

October 2, 1937.

The Commission

David Saperstein, Director of Trading and Exchange Division

Status of Foreign Selling Survey

Pursuant to the direction of the Commission, on September 15, 1937, three members of the staff conferred with Charles R. Gay, President of the New York Stock Exchange and several members of the Committee on Foreign Business of the Exchange, with a view to devising a feasible method of accumulating data on foreign trading in domestic securities during the period of sharp decline commencing September 7, 1937. As a basis for discussion, we proposed that the Exchange send a questionnaire to those member firms which are known to transact the great preponderance of foreign business effected on the Exchange. The questionnaire would, in general, be designed to elicit information with respect to such matters as the sources and amount of foreign selling, the securities sold, the types of orders transmitted for execution, the time of execution, the price of execution and the details of delivery.

At the outset it was pointed out by Exchange officials that the information to be compiled would, of necessity, be incomplete in the following important respects:

(1) Customers of foreign banking and brokerage houses cannot ordinarily be identified by the New York broker. The names of customers are regarded as entirely confidential abroad. Moreover, the difficulty of tracing the identity of the foreign seller is enhanced by the fact that, when American securities are entrusted to a London broker for sale, the broker usually sells them to a London jobber who, in turn, sells them to, or through a joint arbitrage account which sells them on the New York Stock Exchange. Other permutations of this process were pointed out as illustrative of the difficulty of tracing a selling order to its ultimate source.

(There appears to be little doubt that the difficulty suggested by the Exchange officials in this respect is genuine. The Commission has heretofore endeavored to enlist the cooperation of the London Stock Exchange in identifying customers who effected transactions in American securities through London brokers and has invariably been met with the response that the Exchange and its members regard the identity of their customers as confidential. The Commission has also requested foreign banks to divulge the names of customers in particular transactions with similar response.)

(2) A large part of the business [\_\_\_\_\_] Europe is effected through American banks by their correspondents or foreign offices. Members of the Exchange would ordinarily be unable to determine whether orders received from American banks were for foreign or domestic account and hence, the data compiled through the medium of a questionnaire addressed to members would be far from complete.

(This deficiency might be met in part by a questionnaire addressed to American banks known to handle a large volume of foreign business. Such a procedure would involve the exercise of the Commission's subpoena power since American banks also regard the names of their customers as confidential. But even if the subpoena power were invoked American banks are usually in no better position to identify the ultimate customer than are American brokers.)

(3) There is no certain method of determining whether foreign selling orders originated for short account or for long account. A rule of the New York Stock Exchange prohibits its members from using the facilities of the Exchange to effect short sales in the unit of trading below the price of the last preceding sale on the Exchange. To implement this rule, the Exchange requires that, before executing any selling orders, members shall ascertain and notify their floor brokers whether such orders are for long or short account. The question as to how to apply these restrictions to European orders has been a vexatious one in view of the jobber system employed in many of the most important European markets. If a customer orders a London broker to sell American securities for his account the London broker is under no obligation to inquire whether such sale is for short or long account. Neither is the London jobber, to whom the London broker customarily sells the stock, concerned with that question. If the jobber sells the stock through a joint account maintained with a member of the New York Stock Exchange, the order which he transmits to New York is not designated as for short account and neither the jobber nor the New York broker has any reason to consider it as such. Thus, a sale which may, in fact, have been a short sale for a foreign customer sets in motion the machinery by which a long sale is ultimately effected on the New York Stock Exchange. In such cases the restrictions imposed by the Exchange on short sales are inapplicable.

On the other hand, this difficulty is not present in respect of orders transmitted through the foreign offices of member firms of the New York Stock Exchange or transmitted directly to the domestic offices of member firms. Before such orders are transmitted to the floor, the firms are required to ascertain whether they are for short account and, if so, to mark them accordingly.

In view of the difficulties inherent in the compilation of the material sought, it was determined to undertake a sampling process for the three most active days preceding the conference, viz. September 7, 10 and 13. Six of the most active stocks in which foreigners are believed to be interested were selected for sampling. Those stocks are as follows:

Anaconda Copper Mining, Common  
Chrysler Corporation, Common  
General Motors Corporation, Common  
International Nickel Co. of Canada, Ltd., Common  
New York Central R.R., Capital Stock  
U. S. Steel Corporation, Common

In order to guard against premature publicity and possible misconstruction with respect to this survey, and in order to accelerate the sampling process, the Committee on Foreign Business was requested to distribute a questionnaire confidentially among the twelve member firms who

are known to be among the most active in the transaction of foreign business. The following member firms were selected as recipients of the questionnaire:

J. S. Bache & Co.  
Dominick & Dominick  
Fenner & Beane  
Hallgarten & Co.  
H. Hentz & Co.  
Hirsch, Lilienthal & Co.  
Carl M. Loeb & Co.  
G. M.-P. Murphy & Co.  
Post & Flagg  
L. F. Rothschild & Co.  
Shields & Co.  
White, Weld & Co.

The questionnaire, which was prepared by the staff of the Commission, was designed to procure the details of significant transactions for foreign account in the designated stocks on the three days in question. Since it was felt that the execution of an order for less than 500 shares would not be likely to affect the direction of the market to any perceptible degree, and in order further to expedite the survey, it was determined to confine the scope of the questionnaire, in the first instance, to orders involving 500 shares or more. A copy of the questionnaire as distributed to the twelve member firms, is annexed hereto marked Schedule "A".

It will be noted that the questionnaire seeks information with respect to the "Country of Origin of Order." It was felt that this information would be sufficient to indicate at least whether there had been any concentration of orders from a particular country, and that if any transaction appeared to possess special significance, further effort would be made to ascertain the identity of the customer. It will also be noted that reporting firms were requested to distinguish between orders for known foreign customers, foreign arbitrage accounts and domestic customers, such as bankers, dealers or other agents who were known to be acting or who may have been acting for foreign principals. Information with respect to the delivery of securities sold was also sought in order to guard against the possibility that a sale ostensibly for long account was not followed by delivery within the ordinary course of business.

This material was to be correlated with the sales appearing on the so-called "Fitch Sheet" which records transactions in chronological sequence. From the picture so reconstructed, it was anticipated that some indication might be obtained of the effect of foreign trading upon the domestic market during critical periods.

The reports submitted by the designated firms were forwarded to the Commission and a recapitulation of the data contained therein was prepared. A copy of such recapitulation is annexed hereto, marked Schedule "B".

Analysis of the reports did not disclose sales of sufficient volume, frequency or significance in five of the six selected stocks to warrant further inquiry. It was felt, however, that

the selling in U. S. Steel Corporation common warranted further investigation. It was decided, therefore, to request the New York Stock Exchange to procure a complete report of transactions in this stock effected through all its members or member firms for foreign account during a more extended period. The Exchange rendered this request unnecessary by announcing that it had concluded to address a questionnaire to all members with respect to the details of all trades in U.S. Steel common between September 7 and September 25. In view of the fact that the data being compiled by the Exchange will include information concerning sales for long or short account and will also include the names and addresses of persons for whom orders were executed, it was decided to defer further direct inquiry with respect to foreign selling until the compilation by the Exchange has been completed. Since the Exchange requested that members respond to the questionnaire by October 1, 1937, the recapitulation of the data filed should now be in process. We have requested the Exchange to forward to us, as promptly as possible, transcripts of all transactions in U. S. Steel common effected for foreign customers, foreign arbitrage accounts and domestic banks, dealers or agents who may have been acting for foreign principals.

It is expected that these additional data will be received shortly.