FINANCIAL MARKETS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON FINANCIAL MARKETS

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-THIRD CONGRESS

FIRST SESSION

ON

THE IMPACT OF INSTITUTIONAL INVESTORS IN THE STOCK MARKET

JULY 24, 25, AND 26, 1973

PART 1

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FINANCIAL MARKETS

TUESDAY, JULY 24, 1973

U.S. SENATE,
SUBCOMMITTEE ON FINANCIAL MARKETS
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 2221, Dirksen Senate Office Building, Senator Lloyd Bentsen (chairman of the subcommittee), presiding.

Present: Senators Long (chairman of the full committee), Byrd, Jr., of Virginia, Bentsen, Bennett, and Roth, Jr.

Senator BENTSEN. The committee will come to order.

As chairman of this new Subcommittee on Financial Markets, I would like to state at the outset some of the concerns which have caused me to convene this series of hearings on the role of institutional investors in the stock markets.

I am deeply concerned about the possible impact of institutional investments in three areas—the preservation of a vigorous equity market, the opportunity of individual investors to participate in that market, and the assurance that hard-earned funds which are being invested by professional managers are adequately protected.

Now, the questions of fixed versus negotiated commission rates or whether institutional investors should be seated on the exchanges are matters being considered by other committees of the Congress. These hearings will be directed at the broader economic questions which affect every American whether he is an investor, a businessman, or an employee.

The stock markets of this country have provided American businesses with pools of available capital for expansion for over half a century. Even those who have never bought a single share of common stock have benefited from the existence of these markets as they enjoyed the jobs and the products of a vigorous and expanding economy. But today there is an increasing concern that institutional investment is seriously distorting these equity markets and making it exceedingly difficult for small- and medium-sized firms to obtain the funds they need for expansion. There is a growing concern that these distortions are also an invitation to foreign companies to take over—at bargain basement prices—American firms not presently favored by institutional investment managers.

Should the evidence bear out these claims, I believe the Congress must take action. I do not believe we can afford to allow the U.S. securities markets to become a place where only a select few institutions buy and sell the equity of another select group of large institutions. I want to see this country preserve an economy where a man with a good idea and some managerial ability can attract venture capital and start a business with the hope of someday selling stock in his enterprise to the public. To preserve that opportunity we need the flexibility and vitality of individual investors in the market.

There are many reasons given for the individual investor's reluctance to put his savings into common stock. But one of the reasons appears to be the belief that the individual simply does not have a fighting chance in a market where institutional investors are doing 70 percent of the volume, concentrating that volume in a relatively few stocks, and operating in a manner which leads many to believe they are able to fulfill their own prophecy as to their investment choices by the continuous input of money that is coming into those institutions, into their pension funds, and the fact they're continuing, in effect, to support the stocks they have already purchased.

And, finally, there is the question of the security of the pensions, trusts, insurance, and other funds professionally managed by institutions. The tax code provides incentive for much of this investment.

The indirect tax subsidy from the Federal Treasury to private pensions alone is estimated to be in the area of $4 billion a year. Employers are presently placing over $14 billion a year in private pension funds for the benefit of American workers when they reach their older years. And that figure will increase with the passage of pension reform legislation which this committee is presently considering. Clearly, the Congress has an obligation to assure working men and women of this country that they will still have a pension if IBM, Eastman Kodak, and a handful of other stocks lose some of their present glamour.

These are the areas which I believe the committee has a responsibility to explore and that is the purpose of these hearings.

We are pleased to have as our first witness this morning a man of great experience in this field and I think he can make a major contribution to these hearings.

Mr. Regan, for years we have heard about the concern of your firm for the small investor and how your firm has been encouraging small investors to participate in the stock market. I suppose you don't want to see the day when a small company owner or a middle-sized company owner has to go to an institution and give away half the action. I think it will be a sad day in this country if we have a situation akin to the Japanese market or the German market where most of the big companies seem to be controlled by bank trust departments.

With that kind of predicate, Mr. Regan, we are pleased to have you.

STATEMENT OF DONALD T. REGAN, CHAIRMAN OF THE BOARD, MERRILL LYNCH & CO.

Mr. REGAN. Thank you, Senator.

For the record, my name is Donald T. Regan, chairman of the board of Merrill Lynch & Co.

I understand that this is the first hearing held by your committee, which is starting to collect facts, and then to form opinions, about the securities industry. I'm sure you know that you are beginning on a long and complicated pursuit. You will be hearing opposing opinions. You will be exposed to the herds of technical terms that belong in the broker's lexicon. A book I wrote 2 years ago pointed out that just as the cleric forgets he has his collar on backwards, so the broker forgets he doesn't speak like other men.

Mr. Chairman, I have been musing about how you might approach all this complicated subject matter. I was searching for some standard by which you might evaluate all that you will hear and study—looking, if you will, for a touchstone by which to judge the issues and the proposals. The one I hit upon came from your own recently expressed concern about the individual in the marketplace. You might want to take him as your touchstone. As far as I know no one else has done so. Look at every proposal, every opinion, every solution, in the light of the individual investor. How does each proposal affect him? How would it strike him? What good would it do him? And if it does him no good, pass it by.

That rather special angle of vision, I think, would enable your committee to make a very special contribution to the shape of our securities markets. And the contribution would certainly come at a critically important time.

So—perhaps we could begin by asking what a marketplace really is, and how it looks to the individual whom it is intended to serve.

To think of a marketplace as a place is accurate, but it is also quite misleading. I have no idea what level the stocks traded on the New York Stock Exchange will close at today. But I can tell you with certainty that even if every index shows no change, at the close of today's market will not precisely resemble the market at the opening. The market is organic, mobile, and always in flux.

Looking at that environment, the individual today is struck by an important characteristic that was not significantly present 10 years ago. He sees a new power in the market. The power belongs to the large pools of investment capital that we call financial institutions. They are the private pension funds, insurance companies, mutual funds, and banks. From the perspective of the individual, these are awesome forces. An institution may trade on the stock exchanges, but it also has the ability to go off the floor of the exchanges to the third market. There it can trade without disclosure of volume or price. The

institution may pay the same rate of commission as the individual, but it is more likely to make big trades. For those trades it pays only a commission set by the forces of competition, and not a commission fixed by the regulatory bodies. An institution may hold a stock for a long time, but it can sell very swiftly on news that may not reach the individual until much later. Sometimes the individual thinks that the institution may act on information that never reaches him at all.

That is usually an unwarranted suspicion. But the institutions have wrought very important changes in the market. I know that you will be hearing from expert witnesses from the stock exchanges, and the institutions themselves, at these hearings. Doubtless you will have poured over your heads buckets of statistics describing the institutional elephant. Perhaps the statistics will seek to prove that he is not an elephant at all. But I would like briefly to sketch for you just where the institutions stand in the market today.

Institutions as a group now do a great deal more trading than individuals do. About 70 percent of the trading on the New York Stock Exchange is now done by institutions. Institutions have been increasing steadily the share they own of the total value of outstanding common stock. The velocity with which institutions trade in the markets has been on the upturn pretty steadily for a number of years. In 1964, institutions had a 12.9 percent turnover rate. Last year it was 27½ percent. So the big traders have also been busy traders, in contrast to the small investor, who tends to buy his stock and hold it.

Senator BENTSEN. Mr. Regan, if you don't mind, we will interrupt you for questions at points in your testimony. It might get it better in context.

Do you have any percentages for the turnover vote of small investors?

Mr. REGAN. The turnover on the New York Stock Exchange for the first 6 months of 1973 is approximately 16 percent. For all of last year it was close to 20 percent.

Senator BENTSEN. As opposed to 27½ percent for the large institutions?

Mr. REGAN. That is correct.

In fairness one should understand just what functions financial institutions perform, and whom they serve. They are financial intermediaries seeking to attract funds from savers, and to give those savers a reasonable return on their savings. They are in the business of serving individuals to the best of their ability, just as we are at Merrill Lynch.

During the 1960's, individuals sold more stocks than they bought. If you correlate that fact with the purchases by institutions, you end up with the simple conclusion that the 1960's were a time when individuals sold stock to institutions. At first, this trend was judged to be healthy. It was thought that institutions would make their influence

felt principally on the demand side. It was expected that they would be long-term investors, and that as a consequence of their positions price changes would be less erratic. But today's results don't look that way.

We do not really know for certain the consequences of the institutional presence in the market on the price movements of stock. We need more facts and fewer random suspicions on that point. But it seems as though the price volatility of stocks has increased as institutional trading has increased. Institutions often trade in large blocks of 10,000 shares or more. Only an average of nine such blocks per day were traded per day in 1965. But 124 of them were traded per day last year. Institutions usually acquire stocks carefully over a long period of time. But they sometimes sell hastily and indiscriminately.

That is when prices come down with a jolt. The individual gets the unpleasant sensation of suddenly hitting an air pocket. We have seen cases where quick-breaking news is acted upon swiftly by the institutional trader. Drops of perhaps 20 or 30 percent in the value of the stock can result. The individual shareholder is liable to find out about all that when he picks up the paper on the way home from the office.

And I have the intuitive feeling that it takes stocks a very long time to recover from an institutional bailout. The institution may be selling the stock for many reasons besides the belief that the stock just isn't a good investment any more. But remember we have our focus on the individual, who is only the witness to the large institutional sale. He makes the immediate inference that the future of that particular security doesn't look so good. But he simply can't get out on time.

The desire of the institution for instant liquidity works against the interest of the individual. Price volatility arises because institutions want to sell in a hurry. In the long term, that insistence on instant liquidity may work against the interest of the institution, too. Institutions need the individual in the market. Individual willingness to buy and sell helps to keep the market stable and liquid. But these sudden price drops after institutional sales discourage the individual, and dry up liquidity. That trend could in the end hurt the institutional holder as well.

A great feature of American capital markets has been their ability to accommodate the individual who wants to participate directly and not through an intermediary. We want to perserve that feature. We do not want a market that belongs to dealers, or to big institutions selling huge blocks to each other. That would make a radical change in the living organism, and in the end might kill it. It would also change our concept of modern American capitalism, which offers direct access to the system for everyone. A great deal would be lost.

The holdings of institutions are largely concentrated in a few stocks that are described as "super growth" or "glamour" stocks. Those stocks have extremely high price earnings ratios, especially relative to the

values found in the rest of the market today. The customers of the big institutions may have benefitted from that institutional policy, so far at least. But such institutional predilection for only a few securities puts limitations on the abilities of many companies to raise capital. That is not an expected result of institutional trading policies, but it happens nonetheless.

Public offerings of industrial companies totalled $18.5 billion in the first half of 1972. But in the same period this year, the total was only $11.5 billion. The sharpest drop came in the issuance of common stock—down from $4.8 billion to $1.2 billion. There were only 18 initial public offerings or $5 million or more in common stock this year, against $140 last year.

Of course the poor markets this year were the chief deterrent to new issues. But there were other deterrents as well. We know of a company, for example, that planned to issue 400,000 shares of common stock, to raise around $10 million, early this year. But then it discovered that there was no individual interest in its stock. Institutions, however, were most interested in buying. But the company's management decided that it did not want to be owned by institutions to that degree. It therefore backed away from the market entirely. So institutional desire to buy can have strange effects when it is matched with a lack of desire by individuals.

Continuing to look at all this from the perspective of the individual, I believe that two courses of action suggest themselves. One is consideration of means whereby the actions of institutions are somehow regulated so that the individual's sense of disadvantage will be diminished. The other is to consider means other than the possible restrictions on institutional behavior that would encourage more individuals to enter our markets in increasing numbers—to their benefit, the benefit of corporations of all sizes, and ultimately to the benefit of our economy.

At the same time, however, just how to hobble the right of the institution to sell what it owns is not easy to determine. Apparently easy solutions have not so obvious things wrong with them.

Limitations on the institution's right to sell more than a given percentage of its holdings have been suggested. I put forward that idea myself. It might work if properly designed, but it certainly needs study. If the outcome would be that large institutions with small holdings would be able to sell more than small institutions with small holdings, a new inequity would be created. A limit on the dollar amounts permitted to any one institutional sale has been proposed. A formula may be possible there. But different and inequitable effects on stocks with different market values might result. To restrict the maximum

permissible price movements on stock exchanges has also been a suggested corrective. But given the present structure of the securities markets, that might tend to drive trading to the third market, where it would be undisclosed and less regulated.

Right now on the commodities markets, limits are placed on price movements. A maximum decline or a maximum increase in price is set, after which no further swings are allowed. I do not know that such a rule could work with stock trading, since it would raise the possibility of brief flurries of trading in the morning followed by a quick suspension for the rest of the day.

It is always dangerous to tinker with the mechanism of the market, unless we know what we are doing would make the situation better and not worse. Still, some kind of regulation of institutional trading must be found. The rule of numbers requires it. Whatever way we find must not damage institutional services, but it must also help protect the individual investor.

More disclosure of institutional trades in one limitation that I think would help the individual while in no way harming the public that institutions serve. A regulation could be passed that would require institutions to disclose their purchases and sales promptly. I can see no logical objection to the point that the new power of institutions puts on them a new responsibility to disclose quickly.

One requirement that I would like to put forward would oblige the institutions to make public, and perhaps report to the SEC, all its transactions weekly or monthly. The institution would have to reveal the date and purchase price, and the date and sales price of every security it sold. Such a rule would of course give the investing public a great deal more information than it has today about what every major institution is doing. It would certainly be helpful to public confidence, and get rid of current concern over institutional secrecy. It would also discredit the current, usually erroneous impression that institutions often act on inside information not available to the public.

But it would also accomplish even more than that. The institution would know while acquiring a stock that some day it would have promptly to disclose the sale. That might make institution reluctant to take a commanding position where the stock is thin. And that in turn would reduce the possibility of a wide price swing.

Sixty years ago, Justice Brandeis said:

> Publicity is justly commended as a remedy for industrial disease. Sunlight is said to be the best disinfectant. The corporation avoids conduct that will prove embarrassing if disclosed; the possibility of future disclosure constitutes a major element in shaping current decision.

Brandeis added that:

> The climate of public opinion has an almost irresistible pressure in the long-run. Increased disclosure is obviously a powerful element in the formation of public opinion and in the development of public pressures to accomplish social objectives.

Now let me tick off quickly some actions, other than the regulation of institutions, that would encourage the individual to enter our markets directly. There are 32 million shareholders today, including the holders of shares of mutual funds. But there are 87 million members of the working force, whose prosperity is going to increase. How can they be encouraged to participate in our capital markets? How can a climate attractive to these millions of potential investors be created?

First, by improvement of the markets' trading mechanisms. That will come about by a switch from fixed commissions, against which both individual and institution are rebelling. We need the fresh air of competition in ratemaking. That will mean better and more varied service to the individual. The Senate has overwhelmingly passed a bill calling for competitive rates. Add a date certain for those rates, and a lot will have been done for the individual investor.

Then, a change in the tax laws for both foreign and American investors. The end of the withholding taxes on interest and dividends paid to foreign investors would be taken as concrete evidence of the U.S. Government's desire to attract foreign investors. We recently took an informal survey of the managers of Merrill Lynch's foreign offices, asking their judgment about the consequences of ending these withholding taxes. The response indicated that sales of common stock to local customers, that is foreign customers, would increase by somewhere around 15 percent. Some estimates went as high as 30 percent. The common stock of public utilities and certain preferred stocks would be especially attractive if withholding were ended.

Current sales of U.S. debt securities abroad are very small. But there is also a great demand for top-grade, liquid debt secruities abroad. If we were to end our policy of withholding on interest, American corporate debt instruments would become very interesting to foreigners. That would be true, we believe, even when Eurodollar and other foreign rates are higher than rates in this country, because of the quality of our offerings.

There is lots of money out there looking for a happy home. With an effort, we can make that kind of home for it here.

As you know, in 1969 increases were made in our capital gains tax structure. The consequences of the increases probably have been to discourage many potential new individual investors from entering the financial markets. This has been unfortunate for our economy. I believe that the incentives for entry into the markets must be augmented. That is the way to insure that the valuable resource of capital for the private sector will be maximized.

The capital gains tax is really a transfer tax, as economist Alan Greenspan has pointed out. The higher the tax, the lower the turnover. Thus the owners of capital are tempted to decide to move or not to move their capital from one place to another for tax reasons. And in that way the whole process of capital allocation is distorted.

The willingness of individuals to put capital at risk, even at modest risk, is essential to the health of our system. Our tax structure should be built to encourage, not discourage, such risk-taking. I do not want to take your time with elaborate proposals concerning capital gains. I shall only suggest some basic ideas. Losses should be deductible in a way that matches the treatment of gains. And consideration should be given to a sliding tax scale for capital gains, which would decrease the amount of tax as the holding period increases. Perhaps the starting point for capital gains treatment should be with an asset held up to 3 months. Perhaps funds that are invested should get special treatment.

I began by spotlighting the individual investor. Let me conclude by telling you how we at Merrill Lynch gage his mood today. We are the largest retail brokerage firm in the country, with something like a million and a half customers. Historically we have always represented the individual's interest.

You may be surprised to know that the individual, even in the present environment, is not gripped with despair.

Senator BENTSEN. I am glad to note that, Mr. Regan. I have talked to quite a number of people that feel to the contrary.

Mr. REGAN. I understand that, Senator.

To conclude from the fact that the individual is worried that he has fled the market in droves, and become a disappearing species, is wrong. He is in fact neither dsiappearing nor endangered. He has not been trading much for the past 6 months. But his habit is to buy stock and hold it anyway. In bad markets he doesn't trade—for awhile. Then bargains show up. Then he steps in once more.

One measure of the individual's confidence is whether he is on balance a net buyer or a net seller. Our figures for cash accounts now indicate that individual buying has suddenly changed. On a net basis, it is at an all-time high.

Gentlemen, if I may call your attention to this chart behind me? You have a copy of it, I believe, attached to my remarks.

[The chart follows:]

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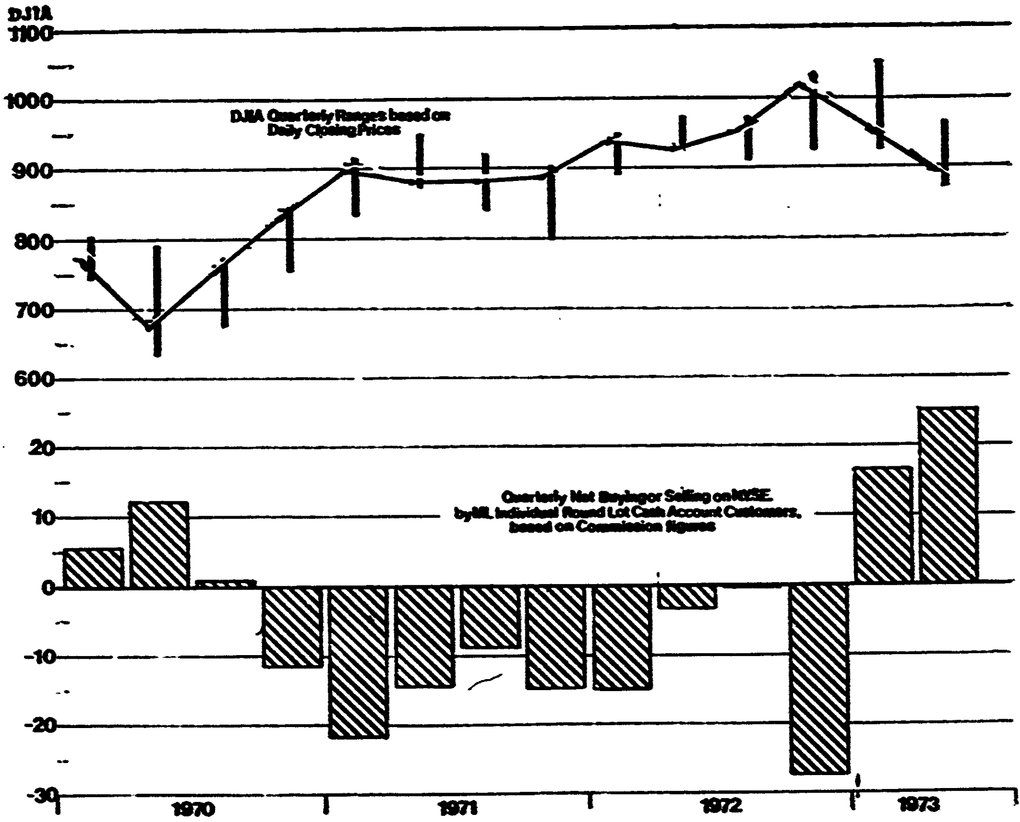


Mr. REGAN. What it indicates is that starting in May of 1970 the individual was a buyer of stock. That is indicated by the bars starting at the zero line. At the same time, above that, if you will notice, as he was buying stocks, the Dow-Jones industrial averages were on their way down. So, on balance, our individual round lot customers in Merrill Lynch were buying as the market went down.

Now, let me explain a little bit what I mean by round lot customers. These are not the odd lot customers, buying anywhere from one to 1,200 shares. These are people buying 100 shares only, and does not include institutions. These are only individuals.

Now you will notice that starting in the final quarter of 1970 and all during 1971 and 1972, the individual was seller as the market was rising, and he sold the most in the final quarter of 1972 when the Dow-Jones averages peaked. Now he has started to buy and he is buying more on balance currently when the Dow-Jones averages are at their bottom. This is contrary to the usual supposition about what the little man is doing. These are not little men. These are round lot buyers. These are not the odd lot buyers. These are wealthy and sophisticated: Doctors, lawyers, businessmen, who make up the bulk of Merrill Lynch's customers.

That is how the chart turns out, which surprised us when we looked at it. We didn't realize that the individual investor is as astute as he is. And there is probably a good reason why he was out of the market; he hasn't liked the downward movement and he stayed away waiting for bargains. And apparently just recently he has started to come into the market to a greater extent.

Now let me conclude. In December and January last year, the individual was a heavy net seller—this is just for the record—and now he is swinging around the other way. In December last year, the owner of odd lots was selling at an all-time high rate. But now he, too, is back in balance. He seems to be moving toward the net buy side.

The sudden rebound of the market in May or 1970 was caused largely because of the re-entry of the individual. He saw opportunities that looked very good to him, and he began to buy. He is apparently making the same kind of decision now, although it is too early to be certain that this is deep and widespread. So the individual is very much around, although he was hibernating in this recent bear market.

Also running counter to the notion that the individual is racing for the exits are the figures on the opening of new accounts at Merrill Lynch. We are opening new accounts during 1973 at the highest rate in our history. For the first 5 months this year, we opened over 212,000 new accounts. That rate is about 5 percent higher than the rate at which were opening them in 1972——

Senator BENTSEN. What kind of criteria do you use to close out an account?

Mr. REGAN. We never close an account, Senator, unless——

Senator BENTSEN. You never close an account?

Mr. REGAN. Not unless it is a margin account in which the equity gets below 30 percent. Then we have to sell enough to bring it back into compliance with regulation T, but apart from that we seldom

close out an account. It has been our experience that very few investors wait around for us to do that. When we send them a notice they are below 30 percent in their margin account, they take action. Of course, cash accounts we never have to close.

Senator BENTSEN. If you haven't had a trade with a customer for 3 years, would you still carry him on the books?

Mr. REGAN. If he still has a security position with us, yes. Of course, naturally, if he hasn't left his securities or his cash with us, we no longer consider him a customer, we consider him removed and——

Senator BENTSEN. But that is exactly what I was asking. There is a point at which you would remove him?

Mr. REGAN. When there is simply nothing in the account, Senator, when there is zero balance in the account.

Senator BENTSEN. Now, how many net new accounts do you have?

Mr. REGAN. That is an impossible question to answer. We keep searching for that valiantly. Each year we open up—well, during the last 3 years—we have opened up over 400,000 new accounts per year, and each year we do business with anywhere from 1,200,000 to 1.5 million customers.

Senator BENTSEN. You see, I don't know how much you lost though. You told me how much you gained, but that doesn't really mean much.

Mr. REGAN. I'm trying to tell you, in a roundabout——

Senator BENTSEN. Well, I am trying to find out, here you started out in the beginning telling me in your testimony about the problems created by the institutions in the marketplace.

Mr. REGAN. Right.

Senator BENTSEN. And then you turn around and you gave me some very optimistic figures here, but I don't know how good your figures are, because they are not net figures. You are telling me how many new accounts you have added.

Well, do you believe you have a structural problem in this market, or do you think this is a temporary aberration because of high interest rates and Watergate or what have you?

Mr. REGAN. That is not an easy question to answer, and I will try not to give a too complicated answer.

First, getting back to the new accounts, and net new accounts, we never know when a customer stops being a customer of Merrill Lynch and becomes a customer of some other firm like Bear Stearns and Co. and the others. You see, Senator, if a person wants to buy $10,000 worth of stocks, and he orders three different issues, of round lots, then accepts deliveries of those issues, and we ship the securities to him, then he has invested. He has no more money to invest now, although he has the three stock certificates. He is off our books and no longer a customer of Merrill Lynch. It is only when he gets his next $5,000 or $10,000 to invest that he will come back to us. We don't know whether we lost that customer or not. That is my difficulty with these net figures.

This is not similar to a checking account where you suddenly withdraw the entire checking account and go elsewhere, so I have difficulty with that.

As far as answering the second part of your question——

Senator BENTSEN. Your sales organization hates to admit it has ever lost a customer. You always think he is going to come back.

Mr. REGAN. I will admit that, since we are partially a sales organization, we do have that problem and we like to think people will come back to us, and we find, indeed, quite a few do.

As for whether this is a temporary aberration or not in the market, you have to remember something else, Senator. This is not a nice side of Wall Street to have to discuss, but it is the true facts. We had at least one major failure of a New York Stock Exchange firm. This is primarily due, of course, to the charges of fraud that have been entered against this particular firm, and——

Senator BENTSEN. Well, I assumed that the failure of some of these firms would have resulted, in a firm of your size, probably gaining customers that are lost from the smaller firms?

Mr. REGAN. That is my point, Senator.

Senator BENTSEN. Because of the concern of the small individual investor?

Mr. REGAN. Again, Senator, of the 412,000—up 5 percent from last year—we were unable to determine at this point how much is due to that, and how much is due to the fact that people are, in accordance with this chart, coming back into the market to buy.

Senator BENTSEN. So this experience of yours may be singular, it may be unique, and this may not be what is really happening overall in the way of numbers of investors coming back into the market?

Mr. REGAN. I can think of at least one other publicly owned member firm of the New York Stock Exchange, Reynolds & Co., which has publicly stated that it has had the same experience as Merrill Lynch. I know E. F. Hutton & Co. shows that its new accounts are practically at an all-time high.

So the experience is not unique to Merrill Lynch, although it may be unique to some of the larger New York Stock Exchange member firms.

Now, just to conclude my statement, the interest in direct ownership of securities, while latent in recent months, is very much still present. A shift to competitive commission rates and the consequent new marketing techniques that would result will increase that interest even more.

The measure of individual participation in our markets is also a measure of their health and the health of our economy. It might not be too much to say that in the end individual confidence measures also the soundness of our kind of capitalism. There is your touchstone.

Thank you.

Senator BENTSEN. Mr. Regan, what percent of Merrill Lynch's volume is attributable to institutions and how much to the individual investors?

Mr. REGAN. Approximately 30 to 35 percent of Merrill Lynch's volume in common stocks is attributable to institutions and the remainder to individuals.

Senator BENTSEN. I am concerned today that the portfolio manager doesn't look so much to such old fundamentals as the price/earnings multiple but rather looks at what the large institutions are buying. It gets into a guessing game trying to follow what the institutions are

doing and trying to anticipate what they are doing in either buying or selling.

How many times do you hear people asking what are big institutions buying?

Mr. REGAN. Quite often, Senator. This is a concern of many individuals as they buy as to whether or not the stock that they buy, or they own, is one of the institutional favorites. Of course, many financial magazines and other financial publications try to keep the public abreast of this.

Recently, for example, there was an article in Fortune magazine on this particular topic. Now a lot of the individuals, however, are themselves looking for bargains apart from what the institutions have already found to their satisfaction to be bargains. Now a lot of the people don't want to go with the supergrowth stocks. So, accordingly, I would say that something in the neighborhood of a good percentage of the market volume is made up of a lesser price/earnings ratio of stocks, and that the volume in the stock exchange marketplace, while ownership is concentrated in a handful of stocks, the volume in the exchange is not similarly concentrated.

Senator BENTSEN. Well, I am concerned about six or seven portfolio managers going down to Delmonico's for lunch and exchanging views and developing a herd psychology and buying into the same stocks and having a self-fulfilling prophecy by the continued input of their money, especially their pension money, into those particular stocks. I am concerned about two of them trying to go out through the gate at the same time and seeing a precipitous drop in those particular stocks. Does that thing concern you?

Mr. REGAN. It does concern us. As I stated in my remarks here, the institutional desire for liquidity and—in your phrase—seeing two of them trying to get out of the gate at the same time, this does cause worry as to what the effect is on the market price of that particular stock. There have been some cases here recently where this has happened.

I think what you should look to—and I will leave it to these other gentlemen to explain themselves—is the difference between institutions. If I might say, institutions are not all the same in their investment objectives, and some institutions are not the competitive style where they must go for performance. There are many, many mutual funds, many casualty insurance companies, many life insurance companies, which have avoided this while others have made a fetish out of it. One of the things I think you should concern yourself with is the kind of dichotomies that exist in American business where a businessman is upset about his price/earnings ratio of his own stock. Maybe it is 5, 6, or 10 times, but he thinks it should be higher and I don't blame him, but at the same time he puts his own pension fund in the hands of three or four different types of institutions and says, "Now fellows, compete. Let me see who is going to give me the best return on my pension money." He is looking for 6, 7, 8, 10, 12 percent returns because it is better for his corporation to get the best rate of return he can get. So if he does that, Senator, then he builds up the individuals who are handling pension funds and then says to them, "Gentlemen, compete." So you have bank A competing against bank B, and you have investment counsellor C competing against investment coun-

sellor D, and maybe all of them competing against insurance company X. So this is a strange thing that I think American businessmen at the top are going to have to concern themselves with now.

Senator BENTSEN. Do you think there are some large companies that would be as much as 90 percent owned by institutions? Do you know of any?

Mr. REGAN. I do not know of any that would be 90 percent, no.

Senator BENTSEN. You say reinvestment funds should have special tax treatment. I assume you mean reinvested into the stock market?

Mr. REGAN. Yes.

Senator BENTSEN. Would you elaborate?

Mr. REGAN. If you take what is allowed in the real estate market at this time, a fellow buys a home and pays $20,000 for it, and due to inflation, or what have you, it gets to $30,000 when he sells it. If he reinvests in another home, that is at least $30,000 or higher, his capital gains tax is postponed on the additional $10,000. I would suggest that much the same thing could be done in the security markets. Were one to reinvest in the securities markets, he would have his capital gains tax, not forgiven, but postponed until such time as he no longer invested it and the taxes were due.

Senator BENTSEN. Senator Byrd?

Senator BYRD. Thank you, Mr. Chairman. Mr. Regan, this is a very interesting presentation. I like the touchstone that you took, the individual in the marketplace. I notice on page 10 that you also mentioned the individual and the number of individuals who are in the working force and who are potential investors.

Now, this figure of 70 percent, that the institutions represent 70 percent of the trading now on the exchanges, if it goes much higher, then it seems to me the individual will have little opportunity in the market. Would that be the way to express it or not?

Mr. REGAN. Well, Senator, I think he will always have an opportunity. You have to remember that the 70 percent of the trading is done by institutions, but quite a good deal of the 70 percent is trading among themselves; an insurance company is selling and a pension fund is buying, and that type of thing goes on all day long.

As I suggested, in mentioning the number of blocks that were traded last year—124 blocks daily of 10,000 shares or more—literally the only buyer there is nowadays for 10,000 shares or more is another institution. So a lot of that trading goes on among themselves. There is still plenty of opportunity for individuals there.

Senator BYRD. I guess maybe I shouldn't have used the word "opportunity," but it seems to me as the trading is concentrated into fewer and fewer institutions—and you have 70 percent now—that the individual is disadvantaged by that. Would that be the correct way to say that?

Mr. REGAN. He is at a disadvantage only when the institutions come to sell and want instant liquidity. If the institution gets out of the market in an orderly fashion when it no longer, for one reason or another, has the desire to own the security for that particular common stock, then the individual is not at a disadvantage.

The buying of securities by institutions is usually good for the individual. That is what has put many of these stocks up in price. And, obviously, the original owners of that stock—or even the secondary

owners—who have participated in the price rise, have benefited. It is only when the institution wants out quickly that the individual is hurt.

Now as far as the buying is concerned, as I said to Senator Bentsen, this is concentrated in a very few stocks. There are probably 100 stocks, at the most, of major concentration with institutions. So that leaves us 1,400 stocks where individuals are daily buying and selling. On the American Stock Exchange, less than 20 percent of their volume is institutional business. So there is a whole broad market there as well as the over-the-counter stocks where individuals are free to come and go.

Senator BYRD. You say that 10 years ago your institutions were not significantly in the market. What would have been the percentage 10 years ago?

Mr. REGAN. I would judge similar to what it is today on the American Stock Exchange; 80 to 20. Eighty percent individual and 20 percent institutional.

Senator BYRD. So it's gone from 20 percent to 70 percent?

Mr. REGAN. Seventy. That is in trading, Senator. There is a distinction there between ownership and trading.

Senator BYRD. Well, trading.

Mr. REGAN. In trading it is 70 percent now up from 20 percent in a decade.

Senator BYRD. You regard that figure of 70 percent as being a dangerous figure, being dangerously high?

Mr. REGAN. I wouldn't characterize it as dengerous. I am a little ill at ease with the situation, but "dangerous" is a little too strong an adjective for me.

Senator BENTSEN. How do you like 90 percent?

Mr. REGAN. Pardon?

Senator BENTSEN. How do you like 90 percent?

Mr. REGAN. I might not go that far, Senator.

Senator BENNETT. What levels would you become at ease?

Mr. REGAN. I would say 50–50, Senator.

Senator BYRD. At what level would you apply the term "dangerous"?

Mr. REGAN. In the neighborhood of 85 or 90 percent. I would think that would almost stifle our markets to have all of that institutional trading. Then you would be getting into the model of foreign markets, as Senator Bentsen has remarked, like the German and English and Dutch types of markets.

Senator BYRD. You say it is always dangerous to tinker with a mechanism of the market unless we know what we are doing to make the situation better and not worse. I think that is certainly correct, but then you follow that up, which I think is also correct, that we need still some kind of regulation of institutional trading which must be found.

Now I sort of like the idea that you throw out about the reporting more regularly business and greater disclosure as to the sales and purchases of these institutions. Perhaps other witnesses will give the other side of this, which I would like also to get, but without having the other side it seems to me you make a very desirable recommendation.

Mr. REGAN. Senator, starting with disclosure, let's first see what disclosure brings. Then, if there is more cause for concern, I think that's

where we start into "tampering with the mechanism," if you will. I am enough of a conservative in my economic thinking to realize that free markets should be free and not hampered, but we have to control the commodity markets and we did put daily limits on the commodity markets. For the most part those moves have been salutary. I am not sure, however, as yet that the same thing would happen in the stock market.

Senator BYRD. Well, there are tremendous numbers of U.S. dollars floating around the world. Are there any strong cases that well-managed American companies may be purchased by bargain hunters if there are a lot of excess dollars floating around?

Mr. REGAN. There have been indications of that and there has been an awful lot of newspaper and magazine talk about it, but I submit there has been more smoke than fire here. We can only think of five or six examples, at the most, in the first 6 months of 1973.

There is no doubt, however, that with the devalued dollar and with our own companies that are long on assets, being so cheap that foreign buyers do go for assets and cheap companies and our companies are in this position at this particular moment. They don't go for conceptual stocks. They go more for asset-type stocks. And I dare say they are looking.

Now, I am not sure that this is all bad. We have enjoyed doing the same thing in Europe for the past 20 years in acquisitions and the like. And I am not sure that we want to shut off the flow of foreign capital over here as long as the plants remain here and as long as American workers are employed and the like. I don't see that the ownership ncessarily hampers our capitalistic system unless, obviously, it is a defense industry or something that is vital to the concern of the United States and that we shouldn't have foreign ownership of.

But, apart from that, I am willing to have them come over here and compete, providing, you know, they increase the work in the factories and things of that nature and contribute to our prosperity.

Senator BYRD. If the institutions concentrate their holdings on a few so-called glamour stocks, how will this affect the mass of medium-sized, American firms in getting equity capital from the market?

Mr. REGAN. It will make it very difficult for them to do it. Very difficult.

Senator BYRD. How closely does Merrill Lynch follow the portfolios of the principal commercial bank trust departments?

Mr. REGAN. Since they don't reveal to us exactly what they are doing, I would say from a distance.

Senator BYRD. Well, thank you, Mr. Regan.

Senator BENTSEN. Senator Bennett?

Senator BENNETT. I have asked that a copy of our Blue Book be delivered to your table and you have it there. Would you turn to page 3?

You will find a list of the 10 leading institutional investors. Can you comment on the relationship between Merrill Lynch and any of those 10?

Mr. REGAN. Well, each one of them, Senator, does business with Merrill Lynch. Merrill Lynch does business with each one of those.

Senator BENNETT. You do business with all 10?

Mr. REGAN. With the exception of Metropolitan Life Insurance. Other than acting as broker or dealer in stocks and bonds, I don't believe we have any other business relationship with Metropolitan Life, nor with the Investors Diversified Services.

Senator BENNETT. But, do I understand that you do act occasionally as broker for all 10?

Mr. REGAN. Yes, sir. And also dealer in other types of securities, Government securities, bonds, and the like.

Senator BENNETT. What kind of other relationship do you have with any of these 10?

Mr. REGAN. Primarily as a borrower, sir. We are borrowing currently close to $1 billion and the majority of these banks are lenders in the market to brokers.

Senator BENNETT. There is not necessarily any relationship between your position as a borrower and your relationship as a broker?

Mr. REGAN. The two are supposedly kept well apart and they are supposed not to have a relationsihp to each other.

Senator BENNETT. Now, institutional investors have substantially higher turnover rates than the average on the New York Stock Exchange list. Is that true?

Mr. REGAN. Yes, sir.

Senator BENNETT. Can you give us any kind of understanding of comparative rates—how much higher?

Mr. REGAN. As I recall them from memory, the turnover rate on the New York Stock Exchange for the first 6 motnhs of this year was 20 percent. For all of last year, it was 23 percent. For June the stock turnover ratio was 16 percent. That is 16 percent for June of 1973 and for all of 1972 it was 23 percent.

Senator BENNETT. That is the average turnover?

Mr. REGAN. That is the average turnover for all stocks on the New York Stock Exchange.

Senator BENNETT. Now, do you have any figures for the average of institutions or for typical institutions, something that we can compare with that?

Mr. REGAN. Twenty-seven and one-half percent, Senator, is the average institutional turnover.

Senator BENNETT. Oh, we have a vote. We have a vote on the floor of the Senate, so we have to leave temporarily, but I would ask you one further question.

Do you think this variation is dangerous; this gap is dangerous? Do you think the margin between the two rates is dangerous?

Mr. REGAN. Not as yet, Senator. I have not seen any evidence that the volatility of the institutional portfolio has so far interfered with the performance. I would be concerned if it gets much larger.

Senator BENNETT. Off hand I would think that there might be more damage to an individual investor if his account churned—in other words, let me say it another way—the individual investor runs a greater risk of having his account churned than the institution.

Mr. REGAN. The average institution, Senator, churns the average recipients portfolio much more than the average broker is doing at the current moment.

Senator BENNETT. That is an interesting comment.

With that, Mr. Chairman, I guess maybe we better vote.
Senator BENTSEN. Mr. Regan, we will recess for about 10 minutes while we vote.
[Recess.]
Senator BENTSEN. The committee will come to order.
Mr. Regan, I think your testimony is very helpful and very interesting to us. There are several points that I would like to pursue with you a little more in order to get the benefit of your experience. What would you think about imposing a limit on the percent of a company's total stock than one institution could hold? Obviously, you would have to have a grandfather clause to prevent precipitous dumping of stock, but do you think there should be a maximum percentage of ownership of a corporation that an institution could own?
Mr. REGAN. All right, we will have to take first, Senator, the point I assume you are talking about, that is a single institution owning a limited percentage of a single institution?
Senator BENTSEN. That is right.
Mr. REGAN. And not all institutions owning a certain percentage of a single corporation?
Senator BENTSEN. Oh, no. I don't know how you could govern that.
Mr. REGAN. I would suggest you take a look at what the Investment Act of 1940 has put in as a rule for mutual funds. Most mutual funds are not permitted to own more than 5 percent of the outstanding stock of a corporation. I would suggest, however, that when it comes to a bank, you are going to run into difficulty because the bank that manages many pension funds doesn't own that stock for itself. It owns a certain portion for pension fund A and B and C and D, and whether collectively you want to restrict all of the pension funds managed by that bank to a certain percentage is something I am not quite prepared to answer now. I would rather think that one over, because it would mean that the first few pension funds were able to buy, let us say, the best recommendation of the bank, and then, having hit their maximum, they would have to go to their remaining stock recommendations for their remaining pension funds. I would rather reflect on that one before offering a definite conclusion, but I do feel that the Investment Act of 1940 should be your guide.
Senator BENTSEN. Let's look at another point. There is concern about the impact on the market if two or three major institutions decide to sell at the same time. There is a concern about large institutions having better avenues of communication and information than the small independent investor might have.
Now, do you think, perhaps there should be a limitation on the percentage of its holdings that an institution could sell per day? I don't agree at all with the idea they should disclose ahead of time what they are going to sell or buy because that would put them in an extremely bad disadvantage and could lead to all sorts of problems with other investors taking advantage of it, but let's say that you had a limitation that they could not sell more than a certain percentage of their stock each day. What would you say to that?
Mr. REGAN. Well, I think I would have to take a pragmatic approach on that one, Senator. I was just thinking of our own position

as a trader if it were known that bank A or insurance company C owned 300,000 shares of a stock—and you have a percentage rule in effect, let us say—so they say, well, we are only allowed to sell 10 percent of our shares today, and, Senator, I would not want to be the broker that bought the first 30,000 shares because, you know, coming behind it are those 270,000 other shares.

Senator BENTSEN. Hanging over the market, you mean?

Mr. REGAN. Hanging over the market, yes, and if you buy at one price, the chances are 99 to 1 that it is going to be less tomorrow and the next day and the next.

Senator BENTSEN. That is a very good answer.

Mr. REGAN. As I said in my opening remarks about tampering with the free market—and I am not trying to be offensive when I say this—but before tampering with the market, this is the type of thing I would definitely anticipate and consider.

Senator BENTSEN. Mr. Regan, that is a good statement and a view that we are well aware of, and we are in complete concurrence with, and that is the reason we are asking men of your experience and your expertise to try to give us suggestions of what could be done in the way of remedial legislation. In this particular committee, we deal with those things of course more from a tax angle.

You made a number of comments about reinvestment of proceeds back into the stock market without taxes being paid at that time.

You talked about grading capital gains over a period of time. So that is something that we will be considering.

I am concerned, too, Mr. Regan, with the fact that I can recall in the new issues, market craze everything was being sold on a conceptual basis, and a bunch of the young gunslingers really had their sideburns burned off. And with the thought of self-preservation—that so many of them have these days—many are going to think like IBM, because if IBM goes down, so far as its value, one can't really blame them too much because they have an awfully good company there, but if they buy into some company that isn't as well known and that one turns bad, why they may be looking for a new job. That has to play its role, too. I don't know how to legislate on that one.

Mr. REGAN. I am not sure you can legislate it, but I would remind you, Senator, of what I also said earlier—that you have to talk to American business also, particularly to the chief executive officers of corporations, about the type of performance that they may be encouraging by asking for better returns on their pension funds.

Senator BENTSON. So they don't have to contribute as much to the pension plan each year.

Mr. REGAN. Yes, Senator.

Senator BENTSEN. And I understand the pressures these portfolio managers are under and the competition among them with that.

Mr. Chairman, would you like to ask some questions at this time?

The CHAIRMAN. No.

Senator BENNETT. A minute ago Senator Bentsen talked about the banks handling pension funds and the problems they have in their trust departments with a series of investments which might take them above any limit that we might put on the amount.

Now, could we handle that—and I recognize the problems—but, could we handle that by putting some kind of a limit on the total stock they could vote, even though they might actually manage more than a minimum amount?

Mr. REGAN. Well, let's turn to votes for a moment, Senator. It's been my experience that banks don't normally pay that much attention to the vote. However, if you do restrict the voting, what you're going to get into is an awkward position where perhaps the workers, whose pensions are being managed, would have a point of view they would like to see expressed at the company's annual meeting. Or it might be that the management of a company would like to see some support from the bank. Yet it would disenfranchise the bank because of a condition of the marketplace and I don't think the two really should be confused. I would much rather have corporate democracy off by itself and allow these issues to be thrashed out at the annual meeting with no interference on the part of an artificial restraint because of who was managing the pension fund.

Senator BENNETT. The fear most people present is that these giant bank trust departments are going to control the corporations, and maybe you should insist with respect to pension funds or similar situations that the bank must insist on instructions from the fund as to how it votes.

Mr. REGAN. I will leave it to the banks to answer that, because I don't honestly know how they handle it.

I can tell you the experience of brokerage firms. Our own firm has $21 billion worth of securities that we are holding for our customers. In the common stock portion of that $21 billion, we never vote a share on our own in controversial matters. We wait for instructions, and if we don't get instructions, we simply don't vote.

Senator BENNETT. That is all.

Senator BENTSEN. Senator Roth?

Senator ROTH. I believe you mentioned that the 10 largest banks holding——

Senator BENNETT. It is in the Blue Book.

Senator ROTH. That is right.

What about the antitrust implications of such ownership? When large trustees vote their stock, do any of these investors concern themselves that the banks may have large holdings in competitive firms? Are there any antitrust implications in that?

Mr. REGAN. I don't think I am qualified to answer that, Senator, because I don't know how the banks vote and what the banks relationships are with the companies whose pension funds they are managing. I don't know what the other relationships are.

I can only tell you from our own point of view of the pension fund we manage through our investment counseling subsidiary, and the stock of companies we hold. Again, we don't vote anything except what we are told to vote, nor do we try to interfere in any way in the management of those corporations.

Senator ROTH. I suppose one could argue there are disadvantages, too, because it is possible for a very small fraction of the ownership to run the company. In a sense you are sustaining the present owner-

ship without participating. You are on the horns of a dilemma whichever way you move?

Mr. REGAN. In effect, we are unique in that particular instance.

Senator BENNETT. May I interrupt? Do you remember approximately what proportion of your total $21 billion—who neglects to tell you how to vote?

You ask these people to vote, I judge, and, if they don't vote, you don't act. How much of the total might be affected in a given year like that?

Mr. REGAN. Well, ordinarily we turn into the corporate secretary's office of each company prior to the annual meeting between 70 and 80 percent of the vote of the shares that we hold.

Senator BENNETT. So, it is only 20 to 30 percent that doesn't get voted?

Mr. REGAN. That is correct, sir.

Senator ROTH. I am pleasantly surprised that it is that high.

Mr. REGAN. Well, actually, of course, we are furnished all of the material by the corporate secretary's office. We get it out to our customers and ask that they get it back in, and most people, surprisingly enough, want to vote in a corporate election. There are very few that are strictly on the sidelines, and simply won't turn in a proxy to management.

Senator BENNETT. Just another curious question.

The people who don't vote, does this tend to be the little fellow with a few shares, or does it tend to be the big investor?

Mr. REGAN. I cannot give you with any preciseness an answer to that. My feeling is that it is usually the smaller shareholder who don't bother to vote. The person owning 10, 15, or 20 shares apparently just says, "Oh, what the heck."

Senator BENNETT. That would be my impression, too. There is more sense of responsibility in the people who have substantial investment.

Senator ROTH. That is all of the questions I have, Mr. Chairman.

Senator BENNETT. That is all I have.

Senator BENTSEN. If we applied the 5-percent limit of the Investment Company Act of 1940 to the other institutions wouldn't we, in effect, force some of the large institutions to at least expand their holdings to more of the lower tier stocks?

Mr. REGAN. You are suggesting that there would be a grandfather's clause?

Senator BENTSEN. Absolutely.

Mr. REGAN. Yes, that would be one of the effects.

Senator BENTSEN. Otherwise there would be the dumping of stocks.

Mr. REGAN. Of course, there is a spreading of ownership of companies.

Senator BENTSEN. You are not prepared at this time to say whether you think that is a good idea or a bad one?

Mr. REGAN. The actual spreading I would like to see. Whether there should be a rule on that, I would want to see the effect on the larger managers of pension funds before I gave a concrete answer. But I am obviously for the principle. There should be wider ownership in these larger funds of more stocks.

Senator BENTSEN. Aren't you in a pretty tough position testifying, having a substantial amount of your money coming from institutions?

Mr. REGAN. So you win some and you lose some, Senator. Obviously, one has to be careful. I wouldn't deny that.

Senator BENTSEN. Senator Long?

The CHAIRMAN. No questions.

Senator BENTSEN. Mr. Regan, you have been very helpful to us. We appreciate your testimony. Are there any further comments you would like to make?

Mr. REGAN. No, sir, except one final remark to Senator Bennett. I was reading this blue book during the break. Just for the record, we have no corporate relationships with any of those 10 institutions. We are not directors of any, or the like. Of course, Glass-Steagall Act does prevent a broker from being on a bank's board, but we have no corporate relationship.

Senator BENTSEN. Before you get away, one last question.

You have expressed some optimism about increasing foreign investment in this country?

Mr. REGAN. Yes.

Senator BENTSEN. If we were to eliminate the withholding tax on interest and dividends paid to foreign investors, is there an effective way to avoid U.S. citizens using that feature—by transferring U.S. funds to foreign investment houses and coming back in that way—is there an effective way to avoid that?

Mr. REGAN. Obviously, tax avoidance is practiced, but I can't see that you would have very many, Senator, who actually would try to cheat on their income taxes that way and try to avoid taxes. I think the overriding good that would come from having literally hundreds of thousands of foreigners individually buying securities over here—tapping the great resources of the oil world, for instance, as far as a direct investment over here is concerned—I think that is a much larger consideration and benefit than whether or not a few individuals would try to cheat on their taxes.

Senator BENTSEN. Let me ask you one more question.

When Nestle's of Switzerland bought out Stouffers——

Mr. REGAN. I am very familiar with that. We are the bankers for Stouffers.

Senator BENTSEN. I understand that and that is why I want to ask you about this 4,300,000 shares of Stouffers Corp. stock, which you had underwritten along with another firm, and that was withdrawn from the market in March. What was the reason for that? Was it an unfavorable market? Were the institutions not interested in that stock? Why was the offer withdrawn?

Mr. REGAN. The price of Stouffers' stock had dropped between the final quarter of 1972, when we originally started talking with Litton about that company, and when the time came for that stock to come to market. We were still negotiating with Litton as to what price they wanted to sell to the public, and the price at which they would not sell. We kept telling them there is no way to sell higher. As I recall the figures, it was a discrepancy between about $32 and $28 or $27 a share. We said we couldn't possibly sell it to the public at more than

$27 or $28—whatever the actual figure was, and they were saying, no, we have to get at least $30 or $31 and maybe more.

Senator BENTSEN. What did Nestles pay?

Mr. REGAN. $32 or $33. They stepped right in and paid more for it, but it was simply a condition of the market that we could not bring that stock to the public marketplace.

Senator BENTSEN. What was the multiple on that stock at the time?

Mr. REGAN. I have forgotten, Senator.

Senator BENTSEN. In effect, it was a bottom-tier company?

Mr. REGAN. Oh, yes; it was a bottom-tier company. That is the reason why it was down in price. It was not coming in as any glamour stock at 25 or 30 times earnings; no.

Senator BENTSEN. And even though a foreign investor found it attractive, the institutions did not find it attractive. Isn't that true?

Mr. REGAN. That is right.

Senator BENTSEN. Well, thank you very much, Mr. Regan. We appreciate your attendance and contribution.

Mr. REGAN. Thank you, sir.

Senator BENTSEN. Mr. Whitehead, we are pleased to have you here this morning, if you will take the witness stand.

Would you state your name and your firm?

Also, your testimony appears to be rather lengthy. If you could summarize it for us, it would be helpful.

STATEMENT OF JOHN C. WHITEHEAD, CHAIRMAN, SECURITIES INDUSTRY ASSOCIATION; PARTNER, GOLDMAN, SACHS & CO., ACCOMPANIED BY LEE KENDALL, PRESIDENT, SECURITIES INDUSTRY ASSOCIATION

Mr. WHITEHEAD. Mr. Chairman and members of the committee, my name is John C. Whitehead. I appear before you as chairman of the board of directors of the Securities Industry Association. In my professional capacity I am a partner in the firm of Goldman, Sachs & Co. Seated with me is Dr. Lee Kendall, president of the Securities Industry Association.

Since you do have our prepared statement and since our views are rather similar to those expressed earlier by Mr. Regan, and much of the information that is in our statement also appears in the briefing material in your committee's blue booklet, I think I will just summarize this statement very briefly and leave more time for questions if that would be your preference, Senator?

Senator BENTSEN. I think that would be fine, Mr. Whitehead.

Mr. WHITEHEAD. We view with great concern the matters that your subcommittee is considering today. We see the growth in the role of the institutional investor as a trend that has harmful aspects to it. We see institutions beginning to reach a dominating role in our securities market and a dominating role in many of the companies in which they invest.

At the same time, we see the individual investor shying away from the market. We see him selling his stock, and we see the securities industry—the industry that services the individual investor—coming upon very hard times with substantial losses incurred by that industry so far this year, with the result that the number of firms in the industry

is shrinking and the ability of the industry to raise the capital required in this country for an expanding economy shrinking as the number of firms and the strength of the firms deteriorate.

Senator BENTSEN. Well, do you think the number of private investors has increased or decreased in the last year?

Mr. WHITEHEAD. We believe that the number of investors has decreased.

Senator BENTSEN. Now, we listened to Mr. Regan talk about over 200,000 new accounts.

Mr. WHITEHEAD. Yes, sir.

Senator BENTSEN. What do you base your thoughts on? Of course, he didn't tell us how many he lost because he wasn't sure yet.

Mr. WHITEHEAD. Correct. I would suggest to you, sir, that after a period of declining stock market prices, such as we have had for the last 6 months, there is a considerable discouragement on the part of individual investors. Many of them have changed brokers as a means of finding new happiness at someone else's store. I think you will find that the number of new accounts opened at most of the leading brokerage firms has increased substantially. But it is not new investors coming into the market; it is customers shopping at a different store.

Senator BENTSEN. What would you say would be the percentage that the unweighted index of the stock market has gone down since 1968? We have some 1,400 different companies.

Now, do you have some numbers on that to give us a feel of what has happened to the stock market apart from the Dow-Jones, which can be quite misleading sometimes.

Mr. WHITEHEAD. Mr. Kendall.

Mr. KENDALL. Yes; since 1968, we have had, as you know, an increase in gross national product and in personal income well over 30 percent. Yet when you look at the Dow-Jones Index, you find it is still below where it was 1968, and the American Stock Exchange Index, both of which are weighted by the value of the shares, is down perhaps 10 percent. The best measure, however, is in the broad range of all stocks and there is another index called the Value Line Market Composite that takes the average price of all of the stocks. It is about as good a measure of an average portfolio as you can find and this index shows that prices are perhaps 50 percent lower than they were in——

Senator BENTSEN. Than 5 years ago?

Mr. KENDALL. In 1968–69, and, in fact, for this broad range of stocks, as low as it was in 1961.

Senator BENNETT. Is that kind of information in your statement?

Mr. KENDALL. Yes, sir, it is on page 6 and exhibit 6 and exhibit 7. You can see the comparison in this chart of the Standard Investors' composite, the New York Stock Exchange composite, the Dow-Jones industrial average, all of which are weighted by the value of the securities.

In the unweighted index, you take everything as a unit.

Senator BENTSEN. Is it fair to say that the disparity is off the most in those smaller companies and medium-sized companies as a generalization?

Mr. KENDALL. As a generalization, yes. And you see that also in our exhibit 7, which was prepared by an organization called Wright As-

sociates that advises a number of our firms. This compares the price/earnings ratios of 30 famous growth stocks with the most famous index, the Dow-Jones industrial 30 stocks index.

And if you will look back at 1961 and 1962, you see that these had a close relationship to each other. The patterns were similar. The average price/earnings ratio on the growth stocks was approximately 29 times earnings, while the Dow-Jones was at 24. If you look into 1962 figures, you can see there was a drop, but again the relationship was 18 to 16.

Today, however, as indicated by the latest figures plotted on the charts, the average price/earnings ratio of the 30 famous name stocks is in the area of 36 times earnings, while the Dow-Jones is in the area of 14. This is what people mean when they talk about a two-tier market with institutions tending to concentrate on one category of securities and ignoring the other.

Now, if we were able to draw something like this for the non-Dow-Jones stocks, it would be even more extreme. I might add, on the question that you asked Mr. Whitehead, that we do have some data also on what has happened to share ownership in actual numbers.

Senator BENNETT. What page is that?

Mr. KENDALL. This is the top of page 8, Senator Bennett. For the first time in history the stock exchange reported the number of share owners was down and the decline was about 800,000 from 32,500,000 to 31,700, 000. You can look at the number of shareholders listed on the books of companies like Exxon, United States Steel, A. T. & T., General Motors, Ford, and many others and see that they actually have fewer numbers of shareholders, and, of course, the mutual fund data in terms of redemptions are reported regularly in the paper and they indicate a declining trend now for almost 18 straight months.

Senator BENTSEN. Let me get to another tax question that I think is very important here. Do you think if we treated commission fees as an investment expense, deductible against ordinary income, that it would be a useful incentive?

Mr. WHITEHEAD. Yes, sir; I believe that would help, although I think that the role of brokerage commission has probably been overemphasized in the dialog over the last several years.

Senator BENTSEN. But I am talking about the tax treatment of those commissions.

Mr. WHITEHEAD. You are suggesting the possibility of having them deductible?

Senator BENTSEN. As an expense.

Mr. WHITEHEAD. As an expense.

Well, yes, sir; I think that would be a very helpful step. It would encourage individual investors and would be an important step to be taken.

Senator BENTSEN. What is the experience of new issues in this current market? What is your experience?

Mr. WHITEHEAD. Well, the experience has been very bad over the last 6 months.

Senator BENTSEN. What is the relationship between the health of new issues and the availability of venture capital to truly new enterprises?

Mr. WHITEHEAD. The number of new issues has been down very substantially, and particularly of course the number and size of new issues of common stocks. It follows at the same time that capital available to small companies has been, in the case of many companies, really unavailable. For some smaller companies it is simply now not possible for them to raise capital in the public markets.

Senator BENTSEN. Does that mean it is difficult, more difficult for a new firm with a new idea to get started and doesn't that really present some real problems for the competitiveness of the United States economy in the future? Doesn't that mean it is going to be more difficult to start a Xerox company or a company like that with a truly unique idea?

Mr. WHITEHEAD. Yes, sir; it certainly does.

Mr. KENDALL. One of the other concerns we have in this area is the disappearance of regional investment banking firms. We have in our statement an exhibit that perhaps highlights the degree to which such disappearance has occurred. This is exhibit 12 at the very end of the statement. What it shows is an advertisement that dates back to 1955. It shows the underwriting account for a public offering of over 4 million shares of General Motors Corp. common stock in that year. The various brokerage companies you see on the succeeding pages were in existence at that time and participated in that distribution. We have circled the companies that have since gone out of business and are no longer part of the distribution system of the country. The first page shows the large national companies, but my principal concern is for the smaller ones which are indicated on the succeeding pages. For example, on page 2 you see in California under Los Angeles, four of the firms have disappeared and there are three remaining. If you look at San Francisco, again you see a major erosion of entities. Then continuing on the succeeding pages, perhaps on page 4, Cleveland is a good example. That is at the bottom of the page. It shows of the number of companies that existed at that time, there are only four left in their present state.

We believe that these regional companies are often the organizations that are addressed first by a corporate officer with a new idea. His company is often too small for the larger national investment banker to concern itself with. So, when this service of investment banking is not available locally, I think there can be slippage in the ability of a corporate management to get the funds it needs to expand and grow and to become one of the success stories of our Nation.

Mr. WHITEHEAD. The normal course of growth for a small company that has had some initial success is for it to go to a small investment banker in the city in which it is located and to seek its first outside financing from that small, local, regional firm. It is those local, regional firms who have been the hardest hit by the bad period of lack of profitability in our industry. And as this exhibit shows, many of them have disappeared from the business scene.

This causes us to be concerned about how companies will be able to raise the capital for growth in the future. You might be interested in an example of a larger company that could be classified certainly as a medium-sized company, and you might be interested in the difficulty that it has had recently in making a decision as to whether or not it

could seek additional capital. This is a point that is not usually understood.

I speak of a company that is in the automobile supply business. I am an outside director of that company. It is listed on the New York Stock Exchange. It is a company with several hundred million dollars of sales, so it is by no means a small company, but it is a company that is in the second tier of the two-tier system. Its stock sells at about $20 a share, and its earnings in the year that will end in August will be about $4 a share. So it sells at 5 times earnings. This company has some very interesting capital expansion opportunities. However, at a board meeting last Monday it decided that it simply could not afford to move forward with those capital expansion opportunities.

Senator BENTSEN. If they voted for stock, in effect, they would have to have a better than 20 percent return I guess in anything they invested in to show any increase for their investors?

Mr. WHITEHEAD. Yes, with a stock selling at 5 times earnings, in order to sell more stock at that price, it has to have a better than 20 percent return on those investments. And I would also point out to you that is a 20 percent after tax return, so it means a 40 percent return on the investment before taxes in order to justify making those expenditures. And their capital expenditure opportunities simply didn't have the potential of a 40 percent return on the investment. So the company decided that it would not proceed with that capital expansion program. I believe that the low price that the stock is selling for is a typical example of a situation where it was not in the public interest for that decision to have been made as it was made.

Mr. KENDALL. Well, it still takes $25,000 a year of new capital—and perhaps a little more—to create one new manufacturing job in the Nation and our concern is, when we see companies buying their own shares in lieu of making a decision of the type suggested by Mr. Whitehead, that means one less job or many fewer jobs in that sector of the economy.

Senator BENTSEN. We have talked a lot about the problem. Do you want to tell us about the solutions.

Mr. WHITEHEAD. Well, I think we can look at solutions maybe in two areas. One is the things that are necessary to encourage the individual investor to return to a feeling that he can make successful investments on his own. The second area is the area of how to, if at all, control the investment of the institutional investor so that his dominance does not become more extreme than it is now.

I tend to focus my thinking on the first approach rather than the second approach because I think that whatever is done with the institutional investor, we must find ways to encourage the individual to come back into equity investment if we are going to preserve the kind of business society that we have become used to which is a society based on broad public ownership.

Now we feel that a more favorable capital gains tax is one of the most important steps that can be taken to encourage the individual to come back in the market. We have proposed a program of capital gains tax improvement, which is included in our prepared testimony.

There are two features of our proposal which I would just like to mention briefly. One is the suggestion to incorporate into the tax structure a sliding scale of graduated capital gains taxes, where the

tax would be lower based on the length of the holding period, so that if a man has held a stock for a longer period of time he would be subject to a lower tax and, he would have more incentive to sell than he now has. The last capital gains tax change in 1968 resulted in a 40 percent increase in the maximum capital gains tax rate from a maximum of 25 percent to a maximum of 36½ percent. Now this has resulted in a severe discouragement to the individual investor. We believe that that should be corrected and that this kind of change, with a graduated scale of taxes, would be a very constructive move.

The second part of our tax suggestion is to provide the same treatment for capital losses as for capital gains. At the present time a man is only allowed to deduct $1,000 of capital losses in excess of his gains.

Senator BENTSEN. What is the logic of that?

Mr. KENDALL. The logic of that, I believe, goes back to 1942 when that $1,000 was first suggested and even just with inflation, it should have resulted in their being a substantial increase in that $1,000 excess.

Senator BENTSEN. So you are recommending that you get the same treatment for capital losses as you get for capital gains?

Mr. WHITEHEAD. Yes, sir. Now, the second part of our program for encouraging the individual investor that we would like to suggest to you is legislation to require disclosure of institutional holdings and institutional trading very much along the lines of Mr. Regan's testimony. We think that kind of legislation is long overdue. I had the privilege of serving several years ago as Chairman of the Advisory Committee to the SEC's Institutional Investor Study, and the principal recommendation of that study, which was made by the SEC, was that legislation along these lines should be passed.

I very much regret that this kind of legislation hasn't been passed and I hope that it can be enacted in the very near future. Our capital markets have prospered under disclosure. The Securities Act of 1933 was an act that required disclosure. Investors have been successful under that concept and security dealers, too, have prospered under that concept of full disclosure.

I doubt that any harm can come to institutional investors from requiring full disclosure of their holdings of equity securities and of their trading in equity securities.

Senator BENTSEN. Senator Bennett?

Senator BENNETT. No further questions.

Senator BENTSEN. Senator Roth?

Senator ROTH. No questions.

Senator BENTSEN. We have some further commitments at 12:30 and we have but one other witness, Mr. Whithead, and we would like to give him an opportunity to testify. He has some limitations on his time, also. We will take all of the information you have presented for the record and I think this would be very helpful; and so if you have any further things you would like to include in the record after additional reflection, we would be interested in looking at them with that possibility.

Mr. WHITEHEAD. Thank you very much.

Senator BENTSEN. I dislike having to terminate your testimony at this time, but because of these limitations of time, we will have to move on. We appreciate your contribution.

99-822—73—pt. 1——3

[The prepared statement of John Whitehead follows:]

STATEMENT OF THE SECURITIES INDUSTRY ASSOCIATION, PRESENTED BY JOHN C. WHITEHEAD, CHAIRMAN, BOARD OF DIRECTORS

Mr. Chairman, members of the Subcommittee. My name is John C. Whitehead. I am Chairman of the Board of Directors of the Securities Industry Association. In my professional capacity I am a partner of Goldman, Sachs & Co. Seated with me is Dr. Leon T. Kendall, President of the SIA.

Since this is our first opportunity to appear before members of the Finance Committee, I would like to offer a few observations about the Securities Industry Association. The SIA has over 800 member organizations across the nation. These firms do over 90% of the securities business of this nation, providing financial services for the over 30 million investors who now own equity securities. These investors span the full range of the people of this nation. The median annual income of shareholders in 1970 was $18,500, and the largest single group (30%) were in the $10,000 to $15,000 income bracket. Almost 19 million shareholders had stock portfolios worth less than $10,000, and they lived in just about every part of the nation. Interestingly, people living south of the Mason-Dixon Line in the states stretching from Delaware to Texas accounted for 77% of the increase in shareownership since 1965. California, for example, is the top state in the number of shareowners, having 3.8 million. Two million live in Illinois; 1.4 million in Texas. The point we make here is that the nation's investor population is both large and broadly dispersed across this nation.

CAPITAL MARKETS: A TROUBLED AREA

One of the most unique assets of the United States is its system of capital markets. Working through a delicately meshed combination of investment bankers, brokerage firms, stock exchanges and institutional investors, the American people have demonstrated a tremendous capacity to generate the savings and investment dollars necessary to fuel this economy, to provide new jobs for its youth, and to finance the needs of its people and governments. Capital is a valuable and scarce resource—one that is just as important but, at times, less understood than our other resources—land and natural resources, labor and management. Capital must be mobile, that is, be in the right places at the right time. It must be efficient, that is, produce as much as it can at as little cost. In an enterprise economy it must be available in ready supply at a fair price. In addition, as we expand the mobility and fluidity of our nation's financial wealth we also enlarge the tax base of this nation.

There are disturbing signs that the savings and investment capital of this nation is not doing the job it can, should and must do for the American people if our economy is to continue expanding to provide more jobs and opportunities for our people and a larger tax base for our government. Moreover, the securities markets of the United States today are vastly different from what we knew just a few years ago. Our objective in the next few minutes will be to set before you a number of new facts which we believe provide new insights into the policy problems facing the nation regarding its securities markets. We believe these observations go right to the heart of the concerns expressed by Senator Bentsen on the Senate Floor prior to the calling of these hearings. We believe there are few questions as important to the long-term economic health of this nation as the issue being examined by this committee.

The problem of the 1970's is the institutional dominance of the equity market, its pricing structure and its relationship to the orderly determination of value. Some like to view the stock exchange as a giant public opinion poll, valuing the accomplishments and potentials of corporate America, company by company, minute by minute. As with opinion polls, so long as the voting process is representative and random, and not dominated by block voting, the answer one gets is likely to be a reasonably close approximation of the truth or of true value. However, if and when and as the values being registered are biased, there is a good chance that they will distort the truth. Distortions caused by institutional dominance must be addressed if national markets are again to respond in an orderly manner and do their job of allocating resources and attracting new capital to risk situations large and small, popular and unpopular.

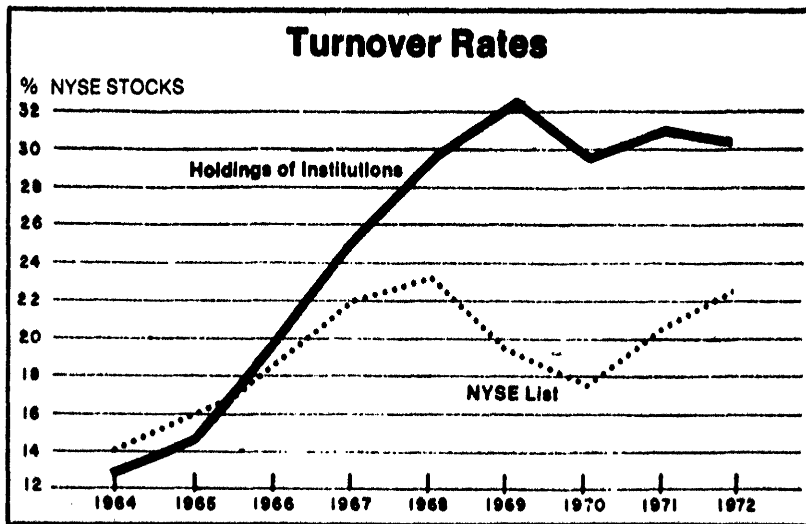
All too little attention has been given to how institutional growth and power have changed the market. Too little recognition has been given to the reacion

of individual invesors to that power and to their unwillingness to invest directly. Too little attention has been given to the concern of corporate America with these changes. Too little concern has been exhibited for the impact of the changes on independent broker-dealers, and on their ability to distribute securities and generate new capital. There seems to be an assumption—explicit and implicit—that national exchange markets will remain deep, liquid, responsive to real forces, and that institutional power will be essentially neutral. This assumption is false. (We submit for the record a copy of a recent Business Week article (June 2, 1973) entitled, "Are Institutions Wrecking Wall Street?" and an editorial from the same issue entitled, "Giants That Rock the Market.")—(Exhibit 1 *)

Financial institutions today own an increasinug proportion of the nation's equities securities. Between 1962 and 1972 their ownership of NYSE stocks rose by one percentage point per year—from 20% to 30% of total. At the end of 1972, insurance companies, pension funds, mutual funds and other institutions owned $258 billion of the $872 billion of NYSE-listed equities. These data do not include bank trust funds. Federal Reserve data for 1971 show personal trust department assets of $348 billion, the great bulk of which were invested in equities. The power of institutions in the marketplace, however, far exceeds their ownership ratio.

Turnover Rates 1964 to 1972.— One reason institutions now dominate stock market trading is their new-found willingness to buy and sell, to trade, assets in their portfolio. Exhibit 2 shows that since 1964 the rate of portfolio turnover by institutions has increased spectacularly from 12% to over 30%. During the early 1960's institutions were viewed as a stabilizing force in securities markets. They tended to be net buyers and somewhat passive long term investors. In the mid-1960's, however, the "go-go" or performance cult took hold and turnover moved upward rapidly. It is evident that individual turnover is well below the institutional pattern. This runs in the general range of 8% to 11% per year.

EXHIBIT 2



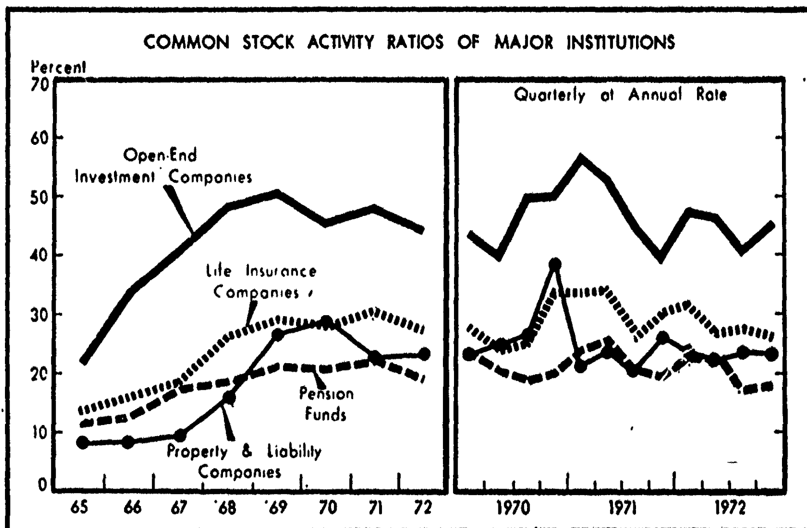
Source: NYSE

Activity Ratios.—Exhibit 3 shows that all major institutions participated in the activity upsurge. Mutual funds have the highest turnover, ranging between 40% and 50% per year. Life insurance companies are next. Property and lia-

*The article entitled "Are The Institutions Wrecking Wall Street?" is reprinted at page 297 of this hearing.

bility and pension funds also have doubled their rate of turnover since 1965. No data are available on turnover by bank trust departments, the largest holders of equities, but information on individual banks indicates that they, too, have more than doubled activity ratios.

EXHIBIT 3

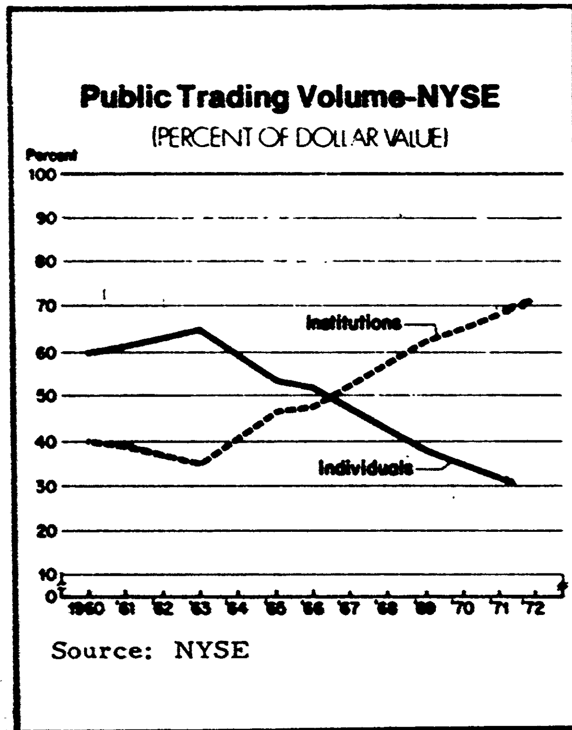


Source: NYSE Research Department

Institutional Volume on NYSE.—(Exhibit 4) The effect of these forces on NYSE trading is a well-known story. During the 1960's institutions assumed the dominant position in the stock market. From 35% of trading in 1963 and 47% in 1966, they now account for 70% of public volume. At the same time institutional volume rose, the relative share of individual activity declined. On regional exchanges and in the third market the rise to dominance of institutional trading has probably been stronger than on the NYSE.

Concentration of Holdings.—Although institutions come in many shapes and sizes, a few large organizations dominate the field. Exhibit 5, taken from the *Business Week* article attached to our statement, shows that the 10 largest institutional investors taken together held investment portfolios, excluding real estate, totalling $156.4 billion. At the end of 1970 the personal trust departments of commercial banks administered investment funds valued at $292 billion, of which approximately one quarter was concentrated in just five banks and fully half in just 21 banks.

EXHIBIT 4



Source: NYSE

EXHIBIT 5

THE LEADING INSTITUTIONAL INVESTORS

Institution	Investment portfolios [billions of dollars]*
Morgan Guaranty Trust	$27.2
Bankers Trust	19.9
Prudential Insurance	18.3
First National City Bank	17.2
U.S. Trust of New York	17.0
Metropolitan Life Insurance	16.5
Manufacturers Hanover Trust	10.9
Mellon National Bank & Trust	10.5
Investors Diversified Services	9.7
Chase Manhattan Bank	9.2
Total	$156.4

*Excludes real estate Investments

Data: Money Market Directories, Inc.

This shift to institutional dominance and concentration in so short a period of time has changed the character of markets, biased their valuation function, effected their liquidity (which shows especially in down markets), and complicated corporate financial decision-making.

It has had a pronounced effect on individual investors and stockbrokers and dealers. Let us look at some of its effects:

The American economy is in a stage of rapid growth, yet the nation's equity markets are not participating in this expansion. Since 1968, personal income and GNP have risen well over 30 percent while stock prices on the New York Exchange, measured by the Dow Jones index, are lower now than in 1968 and the AMEX index is more than 10% below where it was in 1968.

Stock Price Trends.—When one examines an unweighted index of stock prices, the stock price slump stands out even more boldly. Exhibit 6 compares the Value Line unweighed composite index, incorporating 1,450 stocks (the heavy black line), with the S&P index, the NYSE index and the Dow-Jones index. Note how much more the unweighted index is off. Market prices of the average stock today are nearly 50% below their peak in 1968 and 5.6% below year-end levels in 1961.

EXHIBIT 6

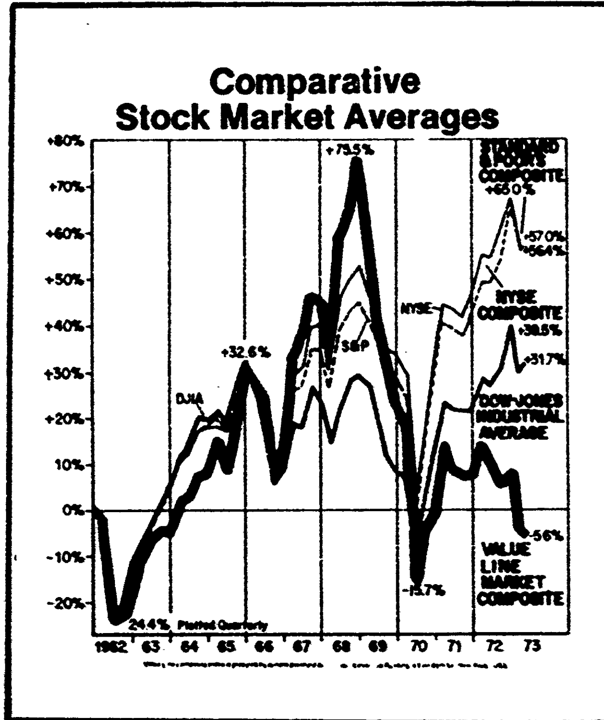
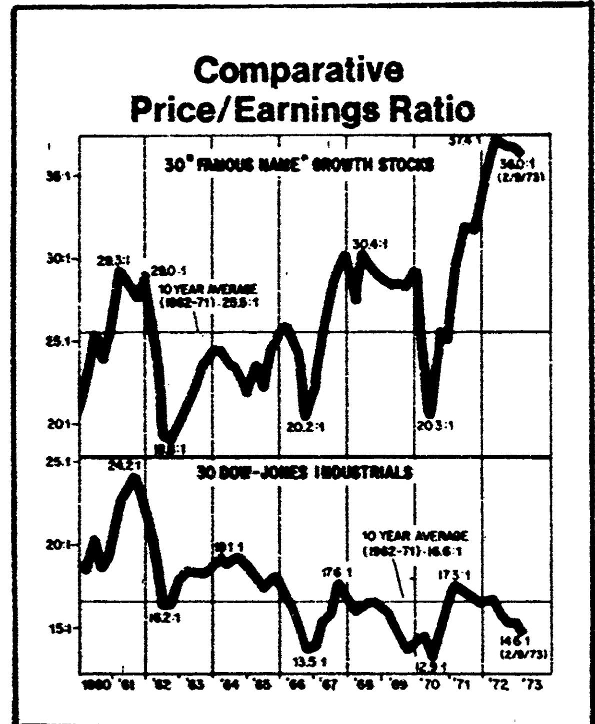


EXHIBIT 7



Price/Earnings Comparisons.—The dichotomy in the stock market valuation process can also be seen in Exhibit 7. This chart compares in terms of earnings ratios the valuation of 30 famous name growth stocks with the P/E trend in the 30 Dow-Jones Industrials. In 1961-62, the growth stocks and the Dow stocks traded at comparable multiples. That was prior to the institutionalization of the market. But since the institutions rose to dominance, the differences have become pronounced—and the greater the degree of institutional dominance, the wider the disparity. Today the Dow-Jones stocks carry a P/E ratio of around 14 while the 30 institutional favorites are at 36.

We seem to have developed two distinct stock markets in terms of valuation.—This raises powerful questions about the functioning of stock exchanges. As Alan Greenspan, the noted economist, has said, "values which are struck on exchanges, hour after hour and day after day, are critically instrumental in allocating the real resources of our economy to those uses most valued by the American people." The securities industry throughout history has striven to foster orderly changes in values of corporations. It serves as an intermediary in permitting corporate expansion and contraction to be an orderly process. Historically, when society needed more uranium mines or computers, our industry helped attract resources there. If it needed fewer coal mines or railroads, it withdrew resources or made their placement there less attractive. When the valuation mechanism is distorted, the whole capital formation process and the nation suffers.

Odd Lot Trends and Mutual Fund Redemptions.—Turning to the other side of the market, individuals are less willing to take the risks of equity investment today. As Exhibit 8 shows, odd lot—less than 100 shares—activity is at a low ebb. In 1972, 4.6% of NYSE volume was in such trades compared with 21% of reported volume in 1960. Since 1966, net sales have far exceeded net purchases. In 1972, for the first time in history the NYSE reported the number of shareholders down by 800,000, from 32,500,000 to 31,700,000. Companies as prominent as Exxon, U.S. Steel, AT&T, General Motors, and Ford had fewer shareholders. Mutual fund redemptions, Exhibit 9, have exceeded sales for 7 out of 8 quarters through the end of 1972, and more recently for each month of 1973.

EXHIBIT 8

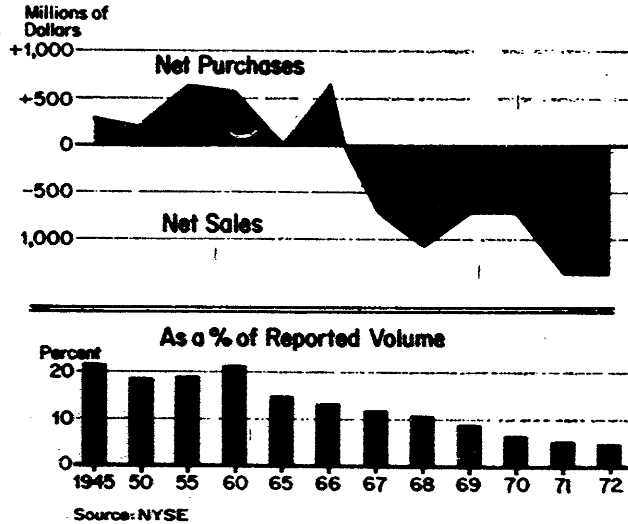
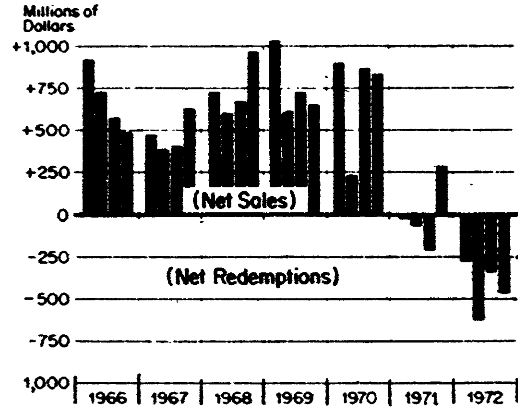


EXHIBIT 9



Stock Exchange Volume.—What effect have these trends had on securities firms? Stock exchange volume (Exhibit 10), the major source of industry revenues, has become more volatile. As institutions came to dominate the markets, volume has moved up and down with dramatic and traumatic frequency. Look back to mid-1970. In six-month swings trading activity moved from eleven million shares a day during the middle of 1970 up 68% to 18 million shares a day by the first quarter of 1971 then down 38% to 13 million six months later, then up to 18.3 million shares, then down, then up and down again! The frequency and size of these moves are unusual even for securities firms. They have produced a major industry more volatile than housing, autos, and even machine tools. This saw-tooth pattern of volume is a top management challenge.

A second force impacting on firms and impacting to a greater degree than previously is the sharper, more volatile character of price movements in securities markets. Such moves, reflecting the rapid, sometimes instantaneous, reaction of institutions to news and to each other, present an historically unique pattern of price fluctuation. Moves up and down of 10% or more in individual stocks in any given day are difficult for the best specialist, blocktrader, or third-market maker.

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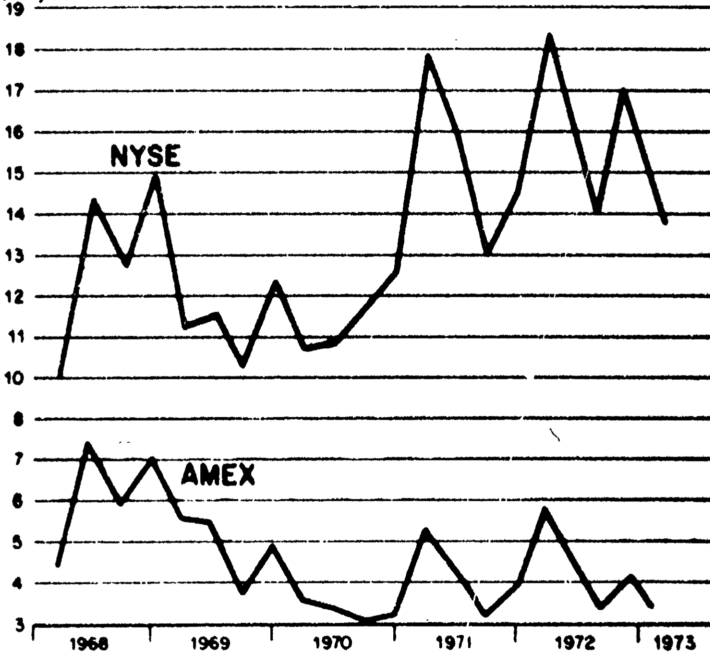
EXHIBIT 10



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Price of Securities Services.—A third impact on securities firms flows from the capacity of institutional investors to exercise their economic weight on securities commissions. Prior to December 1968, the minimum commission charge per share for an institutional size order and for an individual investor order were identical. What happened subsequently is shown in Exhibit 11. On institutional transactions, the volume discount in December 1968, negotiated rates at the $500,000 level in 1971, the new minimum rate schedule of April 3, 1972 and the further lowering of the negotiation breakpoint to $300,000 in that same month have combined to reduce dramatically the per share commission cost. The commission on a typical block trade of 25,000 shares of a $40 stock has declined 61.4% from 39¢ per share to 15.2¢ per share. In contrast, the individual trading 100 shares of the same $40 stock is paying 58¢ per share today, as opposed to 39¢ in 1968, an increase of 48.7%. We believe that institutions are not paying their fair share of the costs of providing investors and corporations with deep, liquid securities markets.

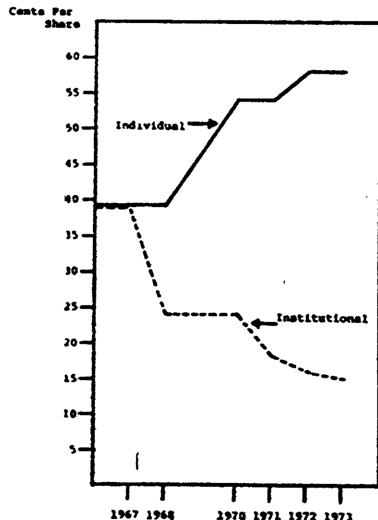
EXHIBIT 11

INDIVIDUAL VS. INSTITUTIONAL COMMISSION CHARGES ON A $40 STOCK 1967 - TODAY

	Commission Per Share	
	Individual: 100 Sh. at $40	Institutional: 25,000 Sh. at $40
1967 (Based on rate schedule in effect since 1963)	39¢	39¢
1968 (Volume discount introduced in December)	39¢	24¢
1970 (Service charge added in April)	54¢	24¢
1971 (Negotiated rates over $500,000 as of April. Typical charge of 12.5¢/share above $500,000)	54¢	18¢
1972 (New rate schedule. Typical charge of 12.5¢/share above $500,000 continues)	58¢	17¢
1972 (Negotiated rates over $300,000 as of March. Typical charge of 14¢/share above $300,000)	58¢	16¢
TODAY (Typical charge above $300,000 now is 3/10 of 1% of value)	58¢	15¢

Note: Average number of shares in block transactions on NYSE in 1972 was 24,559

Source: Securities Industry Association



Why is it important that securities firms operate successfully across the nation? The reason is because they, too, like banks and savings and loan associations are financial intermediaries encouraging saving and investment. This effort enables them to perform the vital capital raising function which creates new jobs, higher personal income and new government taxes. It still takes over $25,000 to create one new manufacturing job in this country. I direct your attention to Exhibit 12 (attached to the end of our statement). It is a copy of a 1955 public notice of a $320 million common stock offering by the General Motors Corporation. Over one-half million of these shares were sold to investors through an investment banking syndicate consisting of 361 broker dealers in major cities across the nation. Pages 2 through 5 of the exhibit show the cities in which these firms were located. The cost to General Motors of the underwriting was 68.7 cents per share.

We use this exhibit to make one very important point. Note how many firms on the list are circled. Each one of these organizations is no longer in existence. They have disappeared through merger or dissolution. There is a question as to how our major corporations will raise funds in the future. More importantly, how will the lesser known, and newer local companies raise capital to get their start? And at what price?

What can be done? First and foremost, we believe, it is imperative that this nation provide positive new incentives to encourage risk-taking by increasing numbers of individual investors. The willingness of Americans to take risk is atrophying. Many older investors are locked in and will not turn over their savings. Others are seeking safe rather than venturesome investments. We view the capital gains tax as a tax on progress. During the 1960's, and particularly after 1969, incentives offered individual Americans through the capital gains tax were reduced. They are now insufficient to attract Americans to risk-taking. The top rate on capital gains rose over 40%—from 25% to 36.5%. The ravages of inflation, the ups and downs of the market, the alternatives of high rate insured savings accounts at banks and other savings institutions all prompt investors to look elsewhere. If these trends continue, this country simply will not have the capital to finance the expansion we need in corporate or municipal services. The institutional investor has shown little appetite for new issues. For individuals it comes down to this: the risks of loss are simply not worth it if the government takes away up to 36½% of any profit—and more, when one considers state and city income taxes such as those in New York, California, and many other states.

The question of the capital gains tax is not a matter of "closing a loophole" which benefits only the wealthy. The issue is preserving the very essence of our free enterprise society, encouraging risk taking, and providing the incentives to prompt new capital formation for the benefit of all Americans. On this count there can be no conflict between the small investor, the big investor, and the non-investor. Therefore, we recommend the following steps:

First, the introduction of a sliding scale in the amount of a capital gain to be taxed to an investor. Simply, the longer an investor held an asset, the lower the proportion of the gain he or she would be required to include in his taxable income. Such a sliding scale would help to recognize the inflationary facts of life—that $100 invested in 1947 has a real value of only $51.30 today and $100 invested even as recently as 1967 is worth only $80.60 today. Because gains due to inflation are lumped for tax purposes in the one year in which the stock is sold, the tax bite on inflation is all the more painful for those who have held assets for many years. The sliding scale we propose would range from a 100% inclusion for a short-term gain held for three months and 40% from one year to five years, 30% at five years, 20% at ten years, 15% at fifteen years and 10% over twenty years.

The downward sliding scale of inclusions, by unlocking locked-in assets, will mobilize capital as well as increase realization and government revenues.

If tax reform were to accomplish nothing other than to free the locked-in generation, it would be most constructive. New York Stock Exchange researchers estimate that persons over 65 own over $275 billion, or 33 percent of all stock. Unless and until these gains are unlocked, the government gets no revenue from them. Nor do they become available for reinvestment in areas of new national need.

What kind of money are we talking about here? Estimates made in the mid-1960's placed unrealized capital gains in equities at between $233 billion and $585 billion. Since then, if anything, these unrealized gains have increased. Unlocking even half of these dollars (using the low estimate) and taxing them at say a 20 percent rate would produce over $20 billion in revenues the government would not ordinarily receive. These estimates do not include vast assets held in the form of land, real estate and other types of property.

Secondly, we believe there is a need for new incentives to attract any unlocked investment dollars to new risk investments. We recommend more equitable treatment of capital losses. From the point of view of the shareholder, taking a loss on a stock that went down hurts just as much as a business loss or a loss due to casualty or theft. We need incentives to encourage investors to *take* those losses and recycle their remaining capital.

Ideally, in order to encourage risk-taking, the deductibility of losses should parallel the treatment of gains. It does not today. This would hopefully stimulate investors to act on economic rather than tax logic. It would also provide a very strong incentive to the individual who is choosing between an insured savings account and a risk asset.

If Congress continues to feel that some arbitrary limit must be placed on the capacity of an investor to offset capital losses against ordinary income, we believe that the economic realities of today mandate a raise in the minimum from $1,000 (which has been in effect since 1942!) to $5,000.

Thirdly, we believe holding period for capital gains treatment should be modernized. All the Treasury Department and industry statistics we have examined show that a three-month period will separate short term speculation from investment as well as a six month interval. We propose that capital gains treatment start at three months and would re-name the 3 month to 12 month interval as intermediate term, rather than short or long.

There you have a specific proposal designed to increase the incentives to investors to participate directly in equity markets and counter-balance the growing institutional power.

Our second recommendation relates to the need for full disclosure by institutions. We know in aggregate terms that institutional holdings and activity in securities have increased dramatically in the past few years to the point where they now dominate the marketplace. Beyond this, little hard information exists. Except for the few that choose to do so voluntarily, banks, self-administered foundations, endowments and employee benefit funds and many insurance companies do not provide information on their holdings or trading activities to the public at large or any governmental agency. We believe that public reporting should be required of all sizable institutional investors. This would permit the exercise of appropriate regulatory oversight, honor the principle of full disclosure, and provide a basis on which to fashion meaningful answers to many of the vital questions posed by this Subcommittee. Indeed, regular and comprehensive institutional reporting was the major legislative recommendation of the SEC Institutional Investor Study undertaken pursuant to a Joint Resolution of the 90th Congress. We believe that action should be taken now to implement that suggestion.

Finally, we believe ways and means should be found to achieve orderliness in the short run in securities markets so that businessmen seeking new funds, governments requiring financing and individual investors seeking sound participation in the growth of Corporate America will be able to base their judgments on long-term trends and fundamentals. In 1972, our industry raised approximately $100 billion in new capital for businesses and governments. In the years ahead, it will be called on to raise even more. The great new challenges in developing new energy reserves, oil, natural gas and atomic power, of financing the housing needs of American families, of restoring the ecological balance, of financing transit systems and other urban services in these difficult times of high interest rates will take more, not less, capital from more and not fewer people. The only group with a pool of monies enormous enough to meet the nation's requirements is the great mass of American households. Public policy must encourage their fullest participation in financial markets.

EXHIBIT I

[From Business Week, June 2, 1973]

EDITORIALS—GIANTS THAT ROCK THE MARKET

The institutional investors dominate Wall Street today. They own half of the stocks on the Big Board and account for more than two-thirds of its trading volume. Their dramatic growth—paced by the bank trust departments with billions of dollars of pension fund money to handle—is forcing profound changes in the structure of the market and in methods of securities regulation (page 58).

The end result of these changes clearly must be broader markets and tougher regulation of the institutions. The price stabilization mechanism of the auction markets provided by the stock exchanges cannot cope with the huge quantities of securities that the institutions want to move. And the regulatory machinery—designed on the assumption that most of the trading would be done by small investors turning over modest blocks—simply does not apply to some of the most dangerous features of institutional trading.

The institutions tend to play follow-the-leader. The stocks they like soar to sky-high prices, while the stocks they don't like go nowhere. As a result, a few issues sell at absurdly high multiples, but the rest of the market is underpriced. There is no room for the small investor, no room for the fledgling company trying to go public. And since institutional favor is such a precious commodity, companies bend the rules in all sorts of ways trying to gain it.

The biggest obstacle to effective regulation of the institutions is ignorance. Mutual funds, which hold some $45-billion in stocks, must report their holdings quarterly. But bank trust departments, which hold nearly four times that much, make no such accounting. The Securities & Exchange Commission's massive study of institutions, based on 1969 data, is now hopelessly outdated.

The starting point for new regulation, therefore, should be to tighten the disclosure rules and extend them to the banks, insurance companies, and all other institutional investors. That would provide up-to-date information. With the facts in hand, Congress and the SEC could then devise the regulations that are needed to restrain the excesses of the institutions without crippling the necessary functions they perform.

This announcement is neither an offer to sell nor a solicitation of an offer to buy any of these Shares. The offer is made only by the Prospectus.

EXHIBIT 12

4,380,683 Shares

General Motors Corporation

Common Stock

($5 Par Value)

Rights, evidenced by subscription warrants, to subscribe for these shares are being issued by the Corporation to the holders of its Common Stock, which rights will expire at 6:00 P.M., Eastern Standard Time, on March 7, 1955, as more fully set forth in the Prospectus.

Subscription Price $75 a Share

The several underwriters may offer shares of Common Stock at prices not less than the Subscription Price set forth above (less, in the case of sales to dealers, the concession allowed to dealers) and not more than either the last sale or current offering price on the New York Stock Exchange, whichever is greater, plus an amount equal to the applicable New York Stock Exchange Commission.

Copies of the Prospectus are obtainable from the undersigned

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BLYTH & CO., INC. ***GOLDMAN, SACHS & CO.*** ***HARRIMAN RIPLEY & CO.*** *Incorporated*

KIDDER, PEABODY & CO. ***LAZARD FRERES & CO.*** ***LEHMAN BROTHERS***

MERRILL LYNCH, PIERCE, FENNER & BEANE ***SMITH, BARNEY & CO.***

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SPENCER TRASK & CO. ***TUCKER, ANTHONY & CO.*** ***G. H. WALKER & CO.***

[illegible]

Best Available Copy

Clauses and Imprints for

General Motors Corporation

Common Stock

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This announcement is neither an offer to sell nor a solicitation of an offer to buy any of these Shares.
The offer is made only by the Prospectus.

Copies of the Prospectus are obtainable from the undersigned.

CLAUSE A

This announcement is neither an offer to sell nor a solicitation of an offer to buy any of these Shares. The offer is made only by the Prospectus. This is published on behalf of only those of the undersigned who are registered dealers in securities in this State.

Copies of the Prospectus are obtainable from only such of the undersigned as are registered dealers in securities in this State.

MARYLAND CLAUSE

This announcement is neither an offer to sell nor a solicitation of an offer to buy any of these Shares. The offer is made only by the Prospectus. This is published on behalf of only those of the undersigned who are registered dealers in securities in this State, or are firms a partner of which is a member of a national securities exchange registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934.

Copies of the Prospectus are obtainable from only such of the undersigned as are registered dealers in securities in this State, or are firms a partner of which is a member of a national securities exchange registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934.

MAGAZINE CLAUSE

This announcement is neither an offer to sell nor a solicitation of an offer to buy any of these Shares.
The offer is made only by the Prospectus.

Copies of the Prospectus may be obtained from only such of the undersigned as may legally offer these Shares in compliance with the securities laws of the respective States.

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This advertisement is for informational purposes only and is not to be construed as a public offering in the Province of Ontario.

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Senator BENTSEN. Our next witness is Mr. Salim Lewis.

Mr. Lewis, we understand you do have some experience in block trading?

STATEMENT OF SALIM LEWIS, SENIOR PARTNER, BEAR STEARNS & CO.

Mr. LEWIS. A bit.

Senator BENTSEN. And if you would state your position, we would be pleased to hear your testimony.

Mr. LEWIS. I am a senior partner in Bear Stearns & Co. in New York and I have been in the business of actively trading securities for just about as long as I can remember. I came into the business in 1928 and, having the benefit of those years, I do have just a couple of comments that I would like to make, and then I would be very happy to try to answer any questions that you want, realizing, of course, the limitations of your time.

I don't think that the market is really quite as surprising as everybody else seems to think it is in this day and age. I can recollect very easily being told in 1931 and 1932 and the public would never be back in the market again, and I lived through the years of 1932 and 1933 and 1934, where the volume ranged in the New York Stock Exchange from 500,000; 600,000; or 700,000 shares a day.

And I heard that same thing repeated in 1938. I heard that repeated in 1962, or late 1961 and 1962. You have seen what has happened from that time on.

In my judgment it was not true then and it is not true today. I think that Don Regan's little picture here tells us that things are going on today that most people who talk about the market really don't see and don't understand, namely that the public has already started to re-enter the market on a limited scale. We are specialists on the floor of the New York Stock Exchange and we are specialists on the floor of the American Stock Exchange. We find that many of our securities which have done nothing but go down, we find now interest starting to come into them again. This has happened before, and I think it will happen again.

I think that, obviously, it is a frightful mess when you have a situation where you cannot publicly finance or raise money at desirable prices and at desirable levels. As Mr. Whitehead stated, for companies who are well worthy of it, but I must say that it can't be legislated. I don't think, except with certain help from tax incentives and so forth and so on, you can legislate this because the market will have to take care of those ills and I think the market will.

Senator BENTSEN. Well, let me ask you, we are going to consider questions of possible changes in taxes and what effect they might have, but would you not consider disclosure a step forward?

Mr. LEWIS. I am 150 percent for disclosure. One hundred and fifty percent. But I am not in favor of putting any restrictions on the trading opportunities or the trading practices of the large banks, because I think, as Mr. Regan put it, and put it very clearly, the sale over a space of time of a block of stock would just create an impossible situation. God knows who is going to buy the first batch of it.

Senator BENTSEN. Yes, even in a situation where it was supposed to be a confidential relationship, with the problem of possible leaks and all, you could have some serious problems there, couldn't you.

Mr. LEWIS. Senator, there are no secrets in Wall Street, they don't last for more than 10 seconds.

One other thing that I think is quite important here. I think that, although I know it is not under the jurisdiction of this committee, and I know you don't want to go into it, or I gather you didn't; nevertheless, institutional membership in the stock exchange and negotiated rates are very, very important factor of the entire market and have to be considered, in my opinion, as part and parcel of where we are going in terms of markets over this space of time.

Briefly, as far as that is concerned, I just want to tell you that I feel that institutions should not be permitted to join the stock exchange unless they are joining to form a securities firm or affiliate to come out and compete with my firm, with Goldman, Sachs, and with Merrill Lynch, and the others, and they should not be permitted to join the exchange for the simple and single purpose of recapturing their commissions.

Senator BENTSEN. Mr. Lewis, I appreciate your views on that but we do want to leave that up to the Banking and Currency Committee, and we would prefer, particularly because of the limitation of time, that we stay on those areas where this committee has jurisdiction.

Mr. LEWIS. OK.

Senator BENTSEN. Fine.

Mr. LEWIS. Well, I am sorry, but the only reason I mentioned it is I felt they are interrelated, and I do recognize the fact that it is not the jurisdiction of this committee, as I stated when I began my statement.

Well, I don't think you would want to go into the preference to the auction market vis-a-vis the dealer market? I think that is Senator Williams' committee.

Senator BENTSEN. Yes, unless you want to give us some background information?

Mr. LEWIS. As far as background information, I am very, very strongly in favor of the continuation and strengthening of auction, the auction market rather than progressing anywhere further along the route of a dealer market.

I feel that it is certainly most beneficial to the public and I think, after all, that is what we are all trying to serve, the public. And I think as you approach a dealer market you are really approaching a real danger.

Senator BENTSEN. Well, let's see, you are a big lot trader. My experience has been—let me see if yours has been the same along these lines—insofar as the institutions holding major blocks of stocks of corporations are concerned, isn't it generally the case when they have—and I am sure there are exceptions to this—but when they have dissatisfaction with a corporation's management, they sell out rather than getting involved in trying to change the management?

Mr. LEWIS. Without any question of doubt.

Senator BENTSEN. And move on to something they think is more attractive rather than staying in to fight the management?

Mr. LEWIS. That is correct, and that obviously is what it should be.

Senator BENTSEN. And let me ask you, do you know of exceptions to that where major institutions have become involved in influencing the management of the corporation?

Mr. LEWIS. I think periodically a few of them have tried. I cannot tell you exactly how successful they have been. I really don't know. I think that it was probably more evident in the mutual fund industry, which you don't hear as much about these days, for obvious reasons, than it would be with the banks. That is my personal experience.

Senator BENTSEN. Well, let me ask you about this kind of situation. Suppose you had an institution that was a major owner of stock of a corporation—let's say they own 15 percent of the stock—and that corporation in turn developed certain problems and then the corporation came to the institution for a loan. Now, do you think there is a possibility they would be influenced as to whether they made that loan or not because of the fact they were a substantial stockholder of that corporation?

Mr. LEWIS. As Mr. Regan said a few minutes ago, supposedly the two sides of the banks don't meet.

Senator BENTSEN. He said "supposedly."

Mr. LEWIS. And I said, "supposedly." After all, I never worked in a bank. I don't know. I said they should definitely be apart and afield from one another.

Senator BENTSEN. How about an insurance company?

Mr. LEWIS. I would think that would be the same.

Senator BENTSEN. Senator Bennett, do you have questions?

Senator BENNETT. No.

Senator BENTSEN. Senator Roth?

Senator ROTH. Just one followup question. Do any of these mutual funds or banks put one of their employees on the board?

Mr. LEWIS. Do any of the mutuals?

Senator ROTH. Where they have a large holding in a company, is there any practice of putting a man on the board?

Mr. LEWIS. It has been done, yes; but I think that is part of yesterday's business. I don't think that is a factor today, but I know of some instances where that has been done.

Senator ROTH. That is all.

Senator BENTSEN. Mr. Lewis, again, what recommendations would you suggest to this committee that you think would help the situation to make it more attractive to the individual investor to participate in the stock market and develop a situation that was healthier from a standpoint of equity money being available to the small and medium-sized corporation in this country?

Don't you think it is important? I am sure you do.

Mr. LEWIS. I think that is extremely important.

Senator BENTSEN. If there is a Xerox company that is coming along and being created, they will need money and——

Mr. LEWIS. Yes; and also, Senator, by the way, it makes block-stock trading possible. It helps to prevent it from becoming a loss leader so-to-speak, and——

Senator BENTSEN. Do you have any recommendations? We have talked about the problems. What are the recommendations?

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Mr. LEWIS. My recommendations are whatever advantages tax-wise you can give them, which I heard suggested here today in several different ways, which I won't bother to repeat, that would be one way. No. 2, I think that we mustn't forget that we are suffering still or maybe just not getting over, in my opinion, the results of a tremendous growth in GNP and income and inflation and all of the rest, which have all been discussed today at some length, and every time you have a situation like one of those, which is accompanied by the way by a heck of a lot of financing and some top grade, some medium grade, some small grade, and some lousy ones, you always pay a price for it. And as long as I have been in this business, we have paid a price for it, and we have just paid one heck of a good price for it, but we mustn't be too surprised at this in retrospect.

I must say one thing, Senator, and this is no criticism of anyone mentioned because it is an unnatural thing to do, I know, but we should have been sitting here talking about this about 2 years ago or 1½ years ago, and not when the damage has been done and when I believe you will find—and I will bet on it—that natural corrective causes within the market will take care of the situation, because the small investor, believe it or not, Mr. John Q. Public, will be back in the market.

I am 100 percent in favor of as much publicity as possible being given to prevent these corporate heads from taking their funds and dividing them in five different places and setting those five places up against each other, because it results in the most unsound thing you can possibly have, and goodness only knows, you have had a belly of it recently.

Senator BENTSEN. Well, thank you.

Mr. LEWIS. But, it is not as unnatural a thing as we might be led to believe today to have a market like ours is as a result of all these causes.

Senator BENTSEN. But, do you not believe that, when you look at the percentage of dollar volume that was done by institutions 10 years ago as opposed to now, that you have a trend there, and that, if you extrapolate that trend, you have a problem?

Mr. LEWIS. I don't think you are having a great problem now in that though.

Senator BENTSEN. You don't think this has expressed a trend over the last 10 years?

Mr. LEWIS. I think that there is a very definite trend over the last 10 years, but I don't think that trend represents any great problem. I think that you will see the percentage of institutional trading down somewhat against the amount of trading that the public will do in the market when and if the public is convinced that the market has turned. But I think over the long run institutional trading will go higher and higher; because, remember one thing——

Senator BENTSEN. You mean percentagewise?

Mr. LEWIS. Yes: the institutional trading in many instances represents the money of the public.

Senator BENTSEN. I understand that very well.

Mr. LEWIS. It is their money in there and it is just being done in a different way.

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Senator BENTSEN. But, it is concentrated into a few parties that are making investment decisions. Now, do you see a problem if institutional trading went up to 90 percent of the market?

Mr. LEWIS. I think 90 percent would certainly bother the heck out of me, yes.

Senator BENTSEN. How much of your firm's business is done with institutions percentagewise?

Mr. LEWIS. Counting here and abroad, I would say about the same percentage as the stock exchange, 70 percent.

Senator BENTSEN. About 70 percent of your firm's business is institutional business?

Mr. LEWIS. Yes; we are not fundamentally a retail house.

Senator BENTSEN. Mr. Lewis, do you have anything further you would like to advise us?

Mr. LEWIS. No.

Senator BENTSEN. We will stand adjourned until tomorrow.

[Whereupon, at 12:30 p.m. the subcommittee recessed, to reconvene at 10 a.m., Wednesday, July 25, 1973.]

FINANCIAL MARKETS

WEDNESDAY, JULY 25, 1973

U.S. SENATE,
SUBCOMMITTEE ON FINANCIAL MARKETS,
OF THE COMMITTEE ON FINANCE,
Washington D.C.

The subcommittee met, pursuant to notice, at 10:15 a.m., in room 2221, Dirksen Senate Office Building, Senator Lloyd Bentsen (chairman of the subcommittee) presiding.

Present: Senators Bentsen and Bennett.

Senator BENTSEN. The committee will come to order.

We will have some other members of the committee with us in a bit. We are in competition with some other committees as always in the Senate.

Mr. Callaway, I want to welcome you and Mr. Smith and Mr. Fiske before this committee. Let me say in order to stop any concern you might have at the outset, so far as this committee is concerned you are not convicted of anything nor is this an adversary proceeding. However, as you have indicated in your statement—and I glanced it over—considerable attention has been focused on institutional investments and some very strong statements of concern have been expressed as to the possible adverse impact of such investments. But since the health of the market is often governed as much by confidence. I guess, as by economic indicators, I believe we will benefit from this inquiry.

In a recent survey in May of this year it indicated that 70 percent of investors believe the market is being manipulated and that an aspect of that manipulation is the unfair advantages to institutions.

So you are going to be given a chance to answer those kinds of beliefs apparently held, according to this survey anyway, by 70 percent of the investors. And if institutions are not a problem in the market, although many investors believe they are, then you will be able to express that viewpoint.

I am concerned, in part, Mr. Callaway, by things that always are irrational in markets. I have never seen any market where you couldn't pick out some irrational examples of things, but I was reading from the London Financial Times, dated July 20, 1973, and I will quote, "When you discover that the stock market valuation of Avon Products, a cosmetic company exceeds that of the U.S. steel industry you know either Avon must be very special or that the steel industry is very sick indeed. And when you learn that the steel industry is in the middle of a boom year, and Avon's growth rate has dwindled over the last decade from 20 percent to around 15 percent, you can decide dis-

tinctively the real problem must be a market with such haywire sense of values.

Now this is supposedly a sophisticated investment writer and certainly it is a responsible periodical.

So these are some of the things I know of that lead to questions by the average investors about institutional investing.

So without any further comment, why don't you begin with your testimony, Mr. Callaway.

STATEMENT OF SAMUEL R. CALLAWAY, EXECUTIVE VICE PRESIDENT, MORGAN GUARANTY TRUST CO. OF NEW YORK, ACCOMPANIED BY HARRISON V. SMITH, SENIOR VICE PRESIDENT AND DEPUTY HEAD OF THE DIVISION AND ROBERT B. FISKE, FIRM OF DAVIS POLK AND WARDWELL, COUNSEL

Mr. CALLAWAY. Mr. Chairman, I have identified myself as Samuel R. Callaway, an executive vice president of Morgan Guaranty Trust Co. of New York, and the head of its Trust and Investment Division, and with me on my right are Harrison V. Smith, senior vice president and deputy head of the division, and on my left Robert B. Fiske of the firm of Davis Polk and Wardwell, who is our counsel.

Mr. Chairman, I have an abbreviated version of my statement and I think our position can be most clearly presented to the committee if I can go through that version and attempt to answer questions later.

Senator BENTSEN. That would be fine.

Mr. CALLAWAY. May the full statement, as filed be included in the record, sir?

Senator BENTSEN. I have read your statement and I think you have presented your side of the argument well and we would be very pleased to have it in full.

Mr. CALLAWAY. Thank you. I thank the committee for this opportunity to appear before it. I am especially appreciative because, along with many others who are engaged in the business of managing investments, I have been dismayed at certain misconceptions which have gained wide circulation concerning the role in our economy of institutional investors, particularly bank trust departments. It was with a view to promoting wider understanding of our function that we in Morgan Guaranty began publishing reports on our trust and investment activity. Copies of the two reports we have issued thus far have been furnished to the committee staff, and I have brought an additional supply with me in case any members wish to have them.

In the Trust and Investment Division our fiduciary activities are concerned with three broad categories of work. First, we serve as trustee and investment manager for employee benefit funds, which are mainly pension funds for the employees of industry. The second category is the administration and investment of personal trusts and estates. The third is the providing of investment advisory service to individuals and institutions.

My statement concentrates on the first category, the trusteeship and investment of employee benefit plans. It is the largest of our three categories in amount of assets managed, and it is the category that in recent years has experienced the greatest growth. In addition, the

employee benefit function most closely reflects our investment philosophy and policies, since it is the one category in which we typically have sole responsibility for determining how the funds are to be invested.

I think it would be useful to the committee for me to describe briefly how we invest the funds which are set aside by employers to provide retirement benefits for ultimately some millions of their workers.

Let me say at the outset, because there has been a great deal of misunderstanding on this point, that a high price-earnings multiple is not uppermost in our minds in seeking out investment opportunities. Obviously, if two stocks had identical histories, identical current situations, and identical future prospects, and one sold for 30 times current earnings and the other for 15 times, we as an investor would choose the latter.

Our investment policy is determined by three basic characteristics of employee-benefit plans which distinguish them from other major types of institutional investor, such as mutual funds. The most important characteristic is that the liabilities to be met by these plans are of a long-term nature. Typically, the trustee can foresee a net inflow of cash for a long period of time. This means he is confident he will not have to sell volatile securities in poor markets in order to pay out benefits, and he therefore can invest for optimum long-term results without undue concern over interim fluctuations.

The second distinguishing characteristic is that the funds, in line with the intent of Congress to encourage employers to establish pension and other benefit plans, are not subject to income or capital gains taxes. This frees the trustee from the tax-related inhibitions that affect many other investors.

The third characteristic is the fact that there is no distinction or conflict between income and principal, because both are dedicated to the same purpose of assuring benefit payments to the ultimate beneficiaries. A dollar of price appreciation is just as good as, but no better than, a dollar of interest or dividend income.

Our constant and overriding objective, as dictated by our fiduciary responsibility, is to achieve the best possible results, consistent with prudent management, for the funds entrusted to our care. This objective has led me, having in mind the basic characteristics of employee-benefit funds, to invest principally in common stocks and other equity securities.

In buying or selling stocks, our emphasis is on selection rather than timing. When we sell stocks out of these accounts, it is not because we consider them overpriced at the moment, but rather because we believe the fundamental factors have changed adversely, or because it has become clear that we made a mistake in buying the stock in the first place.

In sum, we are not traders. The profile of the typical portfolio under our management changes over time, but at a gradual pace. The activity rates and turnover of our employee-benefit plans are noticeably low compared with those of other groups of institutional investors.

Our activity rate last year was 11.5 percent. You will recall that one of the witnesses yesterday mentioned that turnover for individuals on the New York Stock Exchange last year was at the rate of 20 percent.

In selecting stocks, we employ the standard tools of analysis. We look at a company in terms of the general economic framework, the markets the company serves, the competence of its management, the strength of its balance sheet, its history of progress in revenues, earnings, and dividends. We look at the price of the company's stock in relation to book value and to current and prospective dividend payments. We look at the quality of earnings. We look at the ratio of price to earnings—not only to past and present earnings, but most importantly, to our projection of future earnings, since we are investing for the long term.

As earlier stated, between two stocks otherwise identical but selling at different price-earnings multiples, we would choose the one with the lower multiple. But if, in our judgment, the higher-multiple stock has far better future prospects then it becomes a question of how much better, and the margin may be great enough to make that stock—again in our judgment—the better investment for the long-run purposes of a pension fund.

The ideal investment situation is one in which a stock can be bought at a relatively low multiple of current earnings and held while earnings increase steadily and substantially and the multiple rises. We are happy to be able to report that a number of the high-multiple stocks in the pension funds we manage were acquired, at least initially, when their price-earnings ratios were significantly lower.

This discussion of the relationship between stock prices and company earnings brings us to a subject which has occasioned a good deal of heated comment—namely, the present wide disparity in price-earnings ratios between some stocks and others, the so-called two-tier market.

Of course there is nothing new in the notion of a market having gradations—or tiers. What makes the present market different from markets of the recallable past is the greater margin of favor now enjoyed by a few stocks.

Contrary to an impression that many people seem to hold, the condition referred to as the two-tier market is not something that anyone has decreed or willed into existence. It is the product of a series of economic events starting more than a score of years ago and coming down to the present time.

The series of recessions that occurred in the years after World War II produced the phenomenon of the recession-proof company, the company which was able to maintain growth in earnings and dividends even during economic downturns.

Companies enjoying this kind of advantage were singled out for special recognition in the stock market. Their price-earnings multiples began to reflect their special standing. The upgrading, however, apparently went too far and too fast, because these were the stocks that suffered most in the market shakeout of 1962. Then came an unusually long period of freedom from either recession or rampant inflation. During this time, extending into the latter 1960's, the distinctions drawn between companies on the basis of their resistance to adversity were less sharp, because the economy—and corporate earnings generally—kept growing fairly steadily.

The recession of 1969–71 changed that. It was different in configuration from the earlier postwar recessions. Instead of being short and

steep, as they had been, it was long and shallow. Its adverse impact reached a greater number of companies. It had the effect of once again and more dramatically, widening the market premium for the kinds of company that were able to come through the slump relatively unscathed.

This effect was reinforced by the imposition of price, wage, and dividend controls just as the economy was beginning to show improvement in terms of total activity. It became apparent that many companies could not produce earnings increases at a rate greater than the continuing inflation. The stocks of such companies naturally suffered, and this served to accentuate the preference for companies more favorably situated.

The controls on dividend increases particularly affected the market status of stocks of cyclical companies.

Now, with the recovery from the 1969–71 recession appearing to have run its course, the stocks of nongrowth companies have had the down side of a cycle without the full effect of the compensating up side. Further, during the slowdown many companies that had previously been considered recession-proof fell from that state of grace as their earnings growth was impaired by the prolonged duration of the downturn.

This whole combination of factors, I believe, is the main cause of the present unusual disparity in the stock market's evaluation of companies which, at first glance, may not seem all that different in investment quality. It is not a healthy situation. But investors, whether institutional or individual, are not the cause of it. They are merely reacting to the situation they perceive. Blaming the two-tier market on investors is like blaming a rainstorm on the people who put up their umbrellas.

What can be done to restore a more even gradation of investor preference among stocks? I hope it is obvious to all that the answer does not lie in trying to force investors to stop behaving like investors. If we retain any belief in the ability of markets to allocate resources, it should be evident that the correction has to be more fundamental. What is required, in my opinion, is that investors become convinced that the economy is entering a period of sustainable growth with a lower rate of inflation than we have had over the past 6 or 7 years.

As a matter of fact, right now some investors—and we are among them—are looking beyond the slowdown that seems to be approaching, and are appraising opportunities among companies currently out of favor but likely to find a better environment in the years ahead.

Concern has been expressed by yourself, Chairman Bentsen, and others about the ability of American industry to raise capital under the conditions that have been prevailing in the stock market. Without question, a company whose stock is selling at a very low multiple of earnings is reluctant to issue new shares. But let us look at what has been happening in the capital market in the period we're talking about. Last year net new issues of stock by U.S. corporations totaled more than $12.8 billion. In 1971 they were $13.4 billion.

Senator BENTSEN. Let me interrupt at that point, Mr. Callaway.

In the net new issues, that were issued last year, can you give me some idea of the size of those companies; of the multiples of earnings, price times earnings that those companies were dealing in?

In other words, were those companies these top-tier companies rather than bottom-tier companies?

In effect, has this worked to their advantage?

Mr. CALLAWAY. I do not have statistics to prove what in my opinion the answer to that question is. I believe that it ran the full gamut of the high-tier and low-tier, Senator.

Senator BENTSEN. That is your guess?

Mr. CALLAWAY. That is my guess.

Senator BENTSEN. Wouldn't it be reasonable that the low-tier companies would not be investing?

Let's say, let's take the extreme case to make the example of a company that is selling at five times earnings. Now if the company makes an investment, if he goes out and invests, he would have to have an investment in effect that would make 40 percent before taxes and there are not that many around.

Mr. CALLAWAY. That would be difficult, Senator.

Senator BENTSEN. Wouldn't it lead us to believe that this new capital was raised principally by those selling in the top tier as far as price earnings, multiples?

Mr. CALLAWAY. I was basing my guess or opinion on the fact that we did invest in a lot of companies, in 1971 and 1792, as we mention later on in the statement, and in our own experience those investments were made over a wide range of high tier, low tier, low earnings, high earnings, multiple stocks, and it doesn't seem to me that there was any particular emphasis on the high tier multiple stocks.

Senator BENTSEN. But would it be correct to say, even though you say you have covered the spectrum, could you say how much money you put into that spectrum in the different tiers?

Mr. CALLAWAY. Yes; I think those figures will come along in a moment.

Senator BENTSEN. All right.

Mr. CALLAWAY. Those totals were well in excess of earlier years. In fact, in the preceding 5 years, 1966 through 1970, the annual total never got as high as $7 billion, and in 1968 it was a minus figure.

Through the normal workings of supply and demand, the very high volume of new stock issues in the last 2 years was contributed to the general weakening of stock prices. As might be expected, new issues this year are running at a considerably lower rate, totaling—according to one industry source—just over $3 billion in the first 6 months. By historical standards, however, even that level is not exactly an indication of anemia in the capital market.

Senator BENTSEN. On the other hand, Mr. Callaway—and I commend this blue book for your study if you have not had a chance to study this—in that book you will see almost an innumerable number of issues that had to be withdrawn because of an unfavorable response by the marketplace.

Of course, those are generally low-tier companies with low multiples.

Mr. CALLAWAY. Yes, sir.

Low price-earnings ratios on their stocks don't hinder sound, well-established companies from raising money through long-term debt if they're unwilling to sell stock at current prices.

Senator BENTSEN. What would you say that a corporate bond could sell for in the market now and it was a low-tier company? What interest rate do you think they would have to pay?

Mr. CALLAWAY. A low-tier high-quality company?

Senator BENTSEN. Yes.

Mr. CALLAWAY. I would guess just under 8 percent.

Senator BENTSEN. Under 8?

Mr. CALLAWAY. Yes, sir, a long-term capital issue.

Senator BENTSEN. That is an awfully high-quality company then? Well all right.

Mr. CALLAWAY. How about smaller, younger companies that need to raise equity capital to finance their rapid growth? In this connection I would like to describe briefly what we have been doing about investment in such enterprises.

Back in the early 1960's we moved aggressively to increase the participation of funds under our management in investments in carefully selected companies of relatively small size. The attractions of smaller companies as investments for our trusts included the following: There is more room for them to grow in a given product or service market; they normally have greater operating flexibility than the big companies; they stand to get proportionately more mileage out of any one new product or other innovation they may develop.

On the other hand, we realized that there were drawbacks. Among them: Greater risk, less liquidity in the investment, much greater expense—in proportion to the size of the investment—for the research and analysis needed to make the investment and to follow it properly once made.

We felt we could overcome the drawbacks and presreve the advantages by applying the technique of commingling.

So in 1961 we created our special situation—equities commingled fund to invest in smaller companies, defined as those with market capitalization of up to $100 million. Later we established a fund to specialize in small-to-medium-size companies, those with total market capitalization between $100 million and $500 million.

At the end of 1972 the special situation—equities fund had assets with a total market value just under $1 billion, representing investments in 182 different small companies. The fund for intermediate-size companies had $600 million divided among 86 companies.

In the 2 years 1971 and 1972, through commingled funds we put $261 million into stocks of smaller companies and $356 million into medium-size companies, both as heretofore defined. The combined sum represented 84 percent of the total net investment made in common stocks for all our employee benefit funds during the 2-year period.

Investments made by the smaller-company fund during the period involved 213 different companies. In the case of 75 of the companies, the investments were made in connection with registered stock offerings with all or part of the proceeds going as new capital to the companies whose shares were purchased. In addition, 27 smaller companies received direct infusions of capital through purchases of securities by one of our commingled funds which specializes in real estate and housing investments.

I have cited these figures showing our involvement with smaller companies because I think there has been a widespread tendency to

accept too uncritically the contention that large institutional investors invest only in large companies. Just within the past week, a widely read newspaper column dealt—as it often does—with this subject. It said by way of introduction: "The major banks with their enormous capital reserves have limited purchases to their 50 favorite stocks and their impact is such that there are reverberations all down the line." Then the column named two small, young companies as typical victims of the reverberations in that their own stock prices were suffering from the preoccupation of institutional investors with larger companies.

It so happens that our Trust and Investment Division, on behalf of pension trusts, holds 60,000 shares of one of the two small companies named.

There is a good deal of discussion these days about the individual investor's role in the stock market and how it is affected by the role of institutions.

And I was encouraged, considerably, with the testimony given on this subject by yesterday's witnesses. It was more current than any other information I have seen on the subject and I was glad to hear it.

My statement also includes some data which strongly suggests that allegations about the absence of the individual in the stock market have been greatly exaggerated.

Now, in my statement, Senator, in any event, we see no basis for attributing any lessening in trading by individuals in 1973 to the presece of institutional investors. Much more plausible explanations are the general downtrend of stock prices, the attraction of high yields offered by fixed-income investments such as bonds, concern about the well-advertised financial problems of the securities industry, and the general mood of uncertainty induced by political developments here at home and recurrent crises in the international money markets.

I know of no quick and easy way to increase the direct participation of individuals in the stock market. The achievement of convincing progress against inflation, with a consequent reduction in interest rates, and the resumption of a sustainable rate of economic growth with the expectation of a steady expansion in corporate earnings, would be the most powerful stimulants I can think of for the public appetite for equities.

In addition, Senator, the change and tax treatment suggested by witnesses yesterday could be expected to have a very decided and encouraging effect.

In concluding this statement, Mr. Chairman, and members of the commitee, may I respectfully suggest that the current inquiry not disregard the findings which emerged in 1971 from the exhaustive study of institutional investing conducted by the Securities and Exchange Commission at the direction of the Congress. The Commission, in its letter transmitting the report of the study to the Congress, referred to its important finding that institutional trading overall has not impaired price stability in the markets.

This, it seems to me, has important bearing on the whole range of interest that occupies the committee in these hearings. Contentions that the situation is other than that found in the study. I should think, must bear the burden of proof.

Again, I thank the committee for the opportunity to present this statement. I will try to answer questions that you may wish to ask.

Senator BENTSEN. Thank you, Mr. Callaway.

Of course this committee has been studying the report of the Commission. Now, Mr. Callaway, you speak of the percentage of stock that is owned by individuals and of course we have this testimony, but again we also have the testimony that insofar as dollar volume traded on the New York Stock Exchange that in 1963 the private investor had something in the area of 65 percent of it and now he has something in the area of 30 percent of it and the reverse has happened in favor of the institutions.

Now, if that trend is to continue, and if it does, and we see no signs of abatement, would you not think it a matter of concern if it got up to, for example, 90 percent of the dollar volume in the market?

Mr. CALLAWAY. Yes, sir, I think that there are two ways, Senator, if I may, of looking at this particular aspect of the market. One is by the percentage of the market and the other it seems to me is by the volume of actual share trading done in the market.

And our figures from the New York Stock Exchange yearbook indicate that from 1960 through 1963—no, I am sorry—through 1971, the volume of shares traded by the individual increased from 2 million to 5 million shares. Now this was a much less rapid increase than took place in the share trading by institutions which grew from 1 million to 10 million.

I think we find some solace in the fact that the individual investor is not leaving the market. In terms of increasing the number of shares he trades, he is not moving as fast as the institutions.

Senator BENTSEN. Haven't we had figures presented to us that show that there is an actual reduction in the number of private investors in the market?

Mr. CALLAWAY. I am not aware of those figures. I am sorry to say that, sir.

Senator BENTSEN. Would you give me some idea of the size of your trust department? Some idea of the magntude of your company's operations?

I understand that your trust department has some $27 billion in funds. How much of that is in common stocks?

Mr. CALLAWAY. $27.2 billion at the end of 1972 and of that amount, roughly across all three categories of accounts, roughly 80 percent was in equity securities, and that includes convertibles, bonds with warrants, and so forth; largely common stocks, Senator.

Senator BENTSEN. Now, approximately how much new money do you have to invest every month?

Mr. CALLAWAY. Every month, sir?

Senator BENTSEN. Yes, in stocks.

Mr. CALLAWAY. On an annual basis—and the money does not flow evenly—but on an annual basis, I would imagine that this year we will have in the neighborhood of $1 billion. So that would mean, if my arithmetic is correct, $90 million, or $100 million a month, or something like that, sir.

Senator BENTSEN. Well, yesterday this committee reported out a new pension bill with some very stiff funding requirements and I

would assume that that might further increase the intake for investment?

Mr. CALLAWAY. Yes, sir.

Senator BENTSEN. Of your institutions?

Mr. CALLAWAY. Yes, sir.

Senator BENTSEN. And you say, at the present time, you have approximately $1 billion of new money over a year for investment that could go into the stock market?

Mr. CALLAWAY. That is correct, Senator.

Senator BENTSEN. Now yesterday we received testimony from Mr. Whitehead and Mr. Regan that the rate of turnover of stocks of institutions was substantially higher than that of individuals. Would you say that was true of Morgan?

Mr. CALLAWAY. No, Senator; it is not. I think we have given your staff the copies of the two annual reports that we have published and in those pamphlets we have the activity rate in our accounts, in our employee-benefit accounts, as compared with other institutional investors, and——

Senator BENTSEN. I asked you as compared to individuals.

Mr. CALLAWAY. Oh, all right. I apologize.

According to the figures we heard yesterday, sir, and I do not know for myself the turnover rate of individuals, but our rate of activity was 11.5 percent compared to the 20 percent figure that was given yesterday for the individual.

Senator BENTSEN. Well, let me ask you if you think it contributes to the fiduciary responsibility of pension fund managers to be running full-page ads advertising their performance rates. I have some examples here for you.

Mr. CALLAWAY. It is not, I guess, up to me to judge my peers. We have adopted the opposite philosophy. We do not believe in it other than giving such information directly to the clients we are serving. We do not publish our performance rates.

Senator BENTSEN. I know you are doing something on disclosure already but do you see any objection to having to make periodic reports with full disclosure of stocks held in your trust departments? In other words, periodic disclosures, say, every quarter?

Mr. CALLAWAY. We are very much in favor—and I think we are on record—as being in favor of reasonable disclosure and we try to show one way of doing that in our statement.

We do have a bit of question about the frequency of such revelations, because they might conceivablly affect the fortunes of our clients. By that I am referring back to what was said yesterday about——

Senator BENTSEN. Wait, don't the mutual funds have the same problem?

Mr. CALLAWAY. Pardon?

Senator BENTSEN. Whatever applies to you, wouldn't that also apply to the mutual fund shareholders?

Mr. CALLAWAY. I believe it would.

Senator BENTSEN. And, if it is fair for him, isn't it fair for you?

Mr. CALLAWAY. Well, sir, that is a very good point. I think you can use that logic, and I am trying to explain the point of view that we have, which is that yesterday you heard about the large investor who

might want to sell 100,000 shares and, were it known that he held 100,000 shares and offered 10,000 for sale, there would probably be no takers because the market would know there are a great many more shares to come.

Senator BENTSEN. The mutual funds do that all the time. They don't necessarily clean out a portfolio on a particular stock. They may decide to lessen their holdings of a particular issue.

Mr. CALLAWAY. Yes.

Senator BENTSEN. And it is publicized and there are reports that they are holding those stocks.

Mr. CALLAWAY. Yes.

Senator BENTSEN. And if they offer half of that particular holding, that doesn't seem to preclude their being able to sell it. In other words, they have been doing it.

Mr. CALLAWAY. I reiterate, Senator, we are very much in favor of disclosure, and we think it is right, and we have started to do something we thought would help in that. And we will be glad to cooperate with any further rules and regulations on disclosure.

Senator BENTSEN. At what point in the management is the trust department and the commercial side of the bank administered by the same man?

Mr. CALLAWAY. At virtually no point except that I report directly to the chairman of the board on a quarterly basis and to the board of directors.

Senator BENTSEN. The chairman of the board is over both sections?

Mr. CALLAWAY. Yes.

Senator BENTSEN. How about the president of the bank?

Mr. CALLAWAY. No, sir, I do not report directly to the president of the bank. My reports are basically quarterly reports to the chairman of the board, and the board of directors of the bank, and they are very general reports and do not deal with individual purchases or sales of securities.

Senator BENTSEN. Do you vote stock of the companies you hold in the trust department?

Mr. CALLAWAY. In those cases where we are the trustees, the sole trustee, we do vote the stocks, and that would include almost all of our employee benefit plans and personal trusts and estates.

In the case of investment advisory accounts, individuals and institutions, those shares are voted by the individual client.

Senator BENTSEN. In the case where you are the sole trustee and you are dissatisfied with the management, or a management decision, do you try to influence or change the management's course or do you sell the stock?

Mr. CALLAWAY. We would be more apt to sell the stock over a period of time if it appeared that no remedy was being made.

Senator BENTSEN. But you would not be adverse to trying to influence the management's decision if you disagreed with it?

Mr. CALLAWAY. We would very seldom, in my recollection try to influence the management.

Senator BENTSEN. But you have done it? You don't recall having done so though?

Mr. CALLAWAY. No, I really don't Senator.

Senator BENTSEN. Do you think there are any secrets on Wall Street?

Mr. CALLAWAY. Well, there are some. There are some secrets, I am sure. We don't feel it is an open book at all.

Senator BENTSEN. We had a witness yesterday who testified they lasted about 5 minutes.

Mr. CALLAWAY. Well, we hope we can maintain secrecy longer than that in our transactions, Senator.

Senator BENTSEN. It is of concern to us, or to me at least, that some of the portfolio managers no longer seem to pay much attention to what some of us for a long time thought were the fundamentals in studying the purchase of stocks but now it is a guessing game trying to decide what you fellows are doing and what the institutions are buying or what they are going to be selling.

Do you feel that there is an exchange of views amongst portfolio managers of major institutions?

Mr. CALLAWAY. Not in our case. We have no idea whether it is true in other cases, so I can't speak about them, but certainly it is not true in ours.

Senator BENTSEN. Is it your opinion that they do not act in concert and that the herd psychology does not apply?

Mr. CALLAWAY. That is my distinct feeling in our case.

Senator BENTSEN. So far as your institution is concerned?

Mr. CALLAWAY. Yes, sir, that is really all I can speak for.

Senator BENTSEN. You have an investment advisory service, is that correct?

Mr. CALLAWAY. That is correct, Senator.

Senator BENTSEN. You indicate that the only time you sell a stock is when you are aware that the fundamental factors have changed that make it clear it was a mistake to have bought the stock in the first place. Do you advise your investment advisory service of that at the time that you might make changes in your portfolio or your trustee accounts, or——

Mr. CALLAWAY. I see. In effect.

Senator BENTSEN. Is it done simultaneously?

Mr. CALLAWAY. It is simultaneous in a sense, the entire investment department meets as one unit. The governing committee is the Trust and Investment Committee, which meets to review all accounts so that decisions on a single stock will apply to all types of our accounts; all three categories of our accounts, Senator.

Senator BENTSEN. What would you think of limiting an institution's ownership of stock of a given company to 5 percent of that company's stock? This limit presently applies to mutual funds by the Investment Company Act of 1940. What would you think of that if you had a grandfather's clause to protect present holdings? What would you think the feasibility of that would be as applied to insurance companies or trust departments of banks?

Insurance companies already have some of these limitations on them. But what would you think of that being applied to trust departments of banks? What problems would result?

Mr. CALLAWAY. One problem that comes readily to mind is it seems to me it would further accentuate the large holdings of large companies

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because it is much easier and more likely that you would have a holding of over 5 percent in a small, growing company with a limited number of shares outstanding than you would in a very large concern. So that I would think that, if institutional investors were forced to sell down to 5 percent, that that money might very easily flow into the big highly capitalized companies.

Senator BENTSEN. In dollars, how much of IBM do you hold?

Mr. CALLAWAY. Sorry, sir.

Senator BENTSEN. In dollars, how much of IBM do you hold now?

Mr. CALLAWAY. A little over $2 billion at the end of 1972.

Senator BENTSEN. That was billion?

Mr. CALLAWAY. $2 billion.

Senator BENTSEN. You should almost like a government.

Senator Byrd?

Senator BYRD. Thank you, Mr. Chairman.

Mr. Callaway, in your summary sheet at the top of your statement, you say the presumed lessening of individuals' participation at present is explainable in terms of economic and political factors rather than as a result of institutional investors presence in the market. Would you elaborate on that a bit?

Mr. CALLAWAY. Yes, sir, I would be very glad to. I feel—and this I think is somewhat borne out by our complete statement—I feel that the individual investors have been very conscious in recent years of the higher yield that the investor can obtain on fixed income securities, bonds, as compared to the yield on common stocks or the future yield on common stocks. And for that basic reason, for that very reason, a number of years ago the individual investor appeared to be moving from stocks into corporate bonds. And we also attribute part of the reason, in our minds, and there is no way of proving this, to the fact that the individual, through the growth of social security and the private pension systems, is more assured today of his retirement and is therefore more interested in investing today for current income. And therefore, since the bonds give him, let us say, 8 percent, and the stock at best 5 or 6 percent, it would seem to us very natural that he would move in that direction—in the direction of bonds and out of the stock market.

Senator BYRD. That is what you mean by the economic factors?

Mr. CALLAWAY. Certainly. Yes. That is certainly one of them, anyway.

Senator BYRD. Now, what about, you mentioned in terms of political factors. What about that?

Mr. CALLAWAY. I think that investment certainly has a great deal of confidence built into the judgment factor, in other words, are you confident that the economy is going to grow sustainably, are you confident that dividends are going to grow, and so forth, and I think that both domestically and perhaps internationally there has been some lack of confidence on the individual's part that those political factors are stable and will give him the background for a sustainable increase in corporate earnings.

Senator BYRD. The apparent lack of confidence in the dollar abroad, do you feel that has had an effect on the market?

Mr. CALLAWAY. I would think that it has, Senator, yes, I would think it has.

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Senator BYRD. In your judgment, does that lack of confidence reflect a lack of confidence in Washington, so to speak?

Mr. CALLAWAY. I don't think I am any judge of that factor, sir.

Senator BYRD. Let me ask you this question, which I have asked each of the economists who have come before this committee. How does an average individual, not a wealthy person, but an average individual, man or woman, protect himself or herself against inflation?

Mr. CALLAWAY. I would think that one of the ways that he or she could protect themselves against a reasonable rate of inflation would be investment in companies which have great promise of continuing growth in their earnings and more importantly, in their dividend stream which would provide the additional income down the road to offset the inflationary factors and I think that is why I mentioned earlier that, when the inflation factor gets to a point where he doesn't think he can match it with that, he is probably not very interested in investing in stocks.

Senator BYRD. Well, are you saying, I assume, that a way, and perhaps the best way—is to invest in common stocks as an inflationary hedge?

Mr. CALLAWAY. It has been that, over great periods of time, and I think it has been that in recent years, if the selection of those stocks was in the type of company I described.

Senator BYRD. Could you, Mr. Callaway, briefly outline the processes by which the trust department of Morgan Guaranty decides to buy or sell shares in a particular company? Who makes the final decision, for example?

Mr. CALLAWAY. The final decision is made by the Trust and Investment Committee, composed of eight senior officers of our division. There is nobody from any other part of the bank on it. I am the chairman and Mr. Smith is the vice chairman, and there are six other members.

This committee reviews daily the individual accounts, the pension trusts, the individual accounts, the personal trust accounts. We also meet continuously in what we call a weekly meeting, which includes the 45 or 50 investment advisory officers that we have plus the members of our investment research department who are following the industries. And we meet all of the time to discuss the pros and cons of industries, companies, and the economy, and so forth.

No exact decisions are reached at those meetings. The outcome of those meetings is perhaps that the individual officer brings to the committee for approval or nonapproval of stocks, but that is really in the simplest terms I can think of, the way we operate.

Senator BYRD. Well, when a decision is made to take a strong position in a particular company, how rapidly does that decision become known in the financial community?

Mr. CALLAWAY. In the financial community?

Senator BYRD. Yes.

Mr. CALLAWAY. I believe that sometimes it is a long, long time before it does, and other times it may be relatively soon. We are obviously most anxious that it doesn't become known so that we can acquire stocks at reasonable prices for our clients, and we make every effort both in our trading activities and in our personnel to see that the word is not passed around.

Senator BYRD. Could you indicate what factors came to your attention last January that caused Morgan Guaranty to sell a considerable portion of Tropicana stock, which plunged from 58 to 16?

Mr. CALLAWAY. I remember the incident of reviewing Tropicana. We felt that the prospects for the company, the growth and earnings for the company, were not as favorable as they had been previously, and I honestly don't recall, Senator, the exact details of it, but it was a decision made after review in the weekly committee meeting. It was a decision made by the trust committee.

Senator BYRD. Did you have a strong position in that stock?

Mr. CALLAWAY. Relatively I think it was a fairly large position. I mean, relatively to the size of the company, yes.

Senator BYRD. And then would the fact that Morgan Guaranty disposed of its shares, would that cause the stock to drop as sharply as it did, do you think?

Mr. CALLAWAY. I wasn't aware of that at the time, nor am I now, but I could look into the matter and see if they occurred simultaneouly.

Senator BYRD. No; I was just using that as an example of how these large institutional investments might affect the stock. I don't know anything about Tropicana myself.

Mr. CALLAWAY. I am sure you understand our main aim in life is not to disturb the market either way.

Senator BYRD. Mr. Callaway, do you have any figures which might indicate the percentage of a company's outstanding stock held by Morgan?

Mr. CALLAWAY. Do I have those figures with me?

Senator BYRD. Do you happen to have any figures?

Mr. CALLAWAY. No; I do not.

Senator BYRD. Or do you keep figures on that line?

Mr. CALLAWAY. We look at those figures, yes.

Senator BYRD. Do you have information as to what is the largest amount of a company stock owned by Morgan—not the name of the company—but what is the largest amount of stock owned by Morgan in a company.

Mr. CALLAWAY. Percentagewise? We do have that.

You also recall I think we do receive, as a trust company, the estates and trusts that may be entirely invested in the family business where the ownership comes as high as 100 percent of the voting stock, or perhaps even the entire issue outstanding.

Senator BYRD. That should apply to estates?

Mr. CALLAWAY. Estates and personal trusts, yes, sir.

Senator BYRD. And personal trusts.

Other than such estates and personal trusts of family corporations, are there any companies in which institutional investors hold a majority of the stock?

Mr. CALLAWAY. Any companies in which institutional investors what?

Senator BYRD. In which Morgan Guaranty, for example, would hold a majority of the stock, or do you try to stay away from that?

Mr. CALLAWAY. No, sir, I don't recall anything like that.

Senator BYRD. I guess what I am really trying to say, do you try to stay away from owning as much as 50 percent of a company's stock?

Mr. CALLAWAY. Oh, yes, sir, indeed we do. We have no arbitrary limits, but we are very conscious from a standpoint of the liquidity of the investment and also the possibility of control of the investment, and I am sure that we have never gone to 50 percent, sir.

Senator BYRD. Does Morgan do its own investment research or does it rely primarily on brokers?

Mr. CALLAWAY. It relies primarily on its own investment research. We have a staff here in the United States of 45 and maybe 7 or 8 people abroad. We do also use what we think is the best obtainable research from Wall Street that we can get, but we rely primarily on our own in-house research department, and have for as long as I can remember, sir.

Senator BYRD. Is there coordination between the loan department and the trust department?

Mr. CALLAWAY. None at all.

Senator BYRD. Thank you, sir.

Senator BENTSEN. Senator Bennett?

Senator BENNETT. I am sorry I wasn't here to hear your statement, but there are some questions that the staff has prepared because they had the statement in advance, and so for the purpose of getting the information into the record, I will ask them.

About how many brokerage firms do you use in your trading?

Mr. CALLAWAY. At the present time, we use in the neighborhood of 300 or maybe a few more brokers and dealers in our investment transactions.

Senator BENNETT. Are they scattered around the country or are they headquartered in New York?

Mr. CALLAWAY. No, sir, they are scattered around the country.

Senator BENNETT. Could you tell us what kind of criteria you use in selecting the broker, the dealers with whom you will work?

Mr. CALLAWAY. Senator, the first requirement is the ability to execute the order to our best advantage. In addition we of course look at the financial condition of the firm, and we also take into account the research capability of that firm.

Senator BENNETT. As a general rule, do trust departments acquire stocks of companies gradually in a series of steps and then, when it comes time to sell, do you sell them off as a single block? Is that the pattern?

Mr. CALLAWAY. I don't think that is the pattern in our case, Senator. We do acquire them gradually and over a long period of time, and in most cases, unless there is a violent change in the circumstances of the company, we sell them also over a period of time. In other words, we don't think, as we mentioned in our statement, that we are very good at timing, but if we do see a gradual change or if through price increases, a security becomes too large a part of the portfolio, we may start to reduce that concentration in a given portfolio, yes.

Senator BENNETT. Do I understand you to say that it is very rarely that you would move completely out of a stock at a single point in time?

Mr. CALLAWAY. That is correct. It is rare.

Senator BENNETT. Are there any occasions when two institutional investors might act in concert regarding the stock of a particular

company? Do you operate in such a way that you occasionally cooperate with another institutional investor in moving?

Mr. CALLAWAY. Never, to the best of my knowledge. Never.

Senator BENNETT. You always operate on your own?

Mr. CALLAWAY. Yes, sir.

Senator BENNETT. I think you have answered the question of the chairman, as to the question of setting limits on stocks which would be owned.

Now, let's turn to the question of the smaller investor. Is there a minimum amount of money that a potential investor must have available before Morgan Guaranty will take him on?

Mr. CALLAWAY. Yes, sir. We have minimum fees, which in a sense allocate the size of account we will take, and those fees are set in the pension area and in the investment advisory area.

Of course, in the personal trust area, we operate under the statutes of New York State.

Senator BENNETT. In effect, what kind of a minimum investment does that produce?

Mr. CALLAWAY. Well, the minimum fee, Senator, for an investment advisory account, including custody of securities and preparation of some tax material, is $5,000 a year, and the client may wish to pay that minimum even though his account is only $200,000 or $300,000, or $400,000 in size. It is entirely up to him. We will take the account if he pays that.

Senator BENNETT. So it isn't a question of the size of the account? It is the size of the fee that influences the decision of the potential customer?

Mr. CALLAWAY. Well, in all fairness, Senator, we are very interested in keeping the number of accounts, which are approximately 7,300 accounts of all kinds in our trust division, we are anxious to keep those within manageable proportions. We say we give individual attention to accounts and so we are careful about them, and so forth, and we do not want to get big in numbers of accounts. It is very difficult for us to individually take care of a large number of accounts, Senator. We have made a plea that the Congress allow the banks, and not just ourselves, the banks to in effect run mutual funds which would allow us to advise on a commingled basis all of the investors who might want to come to us.

Senator BENNETT. For the record, can you or would you outline for us or list for us all the types of services that are available to such accounts, small accounts, as decide to use your services?

Mr. CALLAWAY. Well, yes. There is first the investment advisory service and the custody of the securities, the checking accounts. Well, and checking accounts, sir.

Senator BENNETT. That is on the other side of the bank, though?

Mr. CALLAWAY. Yes, sir.

Senator BENNETT. Checking accounts is on the other side?

Mr. CALLAWAY. Yes, sir, that is correct. It is really investment advisory and custody of the securities, with some little tax information pertaining to their investment accounts.

Senator BENNETT. I think that is all, Mr. Chairman.

Senator BENTSEN. Well, thank you.

Now, you do have commingled accounts, don't you?

Mr. CALLAWAY. Yes, Senator, but they are not available to any account other than a trusteed account. We can only use commingled accounts for personal trusts and pension trust accounts. The individual or the charitable institution, by law, we cannot use a common trust and——

Senator BENTSEN. I understand. Do you see any reason why your commingled accounts, their performance, shouldn't be as much a public record as mutual funds performance?

Mr. CALLAWAY. Of our commingled and common stocks?

Senator BENTSEN. Yes.

Mr. CALLAWAY. I really don't see any reason if——

Senator BENTSEN. You said you don't see any reason?

Mr. CALLAWAY. If everybody had to produce the figures on a similar basis.

Now, the problem, I think, becomes that commingled funds are set up for different purposes, and they may not be exactly identical in the objectives of the particular fund.

Senator BENTSEN. But different investors invest for different purposes in mutual funds too.

Mr. CALLAWAY. And they of course grade them as growth funds and income funds and so forth. But I am thinking in our industry, I believe where we have a separate fund for special situations, for instance, small companies, that fund may be a part of a larger fund in another bank, and it would be very hard to compare the two unless they were clearly delineated.

Senator Bentsen. Let me get you back to this question of the 1940 act and the 5 percent limitation. What is wrong with having a 5 percent limitation, be it a small or large company, in what you hold in your trust departments, as long as you have a grandfather clause protecting what you held before since the mutual funds have had that kind of limitation since 1940?

Mr. CALLAWAY. Well, I must say that the latter part of your question is difficult for me to answer. The first part I think I gave you one answer to. There is another answer and that is that if we are limited to any low percentage of holding in one company, it would mean that all of our clients, and particularly new clients coming into us for advice, would not be treated equally with an existing clients. If you held 5 percent of IBM and a new client comes to you, you are not permitted to buy him any more IBM. So I think there would be a restriction on the free investment judgment of the institutions.

Senator BENTSEN. How does Morgan Guaranty go about getting new business?

Mr. CALLAWAY. In the pension trust area, we have one individual, a senior officer, who is responsible for soliciting any new business, and he goes to the corporations that are not presently clients, and tries to sell them.

Senator BENTSEN. Does he have a list of the customers of the bank on the other side?

Mr. CALLAWAY. No, sir.

Senator BENTSEN. He doesn't know who the customers of the bank are? He doesn't go over and visit his friend on the other side and try to find out who is doing business with Morgan Guaranty before he goes out to call on them?

Mr. CALLAWAY. He does not, although it is perfectly reasonable a client of the bank would come in and ask if we make a presentation——

Senator BENTSEN. I know, but you would discourage one of your men from going to the other side of the bank and finding out who the other customers are?

Mr. CALLAWAY. That is correct, Senator. We don't do that in any aspect of our work.

Senator BENTSEN. You have rules against that?

Mr. CALLAWAY. Absolutely.

Senator BENTSEN. He doesn't know who the bank is lending money to?

Mr. CALLAWAY. No, sir, he does not.

Senator BENTSEN. Do you think there is any maximum level of assets that your bank could efficiently manage?

Mr. CALLAWAY. That is a good question. That is a good question, and we do consider it all of the time. I think that there are two aspects of it. The first question, can we manage these assets and produce proper returns for our clients, and to this moment at least we seem to be accomplishing that reasonably satisfactorily.

The other is that, while we have grown, the total universe has grown too, and I was interested, as a result of coming down here to meet with your committee, to discover—and I hadn't noticed this before—that the proportion at book value of our pension trusts to the total private pension field has been slipping since 1968. It was then 10.3 percent of the total, and it is now 9.3.

Senator BENTSEN. Why do you use book value instead of market?

Mr. CALLAWAY. Those are the only figures available.

Mr. SMITH. In the aggregate, that is right.

Mr. CALLAWAY. I think maybe some correction of this is taking place, Senator, in the diffusion of the investment of these assets of this growing pension and retirement plan field.

Senator BENTSEN. If there was a 5 percent limit on the amonut of stock that you could buy in a corporation, do you think that would force some buying down into the medium sized companies or not?

Mr. CALLAWAY. Well, as I explained, we are already buying heavily in the medium sized field.

Senator BENTSEN. Do you think that you are unique in this respect or do you think that is the rule of the institutions to buy into medium sized and small companies?

Mr. CALLAWAY. Oh, in small companies, I don't think we are unique any longer. I think we were one of the first to start to do that, but I think that the large trust institutions in most cases are looking for investments in small, rapidly growing and well managed companies and in medium sized companies, too.

Senator BENTSEN. Do you think if a company had 10 percent of its stock held by Morgan and ran into financial problems, that that could influence the other side of the bank as to whether or not they gave him a loan?

Mr. CALLAWAY. In my judgment, it would not.

Senator BENTSEN. On that stock where you are sole trustee, and you vote it, how many people are involved in the decision as to how you vote that stock?

Mr. CALLAWAY. The ultimate decision is made again by the trust and investment committee of eight people.

Senator BENTSEN. Eight people?

Mr. CALLAWAY. Eight people. We also have a committee of senior officers of the department, not members of the trust committee, who screen all of the proxies as they come in and make recommendations to us. As you know, there are a great many proxies that come in and they come in at a certain time of the year. So we have a system of screening these proxies by senior officers in the investment department, and then the voting is approved or disapproved by the trust committee itself.

Senator BENTSEN. Do you have any feeling as to the impact on the corporate management of the fact that you might have 10 percent of the stock of the corporation and have a deal with your bank? For instance, I was talking to the president of a company, a new company, the other days and he was telling me your trust department owned 10 percent of his particular corporation.

Mr. CALLAWAY. I think over the period of time that I have been associated with this company, we have probably sold as many securities where we had 10 percent at one time as we have bought up to 10 percent, at another time. In other words, Senator, I think those companies know today that we are not buying stocks to influence them and the way they run their companies. We are buying solely in the hopes we will get a good return for our clients, and if that isn't obtainable in our judgment, the stock may very well be sold.

Senator BENTSEN. Do you have any feeling for how much your investment decisions influence others in the market who follow you as the largest investor?

Mr. CALLAWAY. I honestly don't, Senator, and I don't think our trading department, which would be the place you might find out that, I don't think they feel that way. Because of the way they do business, I don't think they feel that we, in our trading, do influence the market.

Senator BENTSEN. With $1 billion to invest, aren't you in a position to really have a self-fulfilling prophesy on stocks by continuing to buy them and thereby hold the price up?

Mr. CALLAWAY. I don't believe so.

Senator BENTSEN. But you have the ability, don't you?

Mr. CALLAWAY. If we were to put it all in one security, yes, sir.

Senator BENTSEN. We heard yesterday from representatives of several large brokerage firms that institutional investors such as Morgan are dominating the financial market and driving many of the small regional brokerage firms out of business. What is your response to such allegations?

Mr. CALLAWAY. In our case, I find that we are usually increasing the number of small regional firms that we are using.

Senator BENTSEN. More than you have in the past?

Mr. CALLAWAY. Yes, sir.

Senator BENTSEN. Why?

Mr. CALLAWAY. We find that in the nature of our business of seeking to invest around the country, that small companies in many cases with those the regional firm has the best access to the regional information about the company and also about trading in the securities of the

company. So that I believe—and I might ask Mr. Smith to corroborate this—that our trend is toward a greater number of regional brokers.

Mr. SMITH. Yes; that is correct, because of the knowledge they have of their own areas.

Senator BENNETT. May I ask a question there?

Senator BENTSEN. Yes, Senator.

Senator BENNETT. In using more regional firms, are you doing any more investment in stocks that are not listed on the big board? And in other words, are you doing more in local over the counter?

Mr. CALLAWAY. We have always tried to do that, and we are still doing a great deal of it. I don't know that I can say it is more proportionately, but we have always been interested in this, Senator.

Senator BENNETT. This has always been a part of your portfolio?

Mr. CALLAWAY. Absolutely.

Senator BENTSEN. This committee would like to explore some of the positive ways that we can encourage the individual investor to get back into the marketplace. I for one am concerned about the trend here we see with institutions dominating the market, whether it is a matter of fault or circumstances, or whatever it might be, and I would like to try to avoid that. I don't want to see the situation develop that has developed in the German market, for instance. I think that the individual investor makes a very major contribution to stability in the marketplace.

Some of the suggestions that have been made, such as not having to capitalize commission rates and others, do you have any particular feeling about that, for instance?

Mr. CALLAWAY. I really don't, except I would abide by the judgment of those excellent firms whose judgment is that it would help the individual investor.

Senator BENTSEN. Another suggestion has been made to give, in effect, a free reinvestment or a delay in the capital gains paid if the money is placed back in the market. Does that sound fair to you?

Mr. CALLAWAY. It does; and I think it would be a factor in influencing the individual investor to go to the marketplace.

Senator BENTSEN. What do you think of the possibility of a capital-gains tax that is graduated for the period of holding?

Mr. CALLAWAY. I also feel that would be an added incentive in getting the individual investor back in the market, if in truth he is out of it.

Senator BENTSEN. I don't think anyone says he is completely out of it. It is a question of degree that we are talking about.

Mr. CALLAWAY. Exactly.

Senator BENTSEN. When it comes to selling a large block, do you principally go to the third market?

Mr. CALLAWAY. Not principally, no, sir. We do use the third market and have used it for more than 20 years, I believe, and it has remained a percentage of our normal trading business over most of the periods of time, so we certainly would go to the third market on a large block and test it.

Senator BENTSEN. Is it your feeling that continued inflation has hurt the stock market?

Mr. CALLAWAY. Absolutely, I think it does hurt the stock market.

Senator BENTSEN. Hurts it, and why?

Mr. CALLAWAY. Because I believe that inflation damages the earning power, the future earning power of a great many of a major body of corporations in this country and by doing that, it eliminates the desire for the individual to invest in those companies to protect his purchasing power down the road.

Senator BENTSEN. Well, let's probe that just a bit.

Mr. CALLAWAY. Yes, sir.

Senator BENTSEN. Why can't they pass that on, and why doesn't that increase their profits? In other words, why does it limit their profits?

Mr. CALLAWAY. Competition will really set the prices on these products, and if the inflation of costs is greater than the amount that prices could be raised in an industry, the gap would close on the profit margins and the earnings down the road would be lower.

Second, I think that over the years the economy as a whole has grown somewhere in the range of 4 to 5 percent in gross national product and that that basically is the growth rate of a good body of the corporate community. And if you have an inflation rate higher than that or equal to that, you have obviously siphoned off a lot of the future growth possibilities for the individual investor.

Senator BENTSEN. It is my understanding you are the largest stockholder in the world; is that correct?

Mr. CALLAWAY. I don't know, sir. I really don't.

Senator BENTSEN. How about the United States?

Mr. CALLAWAY. I believe we may be. I have never tried to find out whether that was a fact. I believe we may be, though.

Senator BENTSEN. Do you believe there is an added competitive force in having one institution with that many billions of stocks?

Do you believe that other institutions are put in a disadvantageous position and find it very difficult to compete with the forces of the Morgan Guaranty Co.?

Mr. CALLAWAY. I don't think so. I don't think so. I think thre is plenty of good competition for Morgan Guaranty. I come back in relating our holdings in equity securities to the value of securities on the stock exchange, which is well over $800 billion, and, if you include the other markets—if you include the American Exchange and over-the-counter securities—it comes to well over a trillion dollars. And, I think in that context, we are not that big.

Senator BENTSEN. Senator Bennett?

Senator BENNETT. Well, your last answer reminds me of a wisecrack that used to quite prevalent with respect to this man Morgan's competitors, and that is they would if they could. [Laughter.]

Senator BENTSEN. I don't question that at all.

Mr. Callaway, you have been very helpful. Do you have anything further you would like to add?

Mr. CALLAWAY. No, I do not, sir.

Senator BENTSEN. Well then, we will take your statement, in its entirety, a matter of record.

Senator BENTSEN. At this time I would like to include this article from the London Financial Times in the record.

[The article referred to follows:]

[From the London Financial Times, Fri., July 13]

A SENSE OF IRRATIONAL VALUES

(By Nicholas Colchester)

When you discover that the stock market valuation of Avon Products, a cosmetics company, exceeds that of the entire U.S. steel industry, you know either that Avon must be very special, or that the steel industry is very sick indeed. When you then learn that the steel industry is in the middle of a boom year and that Avon's growth rate has waned over the last decade from 20 per cent per annum to around 15 per cent, you decide, instinctively, that the real problem must be a market with such a haywire sense of values.

The trouble is the domination of Wall Street by the investing institutions and the symptom is the "two-tier" market, of which the over-pricing of Avon is just a solitary example. Other stocks that are part of the backbone of the U.S. economy have been ravaged by the market and a chosen elite among stocks—known as the Vestal Virgins—has somehow defied the force of gravity.

Investment industry statistics begin to hint at a word that has not so far been whispered within it—monopoly. America has long struggled with monopolies in its industrial markets and now faces them in the market that deploys and raises its capital. Like most monopolies in the industrial sector those that are emerging in the investment business are not the edifices of malignant men, but rather the results of business success. They have problematic effects none the less. They distort the trading mechanism that controls the prices of stocks, and they discriminate against stocks of small and cyclical companies in favour of the equities in successful giants. They therefore need a measure of control.

Institutional investors now control 45 per cent of the stock on the New York Stock Exchange and account for over 65 per cent of its trading volume. The latest figures suggest that out of total institutional equity holdings of $310,000m., banks control $170,000m., of which perhaps $110m., is pension fund money, the mutual funds $45,000m., the insurance funds $42,000m., and other professional managers the rest. These figures put the investing power of certain large institutions into perspective: Morgan Guaranty, $27,000m., Bankers Trust $20,000m., Prudential Insurance $18,300m. and First National City Bank $17,200m. These figures represent very great pools of money that are deployed by a small number of men.

One result of this concentration of investing power is that it tends to channel the flow of cash from these big funds into a relatively small number of stocks. To control a giant fund a small management team must invest and disinvest in a series of sizeable trades. There are only a limited number of American stocks that have the liquidity to absorb these trades without price convulsions and they are the 300 or so stocks with the largest capitalisations. A recent survey by Fortune Magazine showed that major bank funds had about half of their equity investments in the 20 most valuable companies in the U.S.

Superimposed on this need for bigness is an obsession with growth. The growth fetish was born in the 1960s when it suddenly became fashionable to price stocks not with a canny eye on the way their current yield compared with the alternative of fixed interest investment, but on the basis of a discounting of earnings prospects that stretched nebulously into the future. This cloud cuckooland of growth through technology, synergy, and imaginative accounting collapsed in the recession of 1970 and a lot of investors wet their feet as a result. But a number of the biggest funds had poured their money, almost defensively, into those companies that were able to keep their promise of growth through bad times—stocks like International Business Machines, Avon Products, Xerox, Sears Roebuck, and Eastman Kodak—and were left high and dry. These growth portfolios were suddenly established as the outstanding success stories, the bandwagon onto which any self-protecting fund manager must leap. So while the average price of stocks on the New York Exchange has halved since the high point in 1968, the value of a portfolio of institutional favourites has risen over the same stretch by 80 per cent.

Of course a growth company should be rewarded with a premium price multiple, but it now seems that this premium has lost touch with reality, and that the divergence in valuation between the favourites and the rest threatens to damage the ability of many companies to raise capital. It is difficult to place the blame for this disparity on anything but the rise in the relative power of the institutions.

The Financial Analysts' Journal ran an interesting article in May that compared a discounted cash flow evaluation of stocks in the growth and nongrowth leagues. The stocks were chosen to be of equal risk (using a technique called beta theory) and it was found that the rate of expected reurn implict in the pricing of growth stocks was 7.7 per cent, while that for the nongrowth stocks was over 10 per cent. Since the risk co-efficient for the two groups was the same, this result implied an irrational predilection for the growth league.

The result was not necessarily bad news for the investor, because investment advice must concentrate on saying what the market will do in all its irriationality rather than on what it should do. But, as with international currencies, what is acceptable to speculators can be bad for national economies. In the case of American equities the concentration of investment money on the Vestal Virgins has hit the venture capital market, has made a nonsense of the stock options offered as an incentive to many American managements, and threatens to lessen the ability of U.S. corporations to raise capital in the stock market, should they need to do so.

There are a number of reasons why the largest investing institutions may be frozen into patterns of irrationality. In the first place they would find it quite impossible to get rid of some of the stocks they have accumulated. To take an extreme example: some $15m. worth of IBM stock is traded daily on the New York Exchange at current trading levels. If Morgan Guaranty accounted for all of this, it would take the bank 140 trading days to get out of the computer company. Morgan is clearly well advised to sit tight.

The managers of these great funds do not think for themselves in ivory towers but are made very conscious of what their rivals are doing and how they are performing. All read the same financial publications. They receive a lot of the same research. They know that by following the leader (a role fashionably ascribed to Morgan) they can only do as well or as badly as the next man. With concentrated investing power a joint decision to buy can be self-fulfilling in its excellence—and vice versa for a joint decision to sell.

To cap it all a joint buy decision, once taken, need never be tested on the outside world. The flow of money into pension funds exceeds the pension outflow by an amount that each year handsomely exceeds 10 per cent of the total pension fund money under management. So the growing inflow can be used to fund the promised appreciation in the outflow, not fraudulently, but simply by buying with the incoming funds the appreciated stock that must be sold to provide the client corporations with their pension money. Reducing this principle to absurdity, the pension fund industry could play this game with any commodity in which it could corner the market. I am not suggesting that the impact of the pension fund industry on the U.S. stock market is so absurd, but only that the ever increasing inward cash flow, coupled with a concentration of resources, may help the willing suspension of disbelief that seems implicit in the current rating of Avon or of the secret researches of Polariod's Dr. Land.

There are other results of institutional dominance, an impact on the ailing securities industry, and perhaps on the faith of individual investors in stocks, but they are another story. The institutions have, in fact, been with us for a long time but only now, with the market down and public out of it, has their impact been made apparent. The investment tide is out and has revealed whales that once maneouvred through the market soundlessly. Various plans are being mooted to decrease their new influence. Most of these schemes would force regulation and revelation of the trades and investments of the big funds, and they may well be less effective and more complicated than a forced reduction in size.

HEARTTHROBS AND WALLFLOWERS ON WALL STREET

	Recent price	P/E ratio	1960–70 high
Heartthrobs:			
IBM	321	35	309
Johnson and Johnson	120	53	60
Xerox	155	47	115
Merck and Co.	95	46	58
Burroughs	228	46	172
Polaroid	139	101	145
Wallflowers:			
Alcoa	60	12	108
Inland Steel	30	8	50
Goodyear	24	8	34
Ford	53	5	62
General Tire	18	5	38
American Brands	39	8	55

Senator BENTSEN. Thank you, Mr. Callaway.

Mr. CALLAWAY. Thank you very much. We appreciate this opportunity.

[The prepared statement of Mr. Callaway follows*:]

PREPARED STATEMENT OF SAMUEL R. CALLAWAY, EXECUTIVE VICE PRESIDENT, MORGAN GUARANTY TRUST COMPANY OF NEW YORK

Mr. Chairman, members of the Committee: I am Samuel R. Callaway, an executive vice president of Morgan Guaranty Trust Company of New York and head of its Trust and Investment Division. With me are (on my right) Harrison V. Smith, senior vice president and deputy head of the Division, and (on my left) Robert B. Fiske, of the firm of Davis Polk & Wardwell, our counsel.

I thank the Committee for this opportunity to appear before it. I am esepcially appreciative because, along with many others who are engaged in the business of managing investments, I have been dismayed at certain misconceptions which have gained wide circulation concerning the role in our economy of institutional investors, particularly bank trust departments. It was with a view to promoting wider understanding of our function that we in Morgan Guaranty began publishing reports on our trust and investment activity. Copies of the two reports we have issued thus far have been furnished to the Committee staff, and I have brought an additional supply with me in case any members wish to have them.

In the Trust and Investment Division our fiduciary activities are concerned with three broad categories of work. First, we serve as trustee and investment manager for employee benefit funds, which are mainly pension funds for the employees of industry. The second category is the administration and investment of personal trusts and estates. The third is the providing of investment advisory service to individuals and institutions.

My statement concentrates on the first category, the trusteeship and investment of employee benefit plans. It is the largest of our three categories in amount of assets managed, and it is the category that in recent years has experienced the greatest growth. In addition, the employee benefit function most closely reflects our investment philosophy and policies, since it is the one category in which we typically have sole responsibility for determining how the funds are to be invested.

I think it would be useful to the Committee for me to describe briefly how we invest the funds which are set aside by employers to provide retirement benefits for ultimately some millions of their workers.

Let me say at the outset, because there has been a great deal of misunderstanding on this point, that a high price-earnings multiple is not uppermost in our minds in seeking out investment opportunities. Obviously, if two stocks had identical histories, identical current situations, and identical future prospects, and one sold for 30 times current earnings and the other for 15 times, we as an investor would choose the latter.

Our investment policy is determined by three basic characteristics of employee benefit plans which distinguish them from other major types of institutional investor, such as mutual funds. The most important characteristic is that the liabilities to be met by these plans are of a long-term nature. Typically, the trustee can foresee a net inflow of cash for a long period of time. This means he is confident he will not have to sell volatile securities in poor markets in order to pay out benefits, and he therefore can invest for optimum long-term results without undue concern over interim fluctuations.

The second distinguishing characteristic is that the funds, in line with the intent of Congress to encourage employers to establish pension and other benefit plans, are not subject to income or capital gains taxes. This frees the trustee from the tax-related inhibitions that affect many other investors.

The third characteristic is the fact that there is no distinction or conflict between income and principal, because both are dedicated to the same purpose of assuring benefit payments to the ultimate beneficiaries. A dollar of price appreciation is just as good as, but no better than, a dollar of interest or dividend income.

Our constant and overriding objective, as directed by our fiduciary responsibility, is to achieve the best possible results, consistent with prudent management, for the funds entrusted to our care. This objective has led us, having in mind the basic characteristics of employee benefit funds, to invest principally in common stocks and other equity securities.

*A subsequent letter of Mr. Colloway appears at page 264 of this hearing.

In buying or selling stocks, our emphasis is on selection rather than timing. When we sell stocks out of these accounts, it is not because we consider them overpriced at the moment, but rather because we believe the fundamental factors have changed adversely or because it has become clear that we made a mistake in buying the stock in the first place.

In sum, we are not traders. The profile of the typical portfolio under our management changes over time, but at a gradual pace. The activity rates and turnover of our employee benefit plans are noticeably low compared with those of other groups of institutional investors.

In selecting stocks we employ the standard tools of analysis. We look at a company in terms of the general economic framework, the markets the company serves, the competence of its management, the strength of its balance sheet, its history of progress in revenues, earnings, and dividends. We look at the price of the company's stock in relation to book value and to current and prospective dividend payments. We look at the quality of those earnings. We look at the ratio of price to earnings—not only to past and present earnings but, most importantly, to our projection of future earnings, since we are investing for the long term.

As earlier stated, between two stocks otherwise identical but selling at different price-earnings multiples, we would choose the one with the lower multiple. But if, in our judgment, the higher-multiple stock has far better future prospects, then it becomes a question of how much better, and the margin may be great enough to make that stock—again in our judgment—the better investment for the long-run purposes of a pension fund.

The ideal investment situation is one in which a stock can be bought at a relatively low multiple of current earnings and held while earnings increase steadily and substantially and the multiple rises. We are happy to be able to report that a number of the high-multiple stocks in the pension funds we manage were acquired, at least initially, when their price-earnings ratios were significantly lower.

This discussion of the relationship between stock prices and company earnings brings us to a subject which has occasioned a good deal of heated comment—namely, the present wide disparity in price-earnings ratios between some stocks and others, the so-called two-tier market.

Of course there is nothing new in the notion of a market having gradations—or tiers. What makes the present market different from markets of the recallable past is the greater margin of favor now enjoyed by a few stocks.

Contrary to an impression that many people seem to hold, the condition referred to as the two-tier market is not something that anyone has decreed or willed into existence. It is the product of a series of economic events starting more than a score of years ago and coming down to the present time.

Companies enjoying this kind of advantage were singled out for special recognition in the stock market. Their price-earnings multiples began to reflect their special standing. The upgrading, however, apparently went too far and too fast, because these were the stocks that suffered most in the market shakeout of 1962. Then came an unusually long period of freedom from either recession or rampant inflation. During this time, extending into the latter '60s, the distinctions drawn between companies on the basis of their resistance to adversity were less sharp, because the economy—and corporate earnings generally—kept growing fairly steadily.

The recession of 1969–71 changed that. It was different in configuration from the earlier postwar recessions. Instead of being short and steep, as they had been, it was long and shallow. Its adverse impact reached a greater number of companies. It had the effect of once again, and more dramatically, widening the market premium for the kinds of company that were able to come through the slump relatively unscathed.

This effect was reinforced by the imposition of price, wage, and dividend controls just as the economy was beginning to show improvement in terms of total activity. It became apparent that many companies could not produce earnings increases at a rate greater than the continuing inflation. The stocks of such companies naturally suffered, and this served to accentuate the preference for compaines more favorably situated.

The controls on dividend increases particularly affected the market status of stocks of cyclical companies. Many of these were held by investors who preferred current yield over other components of gain. With dividends held down,

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high-yielding fixed-income investments such as bonds became relatively attractive to those investors. The dividend limitations, on the other hand, were of little or no consequence in the market valuation of growth stocks, because investors in those stocks looked to dividends as sources of future rather than current income.

Now, with the recovery from the 1969–71 recession appearing to have run its course, the stocks of non-growth companies have had the down side of a cycle without the full effect of the compensating up side. Further, during the slow-down many companies that had previously been considered recession-proof fell from that state of grace as their earnings growth was impaired by the prolonged duration of the downturn.

This whole combination of factors, I believe, is the main cause of the present unusual disparity in the stock market's evaluation of companies which, at first glance, may not seem all that different in investment quality. It is not a healthy situation. But investors, whether institutional or individual, are not the cause of it. They are merely reacting to the situation they perceive. Blaming the two-tier market on investors is like blaming a rainstorm on the people who put up their umbrellas.

What can be done to restore a more even gradation of investor preference among stocks? I hope it is obvious to all that the answer does not lie in trying to force investors to stop behaving like investors. If we retain any belief in the ability of markets to allocate resources, it should be evident that the correction has to be more fundamental. What is required, in my opinion, is that investors become convinced that the economy is entering a period of sustainable growth with a lower rate of inflation than we have had over the past six or seven years.

As a matter of fact, right now some investors—and we are among them—are looking beyond the slow-down that seems to be approaching, and are appraising opportunities among companies currently out of favor but likely to find a better environment in the years ahead.

Concern has been expressed by yourself Chairman Bentsen and others about the ability of American industry to raise capital under the conditions that have been prevailing in the stock market. Without question, a company whose stock is selling at a very low multiple of earnings is reluctant to issue new shares. But let us look at what has been happening in the capital market in the period we're talking about. Last year net new issues of stock by U.S. corporations totaled more than $12.8 billion. In 1971 they were $13.4 billion. Those totals were well in excess of earlier years. In fact, in the preceding five years, 1966 through 1970, the annual total never got as high as $7 billion, and in 1968 it was minus figure.

Through the normal workings of supply and demand, the very high volume of new stock issues in the last two years has contributed to the general weakening of stock prices. As might be expected, new issues this year are running at a considerably lower rate, totaling—according to one industry source—just over $3 billion in the first six months. By historical standards, however, even that level is not exactly an indication of anemia in the capital market.

Low price-earnings ratios on their stocks don't hinder sound, well-established companies from raising money through long-term debt if they're unwilling to sell stock at current prices. How about smaller, younger companies that need to raise equity capital to finance their rapid growth? In this connection I would like to describe briefly what we have been doing about investment in such enterprises.

Back in the early 1960s we moved aggressively to increase the participation of funds under our management in investments in carefully selected companies of relatively small size. The attractions of smaller companies as investments for our trusts included the following: there is more room for them to grow in a given product or service market; they normally have greater operating flexibility than the big companies; they stand to get proportionately more mileage out of any one new product or other innovation they may develop.

On the other hand, we realized that there were drawbacks. Among them: greater risk, less liquidity in the investment, much greater expense—in proportion to the size of the investment—for the research and anlysis needed to make the investment and to follow it properly once made.

We felt we could overcome the drawbacks and preserve the advantages by applying the technique of commingling. This meant putting in one fund the investments we would make in smaller companies, and allowing the individual pension trusts to acquire units of participation in that one, commingled fund. By this method each participating trust would have a well-diversified stake in the smaller-

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company area, the inevitable disappointments among the investments chosen would not do serious damage to any one trust, and the problem of allocating relatively small numbers of shares among a large number of trusts would be solved.

So in 1961 we created our Special Situation—Equities commingled fund to invest in smaller companies, defined as those with market capitalization of up to $100 million. Later we established a fund to specialize in small-to-medium-size companies, those with total market capitalization between $100 million and $500 million.

At the end of 1972 the Special Situation-Equities fund has assets with a total market value just under a billion dollars, representing investments in 182 different small companies. The fund for intermediate-size companies had $600 million invested, divided among 86 companies.

In the two years 1971 and '72, through commingled funds we put $261 million into stocks of smaller companies and $356 million into medium-size companies, both as heretofore defined. The combined sum represented 84% of the total net investment made in common stocks for all our employee benefit funds during the two-year period.

Investments made by the smaller-company fund during the period involved 213 different companies. In the case of 75 of the companies, the investments were made in connection with registered stock offerings with all or part of the proceeds going as new capital to the companies who shares were purchased. In addition, 27 smaller companies received direct infusions of capital through purchases of securities by one of our commingled funds which specializes in real estate and housing investment.

I have cited these figures showing our involvement with smaller companies because I think there has been a widespread tendency to accept too uncritically the contention that large institutional investors invest only in large companies. Just within the past week, a widely read newspaper column dealt—as it often does—with this subject. It said by way of introduction: "The major banks with their enormous capital reserves have limited purchases to their 50 favorite stocks and their impact is such that there are reverberations all down the line." Then the column named two small, young companies as typical victims of the reverberations in that their own stock prices were suffering from the preoccupation of institutional investors with larger companies.

It so happens that our Trust and Investment Division, on behalf of pension trusts, holds 60,000 shares of one of the two small companies named.

There is a good deal of discussion these days about the individual investor's role in the stock market and how it is affected by the role of institutions. A frequent allegation is that the individual is "out of the market," and almost as frequently the explanation is given that the institutional investors have driven the individual out. I have seen no convincing proof offered for either proposition, and I have seen impressive evidence tending to refute both.

Figures published by the Securities and Exchange Commission indicate that individuals owned about 63% of all stocks in the United States, measured by market value, at the end of last year. It is true that this percentage has been declining gradually for a number of years. In 1960 individuals owned 70% of the total. It is also true that the proportion held by institutions has been increasing as that held by individuals has decreased. But individual ownership of 63% of the total is a long way from being out of the market.

Even as their relative share of total ownership has been declining, the absolute dollar value of individuals' total stake in the stock market has increased substantially. In 1960 it was $295 billion. At the end of last year it was $735 billion.

So far as trading activity is concerned, the most recent data are those compiled by the New York Stock Exchange from reports of its member firms for the first half of 1971. In that period individuals accounted for 40% of the share volume done in public trading on the Exchange and for 51% of the share volume in public trading on all markets, including the Exchange. (The term "public trading" here refers to trading done for customers, as distinguished from trading done by member firms for their own account.)

The Stock Exchange has not published data for later periods showing the distribution of trading between individuals and institutions, but it is reasonable to assume that individuals increased their activity in absolute terms in 1972 along

with the increase in total market activity, and that they have decreased it this year as total market volume has declined.

There is no basis for attributing this lessened trading by individuals in 1973 to the presence of institutional investors. Much more plausible explanations are the general downtrend of stock prices, the attraction of high yields offered by fixed-income investments such as bonds, concern about the well-advertised financial problems of the securities industry, and the general mood of uncertainty induced by political developments here at home and recurrent crises in the international money markets.

I know of no quick and easy way to increase the direct participation of individuals in the stock market. The achievement of convincing progress against inflation, with a consequent reduction in interest rates, and the resumption of a sustainable rate of economic growth with the expectation of a steady expansion in corporate earnings, would be the most powerful stimulants I can think of for the public appetite for equities. I believe any of us can predict with confidence that the combination of those events would produce a sharp increase in the absolute level of individual participation in the stock market.

As to the individual investor's relative participation, it is important to recognize that the gradual decline in the percentage of total ownership and activity accounted for by individuals is part of a fundamental social change. Society is restructuring the ways in which it saves a part of current production to provide for its own future.

The growth of the private pension system is the most visible manifestation of this change, but the continuing expansion of Social Security is also part of it, and so is the use of life insurance and mutual funds as a medium of investment by individuals. As a result, the investment process is becoming increasingly institutionalized and professionalized, but the investing is being done on behalf of individuals. To the extent that pension and profit-sharing funds, mutual funds, life insurance companies, and savings banks are investing in the stock market, the individuals whom they represent are actually in the market, albeit indirectly.

In concluding this statement, Mr. Chairman and members of the Committee, may I respectfully suggest that the current inquiry not disregard the findings which emerged in 1971 from the exhaustive study of institutional investing conducted by the Securities and Exchange Commission at the direction of the Congress. The Commission, in its letter transmitting the report of the study to the Congress, referred to its "important finding that institutional trading overall has not impaired price stability in the markets."

This, it seems to me, has important bearing on the whole range of interest that occupies the Committee in these hearings. Contentions that the situation is other than that found in the study, I should think, must bear the burden of proof.

Again, I thank the Committee for the opportunity to present this statement. I will try to answer questions that you may wish to ask.

Senator BENTSEN. Our next witness is Mr. I. W. Burnham II, chairman, chief executive officer, Drexel Burnham and Co., Inc.

Mr. Burnham, pleased to have you this morning.

STATEMENT OF I. W. BURNHAM II, CHAIRMAN, CHIEF EXECUTIVE OFFICER, DREXEL BURNHAM AND CO., INC., ACCOMPANIED BY MARK N. KAPLAN, PRESIDENT

Mr. BURNHAM. Thank you, Mr. Chairman.

Senator BENTSEN. If you would give us your name and position, then proceed with your testimony?

Mr. BURNHAM. Mr. Chairman, my name is I. W. Burnham the second, and I am chairman of the board and chief executive officer of Drexel Burnham and Co., Inc., and I have with me, on my right, Mr. Mark N. Kaplan, who is the president of Drexel Burnham and Co., Inc.

We are members of all principal stock exchanges and commodities exchanges.

We employ approximately 1,400 persons and have capital funds of approximately $50 million. We have 10 offices in the United States, 5 in Western Europe, 1 in Canada, and 1 in Tokyo, Japan. We are in nearly all areas of the securities business and have more than 50,000 public customers. In addition, a substantial part of our business is done with institutional investors, primarily acting as agent and frequently when dealing in over-the-counter market, as principal.

My own experience dates back to the fall of 1931. I founded Burnham & Co., April 1, 1935.

Because of the relative short notice of my appearance before your committee, I have not prepared a lengthy documentation of my position. I prefer to state what I consider to be facts concerning the subject matter and a summary of my personal views. I would like to point out that the opinions expressed in this document are my own and not necessarily those of Drexel Burnham & Co. Inc., or my associates.

FACTS

There is institutional dominance of the equity market as evidenced by the following:

(1) The New York Stock Exchange states that institutional trading has advanced from 35 percent in 1963 to 70 percent at the present time. While the institutional trading volume has been rising, the trading volume of individuals has declined in the same period from 65 percent to 30 percent.

(2) Concentration of holdings. A recent Business Week article stated that the 10 largest institutional investors taken together had investment portfolios excluding real estate totaling $156.4 billion. At the end of 1970 the personal trust departments of commercial banks administered investment funds were valued at $292 billion, of which approximately one-quarter was concentrated in just five banks and fully one-half in just 21 banks.

(3) Turnover ratio of institutions—since 1964, according to the New York Stock Exchange, has increased from 12 percent to over 30 percent.

(4) At the end of 1972 insurance companies, pension funds, mutual funds, and other institutions owned $258 billion of the $872 billion of New York Stock Exchange listed equities. These data do not include bank trust funds, estimated by the Federal Reserve in 1971 to be $343 billion.

(5) The unweighted stock market averages of the value line show that stock market prices are nearly 50 percent below their peak in 1968 and 6 percent below year-end levels in 1961.

(6) Excessive concentration of institutional holdings in approximately 30 "famous name growth stocks" appears to have affected the liquidity of the marketplace.

(7) Bloc transactions have increased substantially as institutional activity has increased and has led to concentration of institutional block business with fewer firms and has caused substantial portfolio losses for some firms.

(8) Negotiated rates have to some extent forced institutions to concentrate their business in order to receive the lowest commission rather than distribute the business more evenly throughout the securities in-

dustry. This has caused a considerable decline in income for some firms, principally small regional firms.

(9) The public investor has become discouraged, for many reasons including, (a) the problems of the securities industry itself, (b) excessive taxation, (c) inability to participate in most block transactions, (d) losses in their investment portfolios and (e) attraction to other forms of investment and/or speculation, such as savings banks, corporate and municipal bonds, real estate, and commodities.

SUMMARY OF MY PERSONAL VIEWS

I do not believe that institutions have been harmful to the economy, the public or the securities industry, and the blame for some of the disappointments and frustrations of investors in the securities industry should not be aimed at them. There is no question in my mind that the increasing trend to institutional dominance of the securities markets and dominance by a few very large financial investors carries with it certain risks which should be considered. Generally speaking, institutions have handled the funds of their clients relatively well, and if for no other reason than the fact that for the most part they do not borrow money, institutional accounts have not suffered greatly.

There have been many periods of our past history during which the stock market declines of major proportions have occurred which were primarily caused by the investing public, not the institutions. In particular, I recall the 1937–38 period when the stock market broke 50 percent in 6 months, entirely influenced by public liquidation. At that time my guess is that institutions were about 5 percent of the marketplace.

It is a fact that institutions have concentrated on a relatively few large growth companies and this has been a successful way for them to come up with good performance in recent years. These institutional holdings are now so large that I would venture to guess that many of them are having second thoughts as to the wisdom of continuing such holdings and/or adding to them. The result may well be that in future years better performance may be attained by institutions who in a balanced portfolio are willing to include the second tier of companies representing American industry presently selling on the bargain counter with high yields and excessively low price/earnings ratios. It is the marketplace which will determine the wisdom of investments, not regulation.

I am sure you are concerned with the fact that some financial institutions, principally banks and insurance companies, not only hold very large positions in the stocks of certain companies, but are also lending money to these companies and doing other forms of business with them. This may lead to conflicts of interest and some financial institutions have already voluntarily separated their portfolio accounts from the commercial side of the banks. It is a trend which should be encouraged.

In the quest for performance institutions in the past 10 years have from time to time invested in small unseasoned companies, and this trend accelerated since 1968 to the point that nearly every financial institution and investment trust had a growth portfolio directed to-

ward smaller companies. They were helped in this respect by the securities industry which poured out a record number of new issues to accommodate them and the public demand.

The result has been rather disastrous not only for the institutions but for the public and the securities industry. Many of these securities have collapsed precipitously from very high prices to a fraction of 5 percent to 10 percent of their former value. To some extent the collapse of these securities was caused by the institutions themselves, who in liquidating the positions were particularly impatient, and in many cases dumped the positions on the first bidder. In many instances, these secondary growth stocks have declined substantially while their earning power has been increasing. It appears to be more a reappraisal of price earning values and the relation to marketability than earnings disappointments. In areas where earnings were disappointing or nonexistent the mrket decline was even more serious.

It is evident that the marketplace with only 30 percent of the transactions going to public customers is inadequate to absorb this type of liquidation. Possibly a lesson has been learned by the institutions because many of them have retired from investing and/or speculating in small-growth companies. There are many instances of changes in policy which are leading to reinvestment of these funds into other less risky and more rewarding areas. This liquidation brings to light the fact that block positioning is extremely costly and dangerous in small companies and that more care must be taken in acquiring and liquidating this type of security. Other means must be found to increase the depth of the marketplace for smaller companies. There are many areas where the securities exchange themeselves without the need for new rules and regulations by Government bodies can encourage the use of special offerings and secondary distributions to improve marketability of smaller company issues.

In my opinion, certain steps have been taken by various agencies of the Government in recent years which have been unwise and adverse not only to the investing public but to the securities industry as well. Some of them are:

(1) The Federal Reserve Board changes the margin regulations much too often and usually appears to do it in order to affect the trend of the market. By reducing the right to switch securities dollar for dollar, the Federal Reserve Board has reduced the buying power of the public enormously. In addition, the Federal Reserve has approved over-liberal margin regulations for block trading firms to take unwarranted risks. It has also approved for margin far too many over-the-counter securities, many of which are relatively unliquid.

(2) The Securities and Exchange Commission and the New York Stock Exchange have collaborated in the practice of interrupting trading in securities without thorough investigation. There are few interruptions which do not cause large price declines and when one considers that the securities industry and the banks are lending money collateralized by securities, the decision to stop trading should be taken infrequently and only after thorough investigation.

(3) We are reading more and more suggestions by securities industry leaders that some controls should be placed on the liquidation of securities by institutions which hold the equivalent of controlling amounts of stock for their clients. It would seem to me in cases where an insti-

tution holds in total 5 percent or more of the outstanding stock of any company, substantial liquidation of a position might require that some disclosure be made in advance, and that a short form prospectus might be used primarily to point out the most recent public figures of the company and refer to the fact that the institution has no information of an adverse nature. In liquidations of this type, institutions should be encouraged to use secondary offerings, and underwritten offerings which would increase the opportunity of the public to participate rather than sudden block transactions which deprive the public of this opportunity and benefit only a few securities firms. Nothing should be done which would seriously undermine the liquidity of institutional portfolios because the marketplace has lost enough of its liquidity already.

(4) The reduction of public interest in the market and the reasons therefore have been covered elsewhere, but the important thing is to encourage the return of the public investor. In my opinion, your committee should give consideration to giving the public investor a tax break which would increase his appetite for equity investments. We need the decisionmakers who would prefer to invest their own money but have for one reason or another turned this decision over to others or have retired from the marketplace entirely.

There are tax benefits at present for pension funds, for investors in tax-free securities and for universities and institutional investors who pay little or no taxes. It seems to me that the overly high capital gains tax is a major deterrent to investment by individuals. Net long-term gains are taxed up to 35 percent before State taxes. I commend to you the brochure of the SIA entitled "Tax Reform on Your Capital Gains."

I believe that a reduction in the maximum rate on long term gains and reducing the holding period would attract small and large investors back to the marketplace. The recent suggestion of an industry member to permit an individual to retain $100,000 once during his lifetime free of tax is worthy of consideration. If we are to finance American industry, particularly the thousands of smaller companies, we must have risk takers, and they won't take these risks with the Government being a 35-percent partner and putting up none of the money. There are many other encouragements needed by risktakers and decisionmakers which you are probably well aware of, such as the end of profit controls on business, complete end of controls on dividends and less expensive money or interest rate.

5. Another area worthy of comment is the fact that for the past 40 years the SEC has been engaged in ruling the insider out of the marketplace. For the most part the rules have completely discouraged officers, directors, and their families from ever contemplating a short term transaction in their own companies. You are no doubt well aware that a short term transaction at a profit made in a period of less than 6 months requires a return of such profit to the corporation. This means that any decision to buy or sell stock by an insider must be a long term decision. I think it is time to review these rules in the light of the need for liquidity in the marketplace.

There is no question in my mind that in the past 6 months the market would have received a tremendous amount of help from officers and directors of corporations if the 6 months' rule had been changed.

I think it is time to be less suspicious of people and to permit such transactions on a shorter term basis, provided there is no insider information upon which the decision to buy or sell is being made.

In closing, I recommend to you that the solution to the problems of the marketplace is not to drive the institutions either from it or into inactivity. The pressing problem is to increase tremendously the public interest in order to broaden the market for the secondary and smaller companies, whose corporate needs must be satisfied, and in which institutions for the most part are not interested.

Thank you very much for your attention.

Senator BENTSEN. Thank you very much, Mr. Burnham. I would certainly agree with you that I, for one, have no desire to drive the institutions out of the market. I want to see them in there. The objective, obviously, is to try to find a way to bring the private investor back into the market.

You made an interesting point that perhaps in the event of an institution owning more than 5 percent of the outstanding stock, that they have some kind of short form prospectus. Would you elaborate on that a little bit?

Mr. BURNHAM. Well, there have been cases, which I can remember, where more than one institution have gotten together on a block transaction, aided, of course, by a block trader or broker, and in the course of a few minutes, sold in excess of 10 percent of a company's stock——

Senator BENTSEN. You realize the previous witness testified he knew of no such instances insofar as his company was concerned.

Mr. BURNHAM. I would suggest, well, I am not privileged, of course, to what takes place in one banking institution; I am sure whatever he said is correct.

Senator BENTSEN. But you do know of instances where at least others have done so?

Mr. BURNHAM. Well, firms that are engaged in block businesses generally like to cleanup the market and if they know there are three institutions around that have blocks to sell, they don't want to take just one. It is a marketing problem.

And one institution could be a seller without necessarily knowing how much others are selling, but there was a case, I think some years ago, where National Airlines, if my memory is correct, where over 10 percent of that company was sold one afternoon without registration. There were three selling institutions, and the people that bought the stock did very well in it, but my point is, Senator, that the controlling stockholder and insiders have certain rules which they must abide by. And it seems to me that when an institutional portfolio gets that large, it is very similar and the rules ought to be less onerous because they may not be insiders at all. So notice should be given by institutions of an intent to sell and some orderly fashion be established to protect the marketplace.

Now, I have heard that this might collapse the market, but I refer to you the fact that we have seen huge distributions by States, by big sellers who have been registered and not only it didn't put the market down, but it actually put the market up.

Senator BENTSEN. Senator Bennett?

Senator BENNETT. I don't have any questions.

Senator BENTSEN. Do you have any tax proposals which might encourage small investors to enter the market?

Do you think that capital losses should be treated in the same manner as capital gains?

Mr. BURNHAM. I am more concerned from the point of view of the investor, in the treatment of capital gains. I think most people when they make investments expect to make money, and it just comes down to the fact how much they will give up if they happen to be right in their selection. And I like very much the thought that you apparently have or are discussing whereby, if a man has made a capital gain and wants to change his investment, that he be able to postpone that capital gain and move into something else. You know, very frequently people have capital gains on companies that may pay very small dividends and their situation changes and they need income and to get that income they're faced with huge taxes, whereas if they didn't have to pay that tax, they could move into some stock like American Telephone without having given up that much money in the form of taxes.

So I think the most encouraging thing is that you're giving some thought to that and also to something that was suggested by Chairman Mills, which sounded interesting to me, which was to reduce the tax; in other words, the longer you held a security; the less the tax became. I think the thought of going to a 1 year holding period even makes the present situation worse. I think a 6-month's holding period is too long. If you really want to get the public back into the equity market, it has to have some tax encouragement, just like when you wanted to get the country out of the doldrums of the Depression in the past, you have given corporations tax incentives to build a plant and to do other things.

Senator BENTSEN. Mr. Burnham, the testimony we had is that the individual investor is more a long term holder than the institution is, and that he isn't the trader the institution is.

Mr. BURNHAM. I would say that is one of the reasons why we have a market which is much less liquid than it should be, due to the tax rules and due to the other things that have been going on in the financial community, and let's say the fact that he feels that he can't get in on the block transactions and so forth, so that most of them have become long term investors.

We do need, as I said in my paper, more risk takers who are interested in attempting a short term transaction because the need of the marketplace is for people who are willing to go for the short trem.

Senator BENTSEN. Do you think we can justify a different capital gains treatment for stock market investments than for real estate transactions, for example?

Mr. BURNHAM. Well, as far as the stock market is concerned, it seems to me, if you define a person who handles his own money and makes his own decision, and not someone who turns it over to somebody else to make those decisions, and you identify that person as a risk taker and a decisionmaker, that type of person I should think should be encouraged and would help bring the participation we want back into the marketplace.

Senator BENTSEN. Are you saying you would give him a different tax treatment than one who turns his portfolio over to an investment adviser for investment?

Mr. BURNHAM. Yes, because the person who turns it over to investment advisers, and we are investment advisers, isn't making his own decisions.

Senator BENNETT. Before you leave that, may I interrupt?

Senator BENTSEN. Yes, Senator Bennett.

Senator BENNETT. We already have one situation in which capital gains can be deferred by reinvestment which is in the purchasing of a home. Now if your idea was followed to its ultimate, if a man could take a piece of capital gains—let's say on $100,000—and invest and reinvest it without capital gains, then you would find it in his estate—and if you carried it to its ultimate—his estate would go through the inheritance tax without paying capital gains, and I think that is a problem.

Mr. BURNHAM. The point is, Senator, if he dies, he does pay an estate tax on the value of his estate.

But, obviously, if you made it exactly like it is on the homes, you would give him complete exemption and I can see why it is not practical to expect a complete exemption, but we need some change, because the rate of taxation is so high. Now, in Europe, you know, for many years, they had no capital gains taxes because many foreign countries do not believe that is the type of taxation that should be applied. It seems to me that since capital gains tax has been applied in Europe, those European markets have, like ours gradually become less liquid. There is no liquid market in Europe except Japan, where there is no capital gains.

Senator BENNETT. In fact, if you are going to give them a partial exemption, what you do is reduce the rate?

Mr. BURNHAM. Yes.

Senator BENNETT. That is the way to give a man a partial exemption. So you are back to where we started; you think perhaps the rates and the present time-pattern terms are too stringent.

Mr. BURNHAM. I think they are. I refer to that in my statement.

Senator BENTSEN. Thank you very much, Mr. Burnham. We appreciate your testimony.

Our next witness is Robert W. Farrell.

Mr. Farrell, we are pleased to have you. Would you state your name and position and the name of the firm that you are associated with?

STATEMENT OF ROBERT W. FARRELL, EXECUTIVE VICE PRESIDENT AND DIRECTOR OF RESEARCH AT BACHE & CO., INC.

Mr. FARRELL. Yes; my name is Robert W. Farrell, and I am an executive vice president and director of research at Bache & Co., Inc.

Senator BENTSEN. Will you tell me what percentage of the volume of your business is institutional business?

Mr. FARRELL. The best figure we have is 17 percent. Probably higher this year. It is 17 percent based on last year's figures.

Senator BENTSEN. Do you think that that low a percentage lets you deal with the subject with objectivity?

Mr. FARRELL. Yes, sir.

Senator BENTSEN. All right, proceed.

Mr. FARRELL. Senator, would you like me to read the whole statement?

Senator BENTSEN. No; I would like for you to summarize it if you will and we will put the entire text in the record.

Mr. FARRELL. All right; I will go ahead. I can summarize it in my own words, in 5 or 6 minutes, I hope.

First, let me emphasize that my experience has been in the research field. I have been on both the institutional side and the retail side. Therefore, I don't think I will attempt to testify in detail on tax matters or commission rates, but will discuss the things I know best and I think you would be better served if I did.

When I studied the problem of whether or not the institutions have caused problems for the stock market, I identified five major problems, all of which to some extent are tied in to the institutional problem or what is known as the institutional problem.

First, the most obvious is that many individual stocks have lost liquidity. We are all familiar with the fact that in recent years certain stocks can go down 10 or 15 or even 50 percent in a single trade.

No. 2, it is obvious that the average private investor has done very poorly in the stock market in the last 5 years, and that, in itself, is a problem. A related problem is that many companies and industries find it virtually impossible to raise equity capital through public sources at the moment, and that is obviously a problem for the whole economy.

Next, we hear much about the so-called two-tier stock market. There is no question that it does exist. I believe that the gap between the supergrowth stocks and all other stocks is, historically, very wide and probably wider than it has ever been.

Finally, brokerage and investment banking firms are in severe financial straights at the moment. Most of them are losing money and obviously capital is less strong than it was a few months ago.

Senator BENTSEN. Would you explain that?

Let me interrupt there.

The volume of trade is now much higher than it was 5 or 10 years ago. Five or 10 years ago those brokerage firms seemed to be making good money, and now, even with much higher volumes, they are losing money. Could you explain that?

Mr. FARRELL. I think there are two general answers to that. One is inflation. Overall, it has been a problem, but in particular, it has been a problem in any service industry, and, remember, the brokerage business is a service business. I believe well over one-half of our costs are people costs; that is, paying our people. And I think that element of inflation has been far greater than the total figures on inflation would suggest. No. 2, we have a real business problem in the brokerage business, and that is the inability to predict what level of business we are going to have, not only next year or 5 years from now, but tomorrow. We have no good way of determining what the volume is going to be, so we literally have to be geared up for 20 million or 25 million share days, when we might just as well average only 10 million shares. And we have big fixed costs. I think with hindsight we made a big mistake in that we projected the volume as it had been for the sixties, into the seventies—therefore, we ended up with more capacity now than we can use. So, we are all in the process of cutting back, but frightened that we will cut back too much, and then not be able to handle the volume, when and if it comes back.

Senator BENTSEN. Couldn't you save a lot of expenses on research people by just taking some of these portfolio managers down to Delmonico's for lunch where they are discussing the big institutional investments? Couldn't you do that and find out what they're buying and selling?

Mr. FARRELL. I don't think so, Senator. I think what we would find is that Morgan Guaranty was buying when the Bankers Trust was selling and vice versa. An awful lot of that always occurs.

I have never been able to distinguish any pattern whereby, let us say, in the mutual funds who do publish figures of what they have done— I have never seen any evidence that it helps an investor to know what they're doing because they usually act in opposite ways from each other.

Senator BENTSEN. Well, I heard a lot of people speak to the contrary. They say that today the game is to try to guess what the large institutions are buying rather than to deal in the fundamentals that in years past were crucial in buying a particular stock.

Mr. FARRELL. Well, I have heard a lot of such talk, too, and I still don't believe that it makes any sense. I doubt that there is any overall record of success by those who have tried it.

Senator BENTSEN. Well, if you would proceed.

Mr. FARRELL. I think I mentioned the side-effects of problems that are related to the institutions and blamed on the institutions.

I would argue strongly that, while the institutions are responsible for some of the problems, by no means are they responsible for all of them.

I would point out a few things in my own experience which show that there are other causes. First, when we talk about the overall stock market being down and the fact that the public has been hurt, I think a far greater portion of the blame must be attributed to the fact that we have been unable to lick our big inflation problem in the last 5 years. As inflation has gotten worse, and as inflationary expectations have gotten worse, interest rates have gone up and the public has been hurt and lost confidence in the market.

Number two——

Senator BENTSEN. Let me ask you on that first one.

Mr. FARRELL. Yes, sir.

Senator BENTSEN. During phase 2 our inflation was held down to an annualized basis of 4 percent. which is as low as any of the major industrialized bodies in the world, and yet our stock market behaved badly. In other nations—some of those inflation rates were higher than ours—their stock markets were behaving rather well. Now, how do you explain that?

Mr. FARRELL. Well, Senator, my recollection——

Senator BENTSEN. If inflation is the problem?

Mr. FARRELL. Well, my recollection is that during phase 2, which ended early this year, the stock market had begun to act well, because it was at that time that the Dow-Jones had reached and exceeded 1,000 and it was in a state of euphoria, I believe, because it looked as if we were making progress incurbing inflation. Then along came phase 3, and for a variety of reasons that confidence deteriorated and all of a sudden investors then began to worry that, "Maybe we are not solving

our inflation problem after all." Things went from bad to worse then, I think expectations went down and, therefore the stock market went down.

Senator BENTSEN. Well, then, how do you explain some of the foreign markets where inflation was considerably worse than ours.

Mr. FARRELL. Well, simply, I think the foreigners noticed during phase 2 that our rate of inflation was, indeed, a lot less than theirs, and during that period the dollar was relatively strong and the price of gold was not going through the roof, so a lot of the foreigners began to invest in our market——

Senator BENTSEN. No; I'm talking about foreign markets themselves.

Mr. FARRELL. Oh, I'm sorry. I thought you meant foreign investments in our market.

Senator BENTSEN. They were having inflation rates substantially higher than ours and yet some of those foreign markets behaved fairly well.

Mr. FARRELL. Sir, I don't really have a good answer to that question.

Senator BENNETT. Could it be that inflation has been over the years more clearly a way of life in the foreign countries than it has been here, and those people tend to discount it.

Mr. FARRELL. Well, that is a good point, I think, Senator, because when I talk about the stock market fearing inflation, I believe it isn't so much the fear of inflation as it is the fear of the remedies for that inflation. I think perhaps there is a greater willingness overseas to live with it than there is here.

Senator BENTSEN. So you are worried about monetary control, and so on.

Mr. FARRELL. And that we will have to force a recession on ourselves to solve the problem. I will proceed with my summary.

I would point out on the question of liquidity, a number of other things that I have run across as an analyst. One is the fact that our rules concerning inside information are so much stricter today than they were 5 or 10 years ago. I believe that fact contributes to the liquidity program and has nothing to do with the institutional existence in the market. It used to be that when a security analyst visited the financial management of the company, he could get a lot of pretty good information, none of it really breaking the rules, but in hindsight some of it might today be described as inside information. It wasn't at the time, and the net result was that bad news had a way of seeping out slowly and could be absorbed by the marketplace gradually, whereas today I find that corporations lean over so far backward not to even hint of bad news, that they wait until they are sure it is noteworthy, then they announce it publicly.

Senator BENTSEN. How would you characterize equity funding in that respect?

Mr. FARRELL. You mean in what respect?

Senator BENTSEN. The inside information and how it became available.

Mr. FARRELL. I think that broke the rules, Senator, and was wrong.

Senator BENTSEN. Would it have broken the rules in the old days?

Mr. FARRELL. Yes, I believe it would.

Senator BENNETT. Let's put it another way, if the old rules were still in effect, would there have been the same temptation to work this way?

Mr. FARRELL. The same temptation on the part of the analyst or——

Senator BENNETT. Allowing the insiders to move.

Of course, equity funding was a fraud operation to start with anyway.

Mr. FARRELL. That is why it is separate from what I have been talking about. I think the rules of fraud have not been changed, and I think it would have been a fraud 10 years ago, as it apparently was recently.

Senator BENNETT. Maybe I should have said under the old rules could the fraud have been kept alive longer?

Mr. FARRELL. I don't see how, Senator. Ten years ago there was enough surveillance on trading activities, for example, to have started some kind of an investigation. I was a practicing analyst 10 years ago, and I am certain I would have known at that time that it would have been bad for me to go to a single customer and say, "I think there is a fraud afoot, and I want you to know about it first."

Senator BENTSEN. All right, sir.

Senator BENNETT. Excuse me for interrupting.

Mr. FARRELL. I will proceed on the question of liquidity.

I also believe that the mania for performance, if you will, has led to illiquidity and tends to be a self-fulfilling prophecy. Many investors, even public investors, when they get wind of the fact that there is bad news will immediately say, "Oh, this means somebody else will start unloading his stock, so I better unload mine before he unloads his."

I think this process ballooned, but I don't think it was limited to institutions. I think many retail brokers and many retail customers have learned to expect it to act accordingly.

Next, on the so-called two-tier market. I mentioned earlier that it certainly exists, but I think there is a logic for it and, again, it cannot be blamed on the institutions or held against them in any way. The logic is that history has shown, especially in the last 10 or 15 years, that the stock market overall doesn't protect one against inflation, but individual stocks do. If the individual stocks are well managed and highly predictable growth stocks. I suggest that those stocks that comprise the favorite 30 or 50 or whatever the number is, really fall into a logical pattern of security analysis. In other words, these companies for the most part, have a rapidly growing demand for their products or services, they are well managed to the extent that they all earn a high return on investment, and they are good enough at whatever they do to do it better than their competitors. All of these attributes have put them on the upper tier. These are things I learned as a securities analyst to distinguish attractive stocks, so I don't think it it is reasonable to say that the institutions have a giant conspiracy going on. I think it is the two-tier market, just a logical outgrowth of a rational approach.

Senator BENNETT. Aren't most analysts serving the retail public aware of those potentials, and aren't they advising their clients the same way the professionals on the inside are advising the corporations?

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Mr. FARRELL. Yes and no, Senator. I think, yes; that was true, going back 6 months or a year ago, but I see now a trend in the opposite direction because the gap has become so wide that perhaps the risks now are too high. For us to start at this late date to tell our individual customers to buy Avon—well, I better not use individual names—but to buy some of the high price earnings, ratio stocks, might be wrong because the risk-reward ratio at this stage is very much against them, and also because of the great fear that the holders will start to sell all at once.

So, in a sense, I am saying I think the problem may be self-correcting, because the gap now is so wide that there are many very fine companies that sell at seven or eight times earnings and that pay dividends yielding 6 percent. I think that type of investment attraction is becoming more and more obvious to investors, and I think probably it will help solve the problem of the two-tier market.

Senator BENNETT. You are getting more diversity of recommendations because there are more and more stocks moving into that area?

Mr. FARRELL. Yes; that is correct.

Senator BENTSEN. You may proceed.

Senator BENNETT. That is all the questions I have.

Senator BENTSEN. One of your recommendations is that investment research of equal quality and timeliness should be made to both individuals and financial institutions. Is that possible?

Mr. FARRELL. Yes, sir, I think it is and I think we do it at my company. I know we do it.

Let me expand on that a little. We have an internal rule—and it has been in effect for as long as I have been at Bache, and longer—that anytime we have a new research recommendation, we make it available to our wire system, which automatically transmits it to everyone of our over 100 branch offices at the same instant and it is available to all salesmen, whether they cover retail sales customers or institutional customers.

Senator BENTSEN. Do you think you are the exception or is that the rule?

Mr. FARRELL. I think it is probably the rule.

Now I don't know for certain, but I don't know of any case where it is not the rule.

And as far as equal quality, Senator, I make sure in our own research department that the amount of research, the amount of comparative analysis, the amount of internal screening is identical for a report that goes to an individual client or an institutional client. The difference is in the way we market it, in the length of the report we write, and in many cases the person who talks to the customer. But the quality, I believe, is identical.

Now, let me proceed, if I may. I think to some extent the problems we characterize as the institutional problem, or problems, will correct themselves as the market becomes healthier and as investment managers realize that the gap between the two-tiers of the market is so wide that it makes sense to be looking at the lower tier right now. I think, for example, that foreigners have noticed the fact that many of our companies are selling at well below book value and well below 10 times earnings. Lately we see a lot of publicity to the effect that foreign companies are looking to buy some of the U.S. companies. That,

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I think, is reminding American investors that some of those stocks are real bargains, and we ought to be buying them. I think this has become noticeable in the last few weeks.

In our company we see the public coming back in, and coming back in to the low-priced earnings, high yeld, and good value stocks.

Senator BENTSEN. Do you think this act of highlighting it or putting the spotlight on it in effect is having a beneficial effect?

Mr. FARRELL. Yes; I do. But I don't mean to say that we can ignore the problem and it will take care of itself. I hope it does, but I don't think we can rely on that. So I honestly believe that it is the proper concern of your subcommittee and your committee, and it is the proper concern, certainly, of the brokerage community. And I think, as I said in my statement, there are a number of things that we can do, all of which are directed towards encouraging the public to come back into the market.

Senator BENTSEN. You have made a number of suggestions here and we appreciate those. We would like to deal specifically, if we can, more with those areas where we would have the jurisdiction of the legislation.

Mr. FARRELL. All right.

Senator BENTSEN. The rest for background information is helpful to us.

Mr. FARRELL. Yes, sir.

Senator BENTSEN. Do you have any particular recommendations taxwise as to what you think should be done to encourage the individual investor?

Mr. FARRELL. I think——

Senator BENTSEN. Or some suggestions?

Mr. FARRELL. I think, Senator, as far as I have gone, I have studied the testimony given on other occasions by the New York Stock Exchange, and I suspect that you will hear more of it tomorrow. I endorse their recommendations and our people similarly endorse their tax recommendations. I don't have any suggestions other than those that they have made already.

Senator BENTSEN. Senator Bennett?

Senator BENNETT. I just had one question—out of curiosity—and it is outside of the tax field.

Over the last few years we have seen some very spectacular activities in particular stocks, the glamour stocks. I wonder if as the volume increases whether the level of research is being maintained, or whether there aren't some hotshots moving into the area of giving advice, giving investment advice, who really are not capable of doing their job? And I wonder how much trouble they might be causing to individual investors with their shortcuts and the advice of these people who are interested only in the glamour stocks and that sort of thing? I wonder if the individual investor is getting a high level and reasonably consistent level of investment advice.

Mr. FARRELL. Well, Senator, I think that is a very good point. Your first question was, as volume increases, do I think the level of research deteriorates? In many cases I think, yes; it does. On the other hand, as volume increases, the brokerage community becomes more profitable

and can afford more research. So on an overall basis when volume is high, we probably do a better job, yet that does allow room for just what you were talking about, the relatively unqualified person coming in and recommending a stock purely on a concept, if you will. Looking back 3 or 4 years ago, apparently there was a lot of that done by securities analysts who really weren't trained as securities analysts.

There is in my statement a recommendation that before long, I believe analysts public brokerage firms should have professional credentials, and the one I suggested is the CFA, which means "chartered financial analyst." Anyone who becomes a CFA isn't automatically a superior analyst, but he must have had sufficient academic training and passed enough examinations to convince us that he does at least have a good chance of being good at his job. We don't have those standards now, and I think we should.

Senator BENNETT. That is further institutionalizing the operation, but I think he is right.

Senator BENTSEN. Under the Investment Company Act of 1940 some mutual funds cannot own more than 5 percent of the stock of a corporation. What would you think if that same rule was applied to other financial institutions?

Mr. FARRELL. Overall, I think it makes good sense. I am not aware of it having caused any major problem for the mutual funds, Senator.

I think it would fit in with my philosophy in that it would tend to convince the public that we are trying to have less problems of liquidity in the future than we had in the past. However, I think Mr. Callaway made a very good point, that I hadn't thought about before, and that is, if you pass such a law, you encourage big institutions, such as his, to concentrate even more on very large companies, so that that has to be thoroughly thought out before we jump into it.

Senator BENTSEN. Well, one of the other witnesses suggested that perhaps a short term prospectus should be used in underwriting when large blocks of stock were held and they had to be disposed of?

Mr. FARRELL. Generally, I would be favorably inclined to that—again, on the grounds that I think it would be reassurance to the public in order to convince the private investor that he is not being manipulated or cheated. In a way, that is the heart of the problem. As you yourself said earlier, Senator, a recent survey said 70 percent of the public thinks that the stock market is manipulated. I don't think that and I don't think any of my peers in the brokerage business think that, but if the public thinks it is true, then it is a real problem.

Senator BENNETT. No further questions.

Senator BENTSEN. Well, thank you very much. Your statement will be placed in the record.

[The prepared statement of Mr. Farrell follows:]

PREPARED STATEMENT OF ROBERT W. FARRELL, EXECUTIVE VICE PRESIDENT BACHE & CO. INC.

My name is Robert W. Farrell. I am an Executive Vice President of Bache & Co. Inc. As you may know, Bache & Co. is a large publicly owned brokerage and investment banking firm with over 100 branch offices in the United States and abroad. We deal in a broad variety of financial products and services including stocks, bonds, commodities and mutual funds, and do business with both individual and institutional investors.

My principal function at the company is Director of Research. In addition, I am involved in broader management activities as a member of the Executive Committee, and during the past year have had overall responsibility for institutional sales. My Wall Street experience is somewhat unusual in that I have had considerable experience in both retail and institutional firms. For eighteen years I was on the institutional side of the securities business, and for the past six years have been employed by big broad-line firms.

I believe the purpose of this hearing is to investigate the problems that have arisen from the rapid growth of institutional investment in the stock markets. I naturally have opinions on many of these problems but I think it would be appropriate for me to confine my discussion chiefly to the areas of my own experience. Accordingly, I will emphasize the research and sales involvement in this discussion, but will not attempt to deal in depth with either the structural aspects of the financial markets or the problems of commission rate structure.

THE NATURE OF THE "INSTITUTIONAL PROBLEM"

As I see it, there are five major problems that have received much attention in recent months, all of which are to some extent related to the fact that financial institutions now represent a major, or even dominant, force in the stock market. These five problems are:

(1) Many stocks have lost liquidity, as evidenced by the severe price declines that often occur in individual issues on a single day.

(2) The average public investor has achieved unsatisfactory results in the stock market during the past four or five years.

(3) Many companies and industries find it virtually impossible to raise equity capital in today's stock market.

(4) Most brokerage firms have been losing money in recent months.

(5) We now have a "two tier" stock market in which a small group of institutionally popular growth stocks are selling at lofty price-earnings ratios while most stocks sell at near-record low prices.

I believe that all of these problems relate to the public interest, and, thus, are properly the concern of Congress.

There is no doubt that the rising influence of institutions has had some effect on each of the five problems, but it is by no means accurate to state that the institutions by themselves are responsible for the problems. Indeed, the price of a stock often drops sharply and suddenly because an institution decides to sell a large block of stock, but just as often the cause is something else. For example, the announcement of disappointing earnings for a company can cause a stock to drop suddenly even if that stock is not widely held by institutions. A few years ago such an announcement would probably have resulted in a much less severe reaction because the impending bad news would have been widely known or suspected beforehand. Nowadays, however, the strict regulations concerning inside information cause corporate managements to treat significant news with utmost secrecy. Consequently, it is inevitable that we have more frequent sudden surprises. I am by no means suggesting that the rules on inside information be relaxed, but am merely pointing out that this is a cause of illiquidity that we must learn to live with.

Another contributing factor to sudden price changes is the reduction in numbers of brokerage firms providing investment research. As this has occurred, the remaining firms have achieved greater influence and at least a small handful of them are able to dramatically affect the price of a stock immediately upon changing their opinion from buy to sell or vice versa.

It is similarly unreasonable to argue that the institutions deserve the blame for the poor stock market results of the public. Admittedly, the "two tier market" suggests that institutional investors have achieved better performance than the average individual investor, but it is difficult to find a cause and effect relationship. In my opinion, the major reason for the poor investment results of the typical private investor is inflation. That problem, which in turn has led to high interest rates, has diminished the attractiveness of stocks in general and has shifted attention to growth stocks as one of the few ways of beating inflation. The fact that institutions adopted this philosophy—which happened to be in contrast to what most individual investors were doing—can hardly be something for which there can be any blame. On the other hand, there has been much negative publicity suggesting that institutions receive favored treatment in terms of research information and price concessions. This unquestionably has

contributed to the loss of confidence in the stock market by the public, and has probably caused stock prices to decline more than they would have otherwise.

The inability of many companies to raise equity capital under existing stock market conditions is chiefly attributable to the relatively low level of the stock market as a whole. Any institutional influence on this state of affairs exists only in the fact that their investment concentration in the established growth stocks has absorbed funds that might otherwise have supported the stock prices of many other excellent and well-managed companies that lacked either growth characteristics or sufficient size to meet the requirements of major financial institutions.

The fact that institutions, during the past few years, have paid much lower brokerage commission rates than formerly has, of course, been a contributing factor to the reduced profitability of the securities industry. Once again, however, there are a number of other important causes such as reduced stock market volume, smaller need for outside financing by American industry, and the rapid pace of inflation, especially in service industries.

Overall it seems reasonable to conclude that institutions have at least inadvertently been responsible for much of the current stock market trouble, but it is equally reasonable to say that there certainly has been no giant conspiracy among them, and that there is much more to the problem than the institutions. Accordingly, I would urge the Subcommittee not to expect that the problems would be solved solely by regulating the investment practices of institutions.

POSSIBLE SOLUTIONS TO THE PROBLEM

I believe there is a good chance that most of the problems described above will be self-correcting. First, if the stock market were now to begin a strong and sustained upward move, most of the problems would disappear, and those that remained would be easy to live with. Even if the market does not go up, there are convincing reasons to believe that the large gap between the favored growth stocks and all other stocks will narrow. On the one hand, many of the non-favored stocks appear to be almost incredibly undervalued, and on the other hand there is a growing number of institutional money managers who feel that the risks of high price-earnings ratios and illiquidity in the established growth stocks are excessive. Consequently many of them have already started to shift emphasis away from the big name growth stocks.

Unfortunately, we cannot rely on self-correction to solve the problems because this would require us to be certain that the market will perform as we expect it to perform. Personal experience suggests that such certainty will never exist.

Our view is that the most promising approach to solving the so-called "institutional problem" is to develop a program that will bring the public back into the stock market. In a sense the institutional problem arises because the institutions are large, there are relatively few of them, and their investment objectives and constraints tend to be similar to each other. The public, on the other hand, has opposite characteristics: they tend to be small investors, there are huge numbers of them, their objectives and ability to take risk range all the way from ultraconservative to wildly speculative, and they can just as easily buy stocks in small companies as in large ones. Thus, it is obvious that the public investors' increased presence in the stock market could do much to restore liquidity to individual stocks, and bring an end to the two tier market. At the same time, it would facilitate the raising of equity capital by small or unknown companies, and it would be a very welcome development to large firms such as Bache and Co. Last, but not least, the return of the public investor to the stock market could hardly have anything but bullish implications for the overall level of stock prices.

Before discussing some thoughts about how we can encourage the public to come back into the stock market, let me say that I realize there are other steps that probably must be taken to solve the problems we are discussing today. For example, I believe we need a central market place, a strengthening of the auction market and perhaps a change in brokerage commission rates. However, as I suggested earlier, I think the Subcommittee could be better served if I confine myself to subjects where my own experience is greatest.

The first question to answer when one talks about encouraging the public to buy stocks is whether or not it is in their best interest to do so. Since that question is not really the subject of this hearing, let me cover it briefly by stating

that we at Bache & Co. are strongly convinced that the stock market currently represents an unusually attractive investment opportunity. As always, there are risks involved in owning stocks, but we think the risks are outweighed by the depressed priced levels of most stocks and the likelihood that we will experience a slowdown in the rate of inflation and a continuation of long term growth in corporate earnings and dividends.

HOW TO ENCOURAGE PUBLIC PARTICIPATION IN THE STOCK MARKET

The job of convincing the public to participate in the market is, unfortunately far more complex than making a case that the stock market will go up. A strong market would indeed provide an incentive, but we see an urgent need for the additional incentive that would be provided by changes in the tax laws applicable to individual investors. I strongly endorse the recent recommendations on this subject made by the Securities Industry Association, and the New York Stock Exchange.

I believe the key to attracting the public back to the stock market is fairness. The individual investor must receive the same level of service as the institutional investor, and equally important, he must *believe* he is receiving the same service. Because of the latter point, I feel that we need a cooperative effort by Government and the securities industry to develop such a program. The industry is willing and able to be fair, but the public probably cannot be convinced of this fact without additional legislation designed to insure fair treatment.

Below are listed some of the elements which I consider essential in encouraging the private investor. In most cases they involve the question of fairness between the two classes of investors, and in some cases allude to the programs undertaken by Bache & Co. to win back the individual investor.

(1) Full disclosure of all institutional purchases and sales should be required. The extent to which institutional trading causes sudden and severe price changes should be minimized. To cope with the problem Bache & Co. recommends the establishment of a joint study group between the securities industry and the Federal Government under the supervision of the SEC.

(2) Investment Research of equal quality and timeliness should be made available to both individual and financial institutions. At Bache we have a single research division serving both markets, and every new recommendation is made available simultaneously to all our institutional and retail sales representatives. In practice, we often send reports to institutional clients that are more lengthy than those sent to individuals, but the opinions are identical, and the individual can obtain the longer report if he wishes.

(3) Brokerage and Investment Banking firms must provide increasingly professional assistance to the investor. The varied skills of research, portfolio management, order execution, and custom service must be made available to all clients. Perhaps legislation is required in this connection. For example, I would recommend that within a few years, all research analysts employed by brokerage firms be required to have earned a CFA. Those letters stand for Chartered Financial Analyst, a designation which implies that the holder has fairly extensive training in the field of security analysis.

At Bache we have attempted to help our individual clients by providing broad portfolio management advice in addition to our recommendation on individual stocks. Another service, which we think is particularly responsive to the needs of individual investors is our Account Management Service. This is a system whereby I, as Director of Research, send a letter directly to certain clients after the Research Department changes its opinion on a stock. These letters are sent to owners of the stock who have left their stock certificate in our care.

(4) Whatever commission rate structure is finally decided upon, it should not provide for "unbundling" of research services. Proposals in this direction argue that the individual investor should not be forced to pay for research if he does not desire the service. We think the alternative would be far worse, and would be against the public interest. In effect, such a system would be encouraging the private investor to take even less professional advice than heretofore, while all available evidence suggests that he needs more.

(5) Brokers must be especially careful about "suitability" when recommending stocks to private investors. Many investors are willing and able to speculate, and those who do are serving an important role in our financial market system.

Nevertheless, it happens all too frequently that an investor who cannot afford much risk buys highly speculative stocks. In my opinion, this is the problem which more than any other justifies the role of investment research. To state the case simply, it is easy to find a "tip" about a stock even without relying on your broker, but it is by no means as easy to determine the degree of risk involved in following the tip.

(6) Investors will not regain confidence in the stock market without first regaining confidence in Government economic policies. The unsuccessful battle against inflation during recent years coupled with rising interest rates and rapidly shifting approaches to wage and price controls has unquestionably undermined investor attitudes. Our view is that extremely high interest rates are not conducive to the orderly functioning of our stock and bond markets and that more stress should be placed on combatting inflation and restoring confidence in the dollar.

In addition, we believe that the present rampant inflation calls for the installation of curbs on consumer credit.

I thank you for the opportunity to appear at this hearing, and now would be happy to answer any questions you might have.

Senator BENTSEN. Tomorrow we continue our hearings.

[Whereupon, at 12:20 p.m., the subcommittee recessed to reconvene at 10 a.m., Thursday, July 26, 1973.]

FINANCIAL MARKETS

THURSDAY, JULY 26, 1973

U.S. SENATE,
SUBCOMMITTEE ON FINANCIAL MARKETS
OF THE COMMITTEE ON FINANCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 2221, Dirksen Senate Office Building, Senator Lloyd Bentsen [chairman of the subcommittee] presiding.

Present: Senators Bentsen, Byrd of Virginia, Nelson, Bennett, and Roth.

Senator BENTSEN. The committee will come to order.

We are in competition with some of the other committees this morning. We will have some of the other members of this committee dropping in shortly.

This is the final day in the first of a series of hearings that this subcommittee expects to hold concerning the subject of institutional investors in the stock market. As we have emphasized from the beginning, this is not an adversary hearing. We are trying to find what effect institutions have on the market, for good or bad, and what remedial legislation might be helpful in that regard. We have tried to have a cross section of opinions on this subject. We have heard from the chairman of the Securities Industry Association, as well as representatives of individual brokerage firms. And now, in concluding today's hearings, we will hear from the chairman of both the New York and American Stock Exchanges, a representative of a group of publicly held companies and two institutional investors.

I believe that these hearings have served to raise questions concerning the role of institutional and individual investors that will be helpful.

I am looking forward to your statement, Mr. Needham. Would you state your name and your position, please?

STATEMENT OF JAMES J. NEEDHAM, CHAIRMAN OF THE BOARD, NEW YORK STOCK EXCHANGE, ACCOMPANIED BY DONALD L. CALVIN, VICE PRESIDENT; DR. WILLIAM C. FREUND, VICE PRESIDENT AND CHIEF ECONOMIST OF THE EXCHANGE; AND DR. STAN WEST, HEAD OF THE RESEARCH DEPARTMENT

Mr. NEEDHAM. Thank you, Mr. Chairman.

My name is James J. Needham. I am chairman of the board of directors and chief executive officer of the New York Stock Exchange, Inc.

With me today are Donald L. Calvin, vice president, Dr. William C. Freund, vice president and chief economist of the Exchange, and Dr. Stan West, head of our research department.

Mr. Chairman, because of considerations of time, I would like to summarize the comprehensive statement we filed with the subcommittee by reading only its most essential sections. Therefore, I respectfully request that the full statement we have filed become part of the hearing record, together with the documents referred to in the statement. In addition, I would like to submit, for inclusion in the record, the 1973 Fact Book, published by the New York Stock Exchange.

Senator BENTSEN. That will be fine. Without objection.

It will be included in the record.

Mr. NEEDHAM. Mr. Chairman we appreciate the opportunity to present the views of the New York Stock Exchange on "The Role of Institutional Investors in the Stock Market." And, frankly, we congratulate this subcommittee for focusing on what has too long been referred to as a phenomenon, when, in fact, it has become an established national problem—that is, the impact of the growth of managed investment accounts on the capital markets and capital-raising process. The growth of financial concentration in this country has concerned me for many years, including those when I served as a commissioner of the Securities and Exchange Commission.

At the outset, let me say it is my hope that, after study of the problem, this subcommittee will consider solutions to insure that our securities markets provide equal opportunity to all investors, regardless of size, so that equity securities will become a more attractive investment vehicle for a greater number of Americans than ever before—and not to create a "laundry list" of restrictions which conflict with the concept of a free market system.

An important issue in these hearings, then, is the role of the individual investor in the Nation's securities markets. This may, in fact, be the key issue, since any proposed legislation dealing with institutional investors should consider the impact on individual participation in the market. Indeed, our essential comment is that rather than focusing on ways of re-restricting the activity of institutional investors, congressional concern and action should be to minimize institutional impact indirectly—by stimulating, in every possible appropriate way, greater individual participation in this Nation's capital markets.

Some observers, noting the extraordinary growth of market activity by financial institutions in recent years, have forecast the virtual exclusion of individual investors from the market in the years ahead.

Senator BENTSEN. Let me interrupt you from time to time, if I may.

Is it your feeling that the trend that we have seen from 1963 to this time—and the numbers that have been shown to us in this committee were approximately 30 percent of the market being institutional in 1963 and, approximately, 70 percent of dollar volume being institutional now—is it your feeling that this increase has leveled off?

Mr. NEEDHAM. No, Mr. Chairman, it is not. I just feel that the Congress has available to it, as I have stated in my statement later on, techniques and means by which the Congress could balance out that trend. On the other hand, Mr. Chairman, when one looks realistically at the vast accumulations of moneys that are occurring, through intermediaries such as pension plans, investment companies and insurance companies, and coupling that with the understanding that ours is a more affluent society, dedicated to a shorter work week and more leisure time and a higher educational level than any other coun-

try in the world—putting all that together one has to conclude that an informed citizenry will turn to professionals to manage their moneys more in the future than they did in the past.

Senator BENTSEN. Well, I am trying to get your statement to jibe, then. You talk about the extraordinary growth by financial institutions and then you say that those who forecast the virtual exclusion of individual investors from the market, are overly pessimistic. Now, at what point do you think percentage-wise there would be a virtual exclusion?

Mr. NEEDHAM. Well, I think maybe we are in the semantics area, where we are saying that virtual exclusion is a total exclusion. But what I interpret it to mean——

Senator BENTSEN. Let me ask you this. Would you think that 80 percent was a dangerous level or 90 percent?

Mr. NEEDHAM. Yes, I would.

Senator BENTSEN. Do you think we are headed for 80 or 90 percent?

Mr. NEEDHAM. I have read analyses by leading academicians and economists where some think that would happen. But we don't think so and, if you like, Dr. Freund can speak to that question. He is our chief economist.

Dr. FREUND. I might just add, Mr. Chairman, that we have to bear in mind that the numbers you refer to, namely, the 30 percent of all public trading that is now individual, has been applied to a larger pie, a larger total, so that in absolute numbers, at least through 1971, there has been no diminution of individual activity.

Senator BENTSEN. Wait a minute. Let's be sure we are talking about the same thing. In percentage of dollar volume, it is my understanding that in 1963 the volume of institutional trading was 30 percent but currently it is 70 percent. Now I know that the total volume in the market has increased greatly but I am asking you the percentage of participation.

Dr. FREUND. Yes. Well, you are absolutely right. In terms of percentage, the individual's share has declined very sharply. But I might just add a bit of perspective by noting that although the percentage of trading by individuals has fallen—indeed dramatically since 1960—the total shares bought and sold on the New York Stock Exchange by individuals in the first half of 1971 reached 10.7 million shares per day, which was more than three times the three and one-half million in 1960.

Senator BENTSEN. Oh, I understand that but what about the institutions, what about the number of shares that they bought as compared to 1963?

Dr. FREUND. You are absolutely right. Of course, that has shown a much faster rate of growth.

Senator BENTSEN. All right. Would you proceed with your testimony, please?

Mr. NEEDHAM. Thank you, Mr. Chairman. If I may just summarize the remarks which have already been made?

Not here, but in other places in the Congress, we are raising the question of the viability of the auction markets of the United States because of legislation which is pending both here and on the other side. Certainly, if we destroyed—directly, deliberately or inadvertently—our auction market system, we predict at the exchange that there

will be less—that is the statistics Dr. Freund is leaning on will go the other way and the individual will withdraw from the marketplace. So there will be less.

At the New York Stock Exchange, we regard the individual investor—including the so-called small investor—as the indispensable participant in the market. We cannot permit the individual to become the forgotten man or woman in our securities markets, as unfortunately has happened in other areas of our society.

The advantage to the individual investor of acquiring an active stake in the Nation's economic growth are obvious. Less apparent are the vital contributions made by the individual investor—both small and large—to the securities markets and to the national economy.

1. Active participation by individuals in the market provides breadth to trading in thousands of stocks which do not attract the interest of institutional investors.

2. A massive flow of orders from individuals helps furnish essential liquidity to the market, without which price changes would be more abrupt and the existing continuity from sale to sale would disappear.

3. Individual investors supply new equity capital to small and growing companies, and make it easier for larger, better-established companies to obtain additional capital.

4. Widespread ownership of American industry by millions of individual investors represents a critical safeguard against undue concentration of power in the hands of large organizations.

The balance between individual and institutional participation in the stock market is a unique feature of the American system of capitalism that must be preserved and encouraged.

There is no need to dwell on statistics showing the growth of institutional interest in equity securities. A few facts, however, will place my remarks in perspective.

First. At the end of 1949, financial institutions held less than 13 percent of the market value of NYSE listed stocks. By the end of 1972, the ratio was up to 30 percent.

Second. The rising turnover of institutional portfolios has contributed to the dominance of institutions in market activity. Prompted in part by a quest for improved investment performance, the aggregate activity ratio of major institutional portfolios reached a peak in 1969 about 2½ times the 1964 rate. Even in 1972, the rate was more than double what it was in 1964.

Third. In 1961, institutions and intermediaries accounted for less than 40 percent of the dollar value of NYSE public volume, and individuals accounted for more than 60 percent. By 1971, institutions were responsible for nearly 70 percent of our public volume, and individuals for only 30 percent.

Fourth. The average size of a transaction printed on our ticker has more than doubled—from 213 shares in 1962 to 433 shares in 1972.

Fifth. Orders involving 10,000 shares or more accounted for less than 3 percent of reported share volume on the NYSE in 1964 and more than 20 percent in the first quarter of this year.

Turning next to the question of institutional demands for what we might call "instant liquidity," we find a different type of problem that has a very sharp and dramatic impact on the market.

Although an institution may take weeks or even months to accumulate a substantial position in a particular stock, it often happens that

at the slightest whiff of bad news—disappointing earnings or what have you—the portfolio manager will rush for the exits, with the idea of liquidating that position almost immediately without any serious impact on the price of the stock. Obviously, that is not a reasonable expectation. Yet, institutional investors often express surprise when such actions trigger a sharp decline in the market price of a stock. And individual holders of that stock—to say nothing of the issuing company—are likely to be seriously perturbed when that happens, and with good reason.

This problem is compounded to the extent institutions concentrate their investment interest in a relatively small number of issues. A number of major periodicals have commented recently on the so-called two-tiered market made up, on the one hand, of institutional favorites and, on the other, of the vast majority of issues with no wide following. Unfortunately, this concentration—if it does indeed exist—may be unavoidable. So long as institutional performance is judged by standards based on one of the popular stock price indexes in which these highly capitalized companies carry considerable weight, institutions will feel obliged to own the so-called favorite stocks, merely to match average performance. And it is pertinent to recognize that the huge number of shares outstanding of these companies also makes it rather easier for institutions to move in and out of their stocks with impunity.

It has been suggested by a number of observers that the problem of institutional domination of the equity markets could be solved by the enactment of legal restrictions on institutional activity. The New York Stock Exchange has taken no formal position as yet on the proposal that limitations be imposed on the size of institutional holdings, or on the extent of institutional activity in the equity markets. Philosophically, however, I would very strongly oppose interfering with the normal supply and demand forces in the marketplace through any imposition of artificial and arbitrary restrictions. The markets are very sensitive mechanisms whose most efficient operation can be seriously distorted by such restraints.

One measure that might deserve more study would be to require institutions to recognize realistically the costs of disposing of large blocks. The equity portfolios of large institutions are valued on the basis of current prices on a particular trading day. Yet, the value of a portfolio containing large blocks of individual securities is undoubtedly less than its liquidating value. It has been suggested that it might be appropriate to assign a discount from the current market price for such holdings—what the securities industry refers to as a "haircut"—based on the size of the holding, the floating supply of the stock and various other relevant factors. Although the exchange is not now prepared to formally recommend that this be done, such a requirement might well have a beneficial effect without interfering directly or arbitrarily with an institution's right to acquire, hold or dispose of stocks.

In any event, we would much prefer a positive approach to the problems of institutional activity—rather than a negative approach of imposing restrictions on portfolio decisions which, properly, should be governed by valid investment considerations.

As this subcommittee is aware, Senator Harrison A. Williams, Jr., earlier this week introduced a bill that would require the disclosure of institutional holdings and activity on a regular periodic basis. This bill appears to be a direct outgrowth of recommendations made in the SEC's 1971 institutional investor study report. The exchange would urge the acceleration of efforts to enact legislation in this area—subject to two very strong qualifications: first, that the SEC must be given adequate funds to administer the reporting requirements; and, second, that the SEC be directed to report back to Congress—say, 1 year after the effective date of legislation—on how the newly disclosed information is being used. In the absence of such provisions, either the reporting process could prove ineffective, or it could simply prove to be an unnecessary burden on the reporting institutions.

I suggested at the beginning of my statement that the key issue at these hearings might well be the role of the individual investor in the Nation's securities markets.

It's no secret that individual investors have been disenchanted with the market for some time—and everyone seems to have a favorite set of explanations for why this is so. To get a clearer picture of investors' doubts and concerns, the Exchange commissioned a broad, in-depth nationwide survey of small investors.

We were gratified to find from this survey that small investors continue to regard stocks as a viable form of investment, and that they have a generally high regard for the professional abilities of stockbrokers.

On the other hand, the study indicates that small investors feel that large institutions—the so-called big guys—receive preferential treatment in the market; that the industry does not sufficiently protect the general public through self-regulation; and that brokerage firms are vulnerable to a recurrence of financial difficulties.

As the subcommittee may be aware, the New York Stock Exchange has been a pioneer in the field of investor education. Our investors information department coordinates a nationwide program of educational and community activities designed to acquaint investors, potential investors and students with basic economic subjects and with the fundamentals of investing. We estimate that these programs reach some 2 million people a year, while our national roster of some 3,500 broker-speakers addresses audiences totaling another million.

Our school and college relations program prepares and distributes free classroom texts and teaching aids used by at least 1 million high school students each year; and our staff of professional educators criss-crosses the country to participate in scores of university-sponsored economic workshops for teachers of social studies and economics.

In early 1972, recognizing that many potential investors simply did not know how to go about contacting a broker to handle securities transactions, our Investors Service Bureau compiled and published a directory of Exchange member firms which serve individual investors. Within 9 months, the Service Bureau responded to requests for nearly 50,000 copies of the new directory and handled some 500 direct requests for assistance and information.

We have already examined some signs of the existing imbalance between institutional and individual participation in the securities markets. That imbalance exists and it is serious. But the way to cor-

rect it is not, I am convinced, to force a reduction in the role of institutions. The more sensible, more constructive approach is to increase the role of individual investors and traders—which can help accomplish the same objective by reducing the relative role of the institutions.

It is obvious from what has been happening in the market—or, rather, from what has not been happening—that this objective cannot be accomplished overnight. In addition to specific efforts to restore investor confidence, it may also be necessary to develop special incentives.

And, these special incentives may be required in the interest of continued sound economic growth. I alluded earlier to the high proportion of NYSE listed stocks in institutional hands, but this proportion does not hold across the board in other kinds of stocks. On the basis of the latest available estimates, as of early 1970, institutions owned a considerable smaller proportion of non-NYSE stocks—less than 30 percent. Institutions, because of investment policy or statutory limitations, favor large well-established companies. The implications for the capital-raising ability of small, less-established enterprises can be serious. Both Government and the securities industry must rebuild the confidence of the individual investor and provide the incentives to encourage his investment in equities.

Ten weeks ago, I announced that the New York Stock Exchange was embarking upon an action program to reverse the recent decline in the number of shareowners and to increase the total number by 25 percent before the end of 1975. Our efforts will center on improving the market system to make it more responsive to the needs of individual investors. Among the specific steps in our program are these:

1. Implementation of measures to improve the handling of securities.
2. Development of new marketing tools for our member firms.
3. Further strengthening our monitoring of Exchange rules on timely disclosure of corporate information.
4. Stricter professional standards for registered representatives.
5. Expended and intensified work with educational institutions at all levels to improve the public's understanding of personal finance.
6. Coordinated advertising, promotional, and marketing campaigns among all segments of the securities industry, to assure the individual investor that the industry is able and willing to serve his investment needs.

One of the findings of our survey of investor attitudes, as I noted earlier, was that the little guys think the big guys get special treatment. Whether or not that's true, the fact that people think it's true means that something has to be done.

At the Exchange, we are strengthening our procedures for monitoring and policing the Exchange's rules on timely disclosure of corporate information. We think it is essential to see that listed companies do not give out so-called "inside information"—either deliberately or inadvertently—to financial institutions or to anyone else before such information is released to the public.

In addition to tightening and improving self-regulatory procedures in the areas of disclosure, securities handling and member firm capital, we have also been giving considerable thought to questions of professionalization—particularly with respect to the qualifications of registered representatives. The registered representative, after all,

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is the securities industry's front-line contact with investors, and it is essential that he be an expert in his field if investor confidence is to be maintained and strengthened. The Exchange believes the credentials of those who deal directly with the investing public should be above reproach. It's as simple as that.

To back our conviction here, we have undertaken a rather expensive program to revise and toughen the Exchange's qualifications for aspiring registered representatives. New tests to meet high standards required by the Exchange are being developed by a nationally prominent authority on testing. We expect to be able to put these tests into operation next year.

We have also had some suggestions to offer financial analysts about avoiding the misuse of inside information that might come their way. And we have strongly urged the Financial Analysts Federation to take appropriate disciplinary action against any member of that professional society who may be found to make improper use of inside information.

In today's society where the appearance of a conflict of interest is equated with an actual conflict of interest, a related area which might merit examination concerns the question of whether there is adequate separation of the activities of the trust and commercial departments of large banks. Do the banks, for example, scrupulously avoid the interchange or leakage of information between their institutional functions and their management of large individual accounts? I frankly do not know the answer to those questions. It may very well be that the doubts expressed by small investors about the advantages available to the big guys are completely unfounded in this particular area. If so, it would certainly seem worthwhile to be able to reassure them on the basis of hard facts. Perhaps this is an area that might be reviewed by an appropriate Senate committee.

Another of our survey findings, as I have already indicated, was that many investors believe brokerage firms are vulnerable to a recurrence of financial difficulties. Anyone who has been following the misfortunes of the brokerage community in recent months knows that the small investor was right on target in that area. This subcommittee is certainly aware of how relentlessly unprofitable the securities business has been in 1973.

During the first 5 months—through the end of May—member organizations of the New York Stock Exchange posted aggregate losses of $153 million. When this is matched against aggregate profits of $580 million during the first 5 months of 1972, the net change shows a decline in profitability of close to three-quarters of a billion dollars.

We are now awaiting the final figures for June—without, I must add, any great enthusiasm, since our preliminary estimates indicate a further loss of some $40 million—and that is obviously no dilution of the red ink in which the industry has been bathing all year.

We are, as the subcommittee knows, proposing a commission rate increase which—it is important to recognize—would do no more than offset the impact of cost inflation over the past 3 years. We testified on these proposals at public hearings last week before the SEC. This pass-through of cost-inflation is essential, not as a means of restoring industry profitability—which it would not do—but to provide continued service to the public.

Obviously, the related areas of institutional impact on the securities markets and individual investor confidence in the market offer many potential opportunities for constructive action by Government.

The administration has already taken one important step to make stocks more attractive to investors by easing the restrictions on dividend payouts.

We also strongly urge elimination of withholding taxes on foreign purchases of U.S. securities.

Another measure that would help considerably would be for the Securities Investor Protection Corporation to revise its rules to encourage brokerage firms to stimulate wider public awareness of what SIPC is and does.

Perhaps the most significant action that Congress can take—and one in which it would seem that this subcommittee might play a key role—is to improve the tax treatment of savings invested in securities.

In testimony before the House Ways and Means Committee on March 21, the exchange offered a five-point program for improving investor confidence through constructive and realistic tax reform in this area. This program is particularly important now because of changes in the tax code in recent years, which have narrowed the differential between the tax treatment of ordinary and investment income. In our testimony at that time, we presented a thorough economic and statistical rationale for these proposals. Let me summarize them briefly. Specifically, we urge Congress to:

1. Increase from $100 to $200 the dividend exclusion from Federal income taxes.
2. Permit commissions paid on stock transactions to be treated as investment expenses and thus as deductions against ordinary income.
3. Permit a limited tax deduction for individuals who buy stocks as part of a personal pension plan, provided they are not covered by employer-sponsored plans or are covered by inadequate plans. In other words, we support enactment of the bill on this issue introduced in the Senate by Senator Javits.
4. Reduce the capital gains tax on securities, depending on the number of years the securities have been held.
5. Raise from $1,000 to $5,000 the maximum tax deduction against ordinary income for a capital loss; and ultimately eliminate the dollar limit and allow a 50-percent deduction of losses from ordinary income, after offsets against gains.

Admittedly, tax changes alone cannot restore investor confidence. Bringing domestic inflation under control and restoring stability to the dollar internationally are of critical importance. Small investors are clearly concerned about economic instability, and economic uncertainties have been a dampening element in the market.

Our national economic ailments are well known to anyone who reads a daily newspaper. The basic solution to the problems that have been buffeting the American economy is a stable dollar—at home and abroad. Life will be much easier for the consumer, the businessman and the investor in an environment of consistent fiscal and monetary policies and lasting international monetary arrangements.

Nevertheless, in the somewhat narrower context of the issues being addressed by these hearings, a realistic tax policy can provide the investment incentives needed to raise the vast amounts of capital

American industry and the Federal Government must have in the years ahead. Appropriate tax measures can be one of the steps in a cooperative effort by Government and private industry to create the proper climate for reaching the goal of 40 million individual shareowners by 1975.

In closing, I again congratulate you on undertaking this serious inquiry into a matter which in the minds of many, urgently requires the attention of policymakers in all branches of our Government. Our capital markets and capital-raising capabilities are among our Nation's most valuable assets, because they provide the means by which our social goals of equal opportunity and higher standards of living will be achieved. It follows, therefore, that any force or combination of forces which debilitate them is a direct threat to the American way of life, which places emphasis, first, on the well-being of our citizens and, secondly, on the objectives of institutions.

Thank you, Mr. Chairman.

Senator BENTSEN. Mr. Needham, I appreciate that presentation, It is obvious you have given this matter a lot of consideration.

In your statement you say that the balance between individual and institutional participation in the stock market is a unique system of capitalism that must be preserved and encouraged.

The balance between individual participation in the stock market and institutional investment in the stock market is something unique to our stock market in comparison to the rest of the world. Part of that balance is being lost and that is of concern to me. Personally, I think it would be a step backward for us, in the funding of small and new businesses in the equity market, if we ended up in a situation like that in Germany where the institutions, in effect, control the stock markets.

I believe that the objectives of the disclosure bill introduced by Senator Williams 3 days ago are very good although I haven't studied the details of it yet. However, I am not sure that disclosure alone is enough and I am trying to decide whether there are other legislative steps that should be taken.

One of the suggestions that was made before this committee was the possibility of taking the 5-percent limitation on ownership of stock in a single corporation which now applies to mutuals and apply this limit to other institutions with a grandfather clause, of course, to stop the dumping of stocks of those holdings that exceed that amount.

Would you consider that a reasonable limitation? What problems would you see forthcoming if that was done?

Mr. NEEDHAM. Section 12 of the Investment Company Act, Senator, deals with the responsibilities of fiduciaries, primarily, and the relationships and the scope of activity of a managed fund; namely, an investment company. And I think it is section 14 of the same act, section 14(b), that directed the SEC to study this problem of concentration of portfolio activities on the part of an investment company. And to my recollection, the SEC has never really addressed that question.

But, using the investment companies as an illustration—and I have no beef against the investment companies—you have what is commonly referred to as a stable of funds, that is, a group of investment companies managed by one investment adviser. If you impose that limitations on the holdings of securities—and let's just address that question—and then, let us say, we set it at 10 percent as the maximum that could be held on any one fund, then it would be possible for a

stable of funds to control 50 percent of a company through a five-funds concept, each one with 10 percent. So, you see, there are difficulties there.

But you know the real problem is not the holdings of the funds. And I would like to move away from investment companies and discuss what I consider a more significant—and, from an economic point of view, a more dramatic—situation, and that is the pension funds that are administered all over the United States.

Now, Mr. Chairman, I am not saying that the pension fund tax benefit should be revised in any way. But if the pension funds were to individually make investment decisions, we wouldn't be here today. The problem is that there is a concentration of the management of these individual pension funds among a handful of men, of investment managers. So you don't solve the problem in my judgment, by addressing yourself to the limitations to be imposed on investment on pension funds. Rather, Senator, you reached the problem more directly by asking what restrictions, if any, are needed. Or, what do we do to give guidance to the people who manage the funds? This report that was made available by your staff contains statistics, for instance, on who manages what in the way of pension funds. So that is the real problem.

It is at management level that you have this decisionmaking process taking place, wherein a bank, for instance, may decide that stock X is no longer a suitable investment for their customers, and they decide to take all of their customers out. Now, that is one man—or rather one group of people—making a decision affecting thousands of pension funds, rather than having each fund making its own individual decision. So that is really the problem.

Now, there is another aspect of financial concentration which I don't think is the subject of this hearing, and that has to do with the voting rights of the owners of these stocks.

Senator BENTSEN. How do you legislate that?

Mr. NEEDHAM. That is what makes the problem so difficult. And that is why, after analysis, we came to the conclusion that the way to get at the problem was to give greater incentives to individuals to invest more money in the stock markets to balance this concentration of management on the other side.

Senator BENTSEN. I must say although I always want to take the positive side and find ways to give incentives, I don't think we can can negate looking into the possibility of remedial legislation on the other side.

Mr. NEEDHAM. Senator, I don't mean to give that impression, either. I think my testimony goes exactly the other way. We urge you to go further. There is just a complete absence of information in this area.

Senator BENTSEN. Senator Byrd?

Senator BYRD. Thank you, Mr. Chairman.

Mr. Needham, in your statement, you list five points that you specifically urge the Congress to adopt. Of those five, which one would you consider the most important to accomplish what you are seeking?

Mr. NEEDHAM. I would say No. 4, Senator Byrd. We think that the capital gains tax is a disincentive to invest in equity securities.

Senator BYRD. That tax was increased in 1969 or as a result of the 1969 Tax Reform Act. Have you found that that has had a depressing effect on the market?

Mr. NEEDHAM. It was about 1969 that the securities market started to come apart, Senator, but I will let our economist answer the question.

Dr. FREUND. I don't think the economists have an answer to that. There is a multiplicity of forces here, but I do think that capital gains played a role.

Senator BYRD. Do you feel it had a major impact?

Dr. FREUND. We have no measure, no way to measure that directly, and there isn't anything I could document statistically on this. But I do think that capital gains taxes have had a significant impact, particularly when you consider the reduction in taxation of ordinary income on wages and salaries.

Mr. NEEDHAM. Excuse me, Senator, but, Dr. Freund, didn't the exchange make a study on this problem some years ago?

Dr. FREUND. We did, but that preceded 1969.

Mr. NEEDHAM. Are we involved in a similar study now?

Dr. FREUND. Yes, we have underway now a survey of investors' attitudes to determine the effects of capital gains taxation on their incentives to invest. We hope to have those results, I might add, within a matter of weeks.

Senator BYRD. Well, it would be helpful, I would think, Mr. Chairman, if those results could be submitted to the committee.

Mr. NEEDHAM. We will be delighted to furnish them to the committee.

Senator BENTSEN. We would be pleased to keep the record open to have them submit it.

Mr. NEEDHAM. Thank you.*

Senator BYRD. Mr. Needham, you recommend reducing the capital gains tax on securities, depending on the number of years the securities have been held. Would you comment on that?

Mr. NEEDHAM. I could, Senator, but I would rather Dr. Freund did it, because this is a matter of economic analysis and I believe he has some backups for you on it.

Dr. FREUND. The details of the proposals were submitted to the House Ways and Means Committee. I find I don't have them right in front of me but, as I recall, they provided for a maximum of a 50-percent rate on holdings liquidated after 6 months, with a reduction to a 20-percent rate at the end of 30 years.

Mr. NEEDHAM. Reaching your question directly, I think one of the efforts that most American businesses try to make is to accomplish what the social views of an era are and, also, what seems to be the intent of Congress. And I think it is safe to say that rather than going that route, we would rather go the other route, which is to go back to where we were in 1968 before the enactment of the 1969 legislation. That would be a more direct way. I think all we are doing here, frankly, is trying to accommodate what we think the Congress wants to try to do to overcome this theory that is being proposed that there is no distinction between ordinary income and capital gains.

Senator BYRD. Is what you are saying then, you would leave the capital gains structure alone, except go back to the 25 percent?

Mr. NEEDHAM. Really, that is cutting it right through, Senator, and that is the best way to do it.

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*At press time the survey had not been completed. The subcommittee was informed that upon completion, it would be forwarded to the subcommittee.

Senator BYRD. And leave it at 6 months, also?

Mr. NEEDHAM. And leave it at 6 months. Frankly, from the Government's point of view, I have heard many people, including my former associate at the Commission, Mr. Hurlong, who served on the House Ways and Means Committee for many years, say that a 3-month holding period—which has been advanced, I believe, by Mr. Regan, of Merrill Lynch, that would produce more substantial revenues to the Government. But we recognize that is even more of a problem. So I think with a 6 months period and 25 percent, everybody would be very happy.

Senator BYRD. Well, now, you favor the positive approach of using tax incentives to attract individuals back into the market. Has your organization made any studies of the revenue impact of the tax incentives you propose?

Mr. NEEDHAM. Yes, we have included those in the record.

Dr. WEST. Senator, about 10 or 12 years ago, we commissioned a study by the Harris organization on this subject. Of course, economic conditions and market conditions have changed drastically since that time, as has the Tax Code in 1969, which you refer to. Some months ago, we commissioned a redo of that study, covering somewhat the same ground that was covered in the earlier one—that is, as far as cutting the tax rate in half, but also going beyond that to the sliding scale which has become part of our tax recommendations. The interviewing phase of that study is now complete and the data is being analyzed, and we hope within the next few weeks we will be able to submit the results of that study to the committee.

Mr. NEEDHAM. We have offered that for the record and, Senator Byrd, we have already included in the record our testimony before the House Ways and Means Committee, which includes the impact data that you are looking for and your staff now has it.*

Dr. WEST. I might add, Senator, that the study very specifically covers the study of revenue impact from the various tax alternatives that are proposed for the individual investor.

Senator BYRD. I am inclined to favor your proposal on capital gains, but I think that the committee and the Congress, as a whole, will certainly have to take into consideration what the revenue impact is and, if it is a major impact, that is going to make it somewhat a difficult thing.

Mr. NEEDHAM. Yes, we are playing cat and mouse in the security industry. I wonder what the impact is of the special tax considerations, which I believe are appropriate, that have been granted to the oil industry? I wonder what the tax impact is of granting deductions to employers for contributions to profitsharing and pension plans? And I could go on down the list. But I realize we would be inconsistent if we were to say to you that we wouldn't care what the cost was, because the thrust of our testimony, when we appeared before other committees of the Congress, is that we advocate always a balanced budget for the U.S. Government.

Senator BYRD. I want to hear that more clearly.

Mr. NEEDHAM. I am glad someone is listening to me in Government.

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*Hearings before the House Committee on Ways and Means, March 21, 1973, entitled "General Tax Reform," pp. 2465–2494.

We believe very strongly that the Government must bear a very heavy burden of proof whenever the budget is not balanced. And the budget has not been balanced for enough years since the Depression to make a good track record for the Federal Government as a leader in financial responsibility.

Senator BYRD. I think you are so right.

Mr. NEEDHAM. Senator, I wish I lived in the State of Virginia.

Senator BYRD. I wish we had you in Washington.

Mr. NEEDHAM. I think I got out at about the right time, Senator.

Senator BYRD. I was somewhat encouraged by the statements last week and by Secretary Shultz' statement, that, for the first time in several years, the administration recognizes that the budget must be got under control if inflation is to be got under control. That is a new recognition insofar as any public statements are concerned or private statements, so far as I know. I don't think we are going to get this economy back in shape and I don't think, personally, we are going to get inflation under control until we do what you have suggested there, and that is, return to the concept of a balanced budget.

Secretary Shultz used the phrase "oldtime religion" and I like that expression. I think it is "oldtime religion." It has been considered out of fashion and out of date, but maybe what has happened to the dollar all over the world and the lack of confidence of the investing public and the lack of confidence of the public as a whole in my judgment may change that opinion in Washington and may cause us to get back to where that is not so old fashioned and so out of date, but an essential element in restoring confidence.

I notice in your statement you certainly do not mean to minimize the overwhelming importance of bringing domestic inflation under control and restoring stability to the dollar internationally. I think that is so very, very sound, and I think it is not generally realized that during the 5-year period from fiscal 1970 through fiscal 1974 that the total accumulated Federal funds deficit will be $119 billion. Another way of saying that is that during that 5-year period, 25 percent of the total national debt of this Nation will have been incurred during that one 5-year period. That is just smashing. I have a feeling that the average citizen, while he doesn't know the figures, that he senses something is drastically wrong here in Washington. That was 25 percent of the national debt incurred in a 5-year period from 1970 through 1974, and the other 75 percent was built up over a period of 150 years—or whatever the figure might be. We fought the War Between the States, the Spanish-American War, World War I, World War II, the Korean war, and most of the Vietnam war during that period that the 75 percent was built up. So that I think that the No. 1 domestic problem facing our country, as I see it, is to get the Government's financial house into order and it is way out of order now.

And I am impressed that your statement recognizes that. And I would say, again, I am so pleased to hear you use that word "balanced budget." You don't hear it very often around this Congress, I will tell you.

Mr. NEEDHAM. Senator, if I may cap off this fiscal discussion by saying, if the Congress wants to really get disturbed about something else—not that you don't have enough on your minds—but you might look at the debt that is being incurred by Federal agencies created by the Federal Government—that is, outside the appropriations process,

which is something else, and which is completely contrary to the American way of running a government.

Senator BYRD. You are quite right and I am glad that you brought that out and I hope that the business community will become excercised about the irresponsibility of the Federal Government in its spending policies. Unless the business community takes an interest in it, I don't know how we are going to solve it.

Mr. NEEDHAM. I have been in business for 27 years—most of it as a practicing CPA, and I have been exercised quite a bit about it. In fact, before that, I was brought up on some fundamentals in this business, and all I can say is the result of my exercising in this has been shadowboxing.

Senator BYRD. What?

Mr. NEEDHAM. Shadowboxing. In other words, I am doing this exercise but I am not hitting anyone.

Senator BYRD. Well, I think the fact that you are speaking out on it is very helpful.

Mr. NEEDHAM. I don't want to prolong my discussion here, but I would say that if I had with me today the members of our International Capital Markets Committee—and these are experts—you might be quite impressed by their thoughts. Dr. Freund, you are much better at recalling names than I am. Why don't you read their names into the record?

Dr. FREUND. The chairman of the committee is John E. Leslie and the other members are: Harry B. Anderson, of Merrill Lynch; George W. Ball, of Lehman Brothers, Inc., and formerly Secretary of State; I. W. Burnham II, of Drexel Burnham & Co., Inc.; Henry H. Fowler, of Goldman, Sachs & Co., and formerly Secretary of the Treasury; Andre Meyer, of Lazard Freres & Co.; Leo Model, of Model, Roland & Co., Inc.; Frank A. Petito, of Morgan Stanley & Co., Inc.; Robert V. Roosa, formerly Under Secretary of the Treasury, and now a partner in the firm of Brown Brothers Harriman & Co.; Nathaniel Samuel, of Kuhn, Loeb, & Co., also formerly of the State Department.

Mr. NEEDHAM. And if they were all here, Senator Byrd, they would say two things to this subcommittee: The first one, balance the budget, and, secondly, get a hold on monetary policy. That is what they would say.

Senator BYRD. Well, that is certainly an outstanding group and one with great knowledge and it is encouraging to me to know that that group, which you have just named, with such outstanding individuals, feel that the No. 1 problem—I believe that is the way you expressed it—is to get a handle on Government spending and to balance the budget.

Mr. Needham, you have strongly urged the elimination of withholding tax on foreign purchases of U.S. securities. Has any thought been given, as to how this repeal could be accomplished without providing a tremendous invitation to U.S. citizens to invest their funds in the United States through foreign banks or security houses for the purpose of avoiding U.S. taxation?

Mr. NEEDHAM. Having some background in the law enforcement area, I recognize the tremendous administrative law enforcement problem that this represents. Now, we have discussed this with Secretary Shultz and initially he was, I might say, not really receptive to what we were proposing. But I notice in the recent testimony that he

gave on the Hill, that he was softening his attitude. I think what you are talking about here, frankly, when we come down to this matter, is trying to arrive at some arrangements with these foreign countries—particularly the Swiss—so that we have access to the information we need in order to enforce our own law.

Senator BYRD. You have expressed your support for the deductibility of commissions paid by investors for the acquisition of securities, as an ordinary and necessary business expense. Would this tax change really be significant enough to encourage small investors to engage more in the purchase of securities?

Mr. NEEDHAM. We have estimated the impact of it to be $30 million in loss of revenue.

Dr. WEST. I don't recall the exact figure. It is a negligible amount and it certainly would not have very much of a revenue effect, as far as the Federal Treasury was concerned. But even as a matter of fairness, there is no difference between brokerage commissions and investment advisory materials, which are now deductible from an investor's tax return. I suppose the answer to your question is: Basically, every little thing will help. And, to the extent that brokerage commissions are treated as any other investment expense, they reduce the cost to the investor of participating in the market and may encourage, to some marginal extent, increased activity by individual investors.

Senator BYRD. You feel it will have an impact?

Mr. NEEDHAM. Yes, it may be a kind of sweetener type of thing. It won't, certainly, be substantial as a roll back in the capital gains tax rate.

Senator BENTSEN. Senator Byrd, would you yield on that? Aren't real estate commissions deductible? How do you differentiate that from a stock purchase? In other words, why should we capitalize a stock purchase insofar as the commission is concerned?

Mr. NEEDHAM. You are asking me to justify why it should be?

Senator BENTSEN. Well, I don't see the reason why, frankly, if a real estate commission is a deductible expense, and I believe it is, isn't it?

Mr. NEEDHAM. I don't believe so. It is a capital item, Senator. You know, historically, Mr. Chairman, the attitude of the Treasury Department in this particular area is founded on two things: Those expenditures which are business deductions, and those which are the cost of acquiring a capital investment, or disposing of it. And so that is the logic.

Senator BENTSEN. I think we would find it very difficult to differentiate between the treatment of one as opposed to the other one, wouldn't we?

Mr. NEEDHAM. I think the Senate and the House, in their national policy deliberations, have broad administrative discretion. And they could decide if the public interest were best served by doing what we are suggesting. They could do it by writing it into the law, Senator.

Senator BENTSEN. Well, I hope you help me answer my letters to the real estate brokers.

Mr. NEEDHAM. Pardon?

Senator BENTSEN. I want you to help me answer my letters, then.

Mr. NEEDHAM. Senator, I will tell you what. I will make a trade: You answer mine and I will answer yours.

Senator BENTSEN. I might take you up on that.

Mr. NEEDHAM. Real estate has been going up. Stock prices haven't.

Senator BENTSEN. Please go ahead, Senator Byrd.

Senator BYRD. Thank you.

Mr. Needham, you bring out some figures which are rather startling to me, at least.

You say that the aggregate losses for the first 5 months of this year were $153 million, compared to the aggregate profits for the first 5 months of 1972 of $580 million, showing a decline of profitability of close to three-quarters of a billion dollars. My question in that regard: Were the profits for the first 5 months of 1972 somewhat normal, or were they somewhat higher than normal?

Mr. NEEDHAM. I believe that most people thought that those were—well, in the context of the whole year of 1972, where there were losses in that year as well, that was closer to a normal yield. Dr. Freund has some statistics on that, and then I want to get back to another point.

Dr. FREUND. Yes. I think that the figures show that the profits were normal, Senator, for the first—well, let me give you a few of the most recent figures for 1972. Comparable figures for 1972 in terms of return on capital after taxes: Now in December of 1972, it was 9.6 percent, and that compares with a yield on high grade corporate bonds now of 8 percent. In November of 1972, it was 17.2 percent; in October of 1972, it was 2.7 percent. So you see, there is a considerable fluctuation month by month. In September, it was 3.5 percent deficit. In August, 10.3 percent return on capital. For the full year of 1972, the after-tax return of all member firms on their invested capital was 10.3 percent.

Mr. NEEDHAM. And Senator Byrd, I asked Dr. Freund to read those numbers to you because the SEC, while I was a Commissioner, granted a rate increase to this industry, which was determined by the Commission as reasonable under section 19 of the 1934 act, to yield a return on capital security investment—eh, no, security commission income—of 15 percent. Now, we know no firms in our industry have experienced a 15 percent return on anything this year. And as Dr. Freund has indicated to you, the overall results of 1972, the result was 10.3 percent.

But, while I have this opportunity, Senator, there is a serious omission from our testimony this morning. Since we are getting into this area, I would like very much to submit at a later time for the record a recommendation to which I commend this subcommittee to give serious consideration to dealing with. Essentially, it is a tax proposal which would give the securities industry a tax cushion to offset a bad year. In other words, a deduction in very good years which would be available to the industry in very bad years. It would be comparable—well, it would be computed for the most part in the same fashion that the loss reserves of a bank are computed. As you know, they are allowed, under the statute, a favored tax treatment in order to establish, for the purpose of protecting their depositors, a reserve against the losses outstanding, despite whatever their actual experience is. Now, insurance companies are similarly——

Senator BENTSEN. Wait, you are talking about the bad debt loss?

Mr. NEEDHAM. That is right. Insurance companies get similar relief to the extent that their investment income on their own portfolios,

not allocated directly to policy surplus, is not taxed either. Also, under the blind form filed by insurance companies with the various State insurance commissioners, there is something referred to as the mandatory security evaluation reserve, which is handled separately in the tax law.

We have a study going on right now which we feel has great merit, which would give the securities industry an opportunity during the years when they do have good profits to set aside, free of taxes, an amount which would protect the customers of those firms in bad years such as the year we are now having. So, if you will please reserve a place in the record, Mr. Chairman, we would like to submit that for the record.*

Senator BENTSEN. You are talking about a reserve that would be set up to take care of your fiduciary role rather than the stockholders in your firm? Like the plan for life insurance companies, for the tax concession that is given to them on earnings that do not accrue to other than policyholders' surplus?

Mr. NEEDHAM. That is right. And you see the way a broker-dealer operates now—and it is all in accordance with the 1934 act—while there is a segregation of cash and securities of customers, per se, in fact, it is controlled through the same corporate entity that does underwriting and so on, and takes other risks. This would be a way, Mr. Chairman, of minimizing whatever dangers are inherent in a combination of dealer and broker activities.

Senator BENTSEN. We would be very pleased to have that statement.

Senator BYRD. That is all. Thank you very much. I appreciate your comments.

Senator BENNETT. Mr. Chairman, unfortunately, I wasn't able to hear the presentation. I was tied up in another committee and I can report to you now, we have approved a new head and another member of the SEC in the Banking Committee this morning.

Senator BENTSEN. That is very good.

Senator BENNETT. That Commission will now be whole and be able to get back to work.

So while I have listened to the discussion, I don't think I have anything to add to it.

Senator BENTSEN. Senator Roth?

Senator ROTH. I have no questions.

Senator BENTSEN. Mr. Needham, when you were talking about a limited deduction for the purchase of securities for a personal retirement plan, you referred to Senator Javits' bill. As you perhaps know, this week the Finance Committee approved my pension reform bill and we permitted a $1,000 deduction for individual retirement savings under some circumstances. Now, we did not limit that to stocks. Do you think that we could allow a deduction for someone who purchases stocks only as opposed to someone who might want to put his savings in government securities or in a bank trust department or insurance contracts or something else?

Mr. NEEDHAM. Well, Mr. Chairman, my sense of public responsibility is a little bit too great to ask you to do that. I still believe that the American citizen should have the right to decide where he wants to invest his money.

*At press time the study had not been completed. The subcommittee was informed that the study would be forwarded to the subcommittee upon completion.

Senator BENTSEN. If you said otherwise, I really would have been surprised.

Mr. NEEDHAM. Incidentally, Senator, I am very pleased to see that this committee has reported pension reform legislation, because I have been following this subject now for about 4 years since the bill was originally introduced by Senators Williams and Javits. I believe that if reform is needed in any area, it certainly is needed in the pension area, and I really hope the Labor Committee and this committee will be able to reconcile the differences.

Senator BENTSEN. I am very optimistic we will be able to do so. We have worked in concert on this. We have a good bill and I think the two committees will work together. And I also believe that the more stringent funding requirements in that bill will require increased contributions to many pension plans across the country which will result in increased stock market investments. In addition, the deduction for individual contributions may also result in individuals purchasing more stock.

Mr. NEEDHAM. We concur with that.

Senator BENTSEN. One statement that you made concerns me and this pertains to increased brokerage commissions. Would that be counterproductive with respect to attempts to bring the small investor back into the market?

Mr. NEEDHAM. I have that answer all ready for you. I have been asked for that more often in the last week than anything else. I have just been handed something which, with your permission, I will submit for the record. This is a background report, entitled "Commissions and the Individual Investor." Then I will attempt to respond to your question verbally.

Senator BENTSEN. Fine. So ordered.

[The document referred to follows:]

BACKGROUND REPORT

COMMISSIONS AND THE INDIVIDUAL INVESTOR

Introduction

The level of brokerage commissions charged on securities transaction has been a subject of increased controversy and debate within the securities industry, government agencies and other concerned parties since the New York Stock Exchange February 1970 proposals for its first increase in commission rates since 1958. These increases, when finally approved by the Securities and Exchange Commission and introduced in March, 1972, resulted in an increase in commissions on small trades and lowering of the negotiated rate level to $300,000. The proposed changes currently before the SEC would raise commissions on small trades still futher, while rates would continue to be negotiated above the $300,000 level.

In light of the current concern over the small investor's future participation in the market, the Exchange's recent proposal to increase commission rates has drawn criticism from those who view higher commissions as a deterrent to greater individual investor participation in the stock market.

Information Sources

To determine the sensitivity of investors to an increase in commission rates, the Exchange has conducted several surveys among investors to determine their knowledge of and attitudes toward existing rates and proposed rate changes. At the time of the Exchange's 1970 announcement of its proposal to raise commissions, surveys were conducted both before (early February) and after (mid-March) the announcement was made. The purpose of these studies was to determine the effect, if any, of the proposed changes on investors' perceptions of the level and reasonableness of commission rates, and what effect the change would have on their future investment plans. A similar one-time study was also undertaken in May,

1970, shortly after the temporary $15 service charge was put into effect, to determine investor attitudes after they had felt the effect of the increase.

More recently (June-July, 1972), small investor perceptions of commission rates were probed as part of a comprehensive Exchange study (Marketing Securities to the Small Investor) of small investor attitudes and investment behavior patterns. Early this year, the Exchange also conducted a qualitative study (The Disenchanted Investor) in which more affluent investors were given an opportunity to express their views on increased commission rates as one of the factors contributing to their negative outlook toward the stock market.

Public and investor perceptions of and attitudes toward commissions were also investigated in the summer of 1972 as part of a Securities Industry Association sponsored study of the securities industry's public image entitled "The Public and Investors Evaluate the Securities Industry".

Findings

The data gathered in all of these independent research projects indicate that individual investors, and small investors particularly, are not greatly influenced in their investment activity by commission rates, and are, for the most part, generally misinformed as to their exact levels. In addition, though investors tend to overestimate commissions, they continually indicate that current commission rates are fair and reasonable.

Investors' activity is not greatly influenced by commission rates.—In the pre-post Exchange study conducted during 1970, investors were asked what effect an increase in commissions would have on their investment decisions for the remainder of that year and beyond. In both waves, only about 10% of the shareowners indicated they would invest less should commissions be rasied. The vast majority would continue to invest at current levels or even increase their investments.

A similar question was posed to investors in the study conducted after the initiation of the $15 service charge. Once agian, only 10% of the shareowners said they would invest less than at present if the service charge were continued indefinitely. Close to one in five indicated they expect to invest more. These two studies seem to show that individual investment activity is relatively insensitive to changes in commission rates and that investors do not take commissions into account when making investment decisions.

Less than half the shareowners interviewed during the Disenchanted Investor Study (1973) claimed to be personally affected by the increase in commissions. Those who did feel personally affected had reacted by holding stocks longer and trading less frequently. Very rarely did investors stop trading altogether or switch to some other investment because of commissions.

Individual and small investors are not familiar with existing commission rate schedules.—When respondents in the Exchange's 1970 pre-post study were asked the commission charged on a transaction involving 100 shares of a $20 stock, over four in ten shareowners in both survey phases were unable to venture an estimate.

In response to a similar question in the more recent SIA public attitude study, more than half of the shareowners (53%) again could not estimate the commission on a given transaction. Shareowners owning over $10,000 worth of stock were only somewhat more knowledgeable—42% could not make a guess.

Investors have an inflated perception of the level of commissions.—While a large segment of investors openly admit to not knowing what commission would be charged on a given hypothetical transaction, another sizable group tend to overestimate commissions.

During the 1970 pre-post study, at least one in every three shareowners overestimated commissions on the purchase or sale of 100 shares of a $20 stock. Barely one in five investors were able to give a correct estimate.

Shareowners interviewed during the Exchange's Small Investor Study showed a similar tendency to overestimate commissions. Over one-third (37%) overestimated the commission on the *sale* of 50 shares of a $30 stock, while better than four in ten (45%) overestimated the commission on the *purchase* of the same amount of stock. Only about one in four small investors correctly estimated the commissions involved in these transactions.

In estimating the commission on the hypothetical transaction described in the SIA study (the purchase of $2,000 worth of stock), nearly three in ten (28%) shareowners overstated the charge. Holders of portfolios valued at over $10,000 were even more likely (30%) to overestimate the size of the commission. Correct estimates were made by only 13% of the shareowners in total and by 21% of the larger shareowners.

Investors have a tendency to underestimate commisions on mutual fund transactions.—The 1970 pre-post study conducted for the Exchange showed one-half of the investors were not able to estimate the commission on the purchase of 100 shares of a mutual fund selling at $20. An additional third underestimated the amount of commission.

In the Exchange's Small Investor Study, over half of the investors underestimated the commission on a transaction in which an additional $50 was invested in a mutual fund already owned.

These findings suggest that individual investors are poorly informed about the cost of financial transactions in general, and not just about commissions associated with securities transactions.

In spite of their tendency to overestimate stock commissions, investors think existing commission rates are fair and reasonable.—On both the pre and post waves of the 1970 study, fewer than 10% of the shareowners felt the existing or proposed rates were too high. Nearly one in four shareowners thought they were about right, and about one in five thought they were too low.

In the SIA public attitude study, respondents who said they knew the amount of commission involved in the hypothetical transaction (regardless of whether or not their estimate was correct) were asked if they thought this amount was fair. Two-thirds of the investors felt the commission was fair, even though three out of five had overestimated the amount.

In summary, based on the data currently available, an increase in commission rates should not adversely affect individual and small investors' business. Although the level of commissions would seem to be a potentially sensitive issue among investors, individuals have not taken the trouble to familiarize themselves with current rates. Furthermore, individual investors have also shown that commission rates do not figure heavily in their investment decision-making process.

Mr. NEEDHAM. The board of directors of the New York Stock Exchange, when it was deliberating—and it did deliberate at length, about the type of rate relief which was necessary for the industry—took into consideration a number of factors. Their No. 1 consideration was a question they devoted a considerable amount of time to, and that is: What would the impact of this be on the individual investor? Now, there were various opinions amongst the members of the board, and finally they did as you would expect them to do, being a reasonable group. They turned to a study which we had just completed, which is now a part of the record, on the attitudes of individual investors. That study disclosed that fewer than 1 percent of the individuals polled felt that the brokerage commission was a major factor in their investment decision.

Senator BENTSEN. What percentage?

Mr. NEEDHAM. Fewer than 1 percent.

In fact, Mr. Chairman, some of the investors who were polled weren't even aware of the range of the brokerage commissions they were paying on their current transactions. That is now in the record.

Senator BENTSEN. Let me ask you about the two-tier market that we have heard about. Do you feel that institutions have contributed to the two-tier market?

Mr. NEEDHAM. They haven't contributed to it, Senator, they have created it.

Senator BENTSEN. What is the problem that now confronts people who want to raise venture capital? Is this a serious problem for a new firm? Doesn't this result in a problem if someone comes along with a new idea, like Xerox once was, and attempts to go into the equity market? Doesn't this, in effect, in the long run restrict the competitiveness of our industrial society?

Mr. NEEDHAM. Yes, it does, and it is one of the major concerns that we have and one which threatens the very fiber of our society. This

country is the great country that it is because it is made up of a lot of small, enterprising and imaginative and innovative individuals who go into business. I have had them as clients—this group of people who start out in garages and basements and then come out with products that are acceptable to the American public and which are usable and needed. And their own entrepreneurial skills lead them, with the assistance of outside capital—public capital, ultimately—to becoming very successful ventures. I could recite for you a list of my own clients that started with this "Mom and Pop" over-the-kitchen-table idea. Now, with high interest rates, with the lack of available capital for small and emerging businesses, I just don't know where the society is going. I really don't know. And you know, not only am I concerned about it from that point of view, Senator, because—and I don't want to repeat myself, but I do feel the small businessman is the backbone of the American business society—it affects the large corporate issues as well.

Senator BENTSEN. Let me ask you this: Do you see an increasing interest by foreign corporations to take over American companies that are selling at low multiples?

Mr. NEEDHAM. Senator, I spoke to that question months ago before the first event occurred. I could see it coming and it has happened, and we will see more of it. We see it more on the west coast and in our island State of Hawaii where the Japanese have invested substantial amounts of money in real estate and companies and businesses in those States. And we are seeing it now on the east coast, where European and English capital is being attracted here to take over some of our companies. And I am not certain that is wrong. We have done it in reverse. But, certainly, cheap stock prices foster that type of investment.

Senator BENTSEN. Do you think there are any secrets on Wall Street?

Mr. NEEDHAM. Pardon me?

Senator BENTSEN. Do you think there are any secrets on Wall Street?

Mr. NEEDHAM. Yes, sir. Anything that happens at the New York Stock Exchange is always secret until we announce it.

Senator BENTSEN. We had a witness yesterday or the day before who testified that there were no secrets on Wall Street. This is not a totally facetious question because we heard in testimony that a lot of investors these days are not dealing in the old fundamentals but rather are trying to estimate what the large institutions are buying or what they are selling? Do you feel they are having that kind of impact on the market or not?

Mr. NEEDHAM. Well, I would rather we discuss that apart from the question of whether there are any secrets on Wall Street, because that suggests that the people on Wall Street have some inside information. And maybe they do, Senator, but hopefully—they are not using it. The SEC will look into it if they are.

But, the individual investor, it seems to me, is out of the stock market to the extent that he is, and not coming into it, because of fundamental economic forces. And after the beating that many of them took, either by direct investment or through pool accounts, it would seem their assets just dwindled down to the point where they are

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maybe worth a third of what they were a few years ago. The individual investor has become more safety prone. He is less willing to take risks. Secondly, when the equity vehicles have to compete with the debentures and savings accounts that yield substantially high yields and yields that exceed the rate of inflation, the fundamental question is economics. Is it better to be with equities, or is it better to be in debt? And you know, Senator, unlike the savings and loan institutions and commercial banks, we are not allowed to give away blankets and coffee pots and things like that.

Senator BENTSEN. I realize that.

You made some comments about institutions and some portfolio managers not giving sufficient consideration to the effect of a block sale as to how it might affect the market.

Do you think there should be any limitation on the size of a block sale, either by amount or period of time, within which it is consummated?

Mr. NEEDHAM. No, I do not, Senator.

Senator BENTSEN. What problems would you see inherent in such limitations?

Mr. NEEDHAM. Well, the first one is the abridgement of freedom. I might start from there.

I believe that a fiduciary in managing a fund has to have an announced investment policy, such as the case of the investment companies. Maybe that is what we need from banks, Senator—an announced investment policy which they would be forced to follow. But even that wouldn't solve the problem you are talking about.

It seems to me the fundamental responsibility, recognizing the large aggregations of capital is something we are going to be living with for a long time, is to make the market more responsive to the needs of all investors. And we dealt with just the individual investor this morning. But the institutional investor has his own problems. So, it is up to us who manage the securities markets to find ways to make our markets more responsive and responsible and, in part, we have. We have in the securities industry now a whole group of specialists who didn't exist 10 years ago, block traders. They came into being by virtue of the need on the part of institutions to dispose of large blocks of stock.

Now, I believe that the efforts to create an efficient options market in Chicago by the Chicago Board of Trade is another response by the marketplace to accommodate the legitimate needs of institutional investors. Once it is understood by institutional investors, how they can take advantage of that options market in a hedging-type operation, I think you will see greater use of it. But I think too—and this is where I began—that maybe that is not enough, maybe the human mind is not capable of reaching out and solving these kinds of problems. We need a kind of discipline and will where we are opposed to restrictions and where we are not opposed to economic incentives. That is why this haircutting procedure I mentioned to you might be an appropriate way that gives a fund manager, in the case of an investment company, incentive not to unload all at once. If he has a built-in profit of 20 or 10 percent, and he is able to sell the stock at the value it is currently being traded, he picks up that 20 percent. So that is an economic incentive.

It has been suggested that that would work with investment companies but would not work with a pension plan. We discussed that, too. One method of handling the pension plans could be to remove some of their tax advantages in order to encourage them or give them an economic disincentive from doing something which was contrary to the public interest.

Senator BENTSEN. Any further questions?

Senator BENNETT. Just for the record. We were talking about real estate commissions. They are only deductible as a business expense to a real estate dealer who is selling for his own account. The homeowner or the corporation that is selling real estate cannot deduct.

Mr. NEEDHAM. Right, Senator. While we are on the subject of limitations—and I think that is what we are on—it has been proposed by a number of people that when there is a break in the price of a security—let's say of 10 percent within a day—that that stock shouldn't be handled.

Senator BENNETT. The commodities market approach?

Mr. NEEDHAM. Right. That has been advanced for a number of years. I have never believed in it. One thing you have in the securities market that you do not have in the futures market for commodities is the securities overhanging the market at all times. You never really know what you have got out there, you know—if someone is willing to buy, someone is willing to sell.

We have that right on the floor of the Exchange. You have floor brokers who have orders in their pockets. They don't tell anyone anything until the right price is struck. And for us to close the New York Stock Exchange for 30 seconds, is a matter that we just take very seriously.

When we halt trading in a stock for any period of time, a number of people collaborate in that decision. And for us to halt trading in a stock, let's say, after it has exceeded its limit of 10 or 20 percent, and then reopen it the next day Senator, it wouldn't open at the price that it closed the preceding day. I just don't think that is a viable consideration for this committee.

Senator BENTSEN. Mr. Needham, we are deeply concerned with any attempt to make investors act other than as investors. Again, that is why we have tried to get outstanding men in this field across the spectrum to advise this committee as to any actions we take. And any actions we take, if any, will not be casual ones, because of our concern with keeping the marketplace as free as we can.

Mr. Needham, we appreciate your testimony very much.

Mr. NEEDHAM. Thank you, Mr. Chairman.

[The prepared statement and an address of Mr. Needham follows:]

PREPARED STATEMENT OF THE NEW YORK STOCK EXCHANGE, INC., PRESENTED BY JAMES J. NEEDHAM, CHAIRMAN OF THE BOARD

My name is James J. Needham. I am Chairman of the Board of Directors and Chief Executive Officer of the New York Stock Exchange, Inc. With me today are Donald L. Calvin, Vice President, Dr. William C. Freund, Vice President and Chief Economist of the Exchange, and Dr. Stan West, head of our Research Department.

We appreciate the opportunity to express the views of the New York Stock Exchange on "The role of Institutional Investors in the Stock Market" and, frankly, we congratulate this Subcommittee for focusing on what has too long been referred to as a phenomenon, when, in fact, it has become an established national problem—that is, the impact of the growth of managed investment

accounts on the capital markets and capital-raising process in this country. The growth of financial concentration in this country has concerned me for many years, including those when I served as a Commissioner of the Securities and Exchange Commission.

At the outset, let me say that it is my hope that, after study of the problem, this Subcommittee will consider solutions to insure that our securities markets provide equal opportunity to all investors, regardless of size, so that equity securities will become a more attractive investment vehicle for a greater number of Americans than ever before—and not to create a "laundry list" of restrictions which conflict with the concept of a free market system.

An important issue in these hearings, then, is the role of the individual investor in the nation's securities markets. This may, in fact, be the key issue, since any proposed legislation dealing with institutional investors should consider the impact on individual participation in the market. Indeed, our essential comment is that rather than focusing on ways of restricting the activity of institutional investors, Congressional concern and action should be to minimize institutional impact indirectly—by stimulating in every possible appropriate way greater individual participation in this nation's capital markets.

Some observers, noting the extraordinary growth of market activity by financial institutions in recent years, have forecast the virtual exclusion of individual investors from the market in the years ahead. In our opinion, the facts to date do not support that pessimistic forecast.

At the New York Stock Exchange, we regard the individual investor—including the so-called "small" investor [1] as the indispensable participant in the market. We cannot permit the individual to become the forgotten man or woman in our securities markets, as unfortunately has happened in other areas of our society.

Why is the individual investor so important to the securities markets? More important, perhaps—why is his continued participation in the securities markets essential to the national interest?

CONTRIBUTIONS OF THE INDIVIDUAL INVESTOR

Particiaption in the investment process enables millions of individual Americans to acquire an active stake in this nation's economic growth. For many, it provides a second income, or the means of financing family educational needs—or a stepping-stone to a higher personal or family standard of living.

At the same time, individual investors—both small and large—through their participation, make a vital contribution to the securities markets and to the national economy—in at least four major ways.

First, their active participation in the market gives needed breadth to trading in thousands of stocks—including many listed on the New York Stock Exchange—which, for one reason or another, do not attract the interest of institutional investors.

Second, a massive flow of individual orders helps provide the indispensible liquidity which is, itself, a major stimulus to further individual participation in the market. Liquidity—the ability to transform cash into securities or securities into cash at a price reasonably close to that of the preceding sale in a particular stock—offers individuals the opportunity to purchase stocks at a fair price at a given moment, and with the realization that they will also be able to liquidate their holdings at a fair price should their personal circumstances make that desirable or necessary at a later date. A drastic reduction in the flow of orders, centering more and more tightly on institutional business, would open the way to more abrupt price changes and loss of existing continuity from sale to sale. Deprived of the assurance of a liquid market, individual investors would find participation in the market far less attractive. Since individual investors also

[1] Much of the controversy regarding the present and future role of the individual investor has centered on the so-called "small" investor. However, many observers—and many investors—tend to regard virtually any individual as a "small" investor. This imprecise use of the term has clouded many issues and triggered a number of intemperate comments. In connection with commission rates, for example, a number of correspondents have identified themselves to the Exchange as "small" investors and have indicated that they hold portfolios valued at several hundred thousand dollars. Many of these individuals clearly are able to trade—and do—in amounts commonly considered as "institutional-sized"—and their needs, just as clearly, differ substantially from those of bona fide small investors.

The New York Stock Exchange regards as an "individual" investor any person, not affiliated with a financial institution, who customarily trades securities for his or her own account. We define a "small" investor as any such person who has (1) household income not exceeding $20,000 a year; (2) a portfolio valued at no more than $10,000; (3) annual transactions valued at less than $5,000; and/or (4) commission charges of $100 a year or less on his transactions.

Thus, as much as two-thirds of the U.S. shareowner population may be considered as "small" investors—while the remaining one-third would more properly be regarded as "medium-sized" or "large" individual investors.

participate in a substantial proportion of institutional trades, their withdrawal would adversely affect all sectors of the market.[2]

Third, individual investors participate in U.S. corporate growth—both by providing new equity capital to small and growing companies and by making it easier for larger, better-established companies to obtain additional capital by reinvesting their retained corporate earnings.

Fourth, the existing widespread ownership of American industry by millions of large and small individual investors—developed over the relatively short span of two decades—represents an essential safeguard against undue concentration of economic power in the hands of large organizations. Individuals continue to own the bulk of the stock listed on the New York Stock Exchange. In other markets, the incidence of individual ownership is even higher than it is on the NYSE. The balance between individual and institutional control of corporations is a unique feature of our system of capitalism; and we are committed to encouraging it in every possible appropriate way.

We look forward to continued vigorous growth in both individual and institutional investors' activity in the years ahead—once the nation emerges from the present period of economic uncertainty. Institutional activity may continue to increase on the New York Stock Exchange and in other markets. However, the massive flow of orders from individual investors—their primary contribution to the liquidity and successful operation of the securities markets—must also continue and, if possible, expand.[3]

GROWTH OF INSTITUTIONAL EQUITY HOLDINGS

In assessing the impact of institutional investment on the capital markets, some historical perspective may be helpful. Institutional interest in equity securities is a relatively recent development in American economic history. Institutional shareownership emerged most dramatically after World War II. The post-war growth has been due not only to increased institutionalization of savings, but also to portfolio policy changes which reflected a more liberal attitude toward stocks on the part of state legislatures and among portfolio managers.

At the end of 1949, financial institutions held less than 13% of the market value of New York Stock Exchange listed stocks. By the end of 1972, institutions owned nearly 30% of the total New York Stock Exchange List.[4]

GROWTH OF INSTITUTIONAL ACTIVITY

Perhaps more significant, however, has been the dominance of institutions in market activity. During the second half of the 1960s, stock market activity surged to unprecedented peaks—largely because of the stepped-up turnover of institutional portfolios. Prompted in part by the quest for improved investment performance, the aggregate activity ratio of major institutional common stock portfolios reached a peak in 1969 that was about 2½ times the rate recorded in 1964. In fact, even with the subsequent decline in portfolio activity, the rate in 1972 was still more than double what it was in 1964.

The result of this activity has been to reverse the relative rates of participation of institutions and individual investors on the New York Stock Exchange. In 1961, institutions and intermediaries accounted for less than 40% of the dollar value of *public* volume on the New York Stock Exchange, and individuals accounted for more than 60%. By 1971, institutions were accounting for nearly 70% of NYSE public volume, while individuals accounted for only 30%.[5]

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[2] The New York Stock Exchange estimates that at least half the "opposite-side" volume in large block trades involving less than $1 million—as recorded during a sample period by the Securities and Exchange Commission's 1971 Institutional Investor Study—was accounted for by public participation. These "smaller" blocks accounted for nearly seven out of every ten block transactions involving 10,000 or more shares. Significantly, the Institutional Investor Study Report concluded that "existing institutional volume and patterns of trading could not be maintained if . . . institutions were segregated into a separate market and compelled to trade with each other."

[3] The Exchange has projected a growth in individual shareownership from 31 million at present to as much as 40 million by 1975 and 50 million by 1980. There is a close relationship between the rise in shareownership and the rise in personal disposable income in this country. We believe this close relationship will continue, particularly in the light of government statistics indicating that, by 1980, more than 25% of U.S. families are expected to have annual income of $15,000 or more—double tue percentage in 1969.

[4] If we were to add the holdings of various types of institutions for which specific estimates are not available—such as bank-administered personal trust funds, investment counseling firms, foreign institutions, mutual funds not registered with the SEC, hedge funds, and non-bank trusts—the percentage of institutional ownership would probably total 45% of the market value of all stocks listed on the Exchange.

[5] In the past, some commentators have tended to confuse "public" volume with total volume on the Exchange. "Public" volume excludes from the total volume figure all transactions for the accounts of Exchange members and member organizations. Thus, institutions and intermediaries accounted for 68% of the dollar value of "public" volume on the Exchange during the first half of 1971. Their share of the dollar value of total NYSE volume in that period, however, was 52%.

Over the past decade, the average size of a transaction printed on the New York Stock Exchange ticker tape has more than doubled—from 213 shares in 1963 to 443 shares in 1972. This has been due primarily to activity by institutions which, as they command larger and larger funds for investment, have tended to place increasingly large orders with brokers. Another way of looking at this phenomenon is in terms of large blocks—that is, orders involving 10,000 or more shares—which are overwhelmingly institutional in origin. As recently as the early 1960s, the number of such orders remained so small, that the Exchange did not include them in its regular statistical roundups of market activity. In the fourth quarter of 1964, large block transactions accounted for less than 3% of reported share volume on the New York Stock Exchange. By contrast, in the first quarter of this year, these transactions reached a record high of more than 20% of reported volume.

INSTITUTIONS AND MARKET FRAGMENTATION

The Exchange and its member firms have not passively sat by and watched these developments; but they have adapted their operations to serve the special needs of the institutional investor. Research efforts have been expanded to provide in-depth reports for the institutional portfolio manager. Communications networks have been improved. Capital has been bolstered to enhance the liquidity requirements imposed by larger transactions. The skills which make for effective execution of institutional orders have been refined.

Nevertheless, serious problems remain. Institutions are the dominant users of the third market—the over-the-counter market in listed securities—and of the regional stock exchanges on which New York Stock Exchange listed issues are also traded. Together, the regional exchanges and the third market accounted for more than 18% of the total market for NYSE-listed common stocks in the first quarter of 1973. As recently as 1965—before institutional activity really began to surge—these other markets accounted for only 11% of all trading in NYSE-listed issues.

The third market and the regional stock exchanges offer advantages to the institutional trader which are not readily available to other investors. The third market in particular, has provided an element of confidentiality—or secrecy, depending upon your point of view—that has enabled institutional traders to keep their trades hidden from public view. Institutional transactions in the third market are generally insulated from public orders on the books of stock exchange specialists and from public orders represented in the crowd on the floor of the Exchange auction market. In the process of shielding institutional transactions from the public, these other markets in Exchange-listed stocks seriously fragment the primary market for listed issues and detract from the all-important element of liquidity.

There is another aspect of the problem of market fragmentation which, I believe, merits a brief digression at this point. I am referring to the liability of foreign institutions to acquire memberships on regional stock exchanges in this country through their U.S. broker-dealer subsidiaries. At a time when foreign interest in U.S. equities is increasing, this form of indirect access further undermines the incentives to membership on the New York Stock Exchange and contributes further to fragmenting the U.S. securities markets.

Chairman Wright Patman of the House Committee on Banking and Currency recently expressed concern about an apparent revival of interest in possibly permitting commercial banks to acquire stock exchange memberships. In a letter to Chairman John E. Moss of the House Subcommittee on Commerce and Finance, Representative Patman noted that:

"The tremendous growth in the activities of bank trust departments in relation to trading on the exchanges since the Glass-Steagall Act was passed would seem to require an even greater rationale for prohibiting commercial banks from becoming members of the stock exchange than existed previously."

Chairman Patman went on to urge the Subcommittee on Commerce and Finance to adopt: "... legislation that once again made it clear that banks should not be permitted to engage in the securities business, including brokerage."

In testimony before that Subcommittee last week, I stressed the New York Stock Exchange's support of Chairman Patman's view that the essential consideration here is not whether institutional membership on stock exchanges would increase competition in the securities business—as some have claimed—but, rather, the far more crucial issue of substantially increasing the concentration of economic power in the hands of institutional investors—particularly banks.

Yet, we find ourselves living with the strange situation in which foreign banks are permitted by the regional exchanges to do exactly what domestic banks are not, and should not be, allowed to do.

The entire question of foreign access to the U.S. securities markets has been explored in considerable depth by the Exchange's Advisory Committee on International Capital Markets. That Committee, which includes some of the nation's foremost experts in the field of capital markets and international finance, has concluded that considerations of existing national policy and potential regulatory problems strongly militate against permitting such access.

The Committee's views are spelled out in a discussion paper which the Exchange is distributing for comment by qualified experts. With the Chairman's permission, I would like to submit for the hearing record the full report of the Advisory Committee, entitled, "Recommendations Regarding Foreign Access to the U.S. Securities Markets."

INSTITUTIONS AND MARKET LIQUIDITY

Turning next to the question of institutional demands for what we might call "instant liquidity," we find a different type of problem that has a very sharp and dramatic impact on the market.

Although an institution may take weeks or even months to accumulate a substantial position in a particular stock, it often happens that at the slightest wiff of bad news—disappointing earnings or what have you—the portfolio manager will rush for the exit, with the idea of liquidating that position almost immediately without any serious impact on the price of the stock. Obviously, that is not a reasonable expectation. Yet, institutional investors often express surprise when such actions trigger a sharp decline in the market price of a stock. And individual holders of that stock—to say nothing of the issuing company—are likely to be seriously perturbed when that happens—and with good reason.

This problem is compounded to the extent that institutions concentrate their investment interest in a relatively small number of issues. A number of major periodicals have commented recently on the so-called two-tiered market made up, on the one hand, of institutional favorites and, on the other, of the vast majority of issues with no wide following. Unfortunately, this concentration—if it does indeed exist—may be unavoidable. So long as institutional performance is judged by standards based on one of the popular stock price indexes in which these highly capitalized companies carry considerable weight, institutions will feel obliged to own the so-called "favorite" stocks merely to match average performance. And it is pertinent to recognize that the huge number of shares outstanding of these companies also makes it rather easier for institutions to move in and out of their stocks with impunity.

It has been suggested by a number of observers that the problem of institutional domination of the equity markets could be solved by the enactment of legal restrictions on institutional activity. The New York Stock Exchange has taken no formal position as yet on the proposal that limitations be imposed on the size of institutional holdings or on the extent of institutional activity in the equity markets. Philosophically, however, I would very strongly oppose interfering with the normal supply and demand forces in the marketplace through any imposition of artificial and arbitrary restrictions. The markets are very sensitive mechanisms whose most efficient operation can be seriously distorted by such restraints.

One prospective aid to alleviating some of these problems may be through the development of more efficient and formally organized options markets. In some instances, options trading can serve as a potentially useful vehicle for mitigating the destabilizing price effects of large block trades. An essential function of options is that they provide an alternative to the direct purchase or sale of securities.

For example, if an institutional investor happens to be pessimistic about the short-term outlook for a particular stock in its portfolio, it could purchase "puts" or sell "calls" in that stock, without resorting to the more drastic action of selling the stock directly from its portfolio.[6]

Of course, the extent to which this technique can be effective depends upon the liquidity and depth of both the options and securities markets in particular stocks. In the past, many institutions have been reluctant to trade options. One important reason is the limited liquidity and depth that has characterized the decentralized options market in New York.

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[6] Essentially, options give the holder the right to buy or sell a fixed amount of a particular stock at a specified price within a specified period. A "put" gives the holder the right to sell the stock. A "call" gives him the right to buy it. Puts are purchased by those who think the market price of a stock is likely to decline. Calls are purchased by those who think the market price is likely to rise.

However, efforts are well underway to organize and improve the options market. The Chicago Board Options Exchange is operating a pilot program in which call options are traded on 23 NYSE issues. To date, the CBOE's pilot program appears to demonstrate the viability of organized options trading.

Moreover, the New York Stock Exchange has been actively studying the options market since last summer. Our purpose has been to determine how NYSE resources can be most effectively deployed to improve options trading in light of the potential public benefits of a more efficiently organized options market.

Another measure that might deserve more study would be to require institutions to recognize realistically the costs of disposing of large blocks. The equity portfolios of large institutions are valued on the basis of current prices on a particular trading day. Yet, the value of a portfolio containing large blocks of individual securities is undoubtedly less than its liquidating value. It has been suggested that it might be appropriate to assign a discount from the current market price for such holdings—what the securities industry refers to as a "haircut"—based on the size of the holding, the floating supply of the stock and various other relevant factors. Although the Exchange is not now prepared to formally recommend that this be done, such a requirement might well have a beneficial effect without interfering directly or arbitrarily with an institution's right to acquire, hold or dispose of stocks.

In any event, we would much prefer a positive approach to the problems of institutional activity—rather than a negative approach of imposing restrictions on portfolio decisions which properly should be governed by valid investment considerations.

As this Subcommittee is aware, Senator Harrison A. Williams, Jr., earlier this week introduced a bill that would require the disclosure of institutional holdings and activity on a regular periodic basis. This bill appears to be a direct outgrowth of recommendations made in the SEC's 1971 Institutional Investor Study Report. The Exchange would urge the acceleration of efforts to enact legislation in this area—subject to two very strong qualifications: first, that the SEC must be given adequate funds to administer the reporting requirements; and, second, that the SEC be directed to report back to Congress—say, one year after the effective date of legislation—on how the newly disclosed information is being used. In the absence of such provisions, either the reporting process could prove ineffective, or it could simply prove to be an unnecessary burden on the reporting institutions.

A CENTRAL EXCHANGE AUCTION MARKET

The problems we have been discussing this morning are basically the twin problems of market fragmentation and threats to market liquidity. The New York Stock Exchange firmly believes that the best answers to these and many other serious problems facing the securities industry today may best be developed in the context of proposals to create a central exchange market for listed securities. This concept has been widely discussed in recent months, but a general consensus as to the best way to go about implementing a central market system is still lacking.

The Exchange's Board of Directors, at its July 11 policy meeting, authorized broad public distribution of a detailed discussion paper prepared by the Exchange staff, analyzing the many and complex questions which surround the task of developing a central market system. This discussion paper attempts, first, to clarify the basic issues involved in implementing the central market concept; and, second, to provide a sound basis for discussions with all interested parties, from which it may be possible to develop a cooperative program for bringing a central market system into existence.

The Exchange's Board firmly believes that a primary objective of a central market system must be to preserve and promote exchange auction markets as the best means of serving the investing public and the national economic interest. The staff discussion paper builds on the Board's determination that all trades in listed securities should be executed on registered national stock exchanges—and that does not necessarily mean on the New York Stock Exchange only—operating under similar rules and regulations. The discussion paper contemplates integration of the third market into such a system on the theory that an auction market—rather than an over-the-counter dealer market—offers the public the best bid-offer spreads; permits rapid adjustment to supply and demand with minimum dealer intervention in the pricing mechanism; provides the best available price for public orders; efficiently matches public buy and sell orders; and provides most effectively for open execution of all transactions. In short, it is the securities auction market that offers fair and equal treatment for all investors, large and small.

Perhaps even more important, the securities auction market supports the vast, nationwide member firm distribution network for securities that provides this country's unique capital-raising mechanism—long the envy of the entire capitalist world.

As this Subcommittee is doubtless aware, the question of integrating the third market into a central market system for listed securities has generated a certain amount of controversy. But it seems clear that if the third market remained outside a central market system—and if, as has been proposed, third market dealers and member brokers were to have equal access to the system—the result would be an unbalanced competitive situation, culminating in the rapid departure of member firms from the component exchanges. This movement would begin with the elimination of fixed commission rates and would accelerate with the introduction of a system of competing quotations.[7]

Rather than take this Subcommittee's time for further discussion of these enormously complex issues, I would like—with the Chairman's permission—to offer this discussion paper, "A Staff Analysis of Issues Affecting the Structure of a Central Exchange Market for Listed Securities," for the hearing record.

However, in the context of these hearings, I might add that the discussion paper contemplates requiring full and timely disclosure of all transactions executed within a central market system—under equal regulatory requirements. This means that the type of institutional transaction that now escapes public scrutiny on the regional exchanges and in the third market would be subject to the same regulatory searchlights that now scan New York and American Stock Exchange transactions. Moreover, to avoid problems of undue institutional dominations and possible unfair advantages over individual investors, membership in the central market system described in our staff discussion paper would not be open to financial institutions.

We are asking all interested parties to comment on this discussion paper by the end of August. The Exchange staff will then analyze all comments and prepare a final document for the Board's approval at its October policy meeting. As I testified to the House Subcommittee on Commerce and Finance last Thursday, we hope it may then be possible, without further delay, to establish viable details of legislation and regulation that will earn broad—and possibly unanimous—support. Clearly, this will bring us appreciably closer to the common objectives which all of us—the Congress, the regulatory authorities and the securities industry—so ardently seek.

RESTORING INDIVIDUAL INVESTOR CONFIDENCE

I suggested at the beginning of my statement that the key issue at these hearings might well be the role of the individual investor in the nation's securities markets.

It's no secret that individual investors have been disenchanted with the market for some time—and everyone seems to have a favorite set of explanations for why this is so. To get a clearer picture of investor's doubts and concerns, the Exchange commissioned a broad, in-depth nationwide survey of small investors. And, Mr. Chairman, with your permission, I would also like to offer the survey report, "Marketing Securities to the Small Investor," for the hearing record.

We were gratified to find from this survey that small investors continue to regard stocks as a viable form of investment, and that they have a generally high regard for the professional abilities of stockbrokers.

On the other hand, the study indicates that small investors feel that large institutions—the so-called "big guys"—receive preferential treatment in the market; that the industry does not sufficiently protect the general public through self-regulation; and that brokerage firms are vulnerable to a recurrence of financial difficulties.

It was small consolation to read in *The New York Times* earlier this week that investors overseas are also beset by doubts and uncertainties—and that, seemingly, everyone in Europe and Japan has a different explanation, too. Still, as the Times implied, there seems to be a common denominator compounded of currency crises and inflation, accompanied by rising interest rates and, to borrow the Time's writer's phrase, "flights of capital into inflation hedges." Despite some new efforts in other countries to strengthen programs of economic education, a big problem

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[7] It should be noted that, for individual investors, competitive commission rates would mean "posted" rates, set by the leading firms in the industry in accordance with the type of services provided, the type of transaction involved, and so forth. The individual investor would not, in any sense, be in a position to negotiate rates on 100-share transactions the way a large institution can on transactions involving many thousands of shares.

remains of just how much investors understand recent economic and monetary happenings.

As the Subcommittee may be aware, the New York Stock Exchange has been a pioneer in this country in the field of investor education. Our Investors Information Department coordinates a nationwide program of educational and community activities designed to acquaint investors, potential investors and students with basic economic subjects and with the fundamentals of investing. Committees of member firm brokers cooperate, with support and assistance from the Exchange, in conducting such special events as investment forums, lecture clinic and radio and television discussion programs in 100 leading cities across the country. We estimate that these programs reach some two million people a year, while our national roster of some 3,500 broker-speakers address audiences totaling another million.

Our School and College Relations program prepares and distributes free classroom text and teaching aids used by at least one million high school students each year; and our staff of professional educators criss-crosses the country to participate in scores of university-sponsored economic workshops for teachers of social studies and economics.

In early 1972, recognizing that many potential investors simply did not know how to go about contacting a broker to handle securities transactions, our Investors Service Bureau compiled and published a Directory of Exchange member firms which serve individual investors. Within nine months, the Service Bureau responded to requests for nearly 50,000 copies of the new directory and handled some 500 direct requests for assistance and information. I would like to offer a copy of this directory for the hearing record, Mr. Chairman—although this particular edition will soon be superseded by an updated version.

In this summary description, I have only scratched the surface of the activities carried on by the Exchange in the field of educational and community relations. And yet, despite the expenditure of well over half a million dollars a year on these activities, we are well aware that a great deal more can and should be done.

THE NEED FOR INVESTMENT INCENTIVES

We have already examined some signs of the existing imbalance between institutional and individual participation in the securities markets. That imbalance exists and it is serious. But the way to correct it is not, I am convinced, to force a reduction in the role of institutions. The more sensible, more constructive approach is to increase the role of individual investors and traders—which can help accomplish the same objective by reducing the *relative* role of the institutions.

It is obvious from what has been happening in the market—or, rather, from what has not been happening—that this objective cannot be accomplished overnight. In addition to specific efforts to restore investor confidence, it may also be necessary to develop special incentives.

And these special incentives may be required in the interest of continued sound economic growth. I alluded earlier to the high proportion of NYSE-listed stocks in institutional hands; but this proportion does not hold across the board in other kinds of stocks. On the basis of the latest available estimates, as of early 1970, institutions owned a considerably smaller proportion of non-NYSE stocks—less than 30%. Institutions, because of investment policy or statutory limitations, favor large, well-established companies. The implications for the capital-raising ability of small, less well-established enterprises can be serious. Both government and the securities industry must rebuild the confidence of individual investors and provide the incentives to encourage their investment in equities.

Ten weeks ago, I announced that the New York Stock Exchange was embarking upon an action program to reverse the recent decline in the number of shareowners and to increase the total number by 25% before the end of 1975. Our efforts will center on improving the market system to make it more responsive to the needs of individual investors. Among the specific steps in our program are these:

1. Implementation of measures to improve the handling of securities.
2. Development of new marketing tools for our member firms.
3. Further strengthening of our monitoring of Exchange rules on timely disclosure of corporate information.
4. Stricter professional standards for registered representatives.
5. Expanded and intensified work with educational institutions at all levels to improve the public's understanding of personal finance.

6. Coordinated advertising, promotional and marketing campaign among all segments of the securities industry, to assure the individual investor that the industry is able and willing to serve his investment needs.

One of the findings of our survey of investor attitudes, as I noted earlier, was that the little guys think the big guys get special treatment. Whether or not that's true, the fact that people think it's true means that something has to be done.

At the Exchange, we are strengthening our procedures for monitoring and policing the Exchange's rules on timely disclosure of corporate information. We think it is essential to see that listed companies do not give out so-called "inside information"—either deliberately or inadvertently—to financial institutions or to anyone else before such information is released to the public.

In addition to tightening and improving self-regulatory procedures in the areas of disclosure, securities handling and member firm capital, we have also been giving considerable thought to questions of professionalization—particularly areas of disclosure, securities handling and member firm capital, we have also been giving considerable thought to questions of professionalization—particularly with respect to the qualifications of registered representatives. The registered representative, after all, is the securities industry's front-line contact with investors, and it is essential that he be an expert in his field if investor confidence is to be maintained and strengthened. The Exchange believes the credentials of those who deal directly with the investing public should be above reproach. It's as simple as that.

To back our conviction here, we have undertaken a rather expensive program to revise and toughen the Exchange's qualifications for aspiring registered representatives. New tests to meet high standards required by the Exchange are being developed by a nationally prominent authority on testing. We expect to be able to put these tests into operation next year.

We have also had some suggestions to offer financial analysts about avoiding the misuse of inside information that might come their way. And we have strongly urged the Financial Analysts Federation to take appropriate disciplinary action against any member of that professional society who may be found to make improper use of inside information.

A related area which might merit examination concerns the question of whether there is adequate separation of the activities of the trust and commercial departments of large banks. Do the banks, for example, scrupulously avoid the interchange or leakage of information between their institutional functions and their management of large individual accounts. I frankly do not know the answer to those questions. It may very well be that the doubts expressed by small investors about the advantages available to the big guys are completely unfounded in this particular area. If so, it would certainly seem worthwhile to be able to reassure them on the basis of hard facts. Perhaps this is an area that might be reviewed by an appropriate Senate Committee.

Another of our survey findings, as I have already indicated, was that many investors believe brokerage firms are vulnerable to a recurrence of financial difficulties. Anyone who has been following the misfortunes of the brokerage community in recent months knows that the small investor was right on-target in that area. This Subcommittee is certainly aware of how relentlessy unprofitable the securities business has been in 1973.

THE PROFITABILITY SQUEEZE

During the first five months—through the end of May—member organizations of the New York Stock Exchange posted aggregate losses of $153 million. When this is matched against aggregate profits of $580 million during the first five months of 1972, the net change shows a decline in profitability of close to three-quarters of a *billion* dollars.

And we are now awaiting the final figures for June—without, I must add, any great enthusiasm, since our preliminary estimates indicate a further loss of some $40 million—and that is obviously no dilution of the red ink in which the industry has been bathing all year.

Declining stock volume has also been a factor. Through the end of June, volume on the New York Stock Exchange has declined by 11%, compared with volume for the first half of 1972. And volume on the American Stock Exchange—which has substantially the same roster of member organizations—has declined by 40%. Despite some small improvement this month, we still have to face the fact that we are now in the midst of the period which has traditionally been known in the securities business as "the summer doldrums."

Few firms have been able to escape the tightening profits squeeze which has largely been the result of inflationary pressures. Since April 1970—the last time there was any increase in securities commission rates—the cost of goods and service purchased by New York Stock Exchange member firms has jumped by 18%. And, in fact, over-all commission rates have *decreased* during this same period with the introduction of negotiated rates on portions of orders over $300,000.

Obviously, all of these factors do not add up to a very good formula for running a profitable brokerage business that can stimulate the confidence of customers and potential customers—even when they are overlaid, as has been the case, with an intensive, industry-wide effort to improve operating efficiency, and stringent efforts by the New York Stock Exchange to monitor member firms' compliance with Exchange capital requirements.

We are, as the Subcommittee knows, proposing a commission rate increase which—it is important to recognize—would do no more than offset the impact of cost inflation over the past three years. We testified on these proposals at public hearings last week before the SEC. Again, with your permission, Mr. Chairman, I would like to offer for the hearing record, our report, "The Urgent Need for a Securities Commission Rate Adjustment in an Inflationary Setting," which we submitted to the SEC in June. In connection with this report, I should note that this pass-through of cost-inflation is essential, not as a means of restoring industry profitability—which it would not do—but to provide continued service to the public. Indeed, throughout the lengthening period of unprofitability—and under conditions which, in other industries, might have spawned a "public be damned" attitude—New York Stock Exchange member firms have continued to *serve* the public, even when that has literally caused them to lose money.

THE ROLE OF GOVERNMENT

Obviously, the related areas of institutional impact on the securities markets and individual investor confidence in the market offer many potential opportunities for constructive action by government.

The Administration has already taken one important step to make stocks more attractive to investors by easing the restrictions on dividend payouts.

We also strongly urge elimination of withholding taxes on foreign purchases of U.S. securities.

Another measure that would help considerably would be for the Securities Investor Protection Corporation to revise its rules to encourage brokerage firms to stimulate wider public awareness of what SIPC is and does.

Perhaps the most significant action that Congress can take—and one in which it would seem that this Subcommittee might play a key role—is to improve the tax treatment of savings invested in securities.

In testimony before the House Ways and Means Committee on March 21, the Exchange offered a five-point program for improving investor confidence through constructive and realistic tax reform in this area. This program is particularly important now because of changes in the tax code in recent years which have narrowed the differential between tax treatment of ordinary income and tax treatment of investment income. Specifically, we urge Congress to:

1. Increase from $100 to $200 the dividend exclusion from Federal income taxes.
2. Permit commissions paid on stock transactions to be treated as investment expenses and thus as deductions against ordinary income.
3. Permit a limited tax deduction for individuals who buy stocks as part of a personal pension plan, provided they are not covered by employer-sponsored plans or are covered by inadequate plans. In other words, we support enactment of the bill on this issue introduced in the Senate by Senator Javits.
4. Reduce the capital gains tax on securities, depending on the number of years the securities have been held.
5. Raise from $1,000 to $5,000 the maximum tax deduction against ordinary income for a capital loss; and ultimately eliminate the dollar limit and allow a 50% deduction of losses from ordinary income, after offsets against gains.

In our testimony at that time, we presented a thorough economic and statistical rationale for these proposals. Rather than take an additional hour or more of this Subcommittee's time today to review that material, I would like—again with your permission, Mr. Chairman—to offer the text of our March 21 testimony for the record of today's hearings.

In stressing these proposed tax measures, which we view as crucial to any determined effort to restore the confidence of both American and foreign investors in the U.S. securities markets, we certainly do not mean to minimize the overwhelming importance of bringing domestic inflation under control and restoring stability to the dollar internationally.

Indeed, our survey of small investors clearly showed that concern about economic instability has been an important factor in the curtailment of their market activity. The American consumer and investor has for many months been confronted by the paradox of coexistent economic prosperity and psychological pessimism. As the economic indicators have climbed higher, confidence in the future of the economy has seemed to slump lower. The dampening element has been uncertainty. And neither the economy nor the securities markets can thrive on uncertainty.

It is easy enough to tick off a catalog of our national economic ailments. The money supply has continued to grow rapidly—as interest rates have been rising right through the roof; the Administration has been trying to hold down Federal spending—while some elements in Congress have been seeking to increase spending; the price of gold has skyrocketed—while the value of the dollar sinks steadily lower overseas. All of these factors—and many others—have been deeply imprinted on the minds and attitudes of virtually anyone who reads a daily newspaper.

All of this has contributed to the pervasive climate of economic uncertainty. What has been making life particularly difficult for the consumer, the businessman and the investor, is the inability to plan further than a few weeks ahead with any degree of assurance. New game plans seem to be adopted, almost experimentally, and then discarded as ineffective within weeks of their implementation. The American economy—despite the superstructure of prosperity that has kept profits at high levels in many industries—has simply been rocked and shocked too many times during the past two years.

It is particularly disturbing that most of the corrective efforts to date seem to have been directed at the symptoms of economic distress, rather than at the root causes. I have no instant prescription for curing our present ills and assuring permanent prosperity and stability, but surely, it does not require great perception to recognize what our essential immediate goal must be. We need a stable dollar—at home and abroad.

This can only be accomplished through coordinated and consistent fiscal and monetary policies and through diligent negotiation aimed at establishing lasting international monetary arrangements.

In the somewhat narrower context of the issues which are being addressed by these Subcommittee hearings, the New York Stock Exchange is firmly convinced that realistic tax policy can play a major role in helping to provide the incentives needed to raise the vast amounts of capital essential to meet and fulfill the nation's demands for both the immediate and long-range future. If investment in stocks is once again made attractive to millions of Americans, that capital will again flow to American industry and we will constructively avoid any restrictive emergency measures to prevent institutional domination of our capital markets.

We have seen the number of individual shareowners of corporate stocks and mutual funds surge from 6½ million to more than 30 million in a mere two decades. We have, certainly, the means to reach the goal of 40 million individual shareowners by 1975. But achieving that goal will depend on whether government and private industry are willing to join in a cooperative effort to provide the right climate in which these millions of individual investors—and the 110 million people who are indirect owners through institutional stock holdings—can share equitably and profitably in the continuing growth of the American economy.

Big Borrowing and Big Spending: Its Impact on the American Economy

ADDRESS BY JAMES J. NEEDHAM, CHAIRMAN, NEW YORK STOCK EXCHANGE, INC., AT A LUNCHEON FOR CORPORATE AND INSTITUTIONAL EXECUTIVES, SAN FRANCISCO, CALIFORNIA, FEBRUARY 28, 1973

In the past, the New York Stock Exchange has not often chosen to speak out on economic matters outside the traditional concerns of the securities business.

But I think it's essential to recognize that, in the 1970s, certainly, the securities business does not and cannot operate in a vacumn.

The efficiency and health of the securities markets—which is a matter of direct concern to us—are closely related to what's going on elsewhere in the national economy. And it seems to me that the New York Stock Exchange, as the securities

industry's principal spokesman, must involve itself in economic issues of national importance.

This belief was reinforced just a few weeks ago, when Congress received the proposed budget for the new fiscal year 1974. As you know, the budget proposals were greeted with warm approval in many quarters, and by vigorous opposition from others.

Most of the controversy stems from various recommendations aimed at decreasing Federal government spending. The heat that was immediately generated by some of the more controversial details threatens, it seems to me, to divert public attention from the goal itself. Our nation cannot afford to let that happen. We must recognize that, if heavy government spending—financed by heavy government borrowing—is allowed to continue unchecked, we may be courting additional serious economic difficulties.

Commitment to Social Programs

Since the end of World War II, our national leaders have repeatedly reaffirmed and broadened a great national commitment to programs of social, educational and environmental improvement among many others all aimed at improving the quality of life in the United States.

These calls to national self-improvement struck responsive chords throughout America. They sparked a growing national perception that, in the midst of prosperity, there were gaping pockets of need and want. They called forth a new awareness of the problems of disadvantaged minorities, of economically depressed areas, of the aged and infirm.

And it should be noted that American businesses quickly realized that there were many areas in which they could help.

Nevertheless, in our national enthusiasm to right wrongs as quickly as possible, we made some mistakes.

Too often, in the flush of our enthusiasm, we prodded government to develop and carry out the programs needed to achieve new social goals, without adequate planning or careful enough thought for possible fiscal consequences. The result, as others have observed, has been a hodgepodge of programs, "hastily conceived and poorly put together," which simply have not done the job they were intended to do.

Realism and honesty force us to acknowledge that, despite the best possible intentions—and despite the vast effort to mobilize America's tremendous human and material resources—we are still far from the summit of achievement envisioned by our national leaders.

We have not reached many of the goals which we have pursued for more than a decade. Worse, while we have witnessed improvement in many areas, we still have poverty in the midst of plenty. We still have disadvantage side-by-side with opportunity. In short, we have not succeeded in helping all those who need and deserve assistance.

Consequently, it is incumbent upon us to rethink and reevaluate programs not only in terms of whether they have been successful, but also in terms of their effect on our national economy.

We cannot ignore the fact, for example—as recent headlines have vividly dramatized—that America occupies a rather less-than-eminent status in current world financial affairs.

Here at home—even as we strive toward the goal of full employment—we are shouldering tremendous tax burdens. We are plagued by continuing inflation—and we are confronting at least the possibility of further inflationary increases in 1973.

Clearly, this is not an auspicious time for the nation to contemplate—or tolerate—extravagant new ways to increase the national deficit. It is a time, I submit, when we should be taking a hard look at all government spending—in the full light of what we are, or are not, achieving.

"Let Government Do It"

Where economic and social issues have been concerned, it has seemed almost obligatory in recent years to blame America's problems on our long involvement in Indo-China. History will judge the accuracy of that analysis.

But when it comes to many of the problems which people today regard as symptomatic of a decadent society—the partial breakdown of moral authority, the denigration of law and order, the abandonment of many of our traditional values—it seems to me that these problems have been building for a long time, and that they pre-date the time when Americans first became aware of places called Saigon and Hanoi.

BEST COPY AVAILABLE

As we look ahead, we may find that we've been using the war in Vietnam as a scapegoat—as an excuse for not coming to grips with our other problems. For example, many of these problems may have taken root in the euphoric economic climate of the late nineteen-fifties and early sixties.

To many people the easiest answer to any new problem was—let's buck it up to the Federal government. "Let Government do it" became a national watchword. And government, responding to pressure, stepped into the breach, taking over one function after another that traditionally had been a carefully guarded province of the private sector.

The time has come for us not only to stop asking government to do so much—but, further to stop allowing government to do so much.

Surely, we have the ability in this country to meet the challenges of social responsibility and change without requiring government's help at every turn.

Private Enterprise: Merit and Need

All of you will agree that America's economic greatness—the real backbone our nation's pre-eminence—has developed, over a period of nearly two centuries, through the evolution of our system of private enterprise. This system is supported and nourished by a very complex network of financial markets. In essence, those markets accumulate, allocate and distribute capital throughout the economy—largely on the basis of merit and need.

One of the key factors in this system—indeed, what makes it unique—is the vast network for distributing new securities which is operated by the nationwide community of New York Stock Exchange member organizations. This network constitutes the major channel through which new investment capital flows to American industry from the nation's great financial institutions and from nearly 32 million individual investors.

In 1971 alone—the last full year for which statistics are currently available—a total of some $133 billion in new equity and debt securities was issued in the United States. The likelihood is that when the 1972 figures are tallied up, the total will be almost as high.

A breaksown of the total figure is illuminating. In 1971, U.S. corporations issued for public distribution a net total of about $48 billion in new securities. Of this, they offered to underwriters nearly $14 billion worth of new stocks and close to $26 billion in new bond issues. Perhaps 90 per cent of this—more than $36 billion in new securities—moved out into the hands of investors through the New York Stock Exchange distribution network. And that same network was active in the private placement of another $9 billion in corporate stocks and bonds.

The Nation's Biggest Borrower

Those are very impressive numbers. But many of you have already recognized that they don't add up to anything like $133 billion. In fact, if you eliminate the duplication, something like $85 billion remains unaccounted for.

It's not hard to find.

For that amount, ladies and gentlemen, represents the total amount of Federal, state and local debt floated during 1971—in that single year. But even this doesn't tell the whole story.

Using estimates for 1972, one of the nation's most respected authorities on fiscal and monetary policy, Dr. Maurice Mann, referred a few months ago to what he called: the "explosion in the number and dollar size of Federal credit programs." Dr. Mann pointed to the tremendous impact of Federal borrowing on the allocation of this country's real and financial resources.

Here, too, you will find the numbers very interesting. But let's go back to 1969, when combined borrowing from the public—by the U.S. Treasury and through Federally assisted programs—totaled some $16 billion. This was about 18 per cent of the total credit demand in the economy at that time. By 1972, the same sources were accounting for an estimated $60 billion of borrowing—according to Dr. Mann—roughly half the total national demand for credit.

I know of no more dramatic example of government's ability to get what it wants—and to distort the function of the public marketplace in the process—in the absence of any articulate public opposition. Over a period of less than a quarter-century—while most of the public was looking the other way, so to speak—the Federal government has thrust itself to the forefront as this nation's principal borrower.

By comparison, most of the world's noncapitalist nations—where government is expected to run the economy without much reference to a private sector—look almost like amateurs.

BEST COPY AVAILABLE

The Most Privileged Borrower

But not only is government the biggest borrower—it also enjoys special privileges which are not available to corporations or individuals.

How many of us are aware that a substantial portion of government borrowing is carried on without scrutiny by elected officials? This takes place through credit programs in which the borrowing agency enjoys what amounts to the extraordinary privilege of setting its own borrowing standards and disciplines.

Nor is this situation unique to Washington. In one large state, for example, the State Comptroller has expressed alarm at the way public financing arrangements erode the constitutional right of the people to vote on questions of state indebtedness.

Undoubtedly other states have also resorted to this method of financing.

So far, the national economy has been able to stand the strain of accommodating the seemingly insatiable demand for funds from government at all levels. But we simply do not have a bottomless well of capital—and unless some brakes are intelligently applied, something will have to give.

Consequences of Big Government

When you look back on the consequences of big government, of big borrowing, and of big spending over the past quarter-century, the wonder of it all is that we have managed to retain any semblance of a free society—that is, of the concept of individual, private initiative which is the bedrock of our American heritage.

The consequences of big government have filtered relentlessly into every aspect of our national life. But nowhere have these consequences been more dramatic than in our national economy. For, as we all know, the cost of big government has to be financed, somehow.

It was Karl Marx who declared that: "The only part of the so-called national wealth that actually enters into the collective possessions of modern peoples is their national debt."

While that statement, as quoted, is nonsense—it is indisputable that the public debt in this country—which has risen to the vicinity of half a trillion dollars—certainly and unfortunately belongs to the American people.

Along with that debt, we find ourselves today with the urgent need to damp inflation. That urgency has been underscored—again—by the recent awkward performance of the dollar on the world's monetary stages.

Just last Tuesday, Federal Reserve Board Chairman Arthur Burns stressed to Congress the crucial importance of whittling down our international balance of payments deficit as speedily as possible.

In terms closer to home—to your home and mine and to the homes of 200 million Americans—the cost of big government is paid for out of our pockets, and out of our family budgets.

We pay these costs in one way or another, whether we want to or not; whether or not we agree with the way the money is being spent; whether we happen to be financially well off, or just getting by, or economically disadvantaged. There has to be a better way than the one the nation has been using.

The Message of the Budget

I think this is the basic message to be gleaned from the budget that is now before the Congress.

The buget refers to "an idea that is central to the preservation of democracy: the consent of the governed."

Elected officials must recognize the disturbing truth that, for a generation, government has expanded and fed upon itself—not so much with the consent of the governed, as in the absence of articulate opposition.

Obviously, it is not necessary to agree with all the details in the new budget in order to support the idea of curbing runaway Federal spending. It makes perfectly good sense—particularly in a time of inflation, when we are so concerned about increasing productivity—to make every effort to allocate capital sensibly and logically: To direct it to those areas where it will do the best job in the context of our national priorities.

Critics of the budget claim to find it neglectful of government's social responsibilities. They imply that the quest for sound fiscal policy must somehow be incompatible with the goal of building a decent life for all Americans.

That attitude is incompatible with common sense. The government of the United States—whatever its shortcomings in some areas—is certainly not going to ignore or neglect the poor, the sick, the aged, the disadvantaged—or anyone else—who, as an American, is entitled to share fully in the benefits and opportunities generated by a healthy ecomony.

Those critics might well consider the words of Thomas Jefferson—in his first inaugural address: ". . . a wise and frugal government, which shall restrain men from injuring one another, which shall leave them otherwise free to regulate their own pursuits of industry and improvement, and shall not take from the mouth of labor the bread it has earned. This is the sum of good government, and this is necessary to close the circle of our felicities."

Jefferson lived in a much less complex age than we do. He would recognize that in 1973, wisdom and frugality are not enough. Certainly, he would add compassion to the characteristics of government needed to set our nation's priorities in order—and to complete a modern circle of felicities.

The People's Responsibility

The task of making certain that the element of compassion figures prominently in any determination of our national priorities should not be borne solely by elected officials but by all Americans, including business and labor groups.

The goal of decreasing the total size of government will take time. But we can make a good start toward bringing the administration of vital public services into a much closer and more logical relationship with the people who require them most.

This means, of course, greater accountability for state and local government. It also means Americans will have to watch what goes on more closely. Such involvement will strengthen what many people today refer to as "participatory democracy."

We live in an era when four-letter Anglo-Saxon words seem to have lost the ability to shock most people. But as we take a hard look at big government—and at big borrowing and big spending—we must voice a four-letter Anglo-Saxon reaction of our own.

And that word is: Stop!

That doesn't mean we should stop doing everything we can to improve the quality of life in America. But it does mean we should stop looking for easy solutions from government—because the kinds of problems we are concerned with have no easy solutions. Therefore the solutions to those problems must be sought by all Americans.

* * * * * * *

As I indicated at the beginning of my talk, the Stock Exchange has traditionally followed a policy of tending chiefly to the matter of running an efficient securities marketplace.

That's still our main business. It always will be.

But as everyone knows, our business is very closely watched by government. And government has never been bashful about giving us suggestions for change and improvement.

I have made it clear that we regard this as a two-way street. Neither the Exchange nor the government is exempt from constructive criticism. The Exchange will state its views when major matters involving the economic well-being of this country are at stake, because any weakening of our economic position is bound to adversely affect every individual American.

Senator BENTSEN. Mr. Kolton, would you state your name and position for the record.

STATEMENT OF PAUL KOLTON, CHAIRMAN, AMERICAN STOCK EXCHANGE, INC., ACCOMPANIED BY NORMAN S. POSER, SENIOR VICE PRESIDENT IN CHARGE OF POLICY PLANNING; AND DAVID LENEFSKY, PROJECT DIRECTOR

Mr. KOLTON. Mr. Chairman, and members of the committee, my name is Paul Kolton, and I am chairman of the board of the American Stock Exchange. With me today are Norman S. Poser, senior vice president in charge of policy planning, and David Lenefsky, project director in the same office.

The subject of these hearings—the role of institutional investors in the stock market—has implications which go far beyond the securities markets and has a profound effect on our national economy. During

the past few years we have seen fundamental changes in the character of the U.S. securities markets—the most dramatic of which has been the rise in importance of institutional activity. In the chain of events which followed, one result, which we are only now perceiving, is the increasing difficulty which many of the Nation's corporations—and particularly smaller companies—face in raising new capital from the American public. Because the problem is so vital, we welcome the decision of this subcommittee to address itself to it.

In the past decade, as the committee well knows, institutional activity in the securities markets has risen to the point where it now accounts for approximately 70 percent of volume on the New York Stock Exchange and approximately 25 percent on the Amex. Beyond these figures, there have been qualitative changes which are more difficult to measure. The markets, which have traditionally served as a vehicle for helping to raise and allocate capital and have served as a sensitive pricing mechanism responsive to thousands of individual investment decisions, have lost a degree of their ability to perform these functions. These conditions developed as institutions grew in size and in impact—and as the individual retreated to the sidelines, convinced, in part, that he could not compete on an equal footing with large institutions.

While such factors as inflation, the plight of the dollar abroad and our political problems at home have certainly played a part in causing the individual to withdraw, his concern over institutional domination has clearly been an important factor. By the summer of 1973, a series of surveys had indicated that individual investors believe that institutions have better access to information, receive better executions in the marketplace, in some instances have an excessive impact on stock prices, and have a better opportunity to receive allocations of desirable new issues. In summary, the public has come to think that institutions receive preferential treatment over individuals.

The result has been what one might predict. The people who believe that they are less favored are turning elsewhere to satisfy their investment needs. For the first time since 1952, when such data were first assembled, the number of individual stockholders in the United States has declined. Stockholders now number approximately 31.7 million, down 800,000 from early 1972. Similarly, trading volume is down substantially. On the New York Stock Exchange activity for the first 6 months of 1973, is down 11 percent from the year-ago period; on the Amex, where the individual investor still accounts for 75 percent of activity, our special concern over the departure of the individual is dramatized by the fact that volume is down by 40 percent from a year ago.

When this withdrawal by the individual is coupled with the recent tendency by many institutions to concentrate their holdings in a relatively small number of issues, a so-called "two-tiered" market is created. For the overwhelming number of common stocks in the second, or noninstitutional tier, price-earnings ratios have fallen to lows which have not been seen in over 15 years. In the wake of the public's absence and given deteriorating stock prices—and even though corporate earnings have continued to rise—the ability of companies to obtain new financing from the public has been substantially impaired. And this goes to a question the chairman asked of Mr. Needham regarding the ability of companies to raise equity capital. A measure

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of the paralysis which is affecting the Nation's capital markets is the fact that, in May and June of this year, only seven companies in the entire country were able to make their first registered public offerings of common stock and this compared with 104 companies in the same 2 months of 1972.

We believe that these developments are a matter of urgent concern, and that they make it so appropriate for this subcommittee to consider legislation which would, first, help restore the confidence of individual investors in the fairness of the securities markets and, second, provide encouragement to individual investors to participate in these markets.

Several months ago I suggested certain steps which might be taken by institutions on a voluntary basis to help win back the investing public, on the theory that the institutions themselves have a vital self-interest in preserving the efficiency and fairness of the markets they use. It is implicit in those suggestions, of course, that if voluntary action is not taken, new legislation would be appropriate, certainly to the extent that these steps do not lie within the existing authority of the SEC.

At the outset, there is now widespread agreement that there should be periodic disclosure by institutions of information relating to their activities and holdings in the markets, similar to disclosures now required by the SEC of mutual funds. Earlier this week a bill was introduced in the Senate to provide such disclosure, and while we have not yet had an opportunity to review the text of the legislation, we strongly endorse this direction in principle. Moreover, such a measure would have a salutory effect on the patterns of institutional activity it the market.

Beyond the question of disclosure, we think it timely to develop clear guidelines concerning the methods and patterns of institutional trading. This suggestion is based on a thoughtful view that the demands that institutions make on the markets are often greater than the markets are reasonably designed to fulfill. For example where an institutional investor has acquired a large position in a stock over an extended period of time, it may be unreasonable to expect the markets to absorb that position within a few hours—or minutes.

One effect of such sudden "dumping" of positions is to change drastically the market price of a security, even though no fundamental corporate events have occurred which would alter the security's inherent value. Price fluctuations of this kind, which may occur only because of a decision by an investment manager to liquidate a position, can be expected to have an adverse impact on public confidence in the markets. Over the years, one of the hallmarks of the U.S. exchanges has been the orderliness and gradualness with which price changes normally occur. This has done a great deal to inspire public confidence and participation. And, the stockholder today who sees a large percentage of the paper value of his holdings disappear during one trading session is likely to be wary of those markets, and of the market mechanism itself.

We believe, therefore, that consideration should be given to limiting an institution's activities in a security, perhaps in relation to that security's recent volume. For example perhaps an institution's volume should be limited to a given percentage of average weekly volume on the Exchange during the previous few weeks. This is a

technique the Amex has used over the years in connection with so-called shelf distributions. In this procedure selling stockholders and companies undertake to sell securities in an orderly manner, generally over a period of time, and the results have been markedly satisfactory.

A third area we believe should be explored is the advisability of limiting the amount of stock of any particular company which an institution is permitted to hold. Such a limitation would encourage institutions to spread their investments among a larger number of companies and avoid the effect of the "two-tiered" market, which tends to focus attention on institutionally favored stocks and simultaneously distort the market value of those which happen to be out of institutional favor. Limitations on holdings also would avoid situations in which institutions, often inadvertently, have placed themselves in a position to dominate the managements of their portfolio companies.

In the few minutes that remain, I would like to turn to the role that tax incentives can play in encouraging the investment process. Several suggestions have been made recently that are designed to encourage risk-taking by individuals, and I will mention those which we believe might receive consideration from the subcommittee, with a view to the possible enactment of an individual investor's tax incentive bill. We start, I might add, by recognizing that thousands of America's publicly held companies, because of their relatively small size and the nature of the investment risks involved, depend on individuals, not institutions, to supply substantial quantities of equity capital.

First, it has been suggested that the dividend exclusion from personal income taxes be increased from its present level of $100 to $200. Such a step would certainly demonstrate that as a matter of national policy we are prepared to encourage the smaller investor to participate in our equity markets.

Second, it has been suggested that the applicable rate on realized capital gains be reduced progressively the longer a security has been held by an investor. Such a step would not only give tax relief to many holders who are, for all practical purposes, "locked in" by the present capital-gains rates, but would at the same time actually increase Government revenues by unlocking these securities, while serving to provide additional liquidity to the market.

A third proposal which the committee has discussed is that commissions paid by investors should be treated in the same way as other investment expenses, and not as part of the purchase or sale price of a security, as they are treated under the present tax code. Such an amendment to the tax law would enable investors to deduct all of their commissions paid against ordinary income.

Finally, it has been proposed that the present $1,000 maximum tax deduction against ordinary income for capital losses should be substantially increased.

All of these proposals for encouraging investment in the equity markets represent positive steps forward and we believe they merit serious consideration by this subcommittee. More than that, Mr. Chairman, we believe the work of this subcommittee itself represents a promising and important start toward encouraging the individual investor to again participate directly in his own—and the Nation's—economic future.

Thank you.

Senator BENTSEN. Thank you very much, Mr. Kolton. Senator Bennett, you can proceed.

Senator BENNETT. There are two or three points in your testimony, that I noted as I read it, because this was interesting because it conflicted more or less with the testimony we had yesterday from Mr. Calloway.

You say that the third area you believe should be explored is the advisability of limiting the amount of stock of any particular company which an institution is permitted to hold, on the theory that that would take the companies deeper into the lower tier.

The point was made to us yesterday that the very large companies have so heavy a capitalization and the small companies so limited a capitalization that, if you put a limit of 5 percent on, this could effectively deter them from an investment in a small company, while they could still go on investing in the very heavily capitalized company, the company with millions of shares. So that if they were thinking of a time when they had to make a fairly quick liquidation, the easiest decision is to go with the company where they probably would not hit the ceiling for a long, long time. So the feeling was that that might be counterproductive.

The witness also told us that Morgan Guaranty were interested consciously and definitely, as a matter of policy, in getting into the lower market now. And when they did, they tended to have a larger percentage of investments in the limited capital company than they do in the big ones.

Do you think that kind of testimony would cause you to change the recommendations you make here?

Mr. KOLTON. I think there are interesting points that have been raised there, Senator. I think that what yesterday's testimony tended to focus on was the upper tier on the one hand and the smaller companies on the other. And it is quite true that with the very smaller companies that are coming into the market, that have just outgrown the "Mom-and-Pop" category and are going public, institutional participation among those companies would pose very serious problems of control and would probably exceed any realistic guidelines that could be developed.

But there are thousands of companies, publicly held companies in America that occupy, what I would call, the middle tier. These are companies that are quite large in their capitalization, and have been enormously profitable over the years that have been largely ignored by the body of institutional investors and are suffering the problems that we are now witnessing, caused because of the two-tier market. So, in this instance, Senator, the focus or the thrust of our proposal would have immediate effect on that middle tier of companies that have been largely neglected and are represented at the present time on the American Stock Exchange, and on the New York Stock Exchange.

Senator BENNETT. As I remember what I heard yesterday, it is the kind of problem that cannot be simply solved.

Mr. KOLTON. Absolutely.

Senator BENNETT. You put one limit here and then it chokes off something else.

Even if it were possible to identify the favorite stocks—the first tier stocks and the middle tier stocks and the third tier stocks—and then say to them, you may only have 40 percent of your investment

in class No. 1, and you must have X percent of your investment in class No. 2, I imagine that is an impossible definition and would be impossible to enforce?

Mr. KOLTON. I would expect that would be very difficult, but I think that it might be possible to construct a formula that was based on either percentage or a given number of shares or certain amount of dollars, and then the formula would be constructed in a way that the activity might be restricted to the greater of those amounts. It seems to me, if there were real interest in exploring this, that the formula would come.

Senator BENNETT. Mr. Calloway also made the point that, as a trustee, if you put a 5-percent limit on, let us say, IBM, he is not then able to provide equal service to all of the accounts for which he is the trustee, and this would present a serious problem, a philosophical problem.

Mr. KOLTON. I think there is a very, very interesting philosophical problem there and, that is, whether a trustee in addition to his fiduciary responsibility to the particular people who owned the security, whether he also had the broader responsibility to the market in which he operates to ensure, both in his own self interest and in the interest of the broader community that that market continues to be a viable one.

I believe that one of the problems that has surfaced in the last several years is that the institutions have properly focused on their fiduciary responsibilities but very few people have paid attention to the broader social responsibilities that may be inherent in making sure that the mechanism works.

Senator BENNETT. That is natural because they are subject to very strict regulations with respect to their fiduciary responsibilities.

Mr. KOLTON. That is right.

Senator BENNETT. Right.

Mr. KOLTON. I might say, Senator Bennett, that Morgan Guaranty is a good example of a major institution that is aware of and is studying its broader responsibilities, and yet it is an institution also in which 40 percent of its holdings are centered in only 20 companies. This is part of our broad dilemma here.

Senator BENNETT. This is the old problem of the conflict of interest, which we all have to live with in one way or another. You also said that limitations on holdings will also avoid situations in which institutions often, inadvertently, place themselves in a position to dominate the management of their portfolio companies.

Again, referring to Mr. Calloway's testimony, he told us in detail how they avoid that risk; how far they go to avoid that risk. Do you think it is a serious risk in the terms of the total holdings of institutions? Are there institutions that use their capacity to influence management? Is it a serious problem or is it just an occasional problem?

Mr. KOLTON. No, sir, we believe and we have done some research on this, which we have reported on previously, that it is a significant problem. We had the Harris organization, some years ago, conduct a series of in-depth interviews with company managements, with executives, of a series of companies, in which we probed—rather the Harris Co. interviewers—probed the corporate relationships with institutions to find out what kind of direct and indirect pressure might be exerted, both in the area of disclosure of information and in terms of

influencing management decisions. And in both of those key areas—I don't recall the exact figures—but we could certainly make them available to the committee—an overwhelming majority of the respondents indicated that they felt they were subject to institutional pressure either for information about the company's prospects or finances or how it was faring or getting into areas that involved what in an orthodox sense must be considered management decisions.

Senator BENNETT. Is there a difference between the position of a fiduciary which, according again to Mr. Calloway, represents the decision of the holder of the stock for which it acts as trustee, rather than the decision of the management? In other words, he told us that in every case, they go back to the person or company for which they are trustee, to ask them to tell them how to vote the stock in the case of where the stock could be voted. And, in most cases, they are told and they vote the stock in accordance with the instructions of the owners. In some cases, they get no instructions.

Now, is there a difference in their situation than that, say, of a mutual fund or a pension fund where you can't identify the owners so readily?*

Mr. KOLTON. I don't know that there is but I strongly suspect that there is. We tend to speak of institutions and use the word as a catch-all and yet institutions obviously cover some 20,000-plus organizations, and include not only the banks and the investment companies, but insurance companies, foundations, charitable trusts, colleges. So I think it is very hard to characterize their practices under one umbrella. The information that the Amex had in the early 1970's and the late 1960's would indicate that institutions were acting very differently depending on the nature of the institutions and the nature of their holdings.

Senator BENNETT. Does this committee have a copy of that study? Could we see we get a copy?*

Mr. KOLTON. We could certainly see that one is made available.

Senator BENNETT. Well, I would start by saying that just within the week this committee finished its work on a very comprehensive pension plan, and so our minds are on that general problem. What could be the potential effect if pension funds were invested in a limited number of stocks? What could be the effect on the solvency of those funds? Should we be concerned from that point of view about more diversification?

Mr. KOLTON. Well, I think that the solvency of the funds, the ability to protect the people who are behind the funds and whose financial futures literally are tied up in many cases, entirely in those funds, is a matter that, obviously should receive the attention of this subcommittee. I think that is a very valid concern that the Senate would have to focus on.

As to its impact, as to how you address it, in terms of the funds' investment decision, I really don't know. I would like to think about that and perhaps as we focus on it, if we could submit a memorandum to the committee, it might be helpful?*

Senator BENNETT. Well, maybe, we should go the way of trying to identify the various types of institutions and beginning to set limits by types rather than to set an overall limit? It seems to me, aren't

*At press time, Sept. 17, 1973 the information referred to had not been received. The Committee was informed that information was forthcoming and would be included in the printing of the hearings held by the Subcommittee on Financial Markets in September 1973.

mutual funds limited in their investment to 5 percent? Now, maybe pension funds——

Mr. KOLTON. Oh, there are a whole battery of limitations that now exist for different categories of institutions. And, of course, by the charter of the institution, depending on the State in which it has been organized, so they range over a whole variety of areas.

Senator BENNETT. There seems to be general agreement on the need for greater disclosure of institutional holdings, but I notice you have also imposed restrictions on the volume of trading.

Can you tie these two together and comment on what you think the problems are?

Mr. KOLTON. The broad problem, Senator, is that we believe the institutions have a vital interest and, in fact, a responsibility in making sure that the markets in which they are so heavily involved continue to operate in a way that encourages participation by the individual investor, which is absolutely essential to the institutions' operations in the marketplace also.

A factor that is frequently forgotten is that a simple 100-share trade by two individuals activates the pricing mechanism that helps an institution value a portfolio that may be worth many, many billions of dollars. And we believe that one of the things that has been lost sight of in the rise of institutional activity is the self-interest that the institutions have in making sure that the markets that they use, continue to be responsive, because the markets have become less responsive with the withdrawal of individuals and with the growing power of the institutions. And we have asked ourselves what steps might the institutions take to be sure that the markets continue to operate in a viable fashion? Two things have suggested themselves.

One is the advisability of limiting an institution's holdings in a particular company. Another is limiting the degree of activity in a particular security at a particular moment in time, to be sure that there are no disruptions in the market that will only serve to alienate or trouble the public even further.

We don't believe that those proposals are in any way mutually exclusive or inconsistent. As a matter of fact, we have over the years taken the position that, as the public has been invited into the market, an increasing number of reasonable restraints have been imposed upon the professionals in the market. Certainly the institutions are professionals in an orthodox sense. And to the extent that they are professionals, to the extent that they have an enormous economic muscle, it seems to us that prudent restraints could be imposed upon the institutions in their use of the marketplace for, as I indicated earlier, their own self-interest.

Senator BENTSEN. Mr. Kolton, do you feel that some of the large institutional portfolio managers in buying stock have the ability to have a self-fulfilling prophecy insofar as what is going to happen to the price of that stock because of the amount of continued increase in the amount of money they have put into the market?

Mr. KOLTON. I think, Mr. Chairman, that we have seen that develop over the years and I think that the very amount of economic power that is concentrated by institutions in the market would indicate that there is, to a degree—and I can't document it—but I believe to a degree there is a self-fulfilling prophecy.

Senator BENTSEN. Does that, in effect, lock them into some of these stocks?

Mr. KOLTON. It may. It may indeed.

Senator BENTSEN. Do you see a tendency on the part of other investors to want to know what the large institutions are buying and selling instead of concentrating on some of the old fundamentals on investing in stocks?

Mr. KOLTON. I think that would be a perfectly human question to ask that if an individual took a look at the market and saw that 70 percent of the activity in that market was conducted by institutions and then he realized, too, that the institutions were focusing their activity in a relatively small group of securities, and that they tended to be more successful in the market, then those securities that the institutions were not favoring, would also not be favored, would also not be favored so much by the individual investor. I think it is a perfectly human question to wonder what activities the institutions were up to; what stocks the institutions are focusing on.

Senator BENTSEN. You made a remark about limiting the percentage of stock in a single corporation that one institution could cwn. Now, a previous witness made the point that a stable of funds could be created. Under this technique each fund could go up to its limit and thereby the management company would have a very substantial interest in the corporation. Now, how would you apply it to a large institution and do it effectively to accomplish your objective?

Mr. KOLTON. There might be several ways to do it but one would be to focus in on who had the management, who had the investment responsibility. If a small group of individuals were managing a group of funds, then I think it would be appropriate to apply this approach to all of the funds that the group managed.

I might say that the on the shelf distribution problem, which is an area the Amex has had specific experience with, and which can involve companies, with perhaps 60 or 100 selling stockholders, including other companies and institutions—and they have raised that identical question, namely: Do you mean this has to apply to all 60 selling stockholders or all participants in the shelf distribution? And our response has been "Yes": The overriding concern is with the orderliness and the stability and the fairness of the market.

And I was interested in some of the earlier testimony of some of the people who appeared before this committee; some of the people who expressed great concern over any imposition of restraints on institutional activities because they were with organizations with which we pioneered in developing the shelf distribution mechanism I have described. They have been, as I said, markedly successful in their ability to, over a period of time, satisfactorily sell large blocks of stock without disrupting the market.

Senator BENTSEN. Senator Byrd?

Senator BYRD. Thank you, Mr. Chairman.

Mr. Kolton, how far flung and deep is the screening of companies which seek to be listed on a stock exchange? I intended to ask that of the previous witness and forgot it.

Mr. KOLTON. There is a very extensive screening that goes on by the securities division of the American Exchange and, to my knowledge, by the stock list department of the New York Stock Exchange. It is a process that begins with confidential and informal discussions with the company in which a whole series of questions are probed, not only matters that deal with the financial information that the

company has available—and that is in the public record—but with questions dealing with conflicts of interest that may exist within a company, questions about its disclosure policy, its relationships within its own corporate community and so on.

Once the staff—and I now turn to the Amex, in particular—once the staff of the Amex has satisfied itself that a company apparently meets the exchange's requirements, it gives an informal preliminary opinion, advising the company that, on the basis of the information that we have available—and this includes a review by an internal examining staff at the exchange—a company is told that it is in a position to submit a formal listing application. When that formal listing application arrives, it is again reviewed and then sent to an outside accountant, to one of the major accounting firms.

Senator BYRD. The exchange does that?

Mr. KOLTON. The exchange does this. The exchange has an arrangement with a series of major accounting firms which review every listing application after the exchange staff has done it. The reason that we have to have this arrangement with a number of accounting firms is that a particular company is very likely to have its own accounting performed by a particular firm and, obviously, we will have to have that information reviewed by still another accounting firm.

And when we send it, we also send to the accounting firm any questions that our own staff may have relative to its financial condition, its statements, or the accounting practices or the problems that may have arisen.

So, by the time the answer comes back, we are reasonably satisfied that we have probed to a point where a recommendation can be made to the board.

Senator BYRD. Well, once a company is listed, do you take any subsequent precautions? Are there any subsequent probings?

Mr. KOLTON. Oh, yes, there is constant attention given to our listed companies. I would say that a very substantial part of the exchange's budget is devoted to following up with companies to be sure that they make timely disclosures of material information, in which the public has a warrantable interest. We follow up closely on the issuance of their quarterly reports and semiannual and annual reports. We have a series of delisting criteria, that is, criteria for continued listing that a company must meet over the years. And when a company falls or even starts to fall below those criteria, our people engage in conversations with the company as to what its problems are and what its prospects for the future are, so that we do try to follow those very closely.

Senator BYRD. If the price of a stock of a particular company were to drop, just to take a figure from 80 to 10, is that, in effect, a candidate for delisting?

Mr. KOLTON. Price, sir, is not a criterion for delisting, but our computers are programed so that at the end of each trading day they give us the names of the securities traded on the exchange that day that have varied by a particular amount from their normal volume and from their normal price variation and that list of securities is immediately distributed to our surveillance division and to our securities division. They go to work and they try to find out why it has happened and what has happened. Frequently, most frequently,

there are developments that are readily apparent as to why those movements occurred but, where they are not, the exchange will launch an investigation.

Senator BYRD. Thank you.

Now, in your statement you say that the New York Stock Exchange activity for the first 6 months of 1973 decreased 11 percent while on the American Exchange the volume decreased by 40 percent. What does that indicate to you?

Mr. KOLTON. To us, that indicates, Senator, the withdrawal of the individual from the market, his increasing sense of concern and alienation over economic conditions in general, and over his disenchantment with the market as an investment medium at the present time, in particular.

I think that the Amex was particularly affected by the withdrawal of the individual because so much of our volume springs from the individual.

Senator BYRD. That is what I was getting at, the wide disparity between 11 percent and 40 percent.

Mr. KOLTON. Yes, sir, because 75 percent of our volume comes from the individual. Out of every 100 shares, the individual is responsible for 75 shares on the Amex and only 30 shares on the New York Stock Exchange.

Senator BYRD. And that is because of a difference in size of the companies?

Mr. KOLTON. Yes, sir.

Senator BYRD. Companies listed?

Mr. KOLTON. Yes, sir. There are a number of companies on the the Amex who by their size would not, at the present time, represent viable investment mediums for institutions because of the size of the institution.

Senator BYRD. You recommend a change in the tax laws concerning capital gains. What is your specific recommendation?

Mr. KOLTON. Well, the specific recommendation, Senator Byrd, is that the applicable rate be reduced progressively the longer a security has been held. Now, this grows out of the earlier studies that Lou Harris made for the New York Stock Exchange which was, I believe in the early or mid-1960's, and subsequent studies that have been made by others. And in all cases, the indication has been that not only would a reduction in the capital gains rate serve to unlock securities and, thereby, add to the market's liquidity, but would generally help——

Senator BYRD. But at what point would you start and at what point would you stop? Would you have 6 months at a minimum?

Mr. KOLTON. We haven't taken a formal position on the rates but I would say that the American Exchange would certainly be interested in seeing that 6 months extended. There are many ways, however, to get at the problem of unlocking the funds that are locked in and we would be very happy to give the subcommittee the specific priorities that we would assign to an adjustment of the capital gains rate and holding period.

Mr. POSER. I think, just to clarify Mr. Kolton's remark on extending the 6-month period, I don't believe that would mean that the present short-term capital gains should be for a longer period than 6 months. I think we are principally talking about the period after the 6 months, that instead of having one stepdown, to have a

series of stepdowns as time goes by; maybe over a period of years.

Senator BYRD. And how low would the rate go on that basis?

Mr. POSER. Well, that, I think, we will submit a memorandum to the subcommittee.*

Mr. KOLTON. In earlier work that we did on this and that we have not brought up to date, we had taken it down to 12½ percent.

Senator BYRD. Thank you, Senator Bentsen.

Senator BENTSEN. Thank you very much, Senator Bryd.

Senator Roth?

Senator ROTH. You made the statement that dumping stocks, on occasion, creates a substantial change in the price of that stock. Why would it be to the advantage of any large institution to dump a large block? Wouldn't it be to their advantage, as a matter of economics, to spread their sales out over a longer period of time?

Mr. KOLTON. I would think that it would be to their advantage but experience would indicate that, when an institution makes a decision, it very frequently wants to act quickly. It really has not been uncommon for us to find, after we have reviewed a particular situation, that an institution may take a period of weeks or months to assemble a block and then once they have reached a decision to sell, that decision may have been reached at 3:10 in the afternoon and by 3:30 they want out. We have seen that happen.

Senator ROTH. Has your organization or any other studied the extent to which dumping has had a substantial impact on the price of a given stock?

Mr. KOLTON. We haven't made a study in the broad sense of your question, where we could aggregate all of the figures and all of the incidents, but we have made a series of studies of individual incidents where this has occurred and where we have been able to see the impact on the market and what happens.

Senator ROTH. In any event, it is your position that the incidents have been high enough so that some kind of corrective action is needed?

Mr. KOLTON. Yes, sir.

Senator ROTH. You mentioned the Harris study which attempted to measure the impact that large holdings have on a particular corporation. If a large institution has controlling holdings in a number of companies in the same industry, doesn't this seem to imply a conflict of interest or possibly even antitrust implications?

Mr. KOLTON. It might, Senator, but I might say that certainly there would be nothing in the Harris study, that I could recall, that would suggest that, because here the information we were seeking was from corporate executives, who were not, in the course of their interviews, being asked to name the particular institutions, where these matters may have arisen. In other words, we were simply asking them for trends and patterns and the kinds of pressure that they might be subjected to. So we would have no information based on the Harris study, per se, as to whether an institution that was talking with company A, might also be talking with company B and company C.

Senator ROTH. Is there any information that shows, for example, the extent to which large institutions buy into a number of companies within the same industry?

Mr. KOLTON. I don't know, Senator. I don't know of any information there.

*At press time, Sept. 17, 1973 the information referred to had not been received. The Committee was informed that information was forthcoming and would be included in the printing of the hearings held by the Subcommittee on Financial Markets in September 1973.

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Mr. POSER. There may be something in the institutional investors study of the SEC, which was published in 1971, that might answer your question.

Senator ROTH. Now to your proposal of tax incentives. We all have read in the newspapers and heard discussions that Congress should eliminate alleged tax loopholes. Capital gains tax treatment frequently is included as one of the biggest. What justification is there for us to extend rather than eliminate it?

Mr. KOLTON. I think, Senator, that the subcommittee in the study that it is engaged in at the moment is addressing itself to broad questions of national policy and one of the broad questions of national policy has to do with what role the individual is expected to play in our securities markets, what role the markets, themselves, fulfill. And to the extent that we require individuals in the markets to make this business of raising and allocating capital work, and to the extent that the markets have to be viable so that individuals as well as the institutions will participate, then it seems to me if those steps, that have been recommended, can be taken and agreed upon, then the subcommittee is in a position to say that this is in the interest of participation in the market and in the interest of a viable market, which will ultimately stimulate the growth of capital and will stimulate the ability to raise it, and, therefore, the benefits and inducements are necessary.

I don't think, for example, that our economy can continue to grow and develop new products to put people to work if over every 2-month period only seven new companies are going public, and yet that is what we had over the past few months.

Senator ROTH. You have made a number of specific proposals to change the tax laws. Do you believe that they are going to make a significant change in the number of small or private investors who will participate in the market? Is this what is really keeping them out or is it what has happened to the stock market generally?

Mr. KOLTON. On, no, I think it would be badly overstating the case to say that the current tax structure, even if it is changed is going to play a decisive role but I think a number of things are having an effect and are going to have an effect. And a revised and what I consider a more favorable tax climate is a very important part of the underpinning, but, obviously, major questions have to be addressed as well; questions of inflation, questions of managing our foreign trade balance, questions of the dollar and certainly questions, as I have indicated in my prepared statement, of our political problems at home are influences that are weighing heavily on the individual. But I think a series of steps has to be taken and one of them is a tax climate which tells the individual that he is wanted.

Senator ROTH. Do you really believe that there is an opportunity to bring back the small investor in a major way? I have had a number of people in the past tell me that they feel that he is a dying breed and it doesn't make much difference what we do.

Mr. KOLTON. I don't believe that at all, Senator. I absolutely believe that the smaller investor, the individual investor, will return to the market when he is assured that there is a climate within that mechanism in which he can deal on an equitable basis and be dealt with fairly and be serviced properly. I don't have any question in my mind that the individual investor will be back. I do have a question as to the timing.

Senator ROTH. Well, if pension funds for example tend to concen-

trate on a few so-called upper tier stocks, aren't we in a sense preventing the creation of thousands of jobs by lack of capital for the medium and small companies?

Mr. KOLTON. I think we are.

Senator ROTH. Have any studies been made as to the this impact?

Mr. KOLTON. I don't know of any studies that have been made but, certainly, it is instructive to look at the new-issue market. For example, Mr. Poser has just given me a month-by-month summary of the number of new issues that have been brought to market. Since January 1972—now, this bears directly on the ability of the corporations, the young ones and the new ones, to go public, and we have talked already about the 7 companies that went public in May and June—now, that number by contrast was 64 in March 1972 and 57 in June 1972. So I think that we are looking or have been witnessing over the past 18 months a slow withering of that process and I think it is a dangerous one.

Senator ROTH. I think any information that you could give us to document the impact of market concentration on new jobs and new industries would be most helpful.*

Mr. KOLTON. I might say, Mr. Lenefsky pointed out one of the figures we have developed is that underwritings, during the first quarter of 1973, were down 49 percent as compared to the first comparable first quarter of 1972. Here, again, is another direct evidence of slowing down of this process of putting people to work and creating new products, new jobs, new markets, new equipment.

Senator ROTH. Some people have proposed that we create a capital gains tax which declines over a longer period of holdings. Apparently one justification for this idea is the notion that a declining rate would help to unlock stock held in accounts for many years. Couldn't it also have the opposite effect? Wouldn't some people find an economic incentive to hold stock longer in order to take advantage of the lower taxes?

Mr. KOLTON. I am not sure I understand the full thrust of your question, Senator.

Senator ROTH. Well, let me restate it.

It has been proposed that the capital gains tax be lowered according to the period the stock is held.

Mr. KOLTON. Right.

Senator ROTH. And the justification of this tax benefit is that this would help unlock stock now being held by individuals who don't want to sell and be subject to tax.

Mr. KOLTON. Yes.

Senator ROTH. I am saying that it seems to me that while there may be some truth in that, it also seems to me it could create the opposite effect; that if we provide those benefits, they may become incentives for people to hold stock longer.

Mr. KOLTON. I see. I think, Senator, that if the rate were to go down gradually, there would probably be, on the basis of the studies that were made a number of years ago, at any rate, sufficient incentive for people to take advantage of their visible profits at the lower tax rate, liquidate their position and achieve the capital gains and also add to the market's liquidity. But we are dealing in the future here and I must say we really don't know.

*At press time, Sept. 17, 1973 the information referred to had not been received. The Committee was informed that information was forthcoming and would be included in the printing of the hearings held by the Subcommittee on Financial Markets in September 1973.

Mr. POSER. Senator, I am not a tax lawyer, so——

Senator ROTH. I am not either.

Mr. POSER (continuing). So you will excuse me if the law has been changed recently, but I believe that one factor is that you do get a stepped-up basis at death and, therefore, I think that maybe there is a great deal of locked-in securities that are highly appreciated that are being held just to avoid the present capital gains rates.

Senator ROTH. Of course, some people would correct that by changing that aspect of the tax law.

Mr. POSER. Yes, sir.

Senator BENTSEN. Some people wouldn't consider it a correction, though.

Senator ROTH. Right.

Mr. KOLTON. Of course, some of us would prefer the situation never arose.

Senator ROTH. Thank you.

Senator BENTSEN. Well, we are motivated very much by a desire to help small companies get started, so that they can go to the equity market. We have today some good companies selling as low as five times earnings. They are faced with an extremely difficult situation, which would hardly justify them going to the equity market and selling stock. In fact, they would have to have better than a net 20-percent return, after taxes. So they would have to have a 40-percent return on investment. So it puts the free enterprise system in a real bind here.

Obiously, as you say, tax incentives represent just one facet of the problem.

We have another witness we would like to hear from this morning. We appreciate your testimony very much.

Mr. KOLTON. Thank you, Mr. Chairman, and gentlemen.

Senator BENTSEN. We would like to have Mr. Wood take the witness stand. We have one other witness and, if it is agreeable with him, we would like to reconvene the subcommittee at 2 o'clock.

Let me first state my deep appreciation that the members have shown such interest in this subject. A majority of this committee has been here through the hearings that we have held, even with the competition of other hearings and other committees.

Would you please state your name and position?

STATEMENT OF C. V. WOOD, CHAIRMAN, COMMITTEE ON PUBLICLY OWNED COMPANIES, ACCOMPANIED BY JAMES J. O'NEILL, EXECUTIVE DIRECTOR; ABE FORTAS, COUNSEL; REVIS L. STEPHENSON, CHAIRMAN OF CLARK INDUSTRIES, INC.; AND FRED M. ZEDER, CHAIRMAN OF HYDROMETALS, INC.

Mr. WOOD. My name is C. V. Wood, Jr. I am chairman of the Committee of Publicly Owned Companies. I am president of McCulloch Oil Corp. which has its headquarters in Los Angeles, Calif. My curriculum vitae is attached to this statement as exhibit A.

With me in the hearing room are Messrs. Stephenson and Zeder, who are members of the executive committee of the Committee of Publicly Owned Companies; Mr. Abe Fortas, whose firm is general counsel for the committee; and Mr. James J. O'Neill, who is executive director of the committee.

I should first like to express my thanks to the chairman and the members of the subcommittee, on behalf of myself and the Committee of Publicly Owned Companies, for this opportunity to state our position.

We have filed a detailed report today with the chairman with many statistics showing how institutions are now dominating the market, and I will try to summarize here just now the thoughts and reactions of our members. Also, we would like to ask that our detailed report be made a part of the record.

Senator BENTSEN. Without objection, that will be done.

Mr. WOOD. We believe that this subcommittee's approach gets to the heart of the critical problem facing this Nation today. It is the problem of concentration of control in our securities markets, and the meaning and effect of the concentration. It is only in this broad perspective that problems such as rates, membership on the exchanges, and the rules and regulations of the markets can properly be considered.

So far as we know, this is the first time that a group of chief executives of publicly owned companies has been organized and has appeared before a congressional committee specifically to express the view of those companies with respect to legislation affecting the securities markets.

The committee now has a membership of 469 companies which is increasing almost daily. Our companies are located in 40 States. These companies represent $43 billion in assets; 1.8 billion stockholders and 1.1 million employees. Of these companies, 73 are listed on the New York Stock Exchange; 311 on the American Stock Exchange; and the securities of 85 are traded over the counter.

Since its organization in March of 1973, the committee has held meetings of executives of publicly owned companies in 12 cities, including New York, Chicago, Los Angeles, Dallas, Houston, Fort Lauderdale, Boston, and Minneapolis—and other meetings are planned.

I would like to say that at these meetings we only have the chief executive officer. In a few cases where he can't possibly make it, we have had the senior vice president of finance but in 99 percent of the cases we are speaking for and reflecting the thoughts of, the chief executive officer of the company. And in each of these meetings, I can also say that the reaction of these executives have been uniform all of the way through the discussions.

The committee's brochure has been circulated to all companies listed on the New York and American Stock Exchanges and about 400 companies traded over the counter. We have received no dissents. Many companies have suggested supplementary ideas, some of which have been incorporated in our program, as I shall mention.

The hundreds of company executives with whom we have talked are deeply distressed about the situation in the securities markets and the problems that are affecting their companies. Their concerns are for their companies, for their stockholders and for their employees and, also, in many cases for the ability of their suppliers; that is, other companies who furnish their products to them and want to be sure it is possible for them to be able to raise money and maintain the operations so that their suppliers' parts will be available to support their own operations.

(1) They feel keenly that they are being starved out of the capital markets.

(2) They are extremely alarmed by the withdrawal of the individual investor from the marketplace.

(3) They are deeply concerned about the dominance of a few great institutions and because institutional policies and practices preclude us—about 90 percent of corporate America—from access to America's storehouse of investment funds through the traditional American channels of independent investment firms and millions of individual, direct investors.

Gentlemen, I cannot over-emphasize the seriousness of the present situation. Unless we—and that really means you in the Congress—come up with a solution, America as we've known it will be a chapter in the history books.

(1) Our freewheeling, vital enterprise system, composed of thousands of aggressive and competitive publicly owned companies, will slow down to a walk.

(2) New, publicly owned companies will be impossible—there will be neither a market on which they can sell their stock nor independent local and regional brokers to underwrite and distribute their stock.

(3) Existing companies, except for a few giants, will starve for equity capital. The only thing they can do—and that's limited—is to hock themselves to the great banks and insurance companies for loans. This means an enormous debt-burden, and a debt-equity ratio which will be so high that a little adversity will drive the companies into the bankruptcy courts. And the demands for more and more loans will drive up interest rates even more, and make the present inflation look like a modest bubble.

Senator BENTSEN. Let me ask you: You say there has been an increase in requests for warrants, for instance, for that type of equity when you go for funding for an institution?

Mr. WOOD. Yes, sir, I would say there has been an increase in that because they know how tough it is for us to get money in the equity market, so they can sit down and write their own ticket.

Senator BENTSEN. All right, if you will continue, please?

Mr. WOOD. (4) Control of our economy will be concentrated in a few great banks, insurance companies and pension fund managers—and in a few giant industrial and service companies. While we're fussing about competitive commission rates for executive transactions on the securities markets, competition where it really counts—competition between big and small companies in our industrial system, will disappear.

(5) We'll have a wave of mergers and takeovers, many by foreign capital who'll pick up bargains two ways: They can buy our companies at the ridiculously depressed prices of our stock on the markets, and they can buy them for cheap, devalued dollars in terms of their own currency.

(6) With all respect to the genius of the people who run our great banks and institutions and the young, longhair analysts who advise them, one of these days the pool they're running in a few religion stocks will start to leak—and the fantastic, overvalues that they've created will be washed away in a flood. Unfortunately, we'll all be the sufferers.

I don't propose to burden you with a lot of figures. They're in our statement, and they're also in the excellent material prepared by your staff as a committee print.

The fact of the matter is that because most of the investable funds in this country are controlled by a few banks and other institutions which also do about 70 percent of the dollar volume of trading on the New York Stock Exchange, the stocks of the companies that we represent are undervalued to the danger point. We can't go to the equity market to raise money for replacement or expansion of our facilities. When we can't avoid raising money we have to do it through debt.

Debt service has become and is increasingly a severe burden on our companies, threatening the financial soundness of many of them. Taking the Standard and Poor's list of 425 industrial companies, long-term debt has trebled from 1962 to the end of 1971. Debt-equity ratio has risen from 26 percent to a dangerous 41 percent, and it is probably higher now.

Further, corporate underwritings of equity issues has dwindled to a trickle. In the first quarter of 1973, underwritings are down 40 percent compared with the same period in 1972; and dollar value of corporate private placements is down 30 percent. And I think most of that has been covered by the two previous gentlemen.

Our companies are inviting targets for takeovers by foreign as well as domestic capital. Some of us, faced with the practical impossibility of raising new money, are looking around for mergers with other companies. Some of us have been the target of tender offers made at a premium above the present depressed market values—and we are great bargains at those prices.

Our stockholders have become unhappy and dissatisfied. Millions of them are faced with the destruction of a lifetime of savings.

Our employees are faced with the destruction of the value of company securities held in pension, retirement, and profit-sharing plans. They are also faced with the prospect that their opportunities for job advancement are curtailed because their companies have had to defer expansion plans and generally engage in belt-tightening.

Our executives are unhappy. Many have invested their lifesavings in stocks of their companies. They can't understand why the market value of these stocks have collapsed despite excellent earnings and unfilled orders. Many of them have stock-options, which have become worthless.

This situation is the cause of, and is aggravated by, the deplorable condition of the broker-dealer community and the disappearance of many independent brokers and investment houses, particularly local and regional firms on which smaller companies and individual investors depend.

The best available estimates are that to supply the equity capital that we will require by 1980, we need to market $7.5 billion annually in stocks by 1975 and $11 billion by 1980. (American Banker, May 11, 1971.)

By 1975 we will need 3.6 million additional jobs, over the present base. By 1980, we will need 11.7 million additional jobs. (Conference Board.)

We need vast new production of goods and services to supply even present demands and stem the tide of inflation. We need much more to meet the needs of our future population and of new world requirements.

Where is this coming from? Is it coming from the 21 institutional favorites—or even 100 companies? Or must it come from the thousands of noninstitutional enterprises in this Nation?

If we are to look to these thousands of companies, we must get a supply of equity capital to them. And we're not going to do it unless we can reverse some of the present trends.

Essentially, there are two ways to go about this: We've got to get the individual investor back into the market, and we've got to change the situation so far as the investment, management and trading of the vast institutional funds are concerned. These are obviously interrelated in the sense that we cannot expect the return of the individual investor as an owner and investor in corporate America unless institutions will change some of their current practices.

I want to emphasize that we believe that institutions—life insurance companies, banks, pension funds and the like—perform an important and vital service in our financial system. They accumulate capital from millions of individuals and they deploy that capital for the use of the public and private sectors of our Nation. Our criticism is not of the institutions, but of certain institutional practices, as I've described. We believe that these practices must be changed, in the interests of the Nation and of the institutions themselves.

Presently, the most important institutions are virtually uncontrolled and unregulated so far as their securities market practices are concerned. Only the mutual funds are subject to Federal laws limiting, in some respects, their holdings in individual companies. In many companies, one or several institutions are so dominant because of their large stock interests that corporate managers live in fear of their displeasure. At the same time, the volume of their trading is so great that they can and do dictate the commission rates that they will pay for the services of a broker or dealer who executes their trades. Negotiated rates in dealing with them is a hoax, because of their enormous power. Actually, as I have said, they are practically dictated rates. They are not negotiated rates. The broker-dealer is virtually helpless to insist upon a reasonable rate.

There are no general requirements that the major institutions—banks and insurance companies—disclose their holdings or their trading. They usually accumulate their positions carefully and quietly over a period of time, and the public is generally unaware of what is going on. Then, because of bad news—or because some analyst has changed his mind about the prospects of a company or an industry—they dump large blocks on the market, far beyond the stabilizing capacity of the specialist.

We have seen some spectacular instances of this, and in practically every meeting that the Committee of Publicly Owned Companies has held, executives have told us of their own experiences as the targets of this dumping. We have some examples in our filed statement.

Because of this, and more importantly because the available investment funds are concentrated in just a few stocks, as a result of institutional concentration on the religion companies and the sharp

decline of individual trading, liquidity, and price-continuity in our markets are at a low point.

Recommendations:

1. Investment and trading by all institutions which manage other people's money, and not just investment and trading by registered investment companies (which are now the only institutions subject to specific SEC regulation), should by subject to specifically designed Federal regulation under the centralized jurisdiction of the Securities and Exchange Commission. These investment and trading activities have reached such dimensions and have such national importance that they cannot be left unregulated, nor can regulations be fragmented among Federal banking agencies, State insurance commissions, and the like.

2. Institutions must be required to disclose and report their holdings of corporate securities, and their trading.

3. Measures must be adopted to induce institutions to invest their funds and the funds of managed accounts in a broader range of American companies. The present dangerous concentration of enormous institutional funds in a few companies must be halted and reversed. The overfeeding of a few companies, resulting in extraordinarily high market prices for them, and the starvation of thousands of sound, profitable companies creates a situation of national peril.

a. Presently, only certain mutual funds are effectively limited as to the percentage of a particular company's security that they may hold in their portfolios. This type of limitation should apply to all financial institutions. We urge prompt study and hearings as to the limits that should be fixed and prompt legislation to affect such limitation. In the absence of such limits, control of America's corporations will increasingly pass to a few institutions; and institutions which are custodians of other people's money will increasingly be vulnerable to the adversities of individual companies in which they have an enormous stake.

b. We also urge that effective limits should be prescribed by Federal law as to the amount or percentage of an institution's assets that may be invested in the securities of a single company. These limits should be so devised that a bank or insurance company, or a pension or other fund, for example, that has vast sums for investment, must make those sums available to a large, and, hopefully, a diversified number of companies. We submit to you that the present situation in which, as I have discussed, there is great concentration in a few companies, is not tolerable.

4. Institutional trading practices should be regulated so as further to discourage and prevent trading on inside information and so as to prevent dumping of large blocks of securities in response to changing market judgments. With respect to the dumping of large blocks of the securities of a company, we believe that it is possible and feasible to limit the amount of stock of any one company that an institution may sell in a single trade. We have made some calculations which I will furnish the subcommittee on request. They indicate that if an institution were limited to a maximum sale of one-quarter of 1 percent of the outstanding shares of any particular company in a 30-day period, that this would not hurt. We are all naturally concerned about the liquidity problem that we know is the backbone of the securities

market. The one-fourth of 1 percent rule would accomplish a number of things: (1) The liquidity wouldn't be that big of a problem. You take the 25 biggest stocks in America. One-fourth of 1 percent of that would represent $750 million worth of sales, so you would be permitted to pick up that much revenue in the top 25 stocks alone, but look at what it would accomplish. You take a company like Mr. Zeder's here, 2 million shares outstanding. Under a one-fourth of 1 percent rule, the maximum they could hit him with would be 5,000 shares in any one given month. My company has 16 million shares outstanding so they could hit us with 40,000. We can live with amounts like those. It is the 100,000- or 250,000-share blocks we can't live through.

Senator BENTSEN. What if you had a block trade that didn't bump the price of the stock? If you had one institution that was willing to trade with another institution without affecting the price of stock, would that concern you?

Mr. WOOD. No, that wouldn't concern us at all. It probably wouldn't concern us as long as it was a maximum of a quarter of a point under the present market.

Senator ROTH. Would that undermine the stock market?

Mr. WOOD. I don't think so.

Senator ROTH. Would you be promoting shopping?

Mr. WOOD. They do that all of the time anyway.

Senator ROTH. All right, go ahead. I am sorry.

Mr. WOOD. Also, we feel that legislation should be enacted which will revise the tax laws.

5. Legislation should be enacted which will revise the tax laws so as to provide needed incentive to individual investors to acquire ownership of shares in corporate America.

We believe that there is an overwhelming national interest in encouraging direct investment by individuals in corporate America. This will not be achieved, under our system of government, unless there is adequate incentive. The present capital gains tax rate is much too close to the effective ordinary income tax rate to provide incentive to small investors, particularly in view of the attraction of high interest rates that are available on fixed obligation investments.

There are various ways of remedying this situation. Chairman Mills has suggested the possibility of a life-time amount of capital gains that may be accumulated, tax free. Another possibility, which the Committee of Publicly Owned Companies has suggested, is an annual exemption of the first $1,000 of capital gains realized as a result of securities transactions.

I should like to point out that many institutionally controlled funds, such as pension funds, enjoy special tax treatment. We believe that it is imperative that the tax laws should correspondingly aid the small, individual investor who puts his funds in corporate America.

6. We strongly oppose institutional membership on any securities exchanges. We oppose membership by any person or entity, directly or through a controlled affiliate or subsidiary, unless such person or entity, including all of its affiliates and subsidiaries, is primarily engaged in the securities business as broker or dealer. In other words, we strongly oppose permitting any entities whose primary stake is as an investor or money manager to hold the preferred position of membership on a securities exchange.

The American people believe they are entitled to trade in a public, auction market, dominated by professionals. They regard institutions as competitors; and they are not likely to have confidence in trading in a market in which their competitors have the special access, benefits and influence over rulemaking that membership necessarily implies.

7. Institutions should be required to bear their fair share of the costs of operating the securities markets. Their enormous power should not be increased by allowing them to trade at bargain rates, which necessarily mean that individual trades must bear a disproportionate share of the expense of the markets. The only way that a fair distribution of costs, which will encourage the individual investor, can be effected is through fixed, minimum rates—fixed by the industry's self-regulatory agencies subject to SEC supervision, or by the SEC if these agencies are reluctant or unwilling to take on the task.

8. There is one further, important, recommendation that has been made by many of the publicly owned companies which are members of our committee, and it relates to the fact that our shareholders are continuously complaining that they don't get timely information. Much of our stock is held by institutions as well as by the brokerage community, in street names or nominee accounts. This means we can't communicate directly with the real owners of our stock when there is some important development. This should be changed. Institutions and brokerage houses should be required to supply us with the names and addresses of the beneficial owners of our stock, at least unless the owner specifically instructs the holder to the contrary.

CONCLUSION

I should like, in conclusion, to thank this subcommittee, its chairman and members. We believe that you are addressing yourself to a problem that is fundamental to our economic system and to the essence of our democratic society. We shall keep our members informed of the work of this committee, and we are confident that all of the companies which we represent will join us in our appreciation of your labors.

Senator BENTSEN. That is a very interesting statement you presented to this committee. We have heard from a number of institutions and we will hear from others and we heard from major brokerage firms. We are delighted to have the views of the chief executives of the companies today.

Let me ask you on this question of jobs. We had some figures given us the other day that capital investment, average capital investment industrywide was about $24,000 for each job. So, in effect, what you are saying, that the companies in not being able to go to the equity market to raise more capital, at least has closed down one avenue of creating new jobs.

Mr. WOOD. Without any question.

Senator BENTSEN. Do you have a pension fund in your company?

Mr. WOOD. Yes, sir.

Senator BENTSEN. Who administers it?

Mr. WOOD. Bache & Co.

Senator BENTSEN. I think you may run into an ironical situation where some of the modest-sized companies, the medium-sized companies, are having pension funds administered by institutions who are, in turn, buying the stocks of very large companies.

Mr. WOOD. That doesn't happen to be our particular case.

Senator BENTSEN. So yours is not a situation where a pension plan participant of a medium-sized company, in effect, is supporting, through his earnings and his contributions, the stock of one of the top-tier companies?

Mr. ZEDER. Senator, earlier you asked if there were any specific instances, when you referred to the warrants, and I can give you a good example of that. Again, this also relates to your question on jobs that are provided.

Now, we had a situation recently, where it seemed necessary to raise about $10.5 million for expansion of a program that we had. At that time, we went to our two lending institutions which are insurance companies and their suggested rate was 9 percent and, in addition to that, 100,000 warrants at market which represented 5 percent of our company. So, to put a pencil to this, this came out to about 11½ to 12 percent or better. Ordinarily, that is about what we would have to pay if we went for equity capital selling at 10 times earnings. So, it hasn't escaped your lending institutions today that those selling with low PE's have to pay a lot of money. And this again, I believe, has had a very serious effect upon our inflationary cycle.

Senator BENTSEN. Well, I certainly don't criticize institutions for asking for warrants, at whatever rate the market is. I would just like a little more spread in the competition of that market.

What do you think in the longrun will be the affect on the competitiveness of domestic industry if we continue to see this inability of new companies and smaller companies and medium-sized companies to raise equity capital?

Mr. WOOD. Well, I think two things—well, more than two things. A number of things are going to happen. One, if they can't get money, either they are not going to expand or they are going to have to sell out to some bigger company. We are going to see many, many companies who just can't get the money to actually get their first issue—and these start-up companies have been the whole backbone of this country—and so our technology is going to suffer. Our competitive situation in the world market is going to suffer. That is one of the big advantages, you know, we always had over the rest of the world; our ability to raise money for the little guys to let them get in there and build and grow. So that if they can't get the money, we are going to have serious problems. Also, you are going to see the problem we have already mentioned, the one of unemployment.

Senator BENTSEN. Do you think there should be a limitation on what institutions should own of a company?

Mr. WOOD. Yes, sir.

Senator BENTSEN. What do you think is a reasonable limitation?

Mr. WOOD. Well, now, I think the 5-percent limitation that mutual funds have would be the maximum.

Senator BENTSEN. Do you have a substantial percentage of your company owned by an institution?

Mr. WOOD. Yes, sir. Close to 20 percent.

Senator BENTSEN. Close to 20 percent?

Would you like to comment, Senator Roth?

Senator ROTH. Yes.

I want to compliment you for your very provocative and informative statement. It raises, in my judgment, a number of serious ques-

tions. I am not sure that some of the actions we have taken with respect to institutions have always been forward steps.

I would like to know, if I may, a little more about your organization. You say you represent a membership of 569 companies with assets of $43 billion. Are your members mostly small- and medium-size companies or dominated by larger companies?

Mr. WOOD. Yes; we have some large companies. The way it happened, there were nine company presidents who got together back around the first of the year and, in talking, we found out we had common concerns. These were companies from various parts of the country and they produced different products.

In March, we decided that it was our stockholders, our stock, and our employees, that were being kicked around here, so to speak, by Wall Street, the stock exchanges, the SEC, and the Government, and, for some reason, we couldn't find if they had ever talked to a chief executive of a company. Our stock is a product of ours, almost the same as if we were building chainsaws or anything else because it is the value of the stock which determines how much money we can get to grow and to do things. So we decided that somehow or another, we needed to get the input and the thinking of a number of company executives all across the country into this whole problem.

So the nine of us, well, we got hold of a list and that is why in the early days we were predominantly mostly American Stock Exchange people. We sent out letters probably to about 400 company presidents and we had meetings in New York, Chicago, and Los Angeles, and 260 of them showed up. We outlined our thoughts and our plans. We gave out a little paper that is attached to our big presentation that we made to you, and they unanimously, to a man, voted to form this committee. They put a little money in; an average of about $500 so that we would have some money for some legal fees and to hire one full-time executive director and for communications. Most of our money is spent in communicating back and forth with our membership.

We held subsequent meetings which have also been well attended. I just feel confident that before the end of September we will have over 1,000 company presidents on this committee. And we really think we reflect their thinking.

Senator ROTH. Do you think that will expand to the larger companies or do you think they would be too fearful if they have large institutional stockholders?

Mr. WOOD. Some of the larger companies—well, gee, I don't know, we just haven't spent that much time talking to them. Remember, we are also busy trying to run our own companies.

Senator ROTH. Trying to get money?

Mr. WOOD. But a number of us have dedicated darn near a day a week to this thing.

Senator ROTH. This is a little off the track but you apparently feel that some congressional action on institutional membership and fixed commission rates have been backward steps rather than helpful legislation.

Mr. WOOD. When you let institutions trade cheap, it makes it easier for them to dump. It makes it easier for them to yo-yo the market up and down. If they were made to pay a fair share of it maybe they wouldn't trade so much. And, also, you can't let anything happen to the securities industry in this country. It is the thing that makes it all

work. It is the conduit through which all the money from the individual investors flows to the companies—and I think the institutions' costs are down over 60 percent and, yet, the individuals' costs are up 50 percent—and this upsets them. We talked to a number of investors around the country and discovered that the individual investor is aware of the fact today he is paying roughly 60 percent of the costs at the New York Stock Exchange, and doing only 30 percent of the trading while the institutions are doing 70 percent of the trading and are paying only 40 percent of the costs. If they think he is not aware of that they are not looking into the situation very deeply. These investors know these numbers and they don't think it is fair. They think they are playing in a game with a stacked deck.

Senator ROTH. Mr. Chairman, I see we have a vote on, so I will relinquish my time. But I want to thank you gentlemen for your very interesting testimony.

Senator BENTSEN. We do have a vote on the floor of the Senate. We are appreciative of your testimony. We think you have made a very major contribution. I just have to ask one parting question of Mr. Fortas.

Mr. WOOD. We would be happy to come back after lunch.

Senator BENTSEN. Well, I do have another witness who wants to testify.

Mr. Fortas, do you see any problems if there is an even larger domination of the market by the institutions? Do you see any problems with the Sherman or the Clayton antitrust acts?

Mr. FORTAS. It would be very difficult to use the antitrust instrument here, Senator, although the total national situation, I must say, as an old man who has been around here a long time, reminds me much too painfully of the days when I first came here during the early days of the New Deal, and the kind of concentration problem we had then. That terribly alarms me.

Senator ROTH. Could I ask a question?

If a large institution is shown to have large holdings in competing companies, would the antitrust laws apply in any way?

Mr. FORTAS. It would be very difficult to show that that power has been used in restraint of trade or that it has approached monopolistic proportions. Antitrust, in my opinion, is a very inadequate instrument to use in this situation

Senator BENTSEN. Mr Wood, there might be a few questions, so if you wouldn't mind coming back?

Mr. WOOD. We wouldn't mind at all, if you just tell us what time you want us to be here.

Senator ROTH. Two o'clock.

Senator BENTSEN. The committee will stand in recess until 2 o'clock.

[Whereupon, at 12:30 the committee recessed to reconvene at 2 p.m., the same day.]

AFTERNOON SESSION

Senator NELSON. Gentlemen, I am very sorry I wasn't able to be here during this morning's testimony. I had to attend a conference of the Senate Labor Committee.

Senator Bentsen, as you know, has an amendment pending before the Senate and I will therefore read to you questions that he left.

In recent months, almost half of the stocks on the New York Stock Exchange have been selling at 10 times earnings. What are some of the problems faced by a company with good earnings and a good future for exapnsion, but whose stock happens to be selling at a multiple of 10?

Mr. WOOD. I think I could answer that.

Senator NELSON. He also has some more and I will read them all at once. Are you familiar with instances of companies curtailing expansion plans because of low multiples? If this continues, what does this mean to the long-run competitiveness of our economy? Our concern is not just concentration of economic power in the stock markets but the concentration of economic power throughout all of our markets.

Mr. WOOD. Well, I think a lot of companies would be happy today if their multiples were at 10. There are a lot of them down to five. But there were companies selling at five and they tried to go to the equity market for some money, Senator, and they have to make 20 percent. If they are selling at 10, they have to make 10 percent. If they are selling at 30 multiples, they have to make only 3 percent to keep their earnings per share constant. So I think that is a prime problem.

Mr. ZEDER. There are a lot of problems. I can address myself to them, because my company is selling at eight times earnings. There are a number of problems that beset a company with a low PE.

In the years past, as I have already said in my previous remarks, it was the opinion of management that all we have to do is run our companies and do a good job and earn money and the stockmarket would take care of itself or the price of our shares would. That isn't true today and it has to be a very real and important part of management's considerations today.

In addition to the problems that Mr. Wood has suggested to you, such as the high price you have to pay for the money, you also have such things as stock option programs. We have in our written statement a number of companies that have stock options. I don't believe my company is mentioned there, but we have just put out 360,000 shares of stock for 57 of our employees 2 weeks ago. We sent them letters congratulating them on the opportunity to participate in our company. Our stock at the time was at $13.06 a share, their option price. When they got my memo, the stock was at $7.50. The response I got from them was "Thanks," I think.

So, what you set out to do today with a stock option program in your company, as an employee incentive, is really negated with a low PE.

The other problem we brought up earlier was the real possibility of takeover of companies. We have seen such a tremendous rise and increase in this type of activity, particularly from abroad, where, for example, in the Japanese market the U.S. currency is, depending on whose figures you use, worth any where from 30 to 40 percent less than it was worth only 2 short years ago. Now, when you take that—well, let's go back to my case. We are selling, I think, today around $9.50 to $10, which is about 20 to 25 percent below the book value of $11.90 per share that our company can be purchased for. Again, if we can be purchased with foreign moneys that are valued in excess of what the dollar is worth today, that is another incentive. So, I think you have a pretty good example there.

Mr. STEPHENSON. As a recent example, I spent the last few weeks in June and July in Japan on behalf of our company to facilitate the selling of our products in order to provide——

Senator NELSON. What products?

Mr. STEPHENSON. A closed circuit pollution system that we sell in the steel mill industry and so forth in Japan. Incidentally, it is a terrific market and a wonderful export market.

In passing, I might say that we export about 25 percent of what we make in the United States.

Well, while I was there, I was approached by one of the businessmen with whom I was doing business and he said he had people who are interested in buying U.S. firms for cash and they were particularly interested in firms that were in the business of exporting to Central and South America. He named specific industries in which he was interested and he said the smallest firm they were interested in was $5 million a year and up to $100 million a year.

Senator NELSON. In sales?

Mr. STEPHENSON. In sales. And he had cash ready and, if a firm was attractive enough, he said they would pay 20 percent over market. And I didn't like that.

Senator NELSON. That was a question I was just going to ask you.

Senator Bentsen's question states that on July 14, the Economist, a British publication with worldwide circulation, carried a story entitled "Good Time To Buy American," in which it was pointed out that Volkswagen could presently buy General Motors for half of what it would have cost 2 years ago. Is that anywhere near accurate?

Mr. STEPHENSON. I don't know. You would have to ask General Motors. I don't think.

Senator NELSON. Well, I think Senator Bentsen is simply quoting the Economist. The quote is accurate. I don't know whether the facts are or not.

Mr. STEPHENSON. And, Senator, I think additionally it is not only a possibility but this threat imposes restrictions on businessmen. This is frightening. This has a bearing on our judgment. This has a bearing on whether we will expand or whether we dare use our cash. We can't go and borrow money. It is freezing the possibility of expansion.

Senator NELSON. Why did it freeze the possibility of expansion?

Mr. STEPHENSON. Because we don't dare use our cash, our available cash. And if we do go into the market to get cash to expand, we put ourselves in jeopardy and, therefore, this is drying up jobs.

Another thing that is important: I think if you will look into the history of successful nations, you will find that there is a direct relationship between the amount of capital expenditure made by the industry of a country and its exports. Your capital expenditures have a direct relationship to your productivity, and your productivity is what controls your position in the international market. You must produce more per manhour in order to compete in the world. And in order to produce more per manhour, you must give your laborers, your people, the type of machinery that gives them an advantage in productivity and this is capital expenditures.

And if you slow that down in any nation, that nation is going to find itself at a disadvantage in world competition. This is one of the things that hurts the balance of trade and the position of the dollar.

Senator NELSON. Well, are there any substantial examples of foreign investment in this country?

Mr. STEPHENSON. I could give you one. Recently, an Italian company now controls Talcott, one of the biggest finance firms in New York. That same company controls the Franklin Bank.

Senator NELSON. The Franklin Bank?

Mr. STEPHENSON. The Franklin National Bank, a big bank on Long Island, and a very progressive bank. That is owned and controlled by an Italian company. Those two have been in the newspaper in the last 10 days.

Mr. WOOD. We have a number of them in the statement.

Mr. STEPHENSON. Yes; we have a whole list here.

Senator NELSON. Is there a dramatic trend in foreign investments occurring in this country since the devaluations of the dollar in the past year or two?

Mr. STEPHENSON. Yes.

Senator NELSON. Do we have any dollar figures, comparable figures?

Mr. WOOD. No; but I can name you some of them: Gimbel Brothers, First Western Bank and Trust Co. of Los Angeles, Stouffer Foods, Talcott National Corp., Certain-Teed Products, Bank of Contra Costa and Security National Bank, Computest Corp. and Commercial Trading Corp. These have all been bought out in the last 6 months.

Senator NELSON. Controlling interests?

Mr. WOOD. Yes, sir.

Senator NELSON. In the past 6 months?

Mr. WOOD. Yes, sir.

Senator NELSON. Well, how does the amount of investment in this country by foreign companies compare with 5 years ago or 10? Are there any periods of comparison?

Mr. WOOD. We don't have those figures.

Senator NELSON. I am advised that the Commerce Department keeps such up-to-date statistics. I think they ought to be made available for inserting in the record over some comparable period.

Mr. STEPHENSON. Another thing that I know from my work in international business, because even though we are a very small firm, we are a highly technical organization and we have to be international, Senator, otherwise, the things that we sell to the steel mills in the United States, if we didn't sell to the Japanese or the Germans, they would copy it and maybe come back into our own market with the very same things, so we have to be international. And everywhere I go there are plans and talk about the British, the French and so on, taking over U.S. firms. They are all looking into this and planning to do it.

Senator NELSON. Well, now——

Mr. STEPHENSON. And it is alarming.

Senator NELSON. You comment on how alarming it is, but isn't that what happened to Europe. We made vast investments in Europe and it didn't seem to have damaged the French, or the German or British or Italian economy, did it?

Mr. STEPHENSON. Well, I think the situation is a little different, Senator. If you will look at the history, you will find that here in the United States we were the most progressive in technology and in productivity. I happen to have been in the position of running busi-

nesses, making comparable machinery in several foreign countries, including Argentina, England, Switzerland, Sweden, France, and so forth. And while we paid over twice as much in the United States to our laborers, the cost of labor as a percentage of the selling price was lower in the United States than it was in any one of those countries. Now the reason that we could go into those countries and benefit them is we brought them a technology that helped their economies. And this was a constructive thing.

But if they come in here and get control of our companies at something below book value of the companies, and take the profits out after they get control, this is alarming.

Mr. WOOD. You will find that when we bought over there, we were probably paying much more than, let us say, book value, Senator. They are able to buy over here now at way below book value. That is the difference.

Senator NELSON. I do recollect that the French and others became quite concerned 4, 5, 6, or 7 years ago, about the invasion of their economy by vast investments by Americans. What did they total? $90 billion or thereabouts? I have forgotten the exact figure but I don't quite grasp how it is so much a greater threat to us than it was to them?

Mr. STEPHENSON. I will tell you one of the reasons, Senator. This country has a better living standard than any country in Europe. No one compares to us. No one has as many refrigerators, automobiles, television sets, vacations and so forth. We have a standard of living much higher than they do. We would like to keep it that way, or at least, not to have our own go down. Let theirs come up—we don't object to that—but let's not reduce the productivity of this country so that we don't have the jobs that are necessary for us to maintain our economy.

Senator NELSON. But how does foreign investment here reduce our productivity?

Mr. STEPHENSON. Well, for one thing it takes the profits out. It also takes the decisionmaking out.

Senator NELSON. Well, that is the same thing we did in Europe.

Mr. STEPHENSON. Well, the shoe is on the other foot. They were very concerned about that and right now, I can tell you, we are concerned. And another thing, this is one of the reasons why nearly everywhere that I go in the world I must establish a subsidiary in that country and do some work there or they close the borders to me. There is no way, for instance, that I can export my equipment into Japan, into Australia, into Mexico, into Brazil, unless I have an operation there and provide employment to the people in those countries. Just no way.

Senator NELSON. I understand that, but that is what they are doing if they invest here when they start building their equipment and automobiles and machinery here. The Japanese, Kekomeen, just opened a soy sauce plant in Jamesville, Wis., because the jobs are here.

Mr. STEPHENSON. The Japanese are building a steel mill up near Attica, N.Y. And, in that case, they are going to build the mill themselves and it is probably a constructive thing, Senator.

Another thing, it is not just this taking over by foreigners. My company happens to be very small and very successful. It was formed

in 1953. We have grown profit-wise and revenue-wise 20 to 30 percent per year and we are a patsy for takeover today.

Senator NELSON. I didn't hear that last word.

Mr. STEPHENSON. I said we are a patsy for a takeover. Our stock is selling for about 10 times earnings, but this happens to be equal to our net worth. Last week, it was selling below net worth in spite of the best year in our history.

Senator NELSON. Well——

Mr. STEPHENSON. Senator, could I make one more point in answer to that question?

If foreign interests take over our companies, there will be more of a problem for the small investor in this country. The whole basis of our economy and our way of life is based on the liquidity of our market and the fact that the smaller investor can get in and out and has had a place in the past to make money and support us. We feel that this must be someway or another maintained.

Senator NELSON. Some countries limit the amount that can be invested or require that either the government or the industry there be a participant with 51 percent of shares. Is that a common practice?

Mr. STEPHENSON. Yes.

Senator NELSON. We don't do that?

Mr. STEPHENSON. No.

Senator NELSON. Would that be advisable?

Mr. STEPHENSON. Well, I think we are getting on to a question that is a little different than what we came here to testify about and I am just maybe getting out of my depth in answering it. I don't like to. I am for the United States.

Senator NELSON. I am, too. I am just trying to find out——

Mr. FORTAS. Senator, may I make an observation about this?

Senator NELSON. Yes, Mr. Fortas.

Mr. FORTAS. From the point of view of the problem of the securities markets, there really isn't a great deal of difference conceptually as to whether the takeover is by a large domestic company or a foreign company. The reason that the foreign company presents a particular problem here is that it is easier for them to take over now than it is for a domestic company to take over another U.S. company and the reason for that is the devaluation of our currency.

Now, when you take a look at the question of the desirability or undesirability of having the small- and medium-sized companies taken over by any other company, domestic or foreign, then you get, I think, close to the heart of the issue with which your subcommittee is dealing because our economy—and to use a hackneyed but a pretty good phrase—our economy and the American way of life depend upon the existence and the encouragement of thousands of small independent enterprises that grow. That is the yeast in our economy. That provides the competition. That provides the infusion of new ideas and technology and that keeps us alive.

Now, I say it really doesn't go to the heart of the question whether the takeover is by a foreign country or domestic company. Now the problem that is germane to the particular issue before your subcommittee is this: At the present time, due in part to the two-tier market and to the fact that available investment and trading funds are going into just a few stocks of so-called institutional favorites—the 21 stocks

or 100 stocks; people vary in their estimates—and the problem is because the available investment and trading funds are going into only those stocks, the bulk of our companies in this country—perhaps 90 percent of them are selling on the securities markets at very depressed prices; prices that are more depressed on an earnings basis than they have been in 30 years, according to some figures. Now, when these companies are being valued on our securities markets—that is the function of the securities markets—at these depressed prices, they can be more easily picked up than a company that is selling at what we used to regard as a realistic price earnings ratio. So, because the prices are depressed, they are a standing invitation for somebody to come in and make a bid to the stockholders at a few points above the market and pick up a great bargain.

Now, it is bad in terms of conventional American philosophy for small companies to be purchased by big companies, foreign or domestic.

Senator NELSON. I have to interrupt you, Mr. Fortas because there is the rollcall.

Mr. FORTAS. Well, that is about the story anyway.

Senator NELSON. I am sorry about these interruptions.

If Senator Bentsen has some additional questions that have not been asked, I assume you would be willing to respond to them in writing for the hearing record?

Mr. FORTAS. Yes.

Senator NELSON. Thank you very much, gentlemen.

[Brief recess.]

Mr. BEST. Because there is another rollcall vote, I am going to run through some questions that I think Senator Bentsen would have asked, so as not to delay this proceeding.

As I understand it, the concern over foreign takeovers is that the two-tier market creates an artificial incentive for foreign companies to buy out American companies? Is that actually the concern?

Mr. WOOD. It is the fact that they can buy them below value.

Mr. BEST. Could you just speak to the question of bloc trading and dumping?

One of the apparent concerns is that institutional investors can gain a significant holding in a particular company and then, for reasons of its own, can dump a large portion of that stock virtually within a half hour. Have you any recommendations in that regard?

Mr. WOOD. I think we made some recommendations on that. We were talking about the one-quarter of 1 percent rule, for instance.

But I can give you some good examples of what happens around the country, both from my own personal experience and the experience of talking with literally hundreds of other company presidents. You have an institutional dump of 50,000 or 100,000 shares and that can drive the stock down a couple of dollars. And then the next day the phone is ringing and the shareholder who is on the other end, says, what is wrong with the company. And he says, well, why did the stock go down $2 or $3? He asked why was that volume of 100,000 shares traded yesterday? And the only answer is, well, it is some institutions dumping. And immediately they think, oh, the institutions know something that we don't know. And then he goes and starts selling himself. He gets nervous. Pretty soon, there has been enough of it sold that they have triggered some margin calls and then

the whole house of cards goes down. So all of this happens because of one dumping in 1 day.

Mr. BEST. Is there evidence that this trend is increasing or that the institutions are doing less and less of this?

Mr. ZEDER. I think there is some evidence that there is more of this. Yes, sir, and if the conditions continue as they are today, the trend is likely to continue. And one of the things that happens—to add to Mr. Wood's comments—I can give you a good example in our case, where a fund accumulated some 40,000 shares of our stock. In order to do that, I understand they contacted 10 individual brokers to assemble these securities over quite an extensive period of time, a number of months. They decided to get out one afternoon for no reason that had anything to do with the way we were conducting our business or the way our company was going because we were having an exceptional year as we have had for the last 6 years. They decided to get out. They, in turn, called the 10 brokers back that had each acquired, let us say, 4,000 shares and told each of them they had 40,000 shares to sell. So it wasn't 40,000 shares that hit the market. There were 10 brokers each trying to sell 4,000 shares and even after the initial supply was taken up, the resulting market conditions helped depress the stock some 30-some percent over a 2-day period.

Mr. BEST. I think Mr. Wood mentioned that your company was 20-percent owned by T. Roe Price?

Mr. WOOD. I don't think I mentioned it but that is the one.

Mr. BEST. How did that come about?

Was that because the market was depressed at the time?

Mr. WOOD. I don't know and I must say T. Roe Price has not been going in and out. We have had a lot of other ones that have hurt us bad, though. They have accumulated their position in a number of funds and in a number of managed accounts. It is not in any one fund of theirs.

Mr. BEST. Do they have control over the management of your company with 20 percent?

Mr. WOOD. Of course not, no, because they are in various different funds and various different managed accounts but they are still under one umbrella.

Mr. BEST. There are a few questions on taxes I might ask, also.

In proposing a graduated scale of capital gains, the primary reason given was that such a change would free up locked-in assets. Isn't it possible this problem can also be redressed by eliminating the incentive to hold such stocks by a change in capital gains at death rules?

Mr. WOOD. I don't think we are qualified to answer that. That is something that has never been discussed with our committee. The best we could do is give you our personal opinion and I think you will want to hear from our 500 company presidents.

Mr. FORTAS. It may also be relevant to point out that the proposal of the Committee of Publicly Owned Companies is not for a stepped-down capital gains tax depending on the period of holding. They haven't taken a position against that but they haven't taken a position for it, but rather, because of the paramount concern of the committee about encouraging the individual investor, the committee has proposed an annual exemption of up to $1,000 capital gains realized on the sale of securities.

Mr. BEST. Let me ask you a question on that. You have suggested an annual exemption of $1,000 of capital gains. This may serve as quite an incentive to the small investor to reenter the securities market. However, what rationale can justify this preference for investment in securities as opposed to other capital assets?

Mr. WOOD. Well, to begin with it would provide the salesman of investment banking houses all around the country added incentive to seek out the business of the individual investor. In other words, it gives him a new twist to his own story of good investments. Let's say the average individual thinks that perhaps he could make a 10-percent return. So to be able to get that $1,000 tax free, he would probably invest $10,000. Now, only half of them will come out with a profit; some of them with a loss, so you probably get $20,000 invested.

I think you could easily say that a lot of them would invest more than $10,000. Now a tax break on $1,000 would cost the Government something in lost revenue or income, and say that is $200. I think you would agree that this would be greatly offset by the new investments which may average up to $40,000. The $200 lost, which is only one-half of 1 percent of $40,000, is a lot cheaper than having to subsidize unemployment or something else later on.

Mr FORTAS. May I supplement Mr. Wood's response? I do believe there is a reasonable rational distinction to be drawn between a capital gain, that is, between treatment of capital gains and securities, and treatment of other capital gains. I believe that there is a profound and overriding national interest in encouraging a securities market which has the features of liquidity, price continuity and the widespread participation of small investors directly investing their savings in the corporations of this country. I know of no comparable situation. I don't think commodity investments, for example, commodity trading, is really comparable and I believe that the securities markets do present a unique situation in that this sort of measure, confined to securities trading, has a national purpose that justifies it.

Mr. BEST. As I have heard the witnesses here address themselves to the problem, the remedies seem to fall in two major categories: Tax incentives to get individuals back into the market and, second, regulatory measures to arrest the alleged domination by institutional investors in the market. Many witnesses favor the positive approach but there has been some criticism of the regulatory suggestions.

Are you familiar with the issue that the Morgan Guaranty witnesses brought out with respect to the problems associated with limiting to say 5 percent or some percentage, the holdings by an institution in any one company? He suggested that this, in effect, would just make the problem that much worse because the institutions are so heavily capitalized that if a bank of Morgan's size, some $28 billion, were to spread its investments around evenly, it would gain control of a lot of the small or medium-sized companies.

Would you want to address yourself to the problem that the Morgan Guaranty witness suggested would arise in any kind of regulation of holdings?

Mr. WOOD. Well, I might just say this, that perhaps we should address ourselves to that problem once they have gotten 5 percent of let us say, the red and white chip companies, and then they didn't have anyplace else to put their money. They aren't at that point yet.

Mr. BEST. But would there there be any more problem for Morgan Guaranty than there would be from mutual funds, if you had that limitation?

Mr. Wood. I don't think I am qualified to answer that. Do you want to speak to that?

Mr. FORTAS. May I add this? It was Mr. Callaway who suggested that there are a great many medium-sized companies so that in all probability Morgan Guaranty—to take it as an example—would be able to find good solid investments for the funds over which it has a fiduciary relationship. Now, if our argument is correct, then it is of extreme national importance that the institutions be induced to spread their funds around. And in that connection, may I say that I have a kind of feeling that it is rather unreasonable to expect the institutions to do this voluntarily for two reasons:

First, they do have a fiduciary responsibility and, unless there is a framework of law within which they discharge their fiduciary responsibility, they may run into a problem if, in their judgment, IBM is the most shining star in the universe, and they do not put their money in IBM. Second, there is a problem of competition among the institutions, particularly for the management of employee benefit funds and it is asking a lot to expect an institution to do anything less than participate in the self-fulfilling prophecy which accompanies the so-called religion stocks. So that it may be necessary, regrettably as I am sure we all feel it to be, that there may have to be some legislative framework within which those institutions can conduct their investment policy.

Now, beyond that, I must say I have a little difficulty with the argument if the argument is that Morgan—to use it as an example and not meaning any thing individually about it but just as an example you cited—the argument, as I understand it, is that Morgan would hardly be justified in buying, let us say, 5 percent of IBM because it might not then be possible to spread it pro rata among all of its managed accounts, regardless of Morgan's judgment about it. Well, that may be some consideration but, on the other hand, our argument is really that there are other advantageous investments in this country if we had the legislative framework which would compel the institutions to take a look at those investment opportunities. So, if it is a national necessity as this committee views it, then Morgan—again, to use it as an example—may have to find some other way of handling its accounts that would be beneficial.

Now, it may indeed conceivably—although I don't believe it—but it might conceivably operate as a limitation on growth of the institutions. I don't believe it.

Mr. BEST. Do you feel that institutional investors are getting a sufficiently diversified research and investment advice to be able to invest a significant part of their portfolio in a broad range of stocks or do you feel that the institutions tend to get limited advice from a few high-powered research centers or their own research departments?

Mr. Wood. I don't know. I do know this, that there are research reports put out by the various research organizations so that if they want to avail themselves of them they are available.

Mr. BEST. How do you explain the alleged herd mentality among the institutions if it is not they are getting limited advice?

Mr. WOOD. I think you would have to ask them that question of why they all play follow-the-leader.

Mr. FORTAS. Well, may I add this? I think there is an obvious tendency of an institution or any investor to concentrate on a few stocks. Some institutions have some analysts in their own shop. The analysts are limited in number and they specialize in the largest companies. I am quite sure that presents an incentive and a temptation to confine their major interests to those larger companies.

Here, again, you get to whether the net result of it is in the national interest.

Mr. ZEDER. Also, I think this is a situation, isn't it, where the institutions are dealing with just a handful of stocks and trading them back and forth amongst themselves? I was telling the story awhile back about the farmer who was bragging about his four sons; that he had four such very smart boys and he said every day they get up in the hayloft there and trade back amongst themselves and each one of them makes 3 or 4 dollars. I think we see a lot of that going on with our institutions.

Going back to the point on Morgan, I don't want to appear to be picking on them but in talking about being able to spread it around, if you take a look at the numbers, Morgan has about $1 billion a year to invest and out of that they have put $650 million last year in about seven stocks. They had another $150 million which they put into eight other stocks. Here you have 15 stocks with $800 million invested in them. I think they could broaden their base beyond that without coming close to controlling white and red chip companies.

Mr. WOOD. Of course, they did get themselves in a box. You take the institutional favorities and say that their PE's are up around 40, and you have many people covered by pension funds who think they are going to get $40 a month, so if that PE goes down to 20, they only get $200 a month. So, really, the instututions have to maintain that. They boxed themselves in.

Mr. BEST. They are locked in?

Mr. WOOD. They have to continue to support that PE.

Mr. BEST. I will ask one more question from Senator Bentsen and then I think I will resume my rightful place.

To what extent is investment in the higher tier, the upper tier, due to the performance cult psychology? Is there really that much higher performance in the upper tier at the present moment? I know they are selling at higher multiples, but is there that much growth potential in the companies or are they locked in? In other words, if it were simply a performance cult, they could go into the lower tier and have a performance cult in those stocks, too.

Mr. FORTAS. I don't think so. That phrase means stock market performance. It doesn't mean earnings performance. For example, in our complete statement that is on file we refer to a study that was made of the 100 highest earning companies and only five of the institutional favorites were in that group of the highest per share earning companies. That appears in our prepared statement. Only 5 of the 21 religion stocks or institutional favorites made the list of 100 companies whose stock showed the greatest earning per share. That was a study that appeared in Forbes magazine in January of 1973.

So when you talk about the performance cult, you are talking not about performance in terms of earnings, but you are talking about performance in terms of what the ticker tape says. And to use Senator Bentsen's phrase, it again is a sort of self-fulfilling prophecy that the

institutions embrace. If it were performance, in terms of a standard that was related to basic conventional values, earnings, we would have a very different story.

Senator ROTH. Are these higher tier companies essentially the largest companies?

Mr. FORTAS. There are some very large companies that are not in the group.

Mr. ZEDER. I think one of the top tier companies listed on many analysts' computer runouts that I have seen is a company not much larger than my company, doing about $170 million a year, so it is not just necessarily the giants, but most of the giants are in there, yes.

Senator ROTH. I apologize for the disruptions we have had today, and I want to congratulate you for coming out and speaking so frankly. I think it is very refreshing.

I think business has made a mistake in the past by failing to take a position. They are like politicians. They are afraid they are going to hurt some part of their constituency or their customers. And I think business has not gotten their story across well enough because they have been unwilling to openly say what concerns them. So I congratulate you on that.

We recently passed legislation in the Senate dealing with freely negotiated commission rates. I voted against the bill, and I think if I followed the thrust of your remarks, you feel this legislation is not in the best interests of competition.

Mr. WOOD. That is right. We very strongly object to that.

Senator ROTH. If we were to adopt the approach that you suggest—a limitation on institutional ownership of any one company—would these same large institutions then grow to dominate a broader section of our corporate life?

Mr. FORTAS. I don't believe so, Senator. If you limited it to 5 percent, the ownership of 5 percent of the stock of any company, that is to say, they would presumably own 5 percent or up to 5 percent of a great many more companies, but it would be an extraordinary situation where 5 percent is a controlling block. You always have the problem of several institutions getting together to exercise management influence, of course, but I think that is more of a theoretical problem than a real problem.

Senator ROTH. But doesn't this speak to our present laws known as the prudent man statutes? If a large fund is forced to limit its investments, it may find that it can only buy, at the margin, stock in firms it feels are unattractive or even unsafe investments. Under most State laws, a trustee normally has a fiduciary duty to protect capital investment. I suppose the Federal Government could preempt the area but is this a desirable situation? This committee has just finished a great amount of work on the pension reform bill. What good would new vesting or funding provisions be if we undermined the value of the investments which are to create the returns necessary to cover pension benefits?

Mr. WOOD. But the mutual funds have been able to live with this rule.

Senator ROTH. I understand that.

Mr. WOOD. The 5-percent rule.

Mr. FORTAS. Well, I think, Senator, perhaps if I might add this? That your point involves two things that the committee has suggested: One is the 5-percent limitation as to the amount of equity of a company that may be owned and, secondly, a restriction on the amount that can be traded within a 30-day period, and it is, of course, true that the situations may arise which raise problems of fiduciary duty. That is, let us suppose that a fiduciary believes that IBM is the best investment around, so why shouldn't the institution be able to put 20 percent of its funds into IBM? And let us suppose that an institution believes that a particular industry or a particular company is running into hard times. So why shouldn't the institution be able to unload all of that on the market? Well, then you look at it from two points of view. (1) From the point of view of economic freedom—and, as in most other situations in the "valley of tears," we have to weigh and balance our considerations—and (2) is the national interest. And our submission is that it is so important to the national interest, to the Nation, to preserve the kind of country that we want, that we feel observance of these limitations is justified. And we feel it is of overwhelmingly greater importance to the Nation to preserve the market than to have an institution free to exercise its untrammeled judgment. And all of us—I certainly do—believe in the maximum freedom for investment judgment but there are times when we believe this consideration must yield to overriding national considerations.

And another point which has to be approached is the technical, legal, moral problem of a fiduciary's responsibilities. And I believe again that that has to be gaged and determined, evaluated in light of larger considerations that I have already described. And as I said a few minutes ago, I believe in all fairness to institutions and to fiduciaries, that you have to set these limits by legislation. In other words, that it is the U.S. Government that is saying to the mutual funds and the banks and so on and to the people who entrust their moneys to those institutions, that you must be aware of the fact that the performance of your fiduciary duty must be within these rules, that the Congress of the United States has prescribed in the national interest. And I think unless you do that, it is unfair, really. I think unless you do it by legislation, it is unfair because there is, undoubtedly, a problem of fiduciary responsibility.

Senator ROTH. If I could, I would like to turn to a different area. One of the gentleman spoke about their dealings in Japan, and if I recall correctly, the Japanese depend very heavily on borrowed money as a means of financing their industrial expansion. They seem to regard our reliance on equity capital as old-fashioned. They borrow extensively from the large banks because they feel that this is a better way.

I remember years ago, when I was at Harvard Business School they taught us that a firm equity base was the necessary foundation for corporate growth. Maybe, in light of our Japanese competition, we ought to reexamine those principles?

Mr. FORTAS. Senator, two things about it: First thing, there is much more of identity between the banks and the lending institutions and the industrial companies in Japan than there is here. So it is sort of one hand washing another, so to speak. The second thing is, this situation, I believe, is changing very rapidly in Japan. I had a very interesting visit just about 3 weeks ago from an official of the Japanese

Stock Exchange, the Tokyo Exchange, and the gentleman, who is chief of the finance division or some such name comparable to our SEC and which has the functions of our SEC, was over here making a really remarkable study of our equity markets. And I had the pleasure of taking him around to the SEC and various other places so that he could get an idea of our regulatory techniques. I think he got more of an idea of our regulatory problems, but nevertheless, things seemed to be changing over there.

Senator ROTH. Yes; I understand that they are taking a careful look at our approach now, but it is interesting that in the past they certainly have very successfully pursued a different course of action.

Mr. ZEDER. I might add and amplify what Mr. Fortas has pointed out. I just came back from Japan a few weeks ago. There is not only a closer alliance between business and their banking associates over there, but there is a very, very close association with their Government bodies in the interest of expanding industry in Japan.

Senator ROTH. Yes; there certainly is a much closer working relationship.

You indicated in your testimony that it is estimated that by 1975, we will need to market $7.5 billion annually in stocks and $11 billion by 1980. What are we currently obtaining in equity capital?

Mr. WOOD. Well, I think Mr. Kolton of the American Stock Exchange testified on that this morning. So far in 1973, it hasn't been enough to even try to add up.

Senator ROTH. If I recall, he mentioned new offerings for six or seven companies.

Mr. WOOD. Something like that.

Senator ROTH. But I assume that wasn't the complete story or maybe it is.

Mr. WOOD. I think that was the total complete story as to new issues.

Senator ROTH. There must have been some small companies that came to market in that period.

Mr. WOOD. Just look in the newspaper every day. There are no tombstones; they are just not there.

Mr. FORTAS. Here, excuse me, Senator, in our complete statement, which is on file, shows some figures and they are drawn from the Securities Industry Association Report from May 21, 1973. This is not a direct answer to your question, but in the first quarter of 1973 underwritings were down 49 percent compared with the same period in 1972. And the dollar value of corporate private placements were down 30 percent. I don't know what the base figure is.

Senator ROTH. Earlier in these hearings I asked how we might justify action which many people might consider an expansion of an alleged loophole. Now, if we were to grant a $1,000 tax exemption, as you suggest, could we logically limit it to investments in securities? There are certainly other investment opportunities—land, natural resources, commodities, and so forth which would theoretically be eligible.

Mr. WOOD. Because it will help to encourage individual investors to come into the marketplace and they have been the backbone of corporate capital in America. It will encourage them to put their money back into equities. It is going to help keep our new companies coming along. We could get them financed. It is going to help our existing

companies to get the money for expansion to keep up our technology and to hold down unemployment. I think the best way to answer that is: If we don't get the individuals to do it, where is the money going to come from? The individuals have left the marketplace and by all of the numbers that have been quoted here today, we see that the money is not coming into American industries for expansion and new industries.

Senator ROTH. And yet I must say, I don't think the average citizen has any appreciation of this problem. I haven't really heard much discussion except in strictly financial circles.

Mr. WOOD. No; but he won't feel this for 2 or 3 years. Companies are expanding with money they raised a couple of years ago, but it is like putting marbles in a pipe. If the pipe slants a little uphill, as long as the pipe is full, they are going to keep coming out of the other end, but when you stop putting them in, you are going to lose them. In other words——

Senator ROTH. I certainly feel that there is a need for organizations like yours, interested in educating people about complex problems, such as this. But if you listen to some of the speeches on the floor here and read the media, you might think the answer to all of our problems lies in the other direction. Many people feel we have too many tax exceptions. So I urge your organization to look at this aspect of the problem. I think it is a very important one, if you want to get support on the Hill.

Mr. WOOD. Very good point, very good.

Mr. ZEDER. Senator, I might comment also on the question to Chairman Wood. I think we should also keep in mind that the United States is one of the few countries that does have a capital gains structure. And again our competitive posture is being affected by how this, too, regulates or tends to regulate the interest of the average investor in our market.

Senator ROTH. Well, gentlemen, we have kept you here a long time, and I don't want to detain you any longer. I want to apologize for the chairman, who I know is anxious to return here and participate, but he has some important amendments on the floor. We all appreciate your coming here and providing us some very useful testimony.

[The prepared statement of Mr. Wood, Jr., follows:]

PREPARED STATEMENT OF C. V. WOOD, JR., PRESIDENT, MCCULLOCH OIL CORP. ON BEHALF OF THE COMMITTEE OF PUBLICLY OWNED COMPANIES

INTRODUCTION

My name is C. V. Wood, Jr. I am Chairman of the Committee of Publicly Owned Companies. I am President of McCulloch Oil Corporation which has its headquarters in Los Angeles, California. My curriculum vitae is attached to this statement as Exhibit A.

With me in the hearing room are Messrs. Stephenson and Zeder, who are members of the Executive Committee of The Committee of Publicly Owned Companies; Mr. Abe Fortas, whose firm is general counsel for the Committee; and Mr. James J. O'Neill, who is Executive Director of the Committee.

I should first like to express my thanks to the Chairman and the members of the Subcommittee, on behalf of myself and The Committee of Publicly Owned Companies, for this opportunity to state our position.

We particularly welcome the creation of this Subcommittee. We have the greatest respect and appreciation for the diligent and dedicated work of the so-called Williams Subcommittee and the Moss Subcommittee in the House. We have observed, however, that the mission of these subcommittees has thus far been concentrated upon the problems of the securities markets in isolation—that is,

without the major, intensive reference to the impact of market conditions and of proposed legislative changes in market rules upon the American economy, upon our democratic enterprise system and upon corporate America.

I hasten to say that this observation is not by way of criticism of either of these able and distinguished subcommittees. In part, the limitation of their perspective has been due to the way their mandate was defined and to the time of definition—that is, their task was defined before the full and dangerous implications of the situation in the securities markets became apparent.

In part, the limitation of the approach of these subcommittees may have been due to a feeling that Congress could first legislate on rates, membership and other problems relating to the governance of the securities markets, and thereafter turn to problems such as institutional dominance and control and the impact of proposals upon corporate America and upon the American democratic, enterprise system.

With all respect, we do not believe this sequence is either possible or prudent without inflicting great damage on our Nation, from which we may not recover. The reason for this, as we shall demonstrate, is that the seemingly technical considerations relating to rates, membership and so on, and the provisions of proposed legislation, are not and cannot be considered as matters that are circumscribed by the parameters of the securities industry. They involve much more than who pays how much for the execution of trades; or who runs the New York Stock Exchange; or who can be a member of an exchange.

These matters determine and will determine to a fundamental degree and a pervasive extent what kind of Nation we're going to have. They will determine such matters as:

Who controls our economy—millions of individual Americans, or a few institutions?

Can small and medium sized—and even a large number of very big companies—survive—can they have access to equity capital, or will equity capital be available only through a few large brokerage-investment firms, and only *from* a few enormous institutions?

Will the American people as investors and potential investors have access to independent local and regional brokers and investment houses—will those houses be able to survive?

Will the American people, as direct investors, continue to control and direct the flow of equity capital to thousands of companies? or

Will we follow the European pattern of control of the economy by a few great banking houses?

It is because this Subcommittee seems to be charged with the responsibility of looking at these fundamental problems that we particularly welcome its creation and these hearings.

I. THE COMMITTEE

Original Membership

I should first like to describe The Committee of Publicly Owned Companies, its origins and activities.

So far as we know, this is the first time that a group of chief executives of publicly owned companies has been organized and has appeared before a Congressional Committee specifically to express the views of those companies with respect to legislation affecting the securities markets.

The Committee now has a membership of 469 companies which is increasing almost daily. The companies are located in 40 states. These companies represent $43 billion in assets; 1.8 million stockholders and 1.1 million employees. Of these companies, 73 are listed on the New York Stock Exchange; 311 on the American Stock Exchange; and the securities of 85 are traded over the counter.

The genesis of the Committee is as follows:

In 1971, following the recommendations of the Martin Report, the American Stock Exchange organized the Listed Company Advisory Committee. The members were nine chief executives of companies listed on the Amex. They were broadly representative of the various regions of the Nation and of different types of companies.

The Listed Company Advisory Committee met quarterly. Its members worked hard at their task and were the beneficiaries of an earnest and effective effort by the officials of the American Stock Exchange to fully acquaint them with the operations of the market and current problems.

I think it is fair to say that all of us had previously paid very little attention to the operations of the securities markets. The information that we acquired as members of the Listed Company Advisory Committee was a revelation, and it

resulted in an awakening. All of us had concentrated all of our energies on running our businesses. We had proceeded on the assumption that if we turned out good products and services and marketed them effectively, we had done our job. We thought that if we turned in a good record of profitable operation and growth, the stock market would take care of itself. I suppose we thought of the stock market as an auction market that more or less automatically responded to supply and demand and which reflected the true values of our companies with reasonable accuracy. We had never thought that the evaluation that the market placed on our companies was greatly affected by the laws, rules and regulations which govern trading in the securities markets.

This illusion was shattered by what we learned as members of the Listed Company Advisory Committee. The way the markets are regulated and the way they operate are of fundamental importance to us. It is our companies—the publicly owned companies—that are bought and sold every day on the markets; and the price and volume of trading, and who is doing it, is of fundamental importance to us. It is our companies that currently are being deprived of access to the equity markets because investment funds are being concentrated in a few great financial institutions which pay practically no attention to thousands of companies like ours—which concentrate on a few so-called "religion" stocks of a few enormous institutional favorites.

Historically, everybody was being heard except the public companies themselves—and they were all talking as if we did not exist; as if we were just the poker chips and not the game itself; as if the important questions were who paid what commissions and who controlled trading, instead of what is going to happen to America and to the thousands of companies that produce the goods and services, the competition and initiative that are the hallmark of America.

Accordingly, the nine members of the Listed Company Advisory Committee decided in January of 1973 that some organized vehicle ought to be formed to present our views. We decided that a broadly based organization should be formed, composed of chief executives of publicly owned companies, to operate with total independence from any of the securities exchanges and from the securities industry itself; that this independent committee should formulate its views as to the problems and prescriptions for the securities markets; and that the committee should present those views to the Congress, the SEC, the securities exchanges and the securities industry.

The Committee's Activities

Since its organization in March of 1973, the Committee has held meetings of executives of publicly owned companies in twelve cities, including New York, Chicago, Los Angeles, Dallas, Houston, Fort Lauderdale, Boston and Minneapolis—and other meetings are planned.

At each of these meetings the reaction of company executives was uniform.

The Committee's brochure, which is attached as Exhibit B to this statement, has been circulated to all companies listed on the New York and American Stock Exchanges and about 400 companies traded over-the-counter. We have received no dissents. Many companies have suggested supplementary ideas, some of which have been incorporated in our program, as I shall mention.

The hundreds of company executives with whom we have talked are deeply distressed about the situation in the securities markets affecting their companies. They feel keenly that they are being starved out of the capital markets. They are extremely alarmed by the withdrawal of the individual investor from the marketplace. They are deeply concerned about the dominance of a few great institutions; the concentration of power over our economy in a few institutions; and the market practices of institutions—particularly the fact that institutions appear to buy or sell at the same time—on a sort of follow-the-leader basis; the fact that they are concentrating activities on the buy-side of the markets in a few religion stocks or institutional favorites, without regard to underlying values; that they engage in dumping of large blocks of stock, without regard to market effect so far as the public or the market makers and specialists are concerned; that they won't or can't invest in the broad spectrum of American companies; and that their activities preclude us from access to America's storehouse of investment funds through the traditional American channels of independent investment firms and millions of individual, direct investors.

II. WITHDRAWAL OF INDIVIDUAL INVESTORS: INSTITUTIONAL CONCENTRATION

The basic fundamental facts of the securities markets which, in our opinion, seriously contribute to the difficulties of our present situation can be briefly summarized.

1. Individual investors and traders have withdrawn from the securities markets

(*a*) The New York Stock Exchange recently reported that the number of shareholders in the U.S. had declined 800,000 since the previous shareholder census, the first such decline on record.

(*b*) Odd-lot investor transactions, characteristic of small round lot (individual) transactions, reveal a steady stock liquidation trend for 35 months. In 1960 odd-lot trades represented 21% of total NYSE volume. In 1972 it was only 4.6%.

(*c*) The ratio of trades of 200 shares and under to total NYSE volume has declined to half of what it was in 1968.

2. Institutions, directly and through managed accounts, dominate the securities markets

(*a*) As of the end of 1972, total institutional holdings of corporate stock amounted to $398 billion or about 34% of the total (*SEC Statistical Bulletin*, p. 519, attached as Exhibit C).

(*b*) Institutions account for 70% of public dollar volume on NYSE, compared to 35% in 1963.

(*c*) Pension funds, most of which are controlled by the great financial institutions, added $8.9 billion to their stock portfolios in 1971 and another $6.7 billion in 1972; while the public withdrew $5.3 billion from stock market in 1971 and another $2.7 billion in 1972. (*Money Magazine*, July 1973.) Morgan Guaranty Trust Co., a giant New York bank, alone managed $16.6 billion in employee benefit assets in 1972. Morgan had more than $10 billion in only 25 companies. I attach as Exhibit D, a table from Barron's Magazine, showing the concentration of that bank's holdings in these 25 companies and the percentage of shares that Morgan owned in each of them.

3. A few institutions own a vast percentage of all institutional holdings

(*a*) The two largest types of institutional stockholders are private noninsured pension funds and personal trust funds. Together they account for over 50% of total institutional holdings (*SEC Statistical Bulletin*, p. 519, Exhibit C). Out of $113.2 billion in total pension fund holdings, $76.5 billion is managed by only ten banks. (*Business Week*, March 31, 1973.)

(*b*) At the end of 1972, bank trust departments managed $292 billion, of which one quarter was concentrated in five banks and one half in just 21 banks. (*SIA Testimony, Williams Subcommittee*, February 22, 1973.)

(*c*) The Nation's largest insurance company controls investible funds of about $33 billion. (*Whitehead Speech*, May 11, 1973.)

(*d*) As of the end of 1972, four New York City banks managed or co-managed the employee benefit assets of 192 of the 300 largest corporate pension funds. (*Pension Magazine*, 1972–73 Directory issue.)

4. Institutional investments and trading are heavily, and amazingly, concentrated in the securities of a few companies

(*a*) Fourteen out of 17 leading banks included in a Fortune Magazine Survey hold IBM as their No. 1 holding. The other three have IBM stock as their second largest holding. More than half have 7% or more in that stock. One bank has 13%. All 17 have General Motors in their top twenty and 19 include Exxon in their top twenty. Eleven include Eastman Kodak in their top three holdings. (*Fortune*, July 1973, p. 189, attached as Exhibit E.)

Morgan Guaranty has $2.1 billion of managed trust assets in IBM; First National City has $1 billion; Manufacturers Hanover has $769 million; Chemical Bank has $610 million. (*Fortune*, July 1973, pp. 86–87.)

(*b*) One of the largest banks, with over $1 billion in pension fund money to invest last year, placed 65% in just seven stocks; another 20% in eight other stocks; and the balance in less than fifteen other stocks. (*Whitehead Speech*, May 11, 1973.)

(*c*) Morgan Guaranty Trust Co., holds 14.3% of the outstanding shares of Walt Disney, and 10.2% of Polaroid. (*Barron's Magazine*, June 18, 1973, *supra*.)

(*d*) The Weisenberger Service lists only 21 stocks as institutional favorites, as of April 1973.

(*e*) Attached as Exhibit F is a group of documents showing investment portfolios of several large banks. This again shows the extraordinary concentration in a few institutional favorites, and it shows that the various banks put large amounts of their managed investment funds in the same stocks.

5. The market price of institutional favorites has vastly increased without substantial relationship to earnings while the market value of the securities of perhaps 90% of publicly owned companies is depressed, despite record corporate

earnings. Their market prices bear no relation to their value. This is because of the absence of individual trading; because fo liquidation of individual holdings; and because available investment and trading capital is concentrated in institutions which, in turn, invest and trade in the securities of only a few glamour or religion companies. In addition to the facts stated earlier, we add these significant reports:

(*a*) The Weisenberger list of 21 institutional favorites advanced 90% from December 1968 to April 1973 and 25% since April 1972. (*Weisenberger Service.*)

(*b*) Even the Dow Jones index, which is heavily weighted with institutional favorites, shows a P/E for industrial companies in its list of about 14, while the 30 institutional favorites are at 36. (*SIA Testimony,* June 15, 1973.)

6. Most companies cannot raise equity capital for expansion or other needs. Underwritings—the means by which companies raise equity capital—have sharply declined

(*a*). Hundreds of thousands of companies in our Nation have shown consistent and increasing earnings in the past few years, but their stock prices are at all-time lows compared with their earnings.

(1) Between 1968–1972, the GNP was up 33%; personal income was up 36%; personal savings were at record levels; but stock prices were off 50%. (*Whitehead Speech,* May 11, 1973.)

(2) Corporate profits were up 26% for the first three months of 1973, but Price-Earnings ratios are at the lowest levels in 20 years. The most broadly-based index, the Value Line index, is off 50% since 1968. (*Money Magazine,* July 1973.)

(3) Between April 1972 and April 1973, nearly 900 companies on the New York Stock Exchange out of 1,532 companies listed, increased their earnings, but suffered a decline in their price-earnings multiple.

(4) During the same one-year period, nearly 500 companies on the Amex out of 1,309 companies listed had the same experience.

(*b*) Here are a few examples of what has happened to companies that are members of our Committee—companies with steady, increasing, high earnings and incredibly low market value:

	Earnings per share			P/E ratio, June 1, 1973
	1970	1971	1972	
Aluminum Specialty Co.	$0.92	1.05	1.13	7
Development Co. of America	.68	1.53	2.30	5
Noel Industries	.45	.82	1.14	6
Missouri Beef Packers	1.15	1.69	2.06	4
National Silver Industries	.68	.81	1.16	4
Resistoflex	.18	.41	.66	7
Leslie Fay	.98	1.11	1.21	7

Exactly what does this picture of undervaluation mean to us?

(1) It means that we can't go to the market to raise money for replacement or expansion of our facilities. It means that we can't raise equity money for such things that are demanded of us, such as improvements to effect pollution control to meet the demands of environmentalists. It means that many of us faced with an unavoidable need to raise money have to go to the banks and saddle our companies with very high interest rates and fixed charges, and dangerously increase our ratio of debt to equity. And as we resort more and more to bank borrowings, interest rates escalate, pyramiding our problem and the inflationary perils facing the Nation.

(2) Evidence of this is the increasing burden of short and long-term debt in our corporations and the raise in debt-equity ratio. Debt service has become and is increasingly a severe burden on our companies, threatening the financial soundness of many of them. Taking the Standard & Poor's list of 425 industrial companies, long-term debt has trebled from 1962 to the end of 1971. Debt-equity ratio has risen from 26% to a dangerous 41%, and it is probably higher now. (Jones, Chairman of General Electric Co., Exhibit, attached.)

(3) Further, corporate underwritings of equity issues has dwindled to a trickle. In the first quarter of 1973, underwritings are down 49% compared with the same period in 1972; and dollar value of corporate private placements are down 30%. (*SIA Report,* May 21, 1973, p. 8.) There were 26 primary underwritings by Amex

companies in the first five months of 1972 as agzinst only 2 in the same period of 1973.

(4) Our companies are inviting targets for take-overs by foreign as well as domestic capital. Some of us, faced with the practical impossibility of raising new money, are looking around for mergers with other companies. Some of us have been the target of tender offers made at a premium above the present depressed market values—and we are great bargains at those prices. Here are some figures:

a. In the most recent five months of 1973, 40 tender offers have been filed with the SEC—meaning that some company believes stock prices are so low that it is offering a premium to the public. In the preceding five months, only 14 were filed.

b. I do not have figures on the number of mergers and acquisitions of companies, but it is common knowledge that the rate is accelerating. Here is a list of just some of the recent, highly publicized take-overs of good American companies by foreign companies with their homebase and loyalties ranging from Saudi Arabia to the United Kingdom.

Acquirer:	Acquiree:
British-American Tobacco (U.K.)	Gimbel Brothers
Lloyds Bank of London (U.K.)	First Western Bank & Trust Co. of L.A.
Nestle (Switzerland)	Stouffer Foods
Michele Sindona (Italy)	Talcott National Corp.
Saint-Gobain (France)	Certain-Teed Products
Adnan Khashoggi (Saudi Arabia)	Bank of Contra Costa and Security National Bank (both California banks)
Siemens Aktiengesellschaft (Germany)	Computest Corp.
United Dominions Trust (U.K.)	Commercial Trading Corp.

(5) Our stockholders have become unhappy and dissatisfied. Millions of them are faced with the destruction of a lifetime of savings.

(6) Our employees are faced with the destruction of the value of company securities held in pension, retirement, and profit-sharing plans. They are also faced with the prospect that their opportunities for job advancement are curtailed because their companies have had to defer expansion plans and generally engage in belt-tightening.

(7) Our executives are unhappy. Many have invested their life-savings in stocks of their companies. They can't understand why the market value of these stocks has collapsed despite excellent earnings and unfilled orders. Many of them have stock-options, which have become worthless. Let me give you a few examples of the collapse of the value of stock-options:

a. Daylin, Inc., a New York Stock Exchange Company, which is a member of our Committee, has a stock-option plan under which the options are exercisable at an average of $14.81. The options were granted. Its stock is now quoted at around 7¾, despite excellent and uninterrupted earnings.

b. Spencer Companies, Inc., has options outstanding to 28 executives issued on October 20, 1972. The exercise price is $7.94. The recent price is 4¾. Spencer is a member of our Committee.

c. Titmuss Optical Corporation has an option plan at $9, the options being granted on January 9, 1973. The recent market price is 3¾.

d. Compac Corporation has options outstanding at $6.31 to $9, the options having been granted December 31, 1972. The market price of its stock is 4½.

So we are all faced with the most serious problems resulting from this abnormal decline in market values—problems affecting our financial ability, the soundness of our capital structure, our ability to produce goods and services that the Nation needs, stockholder disaffection, employee dissatisfaction and the morale of our executives.

We know that this situation is due to many factors—most of which have nothing to do with the rules and practices of the securities markets. But we also know these two things:

(*a*) That the rules governing trading and the organization and practices of the securities markets are a factor, and an important factor, in creating this deplorable situation, and unless we are wise and prudent, changes in those rules and practices can increase the current difficulties instead of aiding in their elimination; and

(*b*) That the phenomenon of withdrawal of the individual from direct trading and investment—and the continued and increasing dominance of institutions as

the source of capital investment funds and the principal traders in securities, especially if accompanied by continued concentration by institutions on a few companies and by uncontrolled and unregulated trading practices by institutions, can convert the present perilous situation into a disaster.

7. *The market prices of a few "religion" stocks which are institutional favorites are at extraordinary high levels because of institutional concentration. Those prices are not generally based on earnings records, but on "follow-the-leader" practices or subjective judgments of a few institutional analysts as to the picture*

(*a*) The religion stocks or institutional favorites are by no means the leading companies in terms of per share earnings. Their popularity with institutions seems to be based on size and subjective judgment as to the future, rather than on the hard evidence of value. Only five of the 21 "religion" stocks or institutional favorites made the list of 100 companies whose stock showed the greatest earnings per share. (*Forbes Magazine*, January 1973.)

(*b*) The situation resembles a pool operation in which a few investor-traders have run up the price of stocks. In part, this is due to the facts that big institutions know the big corporations and frequently have interlocking directors and a variety of business relationships with them, and that institutions do not and perhaps cannot feasibly learn about, and follow, smaller companies. In part, also, it is due to the fact that institutions put their managed funds in stocks that will show market performance, regardless of true value, so they may successfully compete for the benefits of management of pension funds and other moneys.

8. *Independent regional and local brokerage firms upon which our companies depend for underwriting services, for interesting investors in our stock, by selling efforts and by research into our companies which they communicate to prospective investors, have declined in number and suffered substantial losses*

(*a*) One hundred sixty firms have been compelled to leave the securities business since 1970; sixty or so others are presently under NYSE surveillance. (*Money Magazine*, July 1973.)

(*b*) There are presently 543 New York Stock Exchange member firms, the fewest in thirty years. (*New York Times*, July 23, 1973.)

(*c*) For the first five months of 1973, aggregate losses of NYSE member firms were $153.5 million, compared with a total profit of $580 million for the first five months of 1972. Sixty percent of member firms suffered losses in May 1973. (*NYSE.*)

(*d*) The common stocks of all sixteen publicly owned broker-dealer firms are currently selling at below the firms' asset values. (*New York Times*, July 23, 1973.)

III. CONSEQUENCES OF AND REASONS FOR WITHDRAWAL OF INDIVIDUAL INVESTORS: INSTITUTIONAL TRADING PRACTICES

These are the hard facts of economic life in the United States; and I suggest to you that they are intolerable—they cannot be allowed to continue. We cannot starve 90% of our business enterprises. We cannot endure the destruction of the life savings of millions of our citizens. We cannot put a lid on the growth of the American economy. We cannot, we must not, allow the kind of growth of concentration of economic power in a few institutions that we are witnessing, accompanied by confinement of the availability of equity capital to a few, enormous companies. The issue goes far beyond the welfare of our companies, or even of our stockholders and employees. It certainly goes far beyond the surface questions of rates and exchange membership.

We should like to call the Subcommittee's attention to an excellent paper by Mr. James M. Roche, former Chairman of General Motors, in which he points to the urgent need which we have for vastly increased capital investment. In summary, he says:

"The American economy faces an unprecedented need for capital in the next few years. Our companies need vast amounts of equity capital for expansion, to provide the goods, services and jobs that are needed; to meet the demand for modifications of plants and techniques to satisfy ecological considerations; and to modernize and replace the production facilities required to meet foreign competition and assure the flow of products and materials essential to the full employment and well being of our people."

The best available estimates are that to supply the equity capital that we will require by 1980, we need to market $7.5 billion annually in stocks by 1975 and $11 billion by 1980 (*American Banker*, May 11, 1971.)

By 1975 we will need 3.6 million additional jobs, over the present base. By 1980, we will need 11.7 million additional jobs (Conference Board.)

We need vast new production of goods and services to supply even present demands and stem the tide of inflation. We need much more to meet the needs of our future population and of new world requirements.

Where is this coming from? Is it coming from the 21 institutional favorites—or even 100 companies? Or must it come from the thousands of non-institutional enterprises in this Nation?

If we are to look to these thousands of companies, we must get a supply of equity capital to them. This can come only from direct investment by individuals—in any event, unless and until institutions can be induced or compelled to spread their investment funds over the broad spectrum of American business.

We come, then, to the question of why the individual investor has withdrawn from the markets and what we must do—and refrain from doing—to get him back.

Withdrawal of Individual Investor

Obviously, the reasons for the withdrawal of the investor from the securities market are many and varied. Inflation; devaluation of the dollar; the bust in late 1969 and the early 70's following the bull market; the failure of brokerage houses; scandals, such as Equity Funding—these and many other reasons provide a large part of the answer. Some of them to to basic economic factors.

In enacting SIPC, Congress has taken an important step towards shoring-up investor assurance against the failure of brokerage houses. Congress has also required reserves and safeguards to protect customer balances and securities in the hands of brokers.

Corporate America welcomes all of these reforms. But other, vital conditions equally require attention if we are to restore individual investor participation in the securities markets. Many of these can be summed up by a single observation: Individuals do not believe that, in today's markets, they are getting a fair shake. Primarily, they believe that the institutions are getting the breaks, and that they are the step-children of the securities markets—and they're right about it!

In June of this year, the New York Stock Exchange published a study of small investor attitudes towards the securities markets.

The Study found that 75% of small investors surveyed believe that "large investors make out better in the stock market than small investors." (P. 47)

"A substantial majority of small investors feel that large investors make out better than they do. But even more distressing is the feeling among a large number of small investors that a relatively small group of large investors are making money consistently on the basis of 'inside information.' " (P. 3)

The Study also found that 60% of small investors surveyed believe that "a relatively small group of large investors are making money consistently on the basis of 'inside information.' " (P. 47)

Finally, the Study revealed that 79% of potential investors surveyed believe that "large investors have access to tips, inside information and other special services in the stock market that are not available to small investors." (P. 56)

In my own experience, I can tell you that this feeling of investors—that institutions get information not publicly available—is pretty well-founded, despite the company's best efforts to prevent it. I have had the experience of hearing from an institutional analyst who found out about a development in one of my company's offices before I did.—Institutions are really in the category of preferential investors if not technically "insiders." We must devise better rules to keep up the pressure on institutions to penalize trading on inside information, and our companies must continue their efforts to tighten up on leaks. One factor, however, that has a bearing on this is that we, the companies themselves, have no means of direct communication with our shareholders. We don't know the names of the thousands whose stocks are held in street-names or nominee accounts. Brokers have an obligation to send out proxy material; but even brokers can't be compelled to send out purely informational reports in between stockholder meetings. We believe that this should be remedied so that we can obtain the names of our real shareholders from banks, insurance companies and other institutions, as well as from brokers.

The Stock Exchange's Study also reported investor awareness of another fact that has contributed to diminishing individual investment and trading in the stocks of our companies. That is the pronounced decrease of service to smaller investors. This is because the concentration of trading in institutions has meant a decline in the number of activities of brokers who traditionally have serviced the individual investor. This is because of three factors: First, the adverse financial impact upon the smaller firms that has resulted from the diversion of institutional orders to the larger houses. This has come about because the so-called negotiated rates above $300,000 has caused institutions to increase their large-

block trades. On the New York Stock Exchange, during the first quarter of 1973, there were 8,421 block transactions—more than in any of the three preceding quarters.[1] Institutions usually place these with the largest, leading houses, depriving the smaller houses of the smaller trading that they used to handle for some institutions.

Second, where a regional or local house does obtain a block trade, or more likely, a participation in a block trade, it receives only a small commission—actually a nominal commission.

Third, generally speaking, only borkers analyze any except the largest companies and keep the individual investor informed of the investment and trading opportunities presented by the smaller companies. Most banks and other large institutions don't do this.

In addition to the reasons that the Stock Exchange Study developed for the disaffection of individual investors, there are basic and pervasive reasons why individual investors have left the securities markets—reasons which will be increased, with, in our view, disastrous results by the Williams Bill (S. 470), already passed by the Senate, and the Moss Bill in the House (H.R. 5050) if it is enacted.

First, is the extreme distortion that has occurred in the rates for executing trades on the markets. The cost to individual investors has increased sharply since 1968, while the cost to institutions has declined just as sharply.

In 1968, it cost an institution exactly the same per share as it did a small trader to buy or sell a share of stock. In 1968, for the first time, the Exchange recognized that there should be a quantity discount—which is clearly correct. But then, corresponding with the great growth in trading by institutions and the increase of their clout and bargaining power, the rates went to the opposite extreme. This culminated in the adoption of so-called "negotiated" rates on portions of trades above $500,000 which was later reduced to $300,000. Here are the consequences:

In 1968, an individual buying or selling 100 shares of a $40 stock had to pay 39¢ per share or $39. Today he has to pay 48.7% more: 58¢ per share or $58. In 1968, an institution buying a typical block of 25,000 shares of a $40 stock had to pay 39¢ a share. Now it pays 61.4% less—15.2¢ per share.

While the costs to individual investors have *increased* about 50%, the SEC estimates that institutions today pay 67% *less* than they did in 1968 (SEC, 19(b)(2) statement).

Overall, while institutions do about 70% of all trading on the New York Stock Exchange, they pay nowhere near that percentage of the commission revenues. Individuals, who account for only 30% of the dollar volume, bear the majority of the costs.

I have no doubt that the American people are aware of this. They certainly know that the charges to them have sky-rocketed. All you have to do is to talk, as I have to some small investors who have quit trading, and I think you will find that the increases in their broker's charges for executing trades will be cited over and over again as the reason for their withdrawal.

I also believe that the American people resent the fact that institutions—the big fellows—can trade big blocks for only a nominal charge while they have to pay these high costs. The American people do not like that kind of situation at all.

At the same time, they read in the press that the Stock Exchange has proposed even higher rates for the little fellow and no increase at all on the large trades! Do you wonder that millions of them feel that the stock market is not the place for them?

Second, is the fact that small investors believe that the securities markets today are of, by and for the big fellows—the institutions. They feel that the institutions dominate and control the markets; that they get inside information; that they ruthlessly dump stock without notice, leaving the average investor holding the bag; and that the institutions influence and are about to control the management of the markets.

Now, I want to make it clear that we believe that institutions serve and can serve a great and valuable function in the capital and securities markets of this Nation. Banks, insurance companies and mutual funds are extremely valuable means for amassing savings and making them available for the needs of the Nation. They are valuable, and they are necessary. We need them, just as we need the direct, individual investor. But if vast institutions represent the source of most new equity financing and most trading in the markets, if they are overwhelmingly the source of capital funds to the virtual exclusion of direct investment by individuals, we are not going to have the kind of America that we prize so highly. The reason

[1] SEC Statistical Bulletin, p. 577.

that large institutions simply cannot and will not supply the financing and the market facilities that we need if we are going to continue to have an economy composed of thousands of vital, growing companies and not just a relatively few giants. If the individual investor continues to boycott the securities markets, the best we can hope for is that by persuasion and regulation, we can induce the institutions to do somewhat better than at present.

Presently, the most important institutions are virtually uncontrolled and unregulated so far as their securities market practices are concerned. Only the mutual funds are subject to federal laws limiting, in some respects, their holdings in individual companies. In many companies, one or several institutions are so dominant because of their large stock interests that corporate managers live in fear of their displeasure. At the same time, the volume of their trading is so great that they can and do dictate the commission rates that they will pay for the services of a broker or dealer who executes their trades. "Negotiated" rates in dealing with them is a hoax, because of their enormous power. The broker-dealer is virtually helpless to insist upon a reasonable rate.

There are no general requirements that the major institutions—banks and insurance companies—disclose their holdings or their trading. They usually accumulate their positions carefully and quietly over a period of time; and the public is generally unaware of what is going on. Then, because of bad news—or because some analyst has changed his mind about the prospects of a company or an industry—they dump large blocks on the market, far beyond the stabilizing capacity of the specialists.

We have seen some spectacular instances of this, and in practically every meeting that The Committee of Publicly Owned Companies has held, executives have told us of their own experiences as the targets of this dumping. I attach as Exhibit J an article from the *Institutional Investor* narrating 12 instances of dumping. Another well-known example occurred in connection with Levitz Furniture. On one day, September 29, 1972, institutions dumped 700,000 shares of its stock and the market price fell in less than half an hour from 47 to 33! Of course, thousands of small investors were left holding the bag.

I think it is important to realize that institutions are no longer stablizing factors in the market. It is fair to say they are no longer predominantly investors, but they are traders. There is great pressure on them to show short swing profits. They are traders, who, despite their vast power and the vast concentration of their interests, operate substantially without disclosure and without regulation or guiding principles to protect the national interest. In a few short years, from 1966 to the present, their percentage of total New York Stock Exchange dollar volume has rocketed from 47% to 70%. The rate of turn-over of their portfolios has risen from 20% to over 30% (SIA Statement of June 15, 1973, before the House Subcommittee on Finance and Commerce, Exhibit 2). It is probably much greater if the third-market and the regional exchanges were added.

Third, there is no doubt that the individual investor has withdrawn from the market because of the fact and fear of illiquidity. According to a Harris survey, only 19% of stockholders consider stocks to have a worthwhile degree of liquidity. They can no longer feel confident that if they buy stocks, they can sell them on the market at a price which may have gone up or down, but which will move only gradually and in small steps. One of the most significant indications of this is the virtually unprecedented frequency these days of suspension of trading on the New Stock Exchange because of the imbalance of orders, far beyond the capability of the specialists to handle. (*Barron's* editorial, August 21, 1972—Exhibit I attached.)

The basic reasons for this have already been described: Institutional concentration, institutional dumping, decline in brokerage efforts, withdrawal of individual investors, and cessation of market-making.

I should like to observe that this lack of liquidity and continuity in the securities markets is a threat not only to individual investors and publicly owned companes—and the Nation—but also to the institutions themselves—to the banks and the pension and other funds that they represent, to insurance companies and of mutual funds themselves.

Institutions no longer have a basic, underlying flow of investment by the public to underpin the market and to supply liquidity and price-continuity. The habit of institutions to concentrate on a few stocks and the fact that most of them concentrate on the same stocks are sources of great danger. This is the "herd instinct" that I've mentioned. If one institution pulls out of an institutional favorite, others are likely to do the same until the botton drops out of the market and the laggards are left with vastly depreciated holdings.

With respect to the occasional investments of institutions in smaller companies, institutions are also likely to experience severe losses if they are forced to liquidate on a thin market. A number of mutual funds, forced to liquidate some of their portfolios because of shareholder redemptions, have already suffered greatly because of this. In 1972, for example, mutual funds withdrew, net, $1.9 billion from the market because of redemptions. This year will probably see the same sort of phenomenon. In the first quarter of 1973, mutual funds liquidated $725,000,000 in securities held in their portfolios. (Fortune, July 1973, p. 88—Exhibit H attached.) Obviously, in a thin market, they are taking a terrible beating as a result of these sales.

Accordingly, we believe that the return of the public investor, and the correction of practices which exaggerate the illiquidity and lack of price continuity in the markets, are of the greatest importance to the institutions themselves, as well as to the Nation, the average American and to corporate America.

RECOMMENDATIONS

The fundamental problem was stated by the Chairman of this Subcommittee as follows:

". . . our securities markets must be restored as a place where all sound business ventures can seek funds and where individuals can invest those funds with confidence. If we allow the U.S. securities market to become a place where only a select group of large institutions buy and sell the equity of another select group of large institutions, a great deal of American capitalism will be dead. Not only will the competitiveness of the securities market suffer, but the inability of small and medium size firms to raise equity for expansion will cause the competitiveness of our entire economy to decline. Should that happen it will not be just the investor and businessman who will be the loser. It will be the American consumer who suffers the greatest blow." (Cong. Rec., June 27, 1973, p. 12238)

Our general recommendations are as follows:

1. *We respectfully urge* that the Congress should enact comprehensive legislation which will restore to the securities markets a proper balance between the interests of individual investors and those of institutional traders, so that individual Americans may be encouraged again to become direct investors in corporate America with equal access to the securities markets on fair and attractive terms.

2. *We urgently represent* that the Congress in any event should not enact legislation which will enhance the dominance, power or advantages of institutions in the securities markets, either by being able to execute their trades at lower rates or by achieving membership on the securities exchanges, directly or indirectly.

3. *We respectfully represent* that the Congress should not enact legislation affecting the securities markets—or freezing into their structure and practices drastic provisions relating to commission rates and membership on the exchanges, unless and until there has been an adequate evaluation of the effect of such measures on our economy and their impact upon fundamental matters such as concentration of control and narrowing of business opportunities in America.

Specifically, we urge the following:

1. Investment and trading by all institutions which manage other people's money, and not just investment and trading by registered investment companies (which are now the only institutions subject to specific SEC regulation), should be subject to specifically designed federal regulation under the centralized jurisdiction of the Securities & Exchange Commission. These investment and trading activities have reached such dimensions and have such national importance that they cannot be left unregulated, nor can regulation be fragmented among federal banking agencies, state insurance commissions and the like.

2. Institutions must be required to disclose and report their holdings of corporate securities, and their trading.

3. Measures must be adopted to induce institutions to invest their funds and the funds of managed accounts in a broader range of American companies. The present dangerous concentration of enormous institutional funds in a few companies must be halted and reversed. The over-feeding of a few companies, resulting in extraordinarily high market prices for them, and the starvation of thousands of sound, profitable companies creates a situation of national peril.

(a) Presently, only certain mutual funds are effectively limited as to the percentage of a particular company's security that they may hold in their portfolios. This type of limitation should apply to all financial institutions. *We urge prompt study and hearings as to the limits that should be fixed and prompt legislation to effect such limitation.* In the absence of such limits, control of America's corporations will increasingly pass to a few institutions; and institutions which are custodians of

other people's money will increasingly be vulnerable to the adversities of individual companies in which they have an enormous stake.

(*b*) We also urge that effective limits should be prescribed by federal law as to the amount or percentage of an institution's assets that may be invested in the securities of a single company. These limits should be so devised that a bank or insurance company, or a pension or other fund, for example, that has vast sums for investment, must make those sums available to a large, and, hopefully, a diversified number of companies. We submit to you that the present situation in which, as I have discussed, there is great concentration in a few companies, is not tolerable.

4. Institutional trading practices should be regulated so as further to discourage and prevent trading on inside information and so as to prevent dumping of large blocks of securities in response to changing market judgments. With respect to the dumping of large blocks of the securities of a company, we believe that it is possible and feasible to limit the amount of stock of any one company that an institution may sell in a single trade. I have made some calculations which I will furnish the Subcommittee on request. They indicate that if an institution were limited to a maximum sale of ¼ of 1% of the outstanding shares of any particular company in a 30-day period, they could nevertheless, by dealing in the twenty-five largest stocks, which most of them hold, realize proceeds of $750 million. A limitation along these lines would induce institutions not only to refrain from breaking the market to the vast injury of companies and other stockholders, but it might also induce them to spread their investment funds.

5. Legislation should be enacted which will revise the tax laws so as to provide needed incentive to individual investors to acquire ownership of shares in corporate America.

We believe that there is an overwhelming national interest in encouraging direct investment by individuals in corporate America. This will not be achieved, under our system of government, unless there is adequate incentive. The present capital gains tax rate is much too close to the effective ordinary income tax rate to provide incentive to small investors, particularly in view of the attraction of high interest rates that are available on fixed obligation investments.

There are various ways of remedying this situation. Chairman Mills has suggested the possibility of a life-time amount of capital gains that may be accumulated, tax-free. Another possibility, which The Committee of Publicly Owned Companies has suggested, is an annual exemption of the first $1,000 of capital gains realized as a result of securities transactions.

6. We strongly oppose institutional membership on any securities exchanges. We oppose membership by any person or entity, directly or through a controlled affiliate or subsidiary, unless such person or entity, including all of its affiliates and subsidiaries, is primarily engaged in the securities business as broker or dealer. In other words, we strongly oppose permitting any entities whose primary stake is as an investor or money-manager to hold the preferred position of membership on a securities exchange.

The American people believe they are entitled to trade in a public, auction market, dominated by professionals. They regard institutions as competitors; and they are not likely to have confidence in trading on a market in which their competitors have the special access, benefits and influence over rule-making that membership necessarily implies.

Even now, the American people, as we have discussed, believe that institutions have special privileges and inside information. According to the Little Survey, 70% of investors and 64% of non-investors now believe that the market is manipulated. (*Wall Street Journal*, May 4, 1973.)—It takes no great leap of imagination to foresee that this feeling will be vastly accentuated if the very institutions that they now fear become members of the exchanges.

We believe that the result of institutional membership will be to increase the alienation of the individual investor and to drive even more of them out of their positions as co-owners of corporate America. Correspondingly, it will increase the damage to our companies and reduce our ability to provide a vital, competitive factor in American life.

On the merits, we can see no real justification for institutional membership. They are investors and traders for their own account and for managed accounts. They should not make the rules or have a vote on the rules, although there is no reason why their advice should not be heard. They should not be in a position to obtain an inside track on trades by reason of membership.

Fundamentally, it is entirely wrong—entirely contrary to our national interest and our antitrust traditions, to allow institutions to add to their presently over-

whelming dominance, the additional power and control over our economic life which membership on the exchanges will give them. Our great insurance companies—certainly our great banks—our great mutual fund complexes are powerful enough—they control enough money and enough securities and are in a position to control enough companies, merely on the basis of the money they own and manage and the securities which they hold in those capacities. It seems clear that it is little short of reckless to add to this the control over the securities of others which they would acquire as broker-dealer-members of the securities exchanges.

We respectfully submit that there is no valid reason for permitting institutional mdmbership, even if its brokerage business is confined to the public. Indeed, we believe it to be highly doubtful whether banks and insurance companies, directly or througe holding company devices, should be allowed engage in the brokerage business. In fact, there reasons which appear to us to be overwhelming for the denial of such functions to entities which, in the aggregate, are primarily investors and traders in securities, competitive with the general public, rather thrn agents for them. In summary, these are:

(*a*) Adverse reaction of public, described above.

(*b*) Greatly increased concentration of power in the institutions which are also members. These institutions will not only have at their command the vast funds that they control or manage, but they will be able, as broker-dealers serving public customers, to influence the investment and trading of their customers and the public. If, for example, an institution decides to buy or sell the stock of a particular company, it is reasonable to suppose that its member-subsidiary will make the same recommendation. The result will be a multiplication of the power and market effect of the institution.

On the other hand, if the institution is buying a stock and its member-subsidiary recommends sale to the public—or perhaps even if it makes no recommendation—the problem of conflict of interest arises.

A similar situation would be presented with respect to such matters as proxy contests. The institution would not only vote its own stock, but its broker-member-affiliate would influence the votes of its customers.

(*c*) Added to the present enormous power of institutions to provide or withhold funds from companies by stock purchases or loans would be the power of its member-subsidiary to underwrite, distribute or market a company's securities, or to decline to do so. It was this type of concentration that was a chief target of the Glass-Steagall Act, decreeing a separation between commercial banking and underwriting.

(*d*) Institutions which are members of the exchanges, directly or through subsidiaries, undoubtedly would have access to information on a more advantageous basis than the public, particularly if they are floor members.

(*e*) Institutions, as members, would have a vote and, because of their size and strength, a powerful voice, with respect to the rule-making function of the exchanges and their administration.

(*f*) Institutions which, because of their small size or of state or federal limitations, do not become members, will be subject to competitive disadvantage.

7 Institutions should be required to bear their fair share of the costs of operating the securities markets. Their enormous power should not be increased by allowing them to trade at bargain rates, which necessarily mean that individual trades must bear a disproportionate share of the expense of the markets. The only way that a fair distribution of costs, which will encourage the individual investor, can be effected is through fixed, minimum rates—fixed by the industry's self-regulatory agencies subject to SEC supervision, or by the SEC if these agencies are reluctant or unwilling to take on the task.

We respectfully submit that there is nothing peculiar or special about rate-fixing in this type of industry. Brokerage is essentially a service function. It is and should be intensively regulated. It is competitive as to the quality of many services, including research and advice; it is necessarily a somewhat closed industry, restricted in number, as to the execution of orders. It is more like the trucking industry, for example, than like the manufacture of hardware or clothing. Regulation of its rates is essential to make possible the existence and growth of our competitive economy, by making certain that the rates serve a complex public function, including making securities ownership and market activity attractive to millions of small, individual investors.

"Negotiated" rates are and will be a hoax. Rates on large-block transactions, as experience to date has demonstrated, will be dictated by the institutional traders, and will be extremely low or nominal.

Commissions will be probably determined on the basis of the rates fixed by one or a few large, dominant brokerage houses. If the rates are fixed at a very low level, the result will be to drive hundreds or thousands of independent broker-dealers out of business, thus depriving investors and smaller companies of their essential services. Oligopoly is the likely result with the consequence that the financial and economic life of this Nation will be centralized and concentrated in a few houses, in a single city. The Nation and its people, as well as corporate America, will have paid a terrible price for lower costs of executing securities transactions. They will have seriously damaged competition at the heart of American economic, social and political life. At the most, we will have gained competition—assuming it survives—for commission rates at the cost of competition in our industrial economy. In our respectful opinion, this is a bad bargain.

On the other hand, in the absence of the formal fixing of rates under strict regulation and supervision, the securities industry may arrive at a "consensus" as to rates. At best, this will be subject to antitrust attack by the Department of Justice and treble-damage actions by private litigants. This is hardly an attractive alternative to controlled, regulated rates.

We wish to emphasize to the Subcommittee that if oligopoly results from the elimination of regulated rates, the results are likely to be vast and pervasive, far beyond the brokerage business itself. It is likely, for example, to lead to concentration of the underwriting business in the same firms, not only because competitors will be out of business, but also because the firms that have a large brokerage business have the distribution facilities for the securities that are underwritten. Each firm in the oligopoly will probaby have strong business connections with its own list of the giant banks, insurance companies and funds, and the views of these institutions will pervade the brokerage and underwriting business, even more than at present. "Outsiders" will have little chance of access to our financial markets.

It is our strong recommendation that the Congress should not attempt to cure the deficiencies of the prescribed commission rate schedule by abolishing it and turning over what is essentially a service function to a probable oligopoly. If I may say so, with all respect, that would be like the removal of a lung to cure a case of influenza.

On the contrary, we urge the Congress to insist that all investors and traders should bear a fair and reasonable part of the expense of operating the exchanges and our broker-dealer mechanism. There should be fixed, minimum rates applicable to all trades, large or small, with differentials that take into account the national objective of encouraging small trades as well as the economies of large block trades. The present exemption of trades or portions of trades above $300,000 should be eliminated. We suggest that the Congress should resolve the antitrust problem by expressly providing that the fixing and employment of minimum rates by the exchanges with the approval of the SEC shall be exempt from the antitrust laws, but that those laws will, of course, apply to any rates that are otherwise fixed or charged by collusion or in furtherance of a monopoly.

We do not believe that is beyond the capability of the SEC and the industry to come forward with a suitable mechanism for fixing minimum rates. We realize that the brokerage business is extremely volatile, and that it proceesd from feast to famine depending upon volume. We also realize that disentangling brokerage costs from other aspects of a typical broker-dealer business is difficult. But we believe that a mechanism can be devised. One possibility is a schedule based, not upon "average" costs, but upon the approximate median costs of the industry or upon reasonably approximated costs of a reasonably efficient brokerage business. We believe that something of this sort can be devised, perhaps with a mechanism for prompt adjustment which might be geared to the volume of trading over a relatively short period of time.

CONCLUSION

We respectfully submit the foregoing to this Subcommittee, and we repeat our thanks, as representative of a broad segment of corporate America, for this Subcommittee's consideration.

THE COMMITTEE OF PUBLICLY OWNED COMPANIES,
By C. V. WOOD, Jr.,
Chairman.

Counsel:

FORTAS AND KOVEN,
Washington, D.C.

List of Exhibits

Title of Document	*Exhibit*
Curriculum Vitae—C. V. Wood, Jr	A
Committee's brochure	B
SEC Statistical Bulletin, page 519	C
Barron's magazine, June 18, 1973	D
Fortune, July 1973, page 189	E
Investment Portfolios--Banks	F
The Challenge of Capital Attraction—Jones, chairman of General Electric Co.	G
Fortune, July 1973, page 88	H
Barron's editorial, August 21, 1972	I
Institutional Investor, September 1972	J

(Exhibit A)

Curriculum Vitae

C. V. WOOD, JR., CHAIRMAN, THE COMMITTEE OF PUBLICLY OWNED COMPANIES

C. V. Wood, Jr. is President of McCulloch Oil Corporation, a Los Angeles, California, petroleum exploration and production company listed on the American and Pacific Coast Stock Exchanges. Its subsidiary, McCulloch Properties, Inc., creates and develops fully-planned, new communities.

He is a member of the Board of Governors of the American Stock Exchange and previously served as Vice-Chairman of the Exchange's Advisory Committee.

Mr. Wood was named President of McCulloch Oil Corporation and elected to its Board of Directors in 1967.

He started his career with the Convair Corporation during World War II. In 1950, he was appointed Director of Southern California activities for the Stanford Research Institute; and in 1955 was named Vice President and General Manager of Disneyland, Inc., supervising selection and purchase of the land.

He formed Marco Engineering in 1956, providing market research and analysis, design, engineering and construction coordination services. Five years later, Mr. Wood merged his firm with McCulloch Properties, Inc. He has directed the master planning of such sites as Pueblo West in south-central Colorado and Fountain Hills, near Scottsdale, Arizona.

EXHIBIT B

THE COMMITTEE OF PUBLICLY OWNED COMPANIES

NEW YORK STOCK EXCHANGE—AMERICAN STOCK EXCHANGE—OVER-THE-COUNTER

A Voluntary Committee of Chief Executives

To Represent Corporate America's Interests in Fair Market Prices and Fair Trading Practices in the Securities Markets

Before the Congress, the SEC, the Exchanges, the Financial Community, and the Public

Executive Committee:

C. V. WOOD, JR., Chairman
President, McCulloch Oil Corp.

JOHN BORETA,
President, Buttes Gas & Oil Company

JOSEPH E. COLE,
Chairman, Cole National Corporation

SHELDON COLEMAN,
Chairman, The Coleman Company, Inc.

JOHN A. GILLETT, JR.,
President, Circle K Corporation

FRANC M. RICCIARDI,
Chairman, Richton International, Inc.

REVIS L. STEPHENSON,
Chairman, Clarkson Industries, Inc.

FRED M. ZEDER,
Chairman, Hydrometals, Inc.

22 Thames Street
New York, N. Y. 10006
Tel.: (212) 732-0882

THE COMMITTEE OF PUBLICLY OWNED COMPANIES

Organized March 13, 1973, the Committee, as of June 1, had 400 members. It represents companies listed on the New York Stock Exchange, American Stock Exchange, and traded in the Over-The-Counter market.

James Needham, Chairman of the Board of the New York Stock Exchange, said:

The Exchange welcomes the new Committee of Publicly Owned Companies to the ranks of those who are willing and prepared to work hard to preserve the best elements of our existing capital markets system and for the development of constructive new ways to improve that system so that the investing public will regain whatever measure of confidence in the market may have been dissipated in recent years.

Paul Kolton, Chairman of the Board of the American Stock Exchange, said:

The newly formed Independent Committee of Publicly Owned Companies will play an important role in resolving crucial issues involved in reshaping the nation's markets.

W. S. (Bill) Stuckey, Jr., Congressman, said:

Many of the Committee's 400 medium- and smaller-sized member companies believe that they would be the chief beneficiaries of the individual's return to active trading . . . A representative of the Committee of Publicly Owned Companies will address this Subcommittee during our hearings; I think it is imperative that we hear from the companies that are so dependent on the individual investor.

James Roche, retired Chairman of General Motors, said:

Whether we are a part of corporate America, a part of the securities industry, an investor, or just an ordinary citizen, we all have a great interest in the efficient operation of our capital markets. Those of us in the corporate world and in the securities industry have a special responsibility to make the system work effectively in the best interests of all. We must not through indifference, by reluctance to change, or in the pursuit of narrow selfish interests, destroy the important trust imposed upon us. In these unsettled times it is incumbent upon each of us to do what we can to find responsible solutions to the challenges which confront us.

BEST COPY AVAILABLE

THE EMERGENCY: THE NEED FOR ACTION

I. The market value of stocks of our type of Company, companies other than a few institutional favorites, have steeply and arbitrarily declined despite increased earnings.

1. A survey of 2,375 companies listed on both exchanges shows that 75% of these companies increased their earnings over the past year. But only 5% of these companies showed an increase in their price-earnings multiple.
2. On the NYSE (eliminating the institutional favorites) *prices of an average share have declined* 23% in the past year.
3. On the Amex, prices of an average share of our type of company have declined 33% in the past year.

II. The fantastic undervaluation of stocks of our type of company is harmful to our stockholders, our employees and to our country.

We cannot obtain new public financing for our needs or can get it only at sacrifice prices;

Expansion plans must be deferred;

We are targets for take-overs by foreign as well as domestic capital;

Our shareholders are disaffected;

Our ability to provide additional goods and services needed by the nation is threatened;

Our capability to provide more jobs for employees is diminished.

III. The withdrawal of the individual investor from the market is a basic factor contributing to this condition:

There are 800,000 *fewer* Americans who own common stocks, compared with a year ago, seventy percent of the trading on the NYSE is by institutions; only 30% by individuals.

IV. The withdrawal of the individual investor is due not only to economic considerations or to public reaction to the end of the bull market of the 1960's, but to discriminatory commission rates, institutional dumping and market practices which are unfair to the individual investor. These are not the product of free market forces but of statutes and rules. Pending legislation will aggravate these discriminations.

Specifically, the individual investor has suffered from:

1. Sharp increases in the commission rates which the individual investor must pay, while institutions have been relieved of most or all charges for the execution of their trades;
2. Institutional dumping;
3. Institutional concentration of their investments in a few favorite companies;
4. Institutional dominance of the securities markets;

5. Absence of market liquidity and continuity due in large part to individuals' lack of confidence in the markets and institutional concentration;
6. Unequal access to information;
7. Institutional and block trading practices;
8. Fear of institutional control of the markets.

AMERICA'S COMPANIES HAVE NOT BEEN HEARD—ALTHOUGH

The Congress, the SEC, and the Exchanges are all currently considering bills or proposals which vitally affect our companies, their management, stockholders, employees, and the public interest.

It is our companies, our stock, our stockholders, and our employees who are affected.

These bills and proposals will further drive down the value of our stock—make it difficult or impossible for us to obtain financing—keep the individual investor out of the market—further concentrate control in a few institutions—further expose our companies to raids and takeovers at depressed prices.

Your help by membership in the Committee is needed to support the Committee's program!

THE POSITION OF THE COMMITTEE

1. **Investor Confidence.** Individual investor confidence must be restored. He must be assured that he can invest and trade on fair and equal terms, at fair commission rates, in open, auction markets, at prices at or near the last ticker quote, without fear that the market will be unfairly affected by institutional dumping; and that he will have access to the same information as any institution or other trader.

2. **Commission Rates.** We oppose so-called Negotiated Rates. "Negotiated Rates" means that institutional investors buy and sell our securities at little or no cost for executing their trades, while individuals bear most of the expense of the market place. Individuals cannot "negotiate" rates. Negotiated Rates mean higher costs to individual investors.

We urge the lowest possible rates for smaller, individual investors. We urge that institutions should be required to pay fair rates for their trades.

3. **Institutional Membership.** Institutional membership on the Exchanges means that they will unduly influence rules and trading practices; that they may have access to market information denied to individual investors; and that their net cost of trading will be less. There is no good reason for this preferential treatment to one class of investors. The markets should be public, agency markets operated by professionals, open to all on the same basis.

We urge that institutional membership should not be permitted, so that institutions may not obtain preferences or advantages over non-members and individual investors.

4. An Orderly and Fair Market. Individual investors must be assured that an orderly market will be maintained; that wide swings in market prices will be moderated; that public orders will be given preference; and that the individual investor can invest and trade with confidence in the market mechanism.

We urge that the duty of the exchanges and of specialists and market-makers to maintain an orderly market should be preserved and strengthened.

5. Disclosure and Regulation of Institutional Trading. Individual investors are entitled to current information about institutional holdings. Institutions should not be permitted to dump their holdings of a particular company except within prescribed limits. The amount of securities of a particular company that an institution or affiliated group of institutions may hold should be strictly limited, so as to induce institutions to invest in more companies—not in just the largest blue-chip companies. Institutions should not be permitted to use their economic power to obtain or use information not available to the general public.

We urge that institutional trading be subjected to disclosure and reasonable regulation in the interests of an orderly market, the needs of our economy, and to avoid unjustified injury to individual investors.

6. Tax Relief and Incentives. We believe that the first $1,000 capital gains by smaller investors should be exempted from tax.

THE PROGRAM FOR ACTION

Through the Committee, the interests of America's companies have been and will be asserted and defended in the Congress, the SEC, the securities exchanges and the financial community and in the public-media.

The views of Corporate America will be vigorously expressed in defense of our companies, their stockholders, and employees—and of America's vital economy and its free-enterprise system.

Exhibit C

Stockholdings of Institutional Investors and Others

SEC STATISTICAL BULLETIN

Institutional investors held $398 billion of corporate stock, both common and preferred, at year end 1972; their holdings were $327 billion at the end of the previous year. The institutions listed in the accompanying table thus owned 34.0 percent of total stock outstanding; individuals owned 62.9 percent.[1] Comparatively, in 1960, institutional stockholders owned 26.7 percent of outstanding stock and domestic individuals owned 70.1 percent. The percentage of outstanding stock owned by foreign investors was slightly over 3 percent in both 1960 and 1972. Data for 1972 are preliminary and subject to adjustment.

The two largest institutional stockholders are private noninsured pension funds and personal trust funds, which together account for well over 50 percent of total institutional stockholdings. Mutual funds, as the third largest institutional stockholder, owned $58 billion at the end of 1972. Foreign individuals and institutions owned an estimated $36 billion of U.S. stock at theend of 1972.

(Exhibit D)

A Study in Concentration: Morgan Guaranty's Top 25

BARRONS, JUNE 18, 1973

	Holdings on Dec. 31, 1972		Shares outstanding (millions)	Morgan's percent of total
	Dollars (millions)	Shares (millions)		
IBM	$2,094	5.21	116.2	4.5
Eastman Kodak	1,138	7.69	161.5	4.8
Avon Products	651	4.75	57.8	8.2
Sears, Roebuck	605	5.22	156.7	3.3
Xerox	596	4.00	79.3	5.0
Walt Disney	473	3.97	27.8	14.3
Polaroid	423	3.36	32.8	10.2
Procter & Gamble	396	3.64	81.9	4.3
Schlumberger	390	4.29	36.5	11.8
General Motors	344	4.25	287.5	1.5
American Home Products	330	2.70	51.7	5.2
Coca-Cola	320	2.15	59.7	3.6
Exxon	309	3.51	224.2	1.6
American Express	306	4.71	48.6	9.7
Mobil	288	3.86	103.2	3.7
Kresge	285	5.82	117.2	5.0
J. C. Penney	279	3.10	57.1	5.4
Merck	274	3.08	74.2	4.2
Philip Morris	272	2.31	27.3	8.5
McDonald's	262	3.45	33.9	8.9
Texaco	212	5.68	272.0	2.1
1st National City	210	2.73	116.1	2.4
Schering Plough	207	1.51	26.3	5.7
Johnson & Johnson	206	1.57	56.4	2.8
MGIC Investment	203	2.11	21.1	10.0

(Exhibit E)

[From Fortune, July 1973]

Excerpt from Article Entitled "How the Terrible Two Tiered Market Came to Wall Street"

Superior Oil, and Texasfulf, had an earnings decline in the five tough years of inflation and recession that followed. But the fourteen stocks as a whole had a median annual earnings growth of 8.8 percent. In contrast, the earnings growth of the S. & P. 500, even though it is heavily weighted by I.B.M. and a few other stocks that were among the fourteen, was less than 1 percent annually.

Focusing on comparisons of this sort recently, James Lane, president of Chase Manhattan's investment-management subsidary, said they show "there is some rationality to the market and its divergence into two tiers." Lane's thoughts have

[1] See the May 23, 1973 edition of the *Securities and Exchange Commission Statistical Bulletin* for the derivation of market value of outstanding corporate stock in the U. S.

special significance, for during most of that 1966-71 period, Chase was heavily in the "wrong" stocks and did very badly in performance. Lately, like many other converts, it has been swinging more toward the upper tier.

TYRANNY OF QUARTERLY REPORTS

Chase's poor performance cost it a good bit of pension-fund business, and that brings up the final argument as to the banks' current investment policies may be—for—rational. Corporations today keep constant pressure on their investment managers, demanding from them the superior results that will permit reductions in the annual contributions these corporations must make to their pension-funds. Many of the corporate executives who are today most need about the low prices of their stocks would no doubt be among the first to yell if their pension-fund managers bought low p-e stocks and did poorly with them. Many corporate executives, while complaining about the tyranny of a market that judges companies on the basis of such short-range measurements as quarterly results, today exact quarterly reports from their investment managers, and give these considerable weight in assessing performance.

Under such surveillance, many investment managers adopt strategies that seem to them suited to the game they're in. For example, if a bank buys, say, a Xerox, and that company's earnings go up 12 percent in the next year, its stock may follow along. A low p-e "value" situation, on the other hand, may stay depressed for a long time before the gain in its earnings and book value begin to show up in its price; and while it may ultimately prove more profitable than the Xerox situation, that will be of small comfort to the bank if it has lost all of its pension-fund accounts.

The game also forcibly suggests to many investment managers that it is a mistake to be unorthodox and that the percentage play is to do what everybody else is doing. One Wall Street professional who talks regularly to bank portfolio managers counts as all too typical a remark made recently to one of them: "It doesn't really matter a lot to me what happens to Johnson & Johnson as long as everyone has we all go down together."

The few banks that have tried to steer a different course moving into what they see as bargains in the lower tier lately found the going rather tough. One such bank is National of Chicago. Its portfolio, though studded such standbys as I.B.M. and Kodak, is committed also to cyclical stocks and is less concentrated in the very largest companies than most other big bank portfolios are. As a result, the returns First National delivered its pension accounts last year, though these ran to around 14 percent, did not compare well with the returns of more than 20 percent realized by some of the New York banks.

First National has at least one client, Armour, that is not troubled by this fact. Armour also has pension-fund assets with other banks oriented toward growth stocks, and First National thus supplies some balance that Armour welcomes. But it does not appear that the bank, with its "different" approach, is picking up very many new pension-fund accounts these days. Howard E. Hallengren, who heads the trust department's investments, says the situation is not easy to live with. "You get pressures building up to buy major growth stocks. You get them from everyone. From management: Why aren't you in the major growth stocks? From customers. In your own department, from portfolio managers." But Hallengren says he isn't wavering. "I keep thinking of what one of my old bosses used to say: 'Investment people have to have qualities of courage and patience.' "

While Hallengren waits, he can at least keep telling himself that he has bought his low-tier stocks at prices that can be rationalized. That is clearly more than most top-tier buyers can do. Their thoughts about the intrinsic value of growth stocks—which is admittedly one of the murkier subjects around—tend to be underdeveloped. The banks seem to buy instead mainly on the basis of "feel" and historical p-e ranges. We buy I.B.M., they say, when it approaches the lower limits of its range; and we avoid it at the upper limits. The banks tend also to retreat into arguments that price doesn't mean that much anyway. What counts, they say, is to pick the right companies, and even then, they add, you can get by with an occasional misjudgment. "This is a batting-average game," says one trust officer. "You're going to lose a stock now and then—say, a Litton. But if your universe is a bunch of other very profitable companies, you can stand it."

That is true, of course, only so long as the universe itself is not marked down sharply. Were such a markdown to occur today, it would probably imply a

switch from buying to selling by the banks themselves. It is not easy to see this kind of a move taking place right now, but it is always possible. Some market commentators identify weakness in the growth stocks with the end of a bear market, and expect firmly to see these stocks begin to crack.

IS IT HARDER TO BE SUPERIOR?

There can be no doubt, looking at the data that FORTUNE gathered on the largest holdings of the largest trust departments, that cracks in a few big stocks would do broad damage. Fourteen out of the seventeen banks included in the data have I.B.M., the market's biggest stock, as their No. 1 holding (the other three have it in second place) and better than half have 7 percent or more of their common-stock assets in that one company. (One bank, Chemical, has 13 percent.)

EXHIBIT F

BANKAMERICA

The 50 Largest Stock Holdings in Trust Accounts

Security	Shares* (in thousands)	Per Cent of Total Shares of Company
American Cyanamid Company	776	1.6
American Home Products Corporation	405	0.6
American Telephone & Telegraph Company	754	0.1
Amfac Inc.	650	5.7
Atlantic Richfield Company	306	0.7
Avon Products Inc.	203	0.4
BankAmerica Corporation	1,281**	1.9
Brunswick Corporation	507	2.7
Caterpillar Tractor Co.	254	0.4
Champion International Corporation	775	2.7
Coca-Cola Company	106	0.2
Crum & Forster	544	4.5
Dow Chemical Company	280	0.6
Eastman Kodak Company	439	0.3
Exxon Corporation	726	0.3
Federated Department Stores Inc.	384	0.9
First National Boston Corporation	314	2.6
First National City Corporation	265	0.5
Ford Motor Company	390	0.4
General Electric Company	905	0.5
General Motors Corporation	678	0.2
Imperial Oil Limited	482	0.4
International Business Machines Corporation	405	0.3
Jonathan Logan Inc.	270	5.4
Kaufman & Broad Inc.	398	2.5
McDermott (J. Ray) & Co. Inc.	284	4.2
Merck & Co., Inc.	233	0.3
Minnesota Mining and Manufacturing Company	560	0.5
Morgan (J. P.) & Co., Incorporated	176	1.0
Pabst Brewing Company	227	2.4
Pacific Gas and Electric Company	929	1.5
Penney (J. C.) Company, Inc.	236	0.4
Procter & Gamble Company	297	0.4
Quaker Oats Company	373	1.8
Safeco Corporation	390	2.9
Schering-Plough Corporation	173	0.7
Sears, Roebuck and Co.	405	0.3
Southern California Edison Company	667	1.5
Standard Oil Company of California	309	0.4
Standard Oil Company (Indiana)	394	0.6
Sterling Drug Inc.	1,112	1.9
Tenneco Inc.	635	1.0
Texaco Inc.	997	0.4
Transamerica Corporation	1,371	2.0
Union Carbide Corporation	621	1.0
United States Fidelity and Guaranty Company	390	2.4
United Telecommunications, Inc.	773	2.3
Warner Communications Inc.	490	2.6
Western Bancorporation	507	2.2
Xerox Corporation	304	0.4

*As of December 31, 1972
**Excluding shares held in BankAmerica Corporation Family Estate Plan

BANKERS TRUST

discretionary common Fund

List of Investments Comprising Fund
At Opening of Business, January 31, 1973

Number of Shares	COMMON STOCKS		
	Automobile and Accessories		
15,000	General Motors Corporation	$ 479,982.69	$ 1,171,875.00
	Beverage		
20,000	Anheuser-Busch Incorporated	$ 1,200,862.50	$ 1,030,000.00
15,000	Coca-Cola Company	736,454.93	2,175,000.00
		$ 1,937,317.43	$ 3,205,000.00
	Building		
20,000	Standard Brands Paint Company	$ 970,769.80	$ 995,000.00
20,000	Weyerhaeuser Company	1,058,951.62	1,057,500.00
		$ 2,029,721.42	$ 2,052,500.00
	Business Equipment		
10,000	Burroughs Corporation	$ 949,233.83	$ 2,260,000.00
12,500	International Business Machines Corporation	227,587.90	5,487,500.00
10,000	Xerox Corporation	945,969.44	1,550,000.00
		$ 2,122,791.17	$ 9,297,500.00
	Cosmetics		
30,000	Avon Products Incorporated	$ 1,777,936.00	$ 3,855,000.00
15,000	Chesebrough-Pond's Incorporated	1,273,736.25	1,293,750.00
		$ 3,051,672.25	$ 5,148,750.00
	Drug		
18,000	American Home Products Corporation	$ 1,085,619.90	$ 2,241,000.00
15,000	Johnson & Johnson	794,937.13	1,916,250.00
20,000	Eli Lilly & Company	528,383.33	1,450,000.00
30,000	Merck & Company	1,048,140.71	2,831,250.00
7,000	Squibb Corporation	713,246.55	755,125.00
		$ 4,210,327.62	$ 9,193,625.00

	Electrical Equipment and Electronics		
10,000	AMP Incorporated	$ 1,023,212.10	$ 1,180,000.00
25,000	Emerson Electric Company	1,445,087.31	2,325,000.00
18,000	General Electric Company	388,248.55	1,251,000.00
10,000	International Telephone & Telegraph Corporation	556,091.60	527,500.00
12,000	Thomas & Betts Corporation	999,674.20	1,149,000.00
		$ 4,412,313.76	$ 6,432,500.00
	Insurance		
15,000	Chubb Corporation	$ 853,375.00	$ 750,000.00
3,000	General Reinsurance Corporation	1,175,400.00	1,466,250.00
16,000	Lincoln National Corporation	393,280.00	644,000.00
		$ 2,422,055.00	$ 2,860,250.00
	Leisure and Recreation		
28,400	Disney (Walt) Productions	$ 1,460,898.46	$ 3,045,900.00
	Machinery		
16,000	Black & Decker Manufacturing Company	$ 1,309,246.80	$ 1,784,000.00
	Oil and Natural Gas Production		
7,500	K[illegible]in Corporation	$ 369,292.73	$ 705,000.00
25,000	Imperial Oil Limited	975,077.15	1,168,750.00
30,000	Louisiana Land & Exploration Company	432,879.60	1,245,000.00
23,000	Mobil Oil Corporation	629,617.41	1,693,375.00
20,000	Texas Oil & Gas Corporation	722,742.20	682,500.00
		$ 3,129,609.09	$ 5,494,625.00
	Photographic		
24,000	Eastman Kodak Company	$ 788,730.16	$ 3,366,000.00
	Public Utility		
15,000	Central & South West Corporation	$ 673,323.37	$ 690,000.00
12,000	Florida Power & Light Company	446,045.80	432,000.00
20,000	Texas Utilities Company	541,533.27	580,000.00
		$ 1,660,902.44	$ 1,702,000.00
	Publishing		
36,000	Commerce Clearing House Incorporated	$ 503,775.00	$ 1,152,000.00
	Retailing		
15,000	Lowe's Companies Incorporated	$ 1,060,350.00	$ 1,040,625.00
20,000	J. C. Penney Company	833,034.06	1,815,000.00
12,000	Sears, Roebuck & Company	735,931.87	1,351,500.00
37,080	Southland Corporation	1,234,678.00	1,140,210.00
		$ 3,863,993.93	$ 5,347,335.00
	Miscellaneous		
23,000	American Greetings Corporation	$ 884,187.50	$ 1,558,250.00
16,000	Minnesota Mining & Manufacturing Company	364,840.73	1,344,000.00
20,000	Simplicity Pattern Company	$ 892,068.94	$ 1,095,000.00
		$ 2,141,097.17	$ 3,997,250.00
	Total Common Stocks	$35,554,134.39	$65,251,110.00
	Total Investments	$37,784,033.14	$68,651,110.00

CHASE MANHATTAN --

COMMON STOCK HOLDINGS

We have listed below all 220 publicly traded common stock holdings which were held in investment management accounts for individual and personal trusts and estates as of 12/31/72 and had a market value as of that date in excess of one million dollars. The holding of a given stock, in part or in whole, may be at the direction of a client or the instrument creating a trust or estate.

All holdings in excess of twenty million dollars are listed in order of market value. Thereafter, all stock holdings are shown in dollar categories alphabetically.

All stock or security interests of the Chase Manhattan Corporation, parent company of The Chase Manhattan Bank, are held at the direction of the client involved. It is not our policy to direct the purchase of our securities or to recommend them. Nor do we ever determine the voting of its shares.

HOLDINGS IN EXCESS OF $20 MILLION

Company	Value
International Business Machines Corp.	$393,100,000
Exxon Corporation	264,600,000
Eastman Kodak Company	159,500,000
Mobil Oil Corporation	156,600,000
Standard Oil Company of California	135,500,000
General Electric Company	106,800,000
Standard Oil Company (Indiana)	72,200,000
Merck & Company, Incorporated	71,200,000
General Motors Corporation	69,600,000
Xerox Corporation	66,700,000
Texaco Incorporated	50,400,000
American Telephone & Telegraph Co.	49,700,000
Avon Products, Incorporated	48,800,000
Penney (J.C.) Company, Incorporated	44,700,000
duPont (E.I.) de Nemours & Company	43,600,000
Sears, Roebuck and Company	41,000,000
Bristol-Myers Company	33,700,000
International Telephone & Telegraph Corp.	30,000,000
Procter & Gamble Company	25,600,000
Polaroid Corporation	25,000,000
American Home Products Corporation	24,100,000
Minnesota Mining and Manufacturing Co.	23,600,000
American Cyanamid Company	22,200,000
Monsanto Company	20,400,000

HOLDINGS BETWEEN $20 AND $10 MILLION

American Electric Power Company, Inc.
Atlantic Richfield Company
Cummins Engine Company
Dow Chemical Company
First National City Corporation
Grace (W.R.) & Company
Gulf Oil Corporation
Honeywell, Inc.
Illinois Power Company
International Paper Company
Johnson & Johnson
Pfizer Incorporated
United States Fidelity & Guaranty Company
Warner-Lambert Company
Westinghouse Electric Corporation

HOLDINGS BETWEEN $10 AND $5 MILLION

Aetna Life & Casualty Company
American Express Company
Burlington Industries, Incorporated
Burroughs Corporation
C.I.T. Financial Corporation
Caterpillar Tractor Company
Chase Manhattan Corporation
Chubb Corporation
Cities Service Company
Coca-Cola Company
Columbia Broadcasting System, Inc.
Consolidated Natural Gas Company
Consumers Power Company
Continental Oil Company (Del.)
Florida Power & Light Company
General Telephone & Electronics Corp.
Georgia-Pacific Corporation
Goodyear Tire & Rubber Company
Howard Johnson Company
International Harvester Company
International Nickel Company of Canada, Ltd.
Lilly (Eli) and Company
Long Island Lighting Company
Manufacturers Hanover Corporation
Marathon Oil Company
J.P. Morgan & Co., Incorporated
PPG Industries, Incorporated
Phillips Petroleum Company
RCA Corporation
Revlon, Incorporated
Reynolds (R.J.) Industries, Inc.
Scott Paper Company
Shell Oil Company
Southern Company
Standard Oil Company (Ohio)
Texas Utilities Company
Union Carbide Corporation

HOLDINGS BETWEEN $5 AND $2.5 MILLION

3.75

Allis-Chalmers Corporation
Aluminum Company of America
Amerada Hess Corporation
American Air Filter Company, Incorporated
American Airlines, Incorporated
American Natural Gas Company
American Re-Insurance Company
Ashland Oil, Incorporated
Beneficial Corporation
Celanese Corporation
Chrysler Corporation
Combustion Engineering, Incorporated
Commercial Solvents Corporation
Connecticut General Insurance Corp.
Continental Illinois Corporation
Continental Telephone Corporation
Corning Glass Works
Dart Industries, Incorporated
Diamond International Corporation
Emery Air Freight Corporation
Federated Department Stores, Inc.
Firestone Tire & Rubber Company
Ford Motor Company
General Foods Corporation
General Public Utilities Corporation
Gillette Company
Hercules Incorporated
INA Corporation
Ingersoll-Rand Company
Johns-Manville Corporation
Kraftco Corporation
Kresge (S.S.) Company
Loews Corporation
Louisiana Land and Exploration Company
May Department Stores Company
Moore Corporation, Ltd.
National Steel Corporation
Niagara Mohawk Power Corporation
Northern Natural Gas Company
Ohio Edison Company
Prince Consolidated Mining Company
Public Service Company of Indiana, Inc.
Richmond Corporation
Royal Dutch Petroleum Company
Searle (G.D.) & Company
Singer Company
Southern California Edison Company
Southern Railway Company
Sperry Rand Corporation
Squibb Corporation
Superior Oil Company
Texas Instruments, Incorporated
Trans Union Corporation
Travelers Corporation
Virginia Electric and Power Company
Western Bancorporation
Weyerhaeuser Company
Woolworth (F.W.) Company

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HOLDINGS BETWEEN $2.5 AND $1 MILLION

Abbott Laboratories
Air Products and Chemicals, Inc.
Akzona Incorporated
Allied Chemical Corporation
American Broadcasting Companies, Inc.
American Can Company
American Smelting and Refining Company
Anheuser-Busch, Incorporated
Arkansas Louisiana Gas
Armstrong Cork Company
Bankamerica Corporation
Bankers Trust New York Corporation
Beatrice Foods Company
Bethlehem Steel Corporation
CPC International, Inc.
Canadian Pacific Limited
Carborundum Company
Carrier Corporation
Central and South West Corporation
Chemical New York Corporation
Chesebrough-Pond's Incorporated
Christiana Securities
Clark Equipment Company
Consolidated Edison Company of New York, Inc.
Continental Corporation
Denver & Ephrata Telephone & Telegraph Company
Diebold, Inc.
First Chicago Corporation
First Pennsylvania Corporation
Florida Power Corporation
General Reinsurance
Getty Oil Company
Giddings & Lewis, Inc.
Grant (W.T.) Company
Health-tex Incorporated
Hewlett-Packard Company
International Basic Economy Corporation
International Flavors & Fragrances, Inc.
Knight Newspapers, Incorporated
Lincoln National Corporation
Marcor, Incorporated
Marriott Corporation
Martin Marietta Corporation
McDonald's Corporation
Mercantile Stores Company, Incorporated
Middle South Utilities, Incorporated
Morton-Norwich Products, Inc.
Motorola, Incorporated
NL Industries, Inc.
Nalco Chemical Company
National Airlines Incorporated
Northrop Corporation
Northwest Airlines, Incorporated
Norton Simon, Incorporated
Pacific Gas and Electric Company
Panhandle Eastern Pipe Line Company
PepsiCo, Incorporated
Perkin-Elmer Corporation
Philip Morris Incorporated
Pillsbury Company
Pinkerton's, Inc. Class B (non-voting)
Public Service Electric and Gas Company
Quaker Oats Company
Rank Organisation (American Depository Receipts)
Richardson-Merrell Incorporated
Rich's, Incorporated
Roadway Express, Incorporated
Robins (A.H.) Company, Incorporated
Rorer-Amchem, Inc.
St. Regis Paper Company
Santa Fe Industries Inc
Schlitz (Jos.) Brewing Co.
Scott & Fetzer Company
Southern Natural Gas Company
Southern Pacific Company
Sterling Drug Incorporated
Tenneco Inc.
Time Incorporated
Trico Products Corporation
UAL, Inc.
Upjohn Company
V. F. Corporation
Walgreen Company
Whirlpool Corporation
Witco Chemical Corporation
Zenith Radio Corporation

CONTINENTAL ILLINOIS

CIIT EQUITY FUND

SUMMARY FOR QUARTER ENDING DECEMBER 31, 1972

Ten Largest Common Stock Holdings

	Value (Mil.)	%
Xerox Corp.	$ 8,955	6.5%
Eastman Kodak Co.	8,902	6.4
Int'l Business Machines	8,040	5.8
Sears, Roebuck and Co.	8,004	5.8
McDonalds Corp	7,625	5.5
Merck & Co.	7,130	5.2
Avon Products Inc.	5,470	4.0
Minnesota Mining & Mfg. Co.	5,137	3.7
Polaroid Corp.	5,045	3.7
Johnson & Johnson	4,568	3.3
Total	$ 68,876	49.9%
Total Securities	$138,102	

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		MARKET	MARKET VALUE
Oil & Gas (3.6%)			
100,000 Shrs.	Coastal States Gas Producing Co.	34.62	$ 3,462,000
40,000 Shrs.	Quaker State Oil Refining Co.	43.00	1,720,000
			$ 5,182,000
Photography (9.8%)			
60,000 Shrs.	Eastman Kodak Co.	148.37	$ 8,902,200
40,000 Shrs.	Polaroid Corp.	126.12	5,044,800
			$ 13,947,000
Railroad (1.4%)			
70,000 Shrs.	Illinois Central Industries, Inc.	27.62	$ 1,933,400
Retail Trade (6.3%)			
32,000 Shrs.	Marcor, Inc.	28.62	$ 915,840
69,000 Shrs.	Sears, Roebuck and Co.	116.00	8,004,000
			$ 8,919,840
Tobacco (4.7%)			
30,000 Shrs.	Philip Morris, Inc.	118.25	$ 3,547,500
60,000 Shrs.	Reynolds Industries	51.62	3,097,200
			$ 6,644,700
Unclassified (14.6%)			
80,000 Shrs.	AMF Inc.	55.37	$ 4,429,600
100,000 Shrs.	Brunswick Corp.	37.25	3,725,000
70,700 Shrs.	CBS Corp.	50.12	3,543,484
60,000 Shrs.	Minnesota Mining & Mfg. Co.	85.62	5,137,200
35,000 Shrs.	Procter & Gamble Co.	111.50	3,902,500
			$ 20,737,784
	Total Securities (97.1%)		$138,102,074
Net Cash & Equivalent (2.7%)			$ 3,962,881
Accrued Income (.02%)			234,597
	Total Value (100%)		$142,299,552
December 31, 1972 Unit Value			$337.957127

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CONTINENTAL ILLINOIS INVESTMENT
TRUST FOR EMPLOYEE BENEFIT PLANS
EQUITY FUND

			MARKET	MARKET VALUE
Automotive		(1.2%)		
50,000 Shrs.	Monroe Auto Equip.		32.87	$ 1,643,500
Chemical		(2.2%)		
50,000 Shrs.	Nalco Chemical Co.		63.00	$ 3,150,000
Drugs		(20.7%)		
29,000 Shrs.	American Home Products Corp.		122.00	$ 3,538,000
50,200 Shrs.	American Hospital Supply		49.00	2,459,800
40,000 Shrs.	Avon Products Inc.		136.75	5,470,000
35,000 Shrs.	Johnson & Johnson		130.50	4,567,500
80,000 Shrs.	Merck & Co.		89.12	7,129,600
24,300 Shrs.	Searle (G.D.) & Co.		102.50	2,490,750
40,000 Shrs.	Warner-Lambert Co.		97.50	3,900,000
				$ 29,555,650
Electrical & Electronic Equipment		(7.5%)		
50,000 Shrs.	Hewlett-Packard & Co.		86.50	$ 4,325,000
20,000 Shrs.	Honeywell, Inc.		138.00	2,760,000
75,000 Shrs.	Sperry Rand		48.12	3,609,000
				$ 10,694,000
Financial		(4.4%)		
50,000 Shrs.	Bank America Corp		48.00	$ 2,400,000
50,000 Shrs.	First National City Corp.		76.50	3,825,000
				$ 6,225,000
Food		(8.8%)		
100,000 Shrs.	McDonalds Corp.		76.25	$ 7,625,000
35,000 Shrs.	Pepsico, Inc.		87.12	3,049,200
40,000 Shrs.	Quaker Oats		45.00	1,800,000
				$ 12,474,200
Office Equipment		(11.9%)		
20,000 Shrs.	Int'l. Business Machines Corp.		402.00	$ 8,040,000
60,000 Shrs.	Xerox Corp.		149.25	8,955,000
				$ 16,995,000

FIRST NATIONAL CITY BANK

Total Fiduciary Holdings
A Stock Common Trust Fund
A Representative Pension Trust

December 29, 1972

	Issue	Market Value ($ millions)	Sole Voting (%)	Shared Voting (%)	No Voting (%)	Total Fiduciary Holdings (%)
			PERCENT OF OUTSTANDING SHARES			
1	International Business Machines Corporation	$1,028	1.37%	.09%	.74%	2.20%
2	Xerox Corporation	608	3.96	.12	1.57	5.65
3	Eastman Kodak Company	507	1.38	.06	.67	2.12
4	Avon Products, Inc.	404	3.72	.05	1.34	5.11
5	Merck & Co., Inc.	345	3.63	.22	1.46	5.31
6	The Coca-Cola Company	338	2.76	.06	.99	3.82
7	General Electric Company	317	1.63	.06	.71	2.39
8	General Motors Corporation	288	.73	.06	.47	1.26
9	Sears, Roebuck and Co.	259	.91	.04	.48	1.42
10	Phillips Petroleum Company	250	.04	.01	7.45	7.50
11	Minnesota Mining and Manufacturing Company	228	1.79	.02	.55	2.36
12	S. S. Kresge Company	223	2.64	.04	1.22	3.89
13	J. C. Penney Company, Inc.	196	2.42	.05	1.35	3.82
14	Johnson & Johnson	191	1.96	.01	.65	2.61
15	Exxon Corporation	162	.41	.07	.35	.82
16	Atlantic Richfield Company	155	3.36	.04	.96	4.36
17	Caterpillar Tractor Co.	151	3.34	.06	.59	3.99
18	Corning Glass Works	151	.21	.26	7.40	7.86
19	Eli Lilly and Company	150	1.99	.04	.73	2.75
20	Texas Instruments Incorporated	148	5.80	.02	1.50	7.32
21	Ford Motor Company	144	1.37	Neg.	.41	1.78
22	Motorola Inc.	116	4.98	Neg.	1.53	6.51
23	Honeywell Inc.	111	3.14	.05	1.09	4.28
24	American Hospital Supply Corporation	107	3.72	.06	2.54	6.31
25	First National City Corporation	102	0	0	2.32	2.32
26	Schering-Plough Corporation	100	1.61	.03	1.24	2.87
27	Hewlett-Packard Company	98	3.62	0	.65	4.27
28	Texaco Inc.	94	.39	.05	.48	.92
29	International Telephone and Telegraph Corporation	87	1.01	.04	.48	1.53
30	General Telephone & Electronics Corporation	80	1.73	.04	.53	2.31
31	Emerson Electric Co.	76	3.39	Neg.	.24	3.62
32	American Home Products Corporation	73	.59	.05	.52	1.17
33	Westinghouse Electric Corporation	72	.32	.01	1.57	1.90

	ISSUE	MARKET VALUE ($ MILLIONS)	SOLE VOTING (%)	SHARED VOTING (%)	NO VOTING (%)	TOTAL FIDUCIARY HOLDINGS (%)
			PERCENT OF OUTSTANDING SHARES			
34	McDonald's Corporation	$69	1.45%	.06%	.83%	2.33%
35	Whirlpool Corporation	66	3.31	.01	1.74	5.06
36	The Bendix Corporation	66	.01	.01	10.97	10.99
37	E. I. du Pont de Nemours & Company	62	.18	.10	.47	.74
38	Walt Disney Productions	60	.70	.01	.21	.91
39	Virginia Electric and Power Company	58	3.63	.07	1.95	5.65
40	TRW Inc.	57	6.34	Neg.	.28	6.62
41	Federated Department Stores, Inc.	55	1.91	.06	.29	2.26
42	The Travelers Corporation	53	2.77	.04	.22	3.03
43	American Express Company	52	1.06	.03	.55	1.64
44	The Louisiana Land and Exploration Company	51	2.38	.04	.83	3.24
45	J. P. Morgan & Co. Incorporated	49	1.61	.10	.86	2.57
46	The Southern Company	49	2.63	.02	.78	3.43
47	Baxter Laboratories, Inc.	48	2.42	.01	.58	3.01
48	Textron Inc.	47	3.51	.02	1.32	4.86
49	Colgate-Palmolive Company	46	.01	.01	2.32	2.34
50	Marcor Inc.	46	5.39	.02	.32	5.74
51	Armstrong Cork Company	44	4.54	.02	.60	5.16
52	Philip Morris Incorporated	43	1.13	Neg.	.27	1.40
53	The Procter & Gamble Company	42	.32	.05	.09	.46
54	Middle South Utilities, Inc.	42	3.03	.03	.81	3.86
55	The Perkin-Elmer Corporation	40	4.82	.18	1.80	6.80
56	Continental Telephone Corporation	40	3.65	.06	1.21	4.92
57	Mobil Oil Corporation	39	.23	.04	.24	.51
58	Florida Power & Light Company	38	1.88	.36	.72	2.96
59	Southern California Edison Company	38	2.33	.02	.79	3.13
60	The Rank Organisation Limited	38	1.70	.02	.42	2.14
61	Associated Dry Goods Corporation	37	4.85	Neg.	.38	5.23
62	FMC Corporation	37	3.71	Neg.	1.44	5.15
63	MGIC Investment Corporation	36	1.23	.08	.48	1.79
64	Pennzoil Company	35	5.75	0	.37	6.12
65	American Telephone and Telegraph Company	35	.06	.01	.06	.12
66	Standard Oil Company (Indiana)	35	.21	.03	.33	.57

	ISSUE	MARKET VALUE ($ MILLIONS)	PERCENT OF OUTSTANDING SHARES: SOLE VOTING (%)	SHARED VOTING (%)	NO VOTING (%)	TOTAL FIDUCIARY HOLDINGS (%)
67	Colonial Penn Group, Inc.	$35	2.62%	0%	.81%	3.43%
68	AMP Incorporated	35	1.75	0	.45	2.20
69	Texas Utilities Company	34	1.42	.28	.18	1.88
70	Moore Corporation Limited	34	1.95	.03	.14	2.12
71	Carolina Power & Light Company	33	4.07	.05	1.37	5.49
72	United Telecommunications, Inc.	33	3.39	.01	.92	4.32
73	Union Oil Company of California	32	2.49	Neg.	.37	2.86
74	Sony Corporation	32	.82	.01	.17	1.00
75	General Mills, Inc.	32	.84	.01	1.53	2.37
76	Carrier Corporation	31	4.01	.03	.56	4.59
77	The Hobart Manufacturing Company	29	.0	0	7.08	7.08
78	Polaroid Corporation	27	.29	.02	.35	.65
79	The Chubb Corporation	27	.55	0	3.22	3.77
80	Zenith Radio Corporation	25	1.87	.03	.54	2.43
81	Pabst Brewing Company	25	3.44	.01	.01	3.46
82	Marriott Corporation	24	1.84	.01	.44	2.29
83	First Bank System, Inc.	24	2.23	.14	.36	2.73
84	Squibb Corporation	24	.67	.02	.32	1.02
85	The Clorox Company	23	1.58	0	.86	2.44
86	The National Cash Register Company	23	2.23	.04	1.02	3.30
87	Doubleday & Company, Inc.	23	1.82	0	28.49	30.32
88	Dow Jones & Company, Inc.	23	1.83	.55	1.06	3.43
89	Prentice-Hall, Inc.	23	1.17	Neg.	5.51	6.69
90	Bristol-Myers Company	22	.46	.08	.50	1.04
91	Masco Corporation	22	2.70	.03	.88	3.62
92	Houston Lighting & Power Company	22	1.56	.03	.51	2.09
93	Commonwealth Edison Company	21	.68	.04	.51	1.23
94	Kaufman and Broad, Inc.	21	1.15	.04	1.79	2.98
95	Standard Oil Company of California	20	.13	.02	.16	.30
96	Chesebrough-Pond's Inc.	20	1.25	Neg.	.60	1.86
97	The Upjohn Company	19	.55	.02	.46	1.03
98	Allegheny Power System, Inc.	19	2.91	.03	.26	3.20
99	Consumers Power Company	19	.44	.03	2.05	2.52
100	Transamerica Corporation	19	1.05	.01	.55	1.61

Neg.–less than .01%
Source for outstanding shares–Standard & Poor's Corporation Year-End 1972 Stock Guide

HOLDINGS IN A STOCK COMMON TRUST FUND

December 20, 1972

SHARES OR UNITS	ISSUE	MARKET VALUE	GROUP % OF TOTAL MARKET VALUE
	TECHNOLOGY		
29,165	International Business Machines Corporation . . .	$11,724,330	
59,625	Xerox Corporation	8,899,031	
31,110	Eastman Kodak Company	4,615,946	
31,600	AMP Incorporated	4,044,800	
45,052	Merck & Co., Inc.	4,015,260	
29,578	Motorola Inc.	3,871,021	
40,200	Eli Lilly and Company	3,200,925	
58,000	The Perkin-Elmer Corporation	2,218,500	
25,500	Hewlett-Packard Company	2,205,750	
25,302	Minnesota Mining and Manufacturing Company .	2,166,484	
	TOTAL TECHNOLOGY	$46,962,047	30%
	CONSUMER AND SERVICES		
40,066	Avon Products, Inc.	$ 5,470,026	
58,478	General Motors Corporation	4,744,028	
40,000	Philip Morris Incorporated	4,730,000	
34,600	Johnson & Johnson	4,515,300	
73,700	First Bank System, Inc.	4,422,000	
24,524	The Coca-Cola Company	3,641,814	
66,500	Zenith Radio Corporation	3,624,250	
120,000	Beatrice Foods Co.	3,330,000	
37,500	Pabst Brewing Company	2,812,500	
75,000	Whirlpool Corporation	2,718,750	
21,600	American Home Products Corporation	2,635,200	
65,000	The Travelers Corporation	2,526,875	
28,500	Chesebrough-Pond's, Inc.	2,500,875	
20,500	The Procter & Gamble Company.	2,285,750	
8,900	Walt Disney Productions	2,107,075	
20,000	J. P. Morgan & Co. Incorporated	2,100,000	
100,000	Pennsylvania Life Company	912,500	
26,200	Dayton-Hudson Corporation	694,300	
	TOTAL CONSUMER AND SERVICES	$55,780,243	35%

SHARES OR UNITS	ISSUE	MARKET VALUE	GROUP % OF TOTAL MARKET VALUE
	BASIC INDUSTRIES		
60,862	General Electric Company	$ 4,435,318	
50,000	Exxon Corporation	4,375,000	
58,000	Caterpillar Tractor Co.	3,857,000	
50,000	Mobil Oil Corporation	3,700,000	
77,300	Armstrong Cork Company	2,550,900	
100,500	FMC Corporation	2,261,250	
22,200	Emerson Electric Co.	2,025,750	
	TOTAL BASIC INDUSTRIES	$23,205,218	15%
	UTILITIES		
106,200	Southern California Edison Company	$ 2,947,050	
100,000	Middle South Utilities, Inc.	2,675,000	
50,000	American Telephone and Telegraph Company	2,637,500	
86,144	General Telephone & Electronics Corporation	2,595,088	
70,000	Oklahoma Gas and Electric Company	1,995,000	
61,568	Northern Indiana Public Service Company	1,593,072	
50,000	Continental Telephone Corporation	1,287,500	
	TOTAL UTILITIES	$15,730,210	10%
	COLLECTIVE FUNDS		
29,280	Supplementary Common Stock Fund	$12,831,888	
737	Special Equity Fund	825,518	
	TOTAL COLLECTIVE FUNDS	$13,657,406	9%
	Cash and Short Term Investments	$ 2,330,545	1%
	TOTAL PORTFOLIO	$157,665,669	100%

HOLDINGS IN A REPRESENTATIVE PENSION TRUST

December 29, 1972

CATEGORY	MARKET VALUE	PERCENT OF TOTAL MARKET VALUE
Cash, Short Term Investments and Other	$ 668,951	1.6%
Corporate Bonds	1,811,431	4.3
Foreign Bonds	365,890	0.8
Mortgages	626,459	1.5
Real Estate	1,175,232	2.8
Common Stocks	37,722,850	89.0
TOTAL PORTFOLIO	$42,370,813	100.0%

COMMON STOCK HOLDINGS

SHARES OR UNITS	ISSUE	MARKET VALUE	GROUP % OF TOTAL MARKET VALUE
	TECHNOLOGY		
8,360	International Business Machines Corporation	$ 3,360,720	
17,000	Xerox Corporation	2,537,250	
12,600	Eastman Kodak Company	1,869,525	
15,000	Merck & Co., Inc.	1,336,875	
16,000	Hewlett-Packard Company	1,297,500	
8,000	Motorola Inc.	1,047,000	
10,000	Minnesota Mining and Manufacturing Company	856,250	
6,000	Honeywell Inc.	828,000	
4,000	Texas Instruments Incorporated	727,500	
	TOTAL TECHNOLOGY	$13,860,620	37%

SHARES OR UNITS	ISSUE	MARKET VALUE	GROUP % OF TOTAL MARKET VALUE
	CONSUMER AND SERVICES		
12,000	Avon Products, Inc.	$ 1,641,000	
10,000	The Coca-Cola Company	1,485,000	
20,000	Zenith Radio Corporation	1,090,000	
9,000	Sears, Roebuck and Co.	1,044,000	
11,500	J. C. Penney Company, Inc.	1,039,312	
12,000	Ford Motor Company	955,500	
7,000	Johnson & Johnson	913,500	
17,500	American Hospital Supply Corporation	857,500	
25,000	Matsushita Electric Industrial Co., Ltd. ADR	828,125	
8,500	General Motors Corporation	689,563	
10,000	American Express Company	648,750	
15,400	Marriott Corporation	562,100	
16,722	Continental Mortgage Investors	215,296	
	TOTAL CONSUMER AND SERVICES	$11,969,646	32%
	BASIC INDUSTRIES		
10,000	Atlantic Richfield Company	$ 777,500	
11,000	Caterpillar Tractor Co.	731,500	
8,000	Exxon Corporation	700,000	
9,500	General Electric Company	692,312	
	TOTAL BASIC INDUSTRIES	$ 2,901,312	7%
	UTILITIES		
35,000	Southern California Edison Company	$ 971,250	
12,000	American Telephone and Telegraph Company	633,000	
22,000	Virginia Electric and Power Company	492,250	
10,000	Texas Utilities Company	340,000	
15,000	United Telecommunications, Inc.	333,750	
8,000	Florida Power & Light Company	315,000	
6,000	Houston Lighting & Power Company	306,750	
	TOTAL UTILITIES	$ 3,392,000	9%
	COLLECTIVE FUNDS		
11,735	Supplementary Common Stock Fund	$ 5,142,926	
408	Special Equity Fund	456,346	
	TOTAL COLLECTIVE FUNDS	$ 5,599,272	15%
	TOTAL COMMON STOCKS	$37,722,850	100%

US TRUST

2nd discretionary Trust Fund

STATEMENT OF INVESTMENTS HELD

February 29, 1972

Shares or Amount	Common Stock	Book Value	Market Value Amount	%
	Financial			
20,000	Marlennan Corp.	$ 931,790.46	$ 1,252,500.00	1.92
	Food and Beverages			
30,000	Anheuser Busch Inc.	$ 1,147,275.00	$ 1,920,000.00	
16,050	Carnation Company	1,207,643.46	1,963,112.50	
13,500	Coca-Cola Company	964,084.05	1,560,937.50	
24,000	Dr. Pepper Co.	649,317.60	1,095,000.00	
19,500	Pabst Brewing Co.	771,500.00	1,135,875.00	
28,000	Quaker Oats Co.	1,202,344.02	1,603,000.00	
30,000	Seven-Up Co.	765,812.50	1,230,650.00	
25,000	Taylor Wine Co.	1,159,787.50	1,462,500.00	
		$ 7,947,964.13	$12,000,075.00	18.36
	Home Products and Drugs			
22,500	American Greetings Corp. Class A	$ 942,750.00	$ 1,417,500.00	
12,000	American Home Products Corp.	894,272.41	1,135,500.00	
23,000	Avon Products Inc	1,489,855.95	2,499,750.00	
22,500	Baxter Laboratories Inc.	611,853.72	505,625.00	
25,000	Becton Dickinson & Co.	959,861.80	968,750.00	
30,000	Economics Laboratory Inc.	775,312.50	952,500.00	
37,620	International Flavors & Fragrances Inc.	1,335,905.71	2,1[illegible] 970.00	
24,000	Johnson & Johnson	1,04[illegible]97.06	2,472,000.00	
12,000	Merck & Co., Inc.	1,1[illegible]713.67	1,[illegible]02,500.00	
17,600	Rubbermaid, Inc.	835,192.77	1,219,400.00	
20,800	Schering-Plough Corp.	1,11[illegible],614.72	2,007,200.00	
13,000	Squibb Corp.	964,211.91	1,095,000.00	
4,000	Tampax, Inc.	1,297,450.00	1,516,000.00	
10,000	Warner Lambert Pharmaceutical Co.	657,751.78	843,750.00	
		$14,113,[illegible]0.50	$21,023,245.00	32.17
	Tobacco			
15,000	Philip Morris Inc.	$ 934,808.49	$ 1,162,500.00	1.78
	Retail Trade			
8,000	ARA Services Inc.	$ 912,114.32	$ 1,300,000.00	
15,000	Kresge S. S. Co.	775,682.27	1,552,500.00	
15,000	Sears Roebuck & Co.	1,136,731.24	1,651,875.00	
		$ 2,82[illegible],527.84	$ 4,504,375.00	6.89
	Electrical Equipment and Electronics			
12,000	Emerson Electric Co.	$ 515,232.78	$ 1,023,000.00	
15,000	Whirlpool Corp.	1,437,813.25	1,715,625.00	
		$ 1,953,046.03	$ 2,738,625.00	4.19
	Chemical			
12,000	Betz Laboratories Inc.	$ 703,750.00	$ 7[illegible]0,000.00	
15,000	Eastman Kodak Co.	1,121,083.96	1,641,375.00	
15,000	Mallinckrodt Chemical Works Class A	718,125.00	1,110,000.00	
10,000	National Chemsearch Corp.	557,233.01	657,500.00	
		$ 3,100,191.97	$ 4,201,875.00	6.43
	Oil and Natural Gas			
12,000	Atlantic Richfield Co.	$ 812,179.32	$ 849,000.00	
8,000	Standard Oil Company of Ohio	573,250.44	67[illegible]00	
		$ 1,385,429.76	$ 1,51[illegible]	2.32
	Building Material			
30,000	Weyerhaeuser Co.	$ 1,020,968.32	$ 9[illegible]0.00	1.51
	Industrial and Farm Machinery			
10,000	Black & Decker Manufacturing Co.	$ 739,757.32	$ 897,500.00	1.37
	Office Equipment			
4,000	International Business Machines Corp.	$ 1,254,319.10	$ 1,474,000.00	
12,000	Xerox Corp.	1,175,999.83	1,605,000.00	
		$ 2,430,318.93	$ 3,079,000.00	4.71
	Miscellaneous			
20,000	Folders Corporation	$ 961,091.76	$ 835,000.00	
20,000	Gannett Co., Inc.	1,140,365.90	[illegible]	
12,000	Minnesota Mining & Manufacturing Co.	1,036,187.60	[illegible]	
16,000	Pinkertons Inc., Class B	[illegible]	[illegible]	
14,607	Simplicity Pattern Co., Inc.	[illegible]	2,395,[illegible]	
		$ 5,1[illegible],552.[illegible]	$ 7,[illegible]	11.64
	Total Common Stock	$42,567,[illegible].79	$[illegible],573,21[illegible]	93.39

EXHIBIT G

Reginald H. Jones, Chairman and Chief Executive Officer, General Electric Company

The Challenge of Capital Attraction

Address to
Financial Accounting Foundation
New York, New York
March 28, 1973

Reginald H. Jones
Chairman and Chief Executive Officer
General Electric Company

The Challenge of Capital Attraction

The public opinion polls tell us that people today—especially the better educated young, and people of higher income—are looking more and more to business to take a position of leadership in alleviating social problems.

This was indicated by a recent Harris Poll which showed, for example, that 92% of the people think business should provide leadership in cleaning up the environment. High expectations also were shown in the poll for fourteen other socio-economic problem areas.

However, these high expectations were not voiced because people think business had done a good job on these problems. Only 27% of those polled had "a great deal of confidence" in corporate executives. Rather, it is because, as Harris concluded, business is believed to have the power to get such things done.

The Question Of Resources

It is these last several words—"the power to get such things done"—that I want to discuss with you tonight. For at this particular juncture in time, I think we must seriously question whether or not business *will* have the resources, especially the invested capital, successfully to confront the social and economic challenges which our society legitimately expects it to tackle.

It has been estimated, for example, that environmental protection outlays alone over the next decade will require about 7% of the total capital investments of business.

Or consider the nation's energy requirements. Recent studies we have made indicate that the cumulative capital needs of the electric utilities alone in this country between now and the year 2000 will approach one trillion, two hundred billion dollars. And that's in 1973 dollars.

The question that seriously concerns me is whether the private sector will be able to attract the necessary funds to meet such demands, let alone provide the economic growth to fulfill the material expectations of the people.

Uneasy Stock Market

Inasmuch as most of the broad stock market indices hit all-time highs less than three months ago, we might conclude that the mythical average investor would probably answer "Yes" to such a question. However, if we were to dissect one of the broad-based indices—let's use the Standard and Poors 425 Industrials—we'd find the following:

- Just eighteen companies, such as IBM, Xerox, and Eastman Kodak, with a composite price-earnings ratio of 47 and an after-tax return on invested capital of 18%, accounted for an increase equal to *all* the growth in the S&P Industrial Index during the last seven years. Put a little differently, the market value of all of the Standard and Poors 425 increased by about $111 billion between 1965 and the end of 1972, but only 18 companies accounted for all of that increase.
- This means that, taken together, the composite stock market valuation of the other 407 companies in the index hasn't increased a dime during that same period, while the consumer price index shot up nearly 30%. Moreover, the aggregate price-earnings multiple of these other 407 stocks was only in the 9 to 10 range at the high.

It's not surprising that with most industrial equities selling at their lowest P-E's in almost twenty years, many companies are buying back their own stock. And of course, the fact that this can help increase earnings per share—a syndrome to which I'll return later—probably contributes to the trend. It is all too apparent that the current stock markets are characterized by a fundamental uneasiness. But even if we reflect back on the more ebullient markets of a few weeks ago, the great disparities in valuations cause concern about the ability of the basic industrial backbone of our economy to attract the risk capital needed to continue the economy's growth.

Profit Margins: Downtrend

For more than two decades now the profit margins of corporations have been in a long-term downtrend.

Government statistics indicate that back in the early 1950's non-financial corporations earned in the range of 23 percent before taxes on total capital. Ten years ago this ratio had dropped to about 18 percent, and in 1971 it was down to 13 percent. But this disturbing trend does not reflect the inflation of the past decade. In a more revealing context, it is interesting to look at a little-used index of the Department of Commerce which recasts booked depreciation for the higher cost that would have been incurred for replacing worn-out equipment. These ad-

EXHIBIT G2

justed statistics show a pre-tax return on total capital dropping from the 20 percent range in the early 1950's to 12 percent ten years ago, and to less than 9 percent in 1971.

To put this into more specific terms, let's look again at the 425 S&P Industrials. Here, as an unfrocked bookkeeper, I hope you'll let me indulge in the heinous and grievous sin of calculating percentages on percentages. *After* tax margin ratios dropped by over 15% in the decade ended in 1971. And if we were to measure this decrease from 1965 only, when the onslaught of inflation really accelerated, the drop in margin ratios would be over 20%. Even as great a year as 1972 seems to have been, it appears that only about 5 percentage points of that 20 point decline were probably recovered.

But of even greater significance, the *after* tax returns on long-term debt and stockholders' equity for these same 425 industrials also deteriorated by some 15% in the '62 to '71 decade. And in the last half of the period, this segment of America's strongest corporations was able to achieve an after tax incremental return of less than 3% on some $130 billion which was added to capital during those years. In retrospect, many a company didn't even earn the equivalent of interest charges on newly added funds.

There's no need tonight for me to conjecture about all the reasons why costs have been far outrunning revenues; however, one influence has been so pervasive—and will continue to be so for the foreseeable future—that it deserves some mention. I'm speaking, of course, of inflation.

Inflation Squeezes Margins

Especially during the last seven years or so, demand-pull inflation in the services sectors, both private and government, where productivity has been characteristically low has led to runaway prices and soaring taxes. After all, what *are* the economies of scale for lawyers, firemen, or string quartets?

Folded back into the cost of living, and through collective bargaining labor contracts into manufacturers' costs, this demand-pull inflation in services and government functions was translated into cost-push inflation in the manufacturing sector. The end result was a classic squeeze on manufacturers' margins.

In a much needed attempt to improve productivity, to offset rising labor and material costs, and to protect hard-won market positions, manufacturers invested heavily in plant and equipment. Here also inflation drove up the costs of new plants while frenetic cost reduction activity tended to obsolete process technology faster than ever before. The investment in gross plant of the S&P Industrials, for example, more than doubled during the decade ended in '71.

To finance this vast growth in plant, as well as to provide needed working capital, manufacturers had to attract more invested funds. The way they did it, however, exacerbated even further the compression of profit margins. The volume of long-term debt issues virtually exploded while interest rates surged to their highest levels in a hundred years. Our S&P 425 Industrials trebled their long-term debt causing their combined debt/equity ratio to rise from 26% at the beginning of the decade to 41% by the end of 1971. Although the data aren't readily available, we can probably assume that short-term borrowings also took off, because the current ratio for the industrials deteriorated steadily throughout the period from 2.5 to 1.8.

With all due respect for the leverage principle, I'm sure that the earnings per share syndrome also contributed heavily to the desire of many managements to shun equity financing. But for whatever reason, the debt string was pretty well run out without benefit of a solution to the underlying problem of declining profitability—a problem that, from all indications, threatens to become structural.

Most economists expect inflation over the next decade to continue at rates well above U.S. historical standards, perhaps in the range of about 4% annually. More than anythig else, the shift to a services-oriented economy is responsible. While the calculation is complex, it has been demonstrated that about 76% of our inflation from 1960 to 1971 was due to inflation in the cost of private and public services.

And the continuing shift to services is expected by 1985 to result in services employment three times that of manufacturing, contrasted with the two-to-one relationship that existed in 1960. Moreover, the need for investors to hedge against inflation can also be expected to keep long-term interest rates well above their historical levels.

So, now we have the basic dimensions of our concern about whether the industrial backbone of our economy is armed adequately to confront either the social *or* the economic problems it is expected to overcome. Already having increased their debt significantly, can our industrial management take the calculated risks necessary to enhance productivity for services as well as for manufacturing with inflation pressing downward on profitability and upward on interest rates? Could it be that for too long we have concerned ourselves only with inequalities of *consumption* in the expansion of our industrial base? Have we reached the point that investment returns in our manufacturing establishment cast serious doubt upon future exployment opportunities and the ability to compete at the world market level? I don't believe we can pass a judgment—yet; however, the evidence is strong enough to justify a sense of urgency about the needed actions that are so familiar to all of us:

Needed Actions

- First, raising the productivity of our private and public service sectors. We simply cannot compete effectively in a world market with one of the slowest rates of productivity growth of any of the major industrial nations.
- Secondly, formulating domestic tax policies that will be consistent with the needs to encourage risk investment. This may be contrary to a popular theme of the times which is clouded in the rhetoric of "loop-holes," yet our present tax structure has a vigorous bias against private saving and capital attraction. And, any steps that will mitigate this bias will, in the final analysis, be to the mutual long-term benefit of all elements of our society.
- Thirdly, scrutinizing all of our mushrooming public expenditures in terms of efficiency and the optimum allocation of resources. Recognizing that the good society must invest some of its bounty in programs that constructively relieve social problems, we must, nevertheless, achieve a balance of programs consistent with the resources available to us.

EXHIBIT G[3]

Credibility In Financial Reporting

Taken together these efforts can go a long way towards helping to bridge the chasm lying between the American people's high expectations of business and their low evaluation of what they believe the accomplishments of business to be. I believe we can build such a bridge. The very reason why we are assembled here tonight—to launch the Financial Accounting Standards Board—is an indication of our willingness to tackle the assignment. For improving the credibility of financial reporting is virtually a *sine qua non* for effectively communicating with the public. Such credibility would certainly help to attract our capital resources to their most productive economic and social uses.

For instance, I have been deeply concerned with the tendency we have seen for some time now to overemphasize single elements of financial performance. Blind worship at the shrines of "earnings per share" and "price-earnings multiple" has led us to forget other important basic measurements like "return on investment" and even "net to sales." Machinations to improve earnings per share, while ignoring the effect of increased investment, have been a great disservice to all of us. As a matter of fact, with the hypodermic effects we had in the late 60's on "EPS," I wonder just how good—or bad—our total economic statistics on profit margins really are!

A Crisis Of Confidence

It is not my intention, however, to over-emphasize the well-aired problems of the accounting world of the past few years. But, in all honesty, we do have to admit that something like a crisis of confidence in financial statements has been abroad in the land of late.

For instance

- Although I am opposed to total "uniformity" in accounting—because a "cookbook" approach to rule-making inevitably winds up with an unimaginative and bland stew—I do sympathize with the investor who can't understand why two transactions having identical circumstances aren't bookkept the same way.
- The so-called "Chinese money" games of the 1960's were an intellectual delight having all the appeal of medieval theology in some of their subtleties, but at what cost to many individuals and to society as a whole? I suppose some of the principal beneficiaries are those who write books about them or use them for doctoral dissertations! One can't help wondering, though, how much of the recent investor apathy toward the vast majority of industrial equities can be traced in part to an ever-increasing lack of confidence in reported operating results.
- Or, on the procedural side of things, too much investor uncertainty has resulted from lengthy delays in resolving apparent or real accounting principle problems.

All of these criticisms can't be laid at the doorstep of any single group. But frankly, the buck has to stop with corporate management. And on this point, I am sure that I don't have to emphasize to my associates in general management that this new venture is especially important to us, not just to the accountants; for we share with them the responsibility for using realistic and workable ground rules for financial reporting.

A Challenge To Management

What must we then do?

We must recognize that the new Board will not be a cureall for every ailment. We must recognize that with its *first* decision the new Board is going to gore somebody's ox—and *that* will be the time for us to pull together—not to splinter apart.

Let's not lose sight of the public and professional momentum that has brought us this far; and let's not forget that if we falter, government stands ready to do for us what we can't do for ourselves.

Management has the obligation, through example and influence, to be sure that financial statements of the firms whose stewardship is entrusted to them are understandable, complete, unimpaired and sound. In short, they must have integrity written between all the lines.

As a recent *Wall Street Journal* editorial pointed out, "No amount of institutional strengthening will do the job unless the corporate community generally recognizes the importance of reports." Furthermore, says the *Journal* "... the fate of the FASB will not only tell us what kind of accounting we will have—but by measuring whether the business community can force itself to take the long view—also tells us more than a little about how well that community can meet many of the other challenges it faces."

Clearly the personal leadership of all of us has been placed solidly on the line; for there's no escaping the fact that this is one all-important job that business does have the power to get done—and done right.

■

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EXHIBIT G4

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(Exhibit H)

[From Fortune Magazine, July 1973]

Excerpt from Article Entitled "How the Terrible Two-Tiered Market Came to Wall Street"

In any case, the changed circumstances of the funds are a major fact to be reckoned with in the stock market. As recently as 1969, the funds, more often than not playing the role of "anxious buyers," put $2.5 billion into stocks. Forced to meet redemptions, they turned into "anxious sellers" last year and took $1.9 billion out of the market. That meant a swing of $4.4 billion, and the negative impact on the market is difficult to overestimate. This year the swing may be extended still further. In the first quarter the funds were siphoning money from the market at an annual rate of $2.9 billion.

These pieces of gloom relate, of course, to the whole universe of mutual funds, and it should be realized that some funds—those relatively few with good records to talk about—have been taking in large chunks of money this year. And into what kind of stocks was this money being put? Growth stocks mainly, with high p-e ratios mainly—in other words, all of those inhabitants or near neighbors of the upper tier. Meanwhile, the funds hit with the biggest redemptions were those that have put their faith in the lower tier and have little but weak records to show for it. As these funds sold off stocks this spring to raise cash, the lower tier got pushed still lower.

ROOMING WITH DAVY JONES

While all this was going on, certain institutions that are rather like rich relatives of the mutual funds—the life-insurance and casualty-insurance companies, state and local government pension funds, and the biggest stock buyers of all, private noninsured pension funds (normally called "corporate" pension funds)—were accumulating money as they always do and were stoutheartedly funneling huge amounts of it into stocks. Their buying in the first quarter, in fact, was at a quite high annual rate of $14.5 billion (the record is $18.2 billion, set in 1971), about half of that flowing from the corporate pension funds.

But seemingly these buyers were doing almost nothing to support the lower tier. That point is difficult to prove with precision, since these institutions are not required to report publicly the details of their quarterly purchases and sales. Fortune, however, in a good many interviews with institutional buyers this spring, could find very few who were going into lower-tier stocks, or who even seemed to be thinking hard about doing so. And the market itself, of course, counts as evidence; had anyone been giving the lower tier much support, its stocks would not now be rooming with Davy Jones.

It is clear that these institutions do not see in the lower tier those same "choice investment opportunities" that Jim Needham does. Yet Fortune's study of price-earnings ratios shows clearly that a whole army of stocks are at levels that in the postwar period have come to be considered "cheap." Furthermore, if one focuses on *companies* rather than *stocks*, a good case can be made that there are excellent values around.

All sorts of companies, in cyclical industries mainly, that could recently be bought at book value (or lower) have for at least several years averaged a return on book value of, say, 11 percent or better, and have reasonable expectations of maintaining (or improving) that return. An investor who buys into such a company at no more than book can also figure to earn 11 percent (or better) on his investment, both on the money with which he originally buys a piece of the action and also on every dollar of his earnings that the company retains and puts back to work in the company.

IGNORING AN 11 PERCENT PROPOSITION

If such a company pays a 6 percent dividend (which might be the case in today's market), the reinvested earnings will produce an average, though not necessarily steady, earnings growth of 5 percent and a corresponding growth in book value. This growth may or may not be recognized simultaneously in the stock market. In any case, the investor owns a property whose underlying value is gaining at an average rate of 5 percent a year and that gain, combined with the 6 percent dividend, produces the 11 percent total return. The list of companies that look able to deliver 11 percent would run pretty long today. To name just a few of them: Brown Group, Colonial Stores, Goodyear, W.T. Grant, Grey Advertising, Indian Head, Kentucky Utilities, Marine Midland Banks, Munsingwear, Phelps Dodge.

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An 11 percent return is a meaningful standard for several reasons. It exceeds bond interest rates by a margin that many investors would consider "comfortable." It is considerably above the 9.5 percent or so that investors, as a whole, have historically found it possible to earn on stocks. Most significantly, perhaps, it exceeds by quite a lot the annual rate of return that large institutions have shown themselves able to earn on stocks, on the average, over the last ten years.

The average for the 300 large pension funds whose performance is monitored by the brokerage firm of A.G. Becker has been 9.5 percent (and for the last five years only 7 percent). The average for the equity mutual funds followed by Wiesenberger was 9.2 percent for ten years (and only 4.8 percent over the last five years). Moreover, most institutions today, having been sobered by those performance numbers and also battered by a couple of post-1968 bear markets, are very restrained about their expectations for returns in the future. Few seem confident these days of doing better than 10 percent.

Yet the interest of these institutions in that 11 percent proposition appears almost nonexistent. Their attention, instead, is on the companies whose returns on capital are considerably higher—say, 14 percent and up—and whose earnings growth is considerably less subject to cyclical bumps and potentially much faster—perhaps 10 percent or more. These are the "good businesses" of the world, and could all stocks be bought at the same multiple of earnings, these are the ones that everyone would want to own. But the prices of these stocks have been affected relatively little by the bear market that has ravaged the rest of the list, and they can be had only at upper-tier prices. The question then becomes: is it rational for the institutions to stay with these expensive stocks when so many others can be bought at greatly reduced prices?

(Exhibit I)

EDITORIAL COMMENTARY

TEXAS GULF REVISITED—A SET OF GROUND RULES IS INDEED "SORELY NEEDED"

"SOME disasters strike suddenly and murderously: the flood which roared down the Conemaugh Valley to engulf Johnstown, Pa., or the two million tons of rain-soaked coal waste which collapsed upon the small Welsh mining town of Aberfan. Others take a little longer to sink in. In and around Broad and Wall, as a consequence, the ruling cited above (by the U.S. Court of Appeals for the Second Circuit in the case of the Securities and Exchange Commission, plaintiff-appellant, versus Texas, Gulf Sulphur Co., Charles F. Fogarty, Richard D. Mollison, Walter Holyk, Kenneth H. Darke, Francis G. Coates, Claude O. Stephens, John A. Murray, Earl L. Huntington and Harold B. Kline, defendants-appellees) has slight effect to date. On the New York Stock Exchange on Thursday, TG common closed off little more than a point . . . It promptly made up the loss on Friday. With some noteworthy dissent, chiefly from other mining companies, a Dow-Jones midweek news round-up found relatively little concern among corporate executives queried; the case, one observed, 'will do no more to us than to confirm our previous policy of care and scrupulousness in the dissemination of information.' A security analyst was quoted as saying: 'We don't live on tips. I don't think it's really going to hurt us in our work. . . .'"

* * * * * * *

Four years almost to the day have passed since these words first appeared in print (Barron's, Aug. 19, 1968), and nobody is pushing the panic button. Yet far from changing for the better, matters in some respects have gone from bad to worse. Having been found guilty of violating the federal securities laws which govern trading by corporate insiders and ban "manipulative and deceptive devices", Texas Gulf Sulphur Co. and its key executives persisted in seeking to clear their names, a long (and costly) procedure which ended only last December, when the U.S. Supreme Court unaccountably refused their petition for a hearing. As a consequence, by court order, the vice president and general counsel has surrendered a stock option granted him in 1964 on 4,300 pre-split shares. Three other defendants have been compelled to forfeit the difference between what they paid for their stock and the "mean average price" of 40⅜ on April 17, 1964, sums ranging from $2,301 to $35,663 (plus interest at 6% since the time of purchase), while the field geologist must repay not only $41,795 on his own account but also $48,405 representing profits made by others (so-called tippees) on his direct recommendation. In settling various private lawsuits, Texas Gulf Sulphur has agreed to reimburse plaintiffs (all of whom claimed that they were gulled into

selling their stock by a deceptive press release) to the extent of $2.7 million. And a few months ago the company quietly dropped the "Sulphur".

Others also have been getting a whiff of fire and brimstone. Since mid-August, 1968, the SEC, alleging similar violations of the securities laws, has filed complaints against executives of Manor Nursing Centers, Harvey's Stores, IT & T and Lum's, not to mention a clutch of mutual funds, underwriters and money managers. In the process, to the mounting uneasiness of the financial community, the definition of "insider" has expanded to include anyone and everyone—lawyers, accountants, security analysts, newspapermen, printers, clerk typists, ordinary investors—who somehow come into possession of information not generally known and "material," an elastic concept which, as SEC Chairman William J. Casey told the American Bar Ass'n last week, may be taken to mean anything from prior knowledge that "a highly regarded analyst with a large following is about to change his opinion on a particular issue", to advance word on the forthcoming sale of a big block of stock. As official strictures begin to take hold and bite, finally, the impact of news on the market has grown alarmingly pronounced. Suspensions of trading for days at a time, relatively rare in the past, have proliferated, while downside breakouts and gaps of 20–30% between transactions once strictly a panic phenomenon, today sometimes even fail to make the broad tape. Regulation is something Wall Street long ago presumably learned to live with, but the cost of living keeps going up.

So does the pace of SEC enforcement of rules and standards which, prior to the Court of Appeals' reversal of the District Court decision in the Texas Gulf Sulphur case, were scarcely accepted practice either in Wall Street or Washington, let alone the law of the land. In the past four years, as noted, the agency has charged a number of corporate managements with trading on inside information in violation of the antifraud provisions of the security laws, imposing not only consent decrees but also, in a few cases, monetary damages. Regarding the bankrupt Penn Central, the Commission, so its Chairman recently made known, is weighing "possible enforcement actions," and, at his behest, is investigating the recent suspicious trading in Liggett & Myers.

Far and away the most significant proceeding to date has been that involving Investors Management Co. and a number of other money managers, all of whom were accused of using inside information about the worsening prospects for Douglas Aircraft Co., gleaned from its underwriters, Merrill Lynch, Pierce, Fenner & Smith, to effect transactions at the public's expense. In its ruling—which went unappealed by the defendants—the SEC sought to nail down an all-encompassing definition of "insider" to wit: "We consider that one who obtains possession of material, non-public corporate information, which he has reason to know emanates from a corporate source, and which by itself places him in a position superior to other investors, thereby acquires a relationship . . . within the purview and restraints of the antifraud provisions." As to the latter, the agency also cast its net exceeding wide: "The ambit of the antifraud provisions is necessarily broad so as to embrace the infinite variety of deceptive conduct."

Such definitions cover quite a bit of ground—and leave vast uncertainties and gaps. To date, moreover, efforts to gain clarification (notably on the part of security analysts, who, in contrast to their earlier complacency, now recognize that they have cause for concern) have not gotten very far. In a recent issue of the Financial Analysts Journal, several top-flight members of the profession went over some of the issues with SEC Commissioner (and former Chief Counsel) Phillip Loomis. Though all hands tried hard, the colloquy merely served to point up the pitfalls. For example, suppose an analyst, through his own expertise, comes up with an earnings estimate that differs from the generally accepted one. If he seeks and gets confirmation from the company, "he's got a problem," to quote Mr. Loomis. Again "material" information about a company obtained from suppliers is legal now, but may not remain so. Small wonder that the Analysts Journal, citing an SEC investigation of an interview between a representative of Faulkner, Dawkins & Sullivan and the chairman of Bausch & Lomb, Inc. plaintively observed: "The investment community has taken great interest in the case because the circumstances . . . are hard to distinguish from thousands of other circumstances in which an analyst in private meeting with a company executive has discussed future earnings prospects." Or that Roy R. Neuberger, senior partner of Neuberger and Berman, which the SEC is probing in connection with the trading in Liggett & Myers, the other day was quoted as saying: "I think the rules (on inside information) are being broken by analysts all the time." To say nothing of their customers.

"Full disclosure" is the agency's standard recommendation, but, in the light of the penalties incurred by Texas Gulf Sulphur Co. for issuing what subsequently was termed a misleading press release, many corporations not surprisingly have chosen to clam up. With no forewarning, news—good and bad alike—has begun to have an exaggerated impact on a market already far too institutionalized and thin for its own good. On the New York Stock Exchange, for example, since January, issues have been suspended from trading because of an "order imbalance" or "influx" nearly 200 times, well over half again as often (not counting the upside bulges across-the-board on August 16, 1971, day after the White House unveiled the New Economic Program) as a year ago. Unexpected adversity for one company after another—Max Factor, Handleman, Holiday Inns, Wang Laboratories, to cite a few—has triggered delayed openings and heavy overnight losses. If all this serves to "protect" the investor, then protection comes very high.

Some in the Commission—notably the businesslike Chairman—have begun to show a new awareness of what's involved. As Mr. Casey told the American Bar Association last week: "We want you to know that . . . we recognize our obligation to make as clear and definite as possible the rules and standards to which the business and professional community will be held. . . . One area in which such a satisfactory set of ground rules is sorely needed is insider trading." Better late than never.

(Exhibit J)

Illiquidity: Is it Becoming a Problem Again?

(By Fred Bleakley)

(If a money manager's dream is finding a stock that goes up, his nightmares involve being unable to get out of one that is plummeting. And in late July, many managers awoke to find their bad dreams coming true. A surprising number of small to medium-sized instutional growth favorites, in those weeks, took the kind of drubbing that is usually associated only with bear markets. What went wrong? Is market illiquidity once again rearing its ugly head? In the following article, Senior Editor Fred Bleakley provides some answers in describing events which might—just might—show us what we can expect the next time the market turns down.)

For two weeks prior to the release of the latest earnings report from Handleman Co., president David Handleman ducked all phone calls from analysts. And in retrospect, that probably should have been the tip-off. On Friday morning, July 14, the Detroit-based rack jobber of phonograph records and casettes, which had attracted more than a little institutional interest, announced earnings of 2 cents a share in the latest quarter, contrasted sharply with Wall Street's estimates of 30 cents. By 10 a.m., the flood of institutional sell orders to the floor of the NYSE was so great that the specialist was unable to open it for trading, and suspense about where it would open continued through the weekend and into Monday afternoon. Finally, a team of four floor officials, led by former Big Board governor John Flanagan, huddled together and came up with a price. A 360,000-share block, representing about 8 percent of the company's outstanding common stock, went on the tape at 10½, down some 51 percent from the last trade.

By itself, the Handleman affair was nothing more than the sort of one-day phenomenon that has occasionally murdered such stocks as Wm. Wrigley, STP and Levitz Furniture over the past year or so. But what happened in July showed every sign of being much more than a simple aberration in a few stocks. In addition to Handleman, more than a dozen issues of institutional quality, including Genesco, Holiday Inns, McDonald's, Wang Laboratories, Liggett & Myers and Max Factor, all took the kind of sudden, unpredictable drubbings that one normally associates only with bear markets or with very thin over-the-counter situations.

While the very best of institutional growth stocks generally managed to hold their own during the middle weeks of summer, this second echelon of growth candidates evidenced a kind of classic pattern. Bad news, more often than not a disappointment in earnings ranging from slight to major, galvanized a rash of institutional sell orders which was met in the market by what one trader describes as "an incredible—and I mean incredible—vacuum of buying." And the result was also classic: The stocks, when they finally did trade again, did so at substantial discounts from their former prices.

What accounts for this unnerving performance? Were traders and market makers doing a bad job? Did money managers and analysts simply expect too

much? Or has stock market illiquidity, the villain of the 1969–1970 bear market, come back to haunt us?

DOUBTS

Part of the problem was the oft-cited combination of factors now besetting the marketplace: uneasiness about the possibility of a McGovern presidency, lingering doubts about inflation and the continuing dollar crisis. But clearly, with the market as a whole demonstrably able to withstand such uncertainties—during the last three weeks of July the Dow never dropped more than eight points in any one day and remained above the 900 level—more basic forces were at work here. Despite the finding of the SEC's institutional study that institutions are actually a stabilizing force in the market, it would seem that the series of one-day disasters in July meant at the very least a temporary refutation of that view. In the case of Handleman, for instance, when told the stock would open so low, the public withdrew more than half of its orders—which had amounted to about 10,000 shares—to sell at the market, but none of the institutions, whose total "market" orders came to better than 350,000 shares, had second thoughts about bailing out.

The Handleman debacle may have been an extreme case, but the other stocks hit during July showed uncomfortably similar results—often on news that was not nearly so devastating. Holiday Inns merely reported an earnings dip for three months to 39 cents per share (vs. analysts' estimates of about 46 cents), and its shares tumbled from 50 to 40 in one massive trade. Wang Laboratories, which dropped from 59½ to 48½ in a single day, was even clearer evidence of the fickle nature of its holders. While the company admitted half-year earnings would be somewhat lower than originally anticipated, it remained bullish about its new computerized typewriter—the chief reason why the stock had run from 36 to over 60 in the first place. And in trying to account for the drop in Liggett & Myers, which fell 6¼ points in one day (to 46⅜) on news of lower earnings, a company spokesman insists that analysts knew well in advance that almost all of the company's problems were "temporary and not chronic."

To be sure, some of the companies deserved their downward reappraisal—to use the delicate phrase—more than others. Grumman Corp. slid five points to 12½ in a single trade, when it lost out on its bid for the space shuttle contract—which is grounds in the best of markets. And a negative article on the Wankel engine in Barron's cast doubt on the prospects for Curtiss-Wright, Wankel's North American rights holder, once again underscoring the newspaper's ability to affect stocks.

But other developments were less than understandable in an investment environment which, if not the best of markets, certainly was not the worst of markets. And, that being the case, what look like piecemeal aberrations demand closer examination as a possible portent of things to come in a weaker market climate.

COLD BLOODED TRADERS

As Institutional Investor explored the causes of these declines, one important conclusion that emerged is that this experience may be telling us what can be expected in a negotiated rate environment. No hard experience has yet emerged about how block positioners will perform under negotiated rates when the market turns soggy, but the widely held belief is that positioners are no longer as willing to stop a slide by moving in with their own money at high prices. "We'll make bids or offers in any market atmosphere, but we just have to look at each trade more cold-bloodedly," is the way Daniel Murphy, Shields & Co.'s head trader, puts it. And by letting stocks fall where they may, the positioning firms are, in essence, saying that there is no way institutions can make it up to them if they take a licking on positions. Under negotiated rates, even if an institution pays a high rate for a position bid, the rules now do not permit it to pass along continuous follow-up business at higher-than-competitive rates. "Negotiated rates have changed the psychology of the game," reports Will Weinstein, Murphy's counterpart at Oppenheimer & Co. "Despite all the erudite studies to the contrary, the absence of commission incentives is causing illiquidity in the market."

The trend was perhaps inevitable. Some traders at institutions have picked up a reputation for bargaining harder under negotiated rates than brokerage houses think they really would. So, when the tables are turned, and their institutions have a block to unload, they are learning to their dismay that it is much more difficult to find a friend.

But this is only one factor underlying the July declines—and a disputed one at that. Goldman, Sachs head trader Robert Mnuchin, for his part, maintains that the big price discounts which evolved "don't have anything to do with

negotiated rates." And Irving Pollack, head of the SEC's division of enforcement, maintains that negotiated rates probably only mean the difference of a quarter to a half point or so on a position bid.

In any event, no one ever gave the responsibility for stabilizing markets to the block houses. The price they are willing to position at is, in a sense, a part of the service they have to offer. So the big question, on the execution side of these trades at least, is whether the specialists were performing up to their ability. Since a specialist has to turn his decision-making over to floor officials when he is unable to open a stock, the big discounts that were taken in many instances are a reflection of the effectiveness of the whole system.

THE MARKDOWNS

In the case of Handleman, Flanagan says the main reason it was opened so low—in addition to the paucity of buyers—was a block of 100,000 shares set to sell anywhere above 12. Flanagan denies that the fact that Freiday & Co., the specialist in the stock already had a substantial long position in Handleman played a role—or, by implication, that by allowing the firm to take in more stock at 10½ it would better be able to average out the position on a rebound. Even at 10½, of course, it was no guarantee there would be a rebound. And in the case of Wang, even though the stock opened down 9½ points, at 50, specialist Michael Quinn of Benton, Tompane & Co. reports his firm has a "helluva" loss on the position it took. The stock continued to drop in succeeding days to 42.

	On this day	The stock closed at	Down this many points from the previous close	On volume of	And at its low was off from the previous close by (percent)
Max Factor & Co.	July 10	31¼	−7	9,100	18.61
Wang Laboratories, Inc.	do	48½	−11	66,700	18.4
Family Dollar Stores, Inc.	July 11	22	−5	53,700	19.44
Genesco, Inc.	do	15⅛	−5⅝	459,700	29.02
Curtiss-Wright Corp.	July 12	36½	−9⅞	232,300	21.46
Handleman Co.	July 17	12½	−9⅛	837,009	51.47
McDonald's Corp.	do	52⅞	−5⅞	78,300	13.62
Liggett & Myers Corp.	July 19	46⅝	−6⅛	44,700	15.47
Westinghouse Electric Corp.	July 20	45	−3⅛	113,700	7.02
New Process Co.	July 26	21	−8⅝	413,900	30.23
Grumman Corp.	July 27	13⅞	−3⅝	130,900	28.57
Holiday Inns, Inc.	do	42½	−7½	478,300	20.00

Nonetheless, the best measure of whether stocks were marked down too low was the extent to which they rebounded in succeeding days. And in almost all the cases—including Handleman which hovered around the 13 level for over a week, and Holiday Inns which gained back a similar percentage—it would be difficult to make a case that the original markdown price was unreasonable.

The fact remains, then, that the most influential factor in the July action was the edgy temperament of the institutions themselves. Viewing the outlook at that time, they were wary about the economy's prospects beyond the next year. And reluctant to hold stocks for the long term, or to ride out temporary problems, they became obsessed with growth stocks which promised clear sailing over the next six to twelve months. "I know of many a sophisticated, sensible money manager who will not own a stock unless it has the potential of appreciating by an extremely high percentage by year-end," says the research director of one leading brokerage firm. The chairman of White Weld's investment policy committee, Thomas Pryor, puts it this way: "The thinking has been that if a stock's not with me, it's against me. This cyclical economic recovery is now half over and time is running out."

On top of that, the institutional game in this market has many new players, which only serves to heighten the concentration in favorite stocks. This list includes medium-sized regional banks and institutions, many of which research houses have been courting for the first time, as well as pension funds which have been doggedly switching from bonds to common stocks as they invite keener competition for their split funds. All of this, together with the new aggressiveness of bank trust departments and the scramble by mutual funds to avoid net redemptions, brought performance pressures to a pitch.

STARTING STAMPEDES

What happened then is in microcosm of what could happen again. Finding themselves in high-multiple growth stocks, a concept they neither fully trusted nor fully understood, many of these newer entries in the game shied at the first hint of trouble. Meanwhile, everyone, veteran performance manager or not, was getting the same message at the same time—in part because so many insititutions have narrowed the lists of brokers they use and listen to many of the same callers. A firm merely had to put out a "hold" recommendation to start a stampede in one of these issues.

Often, in fact, the impetus to sell stemmed from the mere presence of a single large sell order. "I received an order to sell 150,000 shares of a stock," reports one trader, "so I made my customary two calls to institutions I knew had been buyers. Wouldn't you know that on the first call I made, the guy shot back, 'If you've got 150,000 to sell, you can add 110,000 more.' "

As so often happens, the trend apparently fed on itself as the number of big losers mounted. Potential buyers of one of these stocks became less willing to take on a block close to the last sale because of the big gaps that had already opened up on other stocks and out of fear that their stock might meet the same fate. What's more, the sellers probably became more willing to concede to bargaining. As Carl Wolf, president of the Hedberg and Gordon Fund, which sold out 10,000 shares of Handleman at 32 a month before the price fell apart, says: "If I had known what was going to happen, I certainly wouldn't have argued for a week over one point."

Despite all the apparently understandable excuses for July's burst of selline, seasoned managers of large amounts of growth-stock money are, on the wholg, extremely critical of what transpired. "A very small number of people are putting money management in a bad light," complains the head of one big investment company. "I know of one manager who actually told his broker to sell his Handleman at 'whatever price you can get.' Nuts! That's no way to manage people's money." And, Fred Brown, chairman and president of National Investors Corp., adds that "in the long run, discounts of this kind are going to destroy public confidence in the markets. The block business has to be figured out so the public has a chance."

Fred Brown's words echo the concern of many in the business when it comes to the responsibility of institutions both in trading and evaluating stocks. Is it just possible that the dictum of the best execution should be applied to the timing of the sell order, instead of merely the competitiveness of the bids? Not likely, according to Richard Meyer, Abe Pomerantz's law partner, because that would amount to "second guessing investment managers on investment decisions." But many in the industry feel there is a point here somewhere. And other questions arise as well. For instance, what about valuing big blocks that, if recent history is any guide, may only be sold at a tremendous discount. Is it correct to determine management fees and, in the case of mutual funds, sell shares at the inflated value?

IN ISOLATION?

More important, the concerns aroused by the sudden price slides in so many stocks this summer can do nothing but fuel the controversy over the power of institutions in the marketplace. If the trend continues, it is likely that a consumer-minded Congressman could once again stir up talk of limiting the size of institutional trades, or establishing some form of commodity-type limits for stocks or constructing a two-tier market, isolating the public from the gyrations of institutional trading.

For the time being, such changes do not seem imminent. SEC chairman William Casey made this clear recently when he suggested that changes now in progress in the market's structure will work to curb violent price swings. Among other things, he said, a central marketplace, in which regional exchange specialists through a NASDAQ-type viewing machine, would mean "greater depth, liquidity and price stability than the present situation, with these orders scattered among a number of unconnected places."

Meanwhile, it is possible that the terrible pummeling these dozen or so issues took in July may have a positive effect, if only in persuading money managers to move carefully in the face of what could lie ahead. To be forewarned is to be forearmed. As one portfolio manager, who was able to get out of Handleman in the nick of time puts it, "If I had ever thought I had that much exposure to a bloodbath, I would never have owned the stock in the first place." But perhaps that is too much to hope. More likely, in the view of most investment men inter-

viewed for this article, the pattern which established itself this summer will be around for some time to come. More than a few people are concluding, as Donald Hessler of the University of Rochester endowment fund recently told his investment committee, that "We have to be prepared to live with greater volatility than before."

Otherwise, managers are going to find themselves in the position of trying to find more rationalizations for what happened after the fact, as the words of one who did not get out of Handleman in time amply illustrate. He had bought his block in the mid-30s and upon hearing the surprisingly bad earnings report made up his mind to sell. The question was at what price. First indications were that the stock, having closed Thursday at 21, would open between 15 and 18. Too low, he decided, so he held back his order to "blow it out on the rebound." When Handleman finally did open even lower, he says, "there was no way I was going to panic out at 11." He didn't. By hanging on gamely, he managed to get out at 12 "and a fraction."

Senator ROTH. I would like to ask Mr. Bigler, who has waited such a long time, to come to the witness table.

Senator BENTSEN. This is perfect timing.

STATEMENT OF HAROLD E. BIGLER, JR., VICE PRESIDENT IN CHARGE OF EQUITY INVESTMENTS, CONNECTICUT GENERAL LIFE INSURANCE CO.; REPRESENTING THE AMERICAN LIFE INSURANCE ASSOCIATION, ACCOMPANIED BY PAUL MASON, ASSOCIATE GENERAL COUNSEL

Mr. BIGLER. I got quite an education this morning.

Senator BENTSEN. Well, I just had an education on the Senate floor, too. Were you here yesterday and the day before?

Mr. BIGLER. No, sir.

Senator BENTSEN. Well, why don't you state your name and your position and proceed with your testimony? I apologize for the delay.

Mr. BIGLER. Thank you, Mr. Chairman, if I may, well, first of all, I am Harold Bigler, Jr., and I am vice president in charge of equity investments for the Connecticut General Life Insurance Co., and I am one of those rascal institutional investors you heard so much about this week. I am appearing today, however, representing the American Life Insurance Association. Accompanying me is Mr. Paul Mason, associate general counsel of the association.

If I may, Mr. Chairman, I would like to kind of skip through the prepared remarks we have and ask that our summary statement be accepted for the record with its exhibits.

Senator BENTSEN. Without objection, so ordered.

Mr. BIGLER. The life insurance industry and companies are major holders of common stocks. We have an estimated market value in excess of $17 billion, and this includes well over $6 billion——

Senator BENTSEN. $17 billion?

Mr. BIGLER. $17 billion.

Senator BENTSEN. I thought you said million.

Mr. BIGLER. I might add that that is somewhat at conflict with the $40-some odd billion that is reported in this document, this blue book.

[STAFF NOTE.—The $42 billion figure is derived from Federal Reserve Board statistics. Article in the June 2 issue of Business Week reprinted in this document attributes the figure to Mr. Paul Kolton, Chairman of the American Stock Exchange.]

Senator BENTSEN. What is the source material of the document there?

Mr. BIGLER. I am not sure. This was in text, sir. I am not sure what the source was.

Senator BENTSEN. I see, but you are saying to me that all of the members of your association hold stocks having somewhat less value than what the Morgan Guaranty has in its trust department?

Mr. BIGLER. Oh, yes. Insurance companies, primarily, are lenders, longtime lenders, providing long term debt to the American economy.

Senator BENTSEN. I have some understanding of it.

Mr. BIGLER. Although the subcommittee has indicated that it is not looking into such questions as commission rate structure, institutional membership, and the formation of a central market and so forth, we have attached a number of our previous positions and statements on that.

Senator BENTSEN. We have no objections to that as background information.

Mr. BIGLER. OK.*

We have examined the eight questions that have been referred to in this subcommittee's press release dated July 18, and it might be helpful if I might explain that we operate in our industry through a committee system. I am chairman of the committee on securities investments and this is composed of some 18 or 20 members. We have not had an opportunity to assemble that committee. I am speaking here today quite personally and without the official backing of our committee.

I do feel, however, since I have spent some 16 years in this business, I feel qualified to respond to some of your questions. If, in the process, there areas where I cannot give correct answers, we would be happy to submit material at a later date.

Recently there has appeared some criticism of the manner in which institutions are affecting their trades and the impact of such trades on the liability of the auction market. Some of the criticism manifested itself in the recent Business Week article in which institutional traders are accused of being irresponsible in their trading practices, in that when they begin to sell, their large orders do damage to the auction process. The industry leaders quoted in this article also criticized institutions for concentrating their purchases on 20 to 30 major stocks and as a result, consideration should be given to limiting the amount of shares that may be traded by an institution.

Senator, at this point, I would like to add the question whether that would include the purchase side as well as the sell side, because I think a number of suggestions have been made on the side of selling securities.

We strongly suggest that institutions are being unduly criticized, Senator, for the current situation in the marketplace, and this is not to apologize for what I, personally, would consider excesses in the past. This is a result of the performance cult, which I think we can trace back to the development of the mutual funds in the early 1960's.

I think the performance cult is one of the reasons you don't have the individual in the stock market today. The individual has been notably unsuccessful in his investments.

*This material was made a part of the official files of the Subcommittee.

So we do think institutions are being unduly criticized for the current situation——

Senator BENTSEN. Let me ask you at that point——

Mr. BIGLER. Yes, sir.

Senator BENTSEN. Let me interrupt you from time to time.

Let me ask you why the individual investor has been so notably unsuccessful, as you stated, in the stock market in his investments. Do you have a reason for that?

Mr. BIGLER. Yes; well, let me say that not only has the individual been unsuccessful but there have been many institutions that have been unsuccessful, too.

Senator BENTSEN. So you aren't just singling out the individual?

Mr. BIGLER. No; but I would single him out, particularly. And I think it has to do, Senator, we heard the chairman of the New York Stock Exchange this morning talk about upgrading the caliber of the retail representative and I think there is a great deal that can be done in this area. I don't have, at hand, numbers concerning what the average individual in the market is dealing with. I am sure Dr. Freund would be much better to present those numbers than I, but I recall within the last 2 years, seeing something that the average man in the market is in his early fifties—I am not talking about the mutual fund but the fellow dealing with the retail representative—and he is really not dealing with that much money; something on the order, if I recall correctly, $50,000 to $75,000. And I think if you took today's rates and someone walked into the office of a member firm and wanted to invest $50,000 one time in, that the retail representative would probably net somewhere in the order of $300. That is not a great deal of money to pay attention to an individual coming in off the street with $50,000. He has got to turn that $50,000 into $200,000, and then, he, the representative has an income of $1,200. He does that by churning him over four times and I think that is one of the problems.

Senator BENTSEN. Churning of accounts?

Mr. BIGLER. Not necessarily, Senator, making recommendations that are in the best interest of the customer. That is the problem.

Senator BENTSEN. One of the problems in scheduling hearings is that we are often interrupted by floor votes. A vote is now in progress.

Mr. BIGLER. Yes, sir.

Senator BENTSEN. So, I will continue for 2 or 3 more minutes and then I am going to let Mr. Best of the Finance Committee staff proceed.

Mr. BIGLER. Fine.

Well, I would like to quote from something Don Weeden, chairman of Weeden Co., a third party firm, said in a speech he gave recently:

> There is no need for institutions to be apologetic. They did not cause inflation, the trade deficit, the payments deficit, or the gold crisis, let alone Watergate. So far, 1973 has been a lousy year for lots of reasons, none of which has anything to do with institutional trading practices. Institutions should politely but firmly decline the role of the scapegoat.

Senator BENTSEN. Do you also subscribe to this, which appears in your prepared statement:

> Are the complaints about institutions really part of a cunning campaign to restore fixed commissions?

Mr. BIGLER. I suspect there is a small element of truth there.

Senator BENTSEN. I assure you there is no element of that in this committee's hearings.

Mr. BIGLER. There is no reason to question that at all but there has been, as you are well aware, a great deal of debate over the past 4 years between institutions, the SEC, and various committees on the Hill about that. One of the major areas that appears implicit in the questions raised in this first phase of the subcommittee's hearings appears to concentrate on the question of whether restrictions, if any, should be placed on institutional trading and we believe any such conclusions along these lines are premature and unwarranted.

Senator BENTSEN. How do you feel about disclosure?

Mr. BIGLER. We have absolutely no objection to disclosing at all.

Senator BENTSEN. I don't see why you would.

Mr. BIGLER. I think it is healthy for the whole system, Senator.

Senator BENTSEN. I do, too. I feel it would be OK if you did it on a periodical basis.

Mr. BIGLER. Yes, sir.

Senator BENTSEN. You, obviously, do that anyway for your internal reports in a company of any substance.

Mr. BIGLER. Yes, we do.

Senator BENTSEN. And I have some knowledge about the insurance business having headed a life insurance company once upon a time.

And a mutual management company, too. So I walked both sides of the street and I have gone out to sell stock on my own to raise capital.

Mr. BIGLER. Then you are also aware that there are limitations on the amount of stocks we can hold, particularly, those who do business in New York State, which is the toughest State to do business in. We, in effect, now have a mutual fund type regulatory obligation, the 5 percent, which we have found no problem in living with.

Senator BENTSEN. You don't see any problem with that?

Mr. BIGLER. No, sir, and we have a mutual fund in our complex as well.

I sympathize with the problems of the very large banks because they are dealing for a whole series of individuals or trusts and so forth.

Let's see what else I can just touch on.

Oh, I did want to make one point. If there is a limitation in the amount of trading that can be done, it will reinforce the two-tier market, if there is a two-tier market.

Senator BENTSEN. Tell me why you feel that way?

Mr. BIGLER. I am going to buy stocks I can live with, as is everybody else, and also, I heard the greatest bull story in the world from the bond market here just a moment ago. I am going to buy stocks I can put away in the back of a vault, if I know I am going to be limited as to the amount of stocks I can trade. And these guys who just left the table "ain't seen nothing yet" because wait until they try to raise money on a registered offering, if you know that you are going be limited on the amount of that stock that you can sell. I would submit that there is no stock that is permanent but all of us know the Morgan Guaranty doesn't change its mind on a stock IBM——

Senator BENTSEN. Well, maybe that will explain to me why IBM, with all of the antitrust suit actions and charges against them, stays at a high multiple.

Mr. BIGLER. It stays at a high multiple, because it is well financed, has a reasonable record, and in an inflationary environment should do reasonably well.

The bottom tier or the lower PE stocks would recover dramatically if we could do something about inflation. I hesitate—and I have learned my lesson in this area, to predict anything about the inflation, anything at all—and our own economist has given up as well——

Senator BENTSEN. Secretary Shultz has shared that problem.

Mr. BIGLER. But straightening that up would do more for the lower tier companies than anything else. And, incidentally, my definition of the two-tier market is the upper tier are those stocks that haven't gone down yet, and I think it is that simple. That company is in the second tier in spite of record earnings and so forth.

Senator BENTSEN. That bell means I have to go.

Mr. BIGLER. You have to run? I understand.

Senator BENTSEN. You will excuse me?

Mr. BIGLER. If I may, I just have a couple of pages to go. We understand on July 26, Senator Williams, together with Senators Brooke, Tower, Proxmire, and McIntyre introduced a bill referred to as the Institutional Investor Full Disclosure Act, which would require institutional investors to disclose regularly their portfolio holdings and large security transactions. Senator Williams points out this bill, which is the third bill to result from the securities industry study, conducted by the Subcommittee on Securities of the Committee on Banking, Housing and Urban Affairs, addresses itself directly to the role of institutions in the securities markets and the implications of that role for the small investor and the capital-raising mechanisms. Senator Williams, in introducing the bill, comments that the legislation would accomplish the task of providing needed information about institutional trading practices and investment policies.

Although we have not had the full opportunity to examine this bill in detail, we do endorse the concept of full disclosure or "Truth in Securities" as it is sometimes referred to. We, therefore, endorse this legislation which would implement the significant recommendation of the institutional investors study that the SEC should obtain regular and comprehensive information regarding institutional transactions which may contribute, in part, to unusual price movements. So that it will be continuously in a position to evaluate all recommendations regarding institutional trading.

We should point out that when the SEC submitted its institutional investors study report in March of 1971, it did concentrate on some of the very issues under consideration by this subcommittee. The study reached the significant conclusion that institutional trading has not impaired price stability on the markets. The study did not discover any basis for imposing limitations on the volume of institutional trading or on the size of institutional transactions.

Turning specifically to the question raised with regard to the effect institutional investors are having on the ability of the new- or small- or medium-sized firms to require the capital they need, the Commission, in 1972, held hearings, generally referred to as an investigation into the matter of hot issues which dealt, in part, with the ability of new or emerging companies to acquire capital. That, therefore, is relative to this discussion. For your information, we are

enclosing as exhibit E, a copy of our statement to the Commission on these matters.

We point out in this statement that one of the principal reasons for the dearth of investments and venture capital is that life companies are generally restricted by their liability to policyholders which require a certain level of liquidity and by State laws which have a dampening effect on venture capital investments.

I might also add I think one of the reasons that the public is not in the market is that a large number of new issues have been pushed on them in the past, which were not exactly in the best interests of individual investors.

We recognize that we have not answered some of the specific questions raised, particularly with regard to the tax limitations, but if the subcommittee so desires we could attempt a summary statement. We are prepared to answer any questions you have.

Mr. BEST. Thank you.

I was not in the room when you began your statement but I do understand there was some dispute about the $42 billion figure that appears in the staff blue book. That figure was taken from the "Business Week" article of June 2 which was attributed to Mr. Kolton. I understand the basic source is the Federal Reserve Board.

Mr. BIGLER. I see.

Mr. BEST. And so, the challenge is not with the staff, it is with Mr. Kolton, "Business Week," or the Federal Reserve.

Mr. BIGLER. Might I also make a comment on that page, the top of the blue book, because I think there are some misleading implications in the numbers. I had occasion to call the Prudential Insurance Co. and check that $18.3 billion figure——

Mr. BEST. What page?

Mr. BIGLER. Same page, page 3 of the blue book, the table at the top.

Mr. BEST. Again, the table is excerpted from the same source.

Mr. BIGLER. I understand. The point I want to make is, this includes bonds as well as stocks and that would be true for the Metropolitan as well. I think the implication of that whole article is that they are talking about equities, the stock market and so forth.

Mr. BEST. Fine.

In the "Fortune" article that appeared in July, which you must, undoubtedly, be aware of, there was a table that provided a list of the portfolio holdings of the major banks.

Mr. BIGLER. Yes.

Mr. BEST. Could you supply to the subcommittee for comparative purposes, a similar list for the large insurance companies?

Mr. BIGLER. Easily. Well, relatively easily. Ten largest type of——

Mr. BEST. Something akin to the comparison.

Mr. BIGLER. We could. I suspect you will find many of the same names. Are you talking about the table on pages 44 and 45? Is that the table.

Mr. BEST. Yes, it appears on pages 44 and 45, and 6 and 7. It is the same table.*

Mr. BIGLER. You said for the industry, but might I suggest the major companies of the industry?

*Pp. 320 and 321 of this hearing.

Mr. BEST. Yes, similar to the major banks. Maybe the ten largest companies.

Would you estimate the distribution of holdings of the large insurance companies are similar to those of the 10 largest banks?

Mr. BIGLER. I would suspect that is the way it will come out. You are going to find IBM, Kodak, EXXON, Xerox and so forth, and so on.

Mr. BEST. Would you find that situation analogous to the fact 47 percent of Morgan's holdings are in 20 companies?

Mr. BIGLER. I can tell you 50 percent of our holdings are in 33 companies.

[The following information was subsequently submitted for the record:]

AMERICAN LIFE INSURANCE ASSOCIATION

TABLE ON 20 LARGEST COMMON STOCK HOLDINGS OF THE 10 LARGEST LIFE COMPANIES

September 13, 1973.

Attached is a Table listing the 20 largest common stock holdings of the 10 major life companies, comparable to that prepared for the banks as contained on pages 44–45 of the Briefing Material on the Role of Institutional Investors in the Stock Market (July 24, 1973), prepared for the Subcommittee on Financial Markets.

The selection of the 10 largest life companies is based on the asset size of the life company. However, the ranking of the 10 companies is based on the assets of the life company, plus the assets of any affiliated mutual fund. The selection of the 20 largest common stock holdings for each life company is based (except where otherwise indicated) on the holdings in the general account, separate accounts, and any affiliated mutual fund, as of December 31, 1972.

The Table contains three figures for the life companies, in lieu of the "assets managed" figure of the banks: (a) total common stocks managed by the life company and affiliated mutual funds; (b) total securities managed by the life company and affiliated mutual funds, including bonds and common and preferred stock; and (c) total assets of the life company and affiliated mutual funds. The figures are as of December 31, 1972.

The last horizontal column shows total common stocks managed as a percentage of total assets. We believe that these figures are significant in showing that common stocks managed by the life company constitute a small percentage of total assets.

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Largest U.S. companies by market value: Dec. 31, 1972	Prudential		Metropolitan		Equitable (N.Y.)		New York Life		John Hancock	
	Millions	Rank	Millions	Rank	Millions	Rank	Millions	Rank	Millions	Rank
IBM	$251	1	$116	1	$112	1	$15	4	$95	1
A.T. & T										
Eastman Kodak	113	5	37	10	34	12	14	5	24	6
General Motors	65	18	49	4	30	15	20	1		
Exxon	100	9					11	7		
Sears, Roebuck			47	5	37	10			27	4
General Electric	127	3	51	3	32	13	18	2	19	13
Xerox	118	4			61	3			22	8
Texaco	67	15					10	11	16	17
Minnesota Mining					50	4	8	15	15	18
Procter & Gamble			33	13			10	9	22	7
Coca-Cola										
DuPont										
Ford									15	20
Avon	159	2	32	14						
Mobil	104	8					15	3	16	15
Johnson & Johnson			33	12			9	13		
Standard of California										
Merck					30	16	10	10		
American Home Products			28	17			11	8		
Each Life Company's top 20 holdings	$1,970		$830		$875		$218		$479	
20 holdings as a percent of total common stocks managed	42		48		42		44		39	
Total common stocks managed	$4,731		$1,726		$2,073		$492		$1,236	
Total securities managed	$17,800		$16,285		8,068		$6,235		$6,093	
Total assets (including affiliated mutual funds)	$32,390		$30,776		$16,443		$11,912		$11,381	
Total common stocks as a percent of total assets	15		6		13		4		11	

EACH LIFE COMPANY'S OTHER MAJOR HOLDINGS

Prudential—Texas Inst. (6), Upjohn (7), Sony (10), St. Oil (Ind.) (11), Polaroid (12), Burroughs (13), Matsushita (14), Hercules (16), Westinghouse (17), Gen. Mills (19), Sperry Rand (20).

Metropolitan—Burroughs (2), Warner-Lambert (6), First Nat. City Corp. (7), Kresge (8), Disney (9), ITT (11), Tampax (15), Continental Telephone (16), Kerr-McGee (18), Weyerhaeuser (19), Pfizer (20).

Equitable (N.Y.)—Schlumberger (2), ITT (5), Disney (6), American Express (7), ARA Services (8), Corning Glass (9), Motorola (11), Rohm & Haas (14), Union Pacific (17), Burroughs (18), Household Finance (19), Westinghouse (20).

New York Life—Halliburton (6), Kresge (12), Lousisiana Land & Expl. (14), Westinghouse (16) Caterpillar (17), Deere & Co. (18), Black & Decker (19), Warner-Lambert (20).

John Hancock—Texas Instruments (2), Burroughs (3), Westinghouse (5), Phillip Morris (9), Warner-Lambert (10), Motorola (11), Chubb (12), Kresge (14), Dow Chem. (16), Zenith (19).

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Largest U.S. companies by Market value: Dec. 31, 1973	Aetna		Connecticut General[1]		Northwestern		Travelers		Massachusetts Mutual	
	Millions	Rank	Millions	Rank	Millions	Rank	Millions	Rank	Millions	Rank
IBM	$41	1	$61	1	$21	1	$20	1	$9	3
A. T. & T.							17	2		
Eastman Kodak			14	10	13	2				
General Motors	18	4			11	3				
Exxon					10	8	6	14	7	12
Sears, Roebuck									8	8
General Electric	29	2			11	7				
Xerox	18	3	15	8						
Texaco										
Minnesota Mining										
Procter & Gamble							11	6		
Coca-Cola										
DuPont					10	14				
Ford	17	5			11	5				
Avon					8	18	8	10	6	16
Mobil					10	12				
Johnson & Johnson										
Standard of California										
Merck										
American Home Prod					9	17				
Each life company's top 20 holdings	$267		$347		$211		$184		$145	
20 holdings as a percent of total common stocks managed	37		38		41		24		40	
Total common stocks managed	719		919		510		763		360	
Total securities managed	4,475		4,102		3,241		2,767		2,598	
Total assets (including affiliated mutual funds)	8,475		7,128		6,856		5,870		5,007	
Total common stocks as a percent of total assets	8		13		7		13		7	

[1] Includes all affiliated companies.

EACH LIFE COMPANY'S OTHER MAJOR HOLDINGS

Aetna—Gillette (6), Sperry Rand (7), Pepsico (8), General Telephone (9), Burroughs (10), Eastman Kodak (11), Pickwick Intern. (12), CBS (13), General Mills (14), GEICO (15), INA (16), Milton Bradley (17), L.C.A. Corp. (18), Champion Intern. (19, Kerr-McGee (20).

Connecticut General—MGIC Invest. Corp. (2), Sony (3), Control Data (4), Sperry Rand (5), Deere & Co. (6), Brunswick (7), Utah Intern. (9), Continental Oil (11), Westinghouse (12), Syntex (13), CG Insurance Corp. (14), McDonald's (15), Matsushita (16), Englehard (17), AMF (18), Phillips Pet. (19), Marion Lab. (20).

Northwestern—Dow Chemical (4), Halliburton (6), Burroughs (7), Westinghouse (10), Squibb (11) Simplicity Pattern (13), Illinois Tool (15), Chase Manhattan (16), Gardner Denver (19), Schlumberger (20).

Travelers—Burroughs (3), J.P. Morgan (4), Sony (5), First Chicago Corp. (7), J.C. Penny (8), Eaton Corp. (9), Textron (11), Caterpillar (12), CBS (13), ERC Corp. (15), Kresge (16), Bankamerica Corp. (17), Ingersoll-Rand (18), Deere & Co (19), Brunswick (20).

Massachusetts Mutual—Sunbeam (1), Warner Communic. (2), Brunswick (4), Sony (5), Singer (6), CIT Financial (7), Raytheon (9), Itek (10), ITT (11), Melville Shoes (13), RCA (14), American Broadcast. (15), Johns-Mansville (17), Georgia-Pacific (18), American Airlines (19), Tool Research (20).

Mr. BEST. Could you tell us the amount of pension funds held by insurance companies?

Mr. BIGLER. It is going to be in the order of $50 billion. We will have to check that number and submit it separately to you.

Mr. MASON. We can supply that figure.

Mr. BEST. Could you estimate how much new pension money has flowed into insurance companies?

Mr. BIGLER. It has certainly been a heavy cash flow and a positive cash flow. We will have to provide you with that number, as well.

(The following was submitted in response to the above questions;

(*a*) The amount of private pension plans in the United States funded with life companies: $52.3 billion of reserves in force at the 1972 year-end.

(*b*) The payments made during 1972 into private pension plans funded with life companies: $5.5 billion. This compares with $5.0 billion of payments during 1971.

The source for both of these figures is the *Life Insurance Fact Book 1973*, published by the Institute of Life Insurance, at page 40.

Mr. BEST. Isn't it a concern to have so much of your holdings concentrated in a few companies, from the point of view of your pensioner? In other words, is there a possibility that if one or two of the large companies had serious financial problems or antitrust suits, or what have you, that the stocks could plummet to such an extent that the pensioner's money might be actually in danger?

Mr. BIGLER. Well, that has happened in the past. For example, Litton from 108 to the teens or below, and I can remember Boeing, at one time, the darling of Wall Street, and also Levitt, which we own, sells from 40 to 7 or 8. So, sure, that is a danger but that is built in your actuarial assumptions because what you are doing is measuring the bottom line performance; the total performance and not the individual security.

Now, in our own case, we not only have regulatory rules but we have some internal guidelines and to lose 5 percent of the value of a portfolio is significant of course and it hurts. But you have to look at the portfolio as a whole, because that is what the actuaries are looking at in measuring the soundness of a pension plan and not the individual security. And so, that is one of the reasons you do diversify.

Mr. BEST. Right. So it is in your own interest to diversify and not to have excessive concentrations, however, that is defined, in a few stocks?

Mr. BIGLER. Sure. I manage 23—rather some of my staff manages—different portfolios and we will range in size from 22 issues to the largest portfolio which has 78 different issues within it.

Mr. BEST. Are there any economic reasons why a company like Avon—and I don't know anything about the company—why its stock value might be $7 billion, which is apparently 20 times the value of Merrill Lynch's stock value? Is Avon worth 20 Merrill Lynch's?

Mr. BIGLER. That is a good question. Is IBM market capitalization worth more than twice the assessed value of Manhattan Island? You know, we play these games all of the time. I would, personally, say, no, but, obviously, someone is willing to pay that price. They are looking at a future stream of earnings and putting a value on those.

Mr. BEST. Are they also locked into the stock?

Mr. BIGLER. There has to be some element of that, particularly with those organizations that follow what they call the core stock, this blue list, and they are continuously adding to those.

Those situations do change. The First National City Bank used to have Bristol Meyer as a core stock. It no longer does. So there is this self-prophecy, this self-fulfilling prophecy to some extent, yes, there is.

Mr. BEST. What if one of the holders of this security decided to dump it? What effect would that have on the others?

Mr. BIGLER. It might have a great deal of effect.

Mr. BEST. Would you be able to hold on to a security if you knew that Bankers Trust or Morgan was dumping? Dumping perhaps is the wrong word, let's say disposing of it in a hurry?

Mr. BIGLER. Well, one of the reasons that Morgan and most of us have been concentrating in a higher quality larger capitalization stock with a long record of success, i.e., earnings, dividend increases and so on, in an inflationary environment, is the ability that it gives us to look at a decline in that stock as an opportunity to buy some more if the fundamentals remain the same. If the fundamentals begin to deteriorate in IBM, or Avon, or what have you, there will be a lot of selling in that period.

Mr. BEST. In an inflationary environment, are these kinds of companies in a competitive position that they could easily pass on any increased costs and, therefore, protect themselves against the inflationary environment?

Mr. BIGLER. I don't fully understand phase IV, so I really can't answer that.

Mr. BEST What is to prevent IBM from increasing the price of its computers if there is hardly any other competition?

Mr. BIGLER. I will say that these stocks listed here tend to have low labor content in their cost of doing business and that is another reason. There is a tendency in an inflationary environment to invest in those. Again, you can see the rationale behind the investing in this type of company rather than a labor-intensive industry or company.

Mr. BEST. That does raise questions with regard, then, to the employment effects of this concentration because, if an average-sized company or a medium-sized company has a pension fund—and maybe the company has high labor content—and a good deal of the capital is channeled through this institution that then invests in low labor content industries, the competitive ability of the high labor content business is in jeopardy; isn't it?

Mr. BIGLER. I think so and, also, those high labor content industries tend to be the same ones who have needs for vast capital.

Mr. BEST. And have the most severe foreign competition.

Mr. BOGLER. Steel and so forth; that is right. Also, low return on capital.

Senator BENTSEN. Now that you had all of the tough, penetrating questions, I will ask you some of my own.

Let me ask you this: What do you think about corporations who divide up their pension funds, fcr example, between three or four investment firms and say, now get with it?

Mr. BIGLER. The horse races.

Senator BENTSEN. And then the one who does the best job—and the best job to them means the highest return which you and I probably know may not be the best job in the long run—is the one who gets all of the business.

Mr. BIGLER. May I shift around to the other side of the table because I am a trustee of a committee that has just fired one or two

endowment managers because he didn't perform up to snuff. And yesterday, as a member of the State of Connecticut Pension Committee, if you will, the Treasurer's Advisors Committee on Investments, we spent the full day listening to our four advisors telling us why they didn't do such a good job and why they are going to do a better job in the future. This is a relatively new venture for the State. We have been in equities since 1972, which was not the best time to get into the stock market, but in spite of that, the funds were only down 11 percent for the 12 months ending June 30, which is not bad performance although there was one who was down 18 percent, one of the managers. And when he was all through, I urged him not to try and play catch-up ball and told him to do what was right. I sympathize with him because I go through that same process every week with one of our clients, one or more of our clients.

There was a time here not too long ago when I felt it was time for someone to say, let's change the rules of the game, you know, there are tremendous values in these second-tier stocks, for instance. You hear of sales and earnings of 20 percent a year for 7 years and yet they are selling below book value and that is a PE the stock doesn't deserve. But I feel that it will be self-correcting, Senator, in my humble opinion it is correcting right now today. Yesterday, the breadth of the market was 5 times what it was a month ago and 10 times what it was 3 months ago. If you look at some of the over-the-counter stocks which were in the five, the sixes, the sevens, they have gone to 10, 11, and 12. Those are dramatic increases. And I think you will find the same thing on the New York Stock Exchange. Now, whether Morgan or some of the other banks in New York are getting the message from sessions such as this, I don't know. But what we have to do, we—meaning institutions—is get back to investing instead of buying pieces of paper. We were forced to do that by the mutual funds.

In the insurance company, Good Lord, our turnover 10 years ago was 8 percent. Today it is probably 30 percent or 35 percent. I have a fear that—and I don't know if this committee is aware of the Arthur Lipper Service or the Weisenberger Service of measuring mutual fund performance. The Lipper Service gives us our score sheet every Monday morning and I am afraid that A. G. Becker is going to do that with pension funds, so that, as you can see, the pressure is great. The pressures from the very companies that are concerned about the low PE's on their own stock is great. The pressure on their managers to out perform somebody or to do better than somebody else is great.

And a man at Texas Instruments gave a speech not too long ago—and I am not sure what the occasion was but it might have been the financial analysts meeting here in Washington within the past few weeks and I will see if I can find it—but it really made sense. It is the first time, in a long time, we corporate leaders get up like that and say, don't push your pension managers too hard because American industry has been doing that and it isn't working.

Senator BENTSEN. Well, the incentive for them is, if they can push him hard enough and he gets a high enough return, then they don't have to contribute as much to the pensions.

Mr. BIGLER. Well, that is true.

Senator BENTSEN. Do you think if other institutions have the same kind of limit you have as a result of being qualified in the State of New

York to do business, and you have a 5 percent limitation, don't you?

Mr. BIGLER. Yes.

Senator BENTSEN. If other institutions have that kind of limit, do you think it would force further diversification of their portfolios and might move them down into the lower tier?

Mr. BIGLER. It might move them out of Morgan Guaranty. For instance, the pension account who comes to Morgan Guaranty and is the last fellow in, and they say, I am sorry, but we can't put IBM in your account, he might try to find a trust company who will handle his account. I think that might be a problem. It would be good for the country banks anyway.

Senator BENTSEN. Do you have any questions Senator Bennett?

Senator BENNETT. Unfortunately, I was not here to hear the statement.

I have just been absorbing that last answer. We have had a great variety of answers to that question as to the possible consequences of the limit. I don't know whether you were here to hear Mr. Calloway, but Mr. Calloway suggested that 5 percent of IBM is a lot of shares.

Mr. BIGLER. Yes, it is.

Senator BENNETT. And if they were limited to 5 percent of the Excell Corp. from Salt Lake ,that is only a few shares so they would pass the little one up as just not worth it.

Mr. BIGLER. I think there is a great danger of that. I would do the same thing for that amount of money.

Senator BENNETT. Maybe we better put together some packages that say, in order to buy IBM, you must agree to take so many shares of stock in this class and so many shares of stock in that class?

Mr. BIGLER. You know, that is a technique we use for small capitalization or thinly capitalized stocks anyway. I remember not to many years ago, everybody had a drug package. You didn't know who was going to hit on the research, so you would own five or six drug company stocks but treat it as one investment because you didn't know whether Meyer or Lilly or someone else was going to have the steroid of the year. And we also used to do that with small electronic companies as well, where you create the package in order to get the play of the industry because you weren't quite sure where you create the package in order to get the play of the industry because you weren't quite sure which one was going to be the one to pop up with the product.

Senator BENNETT. I have really no further questions.

Senator BENTSEN. Our deep concern, as you have heard it reiterated time and time again, is how do we get the individual investor back in the market? We think it is bad for institutions and bad for the free enterprise system not to have him there.

Mr. BIGLER. We agree on that.

Senator BENTSEN. Do you think the institutions will finally take over the whole market?

Mr. BIGLER. Well, the individual investor is essential to our financial system.

I think we have an innate right to lose money. On the other side of that equation, I think we have an innate right to make money.

Senator BENTSEN. Do you have any other ideas as to how by the legislative route we might remedy this situation? As I understand it, you said the 5-percent limitation on the ownership of stock in a corporation for you as an institution has not been a problem?

Mr. BIGLER. That is correct.

Senator BENTSEN. On the other hand, you are concerned about any kind of cripple rule on the sale of a stock of a particular issue?

Mr. BIGLER. I am afraid that would not increase the ability to raise capital for the system for the country?

Senator BENTSEN. Insofar as the institutions themselves, do you have any other ideas that might be a contribution?

Mr. BIGLER. From a legislative sense, no; I really don't. But I think the situation is correcting itself.

Another question came up several times before—and I disagreed with Mr. Fortas on this—I think the block business is declining. If there is more capital in Solomon Bros., to use that as an example, and we are in a better position to work that stock out ourselves than to take a two- or three-point discount from the market in order to move something, because two or three points in that market may be 10 or 20 percent. In other words——

Senator BENTSEN. Do you have any numbers to back that up? You said you think the block business is decreasing.

Mr. BIGLER. Well, I think if it hasn't, it will because this is a topic of conversation at all of the seminars and meetings that I go to, and people in similar positions go to. And, in the early stages of a down market, as we began to see last year in the second tier of stocks coming down, obviously, the first sale is the best sale and I am still kicking myself in that I didn't try to work some stocks out. But I think we are now at this market level where I think that that pressure is off or is coming off. And don't hold me to this, but I am rather optimistic for the outlook for equities, technically and fundamentally, and for many other reasons and I think that is going to correct a lot.

This gentleman here is going to be very happy when his stock is back to 12 or 15 times earnings.

Mr. MASON. May I add, as Mr. Bigler pointed out at the outset of his statement, we have not had the opportunity to in anyway poll our membership and certainly we haven't had the opportunity of referring this to a particular committee that consists of some 15 companies that generally consider these matters.

And we would like to take that opportunity in the months to come and, if it is acceptable to the committee, we would like to furnish at an appropriate time some further thoughts with respect to bringing the individual investor back into the market.

Senator BENTSEN. We would be happy to consider, at that time, the inclusion of those into the record.

Mr. BIGLER. I would like to make one final comment and, that is, the question about the deductibility of the commissions that have been mentioned, the retail reps will love it.

Senator BENTSEN. Well, do you think that would encourage people to buy stocks?

Mr. BIGLER. I think it would bring people back in. Unfortunately, in my personal opinion, it would bring people back in the wrong way. Bring them back as traders which adds liquidity, I suppose, but I am not sure that is in the best interest of the man on the street.

Mr. MASON. Mr. Chairman?

Senator BENTSEN. Yes.

Mr. MASON. In 1972, the Securities and Exchange Commission became quite concerned about some of the matters that are now under

consideration by this committee and a number of the chairman's questions in the last several days went to the issue of when a company becomes public, what happens and other such questions and we participated in those hearings, which were, unfortunately, referred to as hot issue hearings, which gave the impression that the hearings were limited to a select list of stocks. But the hearings and the questions that were put to approximately 30 to 50 witnesses were quite far reaching and did explore some of these very same areas you have been raising and I would merely suggest that if that record is available from the Securities and Exchange Commission and some preliminary conclusions that they reached, I would think that would be enormously helpful.

Senator BENTSEN. Well, we appreciate that very much.

Gentlemen, we appreciate your testimony very much. We think it has been very helpful to us.

[The prepared statement of Mr. Bigler follows:]

STATEMENT OF AMERCIAN LIFE INSURANCE CO., PRESENTED BY HAROLD E. BIGLER, JR., VICE PRESIDENT, CONNECTICUT GENERAL LIFE INSURANCE CO.

Mr. Chairman and members of the Subcommittee, I am pleased to be given the opportunity to appear before you today. My name is Harold E. Bigler, Jr., and I am Vice President in charge of Equity Investments for Connecticut General Life Insurance Company. I am appearing today representing the American Life Insurance Association. Accompanying me is Mr. Paul J. Mason, Associate General Counsel of the Association.

The life insurance companies which are members of the Association are major holders of common stock, with an estimated market value in excess of $17 billion, which includes well over $6 billion of equities held in separate accounts funding pension plans.

Although the Subcommittee has indicated that it is not looking into such questions as commission rate structure, institutional membership and the formation of a central market since these areas have been thoroughly studied by other Congressional committees, I do believe that a number of our statements made before other Congressional committees are relevant to the issues at hand. Consequently, we are attaching a list (Exhibit A) of the statements we have submitted in the past several years which explore the evolving pattern of institutional trading. In particular, we are submitting at this time (Exhibit B) a summary statement presented on June 28, 1973 to the House Subcommittee on Commerce and Finance in regard to H.R. 5050. Although this summary statement does deal specifically with some aspects of competitive commission rates and institutional membership, it does at the same time concern itself with more recent institutional trading patterns in response to questions posited to us by the House Subcommittee.

We have examined the eight questions referred to in this Subcommittee's press release dated July 18 regarding the first phase of the Subcommittee's oversight hearings.[1] It might be helpful if we were to explain briefly how we generally prepare our submissions to the respective Senate and House Committees as well as to the Securities and Exchange Commission in matters involving institutional investors and their role in the marketplace. The Association has a Committee on Securities Investments composed of a representative group of companies. The individual from the respective company with the greatest expertise to deal with these issues has been assigned to the Committee. Normally, we have sufficient time to circulate to the Committee the contents of the Senate or House bill or specific inquiry as the case may be. This circulation is designed to initially "test the waters" as to the nature of the response to be made. We usually then discuss the issues in order to assure that our response represents the most reasoned judgment based on the experience in the particular area. This entire process usually

[1] We have also looked briefly at Committee Print 93-744 entitled, "The Role of Institutional Investors in the Stock Market" prepared by the staff for the use of the Subcommittee on Financial Markets. Unfortunately, time did not allow for us to respond to some of the specific points raised in this material. However, we would like to take the opportunity to do so either in writing or in a later appearance before the Subcommittee if it is so desired.

takes no more than two weeks. Unfortunately, in this case, we have not had the opportunity to follow this procedure and, consequently, our remarks this morning are based more on my own reaction, as well as Mr. Mason's. I do not want to suggest at this point in time that I can speak readily for an entire industry. However, this is an area in which I have spent a good number of years and do feel qualified to respond generally. Since the Finance Committee press release indicates that this subject will be under continuing study and that there will be further testimony at a later stage, I respectfully suggest that we can give you some preliminary views at this time but that we be afforded the opportunity to submit at a later date some more specific answers to the questions posed. Further, if the Subcommittee should so desire, we could also participate in these hearings in the fall.

Now that we have reviewed some of the background of this statement, I will turn to some of my more specific reactions to the issues you have raised with regard to the role that the institutional investor is playing in today's market.

Recently, there has appeared some criticism of the manner in which institutions are effecting their trades and the impact of such trades on the viability of the auction market. Some of this criticism manifested itself in a recent *Business Week* article in which institutional traders are accused of being irresponsible in their trading practices in that when they begin to sell, their large orders do damage to the auction process. The industry leaders quoted in this article also criticize institutions for concentrating their purchases on 20 to 30 major stocks and that as a result consideration should be given to limiting the amount of shares that may be traded by an institution.

We strongly suggest that institutions are being unduly criticized for the current situation in the marketplace. A number of arguments that are being made by some of these Wall Street firms are unsupported by facts and are illogical. As pointed out in a recent address by Donald E. Weeden, Chairman of the Board of the Weeden Company, entitled "Institutions: The New 'Bad Guys,' " prepared for the Fifth Annual Institutional Traders Conference on June 13, 1973, and which we attach as Exhibit C:

"There is no need for institutions to be apologetic. They did not cause inflation, the trade deficit, the payments deficit, or the gold crisis—let alone Watergate. So far, 1973 has been a lousy year—for lots of reasons—none of which has anything to do with institutional trading practices. Institutions should politely but firmly decline the role of the scapegoat. . . ."

Mr. Weeden, whose firm deals exclusively with financial institutions, and whose earnings have been significantly down as reported recently in the press, nevertheless, does not blame institutions for the current market situation.[3] He points out in his address that nothing about the good that is done when institutions buy massively is reported—only what happens when they sell.

Addressing himself to the question of depth and liquidity in the marketplace, Mr. Weeden asserts that the volume of stock trading is up dramatically over the past decade and that, for example, on the New York Stock Exchange average daily volume in 1972 was 16.5 million shares which compares with average daily volume on that Exchange of 10 million five years ago and 3.8 million 10 years ago. He suggests correctly, in our view, that this increase in volume is a direct result of institutional trading and that surely the New York Stock Exchange would not want to go back to 3 million share days.

He also suggests the following, and although we have no definitive views on this statement of Mr. Weeden at this time, nevertheless, it is worth consideration:

". . . Are the complaints about institutions really part of a cunning campaign to restore fixed commissions? For example, are not the suggestions that institutions be required to split up their orders merely not so subtle attempts to get those orders divided into small transactions covered completely by fixed rates?"

We will be better equipped to evaluate this statement after we have had the opportunity to digest the written and oral statements of others before this Subcommittee. We are particularly interested, in this connection, in the statements made by brokerage firms and the basis for such statements that may develop regarding the role of insurance companies.

One of the major areas that appears implicit in the questions raised in this first phase of the Subcommittee's hearings appears to concentrate on the question of whether restrictions, if any, should be placed on institutional trading. We believe that any such conclusions along these lines is premature and unwarranted.

[3] Indeed the "Briefing Material" prepared for this Subcommittee and referred to above acknowledges (see pp. 1-2) that the current depressed state of the market may be due to a complex of short-term forces—the sliding value of the dollar at home and abroad, the gold fever, rising interest rates, confidence in government, etc.

There simply is no evidence or basis in fact to justify such abnormal restrictions on trading. We further believe that a first step in evaluating the need for change should be in the direction of greater disclosure as we will now attempt to explain. The *Business Week* article of June 2, 1973 cited in the July 24 staff briefing material recognizes that: "The conventional wisdom on Wall Street is that institutions are a stabilizing force in the market because they are mature, sophisticated investors, armed with plenty of research—in for the long haul and not likely to act precipitously." However, the article goes on to state that much of that wisdom is based on a report on institutional investors completed by the Securities and Exchange Commission two years ago and now out of date. We respectfully submit that the conclusions reached by the Intistutional Investors Study were based on exhaustive research and that there is no hard evidence produced in the *Business Week* article or elsewhere, which refutes the conclusions of the Study.

We believe, and in this connection we support the findings of the SEC's Institutional Investors Study, that the potential or actual impact of institutions on portfolio companies cannot be assessed by institutional beneficiaries, corporate investors or government policy makers without full and fair disclosure of institutional equity holdings and management policy. In this connection, we are submitting as part of this statement (Exhibit D) a brief portion of the 1971 communication from the Securities and Exchange Commission to the Congress regarding the disclosure of holdings as a part of the Institutional Investors Study report. This study pointed out quite clearly that there is a serious need—in order to properly assess the impact of institutional trading—to require disclosure of many large institutions which are presently excluded from disclosure under existing law.

On several occasions in 1973, members of the Securities and Exchange Commission addressed their attention to the criticisms being made of institutional traders as well as to the solutions to existing difficulties. For example, then Chairman Cook on May 10, 1973, in a speech before the Investment Company Institute, pointed out that a number of observers described the current institutional investor as focusing on short-term performance, and that this characteristic may account partially for the "air pockets" that have hit a number of New York Stock Exchange-listed securities. In acknowledging that some observers have advocated restricting institutional ownership or trading of securities, he stated that the Commission has serious problems in creating artificial barriers in the marketplace. He suggested that one of the solutions to restoring the individual investor's confidence in the stock market would be for the Commission to request the Congress to enact an Institutional Disclosure Act to give the Commission rulemaking power to require reports of holdings and transactions from all types of institutional managers. Then Chairman Cook, in another address, before the Economic Club of Chicago on April 25, 1973, said the following in this connection:

"Critics also contend that these institutions suddenly—sometimes overnight—liquidate positions acquired over a long period, causing sudden price drops even in the largest stocks. In reaction, we have heard calls for restrictions on the percentage of a company's outstanding stock which can be held or on the amount which can be sold in a given time period.

"The Commission is opposed, at least at present, to any arbitrary impediments. However, as pointed out in our Institutional Investor Study of 1971, we do believe disclosure of institutional holdings and their significant transactions may be desirable, both to inform investors of institutional concentration and to aid the Commission in meeting its responsibility to assure orderly and equitable markets. Not only would all the participants in the future central market system be better informed, but corporations would have a better understanding of the nature of their shareholders. Accordingly, we will ask Congress to pass an Institutional Disclosure Act, which would give us rulemaking power to require all types of institutional investors—banks, insurance companies, pension funds, and the like—to disclose holdings and transactions in securities over which they have investment authority.

"I believe that institutions will be anxious to provide this information to demonstrate that their market behavior is fair and proper; moreover, the information could be provided without undue burden from the computer records presently maintained by most institutions."

We understand that on July 26 Senator Williams, together with Senators Brooke, Tower, McIntyre and Proxmire, introduced a bill, referred to as "The Institutional Investor Full Disclosure Act," which would require institutional investors to disclose regularly their portfolio holdings and large securities transactions. Senator Williams points out that this bill (which is the third bill to result

from the Securities Industry Study conducted by the Subcommittee on Securities of the Committee on Banking, Housing and Urban Affairs) addresses itself directly to the role of institutions in the securities markets and the implications of that role for the small investor and the capital raising mechanisms. Senator Williams, in introducing the bill, comments that the legislation would accomplish the task of providing needed information about institutional trading practices and investment policies.

Although we have not had the full opportunity to examine this bill in detail, we do endorse the concept of full disclosure or "truth in securities" as it is sometimes referred to. We therefore endorse this legislation which would implement the significant recommendation of the Institutional Investors Study that the SEC should obtain regular and comprehensive information regarding institutional transactions which may contribute in part, to unusual price movements, so that it will be continuously in a position to evaluate all recommendations regarding institutional trading.

As this Subcommittee is aware, in 1968 the Congress directed the SEC to study the purchase, sale and holding of equity securities by institutions, in order to determine, among other things, their effect on "the maintenance of fair and orderly securities markets" and "the stability of such markets." The Institutional Investor Study, conducted by the SEC pursuant to that mandate concluded:

"An effective program of government regulation of institutional investors and the securities markets must emanate from empirical analyses of institutional behavior, weighed on the scales of competing policy considerations. . . . [T]he course of future developments cannot be accurately gauged nor can reasoned regulatory policies be plotted without a continuing flow of such information. The Commission believes that gaps in information about the purchase, sale and holdings of securities by major classes of institutional investors should be eliminated, and recommends that the Securities Exchange Act of 1934 be amended to provide the Commission with general authority to require reports and disclosures of such holdings and transactions from all types of institutional investors."

We believe, therefore, that Senator Williams' bill is a step in the right direction.

We should also point out that when the SEC submitted its Institutional Investors Study report in March of 1971, it did concentrate on some of the very issues under consideration by this Subcommittee. The SEC study was designed to provide a basis for understanding the underlying economic trends evidenced by growing participation by institutions in equity investments and their impact on both securities markets and corporate issuers. The study reached the significant conclusion that institutional trading has not impaired price stability in the markets. The study did not discover *any* basis for imposing limitations on the volume of institutional trading *or* on the size of institutional transactions. With respect to the impact of institutional position changes in NYSE-listed stocks on prices, the Study (Volume 5, at 1465) concludes:

". . . the findings indicate that situations in which the trading of an institution may create or accentuate price movements are more or less matched in number and importance by situations in which the trading behavior of an institution *reduces* the magnitude of the price impacts of trading by others. The most striking result of the analysis is that the original assumption [as to institutional impact on prices] is factually inaccurate. In general, situations in which an institutional position change may have a price impact seem to be no more frequent than situations in which such a position change tends to offset the price impacts of trading imbalances by other market participants.

"This conclusion applies generally to large and small position changes, to those conducted by banks or by investment advisers (including mutual funds) and to both purchase and sales programs. With relatively minor exceptions, it applies even after allowance is made for characteristics of the position change, such as its total size or the size of the individual transactions used, and for the market conditions under which the position change was conducted. The analysis did, however, indicate that, when institutions trade on the third market, they save, on the average, the equivalent of a full stock exchange commission."

Turning specifically to the question raised with regard to the effect institutional investors are having on the ability of new or small and medium sized firms to acquire the capital they need, the Commission on 1972 held hearings (generally referred to as an investigation into the matter of the "hot issues") which dealt in part with the ability of new emerging companies to acquire capital, and is therefore relevant to this discussion. For your information, we are enclosing (as Exhibit E) a copy of our statement to the Commission on these matters.

We point out in this statement that one of the principal reasons for the dearth of investments in venture capital is that life companies are generally restricted by their liabilities to policyholders which require a certain level of liquidity, and by State laws which have a "dampening" effect on venture capital investments. This statement (see in particular pp. 6, 7 and 8 of Exhibit E) highlights the scope of the extensive State law restrictions on investments.

As indicated at the outset of this statement, we recognize that we have not answered some of the specific questions raised, particularly with regard to the tax implications, but if the Subcommittee so desires, we could attempt a supplementary statement.

We are prepared now to answer any questions you may have on the basis of the statements we have made today.

EXHIBIT A

The ALIA (successor association to the ALC–LIAA) submitted the following material on the issues of institutional membership, competitive commission rates and other matters affecting the structure of the securities market:

1. *Securities and Exchange Commission*

(*a*) Comments submitted to the Commission on August 6, 1970, January 12, 1971 and July 27, 1971 in connection with the NYSE proposals on commission rates and institutional access.

(*b*) Statements were submitted to the Commission on August 15, 1971 and December 23, 1971 in connection with its investigatory hearings on the national securities markets.

(*c*) In connection with the Commission's Rule 19b–2 proposal, material was submitted to the SEC on October 3, 1972, December 8, 1972 and July 6, 1973.

2. *Senate Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs.*

(*a*) Statement on S. 3169 (March 22, 1972).

(*b*) Statement on S. 1164 and S. 3347 (April 19, 1972).

(*c*) Statement on S. 470 and S. 488 (February 21, 1973).

3. *House Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce*

(*a*) Statement on problems of the securities industry (April 14, 1972).

(*b*) Letter of comment on H.R. 5050 (June 22, 1973).

EXHIBIT B

SUMMARY STATEMENT, COMMITTEE ON SECURITIES INVESTMENTS, AMERICAN LIFE INSURANCE ASSOCIATION

Mr. Chairman and members of the Subcommittee, I am pleased to be given the opportunity to appear before you today.

My name is Harold E. Bigler, Jr., and I am Vice President in charge of Equity Investments for Connecticut General Life Insurance Company. I am appearing today representing the American Life Insurance Association. Accompanying me is Mr. Paul Mason, Associate General Counsel of the Association. In previous submissions to this Subcommittee we have given you details concerning the makeup of that association. I won't repeat those statistics, other than to say that the life insurance companies involved are major holders of common stock, with an estimated market value in excess of $17 billion, which includes well over $6.0 billion of equities held in separate accounts funding pension plans.

On April 23 of this year, the association submitted a letter of comment on H.R. 5050 in response to an invitation of the Subcommittee to comment on the bill prior to legislative hearings. My brief summary of those comments today will be confined to Title II of the bill. Also, I will attempt to answer some of the Securities Industries Association's assertions concerning institutional investors in its statement of June 15.

The ALIA is in complete accord with the provisions of the bill on the question of competitive commission rates. We agree that the bill should contain a fixed date by which all national stock exchanges must implement the $100,000 breakpoint for competitive rates, and we believe that the February 1, 1974 deadline is a reasonable target date. Furthermore, we agree that the implementation of the $100,000 breakpoint should occur either simultaneously with or prior to the imposition of the so-called "100–0 test" with respect to institutional membership.

Finally, we concur with the provision that would require the exchanges to implement a fully competitive rate structure by February 1, 1975 with the possibility of a one-year extension by the SEC. We support such a rate structure, both for reasons expressed in the Subcommittee's Report and because we believe there are significant savings that could be derived on behalf of beneficiaries of accounts managed by financial institutions with average orders substantially below the $100,000 breakpoint. Furthermore, we believe that the implementation of competitive rates for all institutional size orders, by eliminating the excessive charges that may exist under a fixed commission rate structure, will reduce the opportunity for reciprocal arrangements between member firms which we discuss below.

We are of the view that the fixed dates contained in the bill for phasing out fixed commission rates are essential because of the SEC's recent decision to delay in reducing the level of competitive rates below the present $300,000 breakpoint, and in view of the recent proposals by the NYSE to increase commission rates.

We support in principle the amendments to Section II of the 1934 Act that would impose the so-called "100–0 test" with respect to institutional membership, i.e., institutional membership would be permitted but all member firms would be prohibited from handling the brokerage business of "affiliated persons," including pension funds.

We would like to take this opportunity to explain the basis for our support in principle for Section 205 of Title II of the bill, but also to urge that this Section be amended to expressly prohibit any reciprocal practices among member firms which would circumvent the objectives of the bill.

It is our understanding that the restrictions of Section 205 have two basic objectives: (1) to eliminate the "competitive inequities that now exist in the competition for pension fund management business between member firm money managers and money managers that do not have broker-dealer affiliates;" and (2) to resolve the conflict of interest problems resulting from a member firm functioning as both broker and adviser to the same account. Our comments on H.R. 5050 with respect to institutional membership are addressed exclusively to the issue of competition.

We note at the outset that the problem of reciprocity with respect to the issue of institutional membership has been recognized by the Subcommittee in its Report. Although we acknowledge that any statutory restrictions on reciprocal practices will be difficult to enforce, we believe that it is essential that the bill contain a prohibition against those practices which will defeat the objectives of the bill.

Our member companies are most concerned about the potential loophole in H.R. 5050 that would permit member firms to circumvent the restrictions of the bill through reciprocal or "sweetheart" arrangements between member firms managing institutional accounts. As we have asserted in the past, the competitive advantage of offering both advisory and brokerage services to a potential pension fund customer results from the member firm's ability to reduce or eliminate advisory fees, either directly or indirectly, through brokerage commissions earned on the portfolio of managed pension funds. H.R. 5050 is directed in part at eliminating this unfair competitive advantage.

However, the reciprocal arrangement would permit the member firm to do indirectly what the bill prohibits it to do directly. "Reciprocity" has been described as "doing business with people who do business with you." Various forms of reciprocity are accepted custom in the securities industry, although the stock exchanges have prohibited customer directed give-ups and the NASD has proposed regulations to abolish reciprocal practices in connection with the distribution of mutual fund shares. In addition, the SEC has expressed concern with the various reciprocal practices emanating from the fixed minimum commission.

In the case of a member firm that manages an institutional account with discretion to allocate the account's brokerage business, the firm would be in a position to offer its institutional brokerage business in exchange for the institutional business of another member firm. Under Section 205 the institutional client would not be an "affiliated person" of the member firm receiving the reciprocal brokerage business. As a result—even with the prohibition of H.R. 5050—each firm would be in a position to subsidize its advisory fees to the extent of the profit on its institutional brokerage business based on reciprocal arrangements. Such arrangements could exist with or without the knowledge or consent of the institutional account.

We recognize that there are an infinite variety of reciprocal arrangements that may develop in order to circumvent the restrictions of the bill. However, we believe that the ability of a member firm to obtain reciprocal business will be predicated

primarily on its ability to allocate the brokerage of a managed institutional account. While a general prohibition against reciprocal practices may be difficult to enforce, we are of the view that the trading activities of member firms on behalf of institutional accounts should be kept under close surveillance by the SEC, perhaps aided by reporting requirements.

Therefore, we propose that Section 205 of H.R. 5050 be amended to contain the following language:

> SEC. 11A. "(e) It shall be unlawful for a member of a national securities exchange to utilize any scheme, device, arrangement, agreement or understanding designed to circumvent or avoid, by reciprocal means or in any other manner, the policy and purposes or subsection (a) of this Section."

> I might add that similar language appears in the recently passed Senate Bill 470.

We are satisfied with the definition of "affiliated person" contained in subsection (a)(1) of Section 11A of the proposed amendments to the 1934 Act. We believe that the definition is a considerable improvement over the concept of "investment discretion" as adopted by the SEC in Rule 19b-2. As we have indicated, our pirnciapl concern is that pension funds managed by member firms, regardless of who has investment discretion, should be treated as "affiliated persons" under the "100-0 test." Frequently, member firms manage pension funds on a non-discretionary basis, in which the member firm as investment adviser "has no investment authority . . . and must always obtain approval from (the) client prior to execution of trades." It is our understanding that paragraph (C)(ii) would treat such non-discretionary accounts of members firms as "affiliated persons" because the member firm would "regularly furnish advice with respect to the desirability of investing in, purchasing or selling securities or other property."

Finally, we agree that the requirements of Section 205 should be implemented by a fixed date, with a one-year grace period for persons who were exchange members prior to February 1, 1973 and who do not satisfy the "100-0 test." Again, we concur with the provisions of the bill that would require, in effect, the implementation of the $100,000 breakpoint by all national stock exchanges either simultaneously with or prior to the implementation of the new restrictions on institutional membership. That concludes my remarks concerning the legislation being considered.

The ALLA has requested the members of our industry committee concerned with the issues of institutional membership and competitive commission rates to indicate how their companies approach the negotiation of commission rates on orders or portion of orders above $300,000, and to indicate the most important considerations in the selection of broker-dealers for executing orders on behalf of the managed accounts. Eight life companies responded to our inquiry. Several of the most representative responses are quoted below. In summary, while the procedure for negotiating varies somewhat from company to company (e.g., rates are usually negotiated after the trade, but not always in the case of block trades), virtually all of the responding companies had essentially the same approach to negotiation.

All eight companies indicated that they do not "dictate" the rate of the commission to the broker-dealer. A life company may initially suggest a commission rate (or volume discount) on the trade, but the proposed rate merely serves as a starting point for negotiation. In all cases, the final commission rate reflects "how much the broker (has) brought to the trade", e.g., the price of the stock, the size of the trade, the complexity of the negotiations, the accessibility of the stock, and whether the broker acts as principal or broker. Finally, in all cases, the respondents indicated that the principal consideration in the selection of a broker-dealer is "best net price," which reflects both the execution price and commissions.

Several typical responses from our member companies are indicated below:

(1) "The negotiated portion of each transaction exceeding $300,000 is treated separately. Major consideration is given to our estimate of how much the broker brought to the trade. This primarily includes whether the broker acted as principal in the trade or merely as a broker. In addition, consideration is given to the broker's ease or difficulty in finding the other side of our trade or in the event of the broker coming to us with an unsolicited bid or offering, consideration is given to our trade being necessary to complete the entire transaction. On the average stock we feel a good guide to start negotiation is 0.3% of the price. Few of our trades are actually negotiated at this level since in general some of the above mentioned factors play a part in the transaction. In no way have commissions

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been "dictated" by the Company. In the case of one of our primary brokers they "dictate" the rate to us.

In selection of a broker best net price is the paramount consideration, followed by research. Commission rate would have the least importance."

(2) "In negotiating commission rates on such orders, (our company) takes several factors into consideration, the most important being the execution price and how well did the broker-dealer perform for this account. It would take into consideration whether or not (our company) had originated the inquiry, the size of the block executed, the participation of (our company) in the entire trade, and complexity of the negotiations necessary to consummate the trade; as well as the market level and liquidity of the stock involved and the action of the over-all market in general. In addition, the negotiated rate would take into consideration a fair level of compensation for the broker-dealer's costs such as clearance, floor brokerage, interest, etc.

(Our company) has never "dictated" commission rates to any broker-dealer, but has been willing to pay reasonable but not excessive rates. Rates between brokers are compared periodically for reasonableness, depending on the factors listed above."

(3) "Our traders never dictate commissions on negotiated trades. All commissions on portions of trades over $300,000, with the exception of a block cross, are negotiated at the end of the day. Our traders evaluate how the trade was executed, based on price, volume participation, etc. and determine what they think is a fair commission to pay. If the broker believes he deserves more for his services, our traders then negotiate back and forth until both parties settle on any agreeable price. In the case of a block cross, the commission and price are usually negotiated before the trade is printed.

Our traders always seek the best net price when selecting a broker-dealer to execute an order. Before choosing a broker, they check our Autex, BAS machines, third and fourth markets and the daily block lists they receive via the telephone to determine what bids or offerings are available and where they will get the best price. If there is no active interest in the stock, they then choose a broker who provides (our company) research and has the execution ability to handle the order."

(4) "After completion of a trade, we will ask our counterpart what he would like the negotiated rate to be. The answer varies from broker to broker. For example, most research houses will indicate one half of the full rate; other research houses appear to have a fixed schedule; most trading houses request two thirds of the full rate. Our policy has not been to indicate a certain amount, but rather to cooperate with whatever rate they suggest. On trades where we felt that the broker did an outstanding job in executing, we have "dictated" a *higher* negotiated rate than they had requested.

All things being equal, we do try to obtain the best net price. We will not necessarily execute our orders through a particular broker strictly on the basis that he has the lowest negotiated commission. We do have a list of brokers which we would like to reward for research and services and we try as best as possible to give them orders which they can adequately execute."

2. TURNOVER RATES

We also requested the members of our industry committee to provide us with approximate turnover figures for each separate account of their company funding qualified pension plans (or a representative number of separate accounts) for 1970, 1971 and 1972 based on the SEC formula for measuring turnover rates. The results of our survey will be supplied to the Subcommittee for each of six companies. In summary, the results show some variation among the various life companies in both the level of portfolio turnover and the trend in turnover over the three year period. However, all six companies, whether or not they experienced an increase in portfolio turnover, indicated that neither the level of commission rates nor membership of an affiliated broker-dealer on an exchange (where applicable) had any bearing on the extent of trading activity on behalf of their managed accounts.

Mr. Chairman, if I may, I'd like to take just two more minutes to make a few comments concerning the role of the institutions in our securities market, speaking as an institutional investor.

I have been involved in appearances before various governmental bodies and the courts for three years in matters concerning our securities markets and I have attempted to keep abreast of the various issues and points of view expressed

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by the participants in the debates which have been carried on. On a selective basis I have kept copies of the various submissions made over this period of time to the various official bodies concerned. My sympathy goes out to the members of your staff, for I am sure their records far exceed my two filing cabinets' worth of material. There is a repetitiveness to much of what has been said, is being said, and I am sure will be said. I believe the time for talk is over. It would appear to me that Congress must act and act with dispatch, since the record must be complete by now.

In recent weeks there appears to have been a concerted effort made to paint the institutions black. I believe that the current two-tier stock market in a way is an effort to correct mistakes and excesses which may have occurred. Not all companies are well managed nor are some companies properly financed. American business, up until two years ago or so, had it all too easy. We have forgotten, as a nation, how to sell and, truly, how to compete, particularly in the foreign arenas. Many institutions have been buying pieces of paper (stock certificates) rather than investing in companies. Many institutions have learned the hard way that the majority of turn-around situations don't turn. Many institutions have learned that most "concept" stocks are merely shooting stars and the concepts soon fade away. No longer can some institutions manage their affairs the way an investment club or hedge fund might.

The vast majority of institutions recognize the obligations they have to the millions of small individuals who are relying on those institutions for prudent management of *their* assets. We do represent the small investor. No longer can we as institutions expect (nor should we have to begin with) to accumulate a security over a period of time and then expect to liquidate it in minutes.

When I was in graduate school 15 years ago and when I entered this business our time horizon for investing was five years. The aggressive mutual funds in the early '60's pushed that down to three years, then one year, then one-quarter by the time the decade ended.

It was in 1961, I believe, when I wrote a recommendation to the now long retired Vice President in charge of our investment operations, recommending the sale of Minneapolis Honeywell. He said to me at that time, "No one ever sells Minneapolis Honeywell." We were both right. I on the short term, and he on the long term. I still talk with him and every time he asks, "How's our Eastman Kodak?", which we carry on the books at $2 per share.

We could go on as to why the individual is not in the market and cover many of the other excesses which have gone on in recent years. We can no longer continue to examine and reexamine what has gone on if our financial system is to survive. Decisions have got to be made now. I am as concerned about the health of the financial community as the "Street" is, and, as I am sure you are. Perhaps I am naive, but it just seems to me that reasonable men dealing with reasonable men can, and have to, resolve our differences in philosophy immediately.

Exhibit C

Institutions: The New "Bad Guys"

(Address by Donald E. Weeden, Chairman of the Board, Weeden & Co., June 13, 1973)

No one believes any longer the nonsense of the 1960's when the New York Stock Exchange thought that the Third Market could be driven from the Street by a combination of market forces and boycotts. In those days the conventional wisdom at 11 Wall Street was that the Weeden Brothers and other Third Marketeers desperately needed the umbrella of high fixed rates in order to exist. While the last thing the New York Stock Exchange wanted was to move away from the fixed commission structure, it was always their thought that in the atmosphere of negotiated rates, the Third Market would disappear—that firms like Weeden would get out of the market making business or would run up a white flag and join the New York Stock Exchange.

By 1971 the Exchange had to react to our growing competition. Reluctantly, the Exchange moved to competitive rates for large trades—moved or was pushed by the SEC. The prophecy of our demise could not have been more wrong. The Third Market has survived. The result is that the Exchange knows that we cannot be driven from the Street by competition or boycott. Starting with the Martin

Report in the summer of 1971, the new strategy at the Exchange is to cooper up some high-sounding public interest argument for eliminating the Third Market either by administrative fiat or act of Congress.

A few months ago, the Stock Exchange actually went down to Washington to convince the Williams Committee that a deal could be struck: the Stock Exchange would come out for fully competitive rates right away, all the way, and 100%-0% split on affiliated business for institutional members. The *quid pro quo* was a mere trifle—the elimination of the Third Market. The Securities Industry Association, which claims to represent this industry, joined in the plan. All this was to be passed off under the banner of preserving the auction market and protecting the little guy.

A parallel public campaign was set in motion—membership meetings, speeches, press conferences—you name it. The press was told that the NYSE was finally going for fully negotiated rates. This was only four months ago. They showed off their new logo and talked of Fishbowls. Fishbowl was the code name for eliminating the Third Market. The plan was to organize listed companies which would insist that the stocks they issue be traded only on exchange markets—in order "to save free enterprise". Those "spontaneous grass roots groups", plus the New York and American Stock Exchanges would then petition Congress to put us out of business.

Imagine, in 1973 trying to convince the Congress, the SEC, the Justice Department and you and me that we should reverse the whole trend of rapid efficient stock trading and start going backwards—that henceforth, General Motors, IBM Telephone and Steel would only be traded—could only be traded—on the New York Stock Exchange. How the Exchange staff snuck that one past the public directors of the Exchange, I shall never understand. The idea was ill-conceived and ill-advised at the time and remains so today.

Needless to say, the Washington part of the plan failed. The Exchange is simply kidding itself. The Third Market is here to stay. It has the support of both Congressional committees, the SEC and the Antitrust Division. Most importantly, it has the support of institutional traders. As a result, the New York Stock Exchange has momentarily dropped its direct attacks on us in favor of an even more ridiculous campaign to discredit institutional behavior in the market place.

The sheer gall amazes me. If ever there was a case of the ungrateful biting the hands that feed them! And yet, one leader of the Exchange community after the other has talked in recent days about how institutions are destroying the market, are threatening the viability of the auction process. Have you read the Special Report in the June 2nd edition of Business Week? "Are the Institutions Wrecking Wall Street?" What a fascinating summary of opinions by leaders on the Street! Institutional traders, they say, act like so many sheep. Institutional traders, they say, are irresponsible in their trading practices. When they go to sell, their massive orders do damage to the auction process and to public investors. Nothing, mind you, nothing about the good that is done when institutions buy massively—only what happens when they sell. They criticize institutions for being long on cash in a down market, as if that were somehow unAmerican. They attack institutions for concentrating their purchases on 20 to 30 prime stocks. Institutions, they say, should be regulated not only on where they trade by denying them Exchange membership, but even on how and how much they trade.

The proposals get even more fanciful day by day. One of the latest and silliest proposals is that institutions should only be permitted to buy on the down tick and sell on the up tick. What absolute nonsense can be proposed with a straight face in this industry of ours!

Of course, one approach is simply to laugh it all off and chalk it up to the Watergate market. The trouble is that far too often these days, government is willing to play the role of Uncle Sam the Monopoly Man—for those with political clout. Now is no time to ignore those seeking special privileges—however illogical or unsupported by facts their requests may be. If the institutions, the regional stock exchanges and the Third Market simply roll over and play dead, leaving to the New York Stock Exchange the job of restructuring the securities industry, we may well end up with a jerry-built industry that has all the efficiency and profitability of the nation's railroads. Remember that line from the SEC's 1963 Special Study Report: "Securities markets are not inherently more immune from featherbedding than any other business."

The frequency with which the New York Stock Exchange has been misusing the words depth and liquidity, for example, leads me to suspect that preserving depth and liquidity is the new code word for "Preserve Our Monopoly and Bring Back Fixed Commissions".

One ought not be surprised. The damndest things have been justified in the past in the name of depth and liquidity—Rule 394, the boycott of the Third Market; the concerted effort to keep listed securities off NASDAQ; opposition to institutional membership; and even an attempt to legislate a nationwide monopoly in perpetuity. Just last week the Exchange's proposal for restoring fixed commissions across the board was justified on the grounds of restoring depth and liquidity.

Before you and I blithely accept the notion that our marketplaces have lost depth and liquidity, and that irresponsible institutional trading is the root cause of this evel, let us first examine some of the facts.

Two stand out for me.

First, the volume of stock trading is up dramatically over the past decade. For example, on the New York Stock Exchange average daily volume in 1972 was 16.5 million shares. That compares with average daily volume on that exchange of 10 million five years ago and 3.8 million ten years ago. From less than 4 million to over 16 million is more than fourfold increase over the past 10 years. That is a pretty good rate of growth for an institution!

What would that volume have been without institutions? Does the Exchange really want to go back to three million share days? Or are the complaints about institutions really part of a cunning campaign to restore fixed commissions? For example, are not the suggestions that institutions be required to split up their orders merely not so subtle attempts to get those orders divided into small transactions covered completely by fixed rates?

The second big fact for me has been the steady move toward more disclosure. Notwithstanding the bizarre exceptions like Equity Funding, the hard facts are that those who pay attention know far more about the stocks they trade and know it faster than ever before. The consequence of all that disclosure is that occasionally institutions act like a herd of sheep heading as rapidly as they can for the nearest exit. Those simultaneous reactions to bad news, we are told by the Exchange, rob the market of its depth and liquidity and that that is very bad—so bad something drastic must be done about it. My reply, if I were speaking for institutions, is that I would rather be a smart sheep on the run than a dumb goat awaiting the slaughter. The combined effects of increased volume and more disclosure have inevitably led to more volatile markets—meaning markets that take sudden unexpected swings.

The error in the Stock Exchange's analysis is in assuming that volatile markets are an unqualified evil. Think about it for a moment. When bad news comes out, stocks affected by the bad news should and do drop in price. If nearly everyone gets the same information about the same time and decides to sell, the drop has got to be sudden and sharp—certainly more sudden and more sharp than if the information comes out only in dribs and drabs, so that a handful of insiders can quietly fleece the rest of us. Depth and liquidity should not mean using the innocent—the public or us market makers—as fall guys for big sellers. In all the words being spoken these days about preserving depth and liquidity, where is there recognition by the Exchange leadership that there is no social benefit, no public interest, in having a stock drop, a quarter of a point on each trade; rather than in one fell swoop?

Actually, when you think about it, there may well be a pretty strong argument that the public interest is better protected in having that drop take place in one trade so that innocent people are not hurt by participating on the way down. One thing I know for sure—many of those big declines on bad news would not have been so large if the selling had been exposed to competing market makers in a Central Market.

The impact of a 100,000 share order has got to be much greater than that of 1,000 shares. Large discounts are an appropriate response to large orders. The error is in assuming that those large orders are ruining the market for individuals. In fact, the liquidity for the 100 and 200 share orders is far greater today than it was ten years ago.

We hear the Amex join the attack on institutions—the Amex which boasts that their market has little institutional trading. I suggest, most respectfully, that a

little institutionalization of the Amex markets would be a good thing. During the past twelve months Amex share prices have declined 40% more than prices on the NYSE. Who is the villain for the Amex—certainly not the institutions.

We also hear complaints that institutions are concentrating the bulk of their buying and selling in some 20 or 30 listed issues—and that this too is wrong. Why? Price volatility in these issues has been less this year than it has been for the rest of the market. If you take these anti-institution arguments to their logical conclusion, you end up with the absurd notion that institutions have a moral responsibility to abdicate their investment judgment in order to preserve the auction market by buying shares in every listed stock—one round-lot each day!

What does this all boil down to? I am convinced that a high volume, free market—even with sudden swings—is better than a small, controlled or fragmented market where restrictions are placed on how and where institutions or brokers or anyone else may trade in order to achieve some artificial stability. You do not get depth or liquidity by freezing institutional holdings or creating two-tier markets.

By contrast to all these control gimmicks, institutions acting out of their own self-interest and market makers acting out of their own self-interest can and have already begun making adjustments in trading to minimize or protect against sudden market swings. At Weeden, we are already seeing institutions grow more candid in their dealings with us and more cautious when getting rid of big blocks. We, in turn, have adapted and gotten more astute on balancing our positions. Others are trying other approaches on the regionals, NASDAQ, Instinet—and even on the Exchange. There are plenty of good specialists who know which way the wind is blowing. Quite bluntly, I have more faith in the collective ingenuity of the industry working out a solution to institutional selling than in some New York Stock Exchange inspired solution based on administrative or legislative controls.

For me, the Central Market is the solution—the best technique for rapidly aggregating supply and demand and heightening competition among competing market makers so ever larger volumes can be handled more quickly and more efficiently. Most emphatically, the Central Market does not, ought not mean the lessening of competition through the extension of controls or restraining the freedom of institutions or others to trade how and when they want.

The best way to increase market makers' participation is to eliminate the barriers between marketplaces. The broker you hire, for whatever reason, must be free to go where he should go to get the best execution—to the Exchange, the regionals, the Third Market, or a combination of market centers. And if you do not want or need a broker, you should be free to deal direct in any or all of these markets—or go direct to another institution. Inevitably, I see the Central Market bringing about a redefinition of brokers and dealers, their functions and the source and amount of their compensation. My own prophecy is that in the years ahead institutions will come to recognize that they have more need of dealers than of brokers.

So long as the order gets maximum exposure and the transaction maximum disclosure, I am confident competition will do a better job than regulation in preserving the depth and liquidity of our markets. That is why it is so important that we get on with creating a Consolidated Tape and a Combined Quotation Service. Would that the New York Stock Exchange would stop dragging its feet.

Just as surely as institutions provided the competitive pressure which broke the back of fixed commissions, so too we need the institutions' help to bring about the Central Market System. The handwriting is on the Floor. The Central Market System will bring about the long overdue broadening of the Exchange's single specialist system. Only through competing market makers can we meet the new needs of today's high volume market. The Third Market and the institutions provide the competition and innovation so needed in this over-structured industry of ours. The contribution of the Third Market is in our willingness to stand independent of the Establishment, to refuse to fix rates with the Club or to join in boycotts of others. The contribution of the institutions is in their demand, backed up by volume, for a more efficient market, a more professional market.

There is no need for institutions to be apologetic. They did not cause inflation, the trade deficit, the payments deficit, or the gold crisis—let alone Watergate. So far, 1973 has been a lousy year—for lots of reasons—none of which has anything to do with institutional trading practices. Institutions should politely but firmly decline the role of the scapegoat. The competitive pressures they exert represent the best hope of accomplishing the reform needed in this industry.

EXHIBIT D

EXCERPT FROM A COMMUNICATION

FROM

THE SECURITIES AND EXCHANGE COMMISSION

CONSISTING OF

LETTER OF TRANSMITTAL OF MARCH 10, 1971, FROM THE SECURITIES AND EXCHANGE COMMISSION, LETTER OF THE STUDY ADVISORY COMMITTEE TO THE COMMISSION, AND A SUMMARY OF EACH CHAPTER OF THE INSTITUTIONAL INVESTOR STUDY REPORT, BEING A STUDY AND INVESTIGATION OF THE PURCHASE, SALE AND HOLDING OF SECURITIES BY INSTITUTIONAL INVESTORS OF ALL TYPES, PURSUANT TO SECTION 19(e) OF THE SECURITIES EXCHANGE ACT OF 1934 (PUBLIC LAW 90-438, 91-410)

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Disclosure of Holdings

The potential or actual impact of institutions on portfolio companies cannot be assessed by institutional beneficiaries, corporate investors or government policymakers without full and fair disclosure of institutional equity holdings and management policies. The federal securities laws have consistently recognized the special status of corporate "insiders" and "affiliates"—persons having special access to the centers of corporate authority or the power, actual or presumed, to influence the exercise of that authority. Thus, the securities laws and Commission rules require disclosure of large share holdings and relationships between affected companies and large shareholders.

In practice, however, many large institutional share holdings are excluded from disclosure under existing law; Sections 13(d) and 16(a) of the Securities Exchange Act of 1934 require the disclosure only of large holdings of shares which are *beneficially owned*. As the Study found, institutions frequently hold and manage large amounts of a company's shares, but do not themselves have beneficial ownership of such shares. The limitation of disclosure to beneficial ownership means that the holdings of a complex of institutions or accounts under common management by a single financial manager are not aggregated in determining whether there must be any disclosure, except to the extent that the complex constitutes a group of persons within the meaning of Section 13(d) or 14(d). The Study found that it is common, for example, for a group of investment companies or other types of accounts under common management to invest, on occasion virtually simultaneously, in the same securities. Under existing laws, even if the aggregate holdings of these accounts exceed 10 percent, no disclosure would be required under Section 16(a); disclosure under Sections 13(d) or 14(d), which under recent amendments is at the 5 percent level, would be conditioned upon a finding that members of the complex alone or with other institutions or complexes constitute a "group" for the purposes of those sections.

Because not all situations can be reached through interpretation of the "group" concept in Section 13(d), the Commission believes that it would be appropriate to amend the Securities Exchange Act of 1934 to the extent necessary to require disclosure of holdings of equity securities in excess of 5 percent of the outstanding issue, whether under investment management or beneficially owned. Thus, the test of reportable holdings and transactions would include *either beneficial ownership of or investment management* over the securities in question. A bank trust department, for example, would report the number of shares which it managed (not including those for which it provided solely custodial services), aggregating shares held in various investment or trust accounts. An investment adviser would report the shares held by various investment companies and counselling accounts managed by the same adviser. Disclosure should further be broadened to require an indication of the voting authority of the shares under management, whether sole, partial or none.

In connection with this proposal to expand shareholder reporting provisions of the Securities Exchange Act, it should be recognized that certain other modifications of existing requirements under Sections 13(d) or 16(a) would appear to be in order. Section 13(d) was enacted in the context of transfers of corporate control

and it consequently provides for disclosures concerning such matters as the investor's plans for the portfolio company and its sources of financing which may not be appropriate in the context of an institutional holding where no takeover is contemplated. Similarly, a purpose of Section 16(a) was to provide information concerning possible liabilities under Section 16(b) and consequently, fairly prompt reports of any change, no matter how small, in a holding are required. This might well not be needed in the present context. The choice of Section 13(d) or Section 16(a) or a new section as a vehicle for the type of disclosure here proposed would depend upon whether it was concluded that disclosure of information in addition to the mere existence of the holding and the identity of the institution is needed. General rule-making authority such as requested in connection with Part One above would be the preferable and most flexible and comprehensive approach.

The Commission does not at this time recommend that Section 16(b), dealing with the recovery of short-swing profits, should be modified in any way.

1. *The role of the life insurance industry in providing venture capital financing for new emerging companies?*

The life insurance industry has provided both debt and equity capital for new emerging companies. There are no precise figures on the total dollar amount of such investments. It has been roughly estimated that between $50 and $100 million is invested annually by the entire life insurance industry in venture capital.[1] Moreover, it has been estimated that no more than ten life companies account for the bulk of such investments.

It is important to note that while these figures may not be insubstantial relative to the total annual purchases by all investors of venture capital securities, the amounts are very small relative to the aggregate annual acquisition of corporate securities[2] by U.S. life insurance companies. Corporate securities acquired by life companies during the 1967–1970 period totaled $31.9 billion, $36.5 billion, and $36.0 billion, $45.5 billion, respectively. Even assuming the higher estimated annual figure of $100 million for venture capital investments by life companies, the figure represents roughly only ¼ of 1 percent of total acquisitions of corporate securities by life companies in 1970.

Exhibit E

STATEMENT OF ALC-LIAA TO THE SECURITIES AND EXCHANGE COMMISSION IN CONNECTION WITH THE INVESTIGATORY HEARINGS ON THE HOT ISSUES SECURITIES MARKETS (SEC FILE NO. 4–48)

This Statement is submitted by the American Life Convention and the Life Insurance Association of America, with an agfregate membership of 359 United States and Canadian life insurance companies which account for approximately 90 percent of the legal reserve life insurance in force in the United States and which hold over 99 percent of the reserves of insured pension plans in the United States. Included in this combined membership are substantially all of the companies engaged in the variable annuity business in this country today.

Our Statement is in response to the questions outlined by Mr. Richard H. Rowe, Assistant Director of the Division of Corporation Finance, in his letters to the associations. The associations' response to the staff's inquiry, attached hereto, is based on our understanding that, in the context of the Commission's investigation, an issuer of venture capital securities is generally defined as a new emerging company which does not have a public market for its securities.

Appearing on behalf of the associations are Harold E. Bigler, Jr., Vice President of the Connecticut General Life Insurance Company; William R. Cowie, Vice President of The Equitable Life Assurance Society of the United States; and E. Bulkeley Griswold, Vice President of the Phoenix Mutual Life Insurance Company.

The principal reason for the dearth of investments in venture capital is that life companies are generally restricted by their liabilities to policyholders which require a certain level of liquidity, and by state laws which have a "dampening"

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[1] The findings of the SEC Institutional Study indicate that a number of life insurance companies, representing approximately 75 percent of the assets managed by all life companies, purchased (either in the secondary or primary markets) approximately $155 million and $144 million in 1967 and 1968, respectively, of "restricted" debt and equity securities of non-publicly held companies. We believe that these figures overstate the investment of life companies in venture capital, as defined herein, either because the issuers are not all new emerging companies or the figures, to some extent, reflect life company holdings in affiliated companies. See SEC Institutional Study Report, Vol. 5, Tables XVI–30 and –31, at 2420, 2421.

[2] Corporate securities are defined as bonds, debentures and notes, and preferred and common stock.

effect on venture capital investments, as discussed below. A few life companies have invested in venture capital on a limited experimental basis. In the final analysis, investment decisions with respect to venture capital depend principally on the policy of the individual life company and state law restrictions.

2. *The amount of venture capital being provided by the life insurance industry?*

The answer to this question is contained in our response to question 1.

3. *Federal and state limitations on the amount and type of venture capital financing life insurance companies can engage in?*

Apart from the Federal securities laws that are applicable to registered investment companies managed by life insurance companies, there are no federal restrictions on venture capital financing by life companies.

There are, however, extensive state law restrictions which may vary considerably from state to state. In an effort to outline generally the possible scope of state statutory restrictions on investments, we have summarized below certain investment provisions of the New York Insurance Law.

Generally, there are two levels of investment restrictions imposed on life companies: those applicable to general accounts and those applicable to separate accounts, with some overlap in the restrictions. With respect to the general account, the following is a summary of the relevant provisions of the New York Insurance Law:

(*a*) Securities or other investments must be interest bearing or income paying [§ 80(a)(3)].

(*b*) With respect to corporate bonds, debentures, notes and other evidences of indebtedness, the issuer must meet certain net earnings or other tests for a five to seven year period or such obligations must be adequately secured [§ 81(2)].

(*c*) The issuer of preferred or guaranteed stocks must meet similar earnings tests with respect to coverage of fixed charges [§ 81(3)].

(*d*) The issuer of common stocks must satisfy a number of "qualitative" requirements, including an earnings test for a seven-year period preceding the date of acquisition of the stock with respect to the coverage of dividend payments at an assumed level of four percent per annum on the par value; also, the stocks, with certain limited exceptions, must be registered on a national securities exchange. In addition, all obligations and preferred stock, if any, of the issuer must be eligible for investments, as described in paragraphs (a), (b) and (c) above.

The "quantitative" restrictions limit common stock acquisitions of life companies in any one company to five percent of the total issued and outstanding common stock of the issuer, and to one percent of the admitted assets of the life company. Certain adjustments may be made for separate account investments. Among other things, aggregate investments in common stocks cannot exceed the lesser of the surplus to policyholders or ten percent of the total admitted assets of the life company [§ 81(13)].

(*e*) Generally, no more than ten percent of total admitted assets of a life company may be invested in, or loaned upon, the securities of any one company. Holdings of the separate accounts are included in applying the ten percent test [§ 87].

(*f*) *Leeway Provision*—The investments of a life company which do not satisfy the above restrictions are permitted so long as the aggregate cost of such investments (excluding investments of the separate accounts) does not exceed 3½ percent of admitted assets. However, aggregate investments in or loans upon all the common stock held by the life company cannot exceed five percent of the total issued and outstanding stock of the issuer [§ 81(17)].

The separate accounts of a life company are subject to almost as stringent requirements as the general accounts. The "qualitative" restrictions, indicated above, apply to separate accounts. However, the "quantitative" restrictions, also indicated above, do not apply to the separate accounts, except that a life company cannot hold in the aggregate, for all accounts, more than five percent of the outstanding common stock of an issuer. The "leeway" provision is raised to ten percent of admitted assets of a particular separate account. Moreover, a 15 percent limitation applies "to any separate account maintained solely for agreements which implement pension plans of corporate employers if at least two hundred employees are covered under each employer's plan at the date of execution of its agreement and if contributions into such separate account may be made only by such employers by the terms of such agreements. . . ." [§ 227(1)(b)].

Finally, there are the so-called "insurance holding company" provisions [§ 46], which, among other things, restrict the investment of life companies in their subsidiaries and limit the aggregate amount of common stock holdings of the subsidiaries in any one issuer.

4. *What kinds of information do life insurance companies require prior to making an investment in a company?*

The nature of information required by life companies depends to some extent on whether the investment is in debt or equity of the company and whether a reputable investment banker is involved or a partnership arrangement is used in which the life company is a passive partner. In most cases, life companies require extensive information on all of the matters specified in question 4, as follows:

(*a*) *Company's products and services.* Detailed description of the company's products and services and demonstrations of same; cost breakdowns; copies of independent evaluations, if any; and description of additional products or service contemplated, if any.

(*b*) *Competitive factors.* Detailed descriptions of competitive products; relative strengths and weaknesses of the company's products as compared to that of the competition; financial strength and history of sales and earnings of competition; and proposed steps to meet the threat of competition.

(*c*) *Market or potential market.* A description of how the market has been defined; history of the market, if applicable, as well as the trends of this market; expectations of market growth and how determined; and description of potential customers and how determined.

(*d*) *Backlog.* Amount, identity of customers and expected delivery dates.

(*e*) *Background of officers or directors.* Resumes, including description of activities and references; description of positions presently not filled and indication of when such positions would be filled as well as qualifications required; and dollars invested to date and time committed to business.

(*f*) *Projections, cash flows and budgets.* Generally all statements mentioned on a quarterly basis for the first two years of operations and on an annual basis for the succeeding three years. Such statements would include a description of the underlying assumptions together with supporting documentation.

(*g*) *Use of proceeds.* Detailed with supporting documentation.

There are two critical items of information required before an investment decision on venture capital can be made: (1) the quality of management, principally its past experience in the related business area and its number in depth; and (2) financing requirements and cash flow projections for three to five years, as prepared by management in evaluating the company's capital needs through its early years. The projections are particularly relevant for analyzing management's business judgment.

5. *With regard to question 3 above, does the issuer usually have such information prior to its contact with the life insurance industry?*

Companies seeking venture-type financing generally are not aware of the legal restrictions imposed by the state on life insurance company investments, nor do they have available the necessary investment information about their companies prior to their contact with a life company. Companies which are informed about the suitability of investments for life companies have usually hired an investment banker to guide the financing.

6. *Does the life insurance company do an independent investigation with respect to any of the information provided by the company seeking financing?*

Generally, life companies do a great deal of independent investigation before providing financing. In most cases, it is done "in-house" and in some cases independent consultants are asked to offer an opinion on the information needed for an investment decision. The latter is often required when there is a technical product produced by the company in question. Of course, the extent of investigation would depend upon the material submitted under the financing proposal and on the quality of the sponsorship. If a leading investment banker is involved, with a reputation for doing a thorough investigation of companies it sponsors, then the amount of independent investigation by the life company would be reduced.

7. *What role does the life insurance company play in organizing, developing or managing a company in which it invests.*

Generally, life companies prefer to assume an inactive role in the management of companies in which they invest, by evaluating their investments on a continuing basis through financial data received and periodic visits with management. The life company may require that certain restrictions be provided in the loan or note purchase agreements or "side" agreements if common stock is involved. In certain unusual cases, directorships are evident.

The lack of formal control of a company results from the intent not to have control, as well as the fact that most life companies have a high ratio of assets per

investment employee, perhaps the highest of any financial institution. Investment staffs devoted to the management of venture capital investments are generall limited to two or three managers. From a manpower standpoint, life companies cannot devote a great deal of time to a single investment, generally ranging from $250,000 to $1,000,000. Of course, if a new company has problems, a great deal of time may be consumed in the investment, disproportionate to the amount invested or to the potential investment return relative to the total assets under management.

8. *What are the differences between the information a life insurance company demands and the information made available to the investing public through a prospectus?*

The information required by a life company in evaluating an investment in a venture capital situation is substantially more detailed than that provided in a prospectus. Virtually every area of information outlined in question 4 above would have to be furnished by the company in detail. Personal contacts with the management of the company are very important. Once the investment decision has been made, the life company requires current information, frequently on a month-to-month basis. Again, the kind of information required by a life company will depend, to some extent, on the nature of the investment. For example, the life company investing solely as a long-term lender may be more concerned about earning power and factors that affect the company's ability to retire the debt, than as an investor in equity-type securities.

9. *Does the investment decision process involve elements of intuition or judgment which are not susceptible to the objectivity inherent in SEC registration forms?*

The intuition and judgment of insurance company investment managers may be the single most important element in investment decision making with respect to venture capital. Of course, careful guidelines should be set by the life company before it enters into venture capital investing, and written material on management and projections are helpful. However, there is no substitute for long, in depth conversations with the people who are attempting to execute the company's goals. The judgments resulting from these contracts may not be susceptible to the objectivity inherent in SEC registration forms.

10. *What controls are imposed upon a company by a life insurance company after investment?*

As we indicated in our answer to question 7, life companies generally prefer the inactive role with respect to the operations and policy decisions of companies in which they invest. The flow of current information is the most effective means of observing the progress of an investment, through the use of monthly, quarterly and annual cash flow, profit and loss, and balance sheet information. An annual presentation by management is another effective means of remaining informed. Purchase agreements usually impose certain restrictions on management in order to protect the investor's position. For example, an indenture agreement may provide for limitations and restrictions regarding working capital, borrowing capability, sale and merger, and dividend payments. The covenants may also require financial and other information which may provide the life company with warning signs of trouble, in time to take appropriate remedial measures.

11. *What kind of information must a company supply and how often?*

The answer to this inquiry is contained in our response to question 10.

12. *How does a life insurance company realize upon its investment?*

We assume that this question refers to investments which have equity features since straight-debt investments are normally held until retirement by the borrower. Generally, there are two or three ways in which a life company might realize on its venture capital investments, assuming the company is doing well. First, the life company could sell its holdings of venture capital securities in a public offering. Such an offering by the life company generally would not occur until several years after an initial public offering of the securities by the company. Second, the life company could realize on its investment by an exchange of stock with a larger publicly-held company which acquires the venture capital company. Third, the life company might sell the securities to another financial institution, either directly or indirectly (to or through an investment banking firm).

Senator BENTSEN. Gentlemen, we appreciate all of your patience today.

We will adjourn the subcommittee, subject to the call of the Chair.

[Whereupon, at 4:10 p.m. the subcommittee recessed subject to the call of the Chair.]

(At the direction of the chairman, the following communications were made a part of the printed record:)

BANKERS TRUST CO.,
New York, August 1, 1973.

LLOYD M. BENTSEN,
U.S. Senate,
Washington, D.C.

DEAR SENATOR: Bankers Trust Company appreciated the invitation extended to it to appear as a witness in the hearings conducted by your Subcommittee of Financial Markets of the Senate Committee on Finance on "The Role of Institutional Investors in the Stock Market" held on July 24, 25 and 26 and regretted its inability at that time to so appear.

In this connection we have received and reviewed the list of questions promulgated by your Subcommittee with its press release of July 18 which questions the Committee expected to concentrate on during said hearings.

In order that you may be fully aware that Bankers Trust is concerned with the questions raised by you in your speech on the floor of the Senate on June 27 and contained in the press release dated July 18, we are taking this opportunity to respond to those questions in hopes that our answer may be of assistance to you in your Committee's oversight hearings. We would also expect that you and your staff would call upon us should either of you require or desire further explanation on the information submitted.

Very truly yours,

Q. U. FORD.

ATTACHMENT TO LETTER OF BANKERS TRUST COMPANY DATED AUGUST 1, 1973 TO SENATOR LLOYD M. BENTSEN RE: "THE ROLE OF INSTITUTIONAL INVESTORS IN THE STOCK MARKET."

1. What effect are institutional investors having on the ability of new or small and medium size firms to acquire the capital they need to survive and compete with U.S. corporate giants and foreign producers?

As a major institutional investor we feel that our investment policy has a positive effect on the ability of new, small and medium size firms to acquire capital. By way of example, Bankers Trust Company through a diversified investment approach maintains investments in several hundred companies of all sizes as evidenced by the attached published holdings as of December 31, 1972 of the Bank's General Employee Benefit Trust Supplemental Equity Fund.

2. What factors cause large institutional investors to concentrate their purchases on relatively few corporate issues?

Bankers Trust Company does not have a policy "to concentrate its purchases on relatively few corporate issues." For example, our largest single discretionary common stock issue represents less than 4.5% of total trust assets, the second largest less than 2.5% and the third largest less than 1.5%. In addition, the Supplemental Equity Fund which we refer to above, invests in some 35 industry categories and in more than 250 different corporations which is indicative of our diversified approach.

3. Do the tax privileges offered to our financial institutions need re-examination?

We assume that you are referring to the tax exempt status of employee benefit funds. This tax exemption is solely for the benefit of the eventual recipients or pensioners. The tax deduction currently received by the corporate contributors to such employee benefit plans is an incentive for contributions which might otherwise not be made. This tax deduction, coupled with the tax exempt status of the fund, enables these funds to increase to a much greater size than would otherwise be possible. This results in larger funds available for distribution to pensioners. Upon distribution to the pensioners these funds then become subject to income taxes. To amend these tax provisions could violate the philosophy upon which such tax provisions are based and be a deterrent for the establishment and improvement of employee benefit plans. Finally, investment action unimpeded by tax considerations favorably benefits the ultimate pension recipients.

4. What impact would changes in our capital gains structure have on attracting small investors back into the market?

While the extent of any impact would be difficult to assess, a reduction in the amount of tax and the attendant holding period would surely be favorable. Any change that would reduce or postpone the current capital gains tax should

encourage the return of the small investor, as well as the liquidity he brings to the marketplace.

5. What additional disclosure policies should be developed to serve the public interest?

Bankers Trust Company feels that the disclosure policies for a major trust department, which frequently has several thousand diverse accounts with multiple investment objectives, should be different from those of a mutual fund, which has a single investment policy and is accountable to only a specific group of shareholders. A trust department accounts individually to each customer, or to the courts, for its stewardship. The arbitrary aggregating of securities or transactions of thousands of diverse accounts can be meaningless and misleading. As you may know we currently disclose our 50 largest common stock holdings and we are continuing to study the question of further disclosure provided a format can be devised which would be useful to the public.

6. Is there a need for Federal conflict of interest laws in connection with investment policies pursued by major financial institutions?

While we recognize the need for the highest standards of fiduciary conduct in investment matters, we question whether legislation could effectively accomplish these ends. We firmly believe major financial institutions are fully aware of their fiduciary responsibilities and already maintain proper standards of conduct.

7. Is the current two-tier market system stimulating the take-over of U.S. companies by foreign entities?

To the extent that a two-tier market system may exist, we do not believe that it is the result of investment policies of institutional investors. Traditionally most take-over bids or tender offers occur during depressed markets, as evidenced during the first-half of 1973. Another factor currently stimulating foreign take-over bids is the declining confidence in the dollar combined with the inability to cope with escalating U.S. inflation.

8. What is the long-range impact on the millions of workers covered by pension plans by the fact that the major portion of pension plan investment decisions are made by a handful of investment managers?

The question erroneously assumes that the major portion of pension plan investment decisions are made by a handful of investment managers. In fact, the trend is toward multiple money managers for employee benefit funds. For example, the 50 largest pension funds trusteed with Bankers Trust Company have over 240 additional banks, insurance companies and investment advisors managing separate parts of the same pension funds, of which over 80 different employee benefit money managers are represented. The long range impact on the millions of workers covered by pension plans is favorable because the plans are receiving competent investment management.

DAVID L. BABSON & CO., INC.,
Boston, Mass., August 16, 1973.

LONG-TERM INVESTING AND THE "TWO-TIER" MARKET

The "two-tier" stock market has lately become the focal point of growing criticism. It's no secret that a select group of perhaps 60–70 stocks are selling at wide premiums to the historically low price-earnings ratios at which nearly all other equities are being appraised.

Some observers have concluded that certain large investors—particularly metropolitan trust companies—are concentrating so heavily in a few favorite issues that serious liquidity risks overhang the entire market. Others argue that the lack of institutional interest in low p/e stocks is bad for the economy because it impairs the ability of the underlying companies to raise the capital needed for expansion.

As a result of such thinking, proposals are being made that would limit a) the percentage of its total managed assets an institution could invest in a single issue, and b) the percentage of the outstanding shares of any corporation to be held by one institution.

These proposals, which in effect would regulate the *investment policies* of large institutions, are being set forth along with a number of other recommendations aimed at curbing their *market power*. The latter range from requiring all institutional investors to disclose their holdings—including purchases and sales—on a quarterly basis, to the actual "break-up" of the bigger institutions.

It is ironic that practically no criticism was leveled, *at the time*, against the massive speculation, flim-flam practices and outright fraud carried out under the banner of "performance investing" in the late 1960's. But now that it's become fashionable to lambast the equally misunderstood "two-tier" market, the "bad guy" label is being used against all institutions—including those who have done a responsible job of long-term investing with excellent results.

1. Long-Term Investing and Premium P/E Ratios: Traders and speculators believe the road to stock market success must be paved with a series of profitable buy-sell transactions. The record of the past half century, however, shows that most successful investors have been the *non-sellers*, i.e. those who bought the shares of well-managed, growing companies and kept them through thick and thin as long as they continued to make progress.

Investment return has consisted not just of the difference between original cost and today's price, but of a rising flow of dividends over the years. This often adds up to be many times the initial investment. For example, an investor who paid $210 for IBM in 1950 has received $1453 in dividends for each share he bought and kept. It has now been split into 45.3 shares worth $13,600 and the current dividend provides an annual yield of 97% on the original cost.

Similarly, the $10,000 portfolio of ten growth stocks which our firm selected in early 1951 (and in which no changes have since been made, to rule out hindsight) has produced total dividend income of $32,343 in addition to $169,046 in capital appreciation. This can be seen in the following table. It also compares the trend of the growth portfolio's p/e ratio, weighted in accordance with the relative size of each holding, with the trend of the median p/e of the 30 Dow-Jones issues:

	Market value		Cumulative dividends		P/E ratio	
	10 growth stocks	30 Dow stocks	10 growth stocks	30 Dow stocks	Weighted growth	Median Dow
1950	$10,000	$10,000			10	8
1955	26,732	22,596	$2,678	$3,761	18	12
1960	65,557	28,495	6,833	8,351	38	19
1965	96,536	44,844	13,999	13,909	28	17
1966	104,336	36,351	15,907	15,302	28	15
1967	139,436	41,876	07,896	16,682	35	14
1968	140,444	43,664	20,092	18,132	35	15
1969	146,301	37,030	22,517	19,701	33	14
1970	129,817	38,814	25,198	21,159	28	14
1971	147,488	41,186	28,007	22,587	32	17
1972	186,664	47,193	30,866	24,080	29	12
Current	179,046	41,733	32,343	24,846	28	9

What has this comparison to do with the "two-tier" market? Lots, if not everything. Two decades ago, the growth stock philosophy was understood only by a very few investors and investment advisors. Accordingly, stocks with growth characteristics sold at only modest premiums. For example, the p/e ratio of 10 on the growth portfolio was just 25% above the Dow's median p/e of 8.

By 1955, however, the spread had widened to 50%. From the late 1950's to 1971, the table shows that the growth portfolio was fairly consistently appraised at about twice the Dow's multiple.

Currently, the growth list's p/e ratio is 28, or three times as much as the Dow's. This is the biggest gap ever. *But it has arisen not because growth stock appraisals have increased, but because non-growth appraisals have declined to the lowest levels in two decades.*

The former have held up in recent years largely because the leading growth companies have strong inflation-resistant characteristics. So they have been able to maintain their long-term earnings progress despite the surge of cost-push inflation since the mid-1960's In contrast, companies lacking these characteristics have made little secular (i.e. non-cyclical) earnings headway in this period.

As a result, the 10 growth stock portfolio has nearly doubled in value since the end of 1965. Meanwhile, the Dow Average and stocks generally have declined. And over the past 23 years, the growth list has produced vastly superior results despite the "two-tier" p/e spread that has continually been in effect.

2. The Selection Process: The basic task of non-trading, long-range investors is to a) determine the best companies and b) try to buy their shares at realistic prices. The first step must involve using specific criteria to narrow down the range of investment possibilities. To show how this happens, let's try it. Fortune's latest annual survey covers 362 publicly-owned companies with 1972 net income in excess of $25 million.

Let's assume that as long-term investors we are interested in companies meeting three simple tests: a) average return on stockholders' equity of 12% or more in the past five years, b) earnings per share growth of at least 8% annually from 1967 to 1972, and c) no more than one annual earnings decline in the past decade. How many of the 362 companies would qualify? Only 67, or less than one in five, as shown below:

	Number of publicly owned companies	
	1972 net income over $25,000,000	Passing all 3 tests
Commercial banks	26	8
Life insurance—financial	35	4
Retailers	21	7
Transportation	10	0
Utilities	50	4
Industrials	220	44
Total	362	67

We are not suggesting that these three criteria pinpoint the best companies to own for the long pull. Many other factors are involved. But they do illustrate that a rational screening process will whittle down, to a relatively small group, the number of companies with highly favorable characteristics.

3. Investment Concentration: Critics of the "two-tier" market claim that heavy institutional concentration in 60 or 70 "vestal virgins" or "sacred cows" is a disservice to the economy. They say it not only makes it difficult for the neglected ower-tier companies to raise capital on a competitive basis, but, because their stock prices are performing so poorly, it also discourages small investors from participating in the market.

This argument overlooks the fact that the first responsibility of professional portfolio managers is to their clients. And if they do a reasonably good job of long-term investing, some degree of concentration is inevitable.

For example, a well-managed, diversified portfolio that is invested in bona-fide growth stocks over the years does not remain equally divided among its component holdings. Some are disappointing, most others are fair to good, and a few produce spectacular results.

The last group—which often appreciates to as much as half of the portfolio's market value—is what makes the entire list an above-average investment. We do not view this as excessive concentration, but rather as the hoped-for outcome of the original diversification.

Similarly, an investment firm managing hundreds of accounts tries to put all its growth-oriented clients in a diversified list of companies it believes to be among the best. Due to timing differences, no two established portfolios are ever exactly alike. But neither are there major differences in the types of companies owned by each client.

As a result, the firm's overall holdings are bound to be clustered among a relatively small group of companies. For example, in the case of Morgan Guaranty, the largest institutional investor, 47% of the market value of all the common stocks under supervision were in its 20 largest holdings as of late 1972.

Is this overconcentration? The holdings, most of which were brought at far below today's prices, represent a cross-section of industries with above-average earnings growth. Furthermore, the 20 companies together account for nearly *one-fifth* of the net income of *all* publicly owned U.S. corporations—both large and small.

And it's not really surprising that institutional investors as a group own 50% or more of Merck, Xerox and perhaps IBM. They now manage 35% of the total equity capital in the U.S. *By the law of averages, they would own 35% of all major companies if they had no investment selection process at all.*

4. There's Always Been and There'll Always Be a Top Investment Tier: It's plain logic that the companies with the best earnings history and the most predictable prospects should a) command higher-than-average p/e ratios and b) have the most access to the capital markets. And this would be true even if every institution were limited by law in the shares it could hold of a single company.

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The key feature of the present "two-tier market is *not* the multiples of the leading growth stocks. These are, on average, no higher today than the central valuations of the past 15 years.

What's really striking about the investment background is that so many companies in important basic industries have not been able to achieve good earnings progress since the mid-1960's. The records of the top-tier companies stand out like a beacon in the night.

The Senate's Finance Committee has just issued a report on the "Role of Institutional Investors in the Stock Market." It would be far more fruitful for everyone—including small investors—if they would not study the role of government policies in fostering a chronic inflation, an excessive wage trend and a widening regulatory net that hobble the long-term earnings growth of most American companies. This is what today's "two-tier" market is all about.

DAVID T. WENDELL.

	Latest	Week before	Year ago	1973 range
Stock prices:				
D-J Industrials	874.17	902.02	964.25	1,051.70-869.13
S. & P. 500	103.01	105.55	112.06	121.74-100.44
Investment yields (percent):				
Treasury bills	8.98	8.49	3.96	8.98-5.16
20-year Municipal Bonds	5.58	5.59	5.22	5.59-5.00
New Aa Utility Bonds	8.45	8.50	7.44	8.50-7.32
S. & P. 500 Stocks	3.15	3.07	2.77	3.15-2.65

MORGAN GUARANTY TRUST CO. OF NEW YORK,
New York, N.Y., September 5, 1973.

SUBCOMMITTEE ON FINANCIAL MARKETS,
Committee on Finance, U.S. Senate,
Washington, D.C.

DEAR SIRS: In the course of my review of my testimony before the Subcommittee, I have noticed several areas where it might be helpful if I were to supplement my answers to various questions. These areas are as follows:

(1) *The Investment Company Act of 1940 and its limitation on holdings.*—Because of the various references that were made to the limitations on stock holdings imposed by the Investment Company Act of 1940, I have asked our counsel for a brief explanation of the relevant provisions of that Act, and I have been advised as follows: A registered management investment company may elect status as either a "diversified' or "non-diversified" company. A non-diversified company is subject to no limitations with respect to its investment in the stock of other companies. A conspicuous example of a non-diversified investment company is Christiana Securities Company, which owns approximately 28% of the common stock of E.I. du Pont de Nemours and Company, which holding constitutes more than 99% of Christiana's assets. A "diversified company" is one which, as prescribed by Section 5(b)(1) of the Investment Company Act, meets the following requirements:

"At least 75 per centum of the value of its total assets is represented by cash and cash items (including receivables), Government securities, securities of other investment companies, and other securities for the purposes of this calculation limited in respect of any one issuer to an amount not greater in value than 5 per centum of the value of the total assets of such management company and to not more than 10 per centum of the outstanding voting securities of such issuer."

Thus a diversified company is free to own in its 25% "basket" any amount of stock of any corporation, and in the diversified 75% of its portfolio a diversified company may include up to 10% of the voting stock of any corporation (provided such holding does not exceed 5% of the value of the investment company's total portfolio), notwithstanding the presence of additional voting stock of that same corporation in the "basket". For example, The Madison Fund as of March 31, 1973 owned 25% of the outstanding stock of First National Stores and 10.3% of the outstanding stock of Denison Mines Limited. In addition, it should be noted that these restrictions apply on an investment company by investment company basis and that there is no restriction on the number of investment companies which a single investment adviser can manage. For example, there are 8 investment

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advisory companies which manage two or more funds each of which has assets greater than $300,000,000. The largest of these, Investor's Diversified Services, manages a total of 7 funds. There is no restriction on the separate funds investing in the same stock. Thus, for example, IDS-managed funds owned as of March 31, 1973 8.3% of the outstanding stock of Babcock & Wilcox, the holding being spread among two funds.

(2) *Impact of inflation on stock markets.*—Additional comment on the impact of inflation on the stock market may be of interest to the Subcommittee. Although well-chosen equities offer some advantages over fixed-income securities as a defense against inflation, the effect of inflation on equity value is basically adverse. This is for two main reasons: first, inflation is bad for corporate profits; second, it gives rise to a premium yield element in debt markets that lures investors toward bonds and away from stocks.

The relationship between inflation and profits is exceedingly complex. One particularly important fact is that the heady atmosphere of easy price markups and rapidly rising nominal asset values often induces sloppy management practices and looser financial discipline than normally prevails.

The result typically is weakened productivity performance, rising unit costs, and pressure eventually on profit margins. As experience over the past couple of decades testifies, the profit share of total national income drifts lower in an inflationary environment, usually most sharply when price increases are steepest.[1]

The relative lag in reported profits, moreover, is only part of the story. Perhaps even more significant is the fact that the quality of reported profits deteriorates. This is partly because inflation diminishes the purchasing power of corporate profits, just as it diminishes the purchasing power of other income shares. But there is a further important reason why profit gains, which nominally are frequently large in periods of inflation, can be more illusory than real.

This is true, for instance, to the extent that reported earnings are swollen by so-called inventory profits—the difference between the value of goods when removed from inventory and their value when they first went in. This at times can be very significant. For example, between the second quarter of 1972 and the second quarter of this year, inventory "profits" increased $14 billion. Inventory profits—if corporations were allowed to retain them fully—would merely allow "real" inventories to be maintained at a constant level. The fact is that corporations do not retain them fully. On average, rather, nearly half of inventory "profits" must be paid in federal income taxes, leaving almost half of the inventory replenishment to be financed elsewhere.

The same kind of negative impact on true profits arises from the fact that depreciation charges in inflationary periods are inadequate to allow firms to replace depreciated plant and equipment. George Terborgh of the Machinery and Allied Products Institute has estimated that, of $700 billion of total reported corporate profits in the quarter century following World War II, some $40 billion was illusory because of the undercharging of inventory costs and some $130 billion was illusory because of the undercharging of depreciation. Investors generally are keenly aware of the phantom nature of reported profit increases in times of inflation, and there can be no doubt that that awareness is a negatively conditioning factor in equity markets.

Finally, inflation is bad for the stock market because inflation generally is accompanied by high interest rates. This is partly because an investor who is turning over his funds to someone else expects not only reasonable compensation for the use of his money but also demands an additional return to compensate him for any anticipated loss in the purchasing power of money. Thus, when inflationary expectations are strong, rates of return on debt instruments tend to be high. That tends to have an adverse effect on the equity market, since as inflation and inflationary expectations grow and as higher and higher returns become available on debt instruments, more and more investors will be attracted away from equities. One would have to acknowledge that the shifting is not entirely rational if the special debt-market premiums do nothing more than just compensate for expected inflation. But investment decisions are not purely rational in all instances, and the fact is that "advertised" high rates of return on debt securities do attract at least some investors to debt markets who otherwise would hold stocks.

(3) *Sales of Tropicana stock by Morgan Guaranty's Trust and Investment Division.*—On January 2, 1973, Morgan Guaranty's Trust and Investment Division held for its clients 182,400 shares of Tropicana Products Inc. common stock. The stock was selling on that date at approximately $58 per share. The vast majority

[1] For a discussion of this phenomenon, see G.L. Bach, *The New Inflation*, Brown University Press, Providence, 1972, pp. 31ff.

of these shares (175,000) were held as trustee for various corporate retirement plans. On January 5, 1973, the Division purchased an additional 2,000 shares for investment advisory accounts at an average price of approximately $56.50 per share.

On April 3, 1973, the company was reviewed at the "Weekly Investment Meeting" attended by the majority of the officers of the Investment Department and the members of the Investment Research Department responsible for following this company. The price of the stock on that date was approximately $40 a share. While the prospects for further earnings growth for the company appeared good, it was pointed out that the stock commanded a fairly high multiple of about 29 times projected 1973 earnings of about $1.40 per share.

Subsequently, approximately 5,100 shares of the stock were sold for investment advisory accounts as follows:

	Approximate sale price
April 19, 1973, 1,300 shares	37⅛
May 7, 1973, 2,000 shares	38⅞
May 21, 1973, 1,000 shares	30½
June 19, 1973, 800 shares	21½

On June 21st, it was decided, with the approval of the Trust and Investment Committee of the Division, to offer for sale the entire holding of 175,000 shares in employee retirement accounts. The entire holding was disposed of as a block on that date at 20, the low for the day. On the following day the stock sold down to 17⅞ and on June 25 reached its low for this year of 16. Since then the stock has recovered, and it closed on August 31 at 31½.

It seems clear from the foregoing that selling by Morgan Guaranty was not what caused a decline in the price of Tropicana's stock. Morgan Guaranty's only sizeable sale was made at a price near the low for the year and within a few days of such sale the price began to rebound. The conclusion of the S.E.C.'s *Institutional Investor Study* that block sales normally depress the market in a particular stock only temporarily (Summary Vol. p. 93) seems borne out by price behavior of Tropicana's stock.

On June 18, 1973, we became investment advisor to a new account and among the security holdings in this account were 500 shares of Tropicana. These shares were sold on July 24, at $28 per share.

We still retain 4,000 shares of Tropicana stock in various investment advisory accounts.

(4) *The voting of proxies by Morgan Guaranty's Trust and Investment Division.*—Where Morgan Guaranty is sole trustee of trusts, it has a fiduciary duty to vote stocks held by such trusts in accordance with its best judgment. In such cases, unless otherwise expressly provided in the trust instrument, there is no consultation with anyone outside the Trust and Investment Division of Morgan Guaranty. In cases where Morgan Guaranty is one of several fiduciaries, the Trust and Investment Division makes recommendations as to voting to its co-fiduciaries but the shares are voted as a majority of the co-fiduciaries direct. In the case of all Morgan Guaranty's investment advisory accounts, regardless of whether an individual or an institution is receiving the advice, the Division normally forwards a blank proxy to its client and the client is then free to vote it as he wishes by sending it directly to the company or not to vote it at all. A relatively small number of investment advisory clients have asked that proxies not be forwarded to them, and in these cases the shares owned by such clients are not voted.

(5) *Concentration of new investments in a limited number of stocks.*—During the Subcommittee's session on July 26, 1973, Mr. Zeder stated that in 1972 Morgan Guaranty had $1 billion to invest and that of this sum $800 million was invested in 15 stocks. This gives a highly misleading picture of our investment activity during the year in question. The approximately $800 million invested in stocks of 15 companies was part of a total of $1.8 billion used for the purchase of common stocks for employee benefit plans—not part of a total of $1 billion as Mr. Zeder's statement had it. Of the $1.8 billion, about $1 billion was new money and the rest represented proceeds of sales of other investments. All told, 228 different stock issues were purchased during the year.

It should also be noted that of the 15 stocks in which we made our largest purchases—totaling $800 million—in 1972, only four had been among the 22 stocks in which we had our largest holdings ($150 million or more) at the beginning of the year. Moreover, two of the largest holdings at the beginning of 1972, IBM and Xerox, were reduced during that year by net sales of approximately 158,000 shares and 304,000 shares, respectively.

We also point out that although at the end of 1972 the top 20 common stocks held by the Trust and Investment Division for employee benefit plans accounted for 45.8% of all such stocks on the basis of *market* value, they accounted for only 35.7% on the basis of *book* value (purchase price). In other words, much of the so-called concentration is simply the result of price appreciation in stocks, many of which have been held in whole or in part for years.

We trust that the foregoing material will prove useful to the Subcommittee, and we request that it be included in the printed record of the Subcommittee's hearings.

Respectfully yours,

SAMUEL R. CALLAWAY.

ABERDEEN, MD.,
August 27, 1973.

Senator LLOYD BENTSEN,
Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BENTSEN: In your letter of August 6, 1973, you suggested that if I send a letter expressing my tax views you would have your staff study it and place it in the Committee record.

My concern is strictly with the matter of the tax treatment of long term capital losses. The change made on this matter by the 1969 Tax Reform has injured me deeply. The change seems ill-advised, and my reasons for believing so are enclosed.

I apologize for the length of my discussion, but I felt it necessary to deal with the matter fully. I hope that your committee will agree with me and take action to give fairer treatment to long term capital losses.

Very truly yours,

JOHN FEROLI.

THE CASE AGAINST THE CURRENT TAX TREATMENT OF LONG TERM CAPITAL LOSSES

BACKGROUND

Prior to the 1969 Tax Reform, long term capital losses could be deducted from ordinary income on the basis of dollar for dollar, with a limit of $1,000 in any one year, but with a carryover privilege. This was consistent with the treatment of short term losses. One could argue, with some merit, that this was not entirely fair because other types of losses, particularly business losses, do not have this same $1,000 limitation. Nevertheless, most of the provisions were fair and one could always be optimistic and hope that future years would permit a balancing of gains against carryover losses.

The change made by the 1969 tax bill came, I am sure, as a complete surprise to most small investors, including myself. It was even greeted with disbelief. Certainly the government in all fairness would not suddenly say to a man who, for example, had $10,000 in unrealized losses, that from now on they would only be counted as $5,000 in losses. No, there was not even a grandfather clause. On the other hand, taxes on capital gains (a heavily lobbied area) were left essentially unchanged. Unbelievably, in the name of tax reform a law was passed that increased the miseries of the loser (as if he didn't have enough troubles already worrying about paying for his children's educations) while leaving tax advantages to those with gains.

MY PERSONAL SITUATION

I am an engineer who has been a civil service employee for many years, and having no other source of business or earned income. I had been investing in the stock market over a period of years, and was receiving more than my share of bad advice from brokers. At the time I learned of the 1969 law I found myself in an exceedingly bad position of having nothing but losses. The worse was Nytronics, bought at 35, and selling for 11 when I conclusively learned about the new tax law. Aside from my mortgaged home, just about everything I owned was in the stock market. I decided not to sell, first, because I had no gains to balance losses and, second, because I fully expected that with all the tax experts, economists, congressmen and others around, the injustice of the situation was bound to be rectified. This has, so far, become a fruitless hope. The change in the tax law had in effect locked me in a very serious position. Since then, things have gotten worse. Nytronics, for example, is now selling for under $1.

THE POSITION OF THE TREASURY DEPARTMENT

The position of the Treasury Department is stated in Enclosure 1. In effect, the Treasury Department states that the primary objective is to make the law on long term losses consistent with the tax law on long term gains. The Treasury also mentioned not giving losers the benefit of selecting a favorable time for taking losses. The Treasury never answered my question on why there was no grandfather clause in the law. A subsequent personal visit by me to the Treasury Department confirmed that the primary reason for the change was an attempt to achieve consistency.

THE ARGUMENT AGAINST THE PRESENT LAW

1. Rather Than Consistency, The Treasury Has in Fact Achieved Complete Inconsistency.

This fact is graphically illustrated in Inclosure 2. Short term losses are permitted a dollar for dollar deduction, which I am sure everybody agrees is fair treatment. However, long term losses have been moved from the same dollar for dollar situation (which is fair) to harsher treatment. Something that is harsher than fair must be considered unfair or prejudicial. Meanwhile the Treasury admits that the long term gains tax is preferential. So we have gone from a situation of partial inconsistency (preferential for gains and fair for losses) to complete inconsistency (preferential for gains and prejudicial for losses).

2. If the Treasury Wants Consistency with Long Term Gains, Then Long Term Losses Must Be Given Preferential Treatment Also.

And the only way this can be achieved is to permit a deduction greater than the actual loss. This point should not be taken lightly since it can be proven mathematically. The reasoning and the mathematics involved are contained in Inclosure 3.

3. Consistency is Not the Important Thing; Fairness Is.

The Treasury's explanation of the law change boils down to this: Since long term gains are given preferential treatment according to a certain formula, it makes for consistency to use the same formula even in a prejudicial way. If this same thinking were applied to other fields, say World Series payments, we would find that if the winners were to receive $10,000 apiece, then consistent treatment would require each loser be assessed $10,000. The fallacies are these: First, there is an effort to achieve some manner of consistency, when actually one should be striving for fairness not consistency per se. Secondly, if one is trying for consistency one should be alert to whether he is dealing with a negative or a positive situation. Minus $50 is certainly completely inconsistent with plus $50.

4. The Law Should Have Had a Grandfather Clause.

All good legislation, in order to be fair, has a grandfather clause when appropriate, and this was certainly an appropriate occasion. One cannot in all fairness change the rules of a game in the middle of the game to the disadvantage of one side. But this is exactly what was done. I have never received an answer from anyone as to why a grandfather clause was omitted when the law was changed. The lack of a grandfather clause has been a disaster to me. I am convinced that if the law was challenged in court on this basis the law would not hold up.

5. The Loser Should be Permitted Latitude in Selecting a Selling Date.

As a secondary point, the Treasury says that it doesn't want to grant the loser this option. But, why not? The person with gains has this option. Furthermore, a person with gains can even give good quantities of untaxable stock gains to his children. What am I supposed to do with my losses? Is it the Treasury's intention to make losses as painful as possible?

6. An Income Tax is Designed to Tax Income; It Should Not be Used to Tax Non-Income.

Let's take a hypothetical situation. A man earns $8100 in January and February. He invests it, suffers heavy losses and finally sells it in December for $100. Obviously his actual income for the year is $100. Yet according to the present law, his income for tax purposes is $7100, with the provision for carrying over $3000 in losses, untimately being taxed for $4100. Of the $4100, he is being taxed on the $100 which is income and on an additional $4000 which is non-income.

7. Since Earnings are Fully Taxed, Then Losses in Income Should be Fully Creditable, but since they are not—

Under the Present Law the Effective Tax Rate for the Loser Can achieve Outrageous Levels.

Let's again assume a hypothetical, but realistic case. For simplicity let's assume that all income involved is in the 25% tax bracket. A man decides to place $6000 of his savings in the stock market. This $6000 was what remained after $8000 of his earnings was taxed at 25%. Assume he invests it all, and loses it all—long term. He is allowed an income deduction, under present law of $3000, which amounts to a tax credit (at a 25% rate) of $750. Let's summarize. Of the original $8000 in earnings $6000 was lost, $1250 was permanently held by the government in taxes, and the man ends up with $750. Thus, of the $2000 that was not lost, $1250 or 62.5% went to taxes. Thus, this man paid on a portion of his income a tax rate (62.5%) which is higher than if he had had an income of $1,000,000. Did the Treasury really mean this?

8. The Effect of the Present Law Is: Double Benefits to the Winner; Double Punishment to the Losers.

The man who enjoys long term gains, is given the further benefit of a tax break. The man with losses not only suffers the loss, but he is also battered by being deprived of the right of a fair tax deduction.

9. The Unfortunate are Made to Help the Fortunate and the Rich.

In economics, if the taxes of one group increases and the taxes of another group remain unchanged, then the first group's share of the total tax burden has increased while that of the second group has decreased. Thus, increasing taxes on those with losses has had the effect of further decreasing the tax on those with gains and I think you will find that those who have the biggest gains are inevitably rich.

CONCLUSIONS

The tax treatment of long term capital losses is unsound and completely unjust. There are many arguments to support this contention. Furthermore the Treasury's claim of consistency with long term gains is in error, since long term gains are given preferential treatment whereas long term losses are given prejudicial treatment. But worst of all, the 1969 tax reform that created the current law failed to even contain a grandfather clause.

If Congress and the Treasury are really serious about maintaining consistency then it will be necessary to permit a deduction for long term losses that exceeds the actual loss.

If, on the other hand, Congress and the Treasury are merely striving for fair treatment, then it will be necessary to permit deduction on long term losses on a dollar for dollar basis, with no limit on the amount that can be deducted in any one year, but with an optional carryover provision.

John A. Feroli.

Office of the Secretary of the Treasury,
Washington, D.C., January 14, 1973.

Mr. John A. Feroli,
Aberdeen, Md.

Dear Mr. Feroli: Your letter to President Nixon, commenting on the tax treatment of capital losses under the Tax Reform Act of 1969, was sent to this Department for the attention of Treasury officials directly concerned with tax matters.

Prior to the Tax Reform Act of 1969, individuals could deduct against ordinary income up to $1,000 of the net long term losses in excess of short term capital gains. The Tax Reform Act provided that only 50 percent of net long term capital losses in excess of net short term capital gains may be deducted from ordinary income. The $1,000 limitation on the amount of capital losses which may be deducted from ordinary income continues to apply. However, $2,000 of long term capital losses are required to offset the $1,000 of ordinary income.

The changes in the tax treatment of long term losses remove an inconsistency in the treatment of long term losses and long term capital gains. Because a maximum of 50 cents of each dollar of long term capital gains is subject to ordinary tax, only 50 cents of each dollar of long term losses in excess of long term capital gains should be permitted as an offset against ordinary income. Short term capital losses are fully deductible dollar for dollar against ordinary income. This is consistent with taxing short term gains at ordinary rates.

As long as capital gains income receives the favorable tax treatment which it now does, there seems to be no case for permitting a more generous deduction of losses. An increase in the deduction of long term capital losses against ordinary income would further encourage taxpayers to realize losses and achieve a tax

savings while postponing the realization of gains. Since the timing of the tax on capital gains is at the option of the taxpayer, some limitation must be put on the ability of the taxpayer to time the realization of losses to achieve significant tax savings.

We appreciate your interest in expressing your viewpoint on this question and are glad to have your letter brought to our attention.

Sincerely yours,

GERARD M. BRANNON,
Associate Director, Office of Tax Analysis.

MAKING TREATMENT OF LONG TERM LOSSES CONSISTENT WITH THAT OF LONG TERM GAINS

The Treasury Department's contention is that the present law on long term losses was created to be consistent with the treatment for long term capital gains. The fact is that the two are inconsistent. The analysis below explains what constitutes true consistency.

There are two primary criteria involved in describing the current tax treatment of long term gains. First, the tax treatment gives the individual a break by requiring him *to pay less taxes* than he would under normal treatment. Second, the extent of his benefit is a decrease of taxable income by an amount equal to 50% or .5 of the net of the absolute value of capital gains and losses.

The problem then is to devise a mathematical model that will contain the above elements, applicable for both capital gains and losses. This then would provide exact mathematical consistency. The formula that develops is the one shown below.

$$\text{Taxable income} = I + C - .5 \| C \|$$

I = Taxable income exclusive of long term capital gains and losses
C = Combined long term capital gains and losses

It should be noted that in order to meet the requirements for consistency of treatment, it is necessary to use the "absolute value of" symbol || ||, rather than parentheses ( ).

The following table shows how this formula works in the case of several combinations of long term gains and losses.

Combined long term gains and losses	Change due to consistent preferred treatment	Net effect on taxable income
+$4,000	[1] −$2,000	+$2,000
−4,000	−2,000	−6,000
+1,000	[1] −500	+500
−1,000	−500	−1,500
0	[1] 0	0

[1] According to existing law.

It is apparent from the above table that if, for example, a $4000 loss is to be given consistent treatment with a $4000 gain (namely, a $2000 tax break) then the figures of the third column result.

ABERDEEN, MD., *July 30, 1973.*

Senator LLOYD BENTSEN,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BENTSEN: I would like an opportunity to speak before your committee. Here's why.

Newspapers have reported that at a recent hearing of your Senate Finance Subcommittee, certain recommendations were made by Donald T. Regan, Chairman, Merrill Lynch, Pierce, Fenner and Smith. In portions of his testimony Mr. Regan purported to be supporting the interests of the little man.

Well, I am a little man who has purchased stocks for many years. In fact, I am a customer of Merrill Lynch. In my view, Mr. Regan in no way was representing the interests or opinions of the little man. If he had been he would have said: the most unjust thing to happen to the little man in recent years was the unfair way that the 1969 Tax Reform treats long-term losses, to wit: fifty cents on the dollar. And all this was done without a grandfather clause.

Yes, I, and many other little men, are still suffering from this unjust change in the tax law. The inclosed chart explains the situation graphically.

The explanation that the Treasury Department gives boils down to this. Since long-term gains are given preferential treatment according to a certain formula, it makes for a consistent arrangement to give prejudicial treatment to long-term losses by the same formula. The reasoning applied is that if you do one man a favor you must do another man a disfavor in equal amount—for consistency.

So, I would like to go before your committee to express the true views of the little man. If this can't be arranged, please have your committee consider changing the laws on long-term losses to give them fair treatment. The little man will thank you if you do.

Very truly yours,

JOHN A. FEROLI.

TAX TREATMENT OF GAINS AND LOSSES

	Type of treatment		
	Preferential	Fair	Prejudicial
Short term:			
Gains		X	
Losses		X	
Long-term:			
Gains	X		
Losses			X[1]

[1] Changed from Fair by 1969 tax reform.

APPENDIX A

The Role of Institutional Investors in the Stock Market—Briefing Material Prepared by the Staff for the Use of the Subcommittee on Financial Markets

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THE ROLE OF INSTITUTIONAL INVESTORS IN THE STOCK MARKET

I. Introduction

The depressed state of the U.S. stock market for the past several years cannot be easily explained by the state of the economy or by passing psychological factors. Between 1968 and 1972, our gross national product was up 33 percent, personal income was up 36 percent and personal savings were at an all time high. Yet stock prices as measured by key, unweighted indexes are off 50 percent from their 1968 peak. If the state of the economy itself cannot explain what is happening in the overall securities market, it certainly cannot justify what is happening to individual stocks. The stocks of many individual firms which are well managed and show good earnings are selling at unrealistically low "price-earnings" ratios (between 5 and 10) while others are trading at 40–100 times earnings.

Government officials have been so puzzled by the depressed state of the U.S. stock market while the economy has been booming that they felt compelled to make public pronouncements that "there are bargains out there", or "now is the time to buy." Yet individual investors have not responded to these exhortations of confidence and have been sitting on the sidelines, or selling. "It is a well-celebrated fact that individuals have for years—since 1959, in fact—been net sellers of stock (leaving aside for the moment, their holdings of mutual funds)", a recent article in *Fortune* states. Even the mutual fund business is badly depressed. In the past year, for the first time in 30 years individuals redeemed more mutual fund shares than they bought.

A recent Arthur D. Little survey, as reported in the May 4, 1973 *Wall Street Journal*, further confirmed the public's loss of confidence in the conduct of the security markets. The "most damning" finding in the Little report is that many investors think the market is *"manipulated"*; 70% of investors and 64% of noninvestors shared this view regarding "manipulation." A key aspect of the "manipulation" charge centered upon *"unfair advantages and access by institutions."* The New York Stock Exchange recently reported that the number of shareholders in the United States had declined by 800,000 since the previous shareholder census, *the first such decline on record.*

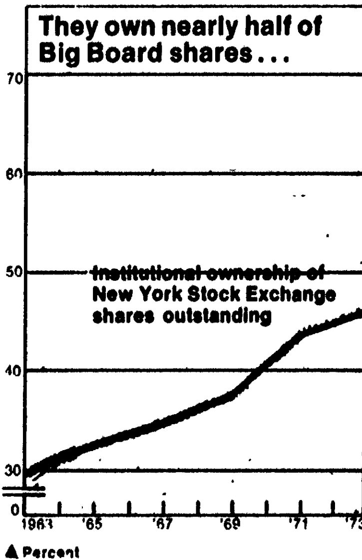
While the current depressed state of the market may be due to a complex of short term forces—the sliding value of the dollar at

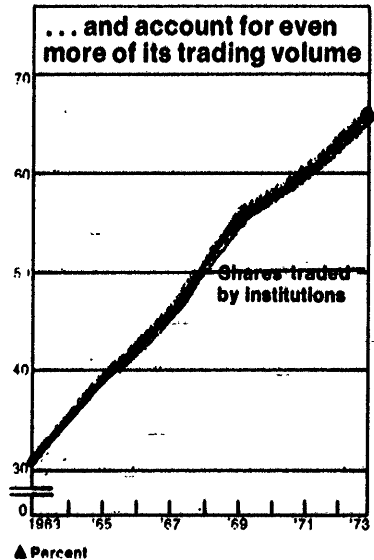
home and abroad, the gold fever, rising interest rates, confidence in government, etc., there may well be longer-run institutional factors in the market itself which are more fundamental causes of the problem.

Institutional investors—trust departments of large U.S. banks, insurance companies, mutual funds, pension funds, large endowment funds, foundations—today dominate market transactions, accounting for over 70 percent of the dollar value of New York Stock Exchange trading, compared with 35 percent in 1963.

All these institutions are afforded special tax treatment which is described in section VII of this document. A number of prominent individuals have suggested changes in the U.S. income tax laws as a solution to the problem of institutional domination of the securities markets.

How the institutions dominate Wall Street





II. The Institutional Investors and the "Two Tier" Market

"In the name of playing safe with their clients' money, large institutional investors have been concentrating their activity in an ever-narrowing circle of investment choices", says James Needham, Chairman of the New York Stock Exchange. Who are these institutional investors and on what issues do they concentrate?

According to an article in a recent issue of *Business Week* (reprinted as Appendix A), the 10 leading institutional investors are as follows:

The leading institutional investors:

Most of the top 10 are banks

Institution	Investment portfolios [billions of dollars] *
Morgan Guaranty Trust	$27.2
Bankers Trust	19.9
Prudential Insurance	18.3
First National City Bank	17.2
U.S. Trust of New York	17.0
Metropolitan Life Insurance	16.5
Manufacturers Hanover Trust	10.9
Mellon National Bank & Trust	10.5
Investors Diversified Services	9.7
Chase Manhattan Bank	9.2

*Excludes real estate investments

Data: Money Market Directories, Inc.

These 10 institutional investors hold $156.4 billion in their portfolios. Chairman Paul Kolton of the American Stock Exchange estimates that total equity holdings of financial institutions today are $310 billion, with banks holding $170 billion, mutual funds $45 billion, insurance companies $42 billion, and with foundations investment counsellors and smaller institutions holding the rest. This $310 billion—36 percent of the total amount outstanding ($1,160 billion)—is disproportionately concentrated in the "big" stocks—those having the highest market value. Individual investors are disproportionately concentrated in the small companies. Thus, there has been created a "two tier" market which is more fully described in the July, 1973 *Fortune* article, reprinted as Appendix B.

Morgan Guaranty appears to be the largest institutional investor ($27.2 billion) with Bankers Trust ($19.9 billion) not far behind. According to *Fortune*, Morgan has a history of investing in growth stocks, and because of its performance (a compounded return better than 13 percent over the 10 years ending in 1972), "Morgan has become the player that everybody in the game watches". "Its influence clearly extends beyond the sum it manages". How does Morgan play the game? Morgan has been quoted as expressing the philosophy that "We are not traders, we are investors. We do not buy stocks with the idea of selling them at a specific price objective. We do not buy with the idea of selling high and buying back low". Obviously,

if Morgan did swing its $27 billion in holdings for quick speculative gain, it would create havoc in the market. As a result, Morgan itself appears to pursue a "two tier" strategy. It invests a considerable portion of its holdings in big companies—by Morgan's definition, those that have at least $500 million in both market value and revenues. There are only about 300 such companies in the country. The second tier is reached through "pools of money" that Morgan apparently sets up and in which its pension accounts participate. These monies are invested in small companies that Morgan believes to be "comers."

This strategy may be quite rational for a bank with $27 billion in stock holdings, but if other institutions play the game the same way as they apparently do, it may provide growth in the "top tier" and pre-empt large sums of capital needed in the lower tier. The "herd mentality" of institutional investors creates problems for small and medium size firms, which may be performing well enough, but which are not viewed as "comers" by the large institutional investors or whose stock is "dumped" by the institutions. Indeed, it may be impossible for such institutions to have adequate knowledge of the many companies which deserve investment opportunities. There is some evidence that stocks of certain firms—Clorox, Tropicana, Kresge, Skyline, Winnebago to mention a few—have taken nose dives because of institutional dumping.

James Lane, President of Chase Manhattan's investment management subsidiary, has been quoted as saying that "there is some rationality to the market and its divergence into two tiers." Chase, of course, is one of the large institutional investors, and is known to have supported the stock of certain companies when others were pessimistic about their future. But others express real concern over the "two tier" market. James M. Roach, former chief executive of G.M., worries about "the deplorable state of our capital markets—at the precise time in our nation's history when we face an extraordinary need for capital and for strong vigorous capital markets".

III. The Concentration Issue: American Zaibatsu

The spectre of growing domination of the stock market by the trust departments of a few large U.S. banks could bring the American economy closer to the industrial banking structure of other nations, most notably Japan. If the trend continues, the major U.S. banks could become the American analogue of the zaibatsu, a powerful family-controlled commercial combine of Japan.

The institutional investor typically concentrates its holdings in a relatively few large corporate issues. Fourteen of the largest 20 U.S. banks have IBM as their number one holding and three others have IBM as their number two holding.

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There may be a lot of "self fulfilling price increases" and "snowballing" declines as institutions adopt a "follow-the-leader" investment strategy. While the risk factor may explain a certain divergency in the p–e ratios of stock, it may well be that many stocks have overblown p–e ratios while others are understated simply because large institutional investors favor some and not others. This, of course, raises a number of issues including conflict of interest.

A 1968 staff report of the House Banking and Currency Committee found substantial interlocking relationships between 49 major banks surveyed and major corporations. The study compared the stock holdings of these banks' trust departments with the Fortune list of 500 largest industrial corporations and found 176 separate instances involving 147 companies in which these 49 banks held 5 percent or more of the common stock of an individual company. The study found interlocking directorships between the banks and the corporations even more substantial. The banks held a total of 768 interlocking directorships with 286 of the 500 largest industrial corporations in the country—an average of almost three directorships for each corporation board on which bank representation was found. Appendix C summarizes the Banking Committee findings for the largest institutional investors. The staff report concluded:

"In addition, there are a number of serious conflict of interest problems that arise from extensive interrelationships between banks and other corporations. Included is the problem of managing an employee benefit fund for the sole benefit of the beneficiaries of the fund and at the same time maintaining numerous business relationships including loans, deposit accounts, and representation on the board of directors with the corporation which created the fund."

On the other hand, there may be sound economic or performance reasons for such large institutional investors to hold the stocks of large institutions. But what are the effects of such concentration on the medium size and smaller company? Appendix D provides a listing of stock issues that have been withdrawn from registration between January and July of this year. It gives some idea of the magnitude of the problem many American firms are experiencing as a result of not being on the "chosen" list. Are there any unsound noneconomic reasons, such as particular relationships among the institutions themselves, for the concentration in the "blue chips"? The following table shows the concentration in "blue chips" stock by large U.S. banks.

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	Morgan Guaranty	Bankers Trust	First National City	Chase Manhattan	Manufacturers Hanover	Mellon Bank	First National of Chicago	Continental Illinois
Assets managed as of late 1972 ($000,000):	[illegible]	[illegible]	[illegible]	16,376	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible] other stock holdings:	[illegible] Philip Morris (19) McDonald's (20)	Disney (6) Polaroid (8) Burroughs (12) Lilly (14) Sony (16) PepsiCo (18) Westinghouse (20)	[illegible] Atlantic Richfield (16) Caterpillar (17) Corning [illegible] Lilly (19) Texas Instruments (20)	I.T.T. (8) Standard (Ind.) (10) Polaroid (11) Atlantic Richfield (14) Warner-Lambert (16) Kresge (17) Union Carbide (18) American Cyanamid (19) Bristol-Myers (20)	[illegible] Caterpillar (16) Corning [illegible] I.T.T. (18) American Express (19) Hewlett-Packard (20)	Gulf Oil (1) General Reinsurance (3) Alcoa (4) Mellon National (5) Heinz (9) Kresge (10) Disney (14) Caterpillar (15) First National City (17) Nalco Chemical (20)	[illegible] First Chicago (8) [illegible] TRW (17) Household Finance (18) American Hospital Supply (20)	[illegible] Polaroid (10) Burroughs (11) [illegible] First National City (17) AMP (18) [illegible]
[illegible] total holdings ($000,000):	[illegible]	Not available	[illegible]	Not available	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	Not available	[illegible]	Not available	40%	50%	[illegible]	[illegible]

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Seven major banks hold $112 billion worth of securities, most of it concentrated in large growth corporations. The individual investor has no knowledge of how the decisions to buy or sell stocks are made by these banks. What are the real relationships between the trust departments and the loan departments of these banks? Is it healthy to have a relatively few individuals at the top echelon of these banks control such vast sums of money? Is there a "herd mentality" under which banks tend to "follow a leader" or act in the same way because they depend on relatively few key placed individuals for their portfolio advice? What about interlocking directorates among the banks, their depositors and their portfolio holdings?

These are serious questions which the Subcommittee may wish to pursue. They are particularly relevant in the context of pension legislation. Approximately $1 billion a month of pension funds are channeled into the securities market, mainly through institutional investors. This sum is likely to grow enormously with pension reform legislation. Do the managers of the pension fund portfolios consider the performance of the chosen few stocks to be synonomous with the interests of the American worker? What effect does the concentration on the glamour stocks have on the industrial base of this country and therefore on the millions of Americans employed in small and medium sized firms?

Mr. James Roche former GM chairman puts the issue this way in a recent address before the Securities Industry Association on "Corporate America's Stake in Sound Securities Markets".

"It may be true that much of the capital which individual investors have withdrawn or withheld from the market has been entrusted to institutions which are themselves investors. But institutional investors do not serve the same function in our capital markets as masses of individual investors. There is no substitute for the interest, pride, and satisfaction that come from a personal investment in a particular enterprise. Then too, institutions tend to invest their portfolio funds in the securities of only a limited number of companies. This is dramatically illustrated by the current market situation . . . institutions now account for nearly 70% of the volume of trading on the New York Stock Exchange. Thus, they carry an awesome responsibility for the stability and operation of our capital markets. But their trading is largely concentrated in a few blue chip and large growth stocks. The Weissenberger service recently listed 21 stocks as institutional favorites. Business Week refers to 75 'super glamour' stocks. Institutional concentration in these stocks is so intense that each of the 75 'super glamorous' are selling at more than 30 times last year's earnings, the highest (as of March 31) being sold at over 100 times earnings.

"This situation may be reassuring to the companies favored by the institutions, but it by no means satisfies the needs of the nation. Our system depends upon the health and vitality of thousands of companies, small as well as large.

"It depends also upon the goodwill and confidence of the nearly 32 million individuals who own shares in our corporate structure. It depends too upon the confidence of those millions of people who while not direct shareholders have vital interests through their insurance and pension programs. Our system cannot flourish solely on the basis of the health and strength of 75 glamour companies or even of Fortune's 500 companies, nor can it survive without the support of individual investors. Every large corporation depends upon hundreds or thousands of small enterprises, as suppliers of components, as generators of ideas and products, as employers of labor, as producers of income for their owners and shareholders who buy our products. Both individual investors and these smaller companies supply an essential quality to American life—a quality we can ill afford to lose."

IV. Effect on Brokerage Houses

As the individuals stay on the sidelines and as a few large institutions take over the main trading activities, the brokerage business as we have known it in this country, suffers radical changes. Many hundreds of small brokerage firms have gone out of business; others have merged.

The consequences of this are felt across the nation as smaller firms are denied capital and individual investors are without familiar advice from their brokers. Remaining brokers often cannot read the minds of the few key individuals managing the large pension funds, etc., so they are at a loss to recommend stocks to clients as traditional indicators (such as price-earnings ratios) lose relevance in a cartelized market structure.

Institutional investors have various types of affiliations with broker-dealers. Many institutional investors have in recent years affiliated through ownership with broker-dealers that execute and/or clear securities transactions. There appears to be a real danger of excessive reliance by the institutions on a few large brokerage houses.

V. Foreign Takeovers

With bargain basement prices for lower tier stocks and with huge amounts of floating devalued dollars all over the world, foreign ownership of American companies has increased dramatically. It is a national policy not to discourage foreign investment in the United States. That is one thing. But it is an entirely different issue if the two tier market, and the devalued U.S. dollar invite "steals" of American

companies by foreign bargain hunters who have more dollars (because of our chronic balance of payments deficit) than they know what to do with. There have been reports that an American bank has helped a foreign company take over Gimbel Bros., Inc. through a Euro-dollar transaction from the bank's subsidiary. This kind of operation could flourish and in the long run it may cause more balance of payments drain than the benefits of a Euro-dollar reflow.

The business pages of American newspapers and magazines have been filled with stories of European attempts to take over United States companies.

The following developments during the spring and summer of 1973 provide a few examples:

—Brown and Williamson Tobacco Corporation, the U.S. subsidiary of British American Tobacco, the largest manufacturer of tobacco products in the world, made a $23-per-share bid for all of the shares of Gimbel Bros., Inc., the department store chain. This British offer halted a tender offer by Loews Corp., for a portion of Gimbel's shares at $16 each.

The financing for the Brown and Williamson tender offer was arranged through a Euro-dollar loan by the London office of the Morgan Guaranty Company to Brown and Williamson.

—Slater Walker Securities, a London merchant banking firm, has bid for control of Franklin Stores Corp., a discount-and-apparel-store chain, for nearly $22 million.

—Nestle Alimentana S.A., the Swiss-based multinational food-products concern, purchased the Stouffer Corporation from Litton Industries for about $100 million.

—The Norwegian shipping magnate Hilmar Reksten, and Britain's P and O Steam Navigation Co. have offered to purchase the Texas-based Zapata Corp., a shipping, oil and real estate conglomerate. Reksten reportedly bid $38 per share for the company stock at the time the stock was selling at $24.

—Liquifin AG, a subsidiary of a large Italian industrial concern, offered to purchase for cash 52% of Ronson Corporation stock for $8.50 a share. Ronson stock had closed the day before at slightly over $6. The move by Liquifin triggered a strong response from the Ronson president and board of directors who unanimously urged stockholders to reject the offer and even took the matter to court. The Ronson management took out a full page advertisement in the June 8, 1973 *Wall Street Journal* to urge its stockholders to reject the offer.

The extent to which the two-tier stock market system has artificially stimulated the foreign takeover of U.S. firms is one of the major questions which the Subcommittee on Financial Markets may wish to study.

What steps are needed to "satisfy the needs of the nation", in the words of Jim Roche, to bring the individual investor back into the market and to generate capital formation for the thousands of well-managed American enterprises which form an integral part of the industrial backbone of this nation?

Various proposals and studies have been made.

VI. The Securities and Exchange Commission Study

Public Laws 90-483 and 91-410 directed the SEC to undertake an economic study of institutional investors and their effects on securities markets, the interests of issuers of securities, and the public interest. The study found little reason to fear the ". . . imminent domination by institutional investors of ownership of the nation's industry—without ruling out such a longer-term eventuality." It should be noted however, that the study covered a limited period of time before 1970 and the findings may be dated now, even if originally valid. The initial conclusions and recommendations of the SEC study are summarized in Appendix E.

A theme of the SEC study is that present reporting requirements and the Commission's present monitoring capacity do not afford the data or permit the continuing review necessary to evaluate the effects of institutional investment.

One indication of increasing concern on the part of the SEC is the statement of the recently departed SEC Chairman G. Bradford Cook who warned that the individual investor already has acquired the status of an "endangered species" and expressed concern about the growing institutionalization of the stock market.

The former Chairman told the Economic Club of Chicago that the Commission plans to ask Congress to pass an "Institutional Disclosure Act," which would give SEC authority to require all types of institutional investors—banks, insurance companies, pension funds, and others—to disclose holdings and transactions in securities over which they have investment authority. He said institutions might be required to report holdings as of the end of each quarter and their past quarter's block transactions. Block transactions might be those involving 1,000 shares or 1 percent of the shares outstanding, whichever is less.

The disclosure of institutional holdings would inform small investors of "institutional concentration" and "aid the Commission in meeting its responsibility to assure orderly and equitable markets." Cook felt institutions would want to provide this information to demonstrate that their market behavior is fair and proper. It could be provided without undue burden from computer records presently maintained by most institutions, he argued. The Commission might assemble and

collate such data, but the data should be of sufficient interest to corporations and market participants that a private collating effort might be profitable.

He expressed growing concern about the exodus of the individual investor from the market. He described the present market as "two-tiered," with large, internationally established growth stocks commanding all the attention and exhibiting high price-earnings ratios, while smaller, less established companies sell at ratios well below the levels of the past, despite record earnings gains. Financial institutions generally concentrate their activity in a relatively narrow range of established stocks. The activity of the individual investor brings trading interest and liquidity to the broad range of other stocks. "If the market-making capital for these smaller stocks continues to run dry, the effects on the over-the-counter market will hinder the ability of smaller and newer companies to raise new capital," Cook pointed out.

The current difficulties in our equity market may be accentuated by a current ceiling on dividends and the use of monetary policy to stem inflation resulting in higher interest rates, the former Chairman suggested. The SEC might explore removing this ceiling so that equities can compete more fairly with debt. The former Chairman further expressed the view that Congress should consider the benefits of an incentive to investment in small, young companies, but he made no specific recommendations.

Concessions such as those allowing deferral of taxes on pension fund participation until the benefits are paid out, and then providing for capital gains treatment on the income and appreciation may well encourage a participant to rely on his pension and avoid making direct market investments, he concluded.

The former Chairman again stressed that SEC is trying to combat the alienation of the small investor by cracking down on the misuse of inside information, bolstering the financial stability of the brokerage industry and expanding opportunities for small investors by pushing the development of the central securities market. That market is designed to put small investors on a more equal footing with institutions by allowing them to execute trades at the best prices available anywhere in the country, he added.

VII. Institutional Investors and U.S. Tax Laws

As former SEC Chairman Cook acknowledged, the issues raised by the growing dominance of institutional forces cannot be divorced from U.S. income tax laws. First of all, U.S. tax laws deal with all the institutions who invest in the market—pension funds, banks, insurance companies, foundations et al. Second, capital gains (and loss) provisions certainly affects market forces—and overall investment—in an im-

portant way. Some observers have claimed that the capital gains tax "locks in" capital that would otherwise be churning into new investment opportunities. A "liberalization" of the capital gains tax is recommended by some as a key to getting the individual back into the market, stimulating capital formation by American business and additional revenues for the Federal Treasury.

Those institutions investing in securities markets include both taxable and tax-exempt entities. Tax exempt entities (such as pension trusts) are generally permitted to exclude from tax all realized gains on investments in securities. Taxable entities are accorded a different benefit, that of capital gain treatment. In addition some institutions (such as life insurance companies) receive tax treatment designed to recognize the particular nature of their business. This special tax treatment generally encourages an increased flow of funds into these institutions by individuals.

The benefit to an institution occurs when its taxable ordinary income is reduced through special tax provisions available to the institution generally. This enables investment income to be offset by any special deductions or to be completely sheltered from tax by specific exclusions or deferral provisions. In addition, institutional investments in securities as well as certain other capital investments become advantageous because of preferential capital gain rates which are applicable to investments generally.

The tax laws provide preferential treatment on any gain received from the sale or exchange of certain types of assets (referred to as "capital assets"), which includes securities. Under present law, in the case of an individual (other than a dealer in securities) or a trust, if a security is held more than 6 months and thereby qualifies for long-term capital gain treatment, only one-half of the gain realized is included in taxable income and taxed at regular tax rates. Thus, long-term capital gains are, in effect, subject to tax at a rate that is one-half the marginal tax rate. Where an individual's or trust's marginal tax rate is over 50 percent, an alternative capital gains rate is available which allows up to $50,000 of long-term capital gains to be taxed at a 25-percent rate.

In the case of corporations, the entire amount of a corporation's excess net long-term capital gains over net short-term capital losses can be taxed either at an alternative rate of 30 percent or at the regular corporate tax rate. Since the corporate tax structure is not graduated (as is the case for individuals) but is computed on the basis of a marginal tax of 22 percent of taxable income and a surtax of 26 percent of that part of the taxable income which exceeds $25,000, usually only those corporations with taxable incomes in excess of $25,000 (on which the tax rate would be 48 percent) will benefit by using the alternative tax.

Present law also provides a minimum tax on specified tax preference income, which includes capital gains, of both individuals and corporations. In general, this minimum tax amounts to 10 percent of the sum of the individual's or corporation's tax preference income to the extent it exceeds $30,000 plus the regular income tax of the individual or corporation for that year, subject to certain other modifications.

Described below is a brief summary of the tax treatment accorded the various institutions which may invest in the securities markets.

In general, financial institutions are taxed in the same manner as regular corporations. However, commercial banks and certain savings and loan associations are accorded special treatment with respect to their bad debt reserves.

Present law allows taxpayers, in general, to compute deductions for business bad debts by either deducting specific bad debts when they become worthless or by deducting a reasonable addition to a reserve for bad debts. Taxpayers (other than financial institutions) who use the reserve method for bad debts generally must compute their addition to the reserve on the basis of their own experience with bad debts using a 6-year moving average (the current year and the 5 preceding years). Financial institutions have generally been allowed more generous bad debt reserve treatment. However, the Tax Reform Act of 1969 substantially limited this special treatment.

COMMERCIAL BANKS

Prior to 1969, commercial banks were able to build up their bad-debt reserves on the basis of an industry-wide 2.4-percent figure of outstanding loans not insured by the Federal Government in lieu of their actual experience (which on the average would have built up a bad debt reserve of only 0.2 percent of outstanding noninsured loans). This preferential treatment was provided in view of the catastrophic losses suffered by commercial banks during the depression years and was devised as a means to allow banks to build a sufficient reserve to cover any large future losses. In view of their actual experience (that is the average loss of about 0.2 percent), Congress believed it was appropriate to reduce the 2.4-percent figure that banks were permitted to use prior to 1969. The Tax Reform Act of 1969 gradually reduced the allowable deductions for additions to bad debt reserves of commercial banks over an 18-year period until 1988, at which time the special percentage method will be withdrawn completely, and they will be required to base their deductions for additions to bad debt reserves on their actual losses for the current and 5 preceding years, following the procedure generally used by other taxpayers. In fiscal year 1970, 14,554 banking institutions reported gross income of $37.1 billion, on which they paid $1.4 billion in Federal taxes.

PENSION TRUSTS

The Internal Revenue Code provides an exemption from tax for trusts which are part of qualified pension, profit-sharing, and stock bonus plans established by employers for their employees. These trusts are established to accumulate funds to make future benefit payments to employees and their beneficiaries. There is legislation pending before the Senate which would significantly increase the flow of funds into pension trusts.

Qualified plans and trusts must be for the exclusive benefit of employees and their beneficiaries, and it must be impossible under the trust instrument for any trust funds to be used for any other purpose. Also, a qualified plan cannot discriminate in favor of officers, shareholders or highly compensated employees. Additionally, the trust must be created or organized within the United States and must be valid under local law. Notwithstanding the tax-exempt status of a qualified trust, a trust may become subject to a tax on income from a business enterprise which is not related to the purpose of the trust.

Treasury estimates that Federal revenues are reduced by $4 billion annually through deferral of employee income and exemption for pension trust income. Employer contributions to qualified pension funds currently approximate $15 billion.

REGULATED INVESTMENT COMPANIES

The Internal Revenue Code provides that Regulated Investment Companies (any domestic corporation, with certain exceptions, registered under the Investment Company Act of 1940, including mutual funds and certain common trust funds) meeting specified requirements as to asset diversification, capital structure, and operations, and which distribute at least 90 percent of their ordinary income to shareholders are treated as "conduits" and taxed only on their undistributed income.

The shareholders of these institutions are then taxed on the income so distributed, and in certain cases, on the capital gains retained by the company which are deemed to have been distributed. In this case, a shareholder is permitted to increase the basis of his stock to properly reflect this tax payment. In fiscal year 1970, 660 regulated investment companies reported $2.6 billion in gross income on which they paid $114,000 in Federal taxes.

MUTUAL SAVINGS BANKS, SAVINGS AND LOAN ASSOCIATIONS, ETC.

Prior to 1969, mutual savings banks, savings and loan associations and cooperative banks (referred to as "mutual institutions" although including some stock companies) were permitted to compute additions

to their bad debt reserves on the basis of their actual experience or one or two alternative formulas, whichever produced the greater addition to the reserve. The Tax Reform Act of 1969 repealed one of the alternative methods and revised the second method; that is, it reduced the deduction available under the second method which was 60 percent of taxable income, with certain modifications, to 40 percent over a 10-year period. In general, this special provision is available only to those institutions primarily engaged in the business of home mortgage financing. In fiscal year 1970 mutual savings banks and savings and loan institutions reported gross income of $15.3 billion, on which they paid $218 million in Federal taxes.

INSURANCE COMPANIES

Life insurance companies.—Life insurance companies are generally subject to tax at the ordinary corporate rates on their income from all sources. Present law does provide, however, that in certain cases a life insurance company may defer the taxation on a portion of its gains from operations.

The net investment income of a life insurance company, investment yield, is allocated between the policyholder's account and the life insurance company.

The portion of the investment yield allocated to the policyholder's account is tax-free. These amounts are used to satisfy the company's contract liability requirements including allocations to life insurance reserves, pension plan reserves and certain additional obligational items.

The investment yield allocated to the life insurance company is subject to current taxation at regular corporate tax rates. For this purpose, the net long-term capital gains are includible in taxable investment income. However, these gains are excluded if the life insurance company uses the alternative capital gains tax rate.

The investment income allocable to policyholders is permitted to accumulate tax free until distributed. In the case of insured death benefits, no Federal income tax whatsoever is levied. In fiscal year 1970, 1,795 life insurance companies reported gross income of $49.9 billion, on which they paid $1.2 billion in Federal taxes.

Other insurance companies.—In general, other insurance companies are taxable at ordinary corporate rates. For this purpose, taxable income includes investment income and underwriting income. (Premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred). Total income is reduced by amounts set aside for losses, expenses or reserves. In fiscal year 1970, other insurance companies reported gross income of $34.3 billion, on which they paid Federal taxes of $167 million.

REAL ESTATE INVESTMENT TRUSTS

Real estate investment trusts (REIT's) which comply with the requirements of the Internal Revenue Code provide a conduit through which income from equity and mortgage investments in real estate, and from stock and securities, can be distributed to investors without being subjected to a tax at the trust level. In computing taxable income, qualifying REITs are permitted a deduction for dividends paid, including capital gain dividends, to their shareholders.

In general, to qualify for this deduction a REIT must distribute at least 90 percent of its net income to its shareholders. A REIT also must have at least 100 shareholders, and at least 75 percent of its gross income must be from specified real estate investments. Up to 25 percent of REIT income may be from dividends, interest and gain from the sale of stock or securities, and up to 25 percent of the value of REIT assets may be in securities. In fiscal 1970, 292 returns reported gross income of $395 million and paid Federal taxes of $262,000.

POOLED INCOME FUNDS

Present law provides that a taxable trust which meets certain requirements and thereby qualifies under the Internal Revenue Code as a pooled income fund is allowed a deduction for amounts that are set aside for charity. Under a pooled income fund arrangement, a person transfers property to a public charity and retains an income interest in the property for the life of one or more beneficiaries living at the time of the transfer. A public charity, in turn, places the property in an investment pool and pays the donor (and any other designated beneficiary) the income attributable to the property for life.

Although the trust is not exempt from income tax, it is entitled to deduct amounts set aside for charitable purposes to the extent of the fund's long-term capital gain income. Accordingly, since capital gains are normally allocable to the public charity remainderman, the long-term capital gain income of the trust is not subject to tax. In the case of short-term capital gain income, the trust is entitled to a deduction only for amounts that the trust actually pays out as a charitable contribution during the year. Thus, the trust is subject to tax on the amount of any short-term capital gain income unless the amount of this gain is paid out to charity during the year. In fiscal 1970, 5,221 pooled income fund returns reported gross income of $25.6 million, on which they paid $1.5 million in Federal taxes.

EXEMPT ORGANIZATIONS

Under present law, certain types of organizations which meet various requirements under the Internal Revenue Code are generally exempt from Federal income tax. These organizations may be corpora-

tions or trusts and principally include charitable, religious, and educational institutions, social welfare organizations, civic leagues, and social clubs.

Although the investment income derived from certain passive sources such as dividends, interest, certain rents, royalties, and capital gains is not subject to tax, any income that is unrelated business income is subject to tax at regular individual or corporate rates. Generally, unrelated business income means income which is derived from regularly carrying on any trade or business that is not substantially related to the purpose for which the organization received its exemption. Although this income is subject to tax, various restrictions are imposed as to the extent to which an exempt organization may engage in business activities which are not related to its exempt purpose.

In addition to the tax on unrelated business income, certain tax-exempt organizations which are classified as private foundations are subject to a 4-percent excise tax on their net investment income which is generally defined to include interest, dividends, certain rents, royalties, and net capital gains. For fiscal year 1972, it is estimated that the 4 percent excise tax will yield approximately $50 million in Federal revenues.

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Appendix A

Business Week article entitled "Are the Institutions Wrecking Wall Street?"

[From Business Week, June 2, 1973]

Are the Institutions Wrecking Wall Street?

"Like the curator of the National Zoo," said G. Bradford Cook, in his last days as chairman of the Securities & Exchange Commission, "I feel constrained to warn: The individual investor has acquired the status of an endangered species."

The individual investor is virtually gone from Wall Street these days—his place taken by the mutual funds, insurance companies, pension funds, and bank trust departments that buy and sell shares in colossal lots.

It is these institutions that dominate the nation's securities markets today, and if their dominance is forcing some long overdue changes in the basic structure of Wall Street, it is worrying a great many people who do not like what the institutions are doing with their enormous resources.

It is a fact that institutions trade stocks in such huge quantities that they accentuate price swings in the market—all the more so because institutions increasingly limit their investing to a relative handful of stocks. What has emerged is a highly volatile market in a few issues, a lackluster market in most issues—and a closed door to many of the companies that want to take their shares public. Beyond all that—and one prime reason the small investor has deserted the market—are allegations that institutions, because of their huge holdings, are privy to inside information of which the small investor is left ignorant. One example: While institutions got the word about Equity Funding and took to the boats, not one single wirehouse warned retail clients to bail out.

The current state of Wall Street—stock prices down sharply, dozens of brokerage houses in financial distress, the flow of new issues down to a trickle—has spotlighted the dominance of the institutions. But the concern would be there even if Wall Street were booming, because the growing might of the institutions, and the way they use that might, have such profound implications for the future of not only the securities industry, but of U.S. business in general.

"The swing to institutional dominance," says John C. Whitehead, chairman of the Securities Industry Assn. and a Goldman, Sachs partner, "has changed the character of the markets, endangered their

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valuation capability, and demolished their liquidity." James M. Roche, until recently chief executive of General Motors Corp., frets about "the deplorable state of our capital markets—at the precise time in our national history when we face an extraordinary need for capital and for strong, vigorous capital markets." Roger G. Kennedy, vice-president for financial affairs at the Ford Foundation, says: "I don't believe you can call this a problem, because problem means an abnormality, something that will go away."

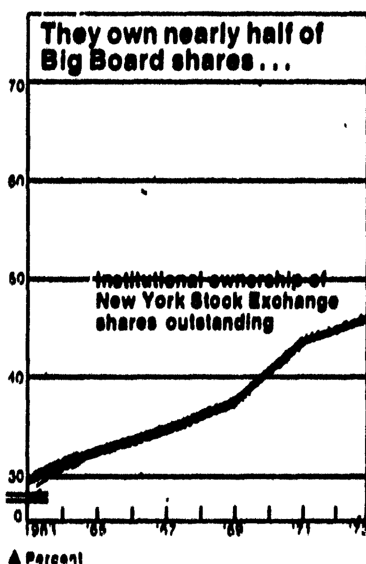
But the institutional domination of Wall Street will not go away. Rather, it is becoming more intense every day.

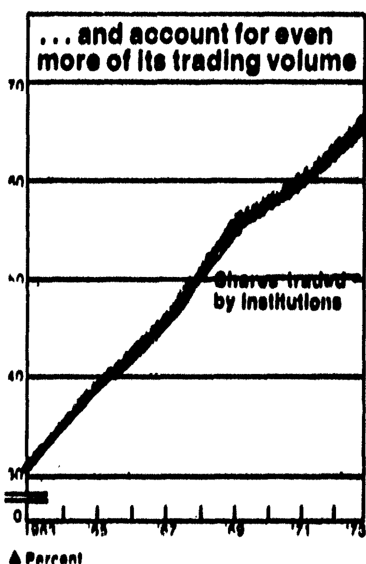
"In 1963," says Whitehead, "institutional investors accounted for 35% of the dollar value of New York Stock Exchange trading volume. That percentage today is over 70%. In some stocks, 90% of volume. is institutional." President Paul Kolton of the American Stock Exchange estimates the total equity holdings of financial institutions today at $310-billion. (Banks hold $170-billion of that, mutual funds $45-billion, insurance companies $42-billion, foundations, investment counsellors, and smaller institutions the rest.) Robert Soldofsky, professor of finance at the University of Iowa, calculates the institutional total will grow to $714-billion by 1980, and to $5-trillion by the end of the century.

THE PASSING OF THE 'PRIVATE CLUB' EXCHANGE

There is a positive side to institutional dominance. The institutions have smashed the stock exchange's fixed commission rules that reward inefficiency by requiring all brokers to charge the same commission on a trade. Price competition is forcing Wall Street to change dramatically from what it used to be—a mélange of thousands of firms, most of them small, poorly capitalized, and badly managed. Tomorrow's Wall Street will mostly feature big, well-capitalized, professionally managed houses. The institutions, by seeking stock exchange membership, are forcing the exchanges themselves to change. No longer are exchanges the private clubs they had been. The institutions are forcing the exchanges to reexamine their basic operating practices, and the exchanges of the future—or, perhaps, the single, central, automated exchange of the future—will be more efficient than exchanges have been in the past.

How the Institutions dominate Wall Street





But there is a price tag on all those changes, and it may prove to be a very high one. "If institutional dominance continues on its present course," warns Whitehead, "we can look forward in another decade to complete dominance of our markets and of our corporations by a relatively small handful of institutions—the kind of industrial society that currently exists in Europe and Japan."

The outstanding characteristic of markets overseas is their extraordinary lack of liquidity. In the U.S. today, such illiquidity is fast becoming the rule in the overwhelming majority of stocks. "In the name of playing safe with their clients' money," says chairman James Needham of the NYSE, "large institutional investors have been concentrating their activity in an ever-narrowing circle of investment choices."

To C. V. Wood, Jr., president of McCulloch Oil Corp. and chairman of the newly formed Committee of Publicly Owned Companies, this ever-narrowing circle consists of "70 sacred cows." President Paul Hallingby, Jr., of White, Weld & Co. thinks that "there are 200 or 300 stocks today in which liquidity is impressive." But a Boston executive puts the figure at only "25 to 40."

Morgan Guaranty Trust Co., with the biggest and often the boldest of the bank trust departments, holds 569 different stocks in its vaults, while the Ford Foundation owns 250 issues and Kennedy says, "I wish it were 1,000. If we could find that many well-managed companies that were well researched and carefully studied, we'd be in them."

Less important than what the institutions hold, though, is what they are buying today. Notes Whitehead: "One of our largest banks received over $1-billion in retirement and pension fund money to invest last year. It placed 65% of that in just seven stocks, another 20% in eight others, and the balance in just 15 more."

TWO-TIER WOES AND REWARDS

So there is a two-tier stock market today. In the top tier, says Hallingby of White, Weld, the interest comes from individuals as well as institutions. In the lower tier, by contrast, "we've got the institutions absent and the individual disinterested."

The vast majority of stocks—90% or more—fall into the bottom tier, and with the institutions disinterested and the public absent, the price performance of these stocks has been simply awful. Wood's Committee of Publicly Owned Companies notes that in the 12 months that ended last March, the price of an average NYSE share declined by 23%, while the average decline of an American Stock Exchange share was 33%. Fully 75% of listed companies increased earnings, but only 5% increased price/earnings ratios.

"Between 1968 and 1972," says Whitehead, "our gross national product was up 33%, personal income was up 36%, and personal savings were at an all-time record. Yet stock prices, as measured by key, unweighted indexes, are off 50% from their 1968 peak."

The two-tier market rewards a few companies lavishly. Because they are institutional favorites, they are free to tap the market for additional equity financing, to use their stock for acquisitions, and to reward key people with valuable stock options. It penalizes a great many companies—shutting the door to additional equity financing and making stock options relatively worthless. Because there is market interest in only a relative handful of stocks, newer, smaller companies are finding it increasingly difficult to go public at all. And because the rewards of becoming an institutional favorite are so great, there is a temptation to do almost anything to achieve it—from cooking the books to lavishing favors on the analysts who recommend stocks and the money managers who buy them.

Whitehead was chairman of a Wall Street committee that provided technical advice to the group that did the study, and he observes that all the data came from 1969 and earlier. "Now there are new facts and figures," he remarks, "facts and figures that didn't exist in 1969, and they are both impressive and alarming."

Morgan Guaranty owns more common stock than any other institution on the face of the earth—$2 billion worth of IBM, $1.1 billion of Kodak, $500-million or more of Avon, Sears, and Xerox. And Morgan executives insist that they have figures showing that their bank still invests for the long haul—that it turned over only 11.5% of its $27-billion portfolio in 1972.

But Morgan also has figures showing that the average mutual fund turned over nearly half of its portfolio last year, and most institutions seem to be going after short-term trading profits more than ever before. That is worrisome because when the institutions trade, they do so in such enormous lots. Charles S. La Follette, senior vice-president of finance at Crown Zellerbach Corp., is concerned about "the pandemonium that would take place if, for example, three institutions sold all their Polaroid or Xerox."

Foreign investors seem particularly disturbed by this trend. In London, Duncan FitzWilliams of the Foreign & Colonial Investment Trust complains that U.S. institutions "are no better than the old odd-lotters. There are huge swings. If you get many institutions to sell one stock, it falls 20 points in one day."

There is nothing really inexplicable about the transformation of institutions, over the last decade, from investors to traders—and the growing tendency of institutions to trade just a very limited number of issues. "The funds all follow the recommendations of a few well-known research advisers," says Robert H. Lentz, vice-president and chief counsel of Litton Industries, Inc. A thoughtful answer also comes from Sidney Homer, now a limited partner at Salomon Bros., but for years its leading theorist: "There are strong structural reasons why institutions tend to go one way or the other massively and almost in unison. They talk together. They know what the others are thinking and doing. They know their fellows can dominate near-term market trends. Furthermore, if their mistakes are shared with the best people in the biggest institutions, they are not censured as severely as if their mistakes arose from bucking a generally accepted opinion."

THE CORPORATION'S HOMEMADE PROBLEM

While there is thus a reasonable rationale behind institutional movements and institutional portfolio concentration, it is of small comfort to the many corporations presently suffering. It is of equally small comfort that, in many cases, the problem is of the corporation's own making.

Company pension plans are the fastest-growing sector of all the fast-growing institutional groups. Already, they account for around 10 percent of total U.S. equities; by the end of the century, in the estimate of Professor Soldofsky of Iowa, they will account for 26 percent, or $2.36-trillion.

Meanwhile, in their eagerness to contribute less of their earnings to their employee plans, corporations press their pension fund managers for pie-in-the-sky performance. In one tabulation of the instructions given managers by 40 corporations, 25 were insisting on "performance"; many ask their managers to outperform the S&P by 25% or more, a goal which would have called for a gain last year of nearly 20%.

To Roger Kennedy of the Ford Foundation, such aims appear unrealistic: "We see a total return of 9% or 10% a year as just fine: We think we'll be lucky to get 9% over the next five years."

But the demand for high performance is there, with banks competing against each other for pension fund business—and against insurance companies and investment advisory services as well. The failure to perform can result in the loss of valuable business, so portfolio managers struggle to outdo—or at least stay even with—their rivals. The result is the herd mentality that grips institutions today—presenting corporations with a plethora of problems.

Among the worst of these is the present worthlessness of previously prized stock options. Says McCulloch Oil's Wood: "My executives hold stock options between $12 and $25 a share, but the price of the stock is now less than $10. They've lost part of their compensation, and I don't know what to do about it. You can't give them new options until their old ones have expired. It has affected their morale, of course, but thank God everyone else has been whacked in the same way."

Indeed they have, unless they are lucky enough to own options in an institutional darling. "Employees have knocked their brains out to improve our profit position," laments Robert V. Luongo, senior vice-president finance for Pennsylvania's Fischer & Porter Co., instrument and control manufacturers, who finds that rewarding them through stock options is now "hardly incentive." "We can no longer say, 'Hey guys, you've done a great job, here's another stock option.' They'll just come back and say that they haven't been able to exercise their last ones. Some of our people are in their fourth year of holding on to options. They say, 'Don't offer us any more incentives.' We may have to turn around and compensate them through direct salary."

Institutional fascination with just a few issues is dangerous in other ways. When a stock falls out of institutional favor, it can plummet like a stone—with a disturbing impact on the over-all tenor of the market. A classic case is Levitz Furniture Corp., which plunged from $47 to $33 in less than a half-hour last Sept. 29—a fall of nearly 30%. Virtually all the selling was by institutions as it was when Wrigley was hit for 30 points in one day, and when Handleman Co. lost 51% of its value in a single trade.

Because of this "air-pocket syndrome," institutions often cannot get out of stocks they want to sell, and despite the enormous resources of the institutions, many are literally starved for liquidity—locked into stocks they cannot dispose of without suffering heavy losses. It is painfully apparent that a substantial share of the assets of some of the biggest institutions are frozen—especially when the market is as depressed as it has been the past four months.

Perhaps the most disturbing aspect of this is that innumerable pension funds, which look rich on paper, would look considerably poorer if the stocks they are invested in ever had to be sold: many would even be actuarially unsound.

Most of the bank money in the market represents pension fund assets, and most banks have been as guilty as anyone in running with the pack—in narrowing their investing to just a few high-multiple issues.

People have come up with plenty of ways of dealing with institutional dominance—from breaking up the institutions into smaller units to limiting the amount of an individual issue that an institution can own, or the amount it can sell. Speaking in New York last week, Donald T. Regan, chief executive of Merrill Lynch and vice-chairman of the New York Stock Exchange, warned that "some restrictive formula about institutional sales may have to be worked out. If the number and amount of blocks dumped on the market at one time were reduced, large price swings would be minimized. That protection could only be realized at the cost of putting a limit on the institutions' right to instant liquidity. It may not be too high a cost."

NEW FACTS AND FIGURES

The conventional wisdom on Wall Street is that institutions are a stabilizing force in the market because they are mature, sophisticated investors, armed with plenty of solid research—in for the long haul and not likely to act precipitously. But much of that conventional wisdom is based on a report on institutional investors completed by the Security & Exchange Commission two years ago, and already sadly out of date.

A somewhat similar problem is noted by William A. Buzick, Jr., chairman of Consolidated Foods Corp. He complains that "institutional investors can trade in and out of our stock, and some institutions are less investors than traders. Many of them will sell off a profitable stock to buy something else they see as a bargain." The result of this institutional practice can be, for many companies, a lackluster stock price.

"This," Buzick observes, "goes to the intangible of morale within the company. You have stock purchase plans and pensions, but more than that you've got pride. You want to see your contributions recognized."

WHEN THE P/E RATIO IS TOO LOW

The agony is even more intense for the company that wants to tap the stock market for money. Batten, Barton, Durstine & Osborn, one of the world's largest advertising agencies, made plans last May (when ad agency stocks were selling at an average 15 times earnings) to go public in the fall. By October, however, the average multiple was down to 10. It has now sunk to 7, and the agency, says chief executive Tom Dillon, has shelved its plan for going public. In Dillon's words, "There are maybe 20 people in the agency who are aching a bit" through not being able to become stockholders.

Many companies, today, hardly know where to turn for expansion funds: President William T. Gimbel, of Los Angeles' Reliance Steel & Aluminum Co., says company executives now spend "70% or 80% of our time" hunting for cash because they can't raise money in the stock market. Reginald Jones, chairman of General Electric Co., recently examined price/earnings ratios of the Standard & Poor's 425 industrials and came up with some rather startling conclusions: 18 companies, with a composite multiple of 47, accounted for an increase equal to all the growth—$111-billion—of the stocks in the index between 1965 and the end of 1972.

"This means that, taken together," says Jones, "the composite stock market valuation of the other 407 companies hasn't increased, during that period, by a dime . . . and the aggregate multiple of these other 407 stocks was only in the nine to 10 range, at the high." Concluded Jones: "The great disparities in valuations cause concern about the ability of the basic industrial backbone of our economy to attract the risk capital needed to continue the economy's growth."

Wood of McCulloch gives a good explanation of the risks of raising equity capital with a low p/e stock: "If a company selling at 10 times earnings sells equity, it has to make a 10% return on that equity to avoid dropping earnings per share. If it's selling at 20 times, by contrast, it only needs to produce a 5% return. If it's selling at 30 times, only 3.3%. You don't mind taking the risk of selling new equity when your multiple is 20 or 30, but nobody in his right mind is going to raise capital through equity when his stock is selling at 10 times." Today, of course, most stocks are selling at 10 times earnings or less.

Speaking specifically of McCulloch, Wood says: "We had planned to raise $25-million in equity this year. We can't afford to sell equity now—so we'll have to raise that money another way. These days,

though, a company has only one other choice: to ruin its debt/equity ratio, and once you do that lenders want so many sweeteners you'd better be selling stock."

Wood raises still another problem. "We have fears of being acquired," he says. "When your company gets down to selling around book, it scares the hell out of you. You're bound to be nervous."

Big Board Chairman Needham worries about low multiples bringing a rash of takeovers from abroad. Joseph E. Cole, chairman of Cleveland's Cole National Corp., is concerned about a rash of companies closing down—and resultant unemployment. Cole, who is also finance chairman of the Democratic Party, predicts that "companies are going to have to shut down operations, putting people out of work—unless the small investor can be brought back to the market and companies can raise capital."

Without the individual investor, most business and financial executives agree, the capital markets cannot do their job. Furthermore, it also seems generally agreed, the individual will not return as long as he has his present feelings about the domination of the markets by institutions. Former SEC Chairman Cook referred to the "frequently expressed feeling" that "the cards are stacked against the individual in the market: that institutions get all the good research, the best prices, and—sometimes—inside information." Moreover, quantitative research proves that this is not just a gut feeling. The great majority of investors, recent surveys show, still believe that the stock market has good long-term potential, and even that it remains a good hedge against inflation—though some statistics might indicate otherwise. But they also believe it is being manipulated against them—partly through the unfair advantages of the institutions.

A FIGHTING CHANCE FOR INDIVIDUALS?

What can be done to give the individual an equal opportunity—or, at the very least, a fighting chance? The question, clearly, is subject to deep debate—as indeed is the question of whether anything should be done at all. There are those—such as Dr. Richard M. Cyert, president of Pittsburgh's Carnegie-Mellon University, and Dr. James H. Lorie of the University of Chicago, one of the world's most celebrated market theoreticians—who believe it would be wrong to restrict the freedom of institutions. Others, including Morgan Guaranty, doubt that the problem is as pressing as it presently appears.

In Washington, however, in most parts of Wall Street, and among businessmen all over the country surveyed by Business Week, there is a strong feeling that something has to be done—and quickly.

On Capitol Hill, a House staffer warns: "What we have is a situation not unlike the 1920s. Institutions are basically just a lot of pooled money—and what we are seeing today is the impact of pooling." Adds John E. Moss (D.-Calif.), chairman of the House subcommittee on commerce and finance: "I don't think we yet know the full impact of the institution on the markets. But this problem is key to what we will be doing to develop a central market system. It raises a serious question of the nature and depth of the auction market, if one continues to exist at all."

The key suggestions, ranked according to the degree of support they appear to enjoy:

1. All institutions should be legally obliged to reveal their holdings, at least quarterly, and to disclose their trading during the quarter.
2. No institution should be allowed to sell more than a given amount of any given stock in any one day.
3. No institution should be allowed to hold more than a small, set percentage of stock in one company.
4. Large institutions should be "broken up."
5. Institutions should be subject to the same restrictions as corporate insiders.
6. Capital gains treatment of small investors should be liberalized, as one means of redressing the balance between individuals and institutions.

There are a number of other suggestions, less widely supported, including limitations—as in commodity markets—on the amount a stock can move in one day; the idea that institutions should—as some are about to on the Philadelphia-Baltimore-Washington exchange—become market makers; a ban on private meetings between corporate managements and institutional shareholders; and a requirement that institutions give 30 days notice of their intention to buy or sell large quantities of any stock in their portfolios.

On Suggestion No. 1 there is near unanimity: This is overdue. Whitehead rather ruefully points out that "the most important recommendation of the SEC's 1971 Institutional Investor Study was that there should be legislation requiring the institutions to disclose their holdings, and their trading, every quarter. How anyone can oppose this sort of essential information gathering is beyond me." One institution that certainly does not oppose it is the Ford Foundation, whose Roger Kennedy says cheerfully: "Sure, we'll disclose as often as you like—every week, if necessary." But Kennedy cautions that too frequent disclosure could conceivably lead to a "follow my leader" type of derby—with everyone, institutions and individuals alike, racing along behind a few favorites. A similar argument is

advanced by Morgan Guaranty: "If brokers know our position, and know Morgan is selling, our holdings can be destroyed. Disclosure would work to our clients' disadvantage."

On balance, however, the benefits of disclosure would appear to outweigh heavily such possible drawbacks. For one thing, the revelation that many large institutions—such as the Ford Foundation and Morgan Guaranty—were *not* trading a given stock would probably serve to discourage panic selling (and panic buying) of a security. For another, disclosure would probably reveal that, in many cases, some distinguished institutions were buying what others, equally distinguished, were selling. (For example: While Morgan Guaranty's holdings of Polaroid were up $170-million last year, First National City Bank was selling—to the tune of $55-million.)

For a third reason, many portfolio managers try to follow the leaders, particularly the bank trusts, anyway, relying not on research but on guesswork and rumor as to what the leaders are doing. If they knew what the leaders were doing—and not doing—this argument goes, they would be less likely to react violently to rumors and to dump stocks on the slightest sign of weakness.

Finally, and perhaps most vital, disclosure would increase the confidence of individuals that the markets were not being manipulated by financiers in dark, small, smoky rooms. Says George L. Shinn, new president of Merrill Lynch: "The individual investor feels much more comfortable when he has more knowledge. When people don't know what's happening in the stock market, they either do nothing or they withdraw. We're seeing both symptoms."

Suggestion No. 2—that institutional dumping should be legally limited—is strongly favored, in one form or another, by powerful voices. It is also strongly disfavored by not a few others—notably from the stock exchanges. But in Business Week's survey, the pros seem to, outnumber the cons strongly. John Whitehead's firm of Goldman, Sachs—with Salomon Bros., one of the two top institutional brokers—could be expected to suffer from any curbs on institutional trading. Whitehead, nonetheless, sees the situation as so serious that he questions not whether there should be curbs, but what form the curbs should take.

Shinn thinks the question needs more study, but he does think it is reasonable to put limitations both on the size of the blocks and the way they are sold. "The problems with institutions," he says, "is their desire for instant liquidity. They spend weeks or months accumulating blocks and then want to dump them in one day. Curbs should relate to the average daily volume in a stock and probably to its 'float.' "

More drastic are the ideas of the Committee of Publicly Owned Companies, whose Chairman Wood proposes: "Institutions should be kept

from selling more than one-quarter of 1% of any company's outstanding stock in one month. An institution selling that much stock hurts, but we can live with it. It's when they drop those two and three percents that you get problems." Another approach comes from La Follette at Crown Zellerbach. He believes that trading could be limited—but by placing limits on daily price movements, as in the commodities markets.

Kolton of the AMEX goes a long way toward accepting the principle of limits on institutional trading. The key question, he feels, is whether institutions will come to grips with their responsibilities—"to their markets, as well as to their beneficial owners."

"If they'll face these responsibilities," Kolton reasons, "there are a number of ways their impact could be controlled." Among those the Amex might favor: the application to institutions of some of the rules it applies to its own registered traders. For instance, such traders must "stabilize" on 75% of their trades—selling on upticks, buying on downs.

Executives of other exchanges are a lot more enthusiastic about Suggestion No. 3, which would limit the size, or percentage, of institutional holdings. Thomas Phelan, president of the Pacific Stock Exchange, feels that the market is now at a crossroads: "If conditions get any worse, definite limits should be placed on institutional holdings." John G. Weithers, executive vice-president of the Midwest Stock Exchange, is thinking along similar lines: "If you can't get the institutional problem into equilibrium without curbs, curbs are better than not doing it at all."

The Committee of Publicly Owned Companies says bluntly: "The amount of securities of a particular company that an institution or affiliated group of institutions may hold should be strictly limited." Industrialist Jacob O. Kamm, who on June 1 returned to the presidency of American Ship Building Co., does not favor fixing limits on institutional ownership by percentages, but he does believe in legislation that would have another, not dissimilar objective: that of keeping institutions from loading up portfolios with a handful of stocks. The average mutual fund, Robert A. Levy, of Computer Directions Advisors, points out, puts 30% of its assets into 10 stocks, while many funds have more than 50% in only 10 securities.

Speaking for one of the largest institutions, Kennedy of the Ford Foundation mentions that the Tax Reform Act of 1969 imposed some fairly stringent restrictions on foundations. "If we can do it," he says, "so can other institutions." Kennedy does point out that any percentage limitation on ownership might be less beneficial if it were applied equally to companies of all sizes. "In a small company," he says, "an institution may need to own a larger share at the outset to provide the company with needed capital."

Suggestion No. 4, concerning the size of institutions, has support. "I think the Eisenhower farewell address is an important document," says Kennedy. "I believe that power should be effective—but that it should also be diffused."

There is a strong undercurrent of feeling these days on Capitol Hill, but also out in the business community, that the institutions are just too big—that they should be broken up. Thomas Phelan believes that the size of an institution—as well as the size of its holdings in a company—should be limited. Whitehead notes that the largest U.S. insurance company controls $33-billion in investable funds—11 times the capital of the entire U.S. securities industry.

Representative Wright Patman (D-Tex.), chairman of the House Banking & Currency Committee, has long been in favor of forcing banks to spin off their trust departments. President Cyert of Carnegie-Mellon does not favor other sorts of restrictions on institutions, but he does feel that the regulation of institutional size may someday become necessary. He is not pushing for such a breakup, but he does say: "If the concern is concentration of power, then we should break up the institutions and bring them down in size, rather than try to regulate their freedom of choice."

Suggestion No. 5. Harold S. Coleman, senior partner of Bruns, Nordeman, the brokerage house, favors another approach: Treat institutions as corporate insiders are treated. As insiders, institutions would be obliged to disclose their holdings in stock, as well as their purchases and sales.

As insiders, they would also be discouraged from taking short-term profits in a stock—though Coleman is not ready to carry his idea that far. Should it happen though, the institutions, as insiders, would be forced to turn over any short-term profits to the company involved. And, as insiders, their responsibilities in regard to the use of information would be a good deal clearer than they are today.

In theory, at least, institutions would take big positions only on a long-term basis. Because they could no longer count on bailing out of a large position in a hurry, they would be encouraged to spread their wealth among a greater array of companies. This should also encourage the smaller investor to return to Wall Street—knowing that the major holders of a company's stock would be subject to a more rigorous set of standards.

As to Suggestion No. 6, the Committee of Publicly Owned Companies wants to get the tax laws changed as one means of bringing more small investors back into the market. "We believe" says the committee, "that the first $10,000 in capital gains by smaller investors should be exempted."

The Securities Industry Assn. would change the tax laws another way—scaling down the capital gains rate according to the length of time the stock has been held. If the stock were held long enough, the investor would pay only a very modest tax. That, says Whitehead, would unleash more than $200-billion—money now locked into positions by the potential capital gains tax bite. At the same time, he estimates, it would yield $20-billion in tax revenues. Meanwhile, the SEC has urged Congress to consider incentives that would encourage investment in small, young companies—the sort of ventures most institutions will not touch.

What all observers are convinced of is what Hallingby of White, Weld calls "the secular trend to institutionalization of savings."

Unless something quite unexpected happens, the flow of money into pension funds—and so into the banks and insurance companies—will continue to grow at a pretty rapid rate. In other words, the financial clout of the institutions will increase—not decrease—in the years ahead.

At the moment, it looks as if this will be allowed to happen without checks or controls: the securities legislation presently stalled on Capitol Hill does not even touch on the dangers of institutional dominance of the markets: Bradford Cook was well aware of the peril—but, since his resignation, the SEC is paralyzed.

If institutional influence increases uncontrolled, the consequences for the capitalist system may be disastrous. As Roche of General Motors has said, "Institutions do not serve the same function in our capital markets as do masses of individuals, and the *vitality* of these markets—based on the increased participation of the individual in corporate ownership—is the capitalist system's life blood.

"Without this vitality," Roche goes on, "many of the business enterprises in our nation . . . will be unable to obtain new public financing . . . to modernize . . . to provide the goods, services, and employment opportunities our nation needs; they could be targets for takeovers by foreign capital; they could face problems of crisis magnitude."

The leading institutional investors:

Most of the top 10 are banks

Institution	Investment portfolios [billions of dollars] *
Morgan Guaranty Trust	$27.2
Bankers Trust	19.9
Prudential Insurance	18.3
First National City Bank	17.2
U.S. Trust of New York	17.0
Metropolitan Life Insurance	16.5
Manufacturers Hanover Trust	10.9
Mellon National Bank & Trust	10.5
Investors Diversified Services	9.7
Chase Manhattan Bank	9.2

*Excludes real estate investments

Data: Money Market Directories, Inc.

Appendix B

Fortune article entitled "How the Terrible Two-Tier Market Came to Wall Street"

99-822 O - 73 - 21 (Pt. 1)

[From Fortune magazine, July 1973]

HOW THE TERRIBLE TWO-TIER MARKET CAME TO WALL STREET

(By Carol J. Loomis)

To many businessmen the stock market this year has seemed inexplicable, about as bizarre, say, as Watergate. The market has ignored the large, and often sensational, earnings gains being reported by corporations, and has gone relentlessly down. More than that, it has gone down with a great unevenness, much as a giant popover might lose steam.

On the one hand, the prices and price-earnings ratios of a few dozen institutional favorites—known around as "the Vestal Virgins"—have fallen only moderately. In fact, some of these stocks, among them Eli Lilly (at about forty times estimated 1973 earnings) and Avon (at about fifty-two times), were recently selling very near their highest p-e ratios ever. In contrast, the great majority of stocks have sunk to levels that suggest they have become virtual pariahs. In the early months of this year, Wall Street was already talking about a "two-tier market" of remarkable proportions. By May, stocks that had seemed cheap at March prices had collapsed still further—many to levels of four or five times expected 1973 earnings—and the situation was being described as unique in stock-market history.

The description is probably accurate, though a bit difficult to check out. What can be said with certainty is that there has been no comparable situation in recent history. This conclusion emerges from a special statistical study of price-earnings ratios that Fortune made for this article. Covering the period since 1948, the year before the great postwar bull market got under way, the study embraced 382 companies, most of them prominent members of the business community. It ascertained their p-e ratios at the end of every year through 1972 (the year-end price was measured against that year's earnings) and also at the end of the first quarter of 1973. Then for each period a "frequency distribution" analysis was done; that is, Fortune determined how many of those 382 companies had p-e ratios under 5 at the end of each period, how many had a p-e between 5 and 10, and so on up the scale.

The results show clearly that 1973 has been an extraordinary year in the market, to be ranked with such aberrant years as 1948 and 1961.

In 1948 stocks were so out of favor that a company was a real highflyer if its p-e was above 10. The median p-e for those 382 stocks that year was an incredibly low 5.8. In contrast, 1961 was a euphoric time when a p-e ratio below 10 was an oddity; the median was way up at 19.4.

TWO EXTREMES AT ONCE

But those were periods when the whole market was carried to extremes. The market this year has been something else, a case of two extremes at once, and in between them a very deflated median. Specifically, at the end of 1973's first quarter, before the severe declines of April and May, the median p-e for those 382 stocks was 11.5, the lowest level since 1957. And in a pattern not otherwise seen during the twenty-six years under examination, 128 stocks had a p-e below 10 and thirty-four stocks had a p-e above 30. Moreover, because the stocks in that upper tier were so highly valued by the market, they absorbed a far greater proportion of investment dollars than the number of companies represented there would indicate.

No doubt, then, there *is* today a two-tier market of major dimensions, as shown in the chart on page 44. No doubt, also, that this situation is raising some new and very serious economic questions. The basic questions concern the country's capital markets, which have in the past demonstrated an outstanding ability to delivery equity capital to broad range of companies. The two-tier market suggests, however, that the range is narrowing and the universe in which investors are willing to sink their money is shrinking. If this situation persists, how are the great majority of companies to raise the equity capital they may need? Beyond that, what happens to the new company seeking equity capital for the first time? Optimistic answers to these questions are hard to come by.

Inevitably, these questions also lead to others about the role of the instititions in the stock market. The two-tier market owes its existence to the actions, and the nonactions, of both institutional and individual investors. But market conditions at the moment suggest that control of the situation lies in the hands of the institutions, and that the two-tier market will disappear only if they—and in particular those giants, the bank trust departments—decide to swerve from the investment policies on which they have leaned very heavily in the last few years. The power of the institutions to shape events seems right now more awesome than ever before—and also more subject to attack.

Already, of course, all sorts of companies in the lower tier of the market have expressed outrage at the low valuations placed on their stocks. Their very specific complaints have lately been joined by others focusing on the broader problem. Two notable protests came

recently from Reginald H. Jones, chairman of General Electric, and James M. Roche, retired chairman of General Motors. Jones was brought to worry about the ability of "the industrial backbone" of the economy to attract risk capital, and Roche warned that "our system cannot flourish solely on the basis of the health and strength of seventy-five glamour companies."

Even the Chairman of the New York Stock Exchange, James J. Needham, who would not normally think it his business to tout some stocks over others, was pushed to doing just about that. "It is certainly pertinent to inquire," he said deploringly in a speech, "why the large institutions persist in tightening their concentration in a favorite [few] stocks while ignoring hundreds of other choice investment opportunities."

INFLATION IS THE THIEF

That does sound like a pertinent line of inquiry to follow, and its pursuit should probably begin with a look at the bear market in which stocks have been trapped. This market, it would appear, reflects investors' growing recognition of certain negative points about stocks that were described by Fortune in an October, 1971, article, "A Bad New Era for Common Stocks." Its thesis was that inflation is robbing stocks of their value. For one thing, the "cost-push" inflation of the late 1960's put enormous pressure on corporate profits. Even now, with inflation more of the "demand-pull" variety and corporate profits booming, investors are obviously looking ahead with apprehension, fearing both a return to a cost-push era and a descent into a recession.

Second, inflation had by 1970 raised interest rates to very high levels and had forced investors to begin reconsidering what returns they expect from stocks. Historically, those returns, taken over the long term and on the average, have worked out to about 9.5 percent, including both capital gains and dividends. As long as interest rates were at much lower levels than 9.5 percent, which was the case during most of the postwar period, an expectation of such a return on stocks shaped up as very satisfactory. But with the yields of high-grade utility bonds above 9 percent, as they were for a time in 1970, or between 7.5 percent and 8 percent, as they have been recently, a return of 9.5 percent on stocks scarcely seems adequate compensation for the added risks that stocks involve.

The logical reaction of investors is to mark down the prices of stocks to levels that suggest future returns will comfortably exceed the rates available on bonds (although one investor's conception of what stock premium is "comfortable" may differ from another's). It would appear that investors have recently been in the process of making such a markdown.

WHY THE DIVIDEND CEILING HURTS

At least a small part of the markdown can surely be attributed also to the government's ceiling on dividends, which until it was modified significantly last month, had limited annual increases, in general, to 4 percent a year—a number both less than the recent rate of inflation and less than the 6.4 percent rate of growth in total corporate dividends in the decade before the ceiling was installed. It can be argued, of course, that what investors do not get in dividends they will instead get eventually in capital gains. But many investors do not find that argument persuasive; they prefer the certainty of dividends to the uncertainty of capital gains (even though these gains get a preferential tax treatment). Any development that reduces the importance of dividends in the total return is regarded as adverse.

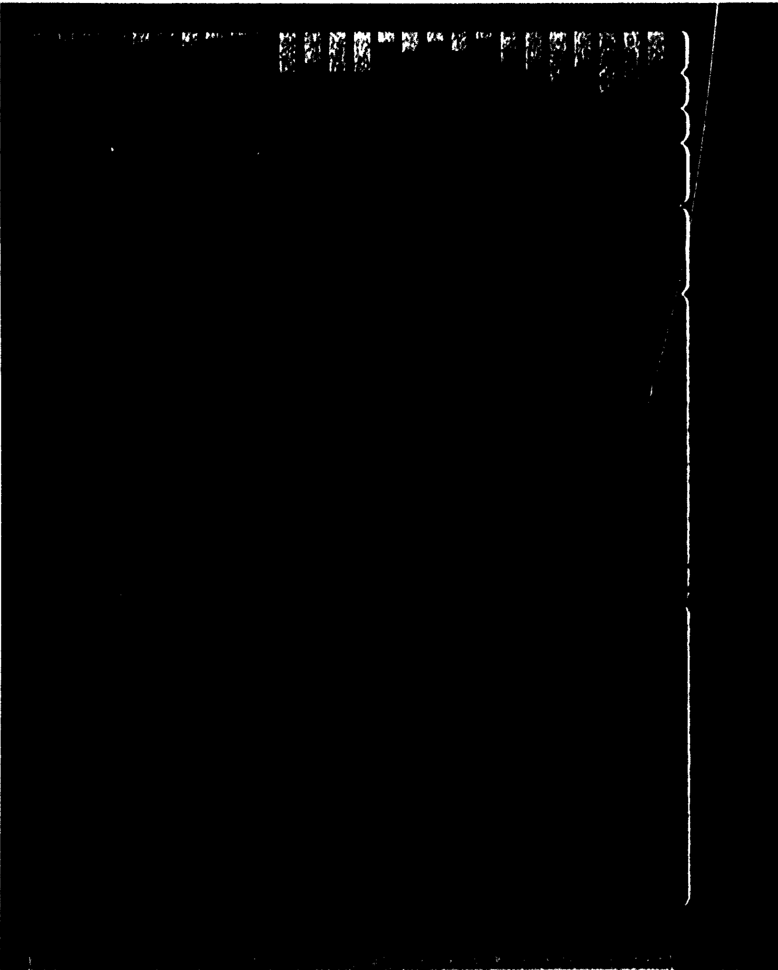
For all these reasons—doubts about profits and the economy, unhappiness about dividends, an awareness of what high interest rates mean—it is probably correct to say, as so many pundits have been saying, that a crisis of confidence has gripped the stock market. It seems much more doubtful that the crisis is also related to other developments, such as Watergate, the weakness in the dollar, and the sorry state of the brokerage industry. These developments seem peripheral, and in the case of the dollar, also closely tied to the basic problem of inflation. What investors are worried about is clearly something very fundamental, and also very resistant to correction.

Since the specter of inflation has been around for some time, it seems reasonable to wonder why stock prices so resolutely ignored its destructive effects through 1972. In other words, why only now the bear market? There are a couple of possible replies to that question. One is that it has simply taken the market a long time to comprehend that high rates of inflation, and with them high rates of interest, may be here to stay. The second reply is an attack upon the validity of the question itself. It all depends, it would appear, on which bear market it is you're talking about.

In the thinking of many investors, the bear market began this year, in January, when both the Dow-Jones industrial average and the Standard & Poor's 500 index hit their peaks; from those peaks until the end of May, the Dow-Jones average fell by 14 percent, the S. & P. index by 13. But those declines, though they probably come close to describing what happened to the total *dollars* invested in the market, delineate the bear market only up to a point. The problem with both the Dow-Jones and S. & P. indicators is that they are heavily affected by what happens to a limited number of large companies, whose experience may or may not reflect what is happening to all companies in the market. The S. & P. index, in particular, reflects the fortunes of companies that are both large and richly valued in the market;

I.B.M. alone, though it is but one stock out of 500 in the index, carries the weight of forty stocks.

To get a fix on what has been happening to the more typical company, it is necessary to look at an average that is both unweighted and broad based. This description happens to fit, among others, the average compiled by a stock-market service called Indicator Digest. Its procedure is simply to maintain an average of prices of all stocks on the New York Stock Exchange. That average peaked not this year but in late 1968! By mid-January of 1973, when the better-known averages peaked, the Indicator Digest average was already down 36 percent. In the next few months it proceeded to fall more than twice as fast as the S. & P. average. By the end of May the Indicator Digest average was down 54 percent from its 1968 high.



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This striking divergence between a broad-based and unweighted average and the more selective averages suggests that the foundations of the two-tier market have been under construction for some time. It may also suggest that the two-tier market is not a temporary phenomenon.

THE INDIVIDUAL HAS KEPT HIS COOL

Of all the groups that have had a hand in this market's construction, individual investors have probably played the most complicated role. It is a well-celebrated fact that individuals have for years—since 1959, in fact—been net sellers of stock (leaving aside, for the moment, their holdings of mutual funds). They remain, however, by far the biggest holders of stock, owning at the end of 1972 close to three-fourths of the total amount outstanding, worth about $850 billion. That leaves about $310 billion held by institutions and disproportionately concentrated, so studies have found, in the "big" stocks—those having the highest market value. Individual investors, perforce, are disproportionately concentrated in the smaller companies.

Their involvement with such stocks means that individuals have almost certainly taken a beating in this bear market, and it might be supposed this experience would have pushed their net sales of stock to new highs. All of those reports about the withdrawal of the individual investor from the market would also suggest that is true. But in fact, those reports appear to be greatly exaggerated. Federal Reserve figures for individuals (a category that includes nonprofit institutions, such as foundations and colleges) show that their biggest burst of selling came in the boom market of 1968, when they unloaded more than $12 billion of stock. Since then they have sold at a much more moderate rate, averaging $6.5 billion annually. Figures for the first quarter of 1973, though these are preliminary, show more of the same: no acceleration in selling at all.

It is possible, of course, that individuals stepped up their selling this spring, though if they did, much of the blame can possibly be given to margin calls, which increased enormously in the second quarter. In a fair number of cases—about a third of the total, one big brokerage firm says—margin calls were not being met. Even those margin customers staying in the market were not trading their holdings to any extent, nor were investors with cash accounts. In that respect, there is truth in all that talk about a flight from the market. Among other reasons, individuals were probably on the sidelines because of a reluctance, known to be ingrained in many investors, to sell at a loss. Any other way of selling has been hard to find lately.

A STUNNING REVERSAL IN MUTUAL FUNDS

With their direct holdings of stock, therefore, individual investors have stuck pretty much to the pattern of gradual selling they began to follow in 1959. But with their holdings of mutual funds, they have recently begun doing something entirely new. The investment world has long been used to a situation in which individuals were steady net buyers of mutual funds, with their purchases in many years going a long way to offset their net sales of regular stock. But last year, for the first time in at least thirty years, individuals redeemed more mutual-fund shares than they bought.

This reversal is surely related to the funds' inferior results in the last few years. Since 1968 the average fund, as tracked by Wiesenberger Services, has not paid off even as well as a 3 percent savings account. Just as surely this reversal is also related to certain alterations in regulatory policies and commission rates that have reduced the incentive brokerage firms and their salesmen used to have to sell mutual funds.

In any case, the changed circumstances of the funds are a major fact to be reckoned with in the stock market. As recently as 1969, the funds, more often than not playing the role of "anxious buyers," put $2.5 billion into stocks. Forced to meet redemptions, they turned into "anxious sellers" last year and took $1.9 billion out of the market. That meant a swing of $4.4 billion, and the negative impact on the market is difficult to overestimate. This year the swing may be extended still further. In the first quarter the funds were siphoning money from the market at an annual rate of $2.9 billion.

These pieces of gloom relate, of course, to the whole universe of mutual funds, and it should be realized that some funds—those relatively few with good records to talk about—have been taking in large chunks of money this year. And into what kind of stocks was this money being put? Growth stocks mainly, with high p-e ratios mainly—in other words, all of those inhabitants or near neighbors of the upper tier. Meanwhile, the funds hit with the biggest redemptions were those that have put their faith in the lower tier and have little but weak records to show for it. As these funds sold off stocks this spring to raise cash, the lower tier got pushed still lower.

ROOMING WITH DAVEY JONES

While all this was going on, certain institutions that are rather like rich relatives of the mutual funds—the life-insurance and casualty-insurance companies, state and local government pension funds, and the biggest stock buyers of all, private noninsured pension funds (normally called "corporate" pension funds)—were accumulating

money as they always do and were stoutheartedly funneling huge amounts of it into stocks. Their buying in the first quarter, in fact, as at a quite high annual rate of $14.5 billion (the record is $18.2 billion, set in 1971), about half of that flowing from the corporate pension funds.

But seemingly these buyers were doing almost nothing to support the lower tier. That point is difficult to prove with precision, since these institutions are not required to report publicly the details of their quarterly purchases and sales. FORTUNE, however, in a good many interviews with institutional buyers this spring, could find very few who were going into lower-tier stocks, or who even seemed to be thinking hard about doing so. And the market itself, of course, counts as evidence; had anyone been giving the lower tier much support, its stocks would not now be rooming with Davy Jones.

It is clear that these institutions do not see in the lower tier those same "choice investment opportunities" that Jim Needham does. Yet Fortune's study of price-earnings ratios shows clearly that a whole army of stocks are at levels that in the postwar period have come to be considered "cheap." Furthermore, if one focuses on *companies* rather than *stocks*, a good case can be made that there are excellent values around.

All sorts of companies, in cyclical industries mainly, that could recently be bought at book value (or lower) have for at least several years averaged a return on book value of, say, 11 percent or better and have reasonable expectations of maintaining (or improving) that return. An investor who buys into such a company at no more than book can also figure to earn 11 percent (or better) on his investment, both on the money with which he originally buys a piece of the action and also on every dollar of his earnings that the company retains and puts back to work in the company.

IGNORING AN 11 PERCENT PROPOSITION

If such a company pays a 6 percent dividend (which might be the case in today's market), the reinvested earnings will produce an average though not necessarily steady, earnings growth of 5 percent and a corresponding growth in book value. This growth may not be recognized simultaneously in the stock market. In any case, the investor owns a property whose underlying value is gaining at an average rate of 5 percent a year and that gain, combined with the 6 percent dividend, produces the 11 percent total return. The list of companies that look able to deliver 11 percent would run pretty long today. To name just a few of them: Brown Group, Colonial Stores, Goodyear, W.T. Grant, Grey Advertising, Indian Head, Kentucky Utilities, Marine Midland Banks, Munsingwear, Phelps Dodge.

An 11 percent return is a meaningful standard for several reasons. It exceeds bond interest rates by a margin that many investors would consider "comfortable." It is considerably above the 9.5 percent or so that investors, as a whole, have historically found it possible to earn on stocks. Most significantly, perhaps, it exceeds by quite a lot the annual rate of return that large institutions have shown themselves able to earn on stocks, on the average, over the last ten years.

The average for the 300 large pension funds whose performance is monitored by the brokerage firm of A.G. Becker has been 9.5 percent (and for the last five years only 7 percent). The average for the equity mutual funds followed by Wiesenberger was 9.2 percent for ten years (and only 4.8 percent over the last five years). Moreover, most institutions today, having been sobered by those performance numbers and also battered by a couple of post-1968 bear markets, are very restrained about their expectations for returns in the future. Few seem confident these days of doing better than 10 percent.

Yet the interest of these institutions in that 11 percent proposition appears almost nonexistent. Their attention, instead, is on the companies whose returns on capital are considerably higher—say, 14 percent and up—and whose earnings growth is considerably less subject to cyclical bumps and potentially much faster—perhaps 10 percent or more. These are the "good businesses" of the world, and could all stocks be bought at the same multiple of earnings, these are the ones that everyone would want to own. But the prices of these stocks have been affected relatively little by the bear market that has ravaged the rest of the list, and they can be had only at upper-tier prices. The question then becomes: is it rational for the institutions to stay with these expensive stocks when so many others can be bought at greatly reduced prices?

There are arguments on both sides of that question, and they are best looked at in terms of two forces that dominate the market: the corporate pension funds, which own about $110 billion of stocks (out of total assets of about $150 billion) and earlier this year were adding to stockholdings at a $7-billion annual rate; and the bank trust departments, which manage about 80 percent of all corporate pension-fund dollars. The banks also manage an estimated $240 billion for individuals. These assets, however, do not get the flow of "new money" that the pension funds do, nor turn over as rapidly in the market.

There is vigorous competition for the pension funds' business. Insurance companies and investment advisers would like to steal business away from the banks. The banks down the line would like to steal from the Big Two, Morgan Guaranty ($16.6 billion in employee-benefit assets at the end of 1972) and Bankers Trust ($15 billion). And Bankers Trust, of course, is gunning for Morgan. It so happens

that Morgan has a history of investing in growth stocks, and it has outperformed most big banks; some of its accounts have had, with their stock portfolios, a compounded return better than 13 percent over the ten years ending with 1972. Because of its performance and its size, Morgan has become the player that everybody in the game watches. Its influence clearly extends beyond the sums it manages.

Morgan operates under certain constraints that set a rather special pattern. In total, the bank manages $27 billion, about $21 billion of it in stocks, and it fervently wishes to keep most of that in a relatively few stocks in which it has maximum confidence. As a result, it needs big companies in which to invest—those whose stocks can absorb, say, $50 million or more without going into orbit. "Big" companies, by Morgan's definition, are those that have at least $500 million in both market value and revenues; companies of that size, of which there are perhaps 300 in the country, qualify for large, direct investments by the pension funds that Morgan manages. Smaller companies usually are reached through pools of money (rather like mutual funds) that Morgan sets up, and in which its pension accounts participate.

Morgan's employee-benefit accounts recently had $13.3 billion in stocks, of which about $9 billion (or 68 percent) was in fifty big companies. That makes an average investment of $180 million per company. The remaining $4.3 billion was invested in more than 550 companies of assorted sizes, for an average around $7.8 million. In that assortment were 182 relatively small companies (generally with under $100 million in market value and revenues) that Morgan believes to be comers and that are held in a $970-million pooled account. There are varying ways to look at all these numbers. Morgan thinks of them as showing that its arms are wide open to smaller companies. Others would no doubt be struck by the degree of concentration in a relatively few stocks.

When Morgan invests in a big stock, it has every intention of staying in that stock, if not forever, at least for a long time. "We are not traders, we are investors," goes the Morgan pitch for new pension-fund business. "We do not buy stocks with the idea of selling them at a specific price objective. We do not buy with the idea of selling high and buying back low." Morgan's belief in these principles is undoubtedly strong, but it should be noted that the bank really has no alternative strategy open to it. You cannot swing $27 billion around from flower to flower. For that matter, you cannot easily swing even a few billion dollars around.

So Morgan and other big banks are constantly looking for what Wall Street has come to call "one-decision stocks" —i.e., stocks that can be bought and put away, with an expectation that they will produce at least some earnings growth in almost any kind of economic situation and will, over the long term, though not necessarily over any given short-term period, outperform the market as a whole.

Warren Buffett, a well-known and very successful private investor whose own preferences run strongly to investing in low-p-e "value" situations, thinks that Morgan's strategy is quite rational—for the bank. "Morgan is sort of like a large conglomerate which must make decisions for the long term as to what kind of businesses it wants to be in. Would it be right for a conglomerate to sell its most profitable, best business just because it has a chance to pick up a not-so-great business at a cheap price? I doubt it. So I think, with all that money it's got to worry about, Morgan is probably handling things about as well as it can. Which doesn't mean, of course, that what they're doing is necessarily right for *me.*"

IT'S RATIONAL BECAUSE IT WORKED

Nor does it mean that what may be rational for a giant like Morgan, or even for a few of its biggest competitors, is necessarily rational for all the smaller banks that are today playing follow-the-leader, and that could instead, if they chose to, go hunting for bargains. Nor are the tactics of any big bank necessarily rational for its clients, the pension funds. These investors are not obligated to place their money with giant institutions whose policies are significantly determined by the huge amounts of money they have to manage. They could instead manage their money themselves, or place it with smaller institutions with greater investment flexibility.

The trend, however, is not in that direction. In the competition for pension-fund money, the banks, as a whole, are probably gaining ground at the moment. Those banks identified with a growth strategy—Morgan, clearly, but also today First National City and Bankers Trust—are surely gaining more than others. And for one very simple reason: they have had their clients in the right stocks. In other words, what the banks have been doing can also be called rational because it has *worked.*

To be sure, it has worked in part because there has been a steady stream of banks and other institutions jumping into the top-tier stocks and pushing up their prices. In other words, the banks' bets about market behavior are to some degree self-fulfilling. But to identify that as the only reason for success would be unfair. For it is also true that most of the top-tier companies have, as businesses, performed during recent years in the superior way they are supposed to.

To illustrate that point by an example that does not require hindsight, let us consider the profit performance of the fourteen companies in Fortune's p-e study that had p-e ratios above 30 at the end of *1966*. Three of these, Corning Glass, Superior Oil, and Texasgulf, had an earnings decline in the five tough years of inflation and recession that followed. But the fourteen stocks as a whole had a median annual

earnings growth of 8.8 percent. In contrast, the earnings growth of the S. & P. 500, even though it is heavily weighted by I.B.M. and a few other stocks that were among those fourteen, was less than 1 percent annually.

Focusing on comparisons of this sort recently, James Lane, president of Chase Manhattan's investment-management subsidiary, said they show "there is some rationality to the market and its divergence into two tiers." Lane's thoughts have a special significance, for during most of that 1966–71 period, Chase was heavily in the "wrong" stocks and did very badly in performance. Lately, like many other converts, it has been swinging more toward the upper tier.

THE TYRANNY OF QUARTERLY REPORTS

Chase's poor performance cost it a good bit of pension-fund business, and that brings up the final argument as to why the banks' current investment policies may be—for *them*—rational. Corporations today keep constant pressure on their investment managers, demanding from them the superior results that will permit reductions in the annual contributions these corporations must make to their pension funds. Many of the corporate executives who are today most incensed about the low prices of their stocks would no doubt be among the first to yell if their pension-fund managers bought low p-e stocks and did poorly with them. Many corporate executives, while complaining about the tyranny of a stock market that judges companies on the basis of such short-term measurements as quarterly results, today exact quarterly reports from their investment managers, and give these considerable weight in assessing performance.

Under such surveillance, many investment managers adopt strategies that seem to them suited to the game they're in. For example, if a bank buys, say, a Xerox, and that company's earnings go up 12 percent in the next year, its stock price may follow along. A low p-e "value" suitation, on the other hand, may stay depressed for a long time before the gains in its earnings and book value begin to show up in its price; and while it may ultimately prove more profitable than the Xerox situation, that will be of small comfort to the bank if it has lost all of its pension-fund accounts.

The game also forcibly suggests to many investment managers that it is a mistake to be unorthodox and that the percentage play is to do what everybody else is doing. One Wall Street professional who talks regularly to bank portfolio managers counts as all too typical a remark made recently to him by one of them: "It doesn't really matter a lot to me what happens to Johnson & Johnson as long as everyone has it and we all go down together."

The few banks that have tried to steer a different course by moving into what they see as bargains in the lower tier have lately found the going rather tough. One such bank is First National of Chicago. Its portfolio, though studded with such standbys as I.B.M. and Kodak, is committed also to cyclical stocks and is less concentrated in the very largest companies than most other big bank portfolios are. As a result, the returns First National delivered its pension accounts last year, though these ran to around 14 percent, did not compare well with the returns of more than 20 percent realized by some of the New York banks.

First National has at least one client, Armour, that is not troubled by this fact. Armour also has pension-fund assets with other banks oriented toward growth stocks, and First National thus supplies some balance that Armour welcomes. But it does not appear that the bank, with its "different" approach, is picking up very many new pension-fund accounts these days. Howard E. Hallengren, who heads the trust department's investments, says the situation is not easy to live with "You get pressures building up to buy major growth stocks. You get them from everyone. From management: "Why aren't you in the major growth stocks? From customers. In your own department, from portfolio managers." But Hallengren says he isn't wavering. "I keep thinking of what one of my old bosses used to say: 'Investment people have to have qualities of courage and patience.' "

While Hallengren waits, he can at least keep telling himself that he has bought his low-tier stocks at prices that can be rationalized. That is clearly more than most top-tier buyers can do. Their thoughts about the intrinsic value of growth stocks—which is admittedly one of the murkier subjects around—tends to be underdeveloped. The bank seem to buy instead mainly on the basis of "feel" and historical p-e ranges. We buy I.B.M., they say, when it approaches the lower limits of its range; we avoid it at the upper limits. The banks tend also to retreat into arguments that price doesn't mean that much anyway. What counts, they say, is to pick the right companies, and even then, they add, you can get by with an occasional misjudgment. "This is a batting-average game," says one trust officer. "You're going to lose a stock now and then—say, a Litton. But if your universe is a bunch of other very profitable companies, you can stand it."

That is true, of course, only so long as the universe itself is not marked down sharply. Were such a markdown to occur today, it would probably imply a switch from buying to selling by the banks themselves. It is not easy to see this kind of a move taking place right now, but it is always possible. Some market commentators identify weakness in the growth stocks with the end of a bear market, and expect firmly to see these stocks begin to crack.

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IS IT HARDER TO BE SUPERIOR?

There can be no doubt, looking at the data that Fortune gathered on the largest holdings of the largest trust departments, that cracks in a few big blocks would do broad damage. Fourteen out of the seventeen banks included in the data have I.B.M., the market's biggest stock, as their No. 1 holding (the other three have it in second place) and better than half have 7 percent or more of their common-stock assets in that one company. (One bank, Chemical, has 13 percent.)

The tendency to bunch their investments in the same few big stocks suggests that the banks have created a kind of neutralized environment in which any one bank will find it extremely difficult to achieve a standout performance. These circumstances should logically prove most adverse to the banks that in the past have done better than others.

Morgan, however, disagrees that superior performance has become harder to achieve; one of its executives describes this premise as another example of the "mythologies" that are forever being created by Wall Street. It is Morgan's contention that the banks will continue to "mix" their stocks in significantly different ways and will continue to disagree about certain important stocks—as, for example, they are now disagreeing about Polaroid. Other banks also react testily to the thought that they have been "neutralized" and predict that the men will keep separating themselves from the boys.

Still, the banks do not feel at ease with the present degree of concentration, since they appreciate all too well the drastic price changes that can take place if a stock goes bad and everybody, as the saying goes, tries to get through the door at once. "Yes," says Quintin Ford, head of trust investments for Bankers Trust, "it does bother me that everybody is doing the same thing." But he finds "solace" in the quality of his research and is none too surprised that research leads other banks to so many of the same stocks.

There is in that statement the roots of a serious thought about the role that the banks are currently playing. It can be argued that they are focusing attention on the differences that exist between good and bad businesses, and are compelling the business world to recognize that smart money is not easily drawn into businesses that produce an inadequate return on capital. Take the top steel companies, for example. Maybe they would be cheap if on their dividends alone they provided investors a good return. But short of that point, why should any informed investor put his money into a business that makes only 5 or 6 percent on its equity capital, and that must, because its capital needs are inexhaustible, continually retain a major part of its stockholders' earnings to reinvest at those preposterously low rates?

COURTING POLITICAL TROUBLE

The two-tier market, however, has created a situation in which not only the bad businesses but also a lot of pretty good ones are in danger of being denied capital, and that puts the banks' concentration in a much more unfavorable light. Indeed, the strongest argument for saying that the banks' policies are irrational is that they probably are politically intolerable. The economic system can stand a lot of things that have been going on in the stock market, but it probably *cannot* stand the institutions all buying the same stocks.

Right now, shock waves from the two-tier market are being felt by venture-capital firms, who can neither in most cases take their investments to the public market nor merge them into bigger companies; those companies do not want to swap their stock when they think it is underpriced. As a result, the venture-capital firms are not freeing up capital with which to move into new investments.

Most larger companies have probably not been pinched for capital yet; they have been helped out by both the strength of profits and the ceiling on dividends. But a capital-spending boom is under way, just when companies have got their debt-equity ratios in decent shape and would like to keep them that way. A time will surely come when a good number of companies will want to sell stock or convertibles, and it is then that a two-tier market will begin to bind.

At such a point Washington could be heard from, and there might be a close race between Wright Patman's Banking and Currency committee and the Securities and Exchange Commission to get into the act first. Patman's committee has long been angry about the concentration of trust assets in the big banks, and there is no reason to think it will remain mute on this new angle. The SEC, meanwhile, approaches almost all problems involving the stock market or Wall Street from the perspective of how these will affect the country's capital-raising mechanism. Obviously it has something to think about here.

WHY US?

The banks certainly do not want any new battles with Washington. Yet they seem curiously unable to take this problem as seriously as they should. Joseph Alaimo, head of pension investments in Continental Illinois' trust department, said recently that there was nothing he would like more than to see the lower-tier stocks rise and do well. But he could not see why Continental Illinois should suddenly desert the investment policies with which it feels comfortable and go down to pull off the rescue. In other words, why us?

One answer may be "who else?" From time to time, market commentators forecast hopefully that foreign money will come pouring into the market. But it is not widely recognized that foreigners were buying U.S. stocks at record rates in the first quarter. They have also lately somewhat depopulated the lower tier by going after several whole companies, including Gimbels, but that is not the kind of help that chief executives of lower-tier companies have in mind.

There is always the possibility that the individual investor will abandon the habits he has formed over the last fourteen years and will once again become a net buyer of stocks. He began his selling, after all, in 1959, just after p-e ratios reached the relatively high levels near which they have since held. Now there is obviously a new p-e situation and maybe the individual might be lured back in. Unfortunately, that scenario would sound more likely if inflation fears were not so great and bond interest rates not so high.

The other answer to "why us?" is that some shopping in the lower tier just might be a pretty smart thing for the banks to do. Certainly they would be better off going voluntarily after the low-tier stocks than being pushed into it by Washington. And just as certainly there are companies down there any bank could live happily with, which is not something that at these price levels, and in this strange market, can be said with quite such conviction about the upper-tier stocks. Who knows? From about any angle, the lower-tier companies could turn out now to be the "right" stocks to buy.

Appendix C

Excerpts from 1968 House Banking and Currency Staff Report on Director Interlocks for Large Banking Institutions

TABLE 1.—*Director and stockholder interlocks of major commercial banks*

Name of bank	Director interlocks		5 percent or more stockholding, total companies
	Companies per bank	Interlocks per bank	
Morgan Guaranty Trust Co.	233	251	270
Chase Manhattan Bank	193	208	158
Bankers Trust Co.	224	259	109
First National City Bank	167	188	229
Manufacturers Hanover Trust	200	257	132
Chemical Bank	278	326	67
Total	+1,295	1,489	965

TABLE 2.—*Interlocking relationships between Morgan Guaranty Trust Co., New York, N.Y., and major corporations*

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Bituminous coal mining—SIC 121:			
Eastern Gas & Fuel Associates	1	1	
Ayrshire Collieries Corp			6.7–C
Rochester & Pittsburgh Coal Co			39.0–P
Crude petroleum, and natural gas—SIC 131:			
Louisiana Land & Exploration Co	1		
Belco Petroleum Corp	1		
Oil and gas field services—SIC 138: Westate Petroleum Co			9.8–C
Crude petroleum and natural gas—Nonproducers—SIC 139: King & Heyne Fifth Oil	1		

See footnotes at end of table, p. 67.

TABLE 2.—*Interlocking relationships between Morgan Guaranty Trust Co., New York, N.Y., and major corporations*—Con.

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Chemical and fertilizer mineral mining—SIC 147: Texas Gulf Sulphur Co.	1	1	12.4–C
Meat products—SIC 201: Wilson & Co., Inc.	1	1	
Dairy products—SIC 202: National Dairy Products Corp.	1		
Canning and preserving fruits, vegetables, etc.—SIC 203:			
General Foods Corp.	1		
Campbell Soup Co.	2	1	
Standard Brands, Inc.	1	2	
Nonalcoholic beverages—SIC 209:			
Coca-Cola Co.	1	1	
PepsiCo, Inc.			7.2–C
Miscellaneous tobacco products—SIC 213: Conwood Corp.		1	7.2–C
Textile mill products—SIC 221:			
Burlington Industries, Inc.		1	14.5–C
West Point Pepperell	1		
Bates Manufacturing Co.			43.4–C 44.1–P
Textile knitting mills—SIC 225: Vanity Fair Mills, Inc.			11.9–C
Apparel—SIC 231:			
Jonathan Logan, Inc.			8.9–C
Bobbie Brooks, Inc.			8.2–C
Lumber and wood products, except furniture—SIC 231: United States Plywood-Champion Papers, Inc.		1	9.8–C
Furniture and fixtures—SIC 251: General Interiors Corp.			11.0–C
Paper and allied products—SIC 262:			
Mead Corp.	2		
Scott Paper Co.	1	1	18.4–P
Union Camp Corp.	2		
Longview Fibre Co.			5.1–C
Hudson Pulp & Paper Corp.		1	5.3–P
			15.2–C
			27.6–P
P. H. Glatfelter Co.		2	5.3–C

See footnotes at end of table, p. 67.

TABLE 2.—*Interlocking relationships between Morgan Guaranty Trust Co., New York, N.Y., and major corporations*—Con.

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Newspapers, periodicals and books—SIC 271:			
Time, Inc		1	8.1–C
McGraw-Hill, Inc			9.9–P
New York Times Co		1	5.6–P
Dow Jones Co., Inc	1		9.7–C
Simplicity Pattern Co., Inc			15.8–P
Harcourt, Brace & World, Inc	1		11.4–C
John Wiley Sons, Inc	1	1	6.0–C
Chemicals—SIC 281:			
Olin Mathieson Chemical Corp		1	6.8–C
Celanese Corp			7.5–C 5.9–C
American Cynamid Co	1	1	
Air Reduction Co., Inc	1	1	
Stauffer Chemical Co	1	1	
Drugs—SIC 283:			
Bristol-Myers Co	1		
Merck & Co., Inc	1	2	
Smith, Kline & French Laboratories	1	1	
Mead, Johnson & Co	1		
Soap, detergents and cleaning preparations—SIC 284:			
Procter & Gamble Co	1		
Avon Products, Inc	1		6.5–C
Chesebrough-Pond's, Inc	1		14.1–C
Max Factor & Co			8.8–C
Lanvin-Charles of the Ritz, Inc			9.1–C
Agricultural chemicals—SIC 287:			
O. M. Scott & Sons Co	1		
Miscellaneous chemical products—SIC 289: Betz Laboratories, Inc			7.5–C
Petroleum refining—SIC 291:			
Continental Oil Co	2	1	
Cities Service Co	1	1	
Atlantic Richfield Co	1		
Tires and inner tubes—SIC 301:			
B. F. Goodrich Co	1	1	

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TABLE 2.—*Interlocking relationships between Morgan Guaranty Trust Co., New York, N.Y., and major corporations*—Con.

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Footwear, except rubber—SIC 314: Endicott Johnson Corp		1	10.5–C
Cement, hydraulic—SIC 324: Northwestern States Portland Cement Co	1	1	
Concrete, gypsum, asbestos, and plaster products—SIC 326:			
Johns-Manville Corp	1	2	
Owens-Corning Fiberglas Corp	1	1	
Vulcan Materials Co	1	1	
Lenox, Inc			5.4–C
Blast furnaces, steel works, and rolling and finishing mills—SIC 331:			
United States Steel Corp	2		
Bethlehem Steel Corp	2		
Abex Corp	1	1	
Carpenter Steel Co	1	2	
Washburn Wire Co	1		
General Steel Industries, Inc	1	1	
Smelting and refining of nonferrous metals—SIC 333:			
Kaiser Aluminum & Chemical Corp			5.7–P 6.6–C
Kennecott Copper Co		3	17.5–C
American Smelting & Refining Co	1		15.5–C
American Metal Climax, Inc			8.7–C
Phelps Dodge Corp	1	1	6.0–C
General Cable Corp	1		
Revere Copper & Brass, Inc			7.9–C
Scovill Manufacturing Co	1	3	11.5–C
St. Joseph Lead Co	1	2	7.4–C
International Nickel Co. of Canada	3		
Alcan Aluminium, Ltd			5.1–C
Metal cans—SIC 341: Continental Can Co	1	6	

See footnotes at end of table, p. 67.

TABLE 2.—*Interlocking relationships between Morgan Guaranty Trust Co., New York, N.Y., and major corporations*—Con.

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Cutlery, handtools, and general hardware: SIC 342:			
Gillette Co	2		
McKinney Manufacturing Co			6.9-P
Cole National Corp			6.1-C
Heating apparatus—SIC 343: American Radiator & Standard Sanitary Co	1		
Miscellaneous fabricated metals—SIC 349:			
Duriron Co., Inc			6.3-C
Hico Corp. of America	1		
Farm machinery, construction, mining, and materials handling machinery and equipment—SIC 352: Deere & Co		1	8.0-C
Metalworking machinery and equipment—SIC 354: Chicago Pneumatic Tool Co			14.5-C
General industrial machinery and equipment—SIC 356: Ingersoll-Rand Co	1		
Office, computing, and accounting machines—SIC 357: Litton Industries, Inc			6.2-P
Service industry machines—SIC 358:			
Carrier Corp			5.6-P 16.5-C
Trane Co	1		11.9-C
Electric transmission and distribution equipment—SIC 361:			
General Electric Co	3		
Cutler-Hammer, Inc		2	17.6-C
AMP, Inc			7.5-C
Superior Electric Co			6.7-C
Household appliances—SIC 363:			
Singer Co	1	1	
Whirlpool Corp		1	5.6-C
Still Man Manufacturing Corp			36.7-C
Schick Electric, Inc	1	1	

See footnotes at end of table, p. 67.

TABLE 2.—*Interlocking relationships between Morgan Guaranty Trust Co., New York, N.Y., and major corporations*—Con.

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Radio and television receiving sets—SIC 365: Andrea Radio Corp	1		
Communications equipment—SIC 366:			
Raytheon Co	1	1	
Texas Instruments, Inc	1		
Gulton Industries, Inc	1	1	
Sigma Instruments, Inc	1		
Motor vehicles and equipment—SIC 371:			
General Motors Corp	3	2	
Ford Motor Co	2		
Chrysler Corp	1		
Aircraft and parts—SIC 372:			
Ling-Temco-Vought, Inc			5.6–P
Boeing Co	1		
TRW, Inc			5.5–C
Railroad equipment—SIC 374: Pullman, Inc	1		
Instruments for measuring—SIC 381: Conrac Corp			5.5–C
Optical instruments and lenses—SIC 383:			
Polaroid Corp			5.5–C
Xerox Corp			9.7–C
Toys, amusements, sporting, and athletic goods—SIC 394: American Machine & Foundry Co	1		
Railroad transportation—SIC 401:			
Pennsylvania RR. Co	1		7.2–C
Southern Pacific Co	1		
Atchison, Topeka & Santa Fe Ry. Co	1		
Northern Pacific Ry. Co	1		
Canadian Pacific Ry. Co	1		
Pittsburgh, Fort Wayne & Chicago Ry	1		
Public warehousing—Sic 422: Merchants Refrigerating Co	1		
Deep sea transportation—SIC 441: United States Lines Co	1		

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TABLE 2.—*Interlocking relationships between Morgan Guaranty Trust Co., New York, N.Y., and major corporations*—Con.

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Air transportation—SIC 451:			
United Air Lines, Inc			8.2–C
American Airlines, Inc	1	1	7.5–C
TWA, Inc		2	7.4–C
Freight forwarding—SIC 471:			
Consolidated Freightways, Inc			9.4–C
Telephone communications—SIC 481:			
American T. & T. Co	1		
General Telephone Co. of Indiana			7.5–P
Puerto Rico Telephone Co		1	23.8–P
Rochester Telephone Corp			40.0–P
General Telephone Co. of Michigan			20.0–P
Electric companies and systems—SIC 491:			
Consolidated Edison of New York, Inc	1	1	7.0–P
Niagara Mohawk Power Corp	1	1	
Florida Power & Light Co		1	10.0–P 5.3–P
Long Island Lighting Co			5.8–P
Gulf States Utilities Co	1		
Louisiana Power & Light Co			7.1–P
Central Louisiana Electric Co., Inc			6.0–P
Texas Electric Service Co			6.3–P
Kansas City Power & Light Co			5.0–P 6.5–P
Oklahoma Gas & Electric Co			13.1–P
New York State Electric & Gas Corp			11.9–P
Florida Power Corp			5.8–P
Pennsylvania Electric Co			10.0–P
Gas companies and systems—SIC 492:			
Columbia Gas System, Inc	1	1	
Texas Eastern Transmission Corp			6.7–P
Panhandle Eastern Pipe Line Co		1	5.8–P

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TABLE 2.—*Interlocking relationships between Morgan Guaranty Trust Co., New York, N.Y., and major corporations*—Con.

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Gas companies and systems—SIC—Continued			
New Jersey Natural Gas Co	1	1	
Laclede Gas Co			6.3–P
Combination gas and electric companies—SIC 493:			
Rochester Gas & Electric Corp			7.7–P
Iowa Illinios Gas & Electric Co			7.5–P
Montana Power Co		1	5.0–P
Water supply companies and sanitary services—SIC 494: Philadelphia Suburban Water Co			10.0–P 9.5–P
Groceries and related products—Wholesale trade—SIC 504:			
Super Value Stores, Inc			7.9–C
Filigree Foods, Inc			17.9–C
Zausner Foods Corp	1		
Farm products—Raw material wholesale trade—SIC 505: Standard Commercial Tobacco Co., Inc			6.1–C
Limited price variety and general merchandise stores—SIC 533:			
W. T. Grant Co	1	1	10.3–C
S. H. Kress Co	1		
Grocery and miscellaneous food stores—SIC 541: Great Atlantic & Pacific Tea Co., Inc	1		
Apparel and accessories stores, excluding shoes—SIC 561: Abercrombie & Fitch Co	1	1	
Jewelry stores—SIC 597: Tiffany & Co			11.9–C
Life, accident, and health insurance—SIC 631:			
Prudential Insurance Co. of America	1		
Metropolitan Life	1		
New York Life	1		

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TABLE 2.—*Interlocking relationships between Morgan Guaranty Trust Co., New York, N.Y., and major corporations*—Con.

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Life, accident, and health insurance—SIC 631—Continued			
Aetna Life	1		
Mutual Life of New York	1		
Penn Mutual	1		
American National Insurance	1		
Fire, marine, casualty, and surety insurance—SIC 633:			
Continental Insurance Co	1		
Insurance Co. of North America	1		
Great American Insurance Co	1		
Glens Falls Insurance Co	1		
Federal Insurance Co	1		
Insurance agents, brokers, and and service—SIC 641: Marsh & McLennan, Inc		1	6.4–C
Real estate—Operators and lessors—SIC 651:			
Century Properties			15.0–C
Select Theatres Corp	1		99.9–C 99.9–P
Massachusetts Real Estate Investment Trust	1		
Holding companies—SIC 671: Northwest Bancorporation			5.9–C
Miscellaneous investing institutions—SIC 1679: Continental Mortgage Investors			10.9–C
Advertising—SIC 731: Grey Advertising, Inc			6.5–C
Business services, not elswhere classified—SIC 739:			
Allied Maintenance Corp			5.5–C
A. C. Neilson Co			5.3–P

[1] The Standard industrial classification designates the principal products manufactured or the major services furnished by each company. These classifications were prepared by the technical committee on standard industrial classification, under the sponsorship and supervision of the Office of Statistical Standards of the Bureau of the Budget, Executive Office of the President.

[2] The letter "C" designates a common or capital stock issue. The letter "P" designates an issue of stock other than a common or capital stock issue. Where more than 1 "P" appears under 1 bank's holdings, in most cases this indicates the holding of several different kinds of preferred stock.

TABLE 3.—*Interlocking relationships between Chase Manhattan Bank, New York, N.Y., and major corporations*

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Gold and silver ores—SIC 104:			
International Mining Corp	1	1	
Metal mining nonproducers—SIC 107: Bristol Silver Mines	1		
General building contractors—SIC 151:			
Stone & Webster, Inc	1		
Universal Oil Products Co			13.5–C
Canning and preserving fruits, vegetables—SIC 203:			
General Foods Corp	2		
Sugar—SIC 206:			
Sucrest Corp	1		
South Puerto Rico Sugar Co	1		
Cigarettes and tobacco—SIC 211:			
R. J. Reynolds Tobacco Co	1		
Textile mill products—SIC 221:			
Burlington Industries, Inc	1	1	
Apparel—SIC 231: Jonathan Logan, Inc			5.2–C
Lumber and wood products, except furniture—SIC 241: Georgia-Pacific Corp	1		
Furniture and fixtures—SIC 25: Diebold, Inc			7.0–C
Paper and allied products—SIC 262:			
International Paper Co	1		
Scott Paper Co	1		
Lily-Tulip Cup Corp	1	2	
Newspapers, periodicals, and books—SIC 271: New York Times Co	1		
Industrial inorganic and organic chemicals, etc.—SIC 281:			
Celanese Corp	1	3	
Hercules, Inc			6.3–C
Rohm & Haas Co			6.0–C
General Aniline & Film Corp	1		
Chemetron Corp	1		
Air Products & Chemicals, Inc			9.6–C
Wyandotte Chemicals Corp			8.3–C
Commercial Solvents Corp	1	1	5.1–C

See footnotes at end of table, p. 74.

TABLE 3.—*Interlocking relationships between Chase Manhattan Bank, New York, N.Y., and major corporations*—Continued

[In order by standard industrial classification [1]]

Classification by SIC code and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Pharmaceuticals—SIC 283:			
Richardson-Merrell, Inc		4	10. 4–C
G. D. Searle Co			5. 5–C
A. H. Robins Co			7. 8–C
Paints, varnishes, lacquers, enamels—SIC 285: National Lead Co	1	1	
Soap, detergents, and cleaning preparations—SIC 284: Colgate-Palmolive Co	1		
Petroleum refining—SIC 291:			
Standard Oil Co. of New Jersey	2	1	
Standard Oil Co. of Indiana	1	1	
Tires and inner tubes—SIC 301:			
Goodyear Tire & Rubber Co	1		
Armstrong Rubber Co			5. 6–C
Cement, hydraulic—SIC 324: Lehigh Portland Cement Co	1	2	
Blast furnaces, steel works, and rolling and finishing mills—SIC 331:			
United States Steel Corp	2		
National Steel Corp			6. 2–C
Youngstown Sheet & Tube Co	1	1	
Allegheny-Ludlum Steel Corp	1		5. 2–C
Smelting and refining of nonferrous metals—SIC 333:			
Anaconda Co	2	1	
Reynolds Metals Co			5. 5–C
American Smelting & Refining Co	1		
Cerro Corp	1		
Fansteel Metallurgical Corp	1		
Arwood Corp		1	74. 9–P 9. 5–C
Titanium Metals Corp. of America	2		
Chile Copper Mining Co	1		
Miscellaneous fabricated metal products—SIC 349: H. H. Robertson Co			9. 7–C

See footnotes at end of table, p. 74.

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TABLE 3.—*Interlocking relationships between Chase Manhattan Bank, New York, N.Y., and major corporations*—Continued

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [3]
Engines and turbines—SIC 351:			
Cummins Engine Co., Inc.	1		9.6–C
Farm machinery, construction, mining and materials handling machinery and equipment—SIC 352:			
Otis Elevator Co.	1		
Bucyrus-Erie Co.	1	1	
Metalworking machinery and equipment—SIC 354: United Engineering & Foundry Co.	1		
Special industry machinery, excluding metalworking machinery—SIC 355:			
Harris Intertype Corp.			7.6–C
Cherry-Burrell Corp.			7.2–P
Miehle-Gross-Dexter, Inc.			7.3–C
Office, computing, and accounting machines—SIC 357:			
Addressograph-Multigraph Corp.			8.5–C
Veeder Industries, Inc.	1		
Service industry machines—SIC 358: Worthington Corp.	1		
Electric transmission and distribution equipment—SIC 361:			
General Electric Co.	1		
Essex Wire Corp.	1		
Household appliances—SIC 363:			
Singer Co.	1	1	
Whirlpool Corp.	1	1	
Sunbeam Corp.			8.5–C
Studebaker Corp.	1	1	
George D. Roper Corp.			7.1–C
Communication equipment—SIC 366:			
Sperry Rand Corp.			5.1–C
Texas Instruments, Inc.		1	8.9–C
Varian Associates			11.0–C
Beckman Instruments, Inc.			8.7–C
International Telephone & Telegraph	1		

See footnotes at end of table, p. 74.

TABLE 3.—*Interlocking relationships between Chase Manhattan Bank, New York, N.Y., and major corporations*—Continued

[In order by standard industrial classification [1]]

Classification by SIC code and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Motor vehicles and equipment—SIC 371: Chrysler Corp	1		
Aircraft and parts—SIC 372:			
Boeing Co		1	8.7–C
United Aircraft Corp	1		6.2–C
Gyrodyne Co. of America, Inc		1	6.6–C
Ship and boat building—SIC 373: Newport News Shipbuilding & Dry Dock Co	1		
Optical instruments and lenses—SIC 383: Bausch & Lomb, Inc			9.4–C
Toys, amusement, sporting, and athletic goods—SIC 394: American Machine & Foundry Co	1	1	
Railroad transportation—SIC 401:			
Pennsylvania RR. Co	1		5.6–C
Potomac RR. Co	1		
Western Maryland Ry. Co	1	1	
Wabash RR. Co	1		
Detroit, Toledo & Ironton RR. Co	1		
Trucking, local, and long distance—SIC 421:			
Consolidated Freightways, Inc			8.8–C
Pacific Intermountain Express Co			9.8–C
Roadway Express, Inc			8.9–C
Merchants Fast Motor Lines, Inc			6.1–C
Ryder System, Inc			7.9–C
Deep sea transportation—SIC 441: Moore & McCormack Co., Inc	1	1	8.5–C
Air transportation—SIC 451:			
Pan American World Airways		1	6.7–C
TWA, Inc		1	7.8–C
Eastern Air Lines, Inc			6.4–C
Northwest Airlines, Inc			11.0–C
Western Air Lines, Inc			6.7–C
Piedmont Aviation, Inc	1		

See footnotes at end of table, p. 74.

TABLE 3.—*Interlocking relationships between Chase Manhattan Bank, New York, N.Y., and major corporations*—Continued

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Telephone communication—SIC 481:			
American Telephone & Telegraph Co	2		
Southern New England Telephone Co	1		
New York Telephone Co	1		
Bell Telephone Co. of Pennsylvania	1		
Radio broadcasting and television—SIC 483:			
CBS, Inc			5.9–C
ABC, Inc	1	1	
Communication Services—SIC 489: Communications Satellite Corp	1	1	
Electric companies and systems—SIC 491: Consolidated Edison of N.Y., Inc	1		
Gas companies and systems—SIC 492:			
Panhandle Eastern Pipe Line Co			5.6–C
North Carolina Natural Gas Corp			5.0–C
Brooklyn Union Gas Co	1		
Department stores—SIC 531:			
Federated Department Stores, Inc	1		
Allied Stores Corp	1	3	
R. H. Macy Co., Inc	1	2	
Limited price variety and general merchandise stores—SIC 533: F. W. Woolworth Co	1		

See footnotes at end of table, p. 74.

TABLE 3.—*Interlocking relationships between Chase Manhattan Bank, New York, N.Y., and major corporations*—Continued

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Grocery and miscellaneous food stores—SIC 541:			
Safeway Stores, Inc		1	6.7–C
Grand Union Co	1		
Purity Stores, Inc			25.4–C
International Basic Economy Corp	1	1	11.0–C 8.4–P
Apparel and accessories stores—SIC 561:			
J. C. Penney Co			5.1–C
Franklin Stores Corp			17.6–C
Eating and drinking places—SIC 581: Automatic Retailers of America, Inc			5.1–C
Drug and proprietary stores—SIC 591: White Cross Stores, Inc			6.3–C
Retail trade, not elsewhere classified—SIC 599: Hammond, Inc			19.5–C
Life, accident, and health insurance—SIC 631:			
Metropolitan Life	1		
Equitable Life Assurance	4		
Aetna Life			5.0–C
Travelers Insurance	2		
Jefferson Standard Life	1		
American General Insurance Co			7.0–C
Fire, marine, casualty, and surety insurance—SIC 633:			
U.S. Fidelity & Guaranty Co	1		
Continental Insurance Co	1		
American Reinsurance Co		1	6.7–C
Insurance agents, brokers, and service—SIC 641: Crum & Forster		2	5.3–C

See footnotes at end of table, p. 74.

Table 3.—*Interlocking relationships between Chase Manhattan Bank, New York, N.Y., and major corporations*—Continued

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Real estate—operators and lessors, exclusive developers—SIC 651:			
American National Trust			5. 3–C
Real estate, subdividers, developers, etc—SIC 655:			
Arvida Corp	1		
Great Southwest Corp	1		
Holding companies—SIC 671:			
Pennsylvania Company	1		
Miscellaneous investing institutions—SIC 679: Virginia Coal & Iron Co	1		

[1] The standard industrial classification designates the principal products manufactured or the major services furnished by each company. These classifications were prepared by the Technical Committee on Standard Industrial Classification, under the sponsorship and supervision of the Office of Statistical Standards of the Bureau of the Budget, Executive Office of the President.

[2] The letter "C" designates a common or capital stock issue. The letter "P" designates an issue of stock other than a common or capital stock issue. Where more than one "P" appears under one bank's holdings, in most cases this indicates the holding of several different kinds of preferred stock.

Table 4.—*Interlocking relationships between Bankers Trust Co., New York, N.Y., and major corporations*

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Iron ores—SIC 101: Hanna Mining	2		
Crude petroleum and natural gas—SIC 131: Canadian Export Gas & Oil, Ltd	1		
General building contractors—SIC 151: Fluor Corp., Ltd		1	12. 1–C

See footnotes at end of table, p. 79.

TABLE 4.—*Interlocking relationships between Bankers Trust Co., New York, N.Y., and major corporations*—Continued

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Food products—SIC 20 (combine 202, 203, 204, and 205):			
National Dairy Products Corp	2	1	
Deltown Foods, Inc		1	12.6–C
Campbell Soup Co	1		
H. J. Heinz Co	1		
General Mills, Inc		3	5.0–C
National Biscuit Co	2	2	5.0–C
Ward Foods, Inc		1	12.5–C
Sugar—SIC 206: American Sugar Co	1		
Cigarettes—SIC 211: Philip Morris, Inc	2	1	
Miscellaneous tobacco products—SIC 213: Block Bros. Tobacco Co			10.5–P
Textile mill products—SIC 221:			
Collins & Aikman Corp	1	1	
Huyck Corp	1		
American Manufacturing Co	1		
Floor covering mills—SIC 227: Bigelow-Sanford, Inc	1	3	
Apparel—SIC 231: Bali Co., Inc	1		
Paper and allied products—SIC 262:			
International Paper Co	2	1	25.5–P
Crown Zellerbach Corp	1	2	5.1–P
Federal Paper Board Co., Inc	1	1	
Printing and allied industries—SIC 275: American Bank Note Co	1	1	
Industrial inorganic and organic chemicals, plastic materials and synthetic resins, synthetic rubber and other manmade fibers except glass—SIC 281:			
Union Carbide Corp	1		
Celanese Corp	1		
Agricultural chemicals—SIC 287: International Minerals & Chemical Corp	1		

See footnotes at end of table, p. 79.

TABLE 4.—*Interlocking relationships between Bankers Trust Co., New York, N.Y., and major corporations*—Continued

[In order by standard industrial classification [1]]

Classification by SIC code and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Petroleum refining—SIC 291:			
Mobile Oil Corp	1	2	
Continental Oil Co	2		
Tires and inner tubes—SIC 301:			
B. F. Goodrich Co	1		
Concrete, gypsum, asbestos, and plaster products—SIC 326:			
Owens-Corning Fiberglas Corp	1		
Flintkote Co			8.7–P
Blast furnaces, steel works, and rolling and finishing mills—SIC 331:			
Abex Corp	1		
Bundy Corp			11.0–C
Smelting and refining of nonferrous metals—SIC 333:			
St. Joseph Lead Co	1		
Foote Mineral Co	1		
Magma Copper Co	1	1	
Metal cans—SIC 341: American Can Co	2	5	
Cutlery, hand tools, and general hardware—SIC 342: Emhart Corp	1		
Farm machinery, construction, mining, and materials handling machinery and equipment—SIC 352:			
Otis Elevator Co	1	2	
Bucyrus-Erie Co	1		
General industrial machinery and equipment—SIC 356: Resistoflex Corp			13.1–C
Office, computing, and accounting machines—SIC 357:			
International Business Machines Corp	2	1	
Pitney-Bowes, Inc	2		
Service industry machines—SIC 358: Carrier Corp	1		

See footnotes at end of table, p. 79.

TABLE 4.—*Interlocking relationships between Bankers Trust Co., New York, N.Y., and major corporations*—Continued

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Electric transmission and distribution equipment; electrical industrial apparatus; lighting and wiring equipment—SIC 361:			
Consolidated Electronics Industries Corp	1	1	
Thomas & Betts Co		1	6.3–C
Standard Motor Products, Inc	1	1	
Communication equipment, electronic components and accessories—SIC 366: Western Electric	2		
Motor vehicles and motor vehicle equipment—SIC 371:			
Rockwell Standard Corp	1	1	
Purolator Products, Inc	1	1	
Aircraft and parts—SIC 374:			
General Dynamics Corp		1	6.2–C
Grumman Aircraft Engineering Corp	1	1	
Fairchild Hiller Corp	1		
Thiokol Chemical Corp	1		
Ship and boat building and repairing—SIC 373: Newport News Shipbuilding & Dry Dock Co	1		
Railroad equipment—SIC 374: ACF Industries, Inc	1	8	
Instruments for measuring, controlling, and indicating physical characteristics—SIC 381:			
Neptune Meter Co	1	1	
Honeywell, Inc		2	7.5–C 8.2–P
Optical instruments and lenses; ophthalmic goods; and photographic equipment and supplies—SIC 383: American Optical Co	1		
Watches, clocks, clock-work operated devices and parts—SIC 387: General Time Corp	1		

See footnotes at end of table, p. 79.

TABLE 4.—*Interlocking relationships between Bankers Trust Co., New York, N.Y., and major corporations*—Continued

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Railroads—SIC 401:			
Delaware & Hudson Co	1		
Delaware & Hudson RR. Corp	1		
Public warehousing—SIC 422: Bush Terminal Co	1		
Telephone communication—wire or radio—SIC 481: Cincinnati & Suburban Bell Telephone Co	2	1	
Electric companies and systems—SIC 491: Holyoke Water Power Co	1		
Gas companies and systems—SIC 492: Florida Gas Co	1	1	
Combination companies and systems, electric and gas—SIC 493:			
Consumers Power Co	1		
Baltimore Gas & Electric Co	1		
Department stores—SIC 531: Allied Stores Corp	1		
Grocery and miscellaneous food stores—SIC 541:			
Grand Union Co		1	12.8–P 5.0–C
Penn Fruit Co., Inc	1		
Shoestores—SIC 566: Melville Shoe Corp	1	1	11.0–P 9.4–C
Jewelry stores—SIC 597:			
Tiffany & Co	1		
Kay Jewelry Stores	1		
Life, accident, and health insurance—SIC 631:			
Prudent al Insurance Co. of America	1		
Metropolitan Life	1		
Connecticut General Life	1		6.4–C
Mutual Life of New York	1		
Lincoln National Life	1		7.7–C
Guardian Life of America	1		
Citadel Life Insurance Co. of New York	1		
Financial Life Insurance Co	1		

See footnotes at end of table, p. 79.

TABLE 4.—*Interlocking relationships between Bankers Trust Co., New York, N.Y., and major corporations*—Continued

[In order by standard industrial classification[1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank[2]
Fire, marine, casualty, and surety insurance—SIC 633:			
Great American Insurance Co.	1		
Federal Insurance Co.	1		
Real estate—Operators and lessors, except development—SIC 651: Furman-Wolfson Corp.			5.0–C
Miscellaneous investing institutions—SIC 678: RAC Corp.	1		

[1] The standard industrial classification designates the principal products manufactured or the major services furnished by each company. These classifications were prepared by the Technical Committee on Standard Industrial Classification, under the sponsorship and supervision of the Office of Statistical Standards of the Bureau of the Budget, Executive Office of the President.
[2] The letter "C" designates a common or capital stock issue. The letter "P" designates an issue of stock other than a common or capital stock issue. Where more than one "P" appears under one bank's holdings, in most cases this indicates the holding of several different kinds of preferred stock.

TABLE 5.—*Interlocking relationships between First National City Bank, New York, N.Y., and major corporations*

[In order by standard industrial classification[1]]

Classification by SIC code and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank[2]
Metal mining—nonproducers—SIC 107: Apex Minerals Corp.			5.3–C
Bituminous coal and lignite mining—SIC 121: Blue Diamond		1	15.0–C
Crude petroleum and natural gas—SIC 131: Panoil Co.		1	5.2–C
General building contractors—SIC 151: Stone & Webster, Inc.	1		
Canning and preserving fruits, vegetables—SIC 203: General Foods Corp.	2	2	
Grain mill products—SIC 204: General Mills, Inc.	1		

See footnotes at end of table, p.86.

Table 5.—*Interlocking relationships between First National City Bank, New York, N.Y., and major corporations*—Con.

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Alcoholic and malt beverages—SIC 208: National Distillers and Chemical Corp	1	2	12. 4–P 16. 4–P
Cigars—SIC 212: Consolidated Cigar Corp			6. 3–C
Textile mill products—SIC 221: Wyomissing Corp	1	2	
Paper & Allied Products—SIC 262:			
St. Regis Paper Co	2	1	
Kimberly-Clark Corp	1		
Boise Cascade Corp			18. 5–P
Potlatch Forests, Inc	1		
Building paper and building board mills—SIC 266: Upson Co	1		
Newspapers, periodicals, and books—SIC 271:			
McGraw-Hill, Inc			5. 8–P
Charles E. Merrill Books, Inc			12. 8–C
Prentice-Hall, Inc			8. 7–C
Wadsworth Publishing Co., Inc			10. 0–C
Allyn Bacon, Inc			7. 5–C
Harcourt, Brace & World, Inc			7. 6–C
American Book Co	1		
Meredith Publishing Co	1		
Doubleday & Co			23. 4–C
Industrial inorganic and organic chemicals—SIC 281:			
Monsanto Co	2	2	
W. R. Grace Co	3		
Allied Chemical Corp	1	1	
Celanese Corp			5. 6–P
Koppers Co., Inc	1		
Hooker Chemical Corp			6. 0–P
Drugs—SIC 283:			
Bristol-Myers Co	1		
Upjohn Co			6. 1–C
Soap, detergents, and cleaning preparations—SIC 284:			
Procter & Gamble Co	1		
Colgate-Palmolive Co	1	2	

See footnotes at end of table, p. 86.

TABLE 5.—*Interlocking relationships between First National City Bank, New York, N.Y., and major corporations*—Con.

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Petroleum refining—SIC 291:			
Standard Oil of New Jersey	1	1	
Mobil Oil Corp	2		
Phillips Petroleum Co		6	6.6–C
Sinclair Oil Corp	2	1	
Glass and glass products—SIC 321:			
Owens-Illinois, Inc	1		
Corning Glass Works	2	4	8.5–C
Concrete, gypsum, asbestos and plaster products—SIC 326: Johns-Mansville Corp	2		
Blast furnaces, steel works, and rolling and finishing mills—SIC 331:			
United States Steel Corp	1		
Dayton Malleable Iron Co			7.8–C
Smelting and refining of nonferrous metals—SIC 333:			
Anaconda Co	2	2	
Reynolds Metals Co			7.5–P
Kaiser Aluminum & Chemical Corp			7.6–P
Kennecott Copper Corp	2		
Phelps Dodge Corp	1	1	
Scovill Manufacturing Co		1	15.8–P
Arwood Corp	1		
Metal cans—SIC 341: American Can Co	2	1	
Farm machinery, construction, mining and materials handling machinery and equipment—SIC 352: Dresser Industries, Inc	1		
Metalworking machinery and equipment—SIC 354: Kearney & Trecker Corp			6.5–C
Special industry machinery, excluding metalworking machinery—SIC 355:			
Ritter Pfaudler Corp	1		
Hobart Manufacturing Co			8.0–C

See footnotes at end of table, p. 86.

TABLE 5.—*Interlocking relationships between First National City Bank, New York, N.Y., and major corporations*—Con.

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
General industrial machinery and equipment—SIC 356: Ingersoll-Rand Co.	1		
Office, computing, and accounting machines—SIC 357:			
International Business Machines Corp.	1		
National Cash Register Co.	2	1	
Service industry machines—SIC 358:			
Carrier Corp.			11.5–P
Tecumseh Products Co.			15.8–P
Electric transmission and distribution equipment—SIC 361:			
General Electric Co.	1		
Westinghouse Electric Corp.	1	2	6.6–P
Servel, Inc.			7.5–P
Radio and television receiving sets—SIC 365: Magnavox Co.	1		
Communication equipment—SIC 366: International Telephone & Telegraph	1	1	
Motor vehicles and motor vehicle equipment—SIC 371:			
Ford Motor Co.	1		
Borg-Warner Corp.	1	1	
Eaton, Yale & Towne, Inc.			11.7–P
Mack Trucks, Inc.			14.8–P
Aircraft and parts—SIC 372:			
Boeing Co.	1	3	
United Aircraft Corp.	2		
TRW, Inc.			6.2–P
Railroad equipment—SIC 374: ACF Industries, Inc.	1	1	
Optical instruments and lenses—SIC 383:			
Bell & Howell Co.	1		
Xerox Corp.	2		5.0–C

See footnotes at end of table, p. 86.

Table 5.—*Interlocking relationships between First National City Bank, New York, N.Y., and major corporations*—Con.

[In order by standard industrial classification [1]]

Classification by SIC code and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Toys, amusement, sporting goods, etc.—SIC 394: American Machine & Foundry Co			8.7–P
Jewelry, silverware, plated ware, etc.—SIC 391: Oneida, Ltd		1	5.5–C
Railroad transportation—SIC 401:			
Southern Pacific Co	1		
Union Pacific RR. Co	1		
Great Northern Ry. Co	1		
Northern Pacific Ry. Co	1		
Local and suburban passenger transportation—SIC 411:			
Trans-Caribbean Airways, Inc	1		
D.C. Transit System, Inc	1		
Public warehousing—SIC 422: Merchants Refrigerating Co	3		10.2–C
Services incidental to water transportation—SIC 446: Coastal Ship Corp			11.2–C
Air transportation—SIC 451:			
United Air Lines, Inc			7.4–P
Pan American World Airways	1	2	
Telephone communication—SIC 481:			
American Telephone & Telegraph Corp	1		
Southern New England Telephone Co	1		
Commonwealth Telephone Co			19.1–P
New Jersey Bell Telephone Co.	1		
New York Telephone Co	1		
Rochester Telephone Corp			10.0–P 7.1–P
Hawaiian Telephone Co			5.0–P 9.6–P
Wisconsin Telephone Co	1		
Ohio Bell Telephone Co	1		
Radio and TV broadcasting—SIC 483: ABC, Inc	1		

See footnotes at end of table, p. 86.

TABLE 5.—*Interlocking relationships between First National City Bank, New York, N.Y., and major corporations*—Con.

[In order by standard industrial classification [1]]

Classification by SIC code and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Communications services, not elsewhere classified—SIC 487: Communications Satellite Corp	1		
Electric companies and systems—SIC 491:			
Consolidated Edison Co. of New York, Inc	2	1	6.1–P
Southern California Edison Co			8.2–P
Virginia Electric & Power Co			5.0–P
Northern States Power			9.1–P 5.8–P 8.0–P
Long Island Lighting Co	1		8.2–P
Gulf States Utilities Co			7.2–P
Texas Power & Light Co			15.3–P
Connecticut Light & Power Co			5.8–P
Narragansett Electric Co			5.3–P
Ohio Power Co			11.3–P
Louisiana Power & Light Co			7.4–P
Dallas Power & Light Co			9.0–P
Texas Electric Service Co			5.3–P
Kansas City Power & Light Co			12.5–P
Florida Power Corp			5.1–P 9.5–P
Arizona Public Service Co			11.8–P
Hawaiian Electric Co., Inc			13.1–P 5.0–P 25.3–P
Gas companies and systems—SIC 492:			
Panhandle Eastern Pipe Line Co		4	9.5–P
Southwest Gas Corp			8.3–P
Intermountain Gas Co	1	1	
Washington Gas Light Co			6.9–P
Northern Illinois Gas Co			7.9–P
Tenneco, Inc			10.9–P 11.5–P 5.8–P 6.2–P
Colorado Interstate Gas Co			10.3–P

See footnotes at end of table, p. 86.

Table 5.—*Interlocking relationships between First National City Bank, New York, N.Y., and major corporations*—Con.

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Combination gas & electric systems—SIC 493:			
Public Service Electric & Co Co			7.3–P
Consumers Power Co	1	4	
Rochester Gas & Electric Corp	2		
Montana Dakota Utilities Co			6.0–P
Department stores—SIC 531:			
Mercantile Stores Co., Inc	2	1	
Mail order houses—SIC 532:			
Sears, Roebuck & Co	1		
Vending machine operators—SIC 534: Canteen Corp	1		
Grocery and miscellaneous food stores—SIC 541:			
Food Fair Stores, Inc			6.1–P
Jewel Companies, Inc		2	6.0–C
Apparel and accessories stores, except shoes—SIC 561: J.C. Penny Co	2		
Shoe stores—SIC 566: Melville Shoe Corp			8.0–P
Life, accident, and health insurance—SIC 631:			
Metropolitan Life	2		
New York Life	2		
Northwestern Mutual Life Insurance Co	1		
Travelers, Inc	1		
Mutual Life of New York	1		
United States Life Insurance Co	1		
Fire, marine, casualty, and surety insurance—SIC 633:			
Great American Insurance Co	1		
Federal Insurance Co	3		6.7–C
Real estate—operators and lessors, except developers—SIC 651:			
City Investing Co	1	1	
General Real Estate Shares			7.2–C

See footnotes at end of table, p. 86.

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TABLE 5.—*Interlocking relationships between First National City Bank, New York, N.Y., and major corporations*—Con.

[In order by standard industrial classification [1]]

Classification by SIC code, and name of company	Director interlocks	Employee benefit funds managed by bank	Percent of outstanding stock held by bank [2]
Holding companies—SIC 671:			
First Bank Stock Corp	1		
Marine Midland Corp	1		
Advertising—SIC 731: Foote, Cone & Belding, Inc		1	7.6–C
Business services—not elsewhere classified—SIC 739: Planning Research Corp			5.9–C

[1] The standard industrial classification designates the principal products manufactured or the major services furnished by each company. These classifications were prepared by the Technical Committee on Standard Industrial Classification, under the sponsorship and supervision of the Office of Statistical Standards of the Bureau of the Budget, Executive Office of the President.

[2] The letter "C" designates a common or capital stock issue. The letter "P" designates an issue of stock other than a common or capital stock issue. Where more than one "P" appears under one bank's holdings, in most cases this indicates the holding of several different kinds of preferred stock.

Appendix D

Corporate Issues Withdrawn From Registration Between January and July 1973

STATEMENTS WITHDRAWN FROM REGISTRATION JANUARY 1–31, 1973

The following list shows those statements which have been withdrawn from registration during the month of June. Those marked with an asterisk (*) indicate statements which have not been officially withdrawn, but application for withdrawal has been filed with the SEC.

Company	Issue	Underwriter	Date withdrawn
Adams Laboratories, Inc	225,000 shares common	L. M. Rosenthal & Co	(*)
BBDO International, Inc	770,000 shares common	Dean Witter & Co	Jan. 4
Beaver Lake Co	252 units of limited partnership interest; 252 partnership notes.	Mitchum, Jones & Templeton	(*)
Boston Educational Research Co	225,000 shares common	D. H. Blair Securities	(*)
Cambridge Coffee, Tea & Spice House, Inc.	$750,000 debs/83	None	Jan. 24
Caribbean Management	150,000 shares common; 150,000 warrants.	Vaisman & Co	Jan. 8
Century Laboratories	300,000 shares common	None	(*)
Clarkson Industries	200,000 shares common	W. E. Hutton & Co	Jan. 9
Colonial Flock Corp	145,000 shares common	M. R. Safir & Co	Jan. 10
Construction Ventures	200,000 shares common; 400,000 warrants.	Buttonwood Securities	Jan. 8
Craddock-Terry Shoe Corp	300,000 shares common	F. S. Moseley & Co.; Wheat, First Securities.	Jan. 17
Craftsman Press, Inc	6,000 units	Ferris & Co	(*)
Data Recall Corp	400,000 shares common	Oppenheimer & Co	(*)
Datamac Inc	125,000 shares common	DeRand Investment Corp	Jan. 3
Deguire Discount Centers	200,000 shares common; 100,000 warrants.	Custodian Security Brokerage	Jan. 24

Statements Withdrawn From Registration January 1–31, 1973—Continued

Company	Issue	Underwriter	Date with-drawn
El Chico Corp	280,000 shares common	Eppler, Guerin & Turner	(*)
Emerald Forest Inc	100,000 shares common	Ferkauf, Roggen Inc	Jan. 9
Envirometrics Inc	200,000 shares common	Maynard, Merel & Co	Jan. 30
Evans-Mathis Furniture	320,000 shares common	Eppler, Guerin & Turner	Jan. 17
F-Tre Industries Inc	150,000 shares common	None	Jan. 11
Fischer & Porter Co	400,000 shares common	Blyth Eastman Dillon	(*).
Forest City Enterprises	327,488 shares common	Smith, Barney & Co	(*).
Hobart Furniture Co	150,000 shares common; 75,000 warrants.	Custodian Security Brokerage	(*).
Image Systems, Inc	472,507 shares common; 472,507 warrants.	None	Jan. 18
Institute for Scientific Information, Inc.	342,232 shares common	Andersen & Co	(*)
Interactive Data Corp	300,000 shares common	C. E. Unterberg, Towbin	Jan. 18
Jetco, Inc	323,820 shares common	Filor, Bullard & Smyth	Jan. 3
Laco Gas Exploration	$18,000,000 debs/80; 540,000 shares common.	White, Weld & Co.; Hornblower & Weeks.	(*)
Medical Scientific International Corp.	154,700 shares common	Wheat, First Securities; First Equity Corp. of Florida.	(*)
Micronics Industries	$600,000 debs/82	Custodian Security Brokerage	Jan. 16
Neptunian Mariculture Industries, Inc.	440,000 shares common	Mayflower Securities	(*)
Off the Bolt, Inc	200,000 shares common	Morgenstern Securities	(*)
Orient World, Inc	200,000 shares common	Gotham Securities	(*)
Pavelle Corp	600,000 shares common	Sterling Grace & Co	(*)

Polyrok, Inc	225,000 shares common	Herbert Young	(*)
Princeton Chemical Research	350,000 shares common	Agio Capital Corp	Jan. 18
Publishers' Broadcasting	652,706 shares common	Paul C. Kimball & Co	(*)
Quantor Corp	200,000 shares common; 200,000 warrants.	Birr, Wilson & Co	Jan. 8
Shelter Partnership of America	4,000 units of limited partnership interest.	Kidder, Peabody & Co.; Piper, Jaffray & Hopwood.	(*)
Shoreco International Inc	245,000 shares common	Bernard Herold	(*)
Southeastern Modular Industries Inc.	$2,000,000 debs/87	Delphi Capital Corp	Jan. 16
Stock-It Corp	150,000 shares common; 75,000 warrants.	Custodian Security Brokerage	(*)
Stretch & Sew	350,000 shares common	Bateman Eichler	(*)
Times Square Stores	410,000 shares common	Bear, Stearns & Co	(*)
Tipco, Inc	200,000 shares common	Faherty & Swartwood	Jan. 4
Trafalgar International Development Inc.	250,000 shares common	Merkin & Co	Jan. 19
United Consolidated Industries	230, 000 shares common	Legg, Mason & Co	(*)
Uranium King Corp	1,218,778 shares common	None	Jan. 10
Whittaker Corp	$25,000,000 debs/92	Smith, Barney & Co.; Goldman, Sachs & Co.	(*)
Wiederkehr Wine Cellars	180,000 shares common	Eppler, Guerin & Turner	Jan. 16

Statements Withdrawn From Registration February 1–28, 1973

The following list shows those statements which have been withdrawn from registration during the month of February. Those marked with an asterisk (*) indicate statements which have not been officially withdrawn, but application for withdrawal has been filed with the SEC.

Company	Issue	Underwriter	Date withdrawn
Aberdeen Manufacturing	306,732 shares common	N.Y. Hanseatic	Feb. 12
Accudyne Corp	180,000 shares common	Securities Unlimited of Beverly Hills.	Feb. 22
Acorn Building Corp	250,000 shares common	Manley Bennett McDonald	Feb. 16
Air Florida, Inc	400,000 shares common	Executive Securities	(*)
American Classic Industries	265,000 shares common	Anderson & Strudwick	Feb. 9
American Program Bureau	26,500 shares common; 31,800 warrants.	None	Feb. 6
Argus, Inc	300,000 shares preferred	do	Feb. 28
B. E. C. Enterprises, Inc	200,000 shares common	Maynard, Merel & Co	(*)
Biomedical Computer Services, Inc	500,000 shares common	None	Feb. 13
Bon Terre Petroleum	do	do	Feb. 26
Century Building Systems	130,000 shares common; 130,000 warrants.	P. F. Stanton	(*)
Collision Devices, Inc	200,000 shares common	Maynard, Merel & Co	(*)
Crane Bio-Medical Instruments, Inc.	100,000 shares common	Granite Securities; Mutual Investors of Rhode Island.	Feb. 9
Crowell-Leventhal, Inc	120,000 shares common	Frank & Drake	(*)
Dorsett Corp	455, 000 shares common	White, Weld & Co.; Robert Fleming, Inc.; Kleinwort, Benson, Inc.	Feb. 28

Ecological Science Corp	1, 449, 681 shares common	None	Feb. 23
Edco Financial Services	100, 000 shares common	Securities Unlimited of Beverly Hills.	Feb. 26
El Chico Corp	280, 000 shares common	Eppler, Guerin & Turner	Feb. 22
First National Realty & Construction Corp.	$3,800,000 debs/87; 114,000 shares common.	None	Feb. 16
Fischer & Porter Co	400, 000 shares common	Blyth Eastman Dillon	Feb. 8
Gaynor-Stratford Industries, Inc	153, 440 shares common	Shearson, Hammill & Co	(*)
Global Vision, Inc	515, 000 shares common	Laidlaw & Co	(*)
Graphic Systems, Inc	300, 000 shares common; 300, 000 warrants.	S. D. Fuller & Co	Feb. 5
Halifax Engineering, Inc	150,000 shares common	Proctor Cook & Co	Feb. 16
Homogeneous Metals, Inc	175,000 shares common	M. Griffith, Inc	Feb. 8
International Fruit Products	100,000 shares common	Chartered New England	(*)
Investment Corp. of Florida	93,361 shares common	None	Feb. 15
LDA Credit Corp	150,000 shares common	Cotzin, Woolf	(*)
Lancer Mobile Homes, Inc	357,143 shares common	Birr, Wilson & Co	(*)
Leasco Industries, Inc	150,000 shares common	Delphia Capital Corp	Feb. 5
Lockeford Vinter Corp	266,666 shares common	First California	(*)
McRae Industries	130,161 shares common	None	Feb. 7
Magnusonic Devices, Inc	250,000 shares common	Grimm & Davis	Feb. 23
Manley Industries, Inc	300,000 shares common	Stifel, Nicolaus	(*)
Maryland Environmental Systems, Inc.	140,000 shares common	Blinder Robinson	(*)
Mediclinic Corp	$3,500,000 debs/88; 301,000 shares common.	L. M. Rosenthal & Co	(*)
Metroflight, Inc	400,000 shares common	Dewey Johnson & George	(*)
Mogul Corp	43,800 shares common	None	(*)
Modular Housing Systems	498,533 shares common	do	Feb. 26
Modular Industries of America, Inc	250,000 shares common	H. E. Simpson Securities	(*)
National Mobile Park	150,000 shares common	Frank Ginberg	Feb. 23

STATEMENTS WITHDRAWN FROM REGISTRATION FEBRUARY 1-28, 1973—Continued

Company	Issue	Underwriter	Date withdrawn
Neptunian Mariculture Industires, Inc.	440,000 shares common	Mayflower Securities	Feb. 16
Pavelle Corp	600,000 shares common	Sterling Grace	Feb. 22
Philips, Appel & Walden	300,000 shares common	First Equity Corp. of Florida	Feb. 5
Port Penn Marina Co	$3,669,000 of limited partnership interest.	None	Feb. 2
Prudential Funds, Inc	2,045,200 shares common	do	Feb. 14
Riviana Foods, Inc	400,000 shares common	Goldman, Sachs; Walston & Co.; Rotan Mosle, Inc.	(*)
Serio Exploration Co	4,000 units of participations	Vance Saunders	Feb. 22
Shoppers Voice, Inc	375,000 shares common	None	Feb. 14
Thomas Holmes Corp	497,296 shares common	Herzfeld & Stern	Feb. 14
Tool Research & Engineering	100,000 shares common	None	Feb. 23
United Cos. Financial	299,472 shares common	Dominick & Dominick; Howard, Weil, Labouisse & Friedrichs.	Feb. 13
Universal Cap Corp	200,000 shares common; 200,000 warrants.	Dopler & Co	(*)
Video Tape Network, In	100,000 shares common	A. C Kluger & Co	Feb. 26
Victor F. Weaver, Inc	250,000 hares common	W. E. Hutton & Co.; Janney, Montgomery Scott.	Feb. 8
Weigh-Tronix, Inc	530,805 shares common	Kirkpatrick Pettis, Smith, Polian	Feb. 16

Statements Withdrawn From Registration March 1–30, 1973

The following list shows those statements which have been withdrawn from registration during the month of March. Those marked with an asterisk (*) indicate statements which have not been officially withdrawn, but application for withdrawal has been filed with the SEC.

Company	Issue	Underwriter	Date withdrawn
Air Florida, Inc	400,000 shares common	Executive Securities	Mar. 28
Air Trac Corp	200,000 shares common	Dargy & Co	Mar. 23
American Bancshares, Inc	300,000 shares common	Walston & Co	Mar. 16
American Modular Development	150,000 shares common	D. H. Blair	Mar. 30
American Television & Communications Corp.	500,000 shares common	Paine, Webber	(*)
Argo Industries Corp	120,000 shares common	Howard Lawrence & Co	Mar. 16
Au-Ag Corp	1,500,000 shares common	Birr, Wilson & Co	(*)
Biomedical Computer Services, Inc	450,000 shares common	Woolard & Co.; Engler & Budd	(*)
Booth, Inc	375,000 shares common	Eppler, Guerin & Turner	Mar. 16
Calumet Industries, Inc	300,000 shares common	Butcher & Sherrerd	Mar. 5
Century Building Systems	130,000 shares common; 130,000 warrants.	P. J. Stanton	Mar. 1
Climatrol Corp	300,000 shares common	Suplee-Mosley Inc	(*)
Coca-Cola Bottling Co. of Mid-America, Inc.	350,000 shares common	Kidder, Peabody & Co.; Scherck, Stein & Franc.	(*)
Colonial Flock Corp	145,000 shares common	M. R. Safir & Co	Mar. 12
Compumatics, Inc	175,000 shares common	S. D. Lunt & Co	Mar. 1
Contech, Inc	250,000 shares common	None	Do.
Data Recall Corp	400,000 shares common	Oppenheimer & Co	Mar. 9
Diversified Mortgage Investors	$25,000,000 debentures/85	Hornblower & Weeks	(*)

Statements Withdrawn From Registration March 1–30, 1973—Continued

Company	Issue	Underwriter	Date withdrawn
Equitable Financial Corp	$5,000,000 debentures	Development Securities	Mar. 14
Eresbo Inc	400,000 shares common	Bache & Co	(*)
Fastrack International	310,000 shares common	Smith, Jackson & Co	Mar. 1
Global Vision, Inc	515,000 shares common	Laidlaw & Co	Mar. 20
Great West Land Mining	800,000 shares common	E. H. Coltharp	(*)
Health Systems, Inc	170,000 shares common	B. J. Lerner & Co	Mar. 7
Hylton Enterprises, Inc	400,000 shares common	E. F. Hutton & Co	(*)
Javelin Corp	258,750 shares common	E. F. Hutton & Co.; Piper, Jaffray & Hopwood.	(*)
Jorges Carpet Mills, Inc	450,000 shares common	A. G. Edwards & Sons	Mar. 21
Judson Bigelow, Inc	100,000 shares common	Leyner, Dreskin & Co	Mar. 7
Junior Spice, Inc	340,000 shares common	None	Mar. 14
Laco Gas Exploration, Inc	$18,000,000 debs/80; 540,000 shares common.	White, Weld & Co.; Hornblower & Weeks.	Mar. 5
Land & Sea Association	4,000 units of limited partnership interest.	Weis, Voisin & Co	Mar. 15
Mariculture Growth Industries, Inc.	150,000 shares common	Kordich, Victor & Neufeld	(*)
Maritime Group, Inc	325,000 shares common	Bear, Stearns & Co	(*)
Meridan Industries, Inc	1,266,897 shares common; 938,000 warrants.	None	Mar. 20
Mobile Development Corp	200,000 shares common	Margolis & Co.; Snodgrass & Co	Mar. 7
Modular Cities, Inc	150,000 shares common	None	Mar. 27
Modular Industries of America, Inc	250,000 shares common	H. E. Simpson	Mar. 9

National Research & Development Corp.	100,000 shares common	Vaisman & Co	(*)
Odec, Inc	800,000 shares common	Lepercq, de Neuflize	Mar. 7
Orient World, Inc	200,000 shares common	Gotham Securities	Do.
Polyrok, Inc	225,000 shares common	Herbert Young & Co	Mar. 9
Princeton Applied Research Corp	150,000 shares common	Clark, Dodge & Co	Mar. 14
Quasar Microsystems, Inc	22,500 shares common; 10,000 warrants.	None	Mar. 13
R. H. Cosmetics Corp	150,000 shares common	do	Mar. 9
RMI Ltd	1,174 units of limited partnership interest.	do	Mar. 21
Republic Development	400,000 shares common	Goldman, Sachs & Co.; Manley, Bennett, McDonald.	Mar. 13
Riviana Foods, Inc	400,000 shares common	Goldman, Sacks & Co	Mar. 12
Rockwood Industries, Inc	300,000 shares common	Andresen & Co	(*)
Rothschild Partnership Fund	5,000 units of limited partnership interest.	Dain, Kalman & Quail	(*)
Stouffer Corp	4,300,000 shares common	Merrill Lynch; Hornblower & Weeks.	Mar. 26
Stradford of Texas, Inc	298,152 shares common	None	Mar. 7
Sunbanc Corp	300,000 shares common	Christian Paine & Co	Do.
Syncor Industries Corp	200,000 shares common	I.R.E. Investors	(*)
System Development	400,000 shares common	Smith, Barney & Co	Mar. 14
Teradyne, Inc	270,000 shares common	Lehman Brothers	(*)
Versa Technologies, Inc	222,500 shares common	Loewi & Co	Mar. 7
Wilson Learning Corp	330,000 shares common	Margolis & Co	(*)

STATEMENTS WITHDRAWN FROM REGISTRATION APRIL 1–30, 1973

The following list shows those statements which have been withdrawn from registration during the month of April. Those marked with an asterisk (*) indicate statements which have not been officially withdrawn, but application for withdrawal has been filed with the SEC.

Company	Issue	Underwriters	Date withdrawn
Advance Biofactures Corp	115,000 shares common	S. D. Cohn & Co	(*)
American Minerals Fund	2,000 units of limited partnership interest.	None	Apr. 3
American Minerals Fund Oil Income Program.	10,000 units of limited partnership interest.	Western American Corp	Apr. 4
American Television & Communications Corp.	500,000 shares common	Paine, Webber	Apr. 9
Analytical Systems, Inc	300,000 shares common	Carlton-Cambrige	Apr. 20
Atco Chemical Industrial Products	321,900 shares common	None	Apr. 25
Automated Communications	300,000 shares common	John Salek & Co	Apr. 17
Automated Optics, Inc	250,000 shares common	None	(*)
Business Exchange, Inc	165,000 shares common	J. Shapiro & Co	Apr. 5
Michael Butler Associates	250,000 shares common	C. B. Richard, Ellis	(*)
C. & R. Clothiers, Inc	300,000 shares common	New York Securities	(*)
Caldwell Development	400,000 shares common	Dominick & Dominick	(*)
Cardinal Income Securities	2,500,000 shares common	Goldman, Sachs; Hayden	(*)
		Stone; Interstate Securities	(*)
Cigol International Ltd	$30,000,000 debs/83; 1,200,000 shares common.	Bear, Stearns; Hornblower & Weeks; Nesbitt Thomson; Pierson, Heldring & Pierson.	(*)
Collectors Coin Co	125,000 shares common	Doherty & Co	Apr. 17

Combyte Corp	do	M. R. Safir & Co	(*)
Colmar Systems, Inc	300,000 shares preferred; 300,000 warrants.	Suplee-Mosley	(*)
Continental Illinois Corp	$100,000,000 notes/79	Halsey, Stuart; Goldman, Sachs	(*)
Courthouse Industries, Inc	296,819 shares common	Janney Montgomery Scott	Apr. 5
Crowell-Leventhal, Inc	120,000 shares common	Frank & Drake	Apr. 18
Dental Communications	200,000 shares common	Lexington Capital; Dopler & Co	Apr. 10
Epic Ltd. Partnership No. 1	720 units of limited partnership interest.	Consolidated Securities	(*)
Excel Investment Co	400,000 shares common	Dean Witter; Dain, Kalman & Quail.	Apr. 25
Food Corp. International	1,000,000 shares common	Paine, Webber	Apr. 10
Franzia Bros. Winery	455,000 shares common	W. E. Hutton; Bateman Eichler	Apr. 18
Freed's, Inc	$2,000,000 debs/83; 325,000 shares common.	Dominick & Dominick	(*)
Frigitemp Corp	250,000 shares common	Loeb, Rhoades & Co	Apr. 5
GCO, Inc	150,000 shares common	Darwood Associates	(*)
Giant Mascot Mines Ltd	1,000,000 shares common	Loeb, Rhoades & Co	(*)
Growth Industries, Inc	100,000 shares common	Mutual Investors of Rhode Island	Apr. 5
Health Learning Systems	250,000 shares common	Kohlmeyer & Co.; Havenfield Corp	Apr. 25
Health Sciences, Inc	175,000 shares common	S. D. Cohn & Co	(*)
Hemisphere Pictures, Inc	150,000 shares common	Kahn, Peck & Co	Apr. 23
Huskin Co	170,000 shares common	Meis & Co	(*)
I. M. S. International, Inc	434,464 shares common	White, Weld & Co	(*)
Javelin Corp	258,750 shares common	E. F. Hutton & Co.; Piper, Jaffray & Hopwood.	Apr. 9
Kapoho Land Ltd	2,000 units of limited partnership interest.	None	Apr. 18
Lease & License Ltd	312,500 shares common	S. D. Fuller & Co	Apr. 5
Lightron Corp	410,000 shares common; 410,000 warrants.	None	Apr. 10

STATEMENTS WITHDRAWN FROM REGISTRATION APRIL 1–30, 1973—Continued

Company	Issue	Underwriter	Date withdrawn
Loom Treasurers, Inc	265,000 shares common	Clark & Clark Securities	(*)
Manaco Enterprises, Inc	3,269,368 shares common	None	Apr. 5
National Shows, Inc	140,000 shares common	Rittmaster, Lawrence	(*)
O. E. M. Medical, Inc	200,000 shares common	Danes, Cooke & Keleher	Apr. 16
Out Island Inn Ltd	88 condominium units	None	Apr. 24
Pine Street Oil Corp	800 units of limited partnership interest.	Kelly & Morey	Apr. 5
Purepac Laboratories	170,000 shares common	Allen & Co	(*)
Regrave Information Resources	100,000 shares common	Raskin Rogers	Apr. 16
S. Riekes & Sons	300,300 shares common	Salomon; Eppler, Guerin & Turner	(*)
Sammons Communications	1,000,000 shares common	Merrill Lynch	(*)
Shop Vac Corp	275,000 shares common	Sutro & Co	Apr. 16
Southwest Forest Industries	200,000 shares preferred	White, Weld; Merrill Lynch	(*)

STATEMENTS WITHDRAWN FROM REGISTRATION MAY 1–31, 1973

The following list shows those statements which have been withdrawn from registration during the month of May. Those marked with an asterisk (*) indicate statements which have not been officially withdrawn, but application for withdrawal has been filed with the SEC.

Company	Issue	Underwriter	Date withdrawn
Advanced Memory Systems	463,500 shares common	E. F. Hutton & Co.; Hambrecht & Quist.	May 29
Allied Tube & Conduit	550,000 shares common	Drexel Burnham & Co	May 7
American Affiliates	300,000 shares common	Thomson & McKinnon	(*)
American Investment Properties Trust.	2,480,000 shares common	None	May 15
American Motor Inns	153,723 shares common	Loeb, Rhoades & Co Legg, Mason & Co	May 24
American Pharmacal Laboratories, Inc.	120,000 shares common	None	May 25
Brougham Industries	250,000 shares common	Brown, Allen & Co	(*)
Caldwell Development	400,000 shares common	Dominick & Dominick	May 22
Carvel Corp	323,863 shares common	Allen & Co	May 29
Castlewood International	346,800 shares common	Oppenheimer & Co	(*)
Cinevest Production	540,000 shares common	Allen & Co	May 11
Cobblers, Inc	330,000 shares common	Sutro & Co	(*)
Coca Cola Bottling Co. of Mid-America.	350,000 shares common	Kidder, Peabody & Co.; Scherck, Stein & Franc.	May 15
Computer Hardware Consultants & Services.	382,860 shares common	D. H. Blair & Co	May 4
Craftsman Press	$1,500,000 debentures; 150,000 shares common.	Ferris & Co	(*)

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Company	Issue	Underwriter	Date withdrawn
Cro-Med Bionics	500,000 shares common	Delphi Capital Corp	(*)
Crouse-Hinds Co	400,000 shares common	Merrill Lynch	May 29
Currency Detection Systems, Inc	70,000 shares common	None	May 11
DLG Enterprises Co	185,000 shares common	Charles Beck & Co	(*)
Daisy Corp	718,700 shares common	None	May 1
Denton Service Corp	120,000 shares common	Grimm & Davis	(*)
Diversified Mortgage Investors	$50,000,000 debentures	Hornblower & Weeks	May 1
Farm House Foods	300,000 shares common	Bacon, Whipple & Co	(*)
Flambeau Products	250,000 shares common	Clark, Dodge & Co.; Robert W. Baird & Co.	(*)
Fox Grocery Co	423,000 shares common	Hornblower & Weeks	May 17
Fox Ledge Housing & Development Corp.	200,000 shares common	Grimm & Davis	(*)
GCO, Inc	150,000 shares common	Darwood Associates, Inc	May 4
Gemeinhardt Corp	225,000 shares common	Bacon, Whipple & Co	(*)
Genesys Systems, Inc	325,000 shares common	J. H. Kern & Co	(*)
Gulf Group, Inc	400,000 shares common	Bear, Stearns & Co	May 29
Hallmark Group Cos	880,997 shares common; 383,774 warrants.	Stifel, Nicolaus & Co	(*)
Hecla Mining	637,674 shares common	White, Weld; Bache; Hornblower & Weeks; E. F. Hutton; Dean Witter.	May 3
Home Income Shares	4,000,000 shares common	Blyth Eastman Dillon; Shearson, Hammill; G. H. Walker.	(*)
Home Sew Industries	135,000 shares common	Leonard Bros	May 22
Humark Films, Inc	125,000 shares common	First Harvard	(*)
Huskin Co	170,000 shares common	Meis & Co	May 1

I.M.S. International	434,464 shares common	White, Weld & Co	May 4
Jewelcor, Inc	279,000 shares common	None	(*)
Kalama Chemicals, Inc	345,000 shares common	Sutro & Co	(*)
Walter Kidde & Co	$65,000,000 debs/98	Goldman, Sachs & Co	(*)
LCA Corp	1,449,275 shares common	None	May 10
Litroniz, Inc	415,000 shares common	do	May 21
Loom Treasures, Inc	265,000 shares common	Clark & Clark Securities	May 4
Mack Land Investors	$13,000,000 debentures 260,000 shares bene. int.	Shearson, Hammill & Co	(*)
Marland Environmental	140,000 shares common	Blinder, Robinson	May 16
Measured Marketing Services, Inc	398,000 shares common	duPont Glore Forgan	May 18
Metrocare Enterprises	960,000 shares common	Shearson, Hammill; Hornblower & Weeks.	May 11
Murphy Oil Co	433,993 shares common	Morgan Stanley & Co	May 21
National Talca Corp	200,000 shares common	A. T. Brod & Co	May 21
Premier Corp	600,000 shares common	Clark, Dodge & Co	May 11
Primate Imports Corp	100,000 shares common	Parish Securities	May 29
Realco, Inc	100,000 shares common	J. Shapiro Co	May 24
S. Riekes & Sons	300,000 shares common	Eppler, Guerin & Turner	May 1
A. H. Robins Co	1,300,000 shares common	Goldman, Sachs & Co	May 4
Rototron Corp	125,000 shares common	Ginberg & Co	(*)
Silo, Inc	275,000 shares common	Drexel Burnham & Co	May 24
Southern States Cooperative	$1,500,000 debs/83; 10,000 shares preferred; 1,500,000 shares common.	None	May 2
Southwide, Inc	450,000 shares common	J. C. Bradford & Co	May 15
Synercap Corp	150,000 shares common	Charles Beck & Co	(*)
TLC Corp	200,000 shares common	M. R. Safir & Co	May 15
Tamms Industries	150,000 shares common	W. E. Burnet	May 10
Technogenics General	150,000 shares common	Cotzin Woolf & Co	May 15
Tylok Assembly Systems	350,000 shares common	M. E. Hand	Do.
Videorecord Corp. of America	250,000 shares common	M. R. Safir & Co	May 18

Statements Withdrawn From Registration June 1–29, 1973

The following list shows those statements which have been withdrawn from registration during the month of June. Those marked with an asterisk (*) indicate statements which have not been officially withdrawn, but application for withdrawal has been filed with the SEC.

Company	Issue	Underwriters	Date withdrawn
Advanced Computer Supplies, Inc.	100,000 shares common	Lineberger, Lowe & Co	(*)
Advanced Terminal	200,000 shares common	None	June 7
Allegheny Pepsi-Cola Bottling Co.	600,000 shares common	Salkin, Welch	(*)
American Indemnity Co	399,350 shares common	Hornblower & Weeks; Moroney, Beissner.	June 11
American Monitor Corp	200,000 shares common	City Securities	(*)
Art Investment & Management Corp.	150,000 shares common	Somerset Equities	June 7
Bond Shares of America	1,600,000 shares common	Loeb, Rhoades & Co.; Kohlmeyer & Co.; Mitchum, Jones & Templeton; Rotan Msle, Inc.	June 19
Brougham Industries	250,000 shares common	Brown, Allen	June 28
CMF Mattress Co	275,000 shares common	McKinney Rose	June 26
CVI Laser Corp	200,000 shares common; 200,000 warrants.	Doherty & Co	June 25
Cambridge Coffee, Tea & Spice House.	$1,000,000 debs/83	None	June 11
Cassette Players Corp	300,000 shares common	A. J. Carno & Co	(*)
Cheese Villa, Inc	135,000 shares common	Bernard Aronson, Taeni	June 7
Computer Communications	$2,000,000 debs	Collins Securities	(*)
Crutcher Resources Corp	100,000 shares common	None	June 18

Desa Industries, Inc	400,000 shares common	Hayden Stone, Inc	June 6
Digionic Data Corp	150,000 shares common	A. J. Carno & Co	June 5
Electro-Med Health Industries, Inc.	220,000 shares common	Mayflower Securities	June 27
Essex Oil & Gas Co	450,000 shares common	Collins Securities	(*)
Ferguson Oil & Gas	500,000 shares common	None	June 27
Field Equities Corp	150,000 shares common	Christian-Paine & Co	June 1
Filtertex, Inc	200,000 shares common	Rowles, Winson	June 27
First National Bancorp	120,000 shares common	None	June 19
Flamboyan Leisure Industries, Inc	230,000 shares common	A. J. Carono & Co	June 5
Four Phase Systems, Inc	600,000 shares common	Blyth Eastman Dillon	June 28
Franklin Mint Corp	120,000 shares common	C. E. Unterberg, Towbin	June 12
Giant Mascot Mines	1,000,000 shares common	Loeb, Rhoades & Co	June 7
Glacier General Assurance Co	800,000 shares common	Drexel Burnham & Co	(*)
Great Things, Inc	88,000 shares common	Midland Securities	June 11
Great West Land Mining Co	800,000 shares common	E. H. Coltharp	June 7
Health Screening Centers, Inc	120,000 shares ommon	A. J. Carno & Co	(*)
Hessee Industries, Inc	200,000 shares common	Wm. C. Roney	June 19
Inland Plastic Materials, Inc	110,000 shares common	Bourse Securities	June 21
Kalama Chemicals, Inc	345,000 shares common	Sutro & Co	June 13
Kayot, Inc	$3,000,000 debentures	Piper, Jaffray & Hopwood	(*)
Kenwood Furniture	500,000 shares common	Max Zerkin	(*)
Larasan Investment Associates	11,980 units of limited partnership interest.	Larasan Real Estate Investment	June 4
Lens Protection Services, Inc	100,000 shares common	Great Northern Investors; I. Ross & Co.	(*)
Meisel Photochrome	400,000 shares common	Rauscher Pierce Securities	June 19
Mid-America Insurance Investors Corp.	500,000 shares common	R. G. Dickinson & Co	June 6
Midwestern Winemakers	300,000 shares common	None	June 27
Modern Animal Care, Inc	do	Todd & Co	(*)

STATEMENTS WITHDRAWN FROM REGISTRATION JUNE 1-29, 1973—Continued

Company	Issue	Underwriter	Date withdrawn
National Accommodations	320,000 shares common	duPont Glore Forgan	June 4
National Architectural Products Corp.	630,000 shares common	Wertheim & Co.; Kidder, Peabody & Co.	June 13
National Shows, Inc	140,000 shares common	Rittmaster Lawrence	June 29
Neuwirth Income Development Corp.	1,750,000 shares common	Edwards & Hanly	(*)
Other Telephone Co	85,100 shares common	John G. Kinnard	June 25
Prime Florida Real Estate Investment.	300,000 shares beneficial interest	First Investors	June 28
Prince George Land & Development Corp.	500,000 shares common	Max Zerkin	(*)
Pullman Bank & Trust	202,358 shares common	Hornblower & Weeks	June 11
Raintree Partners Ltd	6,798 units of limited partnership interest.	None	June 14
Recycling Corp. of America	100,000 shares common	A. J. Carno & Co	(*)
Resers Fine Foods	240,000 shares common	Laidlaw-Coggeshall	(*)
Robinson Furniture	300,000 shares common	C. E. Unterberg, Towbin	(*)
Sheer Financial Corp	1,000,000 shares common	R. W. Pressprich & Co	June 28
Scholl, Inc	500,000 shares common	Goldman, Sachs & Co	(*)
Security Pacific Senior FHA Partnership.	1,490 units of limited partnership interest.	Duane Berentson Investments; Horton, Geib & O'Rourke.	(*)
Servitech, Inc	231,667 shares common	None	June 19
Signetics Corp	715,000 shares common	Lehman Bros	(*)
Southern National	100,000 shares common	E. F. Hutton & Co.; Interstate Securities.	(*)

Texas International Airlines, Inc.	800,000 shares common; 400,000 warrants.	Laird Inc.; Rotan Mosle, Inc.	(*)
Western Tele-Communications, Inc.	2,500,000 shares common	White, Weld & Co.; Dean Witter & Co.	June 29
Wilson Learning Corp.	330,000 shares common	Margolis & Co.	June 21
Wisconsin Real Estate Investment Trust.	1,300,000 shares of beneficial interest.	W. E. Hutton & Co.; Milwaukee Co.	(*)

Appendix E

Summary of Securities and Exchange Commission Findings and Recommendations

SEC Findings and Recommendations

Public Laws 90–438 and 91–410 directed the SEC to conduct an economic study of institutional investors and their effects on securities markets, the interests of issuers of securities, and the public interest. Before summarizing the findings and recommendations of the Commission's study, it should be noted that the study covered a limited period of time before 1970 and the findings may be dated now, even if they were valid then. The initial conclusions and recommendations of the SEC study were as follows:

Part One: *Background Studies of Institutional Investors and Corporate Stock.*—The Commission (which had never undertaken a study of this type) contracted with the National Bureau of Economic Research to devise methodology and statistical techniques to cope with the dearth of accurate information. "An important result of these is to allay fear expressed . . . of imminent domination by institutional investors of ownership of the nation's industry—without ruling out such a longer-term eventuality." Institutions have increased their share of outstanding equity securities, partly through the relative growth of institutions more heavily dependent on the equity markets and partly from shifts toward increased equity investment by other types of institutions. However, the increase has been relatively slow-paced over time. Institutions as a group (excluding endowments, foundations, and various minor types of institutionally managed portfolios) increased their share of total stock outstanding from less than 7 percent to approximately 19 percent between 1900 and 1952. A more comprehensive definition of "institution" yielded figures of 24 percent in 1952 and 26 percent in 1958. Individual holdings amounted to 71.7 percen- of all outstanding equity securities in 1958 and 71.8 percent in 1968. [This finding may be somewhat misleading and is certainly dated. A study prepared by the Research Department of the New York Stock Exchange states ". . . data for a number of institutional categories have not been included since no basis exists for estimating these holdings . . . the inclusion of all these groups would raise the total of institutional holdings to, perhaps, 45% of the NYSE list . . ." in 1972.]

Institutional holdings, however, tend to be concentrated in the shares of larger, publicly traded corporations. In this aspect, the pace of "institutionalization" grew during the 1960's. Three surveys by the NYSE of the ownership of securities listed on the exchange showed

that from 1962 to 1965 and 1970 institutional holdings increased from 31.1 percent to 35.5 percent and 39.4 percent respectively. Institutional investors were net purchasers on a cash basis of corporate stock from individuals over most of the postwar period. Over the same period, institutional investors concentrated their purchases and holdings in the more stable securities of larger corporations while individual investors sought higher returns from somewhat more risky stocks.

During the decade of the 1960's the rate at which corporate assets were valued and earnings capitalized generally increased and a significant portion of returns to equity investors over the period was accounted for by these increases. Should returns over the next few decades be less than those since 1950, more rapid increases in the institutionally-held shares could be expected.

Present law does not contain adequate reporting requirements to afford the SEC an opportunity to monitor institutional investment. Legislation is needed to require greater disclosure of holdings. In addition, the SEC needs economic research capability to continuously monitor institutional investment.

Part Two: *Institutions as Investment Managers.*—Competitive pressures for improved investment performance have changed the environment for institutional investors. Performance consciousness has led many institutional investors to adopt more aggressive investment strategies and resulted in the rapid growth of exotic investment vehicles (hedge funds, offshore funds, etc.). The Commission concludes that improved disclosure of investment returns, portfolio volatility, and short term trading is needed from the managers of most types of professionally managed portfolios.

A second concern reflected in the study was an accelerating trend during the last half of the 1960's toward the integration (or diversification) of formerly specialized functions into multi-purpose financial service organizations. Certain types of combinations among financial institutions may have important implications for concentration of power in the American economy. Incentives for the integration of financial services derive from both economic and regulatory factors. An important stimulus to the recent wave of combinations between equity management and brokerage functions is the fixed, minimum brokerage commission. Efforts to maintain brokerage commissions at noncompetitive levels for large, primarily institutional investors have had profound effects on the structure of the Nation's securities markets. They also have conferred important competitive advantages, reflected in part in lower direct fees, on institutional managers who are either directly affiliated with brokerage firms or who benefit from

well developed reciprocal practices involving the use of brokerage to purchase a number of other services provided by the brokerage industry.

Related to the combination of management and brokerage functions are current economic pressures toward institutional membership on stock exchanges. The Commission believes it cannot ignore indefinitely the asymmetry that results when some persons manage institutional portfolios and belong to major exchanges while others so engaged are prohibited from stock exchange membership.

Part Three: *Impacts of Institutional Investing on Securities Markets.*—The SEC study attempted to assess the impact of institutional investing upon the stability of prices in the secondary equity markets, upon the structure of those markets, and upon the securities industry that services those markets. Data collected on institutional trading indicated that trading by institutional investors is related to or coincident with relatively few of the large price changes that occur in the securities markets. Other analyses of random large position changes by institutions indicate that, even on an inter-day basis, institutional trading appeared to offset price movements about as frequently as it contributed to them. The study did not individually examine institutional transactions and does not discount the possibility during the period studied that one or more institutions trading at particular times in particular securities did impair price stability or otherwise act contrary to public interest. The study did not discover any basis in terms of price stability for imposing generalized limitations on the volume of institutional trading or on the size of institutional transactions.

The study found that institutional investors affect market structure in a number of ways including increased volume of trading, the negotiated nature of many institutional transactions, the fixed minimum commission rates that stock exchanges impose on institutional transactions.The fixed minimum stock exchange commission on large orders, for example, has led to the growth of complex reciprocal relationships between institutions and broker-dealers. These relationships, the study notes, tend to aggravate potential conflicts of interest, to be anti-competitive in nature, and to impede the development of a central market system for securities trading.

Part Four: *Impacts of Institutional Investors on Corporate Issuers.*—The study also undertook to analyze certain aspects of the impact of institutional investors on portfolio companies, defined as companies whose equity securities are held by institutions or held for the benefit of persons whose investments are managed by institutions. Direct purchases of equity securities from corporate issuers (or from under-

writers) is distinguished from institutional participation in the secondary markets. While institutional purchases of outstanding equity securities in the secondary markets tend to involve securities of larger companies, institutional participation in purchases of new issues examined in the study tended to involve financing smaller enterprises. The study found no evidence that institutions as a group have been receiving significant preferential treatment in the primary equity market or that their participation in that market has been so limited as to cause concern regarding a scarcity of access to capital by newer, smaller enterprises.

Institutional investment in non-public offerings is a rather significant factor in enabling companies, particularly less well established companies, secure financing. However, under the law, such securities cannot ordinarily be sold without registration. Accordingly, these securities are ordinarily not equal in value to securities which are freely tradeable. Two consequences flow from this differential: (1) restricted securities are generally issued at a substantial discount, a portion of which represents additional cost to the corporate issuer in obtaining financing; and (2) it is often difficult for the institutional investor holding restricted equity securities to place an appropriate valuation on them, raising serious problems for measuring performance.

The study indicates that: (1) In limited instances, institutions, particularly banks, have the potential economic power, if they were to act together, to control or at least influence a number of portfolio companies, especially large corporations; and (2) institutions generally report, however, that they do not participate in corporate policy decision-making or other corporate affairs preferring instead simply to dispose of their holdings if a corporation pursues policies with which the institution disagrees.

The study cites two important qualifications to these findings: First, the study found it rare that a single institution will have holdings in a company substantially large enough to give it clear economic control over the corporation. Influence over a portfolio company depends on the existence of other types of relationships including creditor relations or the aggregate of institutional power emanating from concerted action. Second, where institutions are able to perceive substantial benefits by participation in corporate affairs, their participation may be both substantial and critical. The study states that this is the case in instances of transfers of control where institutions can benefit from market action.

A fundamental question confronting institutional, corporate and government policy makers, the study states, is the question whether the existence and use of potential economic power held by institutions

can be reconciled with the obligations of financial managers to their own beneficiaries and with the rights and interests of other investors in portfolio companies, and concluded that additional disclosure requirements for institutional equity holdings are warranted.

Federal securities law has long recognized the special status of persons having access to the centers of corporate authority or possessing the power to influence the exercise of that authority. Yet in practice, however, many large institutional shareholdings are excluded from disclosure under existing law. Sections 13(d) and 16(a) of the Securities Exchange Act of 1934 require the disclosure only of large holdings of shares which are beneficially owned. Institutions frequently hold and manage large blocs of corporate shares without having beneficial ownership of such shares.

The Commission recommends that consideration be given to requiring all institutions to state their policies on involvement in corporate affairs with greater specificity than is now required of investment companies. This type of disclosure would focus the obligation of institution investors to act in the interest of their beneficiaries.

The study found a need for additional regulations in the area of corporate takeover. Some institutions have received both preferential economic benefits and preferential informational benefits in connection with transfer efforts.

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