

ISSUE 56 • SUMMER 1996

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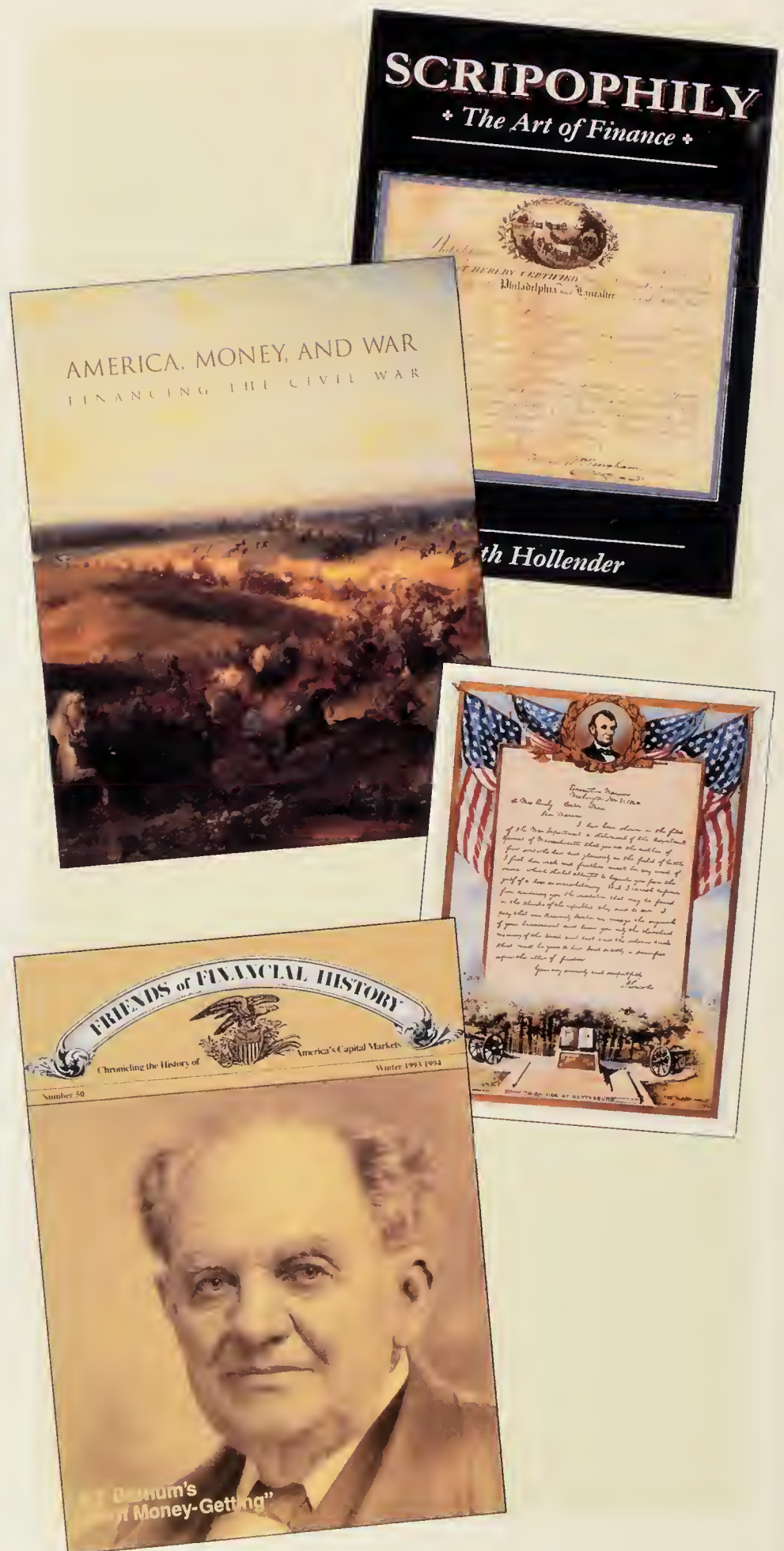
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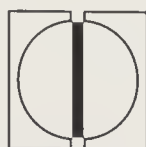
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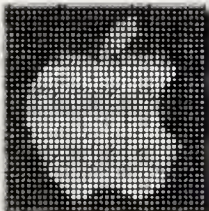
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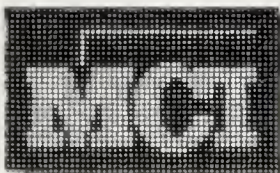
Looking back today, it’s hard to imagine



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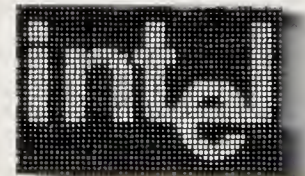
any other market on earth.



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to *Friends of Financial History* at the above address.

Cover photo: Harold S. Vanderbilt sailing the
Enterprise, a Herreshoff yacht. Story, page 14.

Photo courtesy of The Mariners' Museum, Newport News, VA.

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Museum Fundraiser and Internship Program Bring Great Success

BY JOHN E. HERZOG

The joys of summer also bring us good news about developments at the Museum. During the spring term, the Museum had its first full semester college intern, and the project was quite successful. For two days each week, Kristen Mooney, a then senior from Marist College in Poughkeepsie, worked on a variety of tasks for the Museum, and for a few other firms. The Museum had a great benefit and Kristen learned about many different office activities. We are looking forward to the next intern, who is also from Marist College and will be working with us this summer.

Our annual benefit was a great success, and the first one to be held in the financial district. In past years, we have migrated uptown for our events. The venue was The Down Town Association, a

splendid private club on Pine Street, where a warm fire greeted visitors. An Internet demonstration let visitors see the Museum site on the World Wide Web, recently in the top 5% of all Web sites! The guest of honor was Richard A. Grasso, Chairman of The New York Stock Exchange (see page 11). Inevitably, there were some words from your chairman, but the highlight of the evening were the remarks well prepared by Dick Grasso, whose command of his subject combined with a creative use of the Exchange's records, make him an effective and highly respected speaker. Attendance was over one hundred, and many compliments were received from our guests.

Some fine stories await you inside, from a retrospective of "T + 3" and earlier changes of the settlement process, to the

150th Anniversary of the founding of the Pennsylvania Railroad, to the celebration of the Herreshoff Yacht Company, boat builders for the great financiers of bygone palmy days. And who was it who said "If you have to ask how much, you can't afford it.?" Find the answer inside, and have a great short summer read.

Otherwise, many interesting projects are working along, including a new fall show in the form of a major exhibit on railroads, with some seldom seen artifacts. Let us know if you have something you feel should be included, and remember, please, do not throw any of your old stock market letters and papers away without letting us know. We are always interested in adding to the Museum's collection. Have a wonderful summer, and best regards from all of us here. **FFH**

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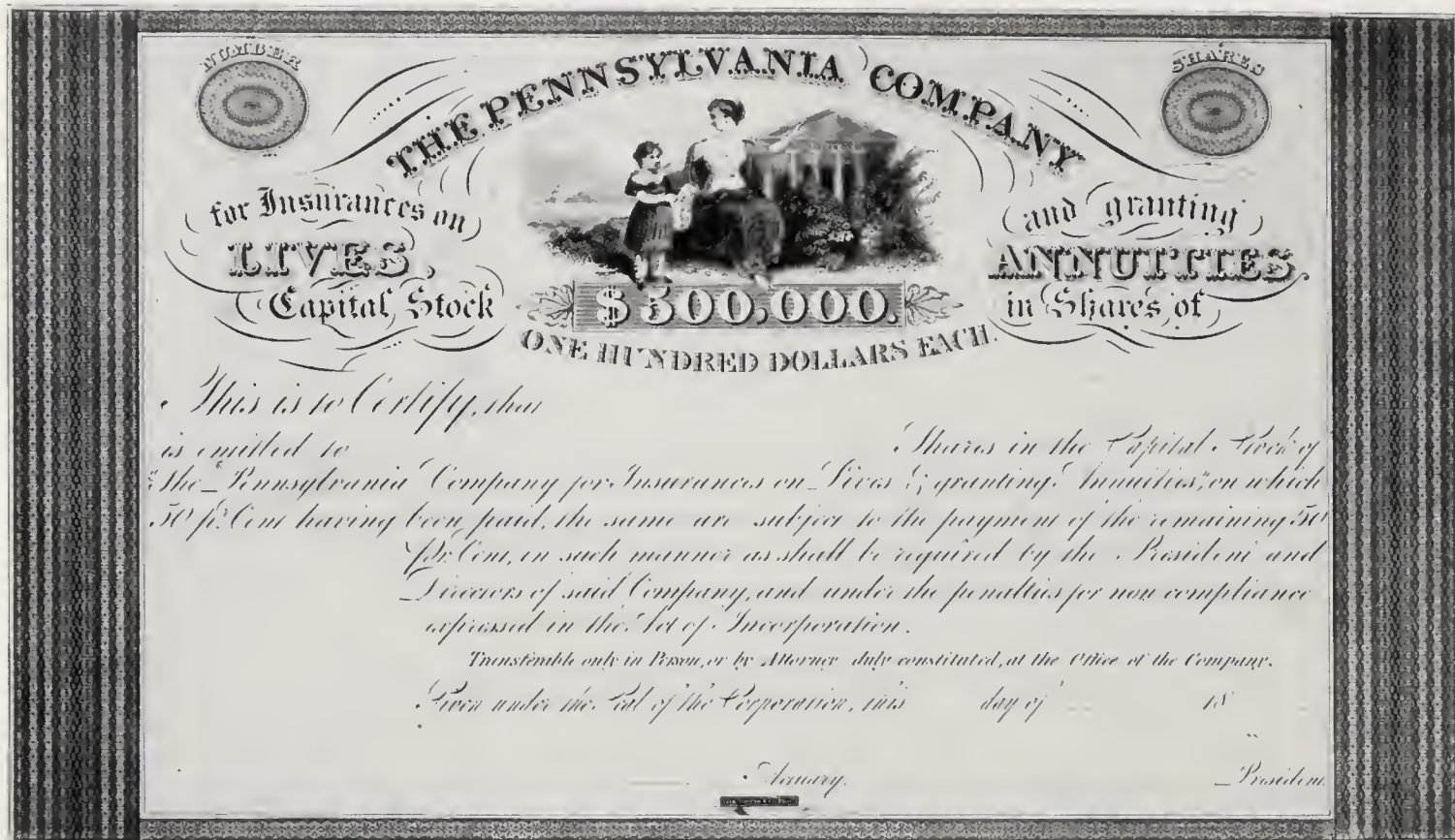
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The Museum of American Financial History is the newest public repository of documents, stock and bond certificates, engravings, and other historically significant artifacts dedicated to the origins and history of the American capital markets.

The Museum is located at 24 Broadway, New York City. Hours: 11:30AM until 2:30PM, Monday through Friday. Admission is free. Special hours can be arranged for group tours. For further information call 212-908-4519.

Coming this Fall! A Century of Railroads 1835-1935



A unique perspective on one-hundred years of railroad development in the United States—as only the Museum of American Financial History can bring—will open this Fall in the New York City Gallery. Join the Museum staff in celebrating the transportation technology that linked our vast country.

The certificate featured here is a Pennsylvania Railroad Company General Mortgage 4¼% Gold Bond, Series D, \$1,000, due April 1, 1981.

The vignette represents the original Penn Station of New York City. On September 8, 1910, the building was officially

opened and underwater tunnel service began between New York City and New Jersey and New York City and Long Island. The station covered an area of 28 acres! The Pennsylvania Railroad annual report of 1910 stated that the cost of the tunnels under the Hudson and East Rivers and the large station was \$112,965,415. As the railroad became the preferred vehicle of travel, the then-traditional ferries from Brooklyn and Jersey City were discontinued two months after the opening of the station.

To learn more about the once-great Pennsylvania Railroad, please see p. 28, the Collector's section.

The Museum of American Financial History is a New York State chartered non-profit educational and service corporation.



University Students Learn Not-for-Profit Business with the Museum

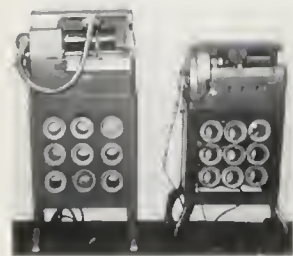
“Every student fears that, at an internship, the only task we will get involved in is filing and photo copying,” said Museum Intern Kristen Mooney, “But at the Museum of American Financial History, the opportunities for project-oriented work are abundant.” A student of Business Administration at Marist College in Poughkeepsie, New York with concentrations in Finance and

Personnel, Kristen Mooney just completed a semester-long internship with the Museum. Kristen worked with the Museum staff, Chairman John Herzog, and Ernst & Company, while experiencing “life on Wall Street”.

“What I like about the people at the Museum is that they asked me what I wanted to do, what would I feel comfortable with. Of course, I did many small organizational projects in the archives, but I also learned about cataloguing the Museum pieces on computer and editing a magazine.” Kristen was asked to get involved in all the current projects of the Museum. In February, she helped to plan the Museum’s annual benefit. In April, she worked on articles for this issue of *Friends* and much, much more.

“Of all my students, Kristen was one of the quickest studies. Kristen embraced information technology and was always looking for ways to learn more about finance. She was a natural first choice to start our internship experience with the Museum,” said Professor Dan Cooper of Marist. Dr. Cooper, a *Friends* columnist and editorial board member, finds time between editions to help select prospective interns from the Marist College finance department.

Collections Manager Meg Ventrudo had praise for Kristen’s positive contribution. “Kristen was very helpful with the Bond Club of New York archive inventory. Kristen came to us with a great attitude, and she was always enthusiastic about the Museum’s projects. We will miss her.”



New Acquisition Reminds Us of Life Before Computers

“Why is a ‘Shaver’ on display in the Museum gift shop?,” you may ask. Because the shaver is not the type of tool you find next to the sink, it is a machine used to remove dictation from a wax cylinder. Alexander Graham Bell, his cousin Chichester Bell, and Charles Sumner Tainter invented the first dictaphone machine in 1881, and the Museum acquired an antique dictaphone, dictaphone listening device, and dictaphone shaver that were used at the Goodall Rubber Company of New Jersey in the 1940s.

When compared to the CD-ROM or even your pocket tape recorder, the three machines seem quite large and, perhaps, medieval. Yet, at closer inspection, one finds that the recording apparatus is a simple, easy to understand version of the incredible technology of the 1990s. A steel stylus cut up and down grooves of the human voice into the wax coating of the rotating drum. The cylinder was then transferred to the listening device for transcription. “Shavers” were then used to remove the dictation grooves of the human voice from the surface of the cylinder for reuse. One cylinder could be used up to 30 times.

The Dictaphone Corporation, the company that mass-produced the machines, has received world recognition and has had profitable years since its beginnings (except 1971). Dictaphone users include famous financier John D. Rockefeller. Like a paint palate to an artist, the dictaphone was an-invaluable resource to the business people of the 1920s and 30s.

“Tree of Life”

In the middle of a harsh, New York City winter, a 350 year old red oak tree trunk was transported to Bowling Green, the oldest public park in America, right across the street from the Museum Gallery. Many remarked on its large size and moss-covered exterior. What is this massive piece of wood doing on Broadway?

Arturo DiModica, the artist made famous for his bronze “Charging Bull” nearby, has agreed to create a masterpiece from the venerable tree trunk from Riverdale, in the Bronx, that was felled by disease. Scaffolding is going up as we go to press, and DiModica will begin work soon, now that the winter is finally behind us. He expects to complete the project by Labor Day. He will work outside, for the enjoyment of the Wall Street community.



“The project hopes to attract attention for the maintenance and care of New York City’s millions of trees,” according to a placard near the tree. The New York City Department of Parks and Recreation and the Bowling Green Association are the main contributors to the project.

Everyone seems to have an opinion on the sculptor’s odd choice of medium. “I wonder if the tree was really dead. If it lasted 350 years, why was it brought here now?,” commented one maintenance worker at 26 Broadway. The financial district eagerly awaits the start of DiModica’s latest project. Will the tree become a bear to accompany the Charging Bull?

Museum's Annual Benefit at the Down Town Association



Honoree Richard Grasso delivers his acceptance speech.



Museum Gallery is Great for Students of all Ages

How many visitors to the Museum Gallery are too young to remember the 1970s? Not too many. Yet, in April, the Museum staff hosted 22 fourth-graders from St. Augustine School in the Bronx, New York. Teacher Stephen Simons guided the students through the Wall Street attractions as part of their study of money.

Meg Ventrudo, the Museum's collections manager, displayed her experience with children and gave a thoughtful tour of the Bicentennial Exhibit of the American Banknote Corporation. To keep the children involved and interested, she passed around stock certificates and asked the children questions. "Can everyone say 'vignette'?"

The entire Museum staff joined in the fun. Normally, only one or two members will be available for a tour, so the St. Augustine children received royal treatment. The children were interested in the famous duel between Alexander Hamilton and Aaron Burr and the anti-counterfeiting tools, like the hologram, of the American Banknote Corporation. Museum Director Diane Moore was spotted giving away Penn Central stock certificates to the young visitors.



Trustees William Behrens and William Pinzler



Trustee Thomas Asher, Chairman John Herzog, and Friends Editorial Board Member Dr. Dan Cooper.

Friends Reaches Larger Audience, Bringing New Members to Museum

The Winter 1996 edition of *Friends of Financial History* was distributed to 3,500 Economics and Finance professors around the country. The Financial Management Association supplied the Museum with address labels, and our first inquiries began immediately after the mailing. One professor from Jersey City State College brought her students to visit the Gallery and many more have called in to subscribe.

Read all about this exciting event, which you surely won't want to miss next year. See page 11.

Who's Who at the Museum of American Financial History

Edward I. Altman, "Z Man", Trustee



BY KRISTEN MOONEY

Edward I. Altman, a professor with a unique interest in finance, offers his expertise to the Museum, helping to preserve American financial history for future generations. Born and raised in New York, he attended City College, then later received his MBA and Ph.D. in Finance at the University of California, Los Angeles, finally relinquishing aspirations of a career in professional baseball. In 1967, Altman began a long career as a professor at New York University.

Altman was the first professor to teach bankruptcy and reorganization in a business school (in 1975). He became interested in bankruptcy in the 1960s, when he was researching a topic for his doctoral dissertation. It was a virgin area. There were few academics and little information in this field. "I thought it would be interesting to try to predict an event like bankruptcy, which is so dramatic." Altman invented the "Z-Score Model" thirty years ago. It is a bankruptcy prediction model that is widely used, even today, because it is accurate, important to many, and easy to calculate. Altman is often affectionately referred to as the "Z Man" by his students and colleagues. He has written and edited over a dozen books and more than 100 scholarly professional articles. His most recent books are *Corporate Financial Distress and Bankruptcy* (John Wiley and Sons) and *Distressed Securities* (Probus).

In 1988, Altman became the first chair of the newly endowed Max L. Heine Professorship of Finance. Max Heine was a partner in the Wall Street firm, Herzog, Heine, Geduld Inc., and a noted portfolio manager for Mutual Shares Corporation, which invests in a variety of equity and fixed income securities, including those of distressed companies. "Heine was a legend in the area of investment in bankrupt company securities," states Altman. Museum Chairman John Herzog was introduced to Ed in 1981 and later invited him to be a founding trustee.

In his spare time, Ed is a consultant to a variety of financial, legal, and government organizations and is on retainer to Salomon Brothers Inc. in their Global Credit and Fixed Income Areas. He is also an advisor to Zeta Services, Inc., which markets a second generation Z-Score Model, called Zeta. He has testified before the U.S. Congress, the New York State Senate, and several other government and regulatory commissions. He is in great demand as a lecturer around the globe on such topics as credit risk management, corporate restructuring, and high yield and emerging market corporate bonds.

While a professor at NYU, he has traveled on sabbatical to Paris; Rio de Janeiro; Australia and Milan to teach, complete research, and just have fun. In 1989, he was named *Laureate de la Fondation HEC* in Paris and later he received the Graham and Dodd Award from the Financial Analyst Federation for his accumulated works on bankruptcy prediction and firm rehabilitation.

When asked how he finds time to do everything, he simply answers, "If you have enthusiasm for what you do and enjoy it, you will do it better and more efficiently." Altman believes that financial history is a tremendous educational vehicle to help describe where finance is now and perhaps

where it is going. "It is a way for people to appreciate the past, not only as history, but also as a way of understanding what is going on today and analyzing what may happen in the future. Many people have no idea that wars, for instance, have had a tremendous financial and economic emphasis. Why they were fought, how they were financed, and the consequences of winning or losing is fascinating."

A subject currently close to Ed's heart is high yield "junk bonds". "People think that Michael Milken and Drexel Burnham created junk bonds, but in fact, there were those high yield securities that go back to the French Revolution. The French Government offered a bond that was tied to the price of salt. Since this commodity was so volatile, investors required the incentive of high return. The interest rate was much higher than for bonds that were tied to more stable commodities, and resulted in big discounts from par. This was perhaps the first junk bond. Sometime later, people thought that U.S. Government Bonds of the Revolutionary period were junk. If one calculated the early trading patterns, especially around the time of the Assumption of State Debt for the new National Debt under Alexander Hamilton's plan, Treasury Bonds were valued at around ten cents on the dollar. These values reflected a dim view of the government's ability to pay our debts. But investors are not always right, and in this case, the optimist speculator carried the day. Hamilton's plan was a success, and by the early 1800's, U.S. Government debt had a higher credit rating than the debt of many other, more established European nations. And it still does! You can learn from the past." ■■■

Editor's Note: Ed is hoping to see the first U.S. corporate, original issue junk bond on permanent display in the Museum? Which one is it, Professor Altman?

One of Wall Street's Prominent Leaders Receives the Museum's Highest Honor

This year, the Museum awarded its "Outstanding Service to the Capital Markets" honor to a person many of us have watched at the close of the business day. Chairman and Chief Executive Officer of the New York Stock Exchange Richard A. Grasso can often be seen applauding the end of a high volume day on CNN's business report. Mr. Grasso joined the Museum trustees and staff at the sixth annual fund-raiser on February 21, which was held at The Down Town Association.

With over one hundred friends of the Museum in attendance, Mr. Grasso applauded the work of Chairman John E. Herzog and all who are involved with the Museum. He related tales of the exponential growth of the U.S. stock exchanges and noted the need for documentation of these changes. Mr. Grasso warned against underestimating this growth. His theme was also reiterated by other speakers Dr. Dan Cooper, a *Friends* editorial board member, and Trustee William Pinzler. The Museum provides a service to the financial community by documenting and preserving the progress and character of America's capital markets.



A distinguished leader, Mr. Grasso has held several offices at the NYSE: director of listings and marketing, executive vice-president of capital markets, president, and chief executive officer. "We chose Mr. Grasso to receive this year's award in recognition of his fine achievements with the Exchange. The New York

Stock Exchange, under Mr. Grasso's leadership, has maintained its bedrock corporate values, respect for the individual, and a customer-comes-first orientation," said Mr. Herzog. Mr. Grasso also is a trustee of the Securities Industry Foundation for Economic Education and currently serves on the board of directors of Computer Associates International, Inc.

Surrounded by the pleasant music of the harp, benefit attendees had an opportunity to ask staff members about the Museum's projects. One of the ongoing projects, the Museum's World Wide Web site, was displayed for all to explore. For some, this was the first time they had seen the site, and the response was overwhelmingly positive.

Mr. Grasso is the fourth person to receive the Museum's "Outstanding Service to the Capital Markets" award. The first recipient was Edward I. O'Brien, president of the Securities Industry Association; the second was Gordon S. Macklin, former president of the NASD; and last year's recipient was Philip L. Carret, founder of Carret and Company, Inc. and director of Pioneer Group, Inc. **FFH**

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Of Buttonwood Trees and Beer: The Beginnings of Exchanges Past and Present

BY DR. DAN COOPER AND DR. BRIAN GRINDER

Exchanges exist to satisfy market objectives such as bringing buyers and sellers together, efficiently distributing information, and helping to assure a secure clearing process. Exchanges in America were established or refined in response to specific market needs. Unless otherwise instructed, today's finance students might think that the exchange system as it currently exists is engraved in stone, unyielding to the pressures of time. However, a closer examination of the evolution of America's exchanges suggests that change has been a constant companion in the evolution of the investing process.

The beginnings of the New York Stock Exchange can be traced to 1792 when a group of twenty-four brokers signed the famous "Buttonwood Agreement" which bound them to trade securities at a commission of at least $\frac{1}{4}$ of one percent and gave preference to members in trading negotiations. The securities market in the United States was virtually nonexistent prior to the bull market of 1792, but as this "first" U.S. bull market raged, more and more investors entered the fray. The Stock Exchange Office which began in March of 1792 was unable to prevent outsiders from attending securities auctions solely for the purpose of gaining pricing information. The outsiders would then later trade the same securities at auction prices but with lower commissions. The "Buttonwood Agreement" set up an exclusive auction system which was closed to outsiders. While this effectively ended competition in commissions, it was the beginning of an orderly exchange system where securities could be bought and sold in an efficient manner.

Likewise, the American Stock Exchange arose out of the "curb trading" activities of traders who were not members

of the NYSE. In fact, the AMEX was called The New York Curb Exchange until 1953. The financial problem the young, ambitious curb traders helped to alleviate was that of access to capital markets for smaller firms who needed to raise capital but were unable or unwilling to meet the listing requirements of the Big Board. The outdoor traders disappeared from the scene shortly after the Curb Exchange moved indoors in 1921.



New York Curb Exchange, Summer 1920

The move indoors by the Curb Exchange symbolized the acceptance of the future American Stock Exchange into the Establishment. While being a part of the establishment has its advantages, it also tends to ossify an organization making it less able to react to change. When the bull market of the late '60s left Wall Street's back offices awash in a backlog of paper work, the Securities & Exchange Commission called for changes in the exchange trading process

and challenged the exchanges to develop an electronic trading system to further improve efficiency.

The National Association of Securities Dealers (NASD), established in the late thirties by the Mahoney Amendment to the Securities and Exchange Act of 1934, accepted the challenge by the Security and Exchange Commission for an electronic trading system. The National Association of Securities Dealers Automated Quotations system (NASDAQ), which debuted in 1971, was the result.

NASDAQ currently lists quotes for about 5,000 stocks. In addition to alleviating the paper backlog problem, this system opened up the markets for the securities of many small to medium size (unlisted) issuers. This had the effect of greatly improving liquidity and growth opportunities for these firms.

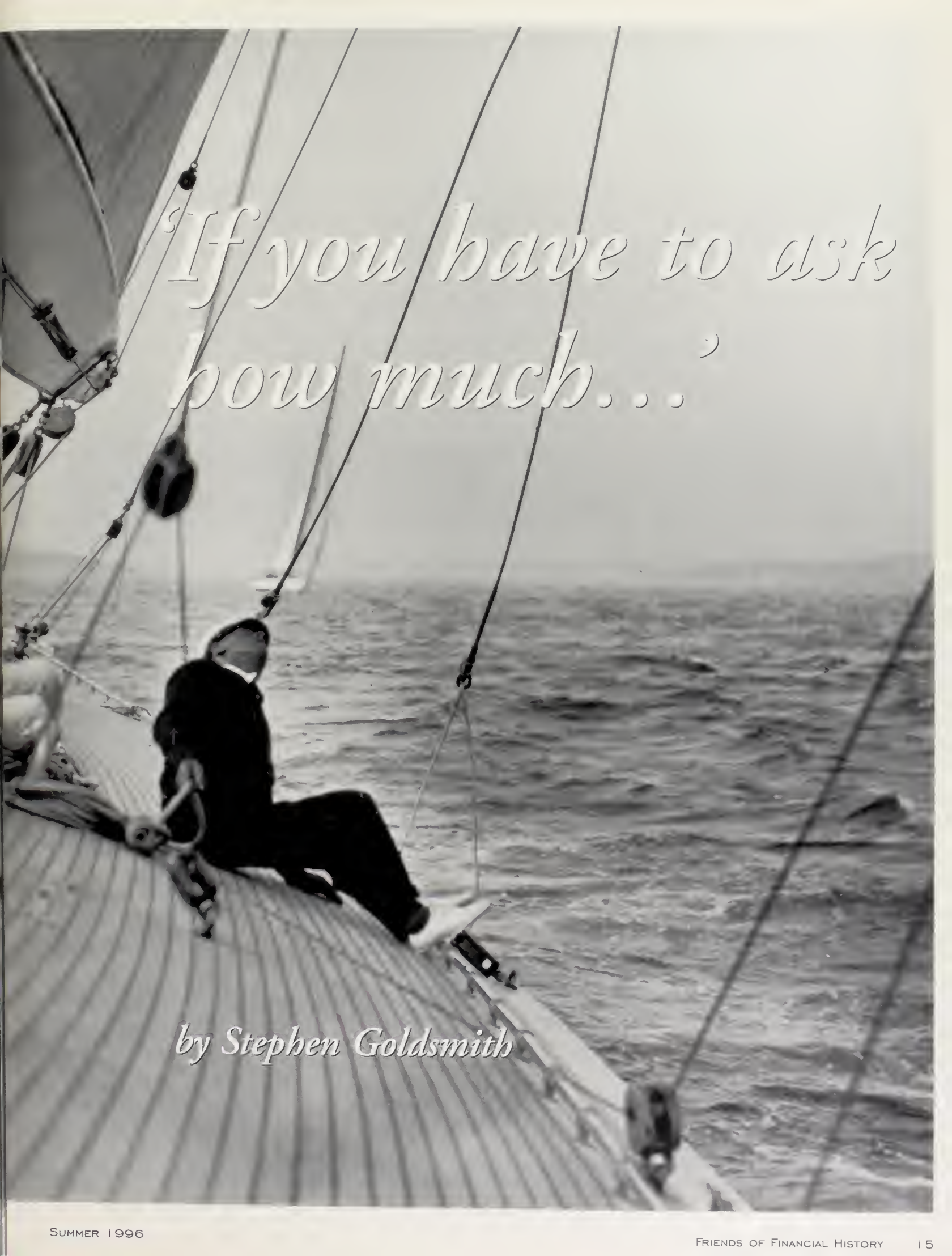
The NASDAQ system is now about to make another technological (and philosophical) evolutionary jump. A new small order system dubbed "NAqcess" is being considered by the SEC. NAqcess would replace the current Small Order Execution System (SOES) that was implemented in response to the 1987 stock market crash. While opinions vary on the worth of the new system, it is clear that NAqcess is being given priority attention by the SEC.

The NASDAQ trading systems clearly demonstrated the usefulness of new technologies in solving the problems and meeting the needs of the market. Some investors are now turning to cyberspace for immediate information and access to low cost trading systems. The Internet's World Wide Web is bringing Wall Street right into America's homes. Discount brokers are setting up virtual brokerages and passing along

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Photograph courtesy of The Mariners Museum, Newport News, VA.



*'If you have to ask
how much...'*

by Stephen Goldsmith

Sociologists and historians call it *zeitgeist*. Translated from German, it means “spirit of the times.” It is an expression often linked with the theory that even ordinary people can rise to an exceptional level of achievement when faced with great challenges or opportunities.

In the late 1800s through the 1920s many people rose to greatness. Indeed, it was a period of extraordinary achievement, ranging from the birth of aviation, to personal fortune, to the emergence of the United States as a world power.

The last decade of this era was tagged with an enduring superlative: the “Roaring Twenties.” The period even included a war so vast, so filled with carnage, that it was



Nathanael Greene Herreshoff, in 1876

misnamed with another extreme: “the war to end all wars.”

In America, some of the legendary names in the history of the nation’s capital markets were making their reputations: Baker, Morgan, Vanderbilt, Gould, Ford, Whitney, Plant, Hearst, Cassatt. These entrepreneurs, financiers and bankers were also spending huge sums that showcased their fortunes and imaginations. Palatial residences were built in New York City, Long Island and Newport. Among their indulgences, particularly those with Wall Street ties, was yachting. True to the spirit of the times, the passion, competitiveness and imagination of these yachtsmen, fueled by

great wealth, elevated the competition of sail racing to an extreme the world had never seen—or has seen since.

Enter the partnership of Nathanael Greene Herreshoff and his brother John, a blind boatbuilder from Bristol, Rhode Island. From 1899 into the 1930s, the brother’s firm designed and built the largest, most complex, powerful and expensive yachts ever created for the defense of yachting’s greatest prize: the America’s Cup. Funded by syndicates headed by the likes of J. P. Morgan and Harold S. Vanderbilt, Herreshoff built or designed every first place finisher. Second place? A member of the Royal Family explained to the Queen as an American yacht crossed the finish line: “There is no second place, your majesty.”

“If you have to ask how much, you can’t afford it,” quipped J. Pierpont Morgan, answering an inquiry on the price of a yacht. But the great bankers and financiers at the turn of the last century could pay the price. To own the fastest, most powerful racing yachts the world had ever seen, they turned to a blind man and his genius brother.

In the *zeitgeist* of this extraordinary time, under extraordinary competitive pressure, the Herreshoff brothers set a record that remains unmatched in the history of all amateur or professional sport.

In the following article, Stephen Goldsmith writes of his casual acquisition of the only Herreshoff stock certificate known in existence. Today, the certificate is on display at the Herreshoff Marine Museum, in Bristol, Rhode Island, a gift from Mr. Goldsmith. The article is illustrated with photographs of Herreshoff yachts designed or built for some of the giants in America’s financial history. The Mariner’s Museum, in

Newport News, Virginia, and the Herreshoff Marine Museum, in Bristol, Rhode Island, graciously co-operated in researching and providing information for this article.

—T. Patrick Harris

He made a mistake that led to the death of a man, yet at one time or another J.P. Morgan, Cornelius Vanderbilt, Harold S. Vanderbilt, Junius S. Morgan, Jr., A.J. Cassatt, and Alfred G. Vanderbilt all relied totally on his skill, judgment, and integrity. His name was Nathanael Herreshoff, and myth says these powerful people rarely even dared suggest anything to him. They told him what they wanted and they paid cash on delivery, knowing that they got the finest

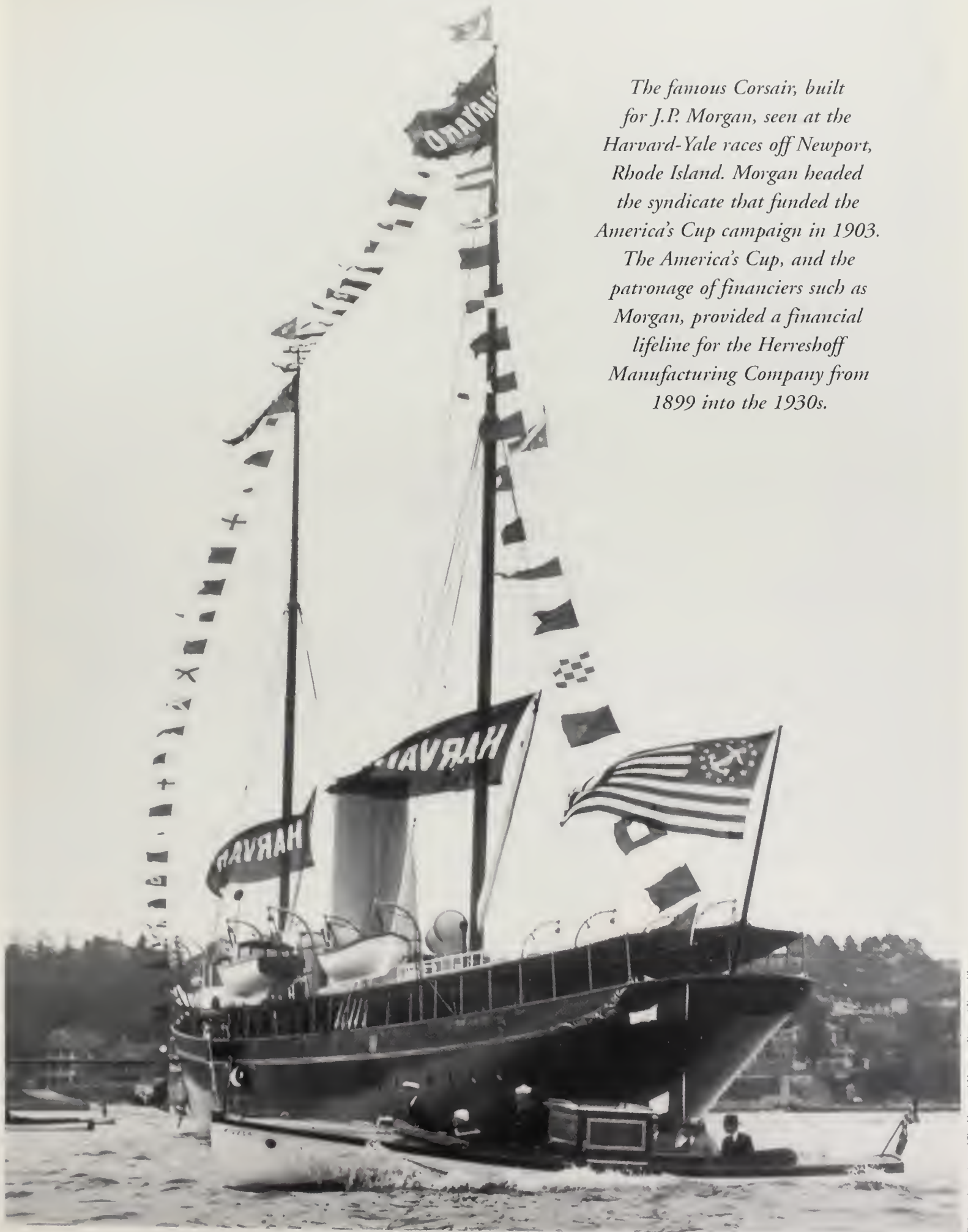


John Brown Herreshoff with daughter Katie, circa 1874

product money could buy. For a period of 37 years, from 1893 to 1930, he was instrumental in defeating the Earl of Dunraven and Sir Thomas Lipton in a series of nautical engagements that caught the fancy of the entire world. I got to know him through a stock certificate I acquired at a “paper money” show, in Willamantic, Connecticut. It was March, 1986 when a man rushed by me, clutching a stock certificate in his hand. I stopped him and asked if I might have a look. “Sure,” he said, “but I bought this thing five minutes ago, only because it’s from my home town.” I took a quick look. At first glance it appeared to be a piece of

The famous Corsair, built for J.P. Morgan, seen at the Harvard-Yale races off Newport, Rhode Island. Morgan headed the syndicate that funded the America's Cup campaign in 1903.

The America's Cup, and the patronage of financiers such as Morgan, provided a financial lifeline for the Herreshoff Manufacturing Company from 1899 into the 1930s.



Photograph courtesy of The Mariners' Museum, Newport News, VA.

“wallpaper,” common, inexpensive and marginally collectable, but I found a few things about the certificate that I really liked. It was from the town where the sailboat I own was built—Bristol, Rhode Island. It was serial number 1. The vignette was nautical and the name, “Herreshoff Manufacturing” had a familiar ring to it. It was signed by “Nath’l G. Herreshoff” as president. I told the gentleman why I was interested and I asked if he could be persuaded to sell the item. He said, “If you will give me a decent profit.”

The timeless spirit of enterprise smiled, and money changed hands.

Who was Herreshoff, the president of the company? I knew I heard that name before, but I could not place it. I knew the company had something to do with sailboats. Why was a naval patrol boat used on the certificates? The corporate seal shows a small “1879” above a larger “1917”. This suggests some form of reorganization or change occurred in 1917. A little research was certainly in order.

Tall Tales, Fast Ships

Nathanael Greene Herreshoff was born in the seafaring town of Bristol, Rhode Island in 1848. In earlier times, the inhabitants of Bristol built and sailed slave ships, operating between Bristol, the Caribbean, and Africa. During the War of 1812 they sailed in fast blockade runners and served on privateers. Nat and his five brothers must have spent many long hours listening to the tall tales spun by retired sea captains and watching the local boat builders at work. No one was surprised when J.B., Nat’s older brother, opened his own boat building establishment. When J.B. became blind at the age of fourteen, Nat became his eyes and hands. Despite his blindness, J.B. went on to become the chief executive of one of the most successful yacht building companies in the world. Nat went to Massachusetts Institute of Technology.

During the Civil War, Nat continued his education, attending M.I.T. and graduating with a three-year degree in mechanical engineering. He took a position with the Corliss Steam Engine Company. In 1876, at the Centennial Exposition the favorite attraction of the entire fair was the

giant Corliss stationary engine which supplied the power for some 13 acres of machinery on display in the Great Hall. Visitors were greatly impressed that the engine, bigger than the average house, was entrusted to the care of one small man. That man was Nathanael Herreshoff. Nat’s knowledge of steam engines was to be applied to the boats, yachts, and launches brother J.B. was now building at his boatyard in Bristol.

In 1878, Nat and J.B. formed a partnership which they incorporated a year later as the Herreshoff Manufacturing Company. They were the sole shareholders. Nat’s designing and engineering expertise and J.B.’s business sense helped them to



The yacht Ventura, built for George F. Baker, founder of Citibank, in 1921. Baker was one of several Wall Street patrons of the Herreshoff Manufacturing Co.

Photograph courtesy of The Mariners' Museum, Newport News, VA.

land contracts with the Spanish, Russian, French, and British Governments for fast gunboats and torpedo boats. Within a few short years, the Herreshoffs gained an unequalled reputation in the field. They began to build high-speed steam driven private yachts as well.

In 1888 Nathanael Herreshoff’s preoccupation with high-speed steamboats came to an abrupt end. He was supervising the speed trials of “Say When,” a 138-footer with an 875 horsepower engine. Just before she got up to the speed that he

anticipated she could reach, a safety valve popped. In an uncharacteristic moment of impatience he screwed the safety valve down. Minutes later a tube in the boiler exploded, fatally injuring a crew member. Nathanael Herreshoff lost his steam engineer’s license and his desire to build high-speed steam yachts.

The America’s Cup

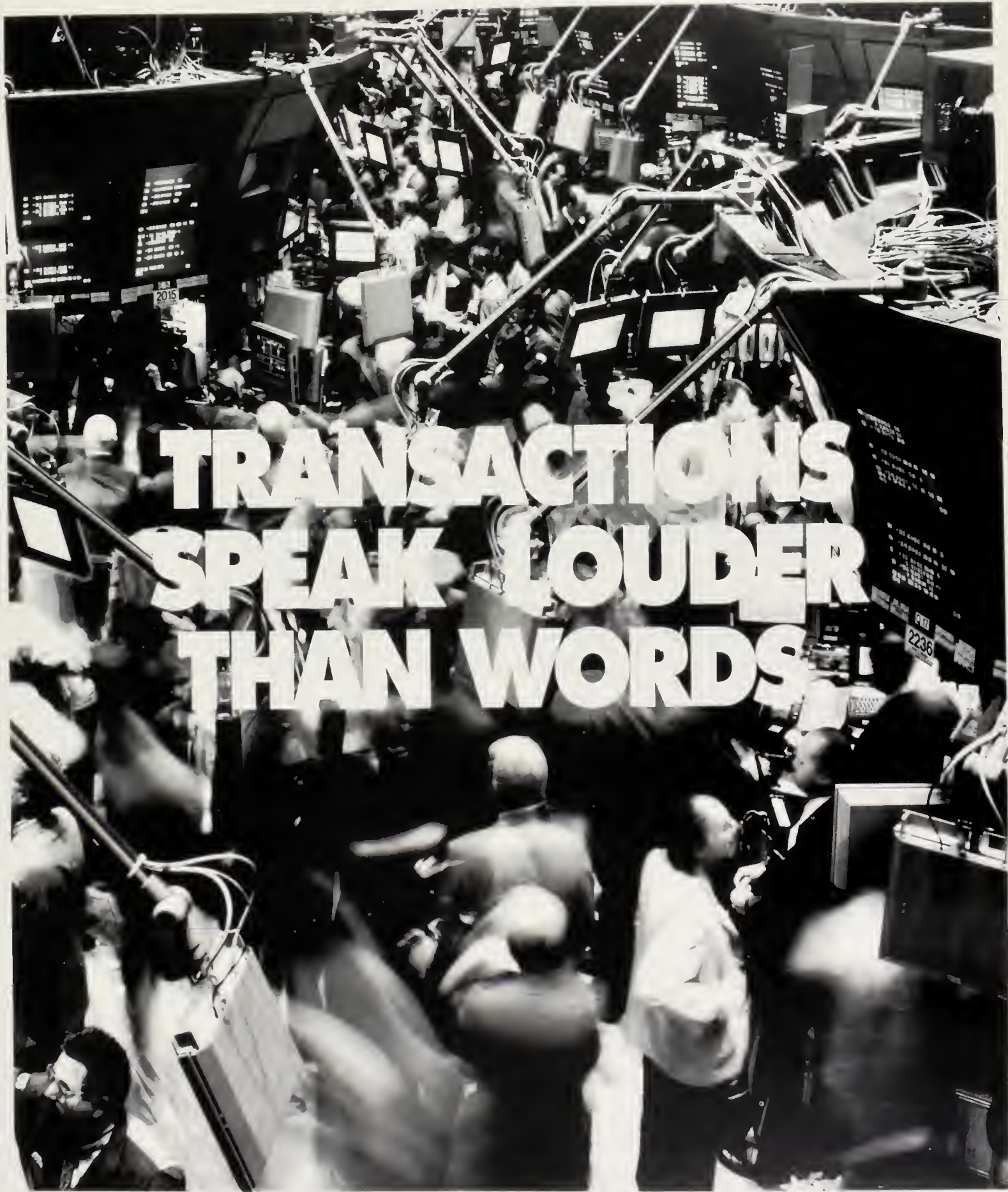
In the 1890’s Captain Nat began designing large sailing yachts. He pioneered the development of the fin keel and bulb keel, two “modern” concepts he used in his designs in the 1890’s. He invented crosscut sails. He developed sail tracts and slides that replaced the cumbersome hoops used previously. The light, hollow metal spars that are in use today were a result of his pioneering efforts. These efforts did not go unnoticed in Newport, just south of Bristol. J. P. Morgan, Cornelius Vanderbilt, Harold S. Vanderbilt, Jay Gould, Harry Paine Whitney, William Randolph Hearst, A.J. Drexel, August Belmont, William K. Vanderbilt, Harold S. Vanderbilt, Junius S. Morgan, Jr., A.J. Cassat, Alfred G. Vanderbilt all bought yachts or tenders at one time or another from the Herreshoffs. They would call Captain Nat, tell him they wanted a yacht of such-and-such length, sail or steam, and the Herreshoffs would take it from there.

In 1892, when Lord Dunraven of Great Britain challenged for the America’s Cup, Captain Nat was ready. He designed and built “Vigilant” for Newport resident E. D. Morgan and C. Oliver Iselin of the New York Yacht Club. Throughout the Cup races of 1893, Captain Nat was at the wheel and he steered Vigilant to victory. It was a feat he would accomplish five more times between 1892 and 1920, designing every America’s Cup winner built during what has since become known as “The Herreshoff Period.”

The End of an Era

We now know who Nathanael Greene Herreshoff was. We know why the date 1879 is on the embossed company seal, but what happened in 1917 to cause the issuance of a new series of bonds? (1917 is mentioned on the company seal and the

Continued on page 37



TRANSACTIONS SPEAK LOUDER THAN WORDS

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Was Trade Settlement





T+3?

A History of Clearance and Settlement Changes

By Kenneth S. Levine

Settlement—the exchange of cash in payment for securities—is a silent, electronic process today. But it used to resemble the chaos and peril of a frontier town in the old Wild West. Consider this description from 1873 by Wall Street chronicler Matthew Hale Smith: “Out into the street; down into cellars; through dark alleys and narrow lanes; up narrow and crooked stairs—in every direction the messengers rush, loaded down with greenbacks and gold, checks, bonds, and gold certificates. Desperate men track these messengers, garrote them in dark alleys, knock them senseless, and steal their treasures; and more than once, on the corner of William and Wall—the most promi-

nent part of the street—parties have been robbed in the presence of a hundred men. ...As stout, energetic, pugilistic men are needed on the Stock Exchange, so daring men of courage, with the dash of a prize-fighter about them, are needed as messengers.” These days, of course, settlement is rarely so life-threatening. In fact, it is the easiest it has ever been. For the first time in the history of the American markets, the time allotted for settlement has been reduced. On June 7, 1995, the settlement date for trades in stocks and corporate and municipal bonds changed from five business days after the trade is executed to three. The Securities and Exchange Commission mandated the switch to

“T+3” settlement in October, 1993, in an effort to make the securities markets safer overall. Since the shorter cycle reduces the number of pending transactions, firms can lower the exposure they have with each other, and limit losses in case one firm fails.

The settlement date for the first 140 years of exchange trading was T+1. This century the settlement period lengthened, one day at a time, mainly because back-office staffs needed more time to handle the ever-increasing volume of trades and the errors that occur when volume swells.

Trading volume on the NYSE increased dramatically in the 1920s and again in the 1960s. In 1962, average daily volume was about four million shares, and the NYSE boldly predicted that it would double by 1980. Instead, it quintupled: By 1968, the Exchange had 20 million share days; the peak day in 1980 was over 84 million shares. Currently, the NYSE averages over 400 million shares a day.

The development of the systems to settle securities trades is a history of miscalculation and poor planning that has hurt investors and run brokerage firms out of business. Until recently, back-office systems were always catching-up to handle large volume. In late 1968, the back-up of paperwork was so bad the exchanges closed down on Wednesdays so brokerage houses could allow their staffs time to process the work. In the avalanche of trading, stock certificates were “stuffed behind pipes in ladies’ rooms, at the bottom of trash baskets, in the backs of filing cabinets with old letters,” noted Wall Street chronicler John Brooks.

“By hindsight,” the Securities and Exchange Commission noted in its 1969 annual report, “it seems that the industry took longer than it should have to regard the progressively higher levels of activity as a new norm and to recognize that such levels of activity would require fundamental changes.”

An “Army of Messenger Boys”

Equity and bond trades settled on the day after the trade was made, or T+1, from 1792 to 1933. Until 1892, there was no clearing house to facilitate settlement and offset, or “net” out opposing trades, despite close to a dozen earlier attempts to develop one.

During the pre-clearing-house days, brokers cleared and settled trades directly with each other. The selling firm would bring trade tickets to the buying firm’s office for “comparison”, generally within an hour after each day’s trading ended. The two firms would compare trading tickets to make sure both sides agreed on the transaction. Conflicts were resolved the next morning.

The trades settled by 2:15 P.M. the next day (there was no settlement on Saturdays: trades made on Friday and Saturday both settled on Monday). Some firms would, for a fee, clear trades for other firms and became known as “clearing firms”.

The settlement practices meant that brokerage houses had to employ “an army of messenger boys,” as one historian, John Grosvenor Wilson, described it in 1905, looking back on the days before the Exchange set up the first system to help clear trades.

“As 2 o’clock approached,” Wilson wrote, “the streets of the financial district presented a curious spectacle. By common consent the delivery boys were given the right of way. Running at top speed, their hands full of securities and checks, the boys were everywhere in evidence. Between 2 and 2:15 P.M. the large offices became blocked with long queues standing at cashiers’ windows with sales tickets and deliveries. In busy times, ‘Past delivery hours—too late!’ was heard in almost every office.”

“It is little less than miraculous,” he added, “that so few losses occurred, but the liability to great loss was the ever present cause of anxiety.”

The New York Stock Exchange Clearing-House (Clearing-House) began operation in May, 1892. It was limited in scope, and did not eliminate the need for messengers (who all had safe jobs in that area of the industry well into the 1970s). The Clearing-House recorded and netted out securities movements and payments among its brokerage participants. If A sold 100 shares of a stock to B, and B sold 100 shares of the same stock to C, the Clearing-House would instruct A to deliver the shares to C. The securities still settled with physical delivery.

The first stocks on the list to settle by this new method, according to the minutes of the Clearing-House on May 9, 1892,





were shares of four railroad companies: Reading, St. Paul (common), Northern Pacific (preferred) and Louisville & Nashville. "The list of stocks to be cleared will be enlarged as members become familiar with the clearing system," the minutes said. Even with just four stocks, 261,000 shares worth \$16 million cleared the first day, and, according to one account, "obviated the employment of approximately \$7,000,000 in certified checks; the manager of the clearing house and his ten clerks could consequently look with real satisfaction on this first day's work."

Three-hundred and forty brokers used the clearing house at first, and by the end of the year, 427 brokers were members "embracing practically all the active operators," wrote Alexander Noyes, a financial journalist, in a scholarly article published in July, 1893. "[A]nd at the present date twenty-one stocks are cleared daily," he said.

Clearing and settlement deadlines changed little with its set-up. The Rules for Clearing-House of the New York Stock Exchange as of 1898 said:

As early as possible in the afternoon and before 4:15 o'clock (before 1:15 o'clock Saturdays), the seller who has contracted to deliver securities through the Clearing-House on the next clearing day, shall send to the office of the buyer his own 'Deliver Ticket,' and shall receive in exchange the buyer's 'Receive Ticket.' Other comparison is unnecessary. The 'Deliver Ticket' must not be left unless the exchange is made, and the tickets exactly agree.

The Clearing-House charged firms 2.5 cents per 100 shares cleared to recoup costs.

The Trouble With Volume

The Special Committee of the Exchange, which set out the plan for the Clearing-House in 1892, said that if the NYSE "is to take the proper place in the future among the stock-markets of the world, a system of doing business will be required which will stand the strain of a volume of business larger than any heretofore known." Indeed, volume did grow, but the systems were not always able to handle the strain.

From 1900 to 1918, the yearly volume at the NYSE never exceeded 232 million shares. Then, with the War over, the markets became quite active. The average

volume from 1920 to 1924 was 339.8 million shares per year; from 1925 to 1929 it was 654.0 million shares per year; and from 1930 to 1934 it was 558.2 million shares per year.

The Stock Clearing Corp. (SCC) was established in 1920 to help firms handle the volume. Essentially, it added a "day" branch, and retained the Clearing-House, which stayed at its 55 New Street location and was renamed the "night" branch. The day branch, in the basement of the stock exchange, acted like a bank clearing house. The clerks recorded all of the debits and credits from securities deliveries on the books of the clearing members. At the end of the day, SCC tallied up each firm's net balance, and either sent the firm a check or told the firm to deliver a check made out to SCC for the net amount.

As of 1931, SCC had 425 clearing members, and 450 stocks out of 1,300 issues were available for the services (these stocks accounted for "about 90%" of the reported sales, according to J. Edward Meeker, an economist at the NYSE). Brokers had to keep a "Clearing House blotter" for the trades they made in the securities eligible for the clearing services, and separate sheets for the remaining securities.

Volume still caused problems in the system, especially during the 1929 Crash. "Although the Stock Exchange refused to suspend trading, the tremendous volume of orders suddenly thrust upon the Exchange system caused such congestion in the business and physical exhaustion on the part of trained employees, that several holidays were declared, and temporarily shortened hours of trading were employed," Meeker wrote in his book, *The Work of the Stock Exchange*, published first in 1922 and revised in 1930. Night Branch clerks did not receive tickets and blotters for comparison until very late in the evening, Meeker wrote, which meant "they were compelled to sleep in the Night Branch offices."

In 1933, the NYSE made its first shift in the settlement date. Speculative trading in July led to such heavy volumes that the NYSE shortened its hours from July 19 to July 22 to rest tired clerks. In August, the exchange decided that it would give those clerks an extra day to clear trades for settlement. A release on August 30, 1933, said:

"In periods of unusual activity the fact that deliveries must be made the next day imposes an almost unbearable burden on employees of members, and results in such exhaustion of the personnel that the Exchange has at times been forced to shorten the hours of trading, or even close for one or more business days."

The new deadlines began September 8 of that year. Friday's and Saturday's transactions were both settled on Tuesday instead of Monday. No change was made to when or how firms compared their trades.

Volume declined in the next few years. After 1.1 billion shares traded on the NYSE in 1929, and 810 million in 1930, the yearly share volume did not exceed 600 million until 1955. The war years were particularly slow, with yearly volume under 300 million shares from 1938 to 1944.

After the war, volume increased again. In 1946, the NYSE dropped Saturday trading in the summer, and on August 2 it announced that settlement would move to the third day after the trade was executed. Comparisons, the release said, "will continue to be made the day of the transaction." The release gave no reason for the changes, which began at the end of the month.

In 1952, the NYSE changed its hours again as well as the clearance and settlement deadlines. On February 21, it announced that settlement would change to T+4, and firms would have until the day after the trade to compare the tickets. Later that year, it extended the closing time of day trading by half-an-hour, from 10:00 a.m. to 3:30 p.m., and eliminated the 10:00 a.m. to noon trading on Saturdays.

The 1960s and the Back-Office Crisis

In the 1960s, investor activity in the markets grew dramatically, and firms' operations were ill-prepared. In 1961—when, for the first time since 1929, more than one billion shares traded for the year—one-fourth of all the NYSE complaints dealt with the late delivery of securities. Merrill Lynch's annual report for 1961 said that its account for "failed to receive" securities totaled more than \$11.5 million. The SEC said in 1963 that late deliveries and failed

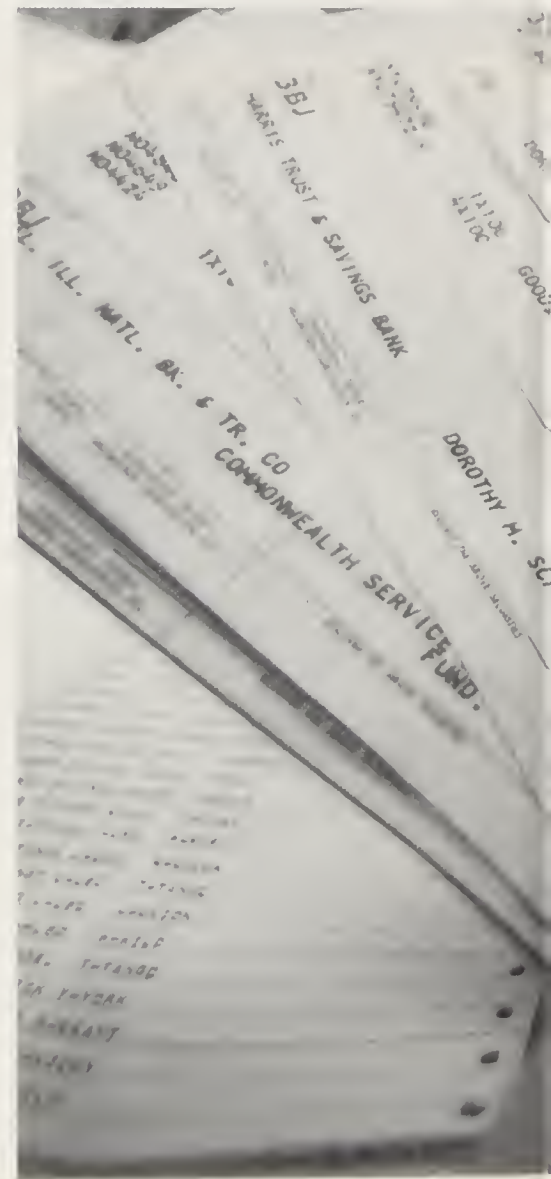
trades were occurring in the entire market, and "these amounts greatly increase in periods of heightened market activity."

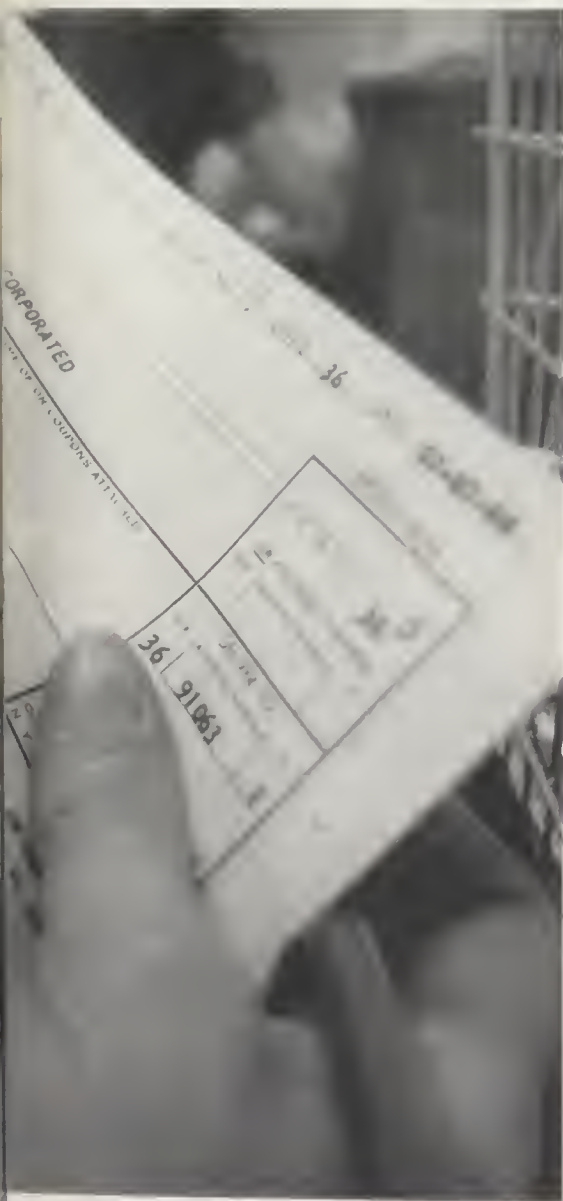
The growth, and problems, continued. From 1965 to 1969, the combined volume at the New York and American Stock Exchanges more than doubled. In 1967, the situation was described as a paperwork problem, a "problem with prosperity" or, less generously, as a "back-office crisis." In August, the exchange took the extreme step of closing trading an hour and a half early, at 2:00 p.m. instead of 3:30 p.m., for nine days to allow back-offices a chance to catch-up. On January 18, 1968, the NYSE, Amex and National Association of Securities Dealers closed trading early again: markets would shut at 2:00 p.m. until further notice because "continued unprecedented high volume in both listed and unlisted securities requires a temporary reduction in the daily trading sessions in an effort to enable operations personnel of member organizations to catch up on heavy workloads."

Meanwhile, the one-day volume record set on October 29, 1929, of 16.4 million shares was broken for the first of 25 times that year on April 1, 1968; on April 10, volume topped 20 million shares. The activity was due in part to investor optimism that the war in Vietnam was coming to an end.

Back-office delays continued, mainly because brokers had to match up trade tickets, tabulate positions, compare printed forms manually and make many deliveries by hand. *The New York Times* said in November, 1968, that "NYSE should shut down between Christmas and New Year's to clear the brokerage paper jam." The NYSE annual report for 1968 noted that "one broker pointed out that, even with automation, a stock certificate had to pass through 70 pairs of hands on its way in or out of his firm's back office."

The peak of the problems occurred in December, 1968. End-of-year activity, a tired work force, and a flu epidemic in New York, all converged to cause a record number of settlement failures. That month, the contracts that were overdue for delivery were valued at \$4.1 billion. In January, 1969, the NYSE closed trading on Wednesdays to give firms a chance to catch up on their paperwork.





All the delays meant that many investors were not getting paid for their trades on time, or receiving their securities on time, or at all. The SEC said that complaints jumped from 3,991 in fiscal year 1968 to 12,494 in 1969, and that more than 90% of them related to back-office problems. Three firms in particular had “critical” problems, according to a NYSE report the next year: Dempsey-Tegeler & Co., Inc., McDonnell & Co., and Blair & Co. Goodbody & Co. also failed, in part because of its back-office problems and was bailed out by Merrill Lynch with \$15 million in Treasury bills. According to a *Wall Street Journal* story on December 11, 1970, a joke in the industry was: “Merrill Lynch delivered \$15 million in Treasury bills to Goodbody, but Goodbody bounced them back, saying it had no record of the transaction.”

The situation led to another extension in the settlement date. On February 2, 1968, the NYSE announced that beginning one week later, trades would settle in five business days instead of four. Brokers considered the change just a small part of a much larger situation.

“The change from T+4 to T+5 guaranteed a weekend before settlement,” noted Junius Peake, now a finance professor at the University of Northern Colorado, who was partner in charge of operations at Shields & Co. at the time. “It gave us an extra day for the mail to be delivered. It helped a little bit, but it didn’t deal with the underlying causes.”

As in the 1920s, the increase in the trading volume caused the NYSE to create a new clearance and settlement system for the industry. In 1966, the exchange began operating the Central Certificate Service, or CCS, the first stage in the critical development of a securities depository that would keep certificates in vaults instead of circulating on the Street. Under the CCS system, certificates could be sent to the depository registered under a generic name of the “central depository” (using a made-up name “Cede & Co.”). CCS would keep track of who owned what, and settlement could take place as an accounting transfer in the ledger books, not a physical movement.

CCS formally succeeded the Stock Clearing Corp. in 1968. It was not a success. First, CCS was reluctant to allow

banks and institutions to include their shares in the depository, which cut off a large universe of certificates. (Banks also saw the depository as a threat to their transfer agent business.) CCS was also slow at transferring shares from a broker’s name into the depository’s name, and therefore did not have quick access to shares for delivery out of the system. And, it did not have a large enough floating supply of shares to make all its deliveries, and ended up settling many transactions late.

Richard Howland, president of the Stock Clearing Corp., told Congress in 1971: “CCS got started in 1968, and fell flat on its face in February or March of 1969. It has taken us 18 months to get respectable again.” A NYSE report to Congress in 1971 said “operational difficulties persisted through August 1969 and had the effect of limiting CCS’ contribution to alleviating the paperwork problem through the remainder of the year.”

The lack of institutional support meant that any trade done between a broker-dealer and an institution required a certificate to be issued and delivered out of CCS.

Enter the Depository Trust Company

The back-office crisis eased somewhat mainly because markets went into a downward spiral and pulled trading volume down with them. A group of bankers, broker-dealers and stock exchange executives formed the Banking and Securities Industry Committee, or BASIC, which set guidelines for how the industry should proceed. It suggested a “super CCS,” with a series of regional depositories all linked together, and with banks, institutions and broker-dealers all working together. It was the framework for the Depository Trust Company (DTC), which formally began operations in 1973 and which exists today.

From its start, DTC worked to bring banks and institutions into the system. It was set up as a trust company and eventually was made independent of the NYSE, with banks and brokers as owners. The release announcing the changeover from CCS to DTC quotes DTC’s first chairman, William Dentzer, Jr. (formerly the

Clearing and settlement refers to the dual processes of verification; agreement in price and quantity, and the transfer of security ownership. As this article points out, the manner in which clearing and settlement transpires in the US markets has evolved through the entire 200 year history of organized trading in the United States. It is enlightening to see what can occur in a less mature (emerging market) environment.

India's market mechanisms are quite young. Recent events highlight the differences between the Indian and US systems. A case in point is Reliance of India. Reliance is the most widely held firm in the world boasting over 2.6 million shareholders. This manufacturer of synthetic fibers is a large and generally well-managed firm. Recently, however, the firm has been plagued by settlement and clearing scandals that have led Reliance to be dubbed the

"Evil Empire" by India's Free Press Journal.

One of the firm's indiscretions was the improper duplication of 26,000 Reliance stock certificates for a stockholder who had sold the shares and then later claimed the shares were lost. Issuance of the duplicate shares effectively cleared the way for the shareholder to sell the same holdings twice. The firm might have been able to claim that an innocent mistake had been made had the stockholder not been the Reliance chairman's physiotherapist.

In a second example of settlement abuse, Reliance is accused of share switching. Reliance was apparently attempting to shift large capital gain tax liabilities to unsuspecting purchasers of Reliance stock by switching Reliance's own lower-cost basis holdings with the more recent higher-cost basis shares of new shareholders at the time of registration.

The Indian market is a prime example of the difficulties of investing outside the influence (and regulatory protection) of the SEC. Reliance's improprieties occurred as a direct result of the lack of an independent central depository in India. Firms shuffle paper among themselves, handling all facets of the settlement process. It can take months for transactions to clear and there are ample opportunities for deceit at each step. In a recent interview with the *Wall Street Journal*, Mathew Panikar, managing director Reliance's European operations, offered little explanation for his firm's actions; "We learn lessons as we go along."

While at times the system of clearing and settlement in the United States may seem unnecessarily complex and unwieldy, when compared to similar processes in emerging markets, the US system is the very model of security and efficiency.

New York State Superintendent of Banks, who retired in 1994 from DTC): "It is important that everyone understand the reasons for this change. Our goal is to immobilize securities certificates, thereby reducing processing costs for our users while increasing safety and speed of deliveries. To achieve this goal, banks must be attracted into the depository; quite apart from their own huge holdings of securities, investments and insurance companies will be heavily influenced by banks' decisions."

DTC has been a success, and currently, the clearance and settlement systems are strong. DTC holds in its vaults about 70% of all NYSE listed outstanding shares, 57% of NASDAQ securities, 50% of American Stock Exchange-listed stocks, 86% of corporate bonds, and 95% of municipal securities—all of which increase each year. The regional depositories—the Midwest Securities Trust Company in Chicago and the Philadelphia Depository Trust Company—have much smaller amounts of securities on deposit. The National Securities Clearing Corp., which was formed in 1977, works with broker-dealers and other clearing organizations to compare and clear trades early in the settlement process to avoid mistakes. Deadlines for

clearing trades are moving up to intra-day comparisons. Many trades on the NYSE or Amex also avoid the comparison process and are "locked-in" when transacted at the exchange, meaning that buy and sell data are automatically compared.

But there is still work to be done. Physical securities, for instance, are slow and expensive to handle, but are still popular. Many investors ask for the registered securities because they either cannot have services like dividend reinvestment plans if they keep shares in Street name, or because they do not trust their brokers.

Investors need a way to hold securities in an electronic form, receive annual reports and proxy materials, and still shop their shares around easily from broker to broker. At some point, all securities should be issued in book-entry form only. (This would, of course, eliminate paper certificates - permanently preventing the supply from expanding. That would be good news for collectors of old certificates.) And since brokers often wait for customers to send checks in the mail to pay for trades, a retail payment mechanism needs to be developed, most likely using the automated clearing house (ACH) system now used for direct-deposit of paychecks, to allow retail

customers to make electronic money movements to brokers quickly and cheaply. **EFF**

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Editor's note: Special thanks to Steven Wheeler, New York Stock Exchange, Margaret Koontz, National Securities Clearing Corp., Evan Cooper, Securities Industry Daily and Friends Editorial Board Member Jason Zueig. Photos courtesy of the New York Stock Exchange Archives.

Kenneth S. Levine was a reporter for Securities Industry Daily. He is currently attending New York University School of Law.

BY PAUL SARNOFF, CONTRIBUTING EDITOR

On May 1, 1937, it was "May Day." The workers were parading around New York against the bosses. But for the owners of the brokerage firms on Wall Street, it was the kind of May Day ship captains call when they hit a reef. Why? President Franklin D. Roosevelt's warchdog agency, the Securities and Exchange Commission (SEC), was hitting Wall Street hard after years of studying alleged abuses. The new, tough regulations effected everything from order taking to execution to clearing and settlement.

I had just started my Wall Street career. I was 19 and, in the Bernard Baruch tradition, I started at the bottom, as a runner. I was paid ten dollars a week. My bonus was all I could earn from delivering lunches to the "customers' men", today known as registered representatives, account executives, or some other fancy title.

Like all the other firms at the New York Stock Exchange at the time, the firm I did the running for was a partnership consisting of general partners and limited partners. General partners were the bosses that ran the firm. Limited partners sup-

plied the money to expand the business. This was because the SEC declared no corporate bodies would be allowed; they wanted personal liability to emphasize honesty and sincerity.

Ironically, under the new SEC rules, the general partners were really at the mercy of the people who worked for them — particularly those who worked in "the Cage." (Today, "the Cage" would be known as back office operations.) Orders to buy and sell, which had been executed, had to be debited and credited to proper accounts. And it was the job of the king of the cage, the Cashier, to make sure everything went smoothly. Under the rules, the books had to be balanced out every night, so the partners would know the exact capital position of the firm.

In this connection, it was imperative that when the stocks were bought on the Exchange, they be delivered within a certain span of time for payment. And if stocks were sold, it was mandatory to deliver the securities against a certified check. When it came to stocks, most purchased shares were put in the name of the buyers and mailed after payment. But

since the number of clearance days then was limited to three, the selling broker would deliver the shares in "street name" on behalf of the seller until his shares arrived. For the services these brokers extended — especially in clearing — the brokers charged regulated, fixed commissions when buying or selling.

I remember May 1937 very well. The Great Crash of 1929 was fresh in all memories, as were stories of blind pools and great legends such as Jesse Livermore. There were even a rash of stock exchanges opening up across the country and overseas, similar to today. It was also a time when a lifelong fascination with the jargon of Wall Street first caught my imagination. I think I may have been hooked by this little sidelight of the brokerage industry when I first heard the advice: "Sit on your can and let go of the gas." I was to find out that stocks had pet names among brokers, and the advice really meant to hold your shares of American Can and sell your Baltimore Gas holdings.

Little did I dream that this fascination with "street talk" would lead me to write the first Wall Street dictionary many years later.

Buttonwood Trees and Beer

Continued from page 13

savings to their clients. Some people believe that on-line brokerages such as E*TRADE (<http://www.etrade.com>), PAWWS (<http://pawws.secapl.com>), and Lombard (<http://www.lombard.com>) are doing to traditional brokerages what Schwab did to full-service brokerages in the mid-1980s.

The information technology of the Internet is also being applied in very unique ways by Andrew D. Klein, ex-Wall Street lawyer turned brewmeister of Spring Street Brewing Company. Klein took his company public in the first Initial Public Offering (IPO) on the Internet in 1995 and raised \$1.6 million. He then went on to establish a trading mechanism called WIT-Trade (<http://www.wittrade.com>) which brings together buyers and sellers of Spring Street's stock. Klein's web site solves at least two problems for his very small firm. First, it

allows an inexpensive and efficient way for financial information to be delivered to investors. Second, it increases the liquidity of the stock by providing an exchange mechanism, and by eliminating the middleman and his commissions.

Like the signers of the "Buttonwood Agreement," Klein is looking for a solution to a problem by founding an exchange. In contrast to those twenty-four 18th century brokers, he has found a way to give the small firm and the small investor access to markets that were previously unavailable to them. Klein's innovations confirm the ability of the market to adapt to new situations and problems as they arise. His new exchange may well revolutionize the way securities are traded.

This ever changing financial marketplace must be emphasized to students. They need to understand not only that change is constant but that change occurs in response to market needs. **FFH**

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A FORUM FOR THE COLLECTOR OF VINTAGE FINANCIAL MEMORABILIA

Relic of a Railroad Wreck

BY SANFORD J. MOCK

If 100 bonds are considered a round-lot, and an odd-lot is less than 100, what does one call a block of \$43,110,000? A mega-lot? A lotsa-lot? Or perhaps, “A nice day’s work for the broker?”

The owner of the bond shown opposite, State Street Bank & Trust Company, is today a 30 billion dollar institution, alive and well in Boston.

The issuer, on the other hand, the New York Central Railroad went off the track in 1968. In February of that year, out of necessity, the monumental merger of the New York Central and Pennsylvania Railroad took place. With combined assets of nearly seven billion, this was the largest amalgamation in American business history.

The two roads could no longer make it as competitors, and they believed that the economies of a joint operation would restore them to financial viability.

The great expectations failed to materialize. The Penn Central Transportation Company, 871 days after the merger, had almost \$750 million in current liabilities, versus \$462 million of current assets.

For the company, the harsh weather of the beginning of 1970 helped to make a bad economic situation worse. Below freezing temperatures and snow paralyzed the Northeast and the railroad. Authors Joseph R. Daughen and Peter Binzen wrote in *The*

Wreck of the Penn Central, “In only one of the thirty-one days in January did the temperature stay above freezing in the eastern cities.... Power lines snapped and switches froze. Sections of steel rail split like dry timber under an ax. Trains of 100 cars or more, crammed with freight, were stranded outside clogged yards.” It appears as if the elements were out to conquer the railroad.

Control had passed from Alfred E. Perlman to Stuart Saunders and David Bevan. Saunders also happened to be chairman of Chase Manhattan Bank. Management desperately tried, but failed, to get a cash guarantee from the U.S. government. On June 21, 1970, the company filed for bankruptcy, issuing this statement, in part:

Because of a severe cash squeeze and having been unable to acquire from any source additional working capital, Penn Central Transportation today filed...in U.S. district Court...under Section 77 of the Bankruptcy Act, which contemplates a reorganization of the company and continuance of its operation.

This procedure is unlike ordinary bankruptcy, which contemplates liquidation.... The railroad is notifying its more than 94,000 employees to stay on the job and continue to perform their usual duties.

Prior to the railroad wreck, and after, shares of the Pennsylvania crashed below \$10, descending from an \$86.5 high two years earlier.

Among the major sellers were trust departments of the biggest banks. Could it have been mere coincidence that 16 of Penn Central’s 23 directors were also chief executives or directors of 14 banks?

Nobody went to jail, though the House Committee on Banking and Currency had this to say: “Which interest were directors of Penn Central representing...when they were also connected with the banking institutions lending money to the railroad? Was it ever possible for these men to act objectively, without violating their fiduciary responsibility to at least one of the several parties they were supposed to be representing?”

Stock and bondholders’ suits followed. The railroad continued operating under court appointed trustees, and it was not until 1978, eight years after the filing, that the company was reorganized as Penn Central Corporation. The Pennsylvania Company, which owned the non-rail assets — extensive real estate, hotels, office buildings, and pipelines — survived.

The \$42,110,000 five percent mortgage bond (acquired by the author at an R. M. Smythe auction in 1991) is of interest for its size and its intended duration. It was authorized by the New York Central and its predecessor, the New York Central and Hudson River Railroad Co., in 1913 with a maturity in 2013. One hundred



year bonds, common from the 1880s through the turn of the century, are a rarity today. The world-renowned Disney and Coca-Cola companies issued them in 1993, and Columbia/HCA Healthcare issued them recently. There has been talk of others coming to market.

The New York Central issue was not authorized for a specific amount, but additional bonds could be sold from time to time, subject to the company not exceeding a three-to-one debt to equity ratio.

The "Canceled by Treasurer" stamp tells us that the bond was sold, redeemed, canceled or exchanged, but we do not know which or when. There is no signature or date on the back, nor do we have a separate signed bond power, which would have made the certificate negotiable.

The \$42 million dollar question is whether State Street Bank still owned the bond at the time of the reorganization in 1978? They may have sold it along the way,

for pennies on the dollar, but if they were still the registered owner, the bank would have received an astonishing bonanza!

Under terms of the reorganization plan, each \$1,000 bond of this issue became exchangeable for \$1,388 in cash, plus 9.38 shares of Penn Central stock.

The company evolved into American Financial Group, whose primary business is property and casualty insurance and annuities, with a minor interest in television stations and Chiquita bananas—quite a departure from its origins. The stock trades on the New York Stock Exchange, tidely symbol AFG, in the neighborhood of \$30.

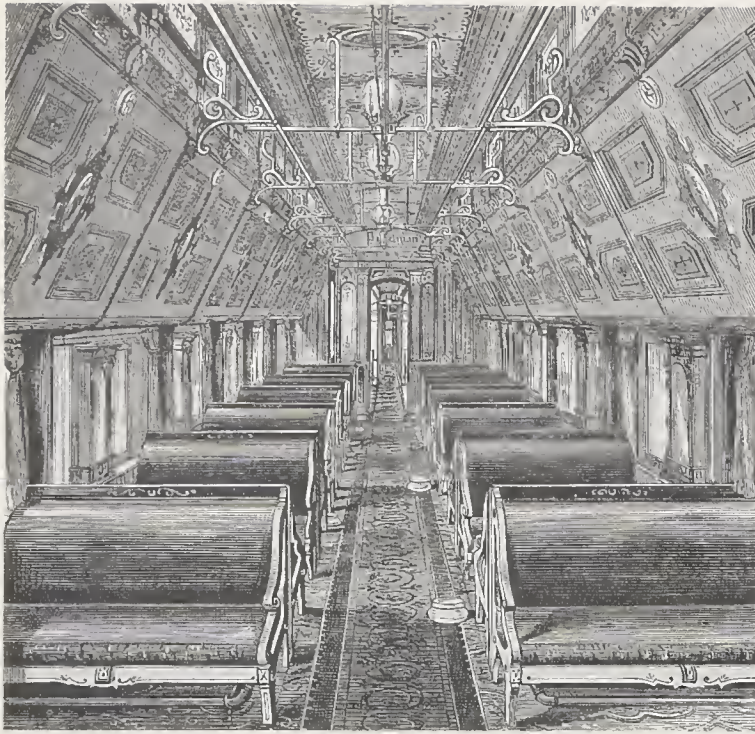
The Glory Days

The modest beginnings of what became one of the nation's most important carriers began as early as 1826, with 16 miles of primitive roadway between Albany and Schenectady. By 1853, ten railroads operating between Albany and Buffalo were consolidated to

form the New York Central. The great consolidator was the steamboat king, Cornelius Vanderbilt, known as "The Commodore." He had been asked to invest in the Harlem Railroad in 1831, but he said, "I'm a steamboat man, a competitor of these steel contrivances you tell us will run on dry land. Go ahead. I wish you well, but I shall never have anything to do with 'em."

By the 1840s, The Commodore had changed his mind. He began to buy major positions in the New York and Harlem and other roads. In 1869, Vanderbilt merged the Hudson River Railroad, operating between Albany and New York City, with the New York Central, thus giving the combination all-important access to the metropolis.

In 1873, Vanderbilt, as president of the Central, brought in the Lake Shore and Michigan Southern. By then, the line extended from New York all the way to Chicago. This connection accelerated the boom period of passenger railroading.



Interior of a luxurious sleeping car



Fifth Avenue before the turn of the century

The comfort and security of customers was important to the designers of the passenger cars. The cars were heated by coal stoves bolted to the floors and lighted by coal gas lights attached to the ceilings. By today's standards, this design would be considered highly dangerous.

The pride of the Central, the "20th Century Limited," made its initial run in 1902. For over half a century it was called "The Greatest Train in the World." passengers boarded the train before dinner in Grand Central Station and arrived in Chicago in time for dinner the next day. It set the standard for comfort, reliability and speed. Their ad told the story. Only 20 hours between New York and Chicago! Running time was cut to 18 hours in 1905 and 15.5 hours in 1958.

In the words of social commentator Lucius Beebe, the "sailing lists" of the 20th Century comprised, "...the names that made news everywhere, the people one encountered aboard The Mauretania, in the Via Mizner at

Palm Beach, in the bar of the Paris Ritz or at Claridges in London."

George Pullman designed the elegant dining car, where stylish travelers could eat heartily for \$1.50 in 1902 (and \$1.35 in the depression year of 1931) for the finest dinner.

The Pennsylvania Railroad competed vigorously with its "Broadway Limited," but "The Vanderbilt Train," as the Century Limited was known, was socially more desirable, more prestigious. Its passengers, like royalty, enjoyed the red carpet which was spread in front of the train for departures and arrivals.

Legend says this practice was inspired by the red carpets Vanderbuilt footmen unrolled along Fifth Avenue in front of his various Vanderbuilt homes whenever a family member came or went to their carriage, or later, automobile.

I remember the red carpet, because, as a boy, in the mid-thirties, I had the excitement and pleasure of riding on the 20th century Limited. And I'm so glad I didn't miss that train! **FFB**

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Sandy Mock, a senior vice president with Paine Webber in Beverly Hills, is a collector of antique financial documents.



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THE WRECK OF THE PENN CENTRAL

(1971 by Joseph R. Daughen
and Peter Binzen)

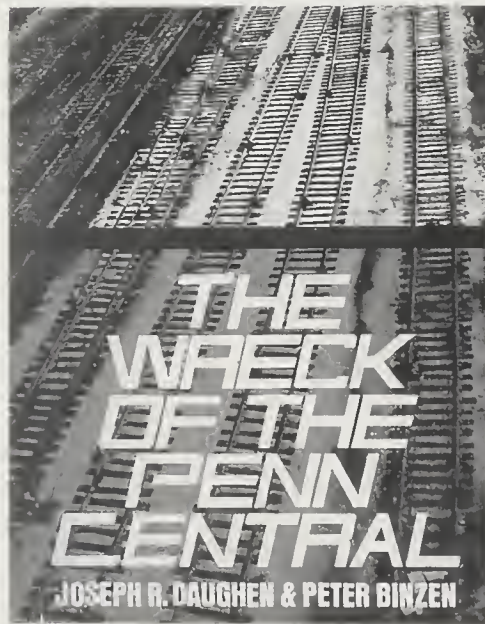
BY RAY BOAS

After ten years of “fighting, bargaining, and negotiations” on February 1, 1968, the New York Central and the Pennsylvania railroads combined in the most ambitious merger in American history to form the Penn Central Corporation. In reading *The Wreck of the Penn Central*, published in 1971 by Joseph R. Daughen and Peter Binzen, both “crack” reporters on the editorial staff of the Philadelphia “Bulletin”, one can’t help but wonder why the merger ever took place, since from “the Fifties, the PRR and the Central started on a decline which was never really reversed.” The resulting conglomerate in the words of the authors, “...was not really the wealthiest dowager in town. It was, rather, like a proud but aging widow secretly selling off her jewelry and silver to keep up appearances.... The house was big and impressive, but there was very little money to heat it and the pantry was nearly bare.” Less than 900 days later, on June 21, 1970, the largest railroad in our history became the “largest single bankruptcy in the history of the United States.”

The brief ceremony signaling the merger, in typical railroad fashion, was three minutes late. The key figures did not get along well before the merger, and tensions began to mount starting with the first Board of Directors meeting on February 1, 1968. The engravings on the Penn Central stock certificates (completed in July, 1966, and stored in a vault until the merger) depicted the conglomerate theme of the Penn Central with “a locomotive, an airplane, a ship, a pipeline, a truck, and clusters of houses and office buildings.” In contrast to the more than ten years with 128 Interstate Commerce Commission hearings it took to put the Penn Central together,

the authors in the second chapter of their book ponder how the robber barons of the late nineteenth would have handled this business. In the summer of 1885, the PRR and the Central (the nation’s largest railroad was the PRR with the Central number two) were plotting to wreck one another. What J.P. Morgan achieved in a few hours is detailed in this history packed chapter entitled “Ties to the Past.”

The reoccurring theme the authors portray is doom from the start. From the outset the Penn Central faced internal problems involving: operations, finances, and people. These problems were interrelated, but the most disruptive were the people



problems. The two railroads had been bitter rivals for a hundred years, and the managements of each were incompatible. Computer systems were incompatible. One line had armrests in its locomotives for the engineers and the other did not, and on and on.

Writing in a style of large scale interpretive reporting, the authors have filled this work with supporting facts of mismanagement, miscalculations, inefficiency, gross personality conflict, bad timing and bad luck. Easily this could have been an intriguing unbelievable novel, proving again that fact is often stranger than fiction. With each chapter, however, there are lessons to be learned. The failure of the Penn Central is similar to any other busi-

ness failure in respect to the fact that it spent more money than it took in. Not just in operations, but in the extravagant expenditures of its executives, and rubber-stamp non-involvement of its Board of Directors. Inefficiencies abounded. It is difficult to turn a profit when the average Penn Central freight car traveled only thirty seven miles in a day, at an average speed of seventeen miles per hour due to the “poor” shape of the tracks. The average freight car earned revenue for less than three hours a day, and documents showed that 20 percent of the cars generated less than \$100 in revenue on any given day. The self-serving interests of management, and the conflicts of interest addressed in the bankruptcy hearings and outlined in this book are sufficient to cause a collapse. The authors further touch on the outside forces impacting on the railroad and transportation industries in this country. When Eisenhower initiated the Interstate Highway System in the mid 1950s, the growth of the trucking industry and its speed of delivery as compared to 37 miles per day for a freight car can spell nothing but doom for a mismanaged conglomerate.

A great deal is covered by Daughen and Binzen in a quick-read fashion. They used the phrase “corporate spaghetti” to describe the complex intertwining of the Penn Central subsidiaries. Much has transpired in the business world in the 25 years since *The Wreck of the Penn Central* was published, but it still should be read for its lessons on the concept of the Board of Directors and its relationship with the chief executive officer. The facts show that boards can be worse than nothing because they give you the feeling that someone knows what is going on and keeping management honest. Robert Townsend said that, “The villains are not nameless and faceless. They are the directors and top management of our largest organizations.” If you have an opportunity, pick up a copy of *The Wreck of the Penn Central*, learn some railroad history, and reflect upon the lessons learned. [FF]

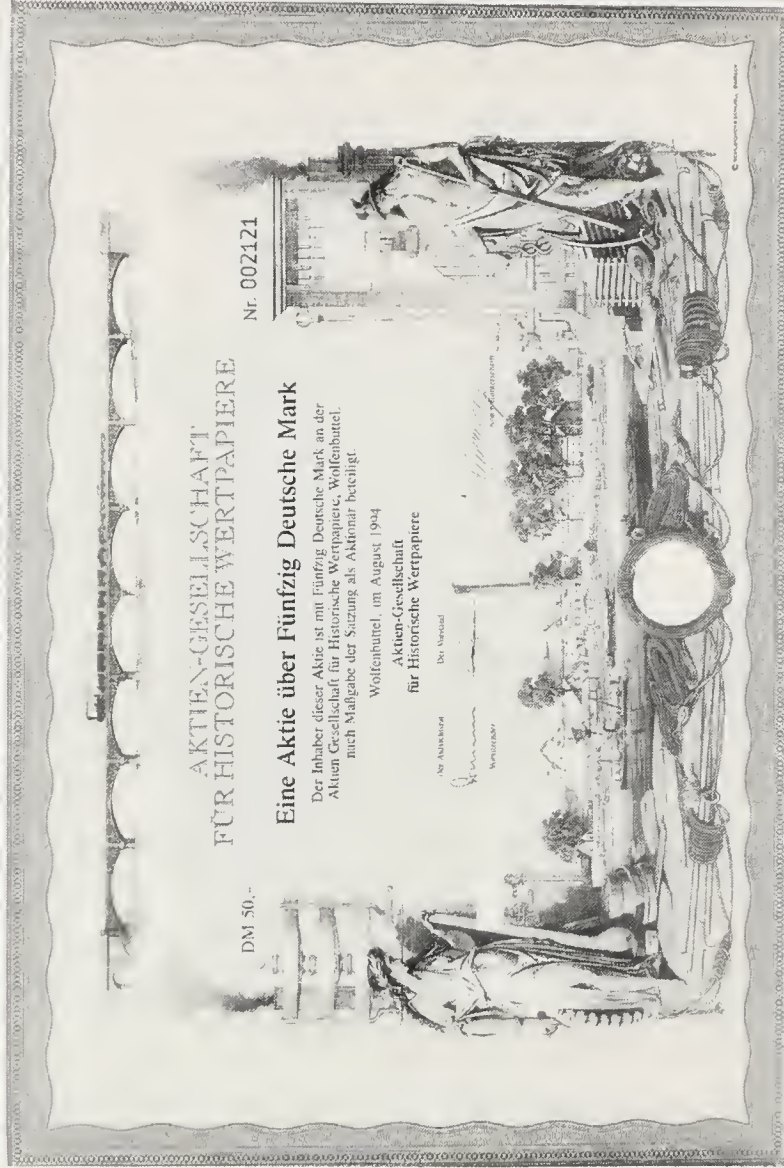
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Brazilian Railways

Dear Editor,

I am a subscriber to *Friends of Financial History* and I am most interested in railways, specifically Brazilian Railways. I am sure that you know the name of Percival Faquhar and his Brazil Rail Company and Madeira Mamoré Railway Company, Port of Pará, etc. I wonder if FFH published articles about the American tycoon; and, if not, may I suggest one? If an article was published, can you please inform me?

I am also looking for literature about Percival Faquhar, the Brazil Railway Company, and the Madeira Mamoré Railway Co. to help with research I am doing for a book I am writing. I would like to read the American side of the history.

Yours very cordially,
Luiz Reginaldo Fleury
Brazil

Dear Mr. Fleury,

I checked the FFH archive (listed at our WWWeb site at <http://www.netresource.com/maf3>) and we do not have any articles on the above subjects. Hopefully, one of our readers will have some leads. Please send information to the attention of the editor, Museum of Financial History, 26 Broadway, New York, NY 10004-1763.

Sarah E. Massey
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EVENTS CALENDAR

SEPTEMBER

- 3** International Bond and Share Society (IBSS) Meeting and Mini-auction, London (44-170-787-5659)
- 14** HP Auction & Show Bern (41-31-312-6116)
- 24** Bonhams Auction - London (44-171-393-3949)
- 20** Currency, Stocks, & Bonds—Strasburg, PA.
R.M. Smythe (800-622-1880)
- 28/29** 42nd Auction and International Collector's Meeting,
Frankfurt/Main, Germany. Freunde Historischer Wertpapiere
(49-531-28184-0)

OCTOBER

- 1** International Bond and Share Society (IBSS) Auction and Meeting,
A London venue, please phone Bruce Castlo for more information
at (44-170-787-5659)
- 5/6** Altoona Railfest '96, "150 Years of Rail Heritage",
Altoona Railroaders Museum, (814-946-0834)
- 5/6** IAB Auction and Show—Berlin (49-30-815-8465)
- 11/13** Pennsylvania Railroad Company 150th Anniversary Symposium
and Celebration. Presentations by the nation's leading scholars and
preservationists. Curators will explore the diversity of the Pennsylvania
Railroad. Strasburg, PA (717-687-8628)
- 12** Weyboda Auction—Vienna (431-512-0130)
- 15** NSFS Auction—Oslo (47-22-52-1308)
- 25** Currency, Stocks, & Bonds—St. Louis, MO.
R.M. Smythe (800-622-1880)

NOVEMBER

Scale Model of Abraham Lincoln's Funeral Train Exhibit, sponsored by the
Historical Society of Dauphin County, Harrisburg, PA. (717-233-3462)

- 5** International Bond and Share Society (IBSS) Auction and Meeting,
118 Eaton Square London SW1, at 6:00pm, (44-170-787-5659)
- 16/17** 43rd Auction and Collector's Meeting, Munich. Freunde Historischer
Wertpapiere, (49-531-28184-0)

DECEMBER

Scale Model of Abraham Lincoln's Funeral Train Exhibit, sponsored by the
Historical Society of Dauphin County, Harrisburg, PA (717-233-3462)

- 3** IBSS Christmas party and auction. A London venue, please phone
Bruce Castlo for more information at (44-170-787-5659)

Friends of Financial History is bringing these announcements
to our readers. If you know of an auction or event of interest
to historians and others interested in finance, please write to
Friends of Financial History, Sarah Massey, 26 Broadway,
New York, NY 10004-1763, or E-mail: maf3@usa.pipeline.com.

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Herreshoff

Continued from page 18

certificate #1, indicating the first of a new series.) L. Francis Herreshoff, Captain Nat's son, dates the decline of the company back to 1915. Captain Nat came home from a trip abroad, and he discovered that his brother, J.B., had made preliminary plans to build a whole fleet of torpedo boats for the Russian Navy. When the brothers formed their partnership in 1879, J.B. had promised never to over-extend the company financially. Captain Nat objected to the Russian business deal and J.B. became disheartened. A few days later, J.B. was dead of a heart attack. The trustees of J.B.'s estate decided to sell out their shares and Captain Nat sold most of his stock as well. The new stock holders consisted of former customers and none of them had the time or skill to successfully manage the business. They hired a professional manager. J.B.'s presence was sorely missed. Things went from bad to worse, and on Feb. 19, 1919 the company was dissolved by court order. In 1924, the physical plant was auctioned off. One can

begin to imagine Captain Nat's thoughts as he walked through the grounds of the Company for the last time. Though he lived to be ninety, it must have been the saddest day of his life. **FFH**

Stephen Goldsmith is Vice President of R.M. Smythe & Co. in New York City.

Editor's note: As source material, the author relied on Captain Nat Wizard of Bristol by L. Francis Herreshoff. Published 1953. The editor also thanks Carlton Pinheiro, curator of the Herreshoff Marine Museum, Bristol, RI, and Thomas Moore, of The Mariners' Museum, Newport News, VA for their help in preparing this article.



Certificate courtesy of Herreshoff Marine Museum

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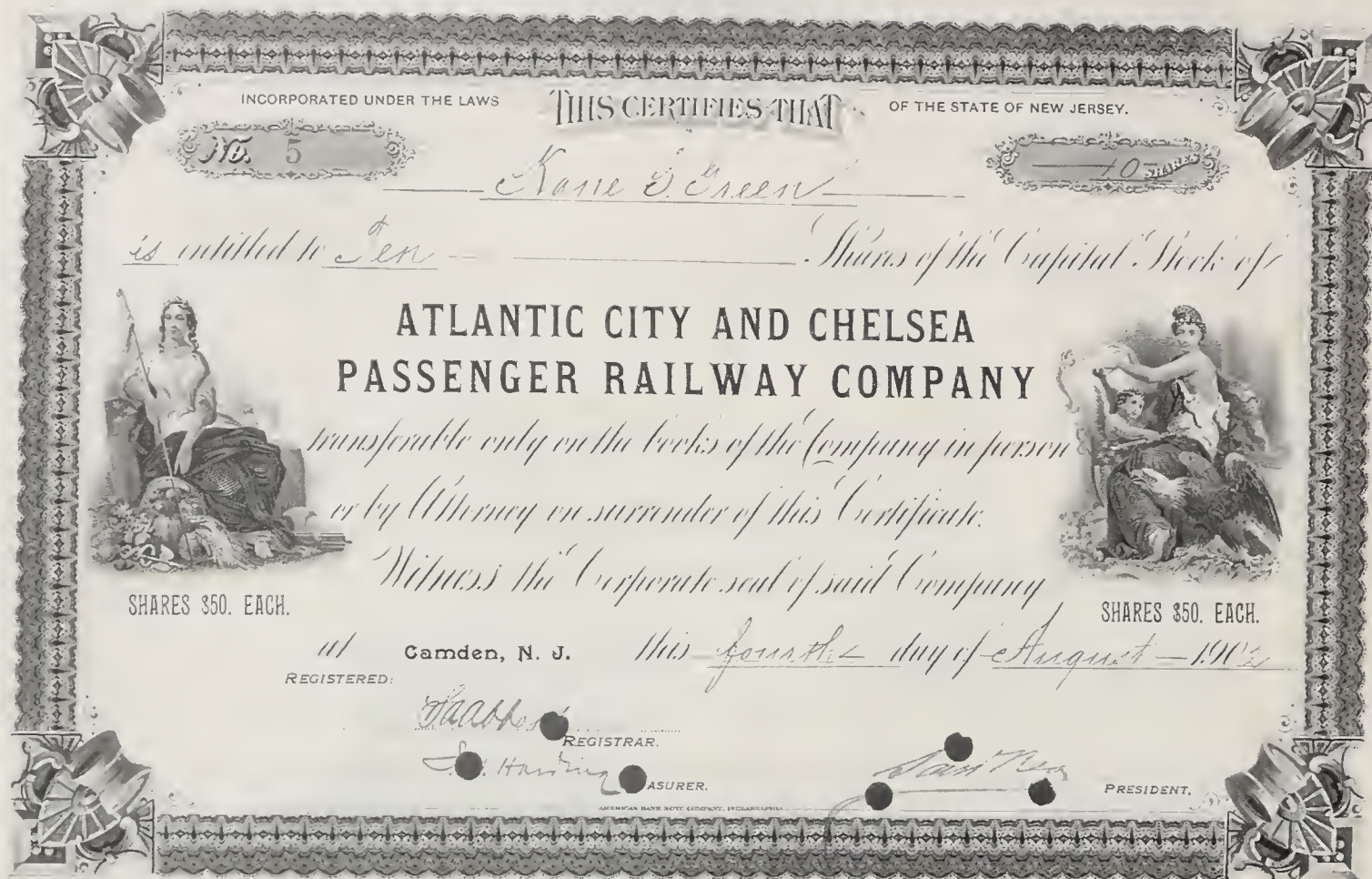
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