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COMPETITION AND REGULATION IN GLOBAL SECURITIES MARKETS: WHAT CAN THE CORPORATE ISSUER EXPECT?

Aulana L. Peters
Commissioner

The views expressed herein are those of Commissioner Peters and do not necessarily represent those of the Commission, other Commissioners, or the staff.

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What Can the Corporate Issuer Expect?

I. Introduction

Good afternoon, ladies and gentlemen. My remarks today concern the internationalization of the world's securities markets and some of the implications for U.S. regulatory policy.

Evidence of the trend toward global capital markets is not difficult to find. In 1985, U.S. companies sold almost $36 billion worth of Eurobonds 1/ and raised over $3 billion in so-called "Euroequity." 2/ In the first six months of 1986 alone, U.S. companies offered over $3.2 billion worth of Euroequity. 3/ The international secondary markets are also expanding. Foreign transactions in U.S. equities totalled $157.7 billion in 1985, up approximately 25% from 1984. U.S. transactions in foreign stocks during 1985 totalled $45.1 billion, up 50% from 1984. 4/

As my husband, the doctor, would say -- the phenomenon is palpable.

One of the principal attributes of the internationalization process was brought home to me during a recent trip to Amsterdam, which, by the way, is the home of the oldest continuously operating

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1/ Wall St. J., Jan. 6, 1986, at 8.

2/ N.Y. Times, Aug. 23, 1986, at D1.

3/ Id.

4/ Securities Industry Association, Securities Industry Yearbook 1986-87 668 (1986).

stock exchange in the world. An etching presented to me while in Amsterdam shows the Amsterdam Stock Exchange building as it looked in 1611. Except for the presence of a roof, the current building looks very much like that in the etching. However, the market it housed was dramatically different. Three hundred and seventy-five years ago, the Amsterdam Exchange was an open-air market where one could have traded silks, spices and tulip bulbs just as easily as securities. Today, it is a technologically-advanced, computerized stock exchange geared to service the world of high finance.

The radical changes that have taken place in the marketing and trading of securities during the last four centuries may well pale in comparison to the changes that will occur in the securities markets within the next two decades, the next two years or even the next two weeks. Therein lies the crux of one of the essential characteristics of the internationalization process, namely the rapidity of its development. Change occurs at an overwhelming pace today. Technology is propelling us towards global markets and the question raised is -- what can we expect? In my view, we can expect, among other things, to see changes in disclosure standards applicable to the capital-raising process. These changes will occur both inside and outside of the statutory framework. Furthermore, I expect that the push to facilitate access by foreign issuers to U.S. capital markets is likely to result in changes to the rules governing domestic issuers as well. Today, I would like to explore with you the reasons why I think these changes will occur.

The internationalization process presents great challenges and significant opportunities both for the SEC and for U.S. companies. The question is how will we meet the challenges and take advantage of the opportunities. Internationalization is resulting in an increasingly open capital market that should increase corporate issuers' financing opportunities. However, the internationalization process is not only having a significant impact on the financing opportunities of U.S. issuers. It is also changing the investment options available to U.S. investors.

Until recently, the transnational flow of capital has been largely a one-way street to the benefit of U.S. issuers. Foreign investors, wishing to take advantage of America's economic and political stability and relatively high interest rates, have snapped up American securities from both governmental and private issuers. In the past few years, however, U.S. investors have been attracted to foreign issuers as well. Last year saw dramatic increases in stock prices around the world as U.S. investors increased their net purchases of foreign stocks to $3.9 billion, an almost 400% increase over the previous year. 5/ This process was facilitated by a significant increase in the number of investment companies specializing in foreign investments. As this trend continues and expands, U.S. issuers may find themselves having to compete harder for each dollar of capital they raise in our domestic markets.

5/ *Id.*

This leads me to my next point. Until now, the ability to trade in most foreign securities has largely been limited to institutional investors which have better access to information about foreign issuers and can absorb the higher transaction costs of trading overseas. As globalization of the capital markets becomes less of an exotic trend and more of a fact of everyday life, the question naturally arises as to what should be done to permit public investors to participate directly in the investment opportunities created by the process and, by the same token, to facilitate foreign issuers' direct access to public investors. The answers of course involve change. Many of the changes that are likely to occur will involve deregulation, which, in my opinion, is not a process good unto itself. Deregulation is beneficial to the extent it encourages competition and provides benefits to investors which exceed the costs of the added risks they must assume.

As you know, reduction of undisclosed risk to investors is one of the primary focuses of the U.S. securities laws. As a result, investor protection under the federal securities laws is founded on a system of detailed disclosure. It is said that compliance and other costs relating to the SEC's disclosure and reporting rules deter foreign issuers' participation in our markets. I know of no studies done to test this hypothesis. However, I have heard enough non-U.S. issuers (among others) assert this as fact to conclude that, at a minimum, it is a perception requiring some response on our part.

As a consequence, the SEC has been considering the relaxation or elimination of certain of its disclosure and reporting rules in order to increase foreign issuers' access to our markets. Indeed, the process started ten years ago in 1977 when the Commission developed a disclosure system specifically designed for foreign private issuers offering and trading securities in the United States. As a result of that effort, the Commission adopted Form 20-F in 1979. 6/ In adopting Form 20-F, the Commission sought to harmonize the U.S. disclosure requirements with the requirements most commonly found in foreign countries.

In 1982, the Commission adopted an integrated disclosure form for foreign issuers similar to the system used for U.S. issuers. This integrated system permits issuers to meet some disclosure obligations by incorporating previous filings by reference. 7/

Non-U.S. issuers are no less shy than you in telling us when there is more to be done. As a result of input from many sources, both foreign and domestic, the Commission is now engaged in a far-reaching effort to open up U.S. capital markets to non-U.S. issuers. I refer to the concept release issued by the Commission in March 1985 with respect to multinational securities offerings. 8/ In this release, the Commission proposed two approaches to the

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6/ Securities Exchange Act Release No. 16371 (Nov. 29, 1979).

7/ Securities Act Release No. 6437 (Nov. 19, 1982).

8/ Securities Act Release No. 6568 (Mar. 1, 1985).

problem of harmonizing disclosure in multinational offerings. Under one approach, the United States and one or more participating countries would agree to adopt a reciprocal system providing that an offering document used by an issuer in its own country would be accepted in connection with simultaneous offerings in each of the other participants countries. Under another approach, the United States and one or more other countries would agree on common disclosure standards for an offering document, "a common prospectus", that could be used in each of the countries.

Seventy commentators responded to the Commission's release. The majority of commentators, including the FEI and a dozen or so U.S. issuers, endorsed the concept of facilitating multinational offerings and favored the reciprocal approach. These commentators opined that the reciprocal approach was simpler and afforded greater respect for each country's sovereignty and for its notions of what constitutes fair and complete disclosure. The Commission's staff is currently formulating proposals to implement the reciprocal prospectus approach to multinational offerings. The staff has not yet made a recommendation to the Commission, but I am brave enough to venture a few guesses about what is likely to be proposed. Of course, my valor stems in part from the fact that I checked with the staff first. As the Commission suggested in its concept release, any initial experimentation with the use of reciprocal prospectuses in multinational offerings will likely be limited in terms of the participating countries. Furthermore, the use of reciprocal prospectuses will

probably initially be limited to debt offerings by world class issuers as well as rights and exchange offers to shareholders already holding foreign securities.

Of course, major issues remain unresolved about which I will not hazard a guess. A decision as to which countries will participate in the reciprocal prospectus experiment is likely to impact the resolution of these open issues. One such issue is whether the Commission should establish certain minimum disclosure standards that must be met by an issuer before the issuer can rely on a multinational prospectus. Another question is whether to require reconciliation of financial statements. Currently, issuers wishing to offer securities in the United States or to list their shares here must reconcile their financial statements to U.S. Generally Accepted Accounting Principles ("GAAP"). I have encountered a difference of opinion among non-U.S. issuers as to whether reconciliation is a major barrier to access to the U.S. capital markets. Some say yes, others no. Both opinions are expressed with equal conviction. Historically, the Commission has regarded audited financial statements as the single most important element of the U.S. disclosure system. Resolution then of the two conflicting goals of reducing compliance burdens while providing the investor reliable financial statements is necessary.

State regulation of securities offerings also raises issues with which we must deal. Currently, many state authorities rely on SEC-mandated disclosure in public offerings. If the Commission

changes its disclosure standards for foreign issuers, some state commissions may feel compelled to increase their regulation of disclosure. Therefore, if harmonization of disclosure through reciprocal prospectus agreements is to be effective, the Commission must work with the state authorities in this area in order to ensure that the states' interests are accommodated.

Finally, the point could be made (and I shall not resist the temptation to make it) that once the reciprocal prospectus concept is established in connection with multinational offerings, there is no obvious impediment in policy, law or logic to applying the same standard to offerings by non-U.S. issuers targeted solely at the United States.

As my comments indicate, just how far the Commission is prepared to relax its rules to accommodate foreign companies remains an open question. However, the Commission's demonstrated willingness to modify its disclosure standards for non-U.S. companies raises questions about consistency with respect to its regulation of disclosures by U.S. issuers. One might well ask: If the Commission believes that investors will be adequately protected under a different disclosure system for foreign issuers, can it continue to require the current level of disclosure from U.S. issuers? The question could be phrased in another way. If Commission action to facilitate access to U.S. capital markets by non-U.S. issuers

imposes a competitive disadvantage on U.S. issuers, 9/ is it not required to correct the imbalance? However you pose the question, I believe the response will ultimately lead to an adjustment in the disclosure requirements imposed on domestic issuers to a level commensurate with that established for foreign issuers. Both logic and fairness dictate such a result. But you may ask whether the Commission is likely to abandon (or should I say depart from) its traditional beliefs on the nature and scope of disclosure necessary under the federal securities laws.

I think the seeds of the answer to that question may be found in a series of recent disclosure-related developments. Certain SEC initiatives, both implemented and pending, represent a subtle but significant shift away from the philosophy of prior full disclosure in connection with each and every securities transaction. These developments include the Commission's adoption of the integration doctrine, its expansion of shelf registration under Rule 415, and the proposed elimination of the requirement to deliver a prospectus with or before a confirmation.

9/ A conclusion that adopting different standards for foreign issuers will disadvantage U.S. issuers would be based primarily upon an assumption that U.S. disclosure, including accounting and auditing requirements, impose higher compliance costs than do foreign requirements. This assumption is less valid if the Commission simply permits different, as opposed to less, disclosure from foreign issuers. Of course, any decision to accept non-standard disclosure from any issuer would be a change from the Commission's traditional approach.

Before implementation of the integration doctrine, the reporting requirements of the 1933 Act were premised on the assumption that adequate disclosure required a full and complete statement of statutorily mandated information in each filing. Relying at least in part on the notion that the market absorbs and retains disseminated information, the Commission developed a system which incorporated by reference already published information, thereby significantly reducing the amount of information required to be filed under certain provisions of the securities laws and consequently reducing the costs of complying with those laws. It was but a short step to expanding the circumstances under which securities could be registered and put on the shelf for continuous distribution over a period of years without the filing of disclosure documents concurrently with the issuance of the securities.

Two recent Commission proposals represent further attempts to reduce the burdens of compliance with current disclosure standards. In August of this year, the Commission agreed to publish for comment a rulemaking petition filed by the Securities Industry Association. The SIA is urging the Commission to adopt a rule which would allow confirmation of a purchase of securities in a registered public offering before the delivery of a final prospectus. At the same time, the Commission decided to propose for comment two alternative rules, surprisingly more liberal than the SIA's proposed rule, dealing with the prospectus delivery issue.

Under one SEC proposal, a confirmation of sale could be sent to a purchaser in an offering before delivery of a final prospectus if there had been no material change in the information in the preliminary prospectus. If there were a material change, it would be necessary to deliver the final prospectus before or with the confirmation. The significance of this rule proposal is that it imposes no prospectus delivery requirement not already required by the federal securities laws. Therefore, in a secondary offering there would be no requirement to deliver a disclosure document to a purchaser at any time before payment for his purchases. The proposed rule is premised upon the assumption that everything the purchaser needs to know about the security is already "known" to the market. Thus, the Commission proposal will emphasize <u>access</u> to information rather than delivery of information.

EDGAR, the Commission's proposed electronic data gathering and dissemination system, is, of course, a key component to further development of this new approach to disclosure. EDGAR liberates disclosure from paper. With EDGAR, both historical and current information will be available upon demand. Access to the information will be available instantaneously to anyone (with a terminal, of course) anywhere. With all pertinent information being available at the flip of a switch, the cost/ benefit equation changes in favor of no longer requiring direct delivery of information to the individual investor before each transaction. It is an appealing concept, and I will be very

interested to learn whether you think the shift in emphasis is justified, particularly in the case of companies already reporting under the Securities Exchange Act of 1934.

Another disclosure-related trend apparent in recent SEC actions is an increased reliance on the sophisticated or institutional investor concept when determining whether capital may be raised outside the framework of the Securities Act of 1933. There have always been exemptions to the registration requirements of the 1933 Act. The reason for these exemptions, of course, is that such transactions usually involved sophisticated investors like institutions and others who were viewed as not needing the protections of the mandatory disclosure provisions of the Act. 10/ Moreover, it was thought unnecessary to burden "small" offerings to limited numbers of people with the requirements of the Act where the benefits to the public are presumed to be remote. 11/

Before another audience, I recently pointed out that the volume of unregistered offerings of securities was staggering in that more than 30% to 40% of all new securities (exclusive of government securities) is not registered with the Commission. I questioned then the future role of our system of statutorily mandated disclosures where that system applies to less than two-thirds of all new issues. 12/

10/ See SEC v. Ralston Purina Co., 346 U.S. 119, 124-26 (1953).

11/ H.R. Rep. No. 85, 73d Cong., 1st Sess. 7 (1933).

12/ Aulana L. Peters, Address to ALI-ABA Course of Study, Scottsdale, Arizona (Mar. 14, 1986).

In this regard, it is interesting to note a recent announcement by the Director of the Division of Corporation Finance, Ms. Linda Quinn, of a project to provide a Rule 144 13/ exemption to permit the immediate trading of restricted securities among institutional investors. 14/ I need not belabor for this audience the significance of a project that would create an immediate trading market for restricted securities. It should create significant financing opportunities. I raise it here to emphasize the extent to which capital may eventually be raised outside the framework of statutorily-mandated disclosures.

To sum up, there has been at least one articulated theme to the Commission's recent efforts to facilitate access to capital, whether in the domestic or international markets. This is the reduction of costs. There may be other unarticulated rationales, but cutting costs seems to be the flag most frequently waved. Each of the initiatives I have mentioned -- integrated disclosure, Rule 415 and reciprocal prospectuses -- reflects the Commission's affirmative interest in decreasing the cost of compliance with its rules.

I would note that issuers incur two different kinds of costs in complying with the SEC's disclosure rules. First,

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13/ Rule 144, 17 C.F.R. § 230.144, sets forth the circumstances under which securities acquired in private placements may be resold.

14/ Linda Quinn, Address to the ABA's Federal and State Regulation of Securities Committees, New York, N.Y. (August 11, 1986.

they incur costs in capturing and recording the information that must be disclosed in Commission filings. Second, they incur costs in assembling, filing and disseminating the information to the Commission and other users. The Commission's recent initiatives are primarily intended to reduce the second set of costs. Its willingness to reduce this set of burdens results primarily from a reliance on the market's access to the information in question.

The proposals now being considered by the Commission with respect to multinational offerings, however, deal with the first set of costs. The information which will not be disclosed is information which foreign issuers may not currently capture or record because the laws of their domicile do not require it. This information therefore may not be available to the market in any form. Accordingly, a decision to relax these disclosure rules means a change not only in the form of disclosures but also in their content. For this reason, the Commission's decisions with respect to multinational prospectuses, given the inevitable impact of those decisions on domestic requirements, are likely to have far greater implications for the full disclosure system than any in the last decade.

Similarly, exemptions that permit and encourage issuing and trading of securities outside the framework of statutorily-mandated disclosures may have significant implications with respect to how our regulatory framework is likely to be adapted to future markets.

Could it be that one day securities will be traded in a U.S. market where the SEC has set no standards for disclosure, but merely monitors disclosures offered for accuracy?