

MEMORANDUM

June 27, 1941

TO: THE COMMISSION
FROM: Harold H. Neff

This memorandum is prepared to present certain points in regard to the memorandum to the Commission under date of May 21, 1941, by Mr. Purcell, Mr. Louchheim, and Mr. Sheridan.

In the first place, it would not seem to me that the purpose of publishing the report would be quite as is expressed in the above-mentioned memorandum. It is there stated that the purpose would be "primarily to demonstrate that the London Stock Exchange was more extensively regulated than our securities markets, to refute Mr. Yandell's conclusions, and to indicate the advantages of the London jobber system over the New York specialist system."

In fact, regarding the first of the points, the report did not attempt to establish that; for it cannot be fairly said that the London Stock Exchange is more extensively regulated than our own markets, if there is meant thereby the quantity of regulation, rather than the deep-cutting effect of organic structure. The difference is that, organically, the limitations on trading are immeasurably greater on the London Stock Exchange than on the New York Stock Exchange.

As to Mr. Yandell, it is my personal opinion that his fact conclusions are essentially correct -- for example, his estimate of volume in the London "American Market", which I believe to be about right,

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My disagreement with him lies in the conclusions which he draws as to the remedies to be applied.

But, it seems to me, the purpose of publishing the report, and its utility, can best be looked at from the standpoint of its stated objective: the study of the trading in American securities on foreign markets, and the remedies that might be applied as correctives.

After much and arduous work, I am convinced that the London "American Market" has been far more important, both in itself and in its effect on our market, than has been commonly assumed. The purpose of the report is to show that this has been true, and to propose a solution to the consequences thereof. And, it may be noted, the importance of this problem is even recognized in the Securities Exchange Act itself, wherein, by Section 30, the Commission was given express power concerning the subject-matter of trading in American securities on foreign markets. It was conceived even at the time of the adoption of the statute that regulation of this market could be, at least in some measure, frustrated by trading abroad. And former Chairman Kennedy -- who has had great experience in trading -- informed me that he had always thought that our market regulation would be taken for a ride by the trading abroad. It seems to me that the problem can be met only by frankly facing it, for it cannot be avoided.

The solution I propose is that, through the control of "undoing" in this market, methods can be evolved by which precise and complete data can be obtained, and a modus vivendi created, to prevent the improper evasion of American regulation. The report, therefore, does not so much pretend to give final answers, as to raise questions, showing that further action is necessary.

A preliminary study of the operations of the British market itself is presented only to enable one clearly to understand, on the one hand, the position of the London "American Market" in London, and, secondly, the relationship of that market to New York. Without such an exposition it is impossible to come to any clear comprehension of the problem of the report, i.e. the London trading in American securities (cf. pp. 146-150, p. 225, p. 175 of the Report, for example). Indeed, in my judgment, it was due to this fact that previous investigators, for example, Mr. Vandell, and as a further example, Mr. Appel in his report, came to conclusions which, in the writer's opinion, are not fully correct. It would not be possible to eliminate the first part of the study, as is suggested later in the above-mentioned memorandum, without completely destroying its purpose and effect.

Incidentally to giving the background necessary to an understanding of the basic problem of the report, the jobber system was described, not primarily as a thing in itself, but to lay the basis for an understanding of the function of the jobber in the London "American Market". In so doing, the apparent advantages and disadvantages of the jobber system were clearly pointed out. No attempt was made to appraise the system itself nor to adjudge in any way whether such a system should be introduced in this country. That, of course, is a very complex problem and one quite beyond the compass of this report.

It is intimated that I did not stay abroad perhaps long enough to complete the assignment. I gravely doubt, however, whether that is correct. In the first place, I had had long experience with foreign matters, many of which directly bore upon the questions in hand, so that in fact many of the problems attacked were not novel for me. Since seven months, however, may

seen a short time to have stayed there, I should like to set forth briefly some of my previous experience, as throwing light upon my ability to make judgments in regard to the questions covered.

My experience with foreign matters prior to going to London for the Commission is, briefly, as follows.

I speak all of the major languages of Europe, and studied both in France and in Germany. I also have an understanding of the European law and practices, through much study and practical experience.

I served about eighteen months in Europe during the World War, and was then with the Allied Dye & Chemical, working principally in the chemical trading department. Thereafter I was in the chemical export and import business in New York, working actively with a man reputed to be the best chemical trader in New York. I then devoted three years practically exclusively to questions coming from the Foreign Department of the Equitable Trust Company of New York, which at that time had the largest foreign exchange business in New York. These questions involved transactions in all parts of the world. I believe that from this varying experience in New York, I got an understanding of the techniques of trading in general and foreign trading particularly. For example, I prepared many of the basic forms used by the bank, such as commodity letters of credit.

I then taught international and private international law, and bills, notes and checks at the University of Virginia for several years.

Thereupon, I was representative in Europe for one of the large New York law firms, handling while there much business for Stock Exchange members. Thus, an important case I had was a large collection against Sir Charles Valadier, one of the most distinguished Parisian dentists, arising from the debit balance on a large margin account with a New York Stock Exchange member firm, which, for the purposes of the case, I had thoroughly to analyze. I did while there all

the legal work for the Parisian office of Hayden, Stone & Company. I also worked on transactions, some of them very important, for Paine Weber & Company, Lehman Bros., Hallgarten & Company, etc.

Thereafter I represented the Irving Trust Company in Europe, under power of attorney, in the collection of assets belonging to the American subsidiary of International Match Corporation. This work gave me a direct insight into the operations from Europe on this market. For example, in Stockholm I examined all the telegrams exchanged between Kreuger and Donald Durant of Lee Higginson & Co., giving directions for operations on American markets, designed to hold up the collapse of the Kreuger securities just prior to Kreuger's downfall. I spent, at that time, some four months in Zurich, in daily conference with the Credit Suisse, probably the most important Swiss factor in the securities business, concerning some millions of dollars of securities of companies all over Europe. I was also for a time director of the Continental Aktiengesellschaft, one of the most important Kreuger European holding companies.

Thereafter I was Special Adviser to the State Department on the resumption of trade with Russia, and was for some years a director of the Export-Import Bank.

And by the Commission I was charged with the drafting of the regulations for the registration of listed securities, including the registration of the great quantity of securities of foreign governments and other foreign issuers. At that time many people, including the then President and other officials of the New York Stock Exchange, thought that registration of the foreign securities could not be accomplished, and they appeared specially before the Commission to insist that exemption be granted. The registration was accomplished, however, without any hitch.

It seems to me that the above background of experience must be borne in mind in considering the length of my stay in London on the particular assignment of the Commission.

And however long one might stay in London, there would be no ability to get exact statistical data; for example, "volume, price, course of prices, amount of credit involved and similar matters." No such current statistical information is available to any one on the British market itself. What information of such character is available I have referred to in the report; for example, that contained in the Macmillan Report, specially assembled.

I do not, of course, contest the value of statistical information, if it could be obtained. But there is no way to get it in the London market, since volume is not reported, nor other similar matters. In the absence thereof, the statements of competent persons have to be taken, since there is no other source of proof. The information obtained by personal interviews is, however, it seems to me, entitled to much more weight than the above-mentioned memorandum indicates.

In the first place, the parties interviewed were of high competence. In the second place, there was a practically complete uniformity in their statements. In the third place, they were not interested in the sense of persons appearing before the Commission asking for a course of action. The persons in question did not know the purpose of my inquiry, nor to what conclusions it might lead. There was no issue. And many of the statements were rather against the interests of the persons making them. For example, persons in the London "American Market", it would seem to me, would not see any interest in saying that the London "American Market" was more speculative in its character than the general London market, nor in saying that the greater bulk of trading in the London "American Market" was purely speculative in character. And when the European representative of Hentz & Company, which, of all the American houses,

handles the largest direct business from Europe, stated that practically all the business coming to him and the various offices under his direction was speculative business, I don't think that his statement can be deemed to have been "interested". It was, in fact, against his interest and therefore, even if hearsay, would, on general principles, be admissible.

Further, the statements made have practically universally been to the same effect, whether made by persons in the London "American Market" or by persons in our own market. The statements of these persons ~~having no interest~~ are entitled to great weight in the absence of proof to the contrary; all the more so since the purpose of the report is to state questions and to show the importance of finding a solution, rather than to make proof statistically. And as to statistical proof, the report, it seems to me, is not nearly so deficient as is indicated.

The primary question, for which statistics would be desired, is the volume in American trading on the London Stock Exchange. Mr. Yandell made an exhaustive study of this matter, by obtaining figures directly from the persons active in the London "American Market", collating and assembling them. I have no reason to question that the figures which he got are correct. Indeed, I think he did a very excellent job in that regard.

I, personally, did not repeat this work, since it had just been done by Mr. Yandell, and it was clear that, since Mr. Yandell, on behalf of the Commission, had just received such large cooperation from the London "American Market" as to his figures, I should not repeat the same work within such a short period of time. And, in this regard, I think I should point out that the wall of secrecy on the part of the British in the London "American Market" was not quite as impenetrable as is intimated in the above memorandum. For me, the people there were most cooperative and frank in their answers to all inquiries;

indeed, more than frank and courteous. However, they could not of course give exact volume and other such data because such statistical data, as stated above, is never assembled. It is only through working out a modus vivendi with the London market, the accomplishment of which is the objective of the report, that real statistical information could ever be obtained.

And, as to the general character of the London market, authoritative sources in the English literature on the subject have been cited in support of practically all facts set forth. Certainly these writings, which are quoted or cited, are hardly to be deemed to be made by interested witnesses. In point of fact, a number of the documents are by persons who are critical of British financial institutions, and some are government publications.

The point is made that these documents have been cited by others. Undoubtedly some of them have been in part, but in no other writing have they been focused on the issue in question, namely, trading in American securities and the relationship of the London techniques thereto. Mr. Vandell's report, for example, in no way fully goes into the pertinent English literature. It is on that account, in my opinion, that his original recommendations were incorrect, as he did not get to understand the relationship of the London "American Market" to the general English market.

The point is made that a limitation of the report is the fact that it is dated. But, it seems to me, this rather militates in favor of its present publication, as Mr. Douglas said when he first suggested that the report be written.

There is no doubt that for the time being the whole question of American trading in London is academic. That would permit, therefore, the report to receive general consideration, while the matter is not a live and active one from a trading standpoint. This would minimize any possible friction deriving from its publication.

But the questions discussed in the report are not academic from any long-range point of view. There is certainly no reason to assume that the capital markets of Europe are going to be destroyed in this war, any more than they were in the last one. And, from present indications, there is no reason to believe that the securities markets of the world will not basically return, in the absence of governmental action, to their old method of operation, upon the cessation of hostilities, as was true in the last war. Indeed, the stock exchanges of Continental occupied Europe have already been re-opened and are in operation; for example, in Holland and France. The interest of the Europeans in American securities has now lasted for over a century, with ups and downs. The successive wars and disturbances have not in any way destroyed this market. Indeed, the present European holdings in American assets are still of enormous proportions, in terms of billions of dollars. And much of that is now "frozen", so that it cannot be re-patriated.

There is therefore no more reason to assume that the London "American Market" will not be recreated upon the cessation of hostilities than there was at the end of the last war. In fact, the London "American Market" has had a life about as long as the New York Stock Exchange itself, and, at times, its role has been of great significance. One of the first non-government securities traded on the London Stock Exchange was an American one. And since the London "American Market" has undoubtedly, to a very great degree, been purely speculative in character, the building up of a large English portfolio would not necessarily be a prerequisite for the recreation of the "American Market" upon the cessation of hostilities.

The publication of the report, and the "mooting" of the questions therein involved, during a time when there is temporarily an inactive market, would, in my judgment, be the very time when the matter can best be broached.

Further, the report is not dated quite as precisely as the above memorandum indicates. It speaks of the time preceding the present war, which, when the war is over, will be of prime interest, if there is to be accomplished the declared policy of this government and that of England, to the effect that we will not return to the old international commercial and financial order. How can that be done without a knowledge of what then existed? Certainly institutions can be reexamined in their basic operation only in the light of the experience of the past. However the international securities markets may be reconstructed after the termination of hostilities, certainly any light cast upon their previous structure is important for the determination of the policies then to be adopted. And, it may be noted, leading economists in Europe are of the expressed belief that one of the contributing causes to the economic confusion existing in the years 1929-40 was the overliquidity of the stock exchanges and the overfacility of means by which current wealth could be transported, as it were instantaneously, from one country to another, thus creating large perturbations both to the country losing capital and to the country receiving it. As confirmation of this may be mentioned the enormous movements of gold to this country, as set forth in the Bulletins of the Federal Reserve Bank; and further the "hot money" difficulties, factors bearing upon which, it would seem, can best be studied when the question itself is not of immediate urgency. Certainly this country cannot permanently have a system, which has been largely the case since 1920, whereby it not only has a large credit, internationally, on current account, but in addition drains the current outside world capital for investment here (see Balances of International Payments).

Therefore, even though some of the matters in the report may, at the present time, seem to be of the past, they merit the best of present consideration; for it is not seen how proper remedies can be proposed without study and consideration of the situation that has existed.

Certainly this report shows that the foreign trading in American securities has been an element of importance in our own market, and leads fairly to the assumption that, in addition to the large movements of capital on balance, there has been a large amount of trading of a purely speculative character. The question may well be presented, therefore, as to whether definite steps should not be taken to prevent, or in any event mitigate, a recurrence.

COMPARISON OF LONDON AND NEW YORK STOCK EXCHANGES

The statement is made: "Questions relating specifically to a description of the British market will be passed over although there are some doubts as to the accuracy of the opinions expressed and to the completeness and justice of the description itself."

No errors are pointed out, however. The writer admits that naturally no two persons would describe the same thing in the same terms. There is always involved selection and presentation, although every effort has been made to obtain a completely objective exactitude in the present report.

There can, indeed, be no doubt as to the major facts set forth in the comparison between the two markets: (1) a much greater percentage of transactions on the London Stock Exchange are in government securities and debt securities of other issuers, than is true in New York; (2) the means available for quick-turn speculation are much greater on the New York Stock Exchange than in London; (3) trading information is very much less available in London than in New York; (4) the segregation of function is much greater in London than in New York; (5) the limitations on trading are much greater in London than in New York, including a much higher cost to do business; (6) finally, the stock exchange prices are much more stable in London than in New York.

These matters are clearly established, and would seem to be the important differences, from which derive others, themselves only of subsidiary character.

The doubt, however, is expressed as to whether the London Stock Exchange should be compared with the New York Stock Exchange, rather than with all of the markets in this country. But the purpose of the study was to consider the trading in American securities on the British market. This trading is limited practically exclusively to securities listed on the New York Stock Exchange. Indeed, the general foreign interest is in securities on the big board, and not those elsewhere traded. Thus, it is fair to say that, if the totality of British trading in American securities is considered, the over-the-counter and other exchange markets in this country may, for all practical purposes, be eliminated. This is apparent from the statistical studies made by the Department of Commerce of foreign investments in the United States, which show that foreigners' interest in American securities is limited, practically completely, to securities listed on the New York Stock Exchange.

There was therefore no reason, within the assigned topic of the report, to enter into a general comparison of the London techniques with those existing in the smaller exchanges and in the over-the-counter markets in this country. That would have made a cumbersome and unwieldy subject-matter, without interest to the question in hand.

And certainly no intelligent study could be made of the trading in London in American securities, and the relation of that trading to the operations in this country, unless there were compared the techniques of trading in the two markets in which occurring, namely the London Stock Exchange and the New York Stock Exchange. Mention, however, is made of the over-the-counter markets in the two countries, when pertinent to the issue. To repeat, an understanding of the different procedures of the London Stock Exchange, as contrasted with the New York Stock Exchange, is necessary to "locate" trading in Americans there. The fact that the over-the-counter markets in this country partake of certain

characteristics of the London Stock Exchange still would not militate against the necessity of showing those procedures of the London Stock Exchange, as necessary to an understanding of the trading in American securities there.

Doubtless, as is indicated in the above memorandum, the over-the-counter markets in this country are less speculative in character than the New York Stock Exchange; but that, it seems, is not contraverted by the report. It is made abundantly clear that whatever is said has regard to the New York Stock Exchange, and not to the other American markets, unless specifically mentioned.

It occurs to me, further, that criticism of the compass of the report is hardly fair to me, because the extent and nature of the ground covered by the report has been repeatedly approved.

In the first place, before undertaking the great amount of labor involved in its preparation, a complete outline was submitted containing all the points that are presently set forth in the report. This outline was approved when I was asked to prepare the report. Further, after the report was finished, I was authorized by the Commission in November of last year to revise it for publication, and at that time the suggestion was made that I should introduce further comparisons with the New York Stock Exchange. And when the report was last before the Commission, it was approved, as I understood it, except for pointing up and to give it more "kick", as former Chairman Frank said. Certainly no point was made of extending its compass -- or of pruning it down to a skeleton, as later suggested in the above memorandum.

It is said that I have an irresistible tendency to criticize New York procedures, and to congratulate the London procedures. I do not know to what is adverted. My only purpose was to set forth the facts as they exist, and within my assignment, to state what seemed to be the consequences. For example, it cannot be deemed critical to point out the perfections of the New York market

for speculative purposes, and the lack of perfection in London, because those are the facts. Nor is it critical to point out that New York prices fluctuate much more violently than the London ones, because that is so. It seems to me that statements of such facts do not involve criticism. Indeed, I made every effort, insofar as I could, to describe the operations of both markets in the language of other writers, so as to obviate any suggestion of bias. Thus, for example, the description of the tape on the New York Stock Exchange is given by quotations from people on the "Street", in extenso, with all the advantages claimed therefor (see pp. 91-93, 95).

Suggestion is made that I should not compare the rules and regulations of the two exchanges unless I can give the degree and measure of enforcement. Of course, there could be no doubt that a rule which is not adhered to is of no consequence. The rules of the London Stock Exchange, however, are so brief in general content, and so clear and precise in their meaning, that I doubt whether there is as little general observance as the memorandum seems to indicate. Certainly, the most important rules of the London Stock Exchange, insofar as the conduct of business is concerned, are, for all practical purposes, self-enforcing, namely those imposing the segregation of members of the exchange from the rest of the business community, those imposing the segregation of broker and jobber, and those prohibiting advertising and circularization other than to one's clients. These rules, since any breach would be open to the world, could hardly be violated to any degree.

Another rule mentioned is that whereby speculative business of employees of any kind requires the written consent of the employer. Although this rule may well be violated from time to time, I still have no doubt that it serves as a great deterrent. And further, the fact that the London Stock Exchange publicly declares and takes the position that such a type of business should be done only

with the written consent of the employer is a fact in itself of importance, as showing the difference in attitude of the two markets in regard to this vital question.

The implication is made that I paint the London Stock Exchange in too rosy a color. I certainly have no idea that the London Stock Exchange is a place of pure virtue. The memoranda which I submitted along with the report, as its support, clearly show that. But it must be borne in mind that the language used in regard to a foreign exchange must necessarily have to be discreet. Insofar as possible, therefore, I put my description of the black parts of the English market in the language of writers concerning that market. But throughout the report there is an abundance of statements from which the conclusion is clear that the London market is no paradise.

Thus I state on page 5 that opinion exists in London that the self-control by the stock exchange of itself has not been sufficient. And, on page 18, I mention that the Stock Exchange has been called "a complete system of knavery, etc.", and that a jobber has been called "a low wretch", and that "many worthless securities were brought out and listed on the exchange in the years prior to 1929"; and on page 19 that "there is opinion these amendments to the Companies Act were not sufficiently effective" and that in other regards further reforms were necessary. I point out, on page 3, that there is criticism in London of the English Companies Act. On page 4 I point out that accounting requirements are very loose, etc. For unpleasant features of the London market, see also, for example, page 109 of the report, and footnotes on pages 55, 56, and 57 of the footnotes. Compare pages 227-237 where I set forth, in the language of authoritative English commentators, a description of manipulation on the London market. And I state inter alia, on page 227: "The antiquity of these cases and the rarity of later reported decisions suggests that, although manipulation has been frowned upon by British law,

there has been no effective enforcement." And throughout the report I mention the operations of the "shops". (See, for example, p. 158). It does not seem to me, therefore, that it is fair to say that I have attempted to paint the London Stock Exchange in any particularly rosy light. What I do say, and as to that there is no possibility of contesting the facts, is that organically the mechanisms of the London Stock Exchange (for example the absence of the tape and branch offices) limit to a severe degree, in comparison with the New York Stock Exchange, the modalities and methods of trading.

The point is made that the members of the London exchange are not subject to scrutiny as are the members of the New York Stock Exchange. It seems to me that that is apparent from my general description; thus I indicate, on page 5, that the self-control by the stock exchange has not been sufficiently effective, citing authority for the statement that the London Stock Exchange is frequently characterized by British commentators as a "private club." And I point out specifically, for example, that the jobber is not subjected to the surveillance provided by our statutes (see page 239). And I indicate in several places that the London Stock Exchange members do not have to furnish financial statements to anyone. But, on the other hand, it must be borne in mind that the London Stock Exchange members are not engaged in a variety of activities, as here, nor do they have extended organizations. They constitute a close and integrated body. Members cannot be in partnership with people who are not actively engaged in stock exchange business. Staffs are small. There are no branch offices. Enterprises are small. Everybody knows everybody, and they meet every day on the floor of the exchange. The Committee itself is actively engaged on the floor and must be aware of the general morale and conduct of their members; and the Committee meets daily, I believe.

THE JOBBER SYSTEM

I do not conceive that it was the function of the report to prove that the "jobber system" is better than the auction system on the New York Stock Exchange. The purpose was merely to objectively describe the London system, which, I think, is fairly done.

Whether the auction system in this country should or should not exist is quite another question. Certainly the report does not imply that institutions can be transferred from one country to another. In fact, it seems to me, one utility of the report may be to show that the structure of the British Stock Exchange is an organic whole, and that the jobber system, as such, could not exist on our market without other organic differences. The British jobbers are certainly of the opinion that you cannot have the jobber system, at least as they have it, if you have price publicity. It does not follow therefrom that we should introduce the jobber system and abolish price publicity, because such a solution would depend upon factors local to this market. Indeed, further, the whole English system of original distribution of securities is tied up organically with the jobber system.

And, as to the disadvantages of the jobber system, I make clear in the report that there is opinion in London that the jobber system entails a cost which is disproportionate to the services rendered, because of the wideness of the spread. Indeed, a long example of a costly deal is set forth. And it is pointed out that, because of the London system, the customer has to rely very much more on the integrity of his broker than is true in this country. On the other hand, as to New York, every effort was made to describe the purported advantages of the New York system in the free language of the street.

Although I could not, of course, attempt to appraise the utility of the jobber system as measured against its cost -- and this is clearly stated -- the attempt was made to point out a priori, which clearly was within the compass of the study, how the trading procedure in London does seem to contribute to price stability. All the other facts bearing upon such price stability, which occurred to the writer, were likewise set forth.

Certainly, in view of the present controversies existing concerning the status of business in New York, the procedures of an institution so close to us as the London Stock Exchange should be of interest in a general consideration of the problems on our market and its future. I am certain that many people on the Street would be much interested, for example, in the exposition which I have made. In that regard it would seem of direct interest to current problems thus to have indicated the difficulties involved in the introduction of a dealer exchange system to this market; the report shows that the problem is not as simple as might appear at first blush. For there can be no doubt that price and volume publicity on this market, combined with the absence of the jobber's turn and the presence of branch brokerage offices, does, to a very large degree, contribute to the complexion of this market, in contrast with London, and must organically affect the whole financial system.

That does not mean, however, that any description of the London system should be taken as proof that the London system should be introduced in this country or anywhere else. Such a description could only be provocative and not probative, because of the complexity of the organisms of great financial markets. In fact, as is brought out in the report, diverse factors operate, so that the study of the institutions of another country should serve rather to raise questions, and to suggest possible solutions, than to show that those solutions are correct.

It may be said, however, that in any appraisal of the utility of price disclosure as obtained through the ticker tape, and the means thereby given the customer to check his particular transaction, there must be considered how effectively thereby is created an instrumentality for quick-turn speculation. It would seem clear that the New York Stock Exchange is the greatest and most perfected mechanism for quick-turn speculation that the world has ever seen. And that would be true even if all artificial manipulations could be completely eliminated. Whether the protection to the individual investor gained by the price disclosure is greater than the disadvantage springing from the creation of such a perfected mechanism for speculation is one which the report does not seek to resolve, as being, necessarily, not within its scope.

Certainly, however, in any consideration of the policy of the Commission towards the New York Stock Exchange, there must be borne in mind the fact that the prices of the New York Stock Exchange fluctuate to a degree greatly beyond comparable securities on the London Stock Exchange. Why is that? Why do we have such gyrations? There must be some operating cause or causes.

The attempt is made in the report to show a priori how, in fact, the trading mechanisms do seem to be a contributing cause. Since the discussion is a priori, a reader either accepts or rejects it.

These fluctuations on the New York Stock Exchange certainly involve losses to the investor of magnitude; and apparently, they are an inherent characteristic of the New York system, as shown by the course of prices on the New York Stock Exchange since the outbreak of the present war, as compared with the movement of prices on the London Stock Exchange.

Whether the advantages of price and volume publicity outweigh the incitement to speculation and its consequence the report does not attempt to adjudge. It may be said in passing, however, that there are other ways than price publicity to assure that transactions made by dealers are not unconscionable; and it must be borne in mind that the excessive variations in price movements involve losses to the investor of perhaps much greater consequence than the sum of the profits that could be taken on individual unconscionable deals. Certainly, the losses involved, and the chaotic movements taking place upon the French defeat, attained enormous proportions. If the structure of our market leads to such a result, the question may be raised as to whether the market mechanism, including the tape, should not be subject to a re-examination in the light of the English experience.

But a description of the English system is not the taking of a position by the Commission on this vexed and difficult question, and the report in this regard is merely an attempt fairly to describe the British system. The fact that it is made by an officer of the Commission certainly does not make the Commission responsible for the description contained therein, any more than would a description by the Department of Commerce of any of the various commercial practices pursued abroad indicate that it was the policy of the Department of Commerce to favor the introduction of such practices in this country. This is all the more true since it concerns a foreign matter as to which the Commission would not

be expected, of its own knowledge, to have expert information. It was for that reason, under the duties charged upon it by Section 30 of the Securities Exchange Act, that it sent abroad an officer to investigate the matter.

The statement is made that my description gives solace to those who claim that American laws, particularly the Securities Acts and the capital gains tax, have driven trading in American securities abroad. But, at the present moment, such a claim really would be a dead herring, whatever may have been the situation several years ago. And I really don't see how my description gives solace to any one. That the Securities Exchange Act would probably have some effect of such character was recognized in the legislation itself. My report is no more a recognition of that situation than is Section 30 of the Exchange Act, itself. As to the effect of the capital gains tax, there can be no doubt. The Treasury came to that conclusion itself, as told me by Deputy-Commissioner King. And, as a matter of fact, in consequence of an investigation made in London, the Treasury caused to be modified the requirements of the capital gains tax insofar as foreigners were concerned.

But above all, the report proposes an effective remedy to the escape from proper American regulation. The escape cannot be prevented by the closing of one's eyes to the

existence of the problem. In fact, Section 30 imposed a duty upon the Commission to find, if possible, a remedy.

That the international mechanisms can and are used to escape our laws is shown by the action of the Treasury. The Treasury became so aware of the evasion, through them, of our own tax measures that it set out upon a long-drawn program to make treaties with the several nations of the world, with two major objects in view: (1) to provide, by treaty, for the international exchange of information of value for tax-enforcement use, and (2) to provide, by treaty, that the several treaty-making powers lend, respectively, to a greater or less degree, their tax-enforcing procedures to one another; notwithstanding the age-old principle that one sovereign does not use its judicial and other procedures for the collection of taxes, even though shown just, of foreign states.

For example, just before the outbreak of the present war, these negotiations had led, as far as France was concerned, to the actual making of a treaty. Ratification has been held up, however, owing to the war. Negotiations were also being conducted with Canada, Holland, and ^{I think,} other nations. Although, owing to the war, this work is quiescent, it has not been abandoned. Deputy-Commissioner King of the Treasury Department and Mr. Turkel of the State Department are charged therewith.

Certainly, the same sort of action that has led to this long-drawn-out program on the part of the Treasury must ex natura have occurred as to our regulations. And, if means are not found by which the international gap can be closed, there will always be this loophole to effective American regulation of stock exchange trading, which will be the larger the more effective our own regulation may become.

The use of the international loophole, moreover, raises the complex substantive problems of private international law, independent of those of process, venue, and jurisdiction. Thus, point is made concerning my statement of the legal effect of the performance of acts in London. Certainly, the general principle of private international law is that penal measures are governed by the lex loci. Whether exceptions would exist under our own legislation would be a question which could be resolved only after legal investigation in the light of the particular circumstances of a given case. All that I say is that the culprit might claim that he was governed by British law. I have little doubt that he would make such a claim. Whether he could get away with it would be another question. But the claim would still be an impediment and issue.

Clearly, in view of the easy means by which international securities transactions can be effected, the Commission must face the problem, if it is over a long period of time effectively to regulate our own markets, how this gap can be closed.

The point is made that I do not adduce real proof as to the extent by which London may be used to escape American requirements. Patently, such proof in any full sense cannot be adduced. That is the reason that further action is necessary. But the record of my conferences, which

constitute the base for this part of the report, are a quite sufficient support, in my opinion, for the statements which I make. Further, various investigations conducted by the Commission and appearing to involve foreign elements could not be carried, notwithstanding the suspicious circumstances, to a conclusion, because of an inability to get across the national lines. And an investigation conducted by me in London concerning the Majestic Radio and Television Corporation definitely indicated, from the precise facts obtained, that manipulative practices in that stock were being conducted from London.

I do believe, however, that further investigations should be made. I, of course, could not undertake that, since I have not had a staff. In point of fact, I have proposed that a complete investigation should be made turning around one particular house, Singer and Friedlander, which there is fair reason to believe, has been made a focal point for violations of American measures.

I would not be surprised also that if a complete investigation could be made of the trading in U. S. Steel at various times, particularly around 1937, evidence would be found which would show that the foreigner, with design and purpose, had much to do with the sudden raising and dropping of the prices in that leading security, which may have had considerable influence in bringing about the collapse of 1937. It is these things which, in my opinion, should merit much further investigation.

The statement is made that "we feel, however, that if Mr. Neff is correct, the Commission has a grave responsibility to do what it can to correct this situation"; that is, the possible use of the London market to escape American law.

In the view of the writer, that is the very purpose for the publication of the report, because, showing the gravity of the problem and proposing a remedy, it would lay the ground for effective action. For the proposed remedy is of such nature that a precedent general public discussion of the issues involved is the best preparation for effective action. And this can best be done now, when the issue is not alive, from a trading standpoint.

Apparently, however, there has been some misunderstanding of the remedy which I propose. Perhaps it would be better if I would state it again. It is, briefly, that the London "American Market" is not a thing by itself, but depends for its life upon the reversal of its transactions, or "undoing", in New York. That view is held, I think I can say universally, by all the professionals in the two markets. Since "undoing" manifestly involves a transaction in New York, this government has got a complete hold on the transaction, since patently it can take any measure it deems proper in regard to such an "undoing" transaction.

Joint account arbitrage is, it is clear, the most effective means of such "undoing", because, through the operations of joint account arbitrage, the British jobber can "undo" cheaper in this market than he can directly. In the above-mentioned memorandum it is intimated that this fact may not be correct. Yet the jobbers and the arbitrageurs in London state unequivocally that such is the case. Expert arbitrageurs in New York have also made the same statement. In fact, Mr. Jacquin, who has handled many foreign questions for the New York Stock Exchange, admitted to me that it was definitely so. If the Commission desires, I shall collate the statements of all these persons in proof. They are found in my memoranda of conferences.

But my recommendation does not limit itself to ~~joint~~ joint-account arbitrage. It extends to all forms of "undoing". For it is clear that

all "undoing", whether or not through arbitrage, must result in action by a New York Stock Exchange member. This government, therefore, has complete power of action, whatever form "undoing" takes.

But it is very doubtful, to say the least, whether the London market could exist if the easy facilities afforded by joint-account arbitrage were destroyed. That it is the most efficient means of arbitrage is recognized by the New York Stock Exchange and its spokesmen (See pp. 161 of the Report, and pp. 67 and 72 of the footnotes). A governor of the London Stock Exchange -- his statement could not be cited as such in the report because it was confidential -- has gone on record with the statement that if joint-account arbitrage were removed the London "American Market" would shrink to a mere shadow of its former self. (See letter set forth in Addendum, marked "A").

Since, therefore, "undoing" rests clearly within the regulative control of this government, it is clear that the London market could be forced to take such steps as would be consonant with the non-ability to use the London market as a means to escape American regulation. And I think that the report demonstrates that this is so.

And it does not seem to me that my report is in conflict with the essentials of Mr. Appel's report, although I would differ with him in certain of his interpretations.

Mr. Appel was concerned with the question as to whether the rules against short-selling should be applied to arbitrage, and he comes to the conclusion that the arbitrageurs, for bona fide arbitrage, should be exempted from the rules against short-selling, but that advance arbitrage should not be so exempted.

He arrives at the conclusion that bona fide arbitrage should be exempted from the short-selling rules "if the Commission accepts as a

starting-point the utility of arbitrage practice to the economic world." (p.11, his report). But that is the real question. He does bring forward, as an introductory statement, certain considerations which seem in his mind to point to the utility of international arbitrage, although I do not believe he would take them as proving the point.

But Mr. Appel does not at all go into the question as to what is the type of trading that occurs on the London Exchange. In the absence of an answer to this question, it is not possible, it would seem, to come to any sound conclusion as to whether arbitrage in the instant case is useful or non-useful, because otherwise its economic function does not appear.

And, secondly, Mr. Appel does not discuss in any complete way the most important question of all, as concerns arbitrage, from the Commission's standpoint; i.e., whether the London market affords a means to escape proper American regulation of the trading in American securities.

And further, Mr. Appel admits that short-selling raids in London would be transmitted, in effect, immediately through arbitrage, to the New York Stock Exchange. From his exposition, it is apparent that in any event, whether there be a short raid or not, if short-selling has brought a lower price in London than in New York, there would be immediate selling, through arbitrage, in New York. The only case in which this would not be true would be where the decline in London was not as great as in New York. In consequence, it appears from Mr. Appel's own exposition, that short-selling in London, for all practical purposes, has an effect on price structure the same as if those sales took place in New York. His justification, however, for exempting arbitrage is that these effects would be carried to New York just as well -- in fact, as he says "with more deleterious effects" -- if arbitrage was prohibited. This, it seems to me, is an assumption because, as is demonstrated in my report, dealing through arbitrage permits effects

to be transmitted at lesser costs than would be the case with direct business. Clearly, therefore, arbitrage serves to make more immediate the effects of London dealing on New York prices than would otherwise be the case. Not only would the cost factor bring about this result, but also the greater facility for communication and the greater rapidity with which transactions can be effected in arbitrage.

CONCLUSIONS

The above memorandum concludes that the report should not be published in its present form for the reasons indicated below, as to which I should like to point out what seem to me to be countervailing considerations.

"1. Because so much of it was necessarily based on hearsay."

A great deal of the report is putting together a large amount of documentary information which has never before been focused on the vital question of foreign trading in American securities. This information is clearly not hearsay. It comprises a large part of the report.

There are also included a large amount of unpublished statistics which are vital to an understanding of the problem at hand.

The descriptions of the relations between the markets are novel.

And, as to that part depending on statements made by competent observers, it does not seem to me fair to qualify a resume of their statements as hearsay. These statements were those of persons directly observing the phenomena in question, which is neither hearsay nor opinion, but direct evidence.

"2. Because we believe that the comparison of the London Stock Exchange and the New York Stock Exchange is invalid."

As pointed out above, the comparisons are direct and immediate in character and the essential facts are not open to question. And this comparison is necessary to an understanding of the trading in London in American securities.

and the link between London and New York.

"3. Because it adds little, if anything, to the already published and unpublished material on the subject, including the Vandell Report."

It is clear that no such general study of the relation of our market to the English market has ever been published, nor prepared, nor has any been documented with the care the present report has received. In fact, the published writings indicate that there is no available source material for many parts of this report, and the ground covered was novel. As far as published data is concerned, there is largely a void.

In view of the importance of the effect of foreign trading on our markets, it would seem to me that the Commission would not be serving those people who study our markets by failing to publish the available data, whatever may be the limitations upon its use from a statistical standpoint.

For there is no reason to believe that upon the cessation of hostilities, foreign trading will not resume, as it has done upon the cessation of all the other wars since ^{approximately} the 140 years that the foreigner has been interested in American securities. In fact, it would seem that these questions should receive consideration now. As pointed out above, the overfacility of the convertibility of investments in one country to investments in another may well have been a large contributing cause to the economic disturbances which, at least in part, must have contributed to the outbreak of the present war. And it is the declared policy of both this government and that of England that the economic conditions existing prior to this present war should not return. Certainly, the relationships between the two most important capital markets of the world was an important phase of the economic life precedent to this present war. The transfer of billions of dollars of gold to this country in that period is clear evidence thereof. And as to any post bellum economic adjustment, it

will certainly be necessary to consider what changes, if any, should be made in the facilities for the flow of capital from one country to another. I feel certain that the present report will contribute to an understanding of the complex problems involved in that regard.

"4. Because by implication it casts distinctly challengeable reflections upon the New York Stock Exchange and the American market."

I do not know to what reference is made. Insofar as I was capable -- and I think it has been achieved -- I have merely tried dispassionately to describe the basic organisms of the two markets. As indicated above, I have, insofar as was practicable, used the language of the Street in describing the New York market. If a person, upon reading, concludes in his own mind that there are certain mechanisms of the New York market which accomplish results not present in London, that springs from the New York mechanisms themselves rather than from any disparagement found in the report.

"5. Because it gives unjustifiable ammunition to those who contend that American statutes have driven American securities trading abroad."

It does not seem to me that this is correct. That there has been a large and active London "American Market" cannot be doubted by anyone, and is known to all those who are familiar with the securities business. This market, it is also commonly known, long anticipated the existence of the Securities Acts. The report merely indicates that their adoption may have contributed to that market, which would seem self-evident. A statement to that effect, in a dispassionate survey of the relation between the two markets, certainly cannot be used in any way against the Commission. It would rather show that the Commission is attacking its problems in an unbiased and temperate manner.