

Review by Members of the Staff of the
Trading and Exchange Division of
“Report on the London Stock Exchange”
and “Report on Foreign Dealings in
American Securities”

The two reports by Mr. Yandell, based on his investigations abroad in the summer of 1938, have been reviewed by members of the staff of the Division in the light of the purposes which the staff understood that the Commission intended to accomplish by sending a representative to Europe. These purposes were discussed by members of the staff with Mr. Yandell prior to his departure and were further elaborated in correspondence with him.

The principal purposes of Mr. Yandell's projects were understood to be the following:

1. To disclose aspects of the operation and practices of foreign markets which were not described in the published literature on the subject and not, theretofore, available to the Commission in another form.
2. To study and report on aspects of international arbitrage which could not be investigated from here, such as the relative amount of dealings in London transferred to our markets by arbitrageurs and the extent of short selling in contravention of the Commission's rules effected through the medium of international arbitrage.
3. To provide data indicative of the effect, if any, of regulations promulgated by the Commission, such as margin requirements, short selling rules, and of the Commission's supervision of the security markets, with particular reference to specific instances of the evasion of such regulations by nationals dealing through European brokers and dealers.
4. To obtain and assemble statistics on the volume of dealings in American securities (a) by nationals in European markets, and (b) by foreigners, both in Europe and on national securities exchanges.
5. To investigate and report on several aspects of the English underwriting and distribution methods not heretofore covered by the Commission's studies on the subject.

In his reports of May 27, 1938 and June 24, 1938, Mr. Yandell has given a thorough description of the operation of the London Stock Exchange. In his later report on Foreign Dealings in American Securities he has also described in detail the London as well as the French, Swiss and Dutch sources of securities dealings. In this same report he has given an historical account of international capital movements. Much of the information on foreign

exchanges and on international capital movements was already available to the staff of the Division from the books and pamphlets on these subjects with which Mr. Yandell was supplied before his departure.

Several handicaps to which Mr. Yandell was subjected may be mentioned before reviewing the results of his project. The fact that Mr. Yandell was unfamiliar not only with the operation of the London and other foreign exchanges but also with the New York and other national securities exchanges should be given consideration in reviewing the conclusions and recommendations which he suggests with respect to the regulation and supervision of our national securities exchanges. Mr. Yandell found the same difficulties which other representatives of the Commission had encountered and which he himself repeatedly refers to, to wit, the customary reticence of Europeans in discussing financial matters. Largely because of this reticence, Mr. Yandell was unable to obtain actual instances or assemble statistics relative to the subject of his discussion and was forced to rely on impressions which he gathered in the course of his conversations with brokers, dealers, bankers and economists. Although Mr. Yandell has not identified his sources, it is assumed that his discussions were with persons of knowledge and authority.

No doubt Mr. Yandell encountered diverse opinions which perhaps accounts for what appear to be conflicting statements in his reports. Mr. Yandell has chosen to present his impressions of the opinions which he gathered, rather than to relate the different thoughts on each subject as he received them.

With these methodological characteristics in mind, the results of Mr. Yandell's project have been reviewed in the light of the principal purposes which were set forth above.

1. The development and outstanding characteristics of the London Stock Exchange are described in the report on the subject as well as in the more general report. The latter includes brief descriptions, also, of the background and trading methods employed in France, Holland and Switzerland.

In the treatment of the London Exchange, emphasis has been placed upon the several methods which differ most widely from those employed in the New York market. A summary is given of the strength and weaknesses of the jobber system, with the implied conclusion that the system would not work in the New York markets.

There are also described the term settlement employed in London and the methods of delivery, and the conclusion is likewise reached that these practices would not be applicable to our domestic securities business. The inapplicability of the London trading methods to American markets is attributed largely to the differences in the temperament of the English as compared with Americans, particularly the speculative tendencies of the latter. Brief reference is also made to the lower rates of margin employed in London as compared with those employed in this country.

While these comments and descriptions provide a concise summary of the subjects covered, they are of a general nature and therefore do not disclose details of the

operations and practices of the various European exchanges which the Commission was desirous of obtaining.

2. The subject of arbitrage was not included in Mr. Yandell's reports. However, in response to Mr. Purcell's cabled request for more detail concerning the conduct of international arbitrage from the London end, information was collected and transmitted in Mr. Yandell's letter of June 27, 1938. This information was primarily descriptive and does not seem to add any information to that available in the published treatises on the subject.

3. In the course of the reports, there are frequent references by implication and direct to irksome regulatory restrictions and to the effect which such restrictions have had on our domestic security markets. In contrast with our regulated markets, the London Stock Exchange is described as a self-governing organization with the result that the markets in London are often far more liquid than in New York, even for American securities. The statement is frequently made that this disparity in liquidity has caused the diversion of a substantial amount of business from the New York to the London exchanges, and the view is expressed that this diversion to the London market is expected to continue until freedom and liquidity are restored to the New York market through the removal of unsound taxes and irksome regulatory restrictions. Among the restrictions generally regarded as most irksome and damaging in their effect on American security markets are those against short selling, legitimate pool operations, and the professional element in general, and the limitation upon margin accounts.

Contradictory, however, is the statement elsewhere that the amount of business which has been diverted is more talked of than actual. In addition to the irksome regulatory restrictions, the capital gains tax and the high withholding rate are attributed as causing a diversion of business to London. Statements to this effect have frequently been made and a check on such statements was one of the principal purposes of Mr. Yandell's project. However, there has not been added to the Commission's information on this subject any actual instance of a diversion of business nor any figures to substantiate these rumors and impressions.

4. Early in the course of the investigation, Mr. Yandell concluded that no statistical data were available abroad either as to the size of foreign holdings of American securities or as to the volume of trading on European exchanges. On the basis of rough approximations and discussions with persons in the business, estimates are given of a range of volume from time to time on the London, Amsterdam and Zurich Stock Exchanges. These may be summarized from the reports as follows:

<u>Exchange</u>	<u>Approximate No. of American Issues listed or traded in</u>	<u>Shs. traded on extremely inactive Days</u>	<u>Shs. traded on very active days</u>	
London	80-100 stocks	20,000	500,000	
Amsterdam	280 stocks	---	225,000	
	115 bonds	---	---	
Zurich	7 stocks	---	25,000	(expected)
Paris	---	("Practically non-existent")		

Aside from these rough approximations, however, there are no statistical data nor reliable estimates of the actual volume of dealings over a given period.

5. Under date of June 13, Mr. Purcell requested a number of particulars with respect to British underwriting and distribution methods. Mr. Yandell has not as yet submitted his report on this subject.

Although no formal conclusions are reached, there are found in the texts of the two reports a number of rather far-reaching conclusions relative to American legislation, as well as suggestions for the amendment of Commission regulations and of the Securities Exchange Act of 1934. There was, for example, considerable discussion of the injustice of the capital gains tax and other features of the tax system, matters which have little bearing upon the subject of the investigation. For the most part, these conclusions are based upon hearsay and opinion and are entirely lacking in supporting data or information of a specific nature.

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