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Subject: Market Problems of Underwriters in a Distribution and Capital Requirements

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MR. EMERSON. I thought the best approach to the problems would be to talk about syndicate procedure this morning. Tomorrow I will get into the dos and don'ts of stabilizing.

Our American capitalistic system would not be possible were it not for the activities of the investment banker. Investment bankers are merchants who bridge the gap between the industrial concern which needs capital and the individual who has spare funds. Their primary function is to sell new issues of securities to a multitude of individual investors. Theoretically a company could content itself with attempting to sell its own securities, or with simply hiring some broker as a sales agent. Many small firms, especially in the extractive industries, do this now. But under such circumstances the money might be obtained only in "dribs and drabs"--perhaps only a small amount of money could be raised. A corporation constructing a plant needs to know that it will have a sufficient sum in hand at a certain date and at no more than certain costs before it lets its construction contract. The necessity for having so many dollars by a set date makes it necessary for a corporation to do something more than sell its securities through a sales agent. The answer lies in a firm commitment underwriting agreement in which the underwriter guarantees that on a given date the corporation will receive a fixed sum for a fixed amount of securities. The underwriter can afford to make such a contract for the reason that our investment bankers have developed techniques which enable them immediately to re-offer the securities contracted for in all parts of the country simultaneously and at a profit.

Basically these techniques are (1) the underwriting syndicate, (2) the fixed price offering, (3) the rapid sale of the issue and consequent promptness of payment to the issuer, and (4) the ability to stabilize.

A firm wishing to raise a large amount of money will discuss its problem with an investment banker, and a general agreement as to the amount and type of securities to be issued will be worked out. This banker will then introduce to the issuer a large group of investment bankers who will become the underwriters. By an underwriting agreement under which the underwriter's liabilities are several, not joint, each underwriter contracts directly with the issuer to purchase a specified amount of the securities.

The originating banker, however, as manager or representative of the underwriters under authority granted to him by an agreement among underwriters handles the price and other negotiations with the issuer and among the underwriters, and generally directs the procedures of purchase and distribution. The manager decides on the necessity for a selling group, he forms it, he makes allotments, he stabilizes the price in connection with the offering if it is necessary, and he handles for the underwriter the transactions incident to payment for and delivery of the securities. These transactions are called the closing or settlement.

Many factors must be considered by a manager forming an underwriting group. One of the most important is the distributing ability of the houses to be invited. This frequently varies as to the type of security involved. Some houses are specialists in high-grade bonds; some are active in preferred stock; others have a clientele that is largely interested in common stock. In addition, certain firms tend to specialize in certain industries. Another factor to be given consideration is the capital or net worth of the various firms. This can be especially important for rights offerings where the security offered is at the mercy of the market for several weeks. The geographical location must be considered. Many issues, particularly utility companies, like to have a large portion of their issues sold in their own locality, and therefore an underwriting group should include many houses in the issuer's territory. It is also natural for consideration to be given to firms who have previously been identified with the financing of the issuer in question. Such firms and their customers are already familiar with the issuer and its business, and are therefore likely to distribute more effectively than can houses who have had no prior business experience with the issuer.

All of these factors are considered not only in determining the underwriting list, but also in the size of the commitment to be offered to each underwriter. Thus, large offerings and those involving greater risk or difficulty of distribution require a greater number of underwriters.

In order to help him judge the distributing ability of various houses, every syndicate manager keeps a complete record of the issues he has managed, showing each firm's participation in each issue and the amount of the issue it sold to its own clients. He knows the locations of the branch offices of each firm, the size of the sales staff, and any preferences the firm may have as to the types of issues. His records note any comment that the firm has ever made as to its own distributing ability. Out of town dealers call on originating houses to keep them posted, and syndicate managers travel around the country calling on the firms with which they do business in order to check up.

The actual formation of an underwriting group after tentative selection by the manager, or perhaps the issuer, is usually done over the telephone, perhaps even before the registration statement is filed.

There are some large securities firms that are very strong financially, but which do not have large sales staffs. Further, there are a great many securities firms who have excellent salesman, but are not rich. To equalize these factors the manager usually forms a selling group.

At the time the underwriting syndicate is formed an understanding is reached between the manager and each underwriter not only as to the size of the firm's underwriting commitment, but also as to its ability to distribute the offering. If an underwriter's commitment exceeds its sales capacity, the excess is added to the block reserved for the selling group. Of course underwriters who wish to distribute more shares than they have committed themselves for ask to join the selling group. When forming a selling group, the manager considers the same factors he took into account in choosing underwriters. There is, however, an additional and very important factor; dealer interest. When an issue goes into registration, dealers all over the country who feel that the issue will have an appeal for their customers make it a point to inform the syndicate manager of the size of their interest and their hope that he will make an offer to them at the time of the public distribution. Even among the dealers, however, the manager must use his own judgment as to the amount of the particular issue that he believes a firm can distribute. Some firms always ask for more than they can handle.

The offering to dealers is made by night telegram so that it is received in the morning of the day of the offering. It is usually made either on a reservation basis or a subscription basis. If the former, the manager wires full details as to price, selling concession, and reallowance, and states that so many shares will be reserved for the dealer subject to acceptance by a certain time. If the latter, the manager informs each dealer of the shares allotted to him. If all shares are not allotted out, the offering continues on a first-come, first-served basis, with the manager reserving the right to reject or allot and to close the subscription books at any time. Rights offerings are always on a subscription basis. The manager keeps a book of firms who, thinking they can distribute stock, have applied to him. When he has stock to sell, he allots it to them.

The manager ordinarily over-allots or sells more stock to the selling group than the underwriters have reserved for such purpose. This gives the manager buying power with which to stabilize and permits him to take back from the group securities which have not been sold.

Shortly after the filing of a registration statement, the syndicate department or the managing underwriter undertakes a series of operations preparatory to the actual offering of the security. Let me describe these operations.

Prospective underwriters are telephoned and a tentative syndicate is formed. The manager by wire or mail, usually by wire, confirms to each prospective underwriter that a registration statement has been filed, that an underwriting commitment of so many shares has been allotted to him, and that the manager has reserved so many shares for selling group purposes. This notice gives the date on which it is hoped that the statement will become effective. The manager then mails to each underwriter a copy of the red-herring prospectus, a copy of the registration statement, a copy of the agreement among underwriters, a copy of the underwriting agreement, and an underwriter's questionnaire. The questionnaire is to provide the manager with such information about the underwriter as may be required in the prospectus. This letter ordinarily asks the underwriter for a list of the States in which he is qualified under the respective blue-sky laws, and asks for an estimate of the number of prospectuses that the firm believes it will require in its distribution. The manager next informs the underwriter of the time and place where the diligence meeting will be held, and the time and place where the agreement among underwriters will be signed. With this notification goes a power of attorney to be returned to the manager so that if the firm cannot be represented at the signing, the manager may sign for them.

The due diligence meeting is a conference where the officers and experts of the issuer meet with the underwriter and endeavor to quiet any doubts any underwriter might have as to the correctness and completeness of the information to appear in the registration statement.

The manager next sends to dealers whom he intends to invite into the selling group copies of the red-herring prospectus. If the offering is to be a security in which banks or investment companies might show an interest, they also get copies of the red-herring.

While all this is going on, the manager also qualifies the security for sale under the blue-sky laws of the various States.

Meanwhile the manager faces the problem of pricing the issue. If the offering is an additional block of a security traded on an exchange, the last price prior to the commencement of the offering is ordinarily the offering price. If the offering is a new security, however, the manager has undoubtedly been charting the prices of all similar securities and analyzing their balance sheets and earning statements for comparison with the security he is going to offer. The manager may also check with other experienced underwriters to get their ideas before finally settling on a price level which, presumably, is the highest price that will permit the distribution to investors of every last unit of the security to be offered.

Thus armed, the manager conducts last minute negotiations with the issuer to set the offering price. You may be sure the issuer has also been collecting his own data. These negotiations are at arm's-length, and are frequently very lively discussions.

Thereafter the manager will sign the underwriting or purchase agreement for himself and on behalf of the underwriters whose power of attorney he holds. This agreement and the agreement among underwriters are ordinarily signed on the afternoon before or the morning of the date it is hoped that the registration statement will become effective.

As soon as the manager learns of effectiveness, his office takes over again. It wires each member of the underwriting group of the fact of effectiveness, stating the offering price, the dealers concession, any re-allowance, and the time when the security may first be offered. The manager also advises each member of the selling group as to his allotment, the price, the dealers concession, the re-allowance, and the time when the offering begins.

The manager may over-allot and place a stabilizing bid.

The manager has ordinarily reserved the right, in the agreement among underwriters, to receive from each underwriter on demand a statement as to the underwriter's position in the stock. He knows how his own distribution has gone. When it appears probable to him that underwriters have largely disposed of their commitment he wires each underwriter, asking for a report on the number of shares unsold. If all have sold out, or if there are only a few shares left, the manager will call back the unsold shares to apply against the difference between his over-allotment and the shares hitherto bought in stabilizing. Since the distribution is then completed, the manager terminates stabilizing. He next notifies the Commission and each underwriter of this fact, and he also removes the trading restrictions which the "agreement among" had imposed on the other underwriters. If the manager still has a short position on behalf of the syndicate, he proceeds to make open-market purchases at whatever price he must pay to cover the short position.

At the time underwriting agreement was signed a date was set for settlement. Perhaps the distribution is not completed, but the issuer is paid anyway. Of course I am speaking here about the usual firm commitment. In a best efforts deal the underwriters settle piecemeal as they take down blocks of stock from the issuer.

The manager's syndicate department has taken a great many other steps to prepare for the settlement. It has reminded the underwriters and the selected dealers of the date and place of settlement and the amount that each is required to pay, and has requested from them a statement as to who will represent the firm at the settlement and obtained identifying signatures so that the issuer could safely hand each such person a batch of securities. The manager has also obtained and sent to the issuer a statement from each underwriter as to the manner in which the securities are to be issued, i.e., 45 100-share certificates, 16 50-share certificates, etc., and the name in which each is to be issued; or (and this is the usual arrangement where a large offering is settled) he has received from each underwriter an assignment for each sale made during the distribution, so that settlement might be made by the issuance of a few large certificates which will thereafter be broken up into the required units by the issuer's transfer office.

At the settlement the issuer presents to the manager the various certificates verifying its undertaking, like opinion of counsel that it is lawfully organized and that the securities are duly authorized, a certification by the president that no material adverse change in its business has occurred--those sort of papers. The manager then presents to the representatives of the issuer certified checks of each of the underwriters, and receives from the issuer the number of shares due each underwriter. He then delivers to each underwriter his commitment less the number of shares each owes to the selling group. He then gives the selling group shares to the selected dealers against payment. Thereafter, each participant makes arrangements to deliver his shares to his customers in the manner in which those customers have requested them. Of course, out of town participants can be serviced by the manager, by mail, under a power of attorney.

In a later settlement, after stabilizing is terminated, the short position is covered, penalties, if any, have been assessed and expenses totaled, the manager pays to or bills each underwriter for its participation in the syndicate account.

That is how the syndicate manager operates. Mr. Loomis will take up net capital requirements.

Mr. LOOMIS. We shall start in, then, on the capital requirements for underwriters and brokers and dealers generally under the Act and the Commission's regulations.

There are two provisions in the Securities Exchange Act which deal with capital requirements for brokers and dealers, and members of national securities exchanges. One of them is Section 8(b) which makes it unlawful for any member of an exchange, or any broker or dealer who does business through the medium of such a member, to permit in the ordinary course of his business as a broker his aggregate indebtedness, with certain exceptions, to exceed such percentage of his net capital as the Commission may fix, not exceeding in any case 2000%. That is, his aggregate indebtedness cannot be more than 2000% of his net worth under that section. That section has given rise to various problems, as a result of which the Commission has not extensively employed it. The most difficult problem is the fact that it makes it unlawful for a person to permit in the ordinary course of business as a broker his indebtedness to exceed the required amount. In the first place, it is hard to determine what is in the ordinary course of business and what is in the extraordinary course of business, so that he may violate the prescribed ratio and state that it is extraordinary. In the second place, it refers only to his business as a broker, and as the securities business is, in fact, done in this country most of the firms do business both as a broker and as a dealer and there is no practical way of separating that indebtedness which may be said to arise in the brokerage business and that which may be said to arise in the dealer business.

The second statutory provision, and the one on which the Commission relies primarily, is Section 15(c)(3) of the Securities Exchange Act, which was added by the Malony Act in 1938. This provides that no broker or dealer shall make use of the mails, or the instrumentalities of interstate commerce, to effect any transaction in or to induce or attempt to induce the purchase or sale of any security otherwise than on a national securities exchange in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors to provide safeguards with respect to the financial responsibility of brokers and dealers. You will note that that is a very broad section insofar as the rule-making power of the Commission is concerned. It can adopt any regulation it finds necessary to provide safeguards with respect to the financial responsibility of brokers and dealers. It has certain limitations insofar as it becomes applicable only to brokers and dealers who do business over-the-counter and depends upon the use of a jurisdictional instrumentality, which means that a broker or dealer doesn't violate that section or the rules if he doesn't use the mails, or if he doesn't attempt to engage in securities transactions while his financial condition contravenes the rule. That is not a very serious problem although it occasionally raises questions of enforcement and proof.

Under that section primarily the Commission has adopted Rule X-1503-1, now 240-1503-1. That rule is a rather complicated document, and when you first look at it you generally conclude, as I did when I first saw it, that it is practically incomprehensible. That perhaps is because it is written in accounting language to a degree, and I am not an accountant. But the basic theory of it is fairly simple. It provides that no broker or dealer shall permit his aggregate indebtedness to exceed 2000% of his net capital. That is the basic provision. That is the so-called 20 to 1 ratio. The theory of the rule is that the broker's liquid net worth, that is, his immediate cash excess of liquid assets over current liabilities shall be not less than one20th or 5% of his total indebtedness. That is, he cannot have more than $20 of debt for each $1 of liquid net worth. In a moment I shall get into how that is worked out.

There are certain exemptions to the rule. The first of them is not important. It is limited to certain brokers whose business is limited to acting as agent for an issuer in soliciting subscriptions for securities of such issuer. These are primarily housewives who act merely on an agency basis for one particular issuer to solicit subscriptions to the securities of that issuer, and who do not ever see either the securities or the cash--the transactions being handled directly with the issuer. I believe there are some investment companies who employ people of that kind.

The second exemption is much more extensive. It exempts members of eight specified stock exchanges--major stock exchanges--New York, Boston, American, Midwest, Pacific Coast, Philadelphia-Baltimore, Pittsburgh and Salt Lake City. These are exempted because they have their own net capital rules, and their net capital rules are a little stricter than those of the Commission. This is primarily so because these exchanges require a certain minimum dollar amount of net capital, which can be fairly high in the case of the big exchanges--$25,000 or $30,000. Under the Commission's rule it is theoretically possible for a broker or dealer who doesn't owe anything to be in compliance with the rule even if his net worth is only $1. We get that in the case of new applicants sometimes. They will file their financial statements showing assets of $100 in cash, liabilities 0, net worth $100. They are in compliance, and are able to open up and do business.

The exchanges, however, would not permit that. Their rules are bascially quite similar to the Commission's rules in substance and effect, although they are written in an entirely different way. They are much more general in their language, and leave much more room for interpretation which the exchanges then apply. Exchanges, naturally, have a great deal more freedom than we do to interpret their rules. As a Government agency, our rule has to be reasonably precise so that people will know what it means.

A major part of the net capital rule consists of definitions of two basic terms used: aggregate indebtedness, and net capital. Net capital is defined there in its ordinary sense, to begin with, to mean the net worth of the broker or dealer, that is, the excess of his total assets over his total liabilities, subject to certain adjustments. Of these the most significant are those found in Paragraphs (c)2(B) and (c)2(C) of the rule. The first one, (B), provides for deducting fixed assets and assets which cannot readily be converted into cash, less any indebtedness secured thereby, including, among other things, real estate, furniture and fixtures, exchange membership, insurance, good will, all unsecured advances and loans, customers' unsecured notes and accounts. In other words, that is the provision of the rule which requires that liquid assets only be taken into account in computing the net worth of the broker or dealer. You exclude completely things like real estate, furniture and fixtures, automobiles--assets of that type.

There is one mitigating feature of this, and that is the provision of the rule that in deducting the fixed assets on the balance sheet, you subtract therefrom, before computing the deduction, the amount of any indebtedness secured thereby. That is, if a man has on his books land and buildings worth $50,000 with a $30,000 mortgage on it, the land being on the asset side and the mortgage on the liability side, he would deduct the $30,000 mortgage from the $50,000 book value of the land, arrive at a figure of $20,000, and that would be the amount that you would throw out in computing his net worth.

There are problems of interpretation which arise not infrequently in connection with assets which cannot readily be converted into cash. Brokers and dealers, particularly those doing a mixed kind of business with a little insurance selling on the side, have all types of assets as to which it is often difficult to determine whether they can be converted into cash readily or not. The principal problem here arises in the case of securities which are closely held and have no readily identifiable market anywhere. Generally they are excluded unless the broker-dealer can show that there is a market for them--that he can go out and sell them. Sometimes if you can persuade a bank to say that they would loan him at least X dollars on those securities, we assume that they can probably be converted into cash for X dollars or else the bank would not stick its neck out that far.

The next important provision in the computation of net capital or net worth is the so-called hair-cut, that is, the deduction that has to be made from the market value of securities carried in the inventory of the broker or dealer. That is inserted in order to provide a cushion against market decline. Brokers and dealers carry in their accounts the securities which they own at market. Unlike other firms who carry their assets at cost, or the lesser of market or cost, they carry securities in inventory at market. Accordingly, this deduction is provided in order that the customers will have a margin of security if the market goes down. The hair-cut on most securities, including common stock and convertible preferred, is 30%--you just drop off 30%. You do the same for commodities contracts.

Because of the fact that non-convertible cumulative first preferred stock is not as volatile in the market--it doesn't move up and down as rapidly as common stocks do--it is given a deduction of 20%. A problem arises in the case of bonds. There are bonds, and bonds. Some of them are very stable securities which move only a little, others are highly speculative. The rule works that out by providing a 5% basic hair-cut and then doubling the discount on the par value of the bonds. That is, if the bond is selling at 90, you take off 10%, and you in effect allow it at 80. If it is selling at 80, you would take off another 20% and, in effect, value it at 60. Thus the more volatile bonds, which ordinarily are those selling at a substantial discount because it has become doubtful whether the obligor is going to pay, carry a heavier hair-cut than bonds which are selling at par and are presumably good.

There are provisions for a hair-cut on so-called open contractual commitments. The most familiar of these is an underwriting agreement or obligation. Where an underwriter has agreed that he will purchase $10,000 worth of stock but the time of settlement has not yet arrived, he has a liability to the issuer for the $10,000, and he is treated for purposes of the rule as if he had $10,000 of securities in hand, but then the hair-cut is taken on those securities. That is where underwriters rather frequently get into trouble. They take a large commitment in an underwriting deal--at least large in proportion to their assets--and then when the hair-cut is deducted in the amount of 30%, they are found to be in violation of the rule. That hair-cut requires, in effect, a 30% margin for the protection of the underwriter's customers in the commitments which he may lawfully undertake.

There are other provisions in the rule for the computation of net capital which are fairly technical and I won't go into them. But this is the basic thing. You take the excess of assets over liabilities, you make certain deductions of which the most significant by far are the elimination of assets which cannot readily be convertible into cash, and the elimination of the real estate and fixed assets, and the 30% hair-cut. Following those adjustments, you arrive at the net capital of the broker-dealer. Then you go back and start over, so to speak, and compute his aggregate indebtedness. The aggregate indebtedness does not mean the same thing exactly as the liability side of the balance sheet, and you have to first compute the net worth without reference to the computation of aggregate indebtedness. That gives you the figure on which he has to have the 5% margin. Aggregate indebtedness means his total money liabilities subject to eight or nine defined types of indebtedness which you exclude in the computation of aggregate indebtedness as set forth in Paragraph 2(c)(1) of the net capital rule. This type of indebtedness is basically those types of debts which are not going to come in and compete with his customers in the event that the business is liquidated. They are basically indebtedness for which the creditor is adequately secured by other types of collateral, so that if the firm should be liquidated, the creditors would satisfy themselves from the collateral rather than from the general assets of the firm which are needed for the protection of customers.

There is also a provision for excluding indebtedness which is satisfactorily subordinated to the claims of general creditors.

Now it should be remembered that these exclusions that are enumerated in Paragraph 2(c)(1) from the definition of aggregate indebtedness have nothing to do with the computation of net worth. This excluded indebtedness is included when you are computing net worth of the broker-dealer for the purpose of computing his net capital. You exclude these items only for the purpose of determining what his indebtedness is in order to apply the 20 to 1 ratio, that is, to determine, after finding his net capital, whether his indebtedness is more than 20 times that net capital.

As you probably know, the Commission enforces the net capital rule rather vigorously. Each time we make a broker-dealer inspection, the broker-dealer inspector ascertains the net capital of the broker-dealer computed in accordance with the rule. Also, when broker-dealers file their annual financial statements with the Commission, which they are required to do by Rule X-17A-5, the net capital under the rule is computed from that financial statement. If the broker-dealer is in violation of the rule, the Commission takes action, which generally means he has to put up the money immediately or else he is enjoined from doing business while that condition exists.

It is also the policy of the Commission that it will ordinarily decline to accelerate the effectiveness of a registration statement if one of the underwriters has insufficient net capital to support his commitments. This means that procedures have to exist by which the list of underwriters is furnished to the Division of Trading and Exchanges, and we compute from available information the net capital of each firm and determine whether that will support the commitment which it proposes to assume. If the capital is insufficient, the firm is advised of that fact and told to either put up the additional money or get out of the group. If it does not do so, the managing underwriter and, if necessary, the issuer are informed of the situation.

The purpose of the net capital rule, as I have indicated, is to provide safeguards for cutomers whose money and securities are very frequently in the possession of broker-dealers against the insolvency of broker-dealers. The securities business is such that a broker-dealer can be doing well one day and be insolvent the next day if the market turns against him. Therefore, the rule requires that only liquid assets be considered and provides these deductions from the market value of securities for the purpose of protecting customers fruther against declines in the market. That, in essence, is the situation with respect to the net capital rule for brokers and dealers.

MR. BLACKSTONE. From the standpoint of registration statements and the acceleration policy of the Commission, what real risk is there to the person who is offered a security under a registration statement that one of the underwriters may not be in compliance with the net capital rule?

MR. LOOMIS. There are really two risks in the situation: If the underwriters are unable financially to take down their commitments, the issuer will not get the money which it is seeking to raise and which it represented in its registration statement it would raise; probably the whole issue would not be sold; and you would have a situation with a considerable potential of damage to the investors who put money into an issue where the issuer did not get the capital which it needed.

MR. BLACKSTONE. Aren't these deals practically all sold at the very minute the registration statement becomes effective, or shortly thereafter?

MR. LOOMIS. Sometimes, but not all deals go out the window. The danger is most serious where an issue may be sticky. The investing public may be very slow to buy it, or may not buy it at all immediately, and the underwriter, if he has a firm commitment, will be obligated at the settlement date to put up the money when he has not sold it. Some of these issues take considerable time.

MR. BLACKSTONE, I don't see in connection with the actual offering that there is much risk again. Isn't it more that this commitment, if he is not able to immediately sell the securities that he has agreed to take down, that his other customers may suffer.

MR. LOOMIS. That is a factor. We had a case down in Texas before this policy was adopted where a small underwriter was so optimistic as to underwrite on a firm commitment basis a registered uranium stock. He was unable to sell it. When the time came for him to pay the issuer, he was unable to meet his obligation. The firm went into liquidation, and it appeared that if the issuer had endeavored to collect even a major part of what was due to it, the customers of the firm would have received about 10 cents on the dollar on their investment. If there are two underwriters--in fact there was another man in Denver who had sold some of the stock and whose customers had paid for it and who tendered payment to the issuer--it becomes quite difficult for the issuer and all concerned to disentangle the situation. Eventually they refunded the money to all the customers who had paid for their securities on the representation that the uranium company would actually realize the money. Also there is the problem where a customer pays an underwriter for the security, the underwriter is unable to pay the issuer, and therefore the issuer doesn't deliver the security to the underwriter, and the underwriter is unable to deliver them to his customers. The question arises as to whether that customer is going to be able to get his money back.

QUESTION. I was wondering how the best efforts deal fits into the situation of underwriters.

MR. EMERSON. A best efforts deal is ordinarily a one-man or a two-man show. They don't have a huge underwriting group. An arrangement is ordinarily made whereby the underwriter will sell, say, 10,000 shares, collect the money, go to the company, pick up the shares, deliver them to customers, and then go out and sell some more.

MR. BLACKSTONE. How soon in advance of the effective date is the due diligence meeting generally held?

MR. EMERSON. That is a little hard to say. I would say five to ten days before effectiveness is about the usual time for such meetings.

MR. LOOMIS. They usually try to hold it after they have the deficiency amendment on file so that they can show the underwriter something that is close to what is going to be the final prospectus.

MR. BLACKSTONE. At the closing, do most of the underwriters actually have the proceeds from the customers, or do they have to raise the money themselves to pay the issuer?

MR. EMERSON. In the ordinary firm offering where the issue was, in fact, distributed, they have the money in hand from their customers. They ordinarily arrange to make settlement with their customers a day or two in advance of formal settlement with the issuer. That varies. Occasionally an issuer may want his money in a great hurry. Sometimes there is a sticky issue and securities are just not sold. The underwriters in those cases simply have to come up with their own funds, or borrow.

MR. LOOMIS. Don't they often arrange, in anticipation of that situation, in the agreement among underwriters that the manager can hypothecate the securities with the bank and raise the money to pay the issuer?

MR. EMERSON. Yes. That is usually arranged.

Adjourned.