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Confidential

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Mr. Frank, Chairman

Harold H. Neff

Report on the Trading in American Securities on the  
British Market

Attached is my report on the investigation of London trading in American securities.

It is divided into two parts. The first is concerned with the description of some features of the general English market, necessary as a background. Incidentally, it is shown, I believe, that certain basic differences between the English market and the American one make for the following results:

1. The restrictions concerning trading on the English market are far greater than on the American one. This is not because of their number, but because of the far-reaching effect of those which do exist. For example,
  - a. The practically complete prohibition against persons in the securities business advertising or soliciting;
  - b. The specialization of function of the members of the Exchange:
    - (1) Members cannot engage in any other business nor be in partnership with persons engaged in any other business;
    - (2) The segregation between the broker and jobber;
  - c. Unauthorized employees cannot do speculative business through members of the Exchange;
  - d. Access to the market is much more expensive, and difficult, typified by the presence of the jobber's turn and the 1% transfer tax, and by the absence of the tape and brokerage branch offices.

2. The English market, except for the American section thereof, is much less a casino than the American one. It is impossible, in the space of this memorandum, to set forth all the considerations in support of this thesis. I do not believe, however, it can be questioned. Competent observers are emphatic in their statements to that effect, for example the London representative of the National City Bank. In fact, it seems clear that the American market has been made the gambling place of the world, as is shown more clearly in the second part of the report. The difference between London and New York in this regard, to use imprecise terms, can perhaps best be expressed by saying that the trading for capital gains there has partaken far more of the character of true speculation than is true in New York.

It seems clear also that the English market has been much more stable in its price movements than New York. This is a statement universally made by observers in London. It is supported by studies of typical shares in the two markets, which show that, for these shares, the amplitude of price swings is much greater in the New York market than in the London one. Multiplied by the total number of shares outstanding, these differences in price swings are translated into vast sums, affecting certainly the whole economic life.

It is my belief, although manifestly not capable of proof, that the differences in the organization of trading in the two markets contribute largely to the differences in violence of the price movements; particularly the London deferred settlement as contrasted with the New York cash market, the high cost of doing business in London, the broker-jobber segregation, and the absence in London of the tape, branch offices and advertising, and, above all, the absence in London of price continuity and the mechanisms which create it. Although there are other factors, which are enumerated in the report, in my opinion the difference in organization definitely contributes to make the London market much more an investor's one.

The London method of organization limits to a large degree the liquidity of that market, in contrast with ours. This is not deplored there, I believe, except by some persons in the securities

business. Thus, Mr. Rodd of Morgan Grenfell told me that certain persons, such as Keynes in England and Rist in France, felt over-liquidity was an economic menace, and that definite steps should be taken to destroy it, such as the imposition of heavy transfer taxes. In contrast with New York, the elements in London limiting liquidity seem prohibitive.

In passing, it may be noted that in the opinion of London traders the English jobber system would be altogether impracticable if there were a tape recording transactions. They are categoric in their opinion that with the tape jobbers could not function.

The second part of the report is concerned with London trading in American securities. The study was rendered exceedingly difficult, due to the absence of any published figures concerning trading there and the lack of any real authority on my part to demand specific information. Further, the Englishman is by nature "touchy" concerning any inquiry into what he conceives to be his personal affairs. An investigation had also just been conducted by another representative of the Commission who had, by too great precision in his inquiries, aroused the antagonism of the English market. Indeed, the doors had been closed to him, as I was told by Mr. Butterworth, who is the representative of the American Treasury in London. In consequence, I had to move slowly and with much caution, because the "City" is a sort of club, quite ready to "freeze out" an intruder. They felt I was that. Further, I had expected to stay permanently and had purposely deferred certain things, to be done later. The war in the offing also made for the presence of only abnormal markets and an unwillingness to talk, due to the pressure of making necessary business adjustments. In view of this, and further, the complexities of the English market, I do not feel that in six months I had in any way exhausted the situation. A much longer stay would have been necessary to get a complete understanding.

I am convinced, however, that the English "American Market" was -- and it will be again when normal relations are resumed -- of such nature that effective regulation of our market is impeded unless some means are found to bring the London American trading within the area of control. This is particularly true as to those securities which have set the tone of our market. As

to those, the English market, at times in any event, certainly has approached in volume that in New York.

I think I have shown also in the report that the London "American Market" partakes in its essential characteristics not of the London market, but of the New York one. It enjoys a special regime. And prohibitions made for the general English market have, from a pragmatic standpoint, no real effect on the "American Market," since they are made for the trading in English securities, the characteristics of which are quite different. The London trading in American securities, therefore, escaping from controls thought necessary for this market, does not fall into apposite ones in the London market.

Indeed, I believe, although again I cannot prove it, that the English professionals definitely set out to divert trading from New York to London in the active American securities. It is shown, for example, that American securities traded in London enjoy a favored tax position, both in contrast with English securities and in contrast with other foreign securities.

This London trading has had at time the gravest influence upon our own market. The best example is perhaps that of U. S. Steel. The Steel market in London has certainly approached in volume that in New York. When there is added the Amsterdam market in Steel, the trading in this security on foreign exchanges has often, I believe, exceeded that in New York. The direct trading by the Europeans on the New York Stock Exchange in Steel has, of course, itself been of large volume. When all of these are put together, clearly the total foreign trading in Steel has often been dominant. This trading is, to a large degree, pure betting. The European uses Steel as a counter by which to go long or short of this country.

English observers state also that sometimes in the leading securities there has been direct European manipulation by persons with large funds, on the London Exchange, for effect on the general level of stock prices in this country.

The report makes clear, however, that the London "American Market" depends upon the ability to "undo" the balance of its transactions in New York. Since the "undoing" has its situs in this country, there exists the complete ability to regulate. Thereby the English "American

Market” could be forced into the area of American jurisdiction. And this is proper because the subject-matter -- affecting the basic credit position of this country -- is one that properly falls within the field of jurisdiction of American law.

I believe that the English market would yield to any just demands, if properly presented. This is so because of their self-interest. The number of principals actively engaged in the “American Market” is relatively few. Some of these, however, are men of influence. Of the forty members of the Committee of the London Stock Exchange, for example, two do practically all of their business in the “American Market.”

In the report I have not gone into the question of how the control of “undoing” could be effected. The threat, however, would probably make the English market come across. Indeed, “undoing” now enjoys specific exemptions accorded by rule and regulation. The mere revocation of those exemptions would probably have great effect upon the London “American Market”; and the threat of the revocation, properly conveyed, might well be sufficient.

The war has of course, for all practical purposes, destroyed for the time being the London “American Market.” On that account, I should think, since the question will undoubtedly be a controversial one, that the issues could be brought to a head by the publication of my report -- not as a report of the Commission, but as one of an officer of the Commission. The matter could thus be aired without the Commission itself having to take any position. I am aware, of course, that some of the matters are controversial in their character and ultimately of opinion rather than of fact, and would think, therefore, that the Commission would not want to take a position until there had been a full and open discussion.

As support for the statements and conclusions made in the report, I am attaching in a separate volume memoranda of interviews with persons in Europe. In the report itself, since I understood it was to be published, I did not include the names of any persons. However, these interviews will show my authority for many of the statements made.

If the report is to be published, certain changes will have to be made. I have taken in, indirectly, statements of certain persons which I think should not be published as involving a

breach of confidence. There should also be certain omissions of matter, set forth to give a concrete picture but which would be too long for publication.

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