

ADDRESS

by

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TEXAS GROUP

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INVESTMENT BANKERS ASSOCIATION OF AMERICA

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It has been a long time --much too long -- since a member of the Securities and Exchange Commission has visited Texas. The invitation of your group was therefore doubly gratifying since it gives the Commission an opportunity to obtain an up-to-the-minute, first-hand report on thinkings and doings in Texas, as well as bringing me my first visit to the people of your great state.

I read a speech not long ago which was made by one of your distinguished Texans, in which he spoke of the development of an enforced modesty on the part of Texans. He said that Texans had had to resort to understatement when talking about their native state because of an embarrassment of riches within its borders. I see now what he meant. It would be difficult, indeed, as he said, to tell the truth about Texas without seeming to boast. This Texan was speaking on that occasion of the physical and material riches of your state. I have always felt -- and no doubt he would modestly agree -- that among your greatest assets is a spiritual wealth and determination which has led to outstanding accomplishment in every field of endeavor.

This spirit has shown itself in many ways in the past. A characteristic of Texans is the willingness to participate in all worthy public causes, one best evidenced today by their complete contribution to the war - both in the field and at home. In times of peace, also, these same qualities have led the people of Texas to dedicate the physical resources of the State to a sound economy in a progressive society. In these troubled days, as in times past, Texans have constituted a reserve of moral and spiritual force to do what is right and good for our country and its institutions. I know that they can be counted upon to supply this same force and direction in the days that lie ahead.

Not so many years ago the country as a whole was straining under a burden resulting from great dislocations in our financial system. There had grown up a habit of financial excesses -- excesses of optimism and a general disregard of fundamental principles of sound business conduct. The really democratic aspects of our financial system had practically disappeared through neglect and disuse so that the good of the many had become, perhaps unconsciously, submerged and our system was being operated for the benefit of the few. This burden was borne, as I don't need to tell this group, certainly as much by the people of Texas as by those of any part of the country.

Beginning in 1933, steps were taken by vigorous and enlightened men to cure that unhealthy situation -- and in this undertaking Texans were in the vanguard. Those early steps, as you will remember, grew into legislation, the main thrust of which was complete fairness to all and the development of a set of rules for the game of finance which outlawed cold decks, required all cards to be on the table and the shooting irons to be parked at the door. In other words, it was aimed in the direction of establishing a system built on public knowledge of the affairs of business and designed to enable all participants, large and small, to make informed decisions -- a system basically analogous to our democratic principles of Government.

As a result of the efforts of these pioneers in the field of financial democracy, we have left more and more behind us the day of corporate management when the little fellow who had contributed his money to the venture rarely found out how things were going and how they were being run until after the petition in bankruptcy had been filed -- if then. The badly shattered faith of the people in the fairness of dealings in securities has been largely restored through the practical elimination of the manipulator and his pin-wheel game.

But these things were not achieved merely by the passage of legislation and the creation of an agency to administer it. They were brought about only by the combination of such measures with a favorable disposition toward their objectives on the part of the people whose operations constitute our financial system -- the men like you who are here today. It has been my experience that no measure ever undertaken in this field through government has been successful until it received the active support of a majority of those whose affairs were concerned.

I think we Americans can be forgiven for indulging in some pride over the fact that the British Empire is beginning to cast rather envious eyes on our record. Recently the British Parliament, apparently concerned over the adequacy of financial and corporate regulations under the Companies Act, has appointed a royal commission to study and make recommendations for necessary changes in the law. The London Chamber of Commerce, which has traditionally represented business and finance in Britain, has submitted a list of proposals to that commission which reads like a catalogue of many of the things which we have done here, and now accept as basic to our system. These proposals include supervision over the proxy soliciting machinery and requirements for greater information to stockholders; improved and uniform standards of accounting; requirements for disclosure by officers and directors of their beneficial interest in securities of the corporation and of their trading in those securities; and a recommendation against the continuation of the all too frequent practice of concealing corporate reserves and profits.

While these improvements in custom and practice have been taking place in our country, we have made only limited progress toward the realization of one of the greatest objectives on the road to financial democracy -- local control of local enterprise. And when I say local control I mean not only local management, but local finance as well. As we have built our businesses, just as we built our system of government, we have always had the problem of centralization as against local government and management. In the business field too often centralization and concentration of control over business units have gone far beyond the bounds of economic advantage. We have seen absentee management of local enterprises grow up and result in abuses which were inevitably detrimental to the public interest. You have seen the brains and brawn of Texas build up profits from Texas enterprise while the men in control, by various financial devices, have siphoned off these profits to be used for their benefit -- and very little for the benefit of Texas.

The development of this system of centralization and high finance reached its climax in the public utility field. The disastrous results of the building up of the great utility holding company empires were felt in every corner of the land. The need for a thoroughgoing reorganization of the utility industry was realized only after painstaking work against tremendous odds. You know the long investigation which was made by the Federal Trade Commission and embodied in over one hundred volumes of reports. Judge Robert E. Healy, of Vermont, now a member of our Commission, had a leading part in the conduct of that investigation as Chief Counsel to the Federal Trade Commission. One of the greatest contributions toward the creation of a formula for bringing about that reorganization on a sound basis was made by a Texan, a former president of your state university, Dr. Walter M. W. Splawn. The legislation which embodies that formula and put it into effect - the Public Utility Holding Company Act of 1935 -- was sponsored in one house of the Congress by a great Texan and a great American, Speaker Sam Rayburn. On the other side, fighting shoulder to shoulder with Sam Rayburn, was Senator Burton K. Wheeler of Montana. This is a good illustration of the wisdom of our political system and institutions which made possible the enactment of national legislation to restore and assure the preservation of the dignity and the self-reliance of our communities through opening to them the opportunities of local enterprise in the public utility field.

The core of the Public Utility Holding Company Act is best expressed in President Roosevelt's message to the Congress recommending the legislation. He urged the restriction of holding companies to single integrated systems in order to "take the control and the benefits of the essentially local operating utility industry out of a few financial centers and give back that control and those benefits to the localities which produce the business and create the wealth." Under that statute it became the duty of the Securities and Exchange Commission to achieve that objective by requiring holding company systems to reduce their holdings to single integrated utility systems and to simplify their complicated capital structures. In this important field of fostering local control the work is going forward at this time with gratifying results. What's happening in Texas under this statute is an outstanding example of achievement. The success of the program in Texas has been in great measure due to the efforts of Texans to put the utility industry in this State in sound condition to operate for the benefit of Texas consumers and to the profit of Texas investors. Let me run briefly over the Texas record to date.

Great Texas utility operating companies, for years the property of interests far removed from the Texas scene, have now been returned to local ownership and management. Other Texas companies which staggered under the weight of capital structures completely unrelated to properties employed in service, have re-examined their capitalizations and reorganized them on a sound basis.

Take for instance the case of Houston Lighting and Power Company, which was formerly owned and controlled by the National Power & Light Company, a holding company in the Electric Bond and Share system. The Commission ordered National Power & Light dissolved as an unnecessary complication in the Bond and Share system. As a step in that direction the common stock of Houston Lighting and Power was in part exchanged for National Power & Light preferred stock and the balance was sold to the public. Today Houston Lighting and Power Company is a locally managed Texas utility company.

Here in the city of San Antonio the benefits of the Holding Company Act have been realized. The electric service facilities in this city have been for many years controlled by The United Light and Power Company system located in Chicago. In October 1942, in the course of complying with the Holding Company Act, American Light & Traction Company, a subsidiary holding company in The United Light and Power system, determined to sell its holdings of the common stock of San Antonio Public Service Company. A majority of the voters in the community chose to have this city buy them and operate the properties as a municipal plant.

The reorganization of the Community Power and Light Company system here in Texas is a good example of the practical results that are being achieved through compliance with the Holding Company Act. Community Power and Light Company was a holding company, managed from its headquarters in Newark, New Jersey, having substantial properties in the Panhandle section of Texas in addition to scattered properties situated in Kansas, Missouri, Nebraska, South Dakota and other states. The company was in dire need of a thorough recapitalization in order to reestablish its credit and enable it to fulfill its duties to its subsidiaries and to its security holders. In 1940 the Commission approved a plan of recapitalization which eliminated substantial dividend arrearages and brought about the conversion of the company's preferred and common ~~stocks~~ into a single class of common stock. Its scattered properties which could not be integrated with the system's principal utility properties in Texas were disposed of, and in 1942 the Commission approved a plan merging the two top holding companies of the system into Southwestern Public Service Company. An interesting thing about the Community reorganization is the fact that the simplification of its system as well as that of The United Light and Power Company was facilitated by an exchange of properties between the two. In this manner each system disposed of scattered properties which it could not continue to hold under the Act, and each in turn acquired properties which it could integrate and operate with its own utility facilities. As I have said, management was formerly located in Newark, New Jersey. Today the system is operated from its headquarters in Dallas, Texas.

The Lone Star Gas Company a few years back was a natural gas system including ten subsidiaries with operating properties not only in Texas but in Iowa, Oregon, Washington and Idaho; and it had a 30% interest in the wholly unrelated Northern Natural Gas Company in addition. Lone Star set about to put its capital structure to rights and to build a system around its major properties located in north central Texas and a small adjoining portion of Oklahoma. The results, as recently completed, are that it disposed of its holdings in Northern Natural Gas Company by distributing them to its stockholders as a dividend; all its properties not a part of the coordinated system in Texas and Oklahoma have been disposed of; its operations are now confined to a single integrated natural gas system with assets of more than \$112 million; its complicated corporate structure has been reduced to a single transmission and distribution company and one subsidiary producing company; its capital structure is composed of notes and common stock in place of the former welter of bonds, notes, preferred stock and common stock, thus reducing its fixed charges from \$2-1/2 million to a mere \$370 thousand; and \$20 million of inflationary items have been written out of its property accounts. And most significant of all, the Lone Star Company, thus put in healthy, sound and stable condition, has completely complied with the Holding Company Act and is no longer subject to its provisions. The Lone Star Company has returned to Texas, and, as stated by its president, will operate to the greater advantage of its security holders.

As I have said, the work is not yet completed. A good many jobs remain to be done throughout the country and in Texas, too. Several Texas utilities are still under the domination of the American Power and Light Company and the Electric Power & Light Corporation in the Electric Bond and Share system. Extensive holdings in Texas and in neighboring portions of Oklahoma and Louisiana are still under the control of The Middle West Corporation and the Engineers Public Service Company. Orders of the Commission, however, are outstanding against these holding companies which will require them to dispose of local properties or to integrate them with local systems.

The results of this work in the utility field, not only those already achieved but those which are in the process of consummation, will do much to protect local enterprise, local management and local interest generally in the future development of the electric and gas utility industry in Texas and throughout the country.

What I see in all this is that when the job is completed Texas capital will have more chance to stay at home and work for the good of those who produced it. Employment will be found for Texas citizens in every step of creating, financing and conducting Texas utility enterprises. Local lawyers familiar with the problems of this region will be called upon to advise your companies; local accountants will handle their auditing and certify their financial statements; and local investment bankers should have the leading positions in the necessary financing. Those jobs can be handled so much more efficiently and satisfactorily by the lawyer, the accountant and the investment banker whose offices are just down the street — or at most in the nearest large city — than they can be by obtaining the same professional consultation from people a thousand or more miles away who must be transported to and from the scene and educated from scratch in the history and possibilities of a venture and the needs and capacities of the community. These are the things which provide a broad base and firm foundation for the healthy and vigorous development of sound and self-reliant local institutions.

The preservation of our democratic institutions as we have known them depends in large measure on our ability to maintain and strengthen the foundations of small and medium sized independent enterprise. One of the essential components in any such design is a responsive, capable local banking machinery which can function freely and effectively only if absentee control and the evils of monopoly are eliminated. In our present critical days, these are fundamental to a democratic solution of our most pressing post war problems -- the maintenance of full employment and a high level of national income.

It is well known that for many years small and medium sized as well as new businesses have faced almost insurmountable difficulties in obtaining new money from the capital markets, particularly equity capital, indicating a substantial gap in the investment banking machinery. When such capital has been available, costs have been excessive, in contrast to the low costs of financing large established companies. To be sure, the R. F. C. has done excellent work in making loans to small business throughout the country but it is precluded by statute from supplying equity funds which is frequently a more pressing need.

A great many people have thought and written about this question. A number of proposals varying in degree of definiteness have been put forward. From time to time members of the Securities and Exchange Commission have, as a result of their day to day experience, stressed the importance of doing something to insure the availability of capital in the locality where it is created. We must establish some system which will provide a lasting source of venture capital to finance existing local enterprise as well as to foster additional businesses which will arise out of individual initiative.

I don't suppose any of us has a ready made prescription for such an institution. Doubtless all of you are as familiar as I am with a good many of the suggestions that have been made. You know the proposal to permit the Government, perhaps through the R. F. C., to supply additional capital to investment bankers through the direct purchase of senior securities or other participation in investment banking firms. You are also doubtless familiar with suggestions for the creation of regional financing corporations, properly staffed to investigate possibilities for investment, their capital to be supplied by local investors, which would make equity investments in businesses operating in the region. A variation of that suggestion is that some sort of senior position in these corporations be assumed by the Government -- again through the R. F. C. Another proposal would set up permanent industrial loan corporations to be owned by the United States Government and operated by the Federal Reserve System to assist financial institutions in making credit available to commercial and industrial enterprises. A variant of this last suggestion, which was made to me in a recent conversation, would be to have the ownership of such institutions in the member banks in the Central Reserve and Reserve cities in proportion to their assets or capital and surplus.

I do not advocate any particular one of these suggestions; nor do I wish to be understood to say that still other proposals may not be forthcoming of equal or greater feasibility. But the thing of greatest moment today is that we are in a position where we can see the outline, at least, of things to come and can, if we will, devise a scheme to emerge from this war -- whenever its end may come -- with a healthy, sound and evergrowing industrial and financial system. At the war's end there will be the immediate problems involved in the termination of war contracts and the reconversion of war time plants, as even today we are experiencing the difficulties incident to the cut-back program.

We have only to look about us to note the possibilities which will be at hand. Both the opportunity for tapping private local sources of funds for worthwhile investment and the need for such funds will probably be greater at the end of the war than ever before. During the war there has been an unprecedented accumulation of savings by individuals and unincorporated businesses. These huge accumulations constitute one of the most important economic phenomena of the war. The growth in the currency and deposit holdings of individuals and unincorporated businesses since the war started in 1939 has exceeded \$35 billion. In addition, their net purchases of U. S. Savings Bonds and other U. S. Government securities have also been close to \$35 billion. Other substantial items of saving include insurance and debt repayment. The total "liquid" saving by individuals and unincorporated businesses during this period amounted to the phenomenal total of over \$90 billion. The present rate of increase in such saving is close to \$40 billion a year, of which over \$30 billion consists of cash and deposits and U. S. Government securities. These immense savings have implications of the utmost importance for the post-war economy. If these resources are safeguarded by a gradual rather than an abrupt lifting of wartime controls, they will provide a substantial source of funds for the capital needs of industry in the post-war era, as well as a huge reservoir of purchasing power for peace-time goods.

Though the increased business activity in recent years has produced a marked improvement in the financial condition of most American corporations, small as well as large, the need for new funds should be very great to take care of the long-deferred replacement and renovation of plant and equipment and the purchase of government plant. Even more important is the anticipated expansion of business to new heights of peace-time activity and into new fields, utilizing the techniques and processes which have been developed during the war. After the war, with the removal of present obstacles to the formation of new firms and with the return of potential business men from the armed forces and war jobs, we can expect a resurgence of small business and a broad demand for investment capital.

For purposes of comparison, it is interesting to note that in 1919, the first year after the last war, the volume of new stock issues amounted to about \$1.5 billion, far larger than any previous figure in our history. Yet that war did not begin to measure up to the present war in the amount of deferred replacements, postponed expansion, or in factors that have curbed new ventures. Furthermore, on the supply side, the volume of saving at that time did not approach the current accumulation of liquid assets.

Here in Texas you have had your share of the increase in national income during the war and in the consequent increase in liquid assets. From 1939 to 1942 income payments in Texas increased by 78% compared with a national increase of 62%. There was a further increase in 1943. The cost of war-time plant and equipment installed in this state through the end of 1943 amounted to \$1.3 billion, compared with \$24 billion for the country as a whole. This \$1.3 billion figure, of which about two-thirds is government-owned, represents large capital expenditures in chemicals, petroleum products, nonferrous metals and aircraft. Paralleling the growth in industrial activity and income, individuals in Texas have increased their holdings of cash and deposits and U. S. Government securities by about \$2.5 billion since the end of 1939.

Thus, after the war, Texas, and the nation as a whole, will have a vast supply of capital for investment purposes, as well as a great potential demand for such funds. The problem will be to convert potential into actual demand and bring the seeker and the owner of capital together. This is indeed a formidable challenge to all of us. Not only to you here today, as leading citizens and investment bankers of Texas, but to us in the Securities and Exchange Commission and the investment banking field generally. I would not presume to underestimate the difficulties of the task, or would I minimize the wealth of resources which we will have to work with which may in turn lessen those difficulties. But one thing is certain -- if we will but bend to the task now, make the necessary decisions and lay out our plans, we will come nearer to meeting that challenge. And with vision, we will utilize these resources in such a way as to attain the highest level of business activity supported by the most healthy economic foundation that we have ever known in the history of our country.