

Speeches for the day

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of

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under auspices of

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## DECENTRALIZATION IN FINANCE

It is several years since I have had the good fortune to be in San Francisco. In fact, I believe I am the first member of the SEC to visit here since Mr. Kennedy came out to open our San Francisco regional office in the spring of 1935 under the able direction of Mr. Judy. This may seem like neglect; but it has not been intended as such. The high performance of your financial community has made our visits unnecessary. The remoteness of Washington and the pressure of administration of our three statutes has made frequent visits difficult.

Twenty odd years residence on the Pacific Coast gave me a sympathetic understanding of the point of view and of some of the problems of this great empire. They also gave me deep admiration of the qualities which have made this empire great. These qualities are not only directness and forthrightness, boundless energies, and contagious enthusiasms; they are also the spirit of individualism and independence. These are the qualities which built the Far West in which I grew up; they are the ones which built California. They are the qualities which have made it possible for the Far West to make such a significant contribution to our economic welfare and to the strength of our national character. And in these difficult days such qualities are a source of national inspiration. They give hope and confidence to those intent on preserving capitalism and democracy. If we can apply them to the solution of our national problems we can overcome any obstacle which confronts capitalism and democracy. For these reasons this great western empire has increasing opportunity for a real position of leadership. I hope it seizes it.

In addition, I have observed in San Francisco a genuine brand of old-fashioned conservatism in the field of finance. I like it. I like it for the reason that old-fashioned conservatism in finance is necessary if we are to preserve capitalism under a democratic form of government. Any other course is dangerous to our liberties, since it breeds investor mistrust in the integrity of our financial processes. That ultimately paralyzes capital markets (the life line of business) and produces social disintegration. I like it for the reason that old-fashioned conservatism is the basic philosophy of the statutes which we administer. Thus one of our tasks is to inculcate conservatism in accounting practices and principles. Another is to require the disclosure of truth. Another is to prevent fancy corporate structures in the utility field. Another is to prevent overcapitalization and write-ups which have brought many utility holding companies into disrepute and which have made it necessary for investors to retain magicians and higher mathematicians to discover and measure the values back of their securities. Our task calls for old-fashioned conservatism in action which will prevent these phoney practices. Hence adherence to that philosophy by the business and financial community makes our task an easier one. I like it for the reason that that brand of old-fashioned conservatism (paradoxical as it may seem) is an earmark of true liberalism. It imparts to finance the elements of simple honesty; it looks through form to substance; it refuses to admit, because lawyers say it can be done, that it should be done; it will not sacrifice humanity for some legal or economic fetish. Because of the abundant supply of this quality, San Francisco has a further unique opportunity for leadership.

And we are heartened at the leadership which this great empire has assumed. Your contributions to the host of specific technical problems which make up our agenda for round table discussion have been substantial. We hope that in the future we can better span the distance between us and you, so that we may lean more heavily on you in the solution of the difficult problems which lie ahead.

Such closer association will also assure that your regional problems are more adequately recognized and more easily solved. And you do have regional problems of first magnitude. We at the Commission do not want to build our regulations solely with a view to the problems of the East or the South. We are a national Commission, as intent on recognition of the requirements and desires of this region as on any other.

I believe there is a growing regional consciousness on all sides. It does not, and should not, take the form of economic barriers or trade walls. It merely recognizes that such a region as this should stand more and more on its own feet, beholden to no outside economic power, dependent on itself for guidance and strength, and yet coordinated in its efforts with other parts of our national economy.

Threads of this regional philosophy run throughout the statutes which we administer. All national securities exchanges are our concern under the Securities Exchange Act of 1934. They are equal in the eyes of that law. It is our duty not to prefer one over the other. It is our task to aid and assist each better to serve its local or regional or national needs. The privilege of unlisted trading privileges is one phase of that problem. But from the viewpoint of some of the smaller exchanges it is important in enabling them to broaden their activities and to increase their resources. A strong local or regional exchange is symptomatic of local or regional financial strength and vitality. It is our sincere hope that with our help these smaller exchanges can be strengthened and improved so as better to serve an increasing number of the needs of their regions.

Under the Maloney Bill we will have the task of assisting and supervising the formation and operation of associations of brokers and dealers which will perform in the over-the-counter field functions similar to those exercised by stock exchanges in the exchange field. Some of those associations will be local or regional ones. As of April 30, 1938 there were 6,825 brokers and dealers registered under the Exchange Act. 4.1% of these had their head office in the Rocky Mountain States; 8.1% in the Pacific States; 5.4% in California; almost 2% in San Francisco. Many of them in your region were leaders in working out the Maloney Bill. And on the basis of their past performance they should assume a position of leadership in working out strong local associations for this area, when that bill becomes law. Strong resourceful brokers and dealers are symptomatic of local or regional health and vitality. The small streams flowing out of the remote hills and valleys converge to make up our great waterways. Dam or dry up these little streams and those main waterways disappear. The same is true of our national capital markets, to which local or regional brokers, dealers or investment bankers are the tributaries.

Take away those tributaries and the national economy suffers. But more than that. Those tributaries are essential to the well being of their own respective valleys. Impair the investment banking, the broker and the dealer facilities in this great empire and the Pacific Coast suffers. It is our hope under the Maloney Bill that local or regional groups of that character may be strengthened and improved.

Congress also expressed a local or regional philosophy respecting the utility industry when it enacted the Public Utility Holding Company Act of 1935. Under the much abused and misnamed death sentence in Section 11 of that Act, it is visualized that geographically integrated utility systems will be the pattern. Instead of far flung properties held together by remote control, there will be local or regional groupings of operating properties. This should result, more and more, in the disappearance of absentee management; in the return of the industry to its home region. So, when we at the SEC concern ourselves with these matters, we are not reading into the statutes our own economic and social predictions; we are expressing the implied or stated Congressional intentment.

There are other indices of the fact that regional development is the modern trend. As I have travelled in New England, the Middle West and the Far West I have heard more and more of that philosophy. I once made the charge that certain legal devices were being employed merely for the purpose of corporate kidnapping. But corporate kidnapping is not restricted to endeavors of a small group to keep control out of the hands of the real owners of a company. It is likewise applicable to formal and informal arrangements to take control of industry away from its regional locus to a more distant part. A great industrialist earlier this year commented on that practice and condemned it. I agree with his philosophy. "Absentee management, no matter how honest and able, cannot equal local management. Remote financial control may be rationalized as sound; but it is likely to be unresponsive to local needs. And it certainly does not sit well with labor, investors, consumers, and the communities back home. It is their industry and they should be in on it. California control of New England would be as bad as New York control of California. I discern what I hope will be a decided trend to bring industry's headquarters back home.

The same philosophy is evident in myriad ways. An isolated example is taxation on dividends of companies in holding company portfolios. This works for logical consolidations when that is possible and divestment where that is the more constructive way. Another is found in corporate reorganizations. I have contacted during the last four years many reorganization situations. A very large number of them involved companies and properties on the Pacific Coast or in the Rocky Mountain area. Most of them involved bonds issued under corporate trust indentures. In large numbers of cases the corporate trustee was located east of the Mississippi. In a smaller number of cases the trustee was located here. Close observers of the matter on the Pacific Coast have told me over and again what my own observation bore out, that the investors by and large fared better with a local trustee than with an absentee trustee. The difference lay in mobility of action and in the cost of operating from a distant point.

This is no disparagement of these great trust institutions of the eastern cities. It merely emphasizes the desirability of using local or regional trustees for the needs of local or regional business. Such use would entail the gravitation of other related business to the respective regions, such as paying agencies, registrar-ships, transfer agencies, depositary-ships, and the like. By such use local facilities would be strengthened and improved. Regional financial facilities would grow. This would help regional independence to evolve. Such independence cannot be achieved if regional facilities are not given an opportunity. It can be achieved if regional facilities are allowed to fatten on regional business.

The same philosophy is present in certain bills introduced in Congress the last session. Senator Pepper of Florida and Congressman Voorhis of California both introduced bills which would establish regional industrial banks throughout the country. The purposes of these banks would be, by working cooperatively with the investment bankers in the respective regions, to service the long-term capital requirements of industry in those regions. From personal observation I have seen an increasing need in certain regions of this country for better service to small business. Wall Street and the larger investment banking machinery is not geared up to service its capital requirements. The same has often been true of larger local enterprises. Business of this kind is the backbone of the country. If we are to retain a strong and healthy capitalistic economy we must make certain that the blue chips of big business are not given all the odds over the white and red chips of small or local business. You know the needs of your region far better than I. Whether the regional industrial bank idea would fit here, I do not now say. But I have a deep conviction that in many situations the answer to a part of the problems of monopoly is to increase the opportunities for small or local business. And one phase of that is providing adequate machinery for servicing its capital needs.

These developments all point the way to more adequate regional recognition; to greater regional development; to a larger degree of regional independence. Much work and study remains to be done. Some light is thrown on limited aspects of your regional problem by the following statistics. Of all demand deposits plus time deposits (exclusive of government and interbank deposits and certified checks, etc.) in all banks, except mutual savings banks, California had 9% in June 1937. And the Rocky Mountain and Pacific States had 12% at that time. Compared with that was New York State with 34%. Here is another interesting compilation. We took all of the underwritten security issues of \$1,000,000 and over which had been registered under the Securities Act of 1933 and offered for sale between July 1, 1936 and March 31, 1938. In dollar amount these totaled \$3,418,820,000 - \$2,608,279,000 of bonds; \$533,648,000 of preferred stock; \$276,893,000 of common. Then we examined the purchase group participations in these issues. Firms with principal offices in New York City had 74.05% participation in the bonds; 69.54% in the preferred stock; 64.72% in the common; 72.59% in all issues. Firms with principal offices in San Francisco had 1.18% participation in the bonds; 2.21% participation in the preferred stock; 1.42% in the common; and 1.36% in all issues. Firms with principal offices in all of the Pacific Coast and Rocky Mountain States only had 1.48% participation in the bonds;

3.27% in the preferred stock; 2.59% in the common; and only 1.85% in all issues.

In these matters I do not wish to disparage the East. From the broad national point of view, as well as from a regional point of view, we need strong capital and securities markets in the East. There are national as distinguished from regional needs to serve. But the tangible and intangible values to the Nation at large and even to Wall Street of regional development are as great as they are to the regions in question. In many instances in the past, the New York market, because of its greater financial and technical resources, has been able to render this service on terms with which the financial machinery of other communities could not compete. But this is not necessarily a permanent condition. Business and finance can will it otherwise. If the larger local enterprises were to patronize their local financial centers more extensively, those local financial centers could develop into healthy resorts for both small and large companies in need of financial assistance. You know the extent to which the welfare of this region rests upon the welfare of local industry. It has often been true that the risks which lie in our own back yards are just as good as the ones which have become glamorous because they caught the fancy of the larger markets. However that may be, we do know that our national economic welfare rests on the welfare of small or local business. Only regional facilities can care for that, for our national financial machinery is almost exclusively big business machinery.

When I think of the importance of strong securities markets to regional development, I am gratified at the progress which your Stock Exchange has made. The expeditious manner in which you in San Francisco accomplished a major operation in merging your two Exchanges indicates your progressive views. That consolidation was taken in the interests of economy and efficiency; but I know it also had the larger purpose of affording a better market place for buyers and sellers of securities in this region. This is not only consonant with sound regional development. It is also in tune with 1938 conceptions of what a securities exchange must be. I am also gratified that you have given those of your members who deal with the public greater voice or participation in your management. These forward steps lay a strong basis for progressive improvement of your Exchange in light of the standards of the Securities Exchange Act of 1934.

As you know, matters relating to Stock Exchanges have been of particular interest to me recently. We are now in the midst of the greatest period of transition in the history of Exchanges in this country. The changes which are taking place come, of course, partly from the fact that there are new laws affecting the business. But to a degree they also spring from an increasing consciousness on the part of those in the business that changes were necessary, if the business was to regain its position in the public esteem. The courage and foresight of these leaders, many of whom are in this group today, have made possible the accomplishment of triumphs over the forces of inaction and reaction which a few short months ago seemed dismally hopeless. Accordingly I am gratified that you are moving like Chicago and New York towards the goal which the 1938 philosophy demands.

You know what a splendid commencement New York has made. You also know how proud I am of their constructive endeavors. As you know, we are now studying jointly with them the items of unfinished business of the New York Stock Exchange. What the items of unfinished business your Exchange and the SEC may have I do not now purport to say. We can canvas that cooperatively. But I do say this - the problems of the regional exchanges vary so much from each other that a formula for one will not necessarily suffice for another. Yet there is a common denominator. That is the principle of cooperative regulation. One example will suffice. As you know the Act outlaws pools, as well as the less apparent types of manipulation. These provisions of the Act constitute the law of the land. We have taken the oath of office to enforce that law. And we have conscientiously been endeavoring to do so. But when government polices exchange trading, it does it less effectively than an exchange can do it. A corps of Federal investigators can never be as efficient as an exchange management in policing exchange members. We are subject (and quite properly) to detailed and laborious requirements of the legal process. An exchange is not. Exchanges, of course, needed time to adjust themselves to these new laws. But we have now arrived at a point where action rather than talk is the necessity. The important thing is the will to make the adjustment. An exchange which has that will have in us a strong ally and a shirt-sleeve partner. If the earnest desire to live under the law of the land is present, the methods of working out details of cooperative regulation are relatively easy. Standing shoulder to shoulder we can solve these problems in a way which will keep government from appearing to the industry as a bureaucratic blight or as a noisome intermeddler. Yet we can do it in a way which will carry out the mandate of Congress.

I know that that philosophy is part of the San Francisco climate of opinion. That is why I am so confident that we can be your strong ally in helping you build constructively. And the consequences of that will be extremely significant. If we succeed, our achievement will constitute a milestone in regional development. If we do it well, that achievement will be entitled to more than footnote reference in the economic history of this country. Actual realization of such a program of decentralization will mean untold tangible and intangible benefits to this great Western Empire and to the Nation at large. The cartoonist then could not draw the picture of the cow who while doing much of her grazing on the Pacific Coast was careful to keep her udders in the East.