stanley, New York; Mr. James J. Minot, of Boston; Mr. Devereaux C. Joseph, of Philadelphia; Mr. E. B. Hall of Harris, Hall & Co., Chicago; Mr. Jean Witter, of San Francisco. He was not only at the hearings before the Senate committee but during the deliberations of the committee was represented by his New York representative.

That committee had hearings with the representatives of the Commission—Commissioner Mathews, Mr. Katz, and Mr. Davis. We had a long and friendly discussion with Senator Maloney, Mr. Mathews, Mr. Katz, and Mr. Davis.

We endeavored in every way that we could to keep in touch with our association by means of communication to those governors and officers, so that so far as possible we might reflect its views.

Our association has all along been in sympathy with a voluntary association for the regulation of over-the-counter markets. The over-the-counter markets are a very large part of the securities business of the country. Perhaps there are 10 times as many securities in the over-the-counter market as are listed on the exchange. There may be anywhere from 6 to 10 times the actual money volume of business done daily in the over-the-counter markets that there is on the Stock Exchange. We are very appreciative of the need of regulation in various directions in the over-the-counter markets and have wanted in every way to cooperate with the commissioners in their endeavor to enforce suitable and reasonable regulations.

That is the background of our whole attitude toward this subject. So far as the municipal men are concerned, we have felt that their situation was a peculiar and special thing and we would leave the handling of it to them.

Outside of that, this association has in no way individually or as an association stimulated or fomented any objection to this bill at any point. Whatever has appeared has appeared voluntarily and as a matter of local interest or by particular persons.

We have felt, as I say, that a voluntary association was highly desirable. This bill we do not consider a self-regulating bill as setting up a self-regulating organization. It is, on the contrary, in so many directions, under the regulation and prescription of the Securities and Exchange Commission that it cannot be so called. Its relationships are, if you choose, all right in many directions. We have no objection to many of them. But, on the other hand, we have felt it our duty to try to put this bill in such shape that it would meet the exigencies of market considerations and difficulties, which we are keenly alive to, while at the same time trying to make a bill that would accomplish the purposes in hand.

Our theory in regard to this bill is that it should be within itself complete and self-explanatory. Any bill or any document, in our business experience, which depends upon interpretations sooner or later does not receive those interpretations. There is a very rapid turn-over amongst us all; a turn-over in the Commission; a turn-over in our own business, a turn-over in life. Already the Securities and Exchange Commission has had three chairmen in the short period of 4 years.

As time goes on those who were responsible for interpretations are no longer with us, and those who have to operate under a bill or operate under any contract that any of us makes among ourselves are sooner or later reduced to the interpretation of the words of the contract.

But our purpose is, not in any antagonistic way but in a friendly, cooperative way, to get this bill, if possible, in that shape so that it will be self-sufficient and self-explanatory.

After this committee that I speak of appeared before the Senate committee and after the Senate committee had passed on the Maloney bill and had given its reasons for its approval, I called a meeting of the board of governors of our association in Chicago. Out of 40 governors, 33 were present, showing the interest that was taken in the matter. Two were sick, two were out of the country, and the other three were detained by important business engagements that they could not set aside. Out of those three, two sent in their opinions,

so that that meeting of the board of governors, which continued through an entire day and exhaustively went over every phase of this bill, represents, as honestly as any could represent, the thoughtful official representations of the Investment Bankers Association.

Now, we were conscious of the fact that there was a very widespread objection to this bill. We felt that perhaps a great deal of the objection was because of a lack of understanding of the bill, because it had not reached the hands of many in the business; and the impressions of it and the interpretations of it we felt were perhaps not based on the broad grounds that they ought to be.

We very carefully refrained, as I telephoned to Commissioner Mathews after our board of governors meeting, from polling our membership or endeavoring to get a vote on the subject, because we felt that that vote would be overwhelmingly adverse to the bill. Our reason for not doing that was that we felt that as the bill became better understood it would come more near to receiving the support which we thought it was entitled to.

At that board of governors meeting we passed two resolutions. One showed a two-thirds majority for the report of the committee, which was to support the bill, if certain further amendments could be made. That first resolution eliminated the amendments and voted by a two-thirds majority to support the bill.

The second resolution referred to the three further amendments which Mr. Mathews has spoken of and which we still feel very important to incorporate in the bill.

That second resolution was supported by a 100 percent vote and the feeling of the board was that if the three amendments were incorporated in the bill, the board of governors' initial vote would have been 100 percent instead of two-thirds.

Immediately that was done, under the instructions of the board, I sent to the Commissioners, to Senator Maloney, to Senator Wagner, a statement of just what the board had done with a copy of these resolutions.

Now, gentlemen, as time has gone on, conditions have changed very materially, have changed in the business world very much for the worse. We are conscious of the fact that the approval of this bill is less substantial than it was originally; that throughout the country there has been a feeling of disquiet and unrest about it. And I think that if a vote were taken today, probably the vote would be against the bill. I have little doubt about that.

There have been groups get together as in New England, as in Chicago, out in Wichita, Kans., and in other places, strongly objecting to this bill, at least unless certain amendments can be made.

The situation is not an easy one to meet. Business is very much disturbed, very much concerned about everything now, as you know. Every step in the way of further regulatory legislation, with detailed prescriptions as to rules and precision of detail, goes so far as seriously to hamper and interrupt the ordinary course of business in the many details which really the businessmen are more familiar with than anybody else can be.

There is no desire, however, on the part of business—I think I can say it—to protect anybody who is guilty of fraud, to protect anybody who is guilty of wrongdoing, in any way to cover up or conceal derelictions. But there is, on the other hand, a very great body of men i

the business who are as earnest as anybody can be in the Government, as any of the Security and Exchange Commissioners can be, to do everything that can be reasonably done to put this business on the plane everywhere that it should be. The business, on the whole, is pretty well handled. On the whole it is honestly handled. To seek out the meticulous and detailed rules which will prevent the few from going "haywire" and greatly inconvenience and slow down the free processes of the capital market is to make a mistake. So that I am perfectly confident that the Investment Bankers Association, every member of it, would agree with me in that statement.

I will not say anything more, gentlemen. I will turn the meeting over now to Mr. Starkweather.

Mr. REECE. Does your association require dues of its members?

Mr. FROTHINGHAM. Yes.

Mr. REECE. Would you mind stating what they are?

Mr. FROTHINGHAM. We have a varying schedule of dues, from the largest to the smallest houses. I think our maximum dues are \$200. We have a class A, a class B, and a class C membership. It does down, as I remember it, to \$50.

Mr. REECE. So the smaller houses, pay less dues?

Mr. FROTHINGHAM. They pay less, yes.

Mr. REECE. May I ask one other question? In order to comply with the provisions of this bill, would it be necessary for the association to increase its dues and if so, approximately to what extent?

Mr. FROTHINGHAM. You refer to the possibility of the Investment Bankers Association becoming one of the registered associations under this bill?

Mr. REECE. That is right.

Mr. FROTHINGHAM. That is a matter that we are now considering, whether or not the Investment Bankers Association should or could be such a body.

The Investment Bankers Association is made up of houses who are primarily in the capital market business, raising new capital for various municipal and industrial and other purposes. We are exclusive at the present time in that respect. But we are inclusive with regard to the entire field of that kind of operation throughout the United States. We have members who also do a brokerage business, but that is not primarily the concern of our association. They do that, so far as we are concerned, incidentally.

Mr. REECE. What I really had in mind is, in order to register with the Commission under the provisions of this act, would your association find it necessary to impose a financial obligation on its members which might, in the case of the small members, become burdensome in view of present conditions?

Mr. FROTHINGHAM. I do not think that is a question, sir, that I can answer, because how these registered associations will be set up and organized is still in the lap of the gods. Opportunity is given under the bill for several of these associations to be set up. My judgment would be that the functioning under the bill will be better if there is one national association, with local groups or affiliates. I cannot very well conceive a couple working parallel.

Now, what organization should become one of these voluntary associations, whether the Investment Bankers Conference might metamorphose itself into such an association; whether or not the

Investment Bankers Association might become one; just how it should be handled, is something that we are earnestly considering now, in order that the most effective operation may be brought about when and if this bill is passed.

Please ask me, gentlemen, any questions you want to, because the Investment Bankers Association has nothing to conceal in this matter. I would like you to understand our position.

Mr. BOREN. Mr. Frothingham, I believe that your association, of course, is built on some particular advantage of service to its members. Is there any feeling on the part of the Investment Bankers Association that whatever advantages lie inherent in their cooperative action are invaded by this bill in any way? There are some benefits that your organization carries to its individual members. Do you feel there is a danger of the loss of some of those benefits in this bill?

Mr. FROTHINGHAM. That might possibly be. It depends upon the functions which a registered association could assume. I am thinking now quite out of my own mind. These matters are still under discussion with us and I can express nobody's views but my own. But I have been unable to see quite how this Maloney bill, being set up in its terms for the regulation of over-the-counter markets, without any word in it suggesting any other functions, either in its wording or between the lines; with the only words in the bill, if I remember rightly, in the preamble which says, "and for other purposes," which would suggest it could be a proper function of this association to watch pending legislation, to take a hand in it, to take positions with regard to it, to appear before the Commission or before the Houses of Congress—

Mr. BOREN. Of course, that is part of all associations.

Mr. FROTHINGHAM. I have not been able to see quite how those functions could be assumed by a body created under this bill. If they could be, they might do away with the need of an Investment Bankers Association. If they could not be, I should say that there is a very definite field for the work of the Investment Bankers Association, in connection with the many legislative matters and the broad problems that come up to be considered by our investment banking field of operation.

That is really an underwriting field, carried down to all the small participants in underwriting which is, to my thinking, separate and apart from the particular job of regulating the over-the-counter markets. All of that is influx, and I do not see quite how it is going to work out.

Mr. EICHER. Does your association assume to do any policing of its individual members? In other words, do you set up a national standard of business practice and provide for some punishment if they do not live up to it?

Mr. FROTHINGHAM. We have, Mr. Eicher, repeatedly set standards of business practice. In a voluntary association, the question of policing, as you can readily see, is a very difficult one. If you over-police, your membership disappears. If you under-police, you do not perform your functions. So that really the thing which the Investment Bankers Association has done as the years have been going by is to put constant pressure on improving standards and methods of business. And we think definitely we have raised them. We have done a great deal of valuable work in connection with bringing to-

gether and making more uniform different State laws, overlapping and similar, such as notably in the "blue-sky" direction. We think our efforts have been cumulatively useful in the direction of improving standards. But when you ask the question about policing, we have to be very cautious.

Mr. EICHER. Do you not think that with just the right amount of governmental support, you would be helped substantially in maintaining those standards?

Mr. FROTHINGHAM. We have no objection at all to Government support. What we want is Government cooperation. What we object to is the meticulous rulings of the Government with regard to the details of a business which we, in the business, can better understand and appreciate.

We realize, of course, that in these times of change, and different points of view, we may be hidebound by some of the things we have been doing forever and want to keep on doing forever, in just the same way that the point of view of those who, under a Securities and Exchange Act, want to rectify all existing abuses, may proceed in that direction more rapidly than the business can absorb the suggestions. That results, in many instances, we are confident, in increased confusion and in a slowing down of the normal processes of a free capital market.

Now, the Securities and Exchange Commissioners are alive to that, I am fully convinced. They are alive to the fact that there should be many simplifications. And one of the things which the Investment Bankers Association would like to do is to cooperate with the Commissioners in a sincere effort; while not standing in the way of the curing of abuses, yet helping to make the steps toward those cures more rational and workable than many of them are at present.

Mr. EICHER. Do you have any statistics indicating the proportion of the total volume of over-the-counter transactions in the Nation that the membership of your association represents?

Mr. FROTHINGHAM. I suppose, Mr. Eicher, that the Investment Bankers Association probably does at least 85 percent of the underwriting business of the country.

Now, by underwriting business, I mean the collection of capital from the sources where capital is available, and turning it over to industry for the conduct of its operations, or to the municipalities for many municipal improvements which are not of a self-sustaining character; at least 85 percent.

Mr. EICHER. If there are no further questions, thank you very much, Mr. Frothingham.

Mr. FROTHINGHAM. Thank you, Mr. Chairman.

Mr. EICHER. Our next witness will be Mr. Starkweather. It is now 11:45, and I think it would be best if we recessed until 1:45 when Mr. Starkweather will take the stand. May I say that the clerk suggests that any persons who are here who wish to testify and are not on record with him, make their application to him during the recess. Also, in the meanwhile, during the noon recess, if there are any groups here who would like to unite upon one spokesman for the afternoon, we would be very glad to have the number of appearances reduced as far as we can, with full opportunity, however, for full expression from anyone who wishes to be heard.

The committee will stand in recess until 1:45.

(Whereupon a recess was taken until 1:45 p. m.)

AFTER RECESS

The subcommittee reassembled, pursuant to the taking of the recess, at 1:45 p. m., Hon. Edward C. Eicher (chairman) presiding.

Mr. EICHER. The committee will please come to order. We will hear Mr. Starkweather. Will you give your full name for the record, Mr. Starkweather?

**STATEMENT OF JOHN K. STARKWEATHER, STARKWEATHER & CO.
NEW YORK, N. Y.**

Mr. STARKWEATHER. My name is John K. Starkweather, of Starkweather & Co., New York.

Mr. Chairman and gentlemen of the committee: In speaking on this bill I am speaking as chairman of a special committee organized by the Investment Bankers Association to consider this matter, but I should also like to say that I speak, having in mind the fact that as one of the smaller dealers in securities, this bill influences my own business and, therefore, it is entirely possible that some of my feelings may reflect that also.

The Investment Bankers' Association at their meeting in Chicago passed two resolutions, the first one endorsing the action of this committee, of which I am chairman, in supporting the Maloney bill. At the same time it was evidenced at that meeting that there was a very strong undercurrent of opposition. That opposition centered in certain definite sections of the country, particularly in New England and in a district of the Ohio Valley, centering on Cincinnati and Louisville. That opposition was so strong that the board of governors finally passed a second resolution in which the president of the association was instructed to advise the Securities Commission and the Congress that in their opinion the organization of the association under the bill might, and probably would be, seriously hampered if certain changes were not made; that the committee and the board of governors were prepared to do all in their power to see that an organization was successfully carried through, but that they felt there would be great reluctance on the part of many groups, and that the whole process would be slowed down and made more difficult.

With that as a preliminary, our first change, which I should like to discuss, has to do with a matter which Commissioner Matthews discussed this morning, namely, the insertion of the word "willfully" on page 15 of the bill, line 7, before the word "violated."

You will notice in the bill as it is before you that where violations involve the Securities Act of 1933 "willfully" is inserted; where it becomes a question of removal of officers of the association the word "willfully" is also inserted. In connection with the Securities Act of 1934, the word "willfully" has been omitted.

We believe that "willfully" should be inserted in that place. We believe that it is entirely logical and in line with the other sections of this act which involve similar wording. We believe it is only fair to the individual dealer, and I speak in this connection, having in mind my own particular situation. We have in the Securities Act of 1934 a bill which in this copy I have is some 39 pages long. We have in the bill before us an additional 19 pages and we have built up—

Mr. BOREN. Mr. Chairman—

Mr. EICHER. Mr. Boren would like to ask a question.

Mr. STARKWEATHER. Yes.

Mr. BOREN. I would like to ask you, where you wanted to insert the word "willfully", when it refers to the officers of the organization—

Mr. STARKWEATHER. Where the Commission has the authority to remove from office any officers or director. That is, starting in line 18 of the same page.

Mr. BOREN. What page?

Mr. STARKWEATHER. Page 15.

Mr. BOREN. And where else is it that you want that word inserted?

Mr. STARKWEATHER. We want the word inserted in line 7, where it applies to the Securities Act of 1934. You will note that under the first section it reads this way, in effect, that a member may be suspended from an association for any violation of this title which includes the Securities and Exchange Act of 1934, as well as this amendment to it.

Mr. BOREN. The term "willfully" is used in the section referring to the officers—that is now in the bill?

Mr. STARKWEATHER. The term is used in referring to officers; used in the section referring to the Securities Act of 1933. It is left in that section having to do with the Securities Act of 1934 and this amendment thereto, and we see no reason why it should—

Mr. BOREN (interposing). You do not find any objection to the language in this paragraph, giving in broad general terms powers to make rules, regulations, and so forth, and so on, provided the word "willfully" is inserted.

Mr. STARKWEATHER. We have no objection if the word "willfully" is inserted. Of course, I realize the strength of one point Mr. Matthews brought out this morning, and it is perfectly true, that insofar as the word "willfully" is concerned, in a section like this, it increases the difficulties of administration. There is no question about that. On the other hand, looking at it from the standpoint of the businessman, it seems to me that when you say a man's business in effect can be killed for any violation of the Securities Act of 1934, or this amendment to it, or any rules or regulations put out under it, it seems to me that you are inflicting on the dealers of the country, the small-business men, as well as the large-business men, a tremendous burden. We cannot all sit with a lawyer at our right hand every minute. We have got to handle our business without legal help continuously and the very idea that I might be put out of business for a technical violation on the part of one of my men, which I know nothing about, appeals me, frankly.

It is—I think that it is perfectly true, what Mr. Matthews said, that you cannot assume and you ought not to assume that any action of the commission will be capricious. I do not expect it to be; but I do know this, that the views of men differ on even the same wording. The views of men differ as to very small nets in this life and the very idea that I may be put out of business or in effect put out of business—because that is in effect the penalty here—is a pretty violent penalty to place in the control of any commission. It seems to me—

Mr. BOREN. You would be agreeable to inserting the word "willfully" after the term "violates any provisions of this title"?

Mr. STARKWEATHER. That is what we would like.

Mr. BOREN. After that, and not prior to that; not say has "willfully" violated any provision of this title?

What I am getting at is, you are not wanting the word "willfully" in there with reference to the law as it appears in this act. You do want it in there as to the rules and regulations which the Commission may lay down?

Mr. STARKWEATHER. I think it should be in for the whole thing, Mr. Boren.

Mr. BOREN. As a general matter of law you would not hold that we ought to test the law on whether or not there is an intent to violate the law. I think that ignorance of the law does not excuse violating it as a general principle.

Mr. STARKWEATHER. That is perfectly true; yet I myself see very little difference in the use of the word "willfully" in subsection (B), line 12, where it reads:

has willfully violated any provision of the Securities Act of 1933, as amended, or of any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe, was willfully violating with respect to such transaction any provisions of such act or rule or regulation.

I see very little difference.

Mr. BOREN. I agree with you there, all right. I do see a distinct difference where you say "willfully," with relation to the officers of the company, but now what I am trying to get at is this: Is it the law itself that you want to have tried on the basis of intent, or is it your fear of the possible great accumulation of specific rules, technical rules, we will say, by the Commission?

Mr. STARKWEATHER. Well, it is a combination of both. The law itself is very technical, in spots. The regulations are becoming even more technical and are piling up continuously. Every case that is brought before the Commission results usually in some new interpretation of some specific item of it.

Now, that process is probably going on for years. We are piling up the body of interpretation, rules, and regulations, which it becomes extremely difficult for the ordinary dealer to follow. It may be that the larger dealer who can afford to employ counsel continuously can do that. The smaller dealer certainly cannot. The smaller dealer, in the smaller towns, I know, cannot. And, I feel that the word "willfully" is properly in the second portion of this starting with (B). I think the same provision ought to be in (A), where it applies to the 1934 act. I can see really no reason why it should be a violation, should be the subject of these penalties for a violation of the 1934 act and not the 1933 act. It seems to me the same general theory applies to both of them.

Mr. BOREN. I find no fault with your analogy there, but if there is anything in this law that is highly technical and not clear, then I, as a member of the subcommittee, would like to clarify any portion of the law where there is any doubt about it.

Now, I think that is sufficient answer to your contention. You want the law also to be based on intent.

Now, acting on that assumption, you do not want the wording to apply necessarily to the law itself as to any possible regulation and so forth that the Commission might in a sense put upon your business. I can see that there is as much logic in believing that the Commission will put such regulation in as there is in the assumption that they will

not. I mean after all, men are just men, and this is a Government of law and not of men.

Mr. STARKWEATHER. That is right.

Mr. BOWEN. And so I am interested very much in your point; but I would like to see if what you have to offer applies to the rules and regulations of the act.

Mr. STARKWEATHER. A little later I want to go a little more extensively into this, but let me just call your attention to page 16, line 15, the wording "to prevent fraudulent, deceptive, or manipulated acts or practices."

Now, the word "manipulation," which I would like to discuss more at length a little later, is a very broad word.

You take the popular conception of manipulation and you might get one set of facts, but if you take some of the highly technical interpretations of the word "manipulation," you can arrive at an entirely different aspect.

Now, that is the type of thing, and as I say, I should like to discuss that particular section more at length later and would rather not do so now; but that is the type of phraseology in this act which bothers the dealers.

If you have an exact definition of "manipulation," that is one thing. I do not think the Commission has as yet been able to arrive at an exact definition of manipulation. I know that there is a tremendous amount of confusion on the part of dealers as to just what constitutes manipulation and what does not.

As I say, I should like to develop that thought a little bit further and possibly in connection with that section I should bring out a little bit more clearly what I mean about this.

Mr. BOWEN. Your argument here is about the use of the term "willfully." If you can, or are prepared to do so, I would like for you to present an argument not on the assumption that it is correct in (B), but on the assumption that this subcommittee will probably strike out "willfully" from all sections.

Mr. STARKWEATHER. I would answer that in this way: I am speaking not as a lawyer. I cannot speak from the legal aspect of it. I can only speak upon the basis of my own experience in business.

I have in my organization—a relatively small organization—but I have some 30 or 40 people.

Now I try, and my partners try, to see that there is nothing done in our office which is not in entire conformity with the law. That is our intention. But I never know when some of my men may do something which is contrary to some technical section of this law. I do not know what those will be. I never know what they will be. But I have a strong feeling myself, and I say, speaking entirely not as a lawyer at all, I have a strong feeling myself that I should not be put in a position where a nonwillful and technical violation of the law should subject me to suspension from this association.

You will recall, gentlemen, that the reason, the only reason, you can organize these associations lies in the power granted these associations in that section of the law to withhold from the nonmembers, commissions on sales of securities; also to prevent, presumably, a non-member from being a member of a syndicate headed by members.

Now, for those of us, those in the business, who do not ordinarily go into syndicates, either as underwriters or as selling group distributors, that may make no difference; but in the business of a very large percentage of the dealers of the country that would make a very serious difference. It would mean that a large part of the income of my firm and other firms would be eliminated if I could not do business with members of that association.

Now therein you give in effect to the Commission the power of life or death over my business.

I do not object to that if I willfully violate the law, knowing what the law is, and deliberately violate it; but I do object to that theory of it if it is a technical violation of the law which I know nothing about.

Now, I think, myself, that any serious violation of this law would certainly probably be willful. So, the Commission would have entire authority, presumably, to suspend a dealer for any serious violation, but I do not think, speaking of it from the standpoint of the dealer, I do not think that the Commission should have the authority to put anyone out of business because he breaks a technical rule.

Now, gentlemen, that generally is a nonlegal explanation. I am giving my personal explanation as a dealer and I know it is the feeling of hundreds of dealers all over the country, feeling that that power is excessive, that the possible penalty is excessive, while it may not be used and probably would not be used in 100 cases, if it is used in 1 case unfairly, it should not be in there.

Mr. REECE. I see that "willfully" is used in section 6, subsection (B), dealing with the registration on national security exchanges in the Securities Exchange Act of 1934.

Mr. STARKWEATHER. Willfully is not in that. My understanding is that "willfully" is not included in the present 1934 act having to do with members of exchanges, but is in the 1933 act under somewhat similar conditions.

Mr. REECE. What is the relationship of it in section 6, this provision under subsection (B) to the effect that no registration shall be granted or remain in force, and I interpret that "remain in force" as carrying the power to annul the registration, unless the rules of the exchange includes a provision for the expulsion, suspension, disciplining of members for conduct or proceedings inconsistent with just and equitable principles of trade and declaring the willful violation of any provision of this type or any rule or regulation thereunder shall be considered conduct or proceedings inconsistent with just and equitable principles of trade.

Mr. KATZ. That relates to an entirely different subject matter. That relates to the basis for permitting an exchange as such and an entire exchange, the New York Stock Exchange, for example, to do business and does not relate to business which determines whether or not a particular individual member of an exchange should be permitted to retain his membership on that exchange.

Now, the second problem, the problem of determining the position of an individual member on an exchange is governed by section 19 (a) (3) which is in the present law.

Mr. STARKWEATHER. That has been my understanding, Mr. Reece.

Mr. KATZ. That relates to another question, section 6. Section 19 (a) (3).

Mr. STARKWEATHER. Perhaps. That is another question. I am sure that I cannot answer that.

Mr. REECE. This section, however, would seem to require the exchanges to have provisions in their organization by which the willful violation of this title or rule or regulation of the Commission should subject a member of the exchange to discipline.

Mr. KATZ. By the exchange.

Mr. STARKWEATHER. By the exchange; suspension by the exchange.

Mr. KATZ. Yes; by the exchange.

Mr. REECE. By the exchange; but under penalty of having registration revoked if such suspension, expulsion, or other disciplinary action were not taken which indirectly leaves it with the Commission.

Mr. KATZ. Well, I should think that you might describe the situation in this way: Let us take the position of an individual member of an exchange. Let us consider how he stands. Let us say that he is an individual and a member of the New York Stock Exchange—

Mr. BOREN. Mr. Chairman, if I may interrupt here, I would like to request that Mr. Katz rise that we might hear him better, and I am perfectly willing for him to, while he is on that subject, point out examples in this bill, and tell us what the effect would be if we put it in one section and left it out of another.

Mr. EICHER. That might shorten our hearings, if Mr. Starkweather is agreeable to it.

Mr. STARKWEATHER. That is perfectly agreeable.

Mr. KATZ. To take into consideration first your question, Mr. Reece: You see, if an individual member of an exchange violates a provision of law he may, as a result of that action, render himself subject to three kinds of disciplinary action. First, discipline by the Commission; secondly, discipline by the exchange under its own rules, adopted by the exchange as a voluntary matter; third, discipline by the exchange under such rules as the exchange requires, or as the Commission requires the exchange to adopt.

Now, to consider the last category first: Section 6 merely says that as a minimum requirement, the least we will require of an exchange is that it should expel its member for a willful violation of law. That is the least we require of an exchange. An exchange may go further and, indeed, consistently the exchanges do go further, and lay down a great many other rules for violation of which an exchange may expel a member.

Now, the law says, supposing an exchange restricts itself to a provision that a member of the exchange shall be expelled only for willful violation of law.

What about the member of the exchange who violates the law under circumstances where the exchange does not see fit to find violation, willful violation? What happens to him? Shall the exchange have now power to act?

Well, the answer to that is contained in section 19 (a) (3), which says in any such case if a member violates the law the Commission may prescribe expulsion of the membership. Now, the actual procedure by the Commission in the expulsion of membership is one under which he has protection other than a procedure by the exchange itself, for the law requires the Commission to have a public hearing. The law requires the Commission to accumulate evidence. The mere finding of the fact is not sufficient. The law requires the Commission

to act by organization, which is appealable to the circuit court of appeals. None of these safeguards in the way of the requirement of a hearing, a finding of facts, a determination supported by facts, and provisions for appeal to the courts apply in the case of action by the exchange.

That is, clause (a) is parallel with section 19 (a) (3) in its present form. So far as control over a member is concerned, in one of these associations, it would be precisely the same control so far as the Commission is concerned as the member of an exchange now is controlled, under section 19 (a) (3).

Mr. STARKWEATHER. That is our understanding about it, and the two parallel without any question; but regardless of that fact, our association believes that it is only fair and just that a member should not be put out of business for a nonwillful and technical violation.

Mr. REECE. Do you know of any member of the exchanges having had any difficulty with this provision in 19 (a) (3) since it has been in operation?

Mr. STARKWEATHER. I believe there has been none at all, Mr. Reece. I do not know of any such cases.

Mr. BOREN. This provision only has to do with removing a member from the association.

Mr. STARKWEATHER. That is correct, suspending or expelling.

Mr. BOREN. And that is true of both sections (A) and (B).

Mr. STARKWEATHER. Yes; that is this section having to do with the power of the Commission to suspend members from the association, or expel them.

Now, the second point that the Investment Bankers' Association has in mind occurs on page 16, section 2, subsection (c), and sub-heading (1), which in effect gives the Commission authority to make rules to prevent fraudulent, deceptive or manipulative acts or practices.

Now, I believe that in reading that over casually, the intent of it, to my mind, at any rate, would be that the section had to do with fraudulent transactions. The wording of the present act which is the wording we suggest, occurs in section 15 (c), and we recommend the change of this wording to read as follows, which is exactly taken from the other act, or mostly so. I think the wording is exactly the same, "prevent transactions by means of manipulative, deceptive, or other fraudulent devices or contrivances."

The Commission shall for the purpose of this subsection by rules and regulations define such devices and contrivances, or manipulative, deceptive or otherwise fraudulent.

We see no reason why this change in wording has occurred. As I understand it, the original wording was agreed upon by and between the Commission and the dealers and the committees of Congress.

I think there is no question it was intended originally to guard against fraudulent transactions. We have no quarrel with that at all. We are just as anxious to prevent fraudulent transactions as anybody else can possibly be. We have just as much interest as anybody else can have; but when you analyze this particular section of the law, you see that it carefully distinguishes between fraudulent, deceptive or manipulative acts or practices.

To most people the word "manipulation," I think, conjures up the picture of a large operator in the stock market going in and buying up

a lot of securities and running the price up 10 or 20 points and unloading them on the unsuspecting public. There may be some of that. There may have been some of that in the past. I think there is very little of it going on at the moment. But there are a great many other things which may come within the technical meaning of "manipulation" which are quite different and for which the penalty involved in this bill is excessive.

There is one case which is before the dealers of the country now, which is in point, I think, and that is the case of the syndicate which handled the Pure Oil preferred stock. I should like to discuss that for a moment. That syndicate made a contract with the Pure Oil Co. for the purchase of some \$44,000,000 of convertible preferred stock and that stock had to be offered to the stockholders for a period of a month or thereabouts, and at the expiration or during the month, the market changed rapidly and the stockholders took practically none of it, and at the expiration of the period the syndicate took on approximately \$43,000,000 worth of the stock.

With that amount of stock on hand, and with market conditions upset anyway, it was only natural that the stock should substantially decline and after the syndicate had held it for a number of weeks or months, the group was finally closed, and the market became free.

At that time, the market was approximately 74½. There then came up the question as to what the syndicate might do in the way of trading and, as I understand the situation—I am not a member of that group and I have no interest in it whatsoever. I am purely an observer. As I understand it that group approached the Commission to inquire what in their opinion could be done. It is my understanding that no ruling was ever issued, but that a very informal opinion was issued to the effect that if the dealer wanted to sell his own stock and take his loss, he could do it at any price he wanted; but if the price happened to be above 74½ and he told one of his customers he thought it was a good thing to buy, and went out and executed that order at over 74½ he would run the risk of being subject to a charge of manipulation; but if he bought it at 74½ or under, he would be all right.

Now, whether or not that is exactly the way the Commission put it, I do not know, but that is certainly the way the business understands it.

The net result of that is something like this: that if on a share of stock worth some seventy-odd dollars the dealer in that group buys stock at \$75 a share, he may be breaking the law. He may be subject to penalty for manipulation. If he buys at \$74.25, he is apparently well within the law and an honest dealer.

Now, that illustrates the fact that the difference of 75 cents on a share of stock selling at seventy-odd dollars, makes the difference between being a law-abiding citizen and a lawbreaker, which illustrates the fear that the business has of this particular wording.

There certainly cannot be any question that if a matter of 75 cents can make the difference between the legality and the illegality in the mind of the authorities, we arrive at a pretty fine definition of what manipulation is.

If there is an intent to defraud the customer by selling at 75, that is one thing, but it hardly seems that selling at 75 is defrauding, and selling at 74½ is not. We are not objecting to the inclusion of all of these things so long as they are connected with fraud, and I may say,

that has been the position of the Investment Bankers' Association right from the start of the discussions on this bill, that we have felt right along that these things should be tied into fraud. If they are not tied into fraud you will arrive at the position where a Government commission has to define a very broad and uncertain term, a term which is very difficult to define, as is evidenced as well as anything else by the fact that the similar wording in the 1934 act has never resulted, so far as I know, in any definite set of rules as to what constitutes manipulation. It is a very difficult thing to do, I will admit, but I think that to leave that to the discretion of the Commission is a mistake. We think strongly that it should be tied in with fraud.

Now, there is another type of manipulation which in my particular business interests us very much. Take for instance an industrial company that I know of that has some bonds outstanding, 4 1/2-percent bonds, that I think are good. They earned their interest several times over, last year, and are commonly regarded, pretty well regarded, as sure of paying their interest, but due to market conditions those bonds have gone down to a figure which I do not believe represents their value.

Now, under ordinary circumstances in the past, if I found a bond that I felt was seriously undervalued, as this bond, I might say, selling at 60. I think it is worth substantially more. I would feel entirely justified in going out and buying such bonds under the price I thought a fair price. Is that manipulation? I do not know whether it is today or not. I would not dare do so. Therefore, the bond sells at 60 to the detriment of the public; to the detriment of the company, and nothing can be done about it.

Now, this wording as it stands today, in my opinion, would make it extremely difficult for anybody to make any attempt to buy these bonds with the idea of remarketing at what they regarded as a fair value. It also, without any question, is going to make it extremely difficult for any company in the future to underwrite issues such as the Pure Oil deal, where it involves delay through offering rights to stockholders. I think it will be impossible until there is some clarification of this situation. I think that is very unfortunate for everybody concerned, because it interferes with the raising of funds which is desirable and necessary for industry.

The third section which the Investment Bankers' Association at their meeting in Chicago felt should be changed has to do with section 3, starting on page 17, and we have felt that all of that paragraph starting with line 7 and running on to the end should be eliminated. I am going to touch on that a little briefly, because I understand that a group of dealers in Boston who are very much interested in that section are going into it a little more exhaustively. But in general this situation has to do with the civil liabilities which may be incurred for violation of items 3, 4, and 5 of section 2 on the preceding page.

Now, if you notice those sections, you see that they are hypothetical types of sections. The first one, No. 3, to provide safeguards with respect to financial responsibility of brokers and dealers; the next one, to regulate manner, method and place of soliciting business; the next one to regulate the time and method of making settlement payments or deliveries.

I do not know what type of regulation the Commission has in mind under those sections. It is obvious that for the most part they will have to do with routine and highly technical subjects. For instance, time and method of making settlement; I cannot imagine why such a section as that should require power on the part of the Commission to put into effect a penalty which may involve recession at some date later which is always after the market has gone substantially down. Resession cases, of course, as we all know, only come after big breaks in the market. Why a man should have the right to come to me a year from now and say, "I want my money back because you have violated a particular provision relating to the time or the manner in which you should have made delivery, or because you have violated a technical provision as to the time or place of soliciting the business," I cannot see.

Mr. EICHER. If he had made money, you would not have heard from him.

Mr. STARKWEATHER. If he had made money, that is right, you would not have heard from him. You never do. Nobody ever asks for money back at cost if the market goes up. The only time they ask for their money back is when the market is down.

Now, I have no objection, of course, to any man asking for his money back if I have done something which was improper. If, for instance, I have given him improper information; if I have misled him, or deceived him in any way, obviously there is no objection. But, just take as an example—these may be frivolous examples. I do not know. But, suppose that the Commission put into effect a rule that I cannot solicit business at a man's home and I go to your home for dinner and in the course of a casual conversation we discuss a certain security and the next morning you come to my office and say, "I was rather interested in that. I think I will buy some of those." And, I execute your order, and a year later the market goes down 20 points and you come to me and say, "Now, you came to my house and solicited this business. I want my money back."

Maybe that is pretty frivolous. I do not know. But, why should the Commission have the power to do such a thing? I do not think they should.

Mr. EICHER. That is a rather extreme illustration; is it not?

Mr. STARKWEATHER. I think it is. I purposely made it a little extreme, Mr. Eicher, because I thought it would bring out the point I have in mind more clearly if I did. As I said, I think that these capricious examples, but under this law they have that power and any smart lawyer could probably make trouble for me if he wanted to.

The point I wanted to bring out is this, that this is the type of thing I do not think should be subject to that type of penalty.

Now, if it is a question of fraud; if it is a question of fraudulent manipulation, I have no objection at all; but when it comes to a question of a violation of a highly technical rule, I see no reason why the Commission should have the power to say to me that this particular rule for reasons that seem to us desirable, shall make you subject to the voiding of that contract.

Now, as I say, there are other members here who will develop that a little bit more, but I wanted to bring that before you and give you my observations on it.

Mr. EICHER. Any questions? Thank you, Mr. Starkweather.

We will hear Mr. Minot.

Commissioner MATHEWS. Is that not true of the regulations dealing with municipal securities rather than—

Mr. WOOD (interposing). No, not entirely; in the various States they have laws that deal with it.

Commissioner MATHEWS. The regulations of dealers in municipal securities is not the same as that which regulates the dealers in corporate securities.

Mr. WOOD. No; I do not think it is.

Commissioner MATHEWS. And quite generally, they are exempt from blue-sky laws.

Mr. WOOD. Yes; I think that is true, but I do not subscribe to the thought that the States are not regulating them.

Now, the investing public does not appear, demanding this legislation, as far as I can find; and no investors or investing organization has appeared in support of the legislation. I know that the States and municipalities do not want it; the dealers do not want it, and the only evidence that has been brought to either the Senate or to this committee, in support of the bill has been offered on the part of the Securities Exchange Commission.

We know that the investment organizations, such as insurance companies, are opposed to it, and we do not find that there is any demand from the public, indicating there is a need for it, and, as I say, I am opposed to regulation merely for the sake of regulation.

In all the time these laws have been on the books, I have yet to see any municipal dealer prosecuted by the Securities Exchange Commission for fraud. There may have been some. The business is large and possibly there may be some fraud, but if it were so widespread, I think it is a pertinent question to ask why the Securities Commission has not done something about it.

Thank you, Mr. Chairman.

Mr. EICHER. Thank you, Mr. Wood.

Do you want to be heard, Commissioner Mathews, for a few moments? We will have to suspend in time to answer the roll call.

STATEMENT OF COMMISSIONER GEORGE C. MATHEWS—Resumed

Commissioner MATHEWS. Mr. Chairman, I realize perfectly well that the cities and other public units have gone on record against this bill. A great many of them went on record against the bill without having seen it; they went on record against the bill on the reputation that it would embarrass their credit and increase the cost of their financing, and the argument itself was made to show that this would increase the cost of financing, that the Commission would embarrass securities merely by its rules and regulations, so as to make it difficult to sell securities in that market, and consequently weaken the credit of the municipalities.

Now, let us assume that argument, and take it for granted for the sake of argument that the power to do such a thing can be found within this act. If that is seriously intimated, as the view of the Commission that it would like to do so, or of any future Commission, then I say, without exaggeration, that you ought to take away from this Commission all the power it has to regulate the security business in any form, because, can any person, possessed with common sense, imagine that a Government regulatory body would set up standards

which are so restrictive that they would increase seriously the cost of securing money for every public purpose in this country?

Furthermore, can you imagine that it would do it without also increasing the cost of money to every corporate or any other agency, as far as securities are concerned?

And a peculiar thing is that the whole argument that is made against this bill, to the best of my knowledge, is just that, and it has never been suggested that the Commission might increase, by its regulations, the cost of money to corporates.

I will admit the argument which Mr. Withington has made this morning, if that is the position of a majority of the dealers, if that is typical throughout the country, might be construed to mean that the cost of financing of corporates would be increased. But what is so peculiar about municipal credit, and why is it so sensitive to regulation by Government that the market for municipal securities is going to be paralyzed, and the cost of money greatly increased when all the dealers in corporate securities in this country have failed to see the danger as it affects their own business?

Now, another thing about those municipal securities, the best figures that we have got indicate that by far the greatest bulk, in the last few years, of municipal offerings, in the case of bonds, have not been made by exclusive municipal dealers; they have been made by syndicates and some large banks apparently in which dealers in corporate securities appeared.

Mr. Withington says that he is representing them now, although when the arguments were presented he was representing not only exclusively municipal dealers, as I understand it, that is, dealers in corporates and municipal securities. On the other hand, the corporate security dealers are now put in the position of saying "We are afraid of the Commission's regulation as far as the municipal side of the business is concerned," but through the Investment Bankers Corporation and the Investment Bankers Association they do not see anything to fear as to corporates.

The argument is just really one that implies that the Commission, in making regulations, has lost all sense of responsibility to the country, and if that is the sort of Commission you have or may have at any time in the future, the only one safe thing to do, is not to increase the Commission's power, but take away from it whatever power it may have.

Let me just refer to another phase of this situation: The proposal for this legislation did not originate entirely with the Commission. After the conference died a natural death, an attempt was made to keep the organization of dealers alive in the hope that the industry could be made to become self-regulating. The origin of this thing goes back to a month or two after the Supreme Court decision in a case brought to test out just how far it might become self-regulating, and I think that pretty nearly all the legislation of this general type that has been suggested to the Congress, has been made in order to make industry bear a part of its own regulation.

Now, if you want to impose Government regulation upon this thing, there is a very direct way to do it, and that is to kill part I of this bill, and leave part II, and do all of it by direct Government assistance.

The fundamental purpose of this bill is to put as much of this control into the hands of industry as can possibly be put there, as it manifests its ability to handle it. Now, obviously, you cannot put into the hands of industry the task of handling the criminal cases—now, if they could handle it, I am not sure but what I would object to their trying it.

Now, what is the alternative to this thing of dealing with municipal people or corporate security people? There is no denying the fact that the security business, which ought to be and which, with many men, I am satisfied, is an honorable business, but which also attracts to the profession some people who are not scrupulous, and when it does it results in a most terrible condition; and it sometimes attracts people of that kind to the municipal bond business; in the case which was mentioned this morning, where there was outright forgery of bonds; we have all seen it. It attracts that sort of person, and there is no other way that I know of to regulate it.

If you can suggest a way to adequately regulate those people without having the fellow who is decent under some sort of control, without having some regulations affecting the well-meaning, decent man, I would be in favor of doing it. But, I want to give you this experience out of my own personal experience in administering State blue-sky acts, that I never had a man come into my office and tell me how honest he was, how clean his business practices were, whom I did not later find out was a crook. Honest men do not need to come in and tell you those things.

Now, so far as the situation as it affects the municipal dealers is concerned, I would like to leave with you a memorandum by Mr. Davis, dealing with the forgery situation, which admittedly comes under the present statute. I am not citing this as a condition that cannot be met, but I am citing it merely as an instance of what some people in this business will do.

Mr. EICHER. Without objection, it will be made a part of the record.

(The memorandum referred to is as follows:)

MARCH 30, 1938.

MEMORANDUM RE INDICTMENT OF VARIOUS INDIVIDUALS DOING BUSINESS UNDER THE TRADE NAME OF IRVING-HARRISS CORPORATION

The Irving-Harriss Corporation, Threefoot Building, Meridian, Miss., is listed in the 1937 edition of Security Dealers of North America, but has never been registered with this Commission. Since there is evidence of business having been transacted outside the State of Mississippi, exemption from registration must have been supposed to have existed on the ground that business was conducted exclusively in exempted securities.

Investigation has revealed that this organization was not a corporation but a group of individuals doing business under a trade name. The Irving-Harriss Corporation was registered as a security dealer in Mississippi on March 30, 1936. The individuals conducting this business were indicted for violations of section 17 of the Securities Act in the United States District Court for the Eastern Division of the Southern District of Mississippi, March 28, 1938. The transactions for which indictments were returned involved the forgery and fraudulent sale of various securities of counties and other local subdivisions of the State of Mississippi. The file discloses no evidence that the subject organization transacted any business in corporate securities.

A forgery of securities was facilitated by refunding contracts with local subdivisions of the State of Mississippi, which contracts provided for the issuance of bonds to refund outstanding obligations. The forgery was accomplished by

obtaining bonds from various printing concerns and through forging the signatures and seals thereon.

SHERLOCK DAVIS.

The Meridian Star, March 25, 1938, states that the individuals composing this organization are prominent citizens in their communities.

Commissioner MATHEWS. I would like to read into the record, Mr. Chairman, a letter addressed to Hon. William O. Douglas, Chairman of the Securities Exchange Commission, from William A. Lockwood, of the firm of Morgan & Lockwood, New York.

This is dated March 18, and reads:

DEAR MR. DOUGLAS: Mr. Moffatt referred to our evening conference of some weeks ago to a recent case of an "over-the-counter" spread which had been called to his attention. You have asked me to give you the figures.

A dealer purchased 74 high-class municipals from one owner, and sold them on the same day, I understand, at a profit to the dealer of approximately \$4,600.

On the same day he bought for his own account and sold to the above customer 65 New York State bonds at a loss to the dealer of approximately \$315.

The net profit on the two transactions was approximately \$4,300.

That is signed William A. Lockwood.

Mr. EICHER. Mr. Commissioner, I do not like to interrupt you, but we will have to answer the roll call.

Commissioner MATHEWS. That is certainly all right.

Mr. EICHER. We will take a recess for about 15 or 20 minutes.

(A recess was taken to permit members of the committee to respond to a roll call, after which the following proceedings were had:)

Mr. EICHER. The committee will come to order.

Commissioner Mathews, will you resume?

Commissioner MATHEWS. I understand there are some questions which I will undertake to answer as best I can, after I make a brief statement, and those dealing with legal matters I am going to ask the privilege of having Mr. Katz answer.

Mr. EICHER. Very well.

Commissioner MATHEWS. In connection with this situation, however, I would like to leave this thought with the committee, that I appreciate, and I think the Commission appreciates, the complete sincerity with which some of the arguments made on behalf of certain of the interested representatives here, and I only want to say in connection with the bill, that as it is drafted, it represents the Commission's ideas, but that we want the committee to understand, and we believe that the arguments on behalf of the New England dealers, particularly, represent a firm conviction on their part that a change is necessary to meet their situation.

I think aside from that there is no other summary that I care to make. I shall be glad to answer any questions I can.

Mr. BOREN. The line of questions that I wanted to follow up may be summarized in this: What conditions exist that leads the Commission to the opinion that further regulatory powers are necessary in respect to the municipal field?

Commissioner MATHEWS. In that connection I have to make this statement, that up to the present time, exclusive municipal dealers have not been subject to the requirements of registering with the Commission as brokers and dealers and not all required under this act. Consequently, our first-hand and authoritative information is very meager. We have been advised of instances which I cannot, and I do not think it would be proper, to cite to the committee of abuses in the municipal dealer field.

As I say, I do not think it would be proper and probably not be helpful for the most part. But we know that the opportunity for bad practices are just about as prevalent as in the corporate field if you exclude from that field that fringe of high-pressure stock promoters. The opportunity is there for individuals of that type to operate in the two fields.

Now, as I suggested this morning, in order to answer your questions complete, and about the only way you could answer it at all would be to make an investigation of just what conditions are in the municipal dealer field.

Mr. BOREN. Could the Commission do that under the present act?

Commissioner MATHEWS. I believe it could.

Mr. BOREN. I want to say in respect to the Commissioner's general statement of the principles involved in this bill that I think that the drafters of the bill in its present form have seen the proper recognition of actual economic conditions with which the country is faced, and recognize corporate existence as a corporate system rather than what is generally referred to as a capitalistic.

But when they refer to particular units, the dealer in the field mentioned here, drawing the regulation of the uncontrolled group does not warrant the distinction in the regulation that they have set out.

Commissioner MATHEWS. The only way to get at the tangible situation at all, whatever the conditions in the industry would show, would have to be the result of a thorough investigation of the whole problem.

Mr. BOREN. Well, certainly I would be in favor of making an investigation in order to secure the facts, and if it is shown to be necessary, then extend the regulations, but I think there is a great deal to the argument that we should not extend rules and regulations if it can be shown the conditions do not warrant their being extended.

I would like to ask your thought covering the point I was trying to get, and this discussion, that refers to the question of fictitious quotations. If that clause is put in, with the rest of the language I referred to a while ago being stricken out, would that meet the objection of the dealers to regulation?

Commissioner MATHEWS. Well, if I understand correctly the position of the municipal dealers, their opposition is directed principally to control of fictitious quotations; their opposition is directed to the type of control that is embodied in clause I, and if I understand further their position correctly, their remedy for the condition that creates clause I is substantially identical with Mr. Wirlington's suggestion, which he gave this morning. But I do not understand, as a result of these discussions, there is any particular dispute about the fictitious quotations clause.

Mr. BOREN. What I was trying to arrive at is this: Suppose that the committee should decide to delete the regulations which are claiming our attention—

Commissioner MATHEWS. Yes.

Mr. BOREN. Relating to municipal dealers.

Commissioner MATHEWS. Yes.

Mr. BOREN. And yet felt that including fictitious quotations were necessary in those powers. Would the suggestion that I have later offered with respect to fictitious quotations do that?

Commissioner MATHEWS. That would, I think, furnish the mechanics of it.

Mr. BOREN. Then I could ask for any definite opinion you might have on the question of fictitious quotations; what is the problem that we are trying to reach?

Commissioner MATHEWS. I think Mr. Davis probably is in better position to deal with that general problem than I am.

Mr. Davis, do you want to answer that?

Mr. BOREN. Suppose we just waive that question for the moment.

Commissioner MATHEWS. Yes.

Mr. BOREN. And I will come back to it later.

Commissioner MATHEWS. Mr. Davis has been working on that particular problem on the committee of the Commission, and I think is better qualified to answer it than I am.

Mr. BOREN. Then I will ask you another question and come back to that later.

Commissioner MATHEWS. Very well.

Mr. BOREN. On page 15 of the bill, with reference to the use of the term "willfully" will you give me an analysis of that page in which the term "willfully" is used twice in paragraph (2) (B), and also in paragraph (3)?

Commissioner MATHEWS. May I see the bill?

Mr. BOREN. Yes; just why should that be used?

Commissioner MATHEWS. What page is that on?

Mr. BOREN. This is on page 15. I can see why it was put in the first paragraph; I can readily see the need for it, but it is used again in a similar and comparative situation in a place that does not seem to require it.

Commissioner MATHEWS. Let me take up first the use of the word "willfully" which appears in paragraph 3 on page 15.

Mr. BOREN. Yes.

Commissioner MATHEWS. Now, my recollection is—and I will have to check with Mr. Katz—as the bill was originally drafted the word "willfully" was not in that paragraph.

Mr. KATZ. Not in that place.

Commissioner MATHEWS. And that was put in after being urged by the representatives of the Investment Bankers field, that the administrative problem would not be so hard to determine in such cases.

Now, as to the other provision in (B), I think the history is for the same reason that after we originally prepared the draft of this we thought, although it had not been in (3), after we discussed it, we agreed that we should recommend the bill with the word "willfully" to be in "B" and also in paragraph (3).

Now, as to (B) my understanding of the situation is this, that there are so many minor violations possible under the Securities Act, that we rather acceded to the fears that were expressed, that to leave out the standard of "willfully" it might be possible to abuse the power of the Commission.

Now, we refused to go along with the other suggestion, the parallel there, of the right to discipline members of the Stock Exchange for violation of the Exchanges Act, where the standard of "willfully" is not violated, and we have had three years and a half experience with the administration of the Securities Exchange Act. I think that too established willfulness in cases that are called to our attention for discipline, particularly if we had to use that standard of the word "willfully" would make it almost impossible in a great many cases.

Furthermore, we feel this way, that in the 3½ years experience in the administration of the Exchanges Act, we have pretty well demonstrated that the Commission was not arbitrary in exercising its disciplinary powers; that we were disciplining essential cases, where everybody would agree that there was a call for it.

Mr. BOREN. I want to say in that connection, if I may interrupt your statement—

Commissioner MATHEWS. Certainly.

Mr. BOREN. That the questions that I have asked might indicate to the casual observer that the trend or course that I was following indicated I was unwilling to trust the Commission with other powers, but I want to make it clear that as a general proposition in delegating powers to any Commission. I do not care how perfect the Commission may be, I think it is always questionable to increase that delegation of power unless it is positively shown there is a necessity. These questions were not in any way meant as an inference of criticism against the Commission.

Commissioner MATHEWS. I think you would agree, that if cases arose where it was necessary for us to meet that condition, and we did have the standard completely laid down in the legislation, it would make the administrative job—looking at it purely from a selfish standpoint—much easier, and the responsibility of enforcing the legislation much less.

Now, with reference to your question of conditions covered on page 15, frankly the appearance of "willfully" twice in that text represents a concession which the Commission felt originally should not be made, and which was made reluctantly.

As to the third one, our feeling very definitely is that the word "willfully" is required there, and it makes the Commission's control, that is necessary to implement that, practically impossible without it. I am not certain if "willfully" is inserted after that place, but that the Commission would instruct me to come back and ask you to kill the bill, that we would be entrusted with an impossible administrative task.

Mr. BOREN. And where your action was objected to in the courts, it is your opinion that in the majority of cases they would rest upon the question of "intent" rather than the question of violation.

Commissioner MATHEWS. Yes; I think without any doubt; for instance, I do not suppose anybody could say how many violations of the rules of the stock exchange or minor violations of the Exchange Act would be by members of the exchange. Actual disciplinary powers have been brought into play in three or four cases—four cases I think, not more, which have required formal order.

Now, if we have to establish "willfully" to make the act possible of legal construction, then I think that this bill, if enacted, would turn over to the industry substantially in effect all of the power of control that it embodies; I do not think the Commission has the real reserve power to discipline members of an association.

Mr. BOREN. Now, summarizing all this discussion on the municipal question: Am I right in assuming that at the present time the Commission is not in position to point to the specific needs for extending the powers granted in this bill?

Commissioner MATHEWS. Certainly not in a comprehensive way. I think that the files of our complaint section would produce some

evidence on the subject, but they are incomplete and might be as particularly misleading in one direction as they would be in the other.

Mr. BOREN. Well, it is true, that by and large they are subject to much greater legal control in the States than the corporate bonds are.

Commissioner MATHEWS. No; I think that is not true.

Mr. BOREN. It is not?

Commissioner MATHEWS. It is pretty comprehensive on the question of municipal securities that I think it is quite general that those dealing in municipal securities are completely exempt from State blue-sky laws.

Mr. BOREN. Would you recommend, if the committee should decide to delete the provision that adds the additional power, the inclusion in the present law of the words "fictitious quotations" in addition to the familiar fraudulent, deceptive clause?

Commissioner MATHEWS. I think "fictitious quotations" section is entirely separable from clause I, and should be written in in any event, either in that form or embodied in some other way.

Mr. BOREN. I want to say, Mr. Chairman, and Commissioner Mathews, with reference to the statement made concerning the use of committee reports as a foundation to interpret the law, I certainly think that policy should be carried through all bureaus and commissions.

Commissioner MATHEWS. I think it is very important; we have felt that it was important as determining what the legislative intent was in trying to carry out that intent.

Mr. BOREN. And I know this committee appreciates that method of finding legislative intent.

Commissioner MATHEWS. Yes.

Mr. BOREN. That is all I have, Mr. Chairman, unless Commissioner Mathews wishes to add something further.

Commissioner MATHEWS. Do you want to ask Mr. Davis that question you had in mind?

Mr. EICHER. Suppose you cover that, Mr. Davis.

Mr. DAVIS. That is, with reference to fictitious quotations?

Mr. BOREN. Yes.

Mr. DAVIS. In the first aspect, which deals with the general subject of price manipulation, and the second, with carrying out contractual obligations.

So far as the first question is concerned, as I am sure the committee is well aware, as contrasted with the Exchange market, there is no record of the price at which securities are sold; transactions take place largely by use of the telephone, or as the result of correspondence, and there is no use made of the ticker tape, which records all the transactions made on the Exchange, and the price at which the sales are made, and the time that the sales are made.

Therefore, in the over-the-counter market, the only indication of the price which is readily available to the investing public is the one made available by the dealers themselves. And the quotations, the bid and offer quotations, which are made by firms in the security business for the various issues of securities, for instance, in high-pressure methods that may be used, are largely those that are painted in such a way as to create in the mind of the investor a false impression as to the price at which the securities currently are being traded in.

It is readily apparent that in the over-the-counter markets, insofar as price manipulations are concerned, are accomplished by sales over the telephone, giving quotations, sometimes the actual price at which transactions have been effected, as was shown to be done in the hearings before this committee in 1934, in the case of the exchanges.

Now, therefore, it is deemed desirable on the part of the Commission to have power to prevent, by rules and regulations, fictitious quotations, which lend themselves so readily to price manipulation.

Now, as to the contractual elements: Of course, I suppose it is generally recognized that the vast majority of transactions in the over-the-counter market are consummated as reported to the Government, by word of mouth; in other words, contracts representing perhaps enormous sums of money are executed every day, which contracts, while executory, are perhaps not enforceable due to the statute of frauds, but which are carried more because of the moral persuasion, and sometimes after a contract has been entered into, it may be rescinded. Upon that reason, it is very important, in the opinion of the committee, that the Commission should have authority to get that information.

In other words, there is a quotation for some security, or a bid, let us say, and when it is accepted, and terms are to be one which the broker may not want, it is not forthcoming in that situation when a fictitious quotation has been used. I think most generally it happens when someone may not want to take the bid.

That type of thing undermines the confidence upon which this business so largely depends.

Mr. BOREN. Is that problem generally as applicable in the municipal field as in the corporate?

Mr. DAVIS. It would seem to be so, Mr. Congressman. In fact, I am sure the attitude of this Commission is that you really could not show any difference between the marketing of municipal securities and marketing corporate securities, although, as Commissioner Mathews said, the records of the Commission are not as complete concerning the municipal as in the corporate field.

Mr. BOREN. I think, Mr. Chairman, that answers the question. Now, I want to ask whether there is anyone here in the industry who cares to make any particular observation concerning the inclusion of fictitious quotations in the present regulatory law?

Mr. WOOD. Mr. Chairman.

Mr. EICHER. Yes, Mr. Wood.

Mr. WOOD. Mr. Chairman, I confess I am somewhat at sea to see what the Commission is trying to get at in "fictitious quotations," because if you were to go into the office of any municipal bond dealer and ask him what was the market for some Tulsa's bonds, maturing in 1944, he has no place to which he can turn to see what the quotations on those bonds are, because of the fact that those bonds might not have been traded in on the market for the last 5 years.

What he does is to check the market for similar securities that are floating around in the market and he tries to make up his mind on what the market would pay for similar bonds with similar payments or similar series. That is a matter of opinion just as if you were to come up and ask me what I would give you for a farm or your home. I might say \$1,500, and another man might say it was worth \$2,000. I have my own opinion as to what I think it would be worth, and the other man might think it is worth more.

Now, if he shops around with the bond market, he might find one who might be willing to pay two, three, or four points more than the first offer he received.

As I pointed out before, I have seen bids and offers of sale with a margin of spread of nine points between the high and low bids. Now, the reason for that spread is that there is no one in the market for that particular security, and the dealer simply shops around in the market until he can find a purchaser for that particular bond or investment.

Mr. BOREN. Suppose you take a quotation from a blue list at 2.90 and it turns out that it is 101.02, or whatever you might have, for a certain bond. Now, if those bonds are presented to you, you are going to be tempted to welch out of the terms, and to back down on that contract, are you not?

Mr. WOOD. The quotations for the blue list are only approximate quotations. If the dealer, we will say, gets a quotation on the blue list of 2.90 or 25, let us say, Cleveland, Ohio, bonds, that does not mean that he will be able to buy those bonds at 2.90 because there is a constant change in the bid and offer price. The following day there may be a differential between that bid and offer price. It might be on that day there is nobody in the market for bonds, or it may happen that the broker has another customer for bonds that day, but his banking connections may not be such as to enable him to make the purchase, with the result that the bid and offer for those Cleveland bonds may vary as much as two or three points in that day.

Municipal bonds are sold as a commodity, or as merchandise. There is not any daily quotation on them because they are not daily traded in, so there is no possible way to tell what those Tulsa's bonds are worth that day, and if the holder were in position that he had to dispose of those bonds on that day, he might be in a critical position if they were sold at what somebody was willing to pay for them.

By the same token, the same method is used by dealers for handling other bond issues; they are not all one price; you cannot get the same quotation, and as I say, I have seen quotations vary as much as eight or nine points.

Mr. BOREN. By and large your objection will be removed if you were to insert the words "fictitious quotations" in the present law as it is made applicable to municipal dealers in the proposed legislation?

Mr. WOOD. If the bill was made to read so as to refer to deceptive and manipulative transactions, fictitious quotations, and other fraudulent devices—all those frauds, coupled with the whole thing, there would be no possible objections.

We have the same objection that was indicated before of adding one on top of the other. Now, if the fictitious quotation is a fraudulent quotation of a certain security, well and good, there could not be any objection to that.

But, I want to say, as a general proposition, that if a bond dealer gets a bid for an issue of bonds, and he does not make good on that bid, he goes out of business awfully fast. There is nothing that will kill a dealer in the trading market quicker than the welching on a bid. If a dealer slips up, and sometimes he does, he goes through with the transaction or he does not stay in business. That is one of the unwritten laws, that the man must go through with his bid.

Mr. EICHER. Thank you.

Mr. Starkweather, did you wish to make an observation?

Mr. STARKWEATHER. Yes.

Mr. Chairman, we have not taken any position on that subject during the hearings, although a number of times during the discussion with the Commission, during the past 3 months, we have suggested that the words "fictitious quotations" be included with section I, in the general section against fraud, but we have not discussed it in the hearings, I think, for the reason that it is very difficult for any of us to conceive how the Commission can make a regulation on that subject.

A quotation is a peculiar thing in the security business. Not knowing much about any other business, I do not know whether it is in other lines or not, but so many times it depends upon the volume. For instance, you take in the active utility bonds, of a small utility, or a small company, you may find that there is a fine bid for 5 bonds, but no bid at all for 50 bonds. You may find a man is willing to make a bid at par for 10 bonds, but if you offer him 25 bonds, he will back off, and he will not even bid as much as 95 for them.

I do not know how you are going to make a regulation affecting that.

Mr. BOREN. You heard the statement of one of the gentlemen here, who said that municipal securities are traded like commodities, and certainly if a merchant were advertising a commodity at a stated price you would expect to be able to buy at that advertised price.

Mr. STARKWEATHER. Well, you can buy in small amounts and you can sell in small amounts at the present time, but the quotations vary tremendously on the volume as well as on account of the business conditions. A dealer today may be perfectly willing to take on 25 bonds, because he is quite sure he has a customer who is willing to buy those bonds.

However, suppose you offer him 50,000 or 100,000 bonds, and he is quite sure that the market will not take that many, therefore the market bid may go down; or there may be no market at all. It depends on the volume.

And also, there may be a difference in the same securities at the same time. I have, within the past month or so, asked quotations on inactive bonds, and I have received from reliable dealers quotations of \$7.90; received another of \$3.88, and so on. I think both of these are perfectly honest in their view, but they know that the market has to be worked. They may take bonds and have a great deal of difficulty in selling them, while some other fellow may have a very active inquiry for that particular, and he may sell the bond within a short time at 90. Another man, however, may make a better quotation; he may make a quotation of \$7, or he may get an offer of \$7 and say he is willing to pay only \$5, and yet may get only \$5.88 or even less for the bond.

It is a very complicated problem, and I do not see how any Commission is going to make rules and regulations which will be able to cover that question; and I do not see, since my attention has been directed to it, how if they were to have that in it will affect the transactions. However, we are not objecting to that; merely stating that position for the record.

I thank you, Mr. Chairman.

Mr. EICHER. Thank you.

How would you frame a regulation so as to prevent manipulation without making a crime out of an illustration such as Mr. Kendall gave?

Mr. DAVIS. Well, Mr. Chairman, we have had a great many transactions pointed out. For instance, take the illustration of the dealer who wished to accumulate bonds for the purpose of selling them at a higher price.

Now, in the securities industry—if the sale which that dealer is at the current market price, and he buys bonds at a lower price, to be sold at a later date, and he drops out and waits for the market, for that particular bond to rise, of course that dealer cannot be—

Mr. EICHER (interposing). But suppose the market goes down. Apparently you may have a perfectly innocent manipulation, and the market may go down several points.

Mr. DAVIS. My attention is called to the fact that the immediate answer to your question is found in section 32, the penalty provision of the Exchange Act, limiting criminal penalties to willful violation, so that any innocent violation, without involving criminal intent, does not fall within the punitive provisions of the act. But the point I had in mind—

Mr. EICHER (interposing). Is there anything else you wish to emphasize in that connection?

Mr. DAVIS. The provisions in section 32 (a) for penalties, is for willful violation, and I was going to add, Mr. Chairman, that he would not be guilty of such manipulation where he makes an investment of bonds, for instance, at the current price; there could be no intent, in buying those securities, at the cheapest possible price, and holding them.

Mr. EICHER. Thank you.

Mr. KENDALL. Perhaps the answer is that you have to do business on orders.

Mr. WOOD. May I just add a word?

Mr. EICHER. Yes, Mr. Wood.

Mr. WOOD. But the civil liability would still exist; the fact that he might be able to escape from criminal prosecution would not eliminate civil liability, and that might be a very serious matter.

Mr. EICHER. By civil liability, you mean in what respect?

Mr. WOOD. Civil liability in respect to bonds bought from him because he had been guilty of manipulation in violation of regulations of the Exchange Commission.

Mr. EICHER. For damages?

Mr. WOOD. For damages; yes.

Mr. EICHER. Thank you.

Mr. WITHINGTON, did you wish to say something?

Mr. WITHINGTON. The real answer which Mr. Davis and Mr. Katz have given with respect to the rules and regulations, concerning the questions which have been put to them, is not the answer that you are going to get when you try a case in court before a judge or a jury. You have a question of fact as to whether the prices are fictitious or whether they represent manipulation. Just assume, for instance, that you are dealing with the question of fictitious price. Now, every one of you can look in the paper and see what the prices of the New York Stock Exchange have been the day before, taken from actual transactions. And then we look over on another side, and we find

a great mass of quotations on unlisted securities, published by a newspaper every morning and every evening.

The newspaper people get those quotations by calling up various brokers and dealers in the city and asking what the bid and asked price is on those particular securities. As Mr. Starkweather pointed out, that may be on 10 bonds, or it may be on 2, or it may be on 3 bonds; very seldom is it on a large lot of bonds.

Now, suppose somebody else wants to buy 100,000 of Detroit bonds, and you see in the paper a quotation, we will say, at 98. Then, 3 years from that time Detroit, in the midst of a depression in the automobile business, or for some other reason, has difficulty in meeting the payment on the Detroit bonds, and suppose they drop to around 40 or 50—I believe that was the actual fact a few years ago. Now, the seriousness of the situation is that the fellow who bought those bonds at that time may be able to say, "I want my money back." And he may bring a suit to get back his 98 that he paid for the bonds, and the case is tried before a judge, and jury, to determine whether the price that was quoted in the paper was fictitious.

I do not know whether under the fictitious provision in the act, or under the manipulative section if he is liable for damages. First of all, that quotation may have been only on a few bonds, and you could have sold, perhaps, a few bonds at that price, say a hundred bonds, but \$100,000, a larger volume, might result in depressing the price considerably. But if you have a rescission—the situation is so serious to the business, it would drive the fellow out of the business if he got caught in one such transaction. Of course, if we were to come down before the Commission, we would know that the answer would be, but the Commission makes the rules and the court decides what they mean. That is the difficulty.

Mr. WOOD. Mr. Chairman, may I just add one further word?

Mr. EICHER. Yes; Mr. Wood.

Mr. WOOD. I just wanted to point out, Mr. Chairman, if you read the papers every day, you will see the quotation on United States Government bonds. Now, those quotations represent quotations on the average of volume of bonds, but you come in with \$5,000,000 in United States Government bonds, and see if you can get that price for your bonds. You may get it for \$25,000, but try and get it for \$5,000,000.

Mr. EICHER. Thank you. Mr. Boren, you wanted to ask Mr. Katz some questions.

Mr. BOREN. Yes.

Mr. EICHER. You may proceed.

Mr. BOREN. Mr. Katz, first I want an answer to my question relative to the possibility of making the court of first resort, the district court; what is your view on this?

Mr. KATZ. Mr. Boren, I do not have any opinion on that as a general matter, but it does seem to me that if we were to attempt to do that in the bill which is now before the committee, without a reconsideration of its applicability to the provisions of the Exchange Act of the Securities Act of 1933 and the Holding Company Act of 1934, and for that matter, to every other statute on the books which has a comparable provision, I think, would be a mistake; I think it certainly would confuse the administration of the law. I think the

problem should be considered as a whole and the correction, if any, not taken by piecemeal.

Mr. BOREN. Do you think it would be a practical thing to amend the Securities Act with this amendment, by adopting some provision that in reviews of any of the provisions of this act, or in reviewing any of the Commission's decisions, the court of resort would be the district court; that is, would such an amendment reach the situation?

Mr. KATZ. If such a provision were so framed, I suppose it would; what I had in mind was that the language in this act would not have that effect. What I meant when I made the suggestion before was that we should consider the consequences of such a change made merely in the bill that is now before the committee in considering the administration of all the law, what effect such a change would have on the administration of the law as found in other acts.

Mr. BOREN. The Commission has administration of what other laws, aside from the Securities Act?

Mr. KATZ. The Securities Act of 1933 is one law, the Securities Act of 1934 is another law, and the Public Utility Holding Act of 1935 is another law, and a provision for that kind of review applies to all of those three laws.

Mr. BOREN. Now, suppose we should report this bill out with the provision that so far as the provisions of the Securities Act of 1933 and 1934 is concerned, it is amended to read that in all cases where the term "Circuit Court of Appeals of the United States" is found, the words "District Court" should be substituted therefor. That would mean that about half of the proceedings would, temporarily, at least, go to the District Court, and about half to the Circuit Courts of Appeals, as far as the problems could be separated.

Mr. KATZ. I do not know. I should like to say—I think there would be only one way to answer that, and that would be to consider the amendment in connection with the complaints, and how the amendment would work out in each situation with respect to every section of each law.

Mr. BOREN. It would not be germane to the Holding bill, but I think, it would be germane to the 1933 and the 1934 Securities Act; the 1934 is an amendment of the 1933, is it not?

Mr. KATZ. Quite different subject matters.

Mr. BOREN. I beg your pardon.

Mr. KATZ. The 1933 act covers registration, and the 1934 act regulation of securities exchanges.

Mr. BOREN. I see. I understand the difference now. It would not be germane to change the court of resort, if put in this bill, it would not be germane to the 1934 act?

Mr. KATZ. Yes.

Mr. BOREN. But the 1933 and the Holding Company Act is outside that problem?

Mr. KATZ. That is correct, although they are different acts.

Mr. BOREN. Then of course the provision would be simplified, by saying that wherever the term "Circuit Court of Appeals" appears within the 1934 act, it be stricken, and there be substituted therefor the words "District Court."

Mr. KATZ. Just as an illustration—I do not want to suggest that the provision might not be perfectly sound, but just as an illustration of the kind of difficulties that might occur should such a change be

made in the act, I would like to cite the experience which led to the provision for the three-judge court for reviews of orders of the Interstate Commerce Commission.

Originally, you will remember, orders of the Interstate Commerce Commission could be reviewed in the district court of the United States in the ordinary way. That led to a great deal of complaints, throughout the country, that first the district judge who was not particularly expert on the problem of railroading should not be empowered with the authority to upset the action of 11 Commissioners, especially after that Commission had deliberated on the problem, members of the Commission who were expert in a highly technical railroad problem, and the outcome of that was the law was amended to provide—and I say I am simply offering this as a suggestion—that reviews could be had to district courts of the United States in the district in question, but that in any such case, three judges should sit, or perhaps the panel would be composed of the members of the circuit court, and there might be one member of the district court and two members of the circuit court, but the experience under the Interstate Commerce Act of permitting reviews to be made by the district court, led to the change in the act because of that fact, and it was found desirable to include an amendment for a three-judge court, perhaps including a member of the circuit court, in reviewing orders of the Commission.

Now, whether that would be applicable here I do not know; I just merely suggest the importance of examining into that with reference to this particular problem.

Mr. BOREN. You understand, of course, the point I am getting at.

Mr. KATZ. I understand your point, yes; and in making this suggestion I do not mean to indicate that I think your proposition is not sound. I merely make this suggestion to show the importance of thoroughly considering it.

Mr. BOREN. The application of the present philosophy, if you leave out the question of the expense, and perhaps many other elements, is to take away from the Federal district courts much of their former jurisdiction in the trial of matters of this kind.

On the other hand, I recognize it has been the general practice of the Government to immediately sue for a hearing in the higher court, and there may be instances where that is preferable, but I am very much interested in the point.

And in these three acts you have to administer, I felt that perhaps a recommendation to amend the act—

Mr. KATZ (interposing). Just let me give you another illustration, Mr. Boren. The Commission has been inquiring into the violation of laws involving persons operating on the Los Angeles Stock Exchange. Now it develops, it involves also people who are located in Los Angeles, and a great many who are located in New York, and the people who lost money are located in various parts of the United States.

So we had to take testimony in New York, in Washington, and in Los Angeles. Now, where you have such a situation, the problem of meeting the condition you referred to, would be all the more confusing to everybody involved, if the cases were to be brought by the people who had lost in the district in which they resided.

Mr. BOREN. Yes. But there are other elements involved, and it seems to be the general view that if they can go into the district court as the court of first resort, they are better off.

Now, if the Congress is going to go on and on with this sort of legislation, it will not be very long until there will be no place for the district court.

Now, I did want to ask some of the witnesses later just one or two more questions concerning their general reaction to that sort of plan.

Mr. KATZ. You understand, Mr. Boren, I am not suggesting that the thought is not perfectly sound; I do not know.

Mr. BOREN. I was asking you because I wanted to know what you thought of such an amendment.

Mr. KATZ. Yes.

Mr. BOREN. Because frankly, I would put in such a provision as I have outlined here—

Mr. KATZ. Yes.

Mr. BOREN. I mean, of course, if the other two gentlemen would agree. I mean, I would offer that as a suggested amendment.

Here is the second point I wanted to ask about: Do you find in general there is fear expressed on the part of individual dealers as a result of this law recognizing the corporate entity as being a more or less privileged entity?

You set up an association to which you grant certain powers, which you do not grant to individuals, and it is intimated that there is a possibility that certain economic advantages might arise as between the individuals and the corporate entity. Has there been any particular protest received from the individuals?

Mr. KATZ. As Commissioner Mathews said, we have had a few isolated cases, and in all those cases which have come to my attention, when the purpose of the law was explained, and the safeguards which were given to the individuals, the individuals have expressed themselves as satisfied; there were a few at first—

Mr. BOREN (interposing). One of the purposes of this bill is based, in your opinion, on a more or less fundamental recognition of the economic system of the corporate entity.

I mean that is one of the objects; that is, you set up a field in which the individual is more or less left out, provided the program works out.

Mr. KATZ. As I am advised, I have never heard of it, and I do not know of anyone in the Commission who has thought of it in just those terms. Our idea was that we had a substantive problem, which is the problem of correcting certain abuses in the over-the-counter markets.

Mr. BOREN. Yes.

Mr. KATZ. In facing the problem of administering the interests of the business under a I kinds of conditions, the way it could be set up to administer it on a Nation-wide scale, by setting up an association of businessmen within the business to administer its own matters—

Mr. BOREN. In your judgment that is the better plan?

Mr. KATZ. Yes.

Mr. BOREN. In other words, this Act is entirely a matter of the Government catching up with the existing problems rather than the Government setting up a sort of planned economy.

Mr. KATZ. Oh, yes. As a matter of fact, the way I feel about that is this, the Government is just beginning to catch up with some of those problems in the enactment of the Exchanges Act, which was originally adopted in 1934, section 15 of which was passed by the Congress later so as to provide regulation of over-the-counter markets.

Now, at that time the Congress said in effect that there were certain objectives which we would like to achieve, which we had not as yet achieved in regulation of the securities exchanges.

Now, when the legislation was passed by Congress, originally section 15 of the 1934 act, I can say without much hesitation, was as broad in scope, and even broader in scope than section 2 of this bill. The language of that act said—would you like for me to get it for you, Mr. Boren? I think it would be of interest to quote it in this connection.

Mr. EICHER. Go ahead.

Mr. KATZ. In considering section 2 of this bill.

Mr. BOREN. I am not attempting to go into the text of that, but I think—

Mr. KATZ (interposing). I think it would be interesting to have it. It is no trouble at all. I am very glad you raised the point, because if this bill sets up anything like the provision in the language of section 15 of the 1934 act—well, I will just read it: Here is the language:

It shall be unlawful, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest— and this will give you the set-up—

and to insure to investors protection comparable to that provided by and under authority of this Title in the case of national securities exchanges.

Apparently the purpose of Congress in dealing with that was that Congress was saying in effect that we want a comprehensive statute; it is necessary to have trade, and we also recognize and know the importance of the over-the-counter markets, but we would like to have the individual set-up with a control over the over-the-counter market, which should be comprehensive in its effect, recognizing the difference between the two markets, and its control over those who are subject to the Stock Exchange operations, and Congress went on to say further the kind of rules and regulations which may govern, in this language:

Such rules and regulations may prescribe for the regulation of all transactions by brokers and dealers and on any such markets, for the registration, with the Commission, of dealers and/or brokers making or creating such a market, and for the registration of the securities for which they make or create a market, and may make special provisions with respect to securities or specified classes thereof listed, are entitled to unlisted trading privileges, upon any exchange.

Now that is an interesting view in the light of what we say is set out as the objective of the Securities Act, to bring within the scope of the act by the amendment of May 1936, and the amendments which follow.

The Commission feels that these executive functions and always has felt that they are created to implement the means of carrying out the original intention as provided in that language as expressing the intent of Congress.

Mr. BOREN. There are one or two other questions, Mr. Katz, which I would like to ask you.

Mr. KATZ. Yes.

Mr. BOREN. First, whether the individuals will have their rights properly protected in the association?

Mr. KATZ. Yes.

Mr. BOREN. Secondly, whether or not the bill in its entirety will be greatly affected by striking out the portions that have been objected to by the municipal dealers and as to what extent a combination of the situation is justified.

Mr. KATZ. In answering the first point, I would like to read from the first part of the bill.

First, paragraph (5) on page 5 lays down the conditions which must govern and rule the association. It reads:

the rules of the association assure a fair representation of its members in the adoption of any rule of the association or amendments thereto, the selection of its officers and directors, and in all other phases of the administration of its affairs.

Mr. BOREN. That makes reference to the condition under which the applicant association may be registered.

Mr. KATZ. Yes.

Mr. BOREN. Under the proposed bill. But I want to find out what treatment they will be accorded.

Mr. KATZ. That would be in section 15 A, and that would be under paragraph (4) that the rules of the association shall provide—no, paragraph (3) which provides that "any broker or dealer who makes use of the mails," and so forth, "may become a member of such association," and provided "that the rules of the association may restrict membership in such association—"

Mr. BOREN. Where is that?

Mr. KATZ. That is in paragraph (3) on page 3. And paragraph (5) says that a fair representation of all of the members of the association shall be had in selecting the officers and directors and in the administration of its affairs.

Mr. BOREN. How much leeway are they going to give him in the way of setting dues. Do you have that taken care of?

Mr. KATZ. That is provided for in section (6), which states that the rules of the association shall provide for the equitable allocation of dues among its members at an amount not to exceed what will be necessary to defray the reasonable expenses of administration, and it is proposed that the dues shall be equitably allocated among the members.

Furthermore, there is set up a standard of fees for the membership in the association; furthermore, any action taken by the association in the way of discipline against any member of the association must be confirmed, and there must be an orderly hearing, as described in paragraph (9). For example, the members shall be notified of any charges, and given an opportunity to defend, and a record be kept of the proceedings.

Mr. BOREN. I think in general that satisfies me on those two points.

Mr. KATZ. Yes.

Mr. BOREN. It is generally assumed that there will be many associations of this character, and there will be several members.

Mr. KATZ. There may be several.

Mr. BOREN. It would be possible for the big dealers to form one association and the small dealers to form another, I take it?

Mr. KATZ. Yes, possibly, I should think in certain areas where the business justified the little concerns doing so.

Mr. BOREN. I think I am satisfied on those questions, Mr. Chairman.

Mr. EICHER. Is there anything else in that line you would like to add?

Mr. KATZ. I might just make a general observation with reference to the question asked about the organization of these associations.

Mr. EICHER. Yes; and the membership of the proposed associations.

Mr. KATZ. If we judge from past experience, and that is the only basis on which you have to judge this, or I imagine anything else—our idea is that there may be associations formed which would be regional associations, regional groups, like New England, the southeastern group, or the Pacific coast group.

In the Senate committee hearing reference was made to districts, comparable to the districts of the Federal Reserve System. That was not intended to bind anyone, but was intended merely to indicate to the Senate what was in mind, and to show that in the organizations of the associations they would be of a national sort; the association would be such as to cover a reasonably large area; that they would be reasonably economical in their operation; perhaps as large as the Federal Reserve districts.

Mr. BOREN. And would it be possible to develop some of these associations according to the type of business.

Mr. KATZ. There might be associations of particular kinds, handling particular kinds of securities, such as oil royalty associations, and so on. Those are all within the contemplation of the statute.

Mr. EICHER. Mr. Katz, some of those appearing have joined in a feeling of alarm, particularly with regard to the question involved in transposing the word "fraudulent" in the phrase "fraudulent, receptive, or manipulative acts or practices."

Will you give us the position of the Securities Exchange Commission regarding the necessity for that change?

Mr. KATZ. The position of the Commission, as I understand it is this: That any manipulative act or practice, at least any manipulative act or practice which the Commission would be called upon to deal with, would include that—that is, any manipulative act would be fraudulent in the sense that fraud is understood by the practical man of affairs. However, there is a distinction, possibly a distinction between practices which are fraudulent and which are recognized as such only in the courts.

Now, we believe, and it has been the consistent interpretation of the Commission of this act during its administration of the act for the past 2½ or 3 years, that any form of manipulation is fraud, and we believe that if you transpose that statement, you can show that any form of manipulation could be set up as fraud.

Mr. EICHER. Yes.

Mr. KATZ. And it would be almost impossible to do so otherwise.

Mr. EICHER. Mr. Kendall, did you have an observation you want to make?

Mr. KENDALL. Mr. Chairman, with respect to manipulations: Certainly this legislation concerns itself with acts and not with the intent, and I do not know how you are going to meet the dilemma.

Mr. BOREN. What is the object, Mr. Katz, of transposing the terms?

Mr. KATZ. The only object is this—perhaps there are others—

Mr. BOREN (interposing). I mean, what is the object of transposing the term "fraudulent"?

Mr. KATZ. That is what I was coming to. The only object—well, there are possibly two objects, and perhaps there may be others, but there are two points that could be made, and perhaps one of these is of a technical nature, but it was one of the arguments in the Commission that in that narrow technical sense you could have fraud, in the sense that it was technical sense, and yet it would not come under the provisions of the former act.

And the second difference is really one of administration, in that it would probably avoid some regulations. You might find a man, possibly, who is legalistically inclined, technical, raises every objection when he comes into court, and this language would, I think, give a more practical answer when you come to consider the application of the rules of the Commission under 15 (c) as they now stand, and since the rules under 15 (c) have been in effect, they have been enforced with reasonable success, with reasonable approval on the part of the members of all groups of dealers.

Mr. BOREN. This does change the present wording of the law?

Mr. KATZ. It does; yes.

Mr. BOREN. And you have some good background for the change, have you? I mean at the present time do you have evidence of manipulative practices and deceptive acts that are not fraudulent?

Mr. KATZ. Yes.

Mr. BOREN. Is there any particular experience that you have had that makes you feel you have to reach it in this way?

Mr. EICHER. Is it a matter of burden of proof?

Mr. KATZ. No. No; I do not think so. I mean "no" to your question, Mr. Eicher, and not "no" to Mr. Boren. So far as the question of the Commission having had that experience, I think the answer would be "yes". I understand that inasmuch as a revision of the act has come up, the Commission thought it was desirable to amend section 15 (c). It is possible that if that section had not been reopened, along with the proposed amendment to the whole act, the matter would not have been presented, but as long as the act was up for amendment, that suggestion was made to clarify it.

Mr. BOREN. I would like to get the attitude of the dealers in municipal securities on that.

Mr. EICHER. Mr. Kendall, you had something you wanted to say?

Mr. KENDALL. I simply want to say, Mr. Chairman, that the question of what is the interpretation, not according to the ideas of the Commission; there is not great danger there, because the Commission would know what manipulation was, but I think it would be necessary to clarify what is meant by fraud and fraudulent manipulation, in order that the entire industry might understand it. There is a dilemma there; you have the two horns.

Mr. KATZ. Well, I think the practical interpretation, as adopted by the rules of the Commission, in a good many instances; that has been adopted in its use in connection with the corporate group, and whatever changes have been made I think could be incorporated in the definition.

Mr. BOREN. Commissioner Mathews, do you feel that the language here as it now reads is a real help?

Commissioner MATHEWS. The Commission feels that, because of the situation that Mr. Katz has pointed out, as to the narrow construction put upon the word "fraudulent" by State laws and certain courts,

we feel that the majority of the courts would interpret the section as we have interpreted it, and if there were a uniform interpretation, we would not feel the need of making the change. But we may run into cases where the interpretation may be so narrow, that we will feel that it is desirable to change it, and we have felt that it was desirable to put that change in this act, and I think that is the interpretation which will be followed by most of the courts.

Mr. EICHER. Are there any further questions you wish to ask?

Mr. BOREN. What particular damage would be done to the bill if we struck out the language which I referred to on page 16, lines 12 to 15? That takes out the general regulatory power of the Commission over the municipal dealers, although possibly you would have as much as you have had in the present law.

Mr. KATZ. You mean, as I understand you, to insert the language as it is now written in that place?

Mr. BOREN. I would strike that language.

Mr. KATZ. And re-write the present law?

Mr. BOREN. Yes.

Mr. KATZ. Strike out the language in line 12, beginning with the words "in contravention of such rules," through the figure (1) in line 15?

Mr. BOREN. Yes.

Mr. KATZ. Then you would not have anything in the law—

Mr. BOREN. I mean to re-state the present law and include in the present law the words "fictitious quotations."

Mr. KATZ. Well, that question, I take it, refers particularly to municipal dealers.

Mr. BOREN. Yes.

Mr. KATZ. I should imagine I would answer that question in this way, but I do not know of any reason why, in respect to fraudulent manipulations and deceptive practices or fictitious quotations, for that matter, that dealers that deal exclusively in municipal securities should be placed in one situation and dealers who deal in both corporate and municipals should be in another. I do not see where there is any more or less likelihood of fraudulent, deceptive, or manipulative practices in the one than in the other. What would seem to be good for securities as a whole would not seem to be harmful to municipals.

Mr. BOREN. I think you recognize that throughout the bill there is a recognition of difference in securities.

Mr. KATZ. That is right; that is, some of the provisions in regard to changes and modifications it was felt formed a reasonable basis for the definition of municipals where they have already been exempt, where dealers in municipal securities differed from other dealers.

Mr. BOREN. And under the present law, the question would be with respect to extending the law by including rules and regulations—

Mr. KATZ (interposing). You see, under the present law, we already have the power to implement the statute, under the present law, which provides the Commission shall have the power to make rules and regulations, and the Commission by regulation shall define what is manipulative or deceptive practice, and the reason I referred to that a while ago was that the Commission's definition of fraudulent practice, it is felt, is a more uniform definition.

But while the Commission can define what is a manipulative or a deceptive practice, that is just really another way of saying the same thing, that unless you accept the conditions laid down in the present act, you cannot operate.

Mr. BOREN. Well, I do not think it is the purpose of the act to provide regulations simply for the sake of having regulations. Is not that change contemplated here merely for that purpose?

Mr. KATZ. Oh, no; I think that it was necessary in order to prevent what would arise.

Mr. BOREN. How much difference do you think it would make in the general situation if you simply struck out that language and restated the law with the words "fictitious quotations" added to it?

Mr. KATZ. The only difference it would make, assuming that that change were made uniform to both measures, and I think that that would have to be done—

Mr. BOREN (interposing). Well, you have not had any experience upon which to base this, have you? You have not had the experience to indicate any particular need for this change, have you?

Mr. KATZ. Well, as I said, the Commission has been working under the old law. The answer is no, as far as that goes.

Mr. BOREN. On what basis do you feel the words "fictitious quotations" are necessary addition to the present law?

Mr. KATZ. Well, there again, specifically with reference to the words "fictitious quotations," as I understand the thought expressed by the Commission, it is not specific.

I suppose that the kind of "fictitious quotation" that the Commission had in mind were the quotations that were fraudulent or deceptive, and rather they were relying on the fraudulent quotations for the definition of that.

Mr. BOREN. If those words were added to the present law, do you not think it would be possible for the Commission to define fictitious quotations in an acceptable manner?

Mr. KATZ. Yes; that is the reason why it is changed so that a definition of "fictitious quotations" could be made.

Mr. EICHER. Have you finished?

Mr. BOREN. Yes.

Mr. EICHER. Have you anybody else who wishes to be heard?

Mr. WOOD. No.

Mr. EICHER. Do you know of any horrible examples of losses in municipal securities aside from the bankrupt municipalities in Florida?

Mr. KATZ. I do not know of any that has come to the attention of the Commission in its administration of the law. The only ones I would know of would be as a matter of general information or knowledge.

I want to bring out a point which Commissioner Mathews touched on, but which was not developed very far, and that is this: The vast amount of information we have had concerning over-the-counter transactions, have come to us in the form of general statements; we have had general information come to us, but as you know, municipal dealers are exempt from the requirement to register.

Mr. BOREN. But they are regulated in the States.

Mr. KATZ. Yes; they comply with State requirements. At any rate, they would not be subject to criminal prosecution in case of violation, so I am not sure that had they been required to register,

we would have had occasion to do anything other than what we did, if we had had that information available in more definite form. We might have had no different situation.

Mr. WOOD. May I make a statement?

Mr. EICHER. Yes, Mr. Wood.

Mr. WOOD. The vast majority of the municipal transactions in this country are handled by dealers who are registered with the Securities and Exchange Commission; many of those dealers are people who handle municipal bonds, some corporate bonds, and the great volume of municipal securities business done is done by registered dealers, who are registered with the Securities and Exchange Commission, so that Commission has had plenty of opportunity to contact those dealers in a particular way in case of fraudulent transactions.

And I have not heard of any fraudulent transactions on the part of municipal dealers coming to the attention of the Commission.

Mr. BOREN. Mr. Katz, do you care to refute the statement of Mr. Wood?

Mr. KATZ. No.

Mr. BOREN. That is an admission of the correctness of the statement?

Mr. KATZ. Well, so far as that particular problem of violations are concerned and the violation of the law in respect to municipal securities, I suppose that is true, and that the large part of municipal security transactions are handled by dealers who are registered with the Securities Exchange Commission.

Mr. BOREN. I want to ask Mr. Wood a question, if I may.

Mr. WOOD. Yes.

Mr. BOREN. A while ago it was stated that in order to ascertain the facts, it would be necessary to make an investigation to determine whether or not the situation is such as to need regulation in the municipal field. Is there any disposition on the part of the municipal dealers to feel that they do not want such an investigation, or would you welcome such an investigation?

Mr. WOOD. Yes.

Mr. BOREN. You would welcome that?

Mr. WOOD. Yes; we would welcome such an investigation.

Mr. BOREN. I think that is all, Mr. Chairman.

Mr. EICHER. That is all, thank you.

Mr. KENDALL. There is one matter which Mr. Katz referred to, and which I raised, with reference to intrastate business—

Mr. BOREN. Pardon me for interrupting you, but I would like to ask you a question—if you are interested, I would like to know the answer to my question of a few moments ago.

Mr. KENDALL. May I ask you this question, Mr. Katz. What is the answer to the dealer who does not register, but who conducts a business solely intrastate without the use of the mails?

Mr. KATZ. What is the question?

Mr. KENDALL. The dealer who does not register with the Commission? There seems to be a "no man's land" there.

Mr. KATZ. He is regulated by States.

Mr. KENDALL. Well, suppose he does not join the association?

Mr. KATZ. Yes.

Mr. KENDALL. Possibly the association which provides its members shall do business with the exchange in the same place which he is doing business with the element of profit involved.

Mr. KATZ. You refer to the man that does not use the mails?

Mr. KENDALL. Yes; or perhaps he does sometimes. But suppose in individual transactions or a series of transactions, if he is a wide-awake dealer, and he has an offer to buy, and he gets an acceptance to deliver the securities, and if that dealer is not registered, he might have bought the securities in a straight transaction, or he might have bought some securities, and all he had to do was to go across the street and register them.

Now, suppose he is not registered, if the sale is made, he does not get anything on it. Now, what is the answer to that dilemma?

Mr. KATZ. Well, I think there might be two answers. The first, I should think, is that the dealer were characterized as exclusively an intrastate, it might be possible that he would think that if there were four or five thousand members of the association, he might continue to do business on the outside.

On the other hand, another answer might be that if he wanted to be on the better side, he could join the association and perhaps do a little bit better.

Mr. KENDALL. Except he would have the added expense.

Mr. KATZ. That is true. Of course all this matter—

Mr. KENDALL (interposing). What I have back in my mind is this: It is not that I do not think it is all right, but I thought it worth while to bring it out so we could have the entire situation before us.

Commissioner MATHEWS. You are referring now to the dealer who does business without using the mails?

Mr. KENDALL. Yes.

Commissioner MATHEWS. I see.

Mr. KENDALL. I have in mind, Commissioner Mathews, the question of control over the individual transaction.

Commissioner MATHEWS. You have to meet that problem to that extent with everybody in the business.

Mr. KENDALL. Yes; as a practical matter—

Commissioner MATHEWS. That is one of the problems that you have in the conduct of the business as a general dealer?

Mr. BOREN. I wonder, Mr. Kendall, if you do not have in mind that the individual dealer will not want to be compelled to join the local association?

Mr. KENDALL. And probably would have to become a member?

Mr. BOREN. You do not believe there would be a very serious objection on the part of the individual dealer to that probability?

Mr. KENDALL. No; but there is the aspect of it, as to whether this implements the State statutes or whether it is an infringement of State rights. That, I think, is really where he might object.

Commissioner MATHEWS. I cannot see how the setting up of the association would impose any infringement of State's rights.

Mr. KENDALL. Why?

Commissioner MATHEWS. Well, it would be a matter of intrastate transaction, and there would hardly be an infringement of State's rights involved. It would be a good deal as if you should say that the Commission should not discipline such members of the stock exchange who engage in certain types of transactions. They discipline the members of their association.

Mr. KENDALL. Yes.

Commissioner MATHEWS. And if it came to a question of criminal cases, he would be in no different position than he is now in.

Mr. KENDALL. No.

Commissioner MATHEWS. There would be really no difference there.

Mr. KENDALL. No.

Commissioner MATHEWS. So I do not think you have really got as serious a question concerning the infringement of State's rights as it might at first seem.

Mr. KENDALL. Well, as I say, I raised the point more because I thought it might come up for discussion at some other time.

Mr. EICHER. Mr. Boren, do you have any further questions?

Mr. BOREN. I just want to reassert the general question to find if there is any interest on the part of the dealers as to what the court of resort should probably be, in the event of the necessity for appealing from the orders of the Commission.

Is there any dispute in your own minds in regard to whether it should go to the district or to the circuit courts?

Mr. WITHINGTON. I think probably the matter has already been covered pretty well, Mr. Chairman, but it would not come up so much in the States where the circuit courts sit in the cities, such as we have in Boston.

In many States, however, where the circuit court does not come around more than once a year, perhaps twice a year, it might be difficult for that reason to have it go to the circuit court of appeals.

From our standpoint, in the city of Boston, we have a circuit court sitting there throughout the year, and where one is sitting, I think that somehow the United States citizens would perhaps prefer to appear before a circuit court of appeals before a 3-judge court, for somehow three judges seem less inclined to be overawed by the Securities and Exchange Commission than one judge.

Mr. EICHER. And it would save him the expense of one jump in the litigation, wouldn't it?

Commissioner MATHEWS. That is, if the Government were to have to take the case before the lower court. If it were to start them in the district courts, I suppose the argument of the Government would be that it would have to file its cases in a number of additional courts.

Mr. BOREN. It is a problem that interests me; the only question I have in mind, is the fundamental one, and I was just wondering whether or not the dealers had any particular preference one way or the other.

Mr. EICHER. Is there anything else you wish to contribute?

Mr. WOOD. In answer to that, I think I have nothing to say, Mr. Chairman.

Mr. EICHER. Is there anyone else who wishes to make a statement? If not we will consider the record closed with one reservation, that one witness who intended to be here but could not come has asked permission to file a statement, and that permission will be granted, and it will be made a part of the record when it comes; that is from Cathrine ———, National Director of Women Investors in America, Inc., New York City.

Also, any Member of Congress who wishes to extend a statement in the record may have the privilege of doing so.

If there is nothing further, the committee will stand adjourned.

(At 6:30 p. m. the hearing was adjourned.)

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