

January 29, 1938

Dr. Herbert Feis  
Adviser on International Economic Affairs  
State Department  
Washington, D.C.

Dear Dr. Feis:

The Commission has given consideration to the plan (copy of which was attached to your letter of January 20th) developed by a group of European bankers for setting up an organization in London to facilitate trading in Europe in the shares of American corporations.

Giving weight to the manifold factors involved, the Commission feels that the formation of a company which would issue its own bearer certificates against the deposit of American stocks is undesirable from its point of view. In coming to this conclusion, no account has been taken of objections to such an organization which, in our opinion, might well be raised from the point of view of fiscal or general monetary policy.

We feel that the basic idea which apparently is guiding the organizers in their plans is one which runs entirely counter to the implicit or explicit purposes of the legislation on trading in securities enacted in this country since 1933. The operation of a nominee company for American securities held by European investors will increase the volume of trading in American securities in Europe and will correspondingly decrease the volume of trading done for the account of foreigners on American exchanges or over the counter markets. Such a tendency, if it progresses far enough, may seriously impair the representative character of the New York Stock Exchange -- and to a much smaller extent that of other national securities exchanges -- and may jeopardize the satisfactory exercise of the supervisory functions over exchange trading which are vested in the Commission. Also, such a tendency would curtail the commission income of American bankers and brokers to benefit of their foreign competitors.

The sponsors themselves in their memorandum well summarize what appears from the Commission's point of view to be the least desirable feature of the plan, viz., that it will "create a wide European market in such shares which would be, to some extent at least, independent of the American... securities markets..." Of the sponsors' further assertions that the operation of such a nominee organization will cushion our markets against the impact of foreign trading and would even exercise a stabilizing influence on them, we are entirely unconvinced. The statement that the market in American securities abroad can be "independent" to some extent of the American securities market is naïve. If it

were at all conceivable, it would be highly undesirable. It could only mean the injection of artificial forces in the market of American securities in foreign centers with its inescapable repercussions sooner or later on the American market, and rather sooner than later, because of the existence of arbitrage.

A spread of the use of nominees by owners of foreign certificates of deposit of American securities will add further difficulties to the establishment of the identity of their beneficial holders, as well as to any attempt to subject such holders in their trading and other activities in American securities. It is well conceivable, to cite a few instances, that the development of such a nominee organization might facilitate short selling of American securities on European exchanges, thus endangering any measures which the Commission may take. It may effectively break down margin regulations and it may greatly facilitate manipulative practices which could not fail having an impact on the American market through arbitrage operations.

The Commission also feels that -- apart from the objections based on a possible impairment of its supervisory and regulatory activities -- any organization which at the present time tends to increase foreign ownership in American securities is undesirable in the public interest. Clearly with the present distribution of capital and the present differences in internal interest rates throughout the world, there is no reason why a flow of capital into the United States should not be discouraged. We do not particularly favor a condition whereby an increasing amount of American securities held abroad may be dumped, because of political exigencies, into the New York market, particularly as under the plan they could be instantly mobilized, if and when the emergencies of foreign governments make it advisable.

We finally would like to mention a further undesirable feature of the contemplated nominee organization. Since most of the holders of its bearer certificates will not exercise their voting rights, the nominee organization in fact will be in a position to vote the great majority of the stocks for which it has issued certificates. European holdings being quite considerable in a number of large American corporations, the nominee organization through a concentration of these votes might become an important factor in the conduct of the affair of some American corporations, particularly those with diffused stock ownership. We do view such outside pressure on management as making sound national policy.

To summarize, the Commission feels that the proposed scheme is contrary to the public interests of our economy from every point of view and will have an unstabilizing influence on our markets. It will also mean a loss of commission to American brokers, transfer fees to American trust companies, etc. to the benefit of the foreign banks and foreign brokers.

We shall appreciate it if, in accordance with the procedure suggested in your letter, you will make known our position to the sponsors of this plan through the American embassy in Paris in whatever form you deem appropriate. Inasmuch as your original communication to us states that you were transmitting a copy of the dispatch and memorandum to the Treasury Department, the Board of Governors of the Federal Reserve System, and the Department of Commerce, we are taking the liberty of sending a copy of this communication to each of them.

Yours faithfully,

William O. Douglas  
Chairman.