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INTERNATIONALIZATION OF THE WORLD'S CAPITAL MARKETS -- CAN THE SEC HELP SHAPE THE FUTURE?

An Address by

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I. Introduction

It is a great pleasure and an honor to address this distinguished group of business executives and lawyers. Nevertheless, I approach the subject of my talk -- the Securities and Exchange Commission's ("Commission" or "SEC") potential role with respect to the growing integration of the world's capital markets -- with some trepidation. For the SEC has not historically been in the forefront of discussions concerning international matters.

Since its creation almost 50 years ago, the SEC has been charged with maintaining the integrity of the American securities markets. In large part, we have met that responsibility by requiring corporate issuers to fully disclose to investors material facts about their businesses and their securities. The consensus view, which I strongly share, is that this system of investor protection, through full and fair disclosure, has been effectively administered by the SEC. The investor confidence which it has engendered is a cornerstone of the world's best securities markets.

Nevertheless, in the past, the SEC has focused primarily on domestic concerns -- U.S. investors, U.S. issuers and U.S. markets. Such an approach may have been justifiable when the U.S. markets dominated the world's capital markets and the mobility of capital across national borders was severely limited. However, as the developed nations of the world enter the "post-industrial age," dramatic changes in world commerce, communications, and transportation, driven by an unyielding technological revolution and market forces, are leading inevitably to the internationalization of the world's capital markets. Investors are engaging in securities transactions in all parts of the globe, corporations are crossing their native borders to raise capital in distant foreign markets, and new financial products are being offered around the world. What was once only talked about by academicians in abstract and futuristic terms -- the internationalization of the securities markets -- is today becoming a reality.

As the new order unfolds and the mobility of the world's capital increases, what is the SEC's appropriate regulatory role in an increasingly interdependent, international financial environment? Some would have the SEC adopt a protectionist attitude reflected in a conscious effort to promulgate restrictive rules which inhibit access to U.S. capital markets by foreign concerns. Such a posture, it is currently being argued, would help to ensure that American capital goes to American business.

I, however, continue to believe in the benefits of the free flow of capital, and that such protectionism is shortsighted and is ultimately not in the best interest of American business. It has been repeatedly shown in the past that the consequences of protectionism can far outweigh any benefits resulting from such a superficially appealing policy. In this case, it is likely that closing our doors to foreign companies seeking to raise capital in the United States could spur retaliation by other nations, lead to full-scale trade wars, and make it progressively more difficult, if not impossible, for U.S. companies to raise capital and do business abroad.

Accordingly, I think that the SEC should, consistent with the maintenance of investor protection, begin to remove disincentives to foreign issuers who are considering offering their securities in American markets, while at the same time, assist American businesses in their efforts to utilize capital markets outside the United States. This simple, common sense proposition, however, belies the complexity of the underlying issues, several of which I would like to discuss today.

First, how will increased foreign access to U.S. capital markets effect American investors, American corporations and the American securities industry?

Second, in what ways can, and should, the SEC faciliate access by foreign issuers?

Third, to what extent can, and should, the SEC help to ensure fair treatment of U.S. companies doing business abroad?

II. Impact of Increased Foreign Access

With respect to the predictable impact of enhanced access by foreign issuers to U.S. capital markets, the issue is not whether U.S. investors will purchase foreign securities, but where they will purchase such securities. Indeed, from 1970 to 1980 American investment in foreign stocks increased from $6.4 billion to $18.9 billion. Similarly, American investment in foreign bonds rose from $13.2 billion to $43.2 billion during that same period. Thus, these trends suggest that foreign investment will continue to increase as Americans seek higher returns on their investments and more international diversification of their portfolios.

I believe that, on balance, individual investors particularly would benefit if foreign issuers could more readily sell their securities in the United States. American investors would benefit from the availability of more information, because SEC disclosure requirements, even if modified to accommodate some of the concerns of foreign issuers, would continue to be significantly more rigorous than those of other countries. American investors also would benefit from increased professional analysis of such information, because a larger U.S. market would encourage the U.S. securities firms to devote more resources to coverage of such issues.

An enhanced foreign presence in U.S. markets would benefit American investors in more tangible ways as well. It would, for example, be far less expensive and more expeditious to purchase the securities of foreign issuers in U.S. markets rather than in foreign markets. At the same time, a U.S. market (with perhaps an exchange listing) could greatly enhance the liquidity of these foreign securities.

In addition to improved disclosure and lowered transaction costs for American investors, increased entry by foreign issuers into the U.S. would benefit the American <u>economy</u> by generating business for the securities industry and service industries related to it. Moreover, greater foreign entry into our markets would increase employment and income in major U.S. financial centers, and increase tax revenues for both the federal government and the states.

This phenomenon has long been appreciated in Great Britain, where tremendous economic benefits have been derived from London's status as a center of international finance. It is not difficult to understand why, whatever taxes or restrictions are placed upon other industries, the financial institutions are left to function with a greater degree of freedom.

While it may be more debatable, I also believe that an enhanced foreign issuer presence will not be a significant detriment to American companies. In this regard, the primary concern of American companies has been that increased foreign access will divert critically needed capital from U.S. industries. I am persuaded, however, that this argument is grossly exaggerated.

First, during the past decade, the net international flow of capital clearly has been <u>toward</u>, rather than <u>away</u> from, American companies. Between 1971 and 1980, net purchases of United States stocks by foreigners were almost ten times the net purchases of foreign stocks by Americans. Similarly, net purchases of U.S. bonds by foreigners were twice as high as net purchases of foreign bonds by Americans. Thus, with respect to net capital flows, efforts to <u>discourage</u> an international marketplace would hurt U.S. companies more than foreign issuers.

In this same vein, increased protectionism could impair sales of securities by American companies more than sales by foreign companies. Because U.S. companies increasingly have pursued international financing alternatives, efforts to restrict foreign activities in the United States could stimulate a backlash of restrictive actions abroad.

Second, limited steps to ease foreign access to our markets is not likely to result in foreign issuers obtaining a commanding share of the U.S. capital markets. The equity capital raised in the U.S. by foreign issuers between 1976 and 1980 comprised only between 1% to 2% of the total United States equity market, except in 1977 when the figure was 6.1%, as a result of a $250 million equity offering made in the U.S. by British Petroleum. Similarly, between 1976 and 1980, foreign issuers attracted no more than 3.2% of the debt capital raised in the United States.

Moreover, foreign investors historically have accounted for a significant portion of foreign securities sales in the United States. Indeed, it has been estimated that foreign purchases of a foreign offering in the U.S. may range from 20% to 60% of the total offering. In other words, the distinctly American capital raised by foreign issuers appears to be small. Thus, even if the amount of foreign securities offerings in the United States doubled, it would divert only a modest amount of uniquely American capital.

Third, even if there is a small incremental loss of U.S. capital to foreign issuers, such a reallocation of capital may, nevertheless, be consistent with, and aid American economic growth. When a foreign company chooses to abandon the relatively unregulated foreign markets for the highly regulated American one -- it often does so in order to increase its corporate presence here. Many have existing American operations and desire American shareholders; and others plan to commence operations here with the proceeds from their offering by investing in plants and equipment, which aids our economy.

Finally, it seems clear that, in the long run, we would not benefit American companies by "protecting" them from the increased competition of a world securities market. Indeed, we cannot. Just as our multinational corporations must compete in the world marketplace for raw materials and customers, so, too, we must recognize the world competition for capital. Closing our doors would not preclude competition -- it would merely shift the competitive arena to another trading forum such as the Eurodollar market.

III. What Can the SEC Do?

In light of the benefits associated with the emergence of a truly international securities market, can the SEC influence the shape of such a market?

I acknowledge that factors other than the U.S. securities laws, such as tax and trade policies and technological change, will strongly influence the development of a world marketplace. Nevertheless, the SEC can make an important contribution by removing the unnecessary barriers which it has created. Indeed, the Commission recently has begun this process.

In November of 1981, the Commission proposed for comment new rules governing offerings by foreign private issuers in the United States. The rules, in part, revise the registration requirements under the Securities Act of 1933 ("Securities Act"), by providing an integrated disclosure system for foreign issuers which approximates the integrated disclosure rules adopted in February of 1982 for domestic issuers. The pending proposal permits certain foreign issuers to incorporate by reference into or attach to, an abbreviated prospectus, the information contained in their 20-F annual report filed with the Commission under the Securities Exchange Act of 1934 ("Exchange Act").

The proposal is designed to streamline disclosure requirements, reduce the cost of raising capital, and facilitate timely access to the increasingly volatile capital markets. Significantly, the proposed rules permit foreign issuers, in certain circumstances, to offer debt and equity securities in the U.S. markets without complying with a few of the disclosure requirements applicable to U.S. issuers. These accommodations to foreign issuers include less stringent disclosure requirements for certain non-convertible debt offerings, and for certain equity offerings to existing shareholders.

While the proposed rules, if adopted, are an important initial step in establishing the framework for discussing international issues, they will not significantly increase foreign access to U.S. markets. A serious effort to lower regulatory barriers needs to go much further. Let me briefly suggest seven areas for future consideration. I would caution that these are only my preliminary thoughts and, to the extent they touch upon the Commission's proposed rules, I am, of course, reserving judgment.

First, I would hope to see the development of a more flexible attitude at the Commission. In the past, the SEC has too often rigidly applied precisely the same standards to foreign issuers as to domestic issuers. At times, this principle has unfairly disadvantaged foreign issuers, because equal regulation of unequals can be inherently unequal.

As an alternative, we can and should work with foreign issuers to ensure effective, even if not identical, disclosure to investors. This can be done by recognizing that foreign companies often use accounting and reporting systems which -- while different than the U.S. approach -- are not necessarily improper or inadequate.

Second, we should informally explore with foreign securities regulators the idea of designating certain large, widely-followed corporations as <u>world class issuers</u>. Under this approach, if a corporation is capable of meeting certain issuer characteristics, and is willing to satisfy certain uniform standards with respect to international disclosure requirements, it would be permitted to qualify its securities for distribution on all the world's major securities exchanges. Thus, these issuers could enter any capital market utilizing one set of disclosure documents.

The prestige and quicker access to the world's capital markets that would result from a "world class" designation should provide a significant incentive for companies to seek to attain such status. Although it may be difficult to achieve a consensus among nations on the appropriate level of disclosure for world class issuers, due to the varying disclosure traditions around the world, I firmly believe that a positive attitude and a close working relationship among the world's securities regulators could bring to fruition such a regulatory concept.

Third, the Commission might consider modifying the float requirements contained in its recent proposals. Under the proposals, a foreign issuer is permitted to use the shortest of three available registration forms if it has voting stock held by non-affiliates ("float") amounting in value to at least $500 million worldwide, of which at least $150 million is held by U.S. residents. This float requirement is designed to ensure that the short form registration statement is used only by foreign issuers that are followed closely by U.S. financial experts, who, theoretically, will disseminate current information about the foreign issuer to American investors. It is arguable, however, that these float requirements, while well conceived, are unnecesarily high. Lower eligibility criteria might accomplish the same purpose.

One commentator has estimated that currently, only three of the 100 non-North American foreign companies actively traded here would meet the U.S. float requirement contained in the proposed rules.

Fourth, the Commission might consider eliminating the float requirement for certain types of transactions, such as rights offerings. Such a modification would be based upon the theory that existing shareholders are familiar with the financial information about their own company, and therefore, a short form is all that is necessary to meet their informational needs. Since many foreign issuers' major source of financing comes from rights offerings, this change would provide important benefits for U.S. investors who, under the current rules, are often deprived of participating in these offerings because foreign issuers frequently decide not to register and offer their rights in the United States.

Fifth, the SEC might change its <u>segment reporting requirements</u>. The proposed rules would continue to require most foreign issuers to disclose information about corporate profits and revenues by specific industry and geographic segments. While segment disclosure is considered useful in the United States, many foreign issuers who do not disclose segment information in their home countries are reluctant to do so here.

The SEC proposals permit foreign issuers to report segment data on a modified basis in certain offerings of non-convertible debt securities and to existing shareholders. In these situations, they may report only revenues by geographic and industry segment, with a narrative discussion if revenue and profit contributions from the respective segments materially differ. This proposed accommodation is based on the theory that investors purchasing debt instruments are primarily interested in a company's debt coverage and whether a company is profitable enough to meet its interest payments, rather than segment information disclosing where a company makes its profit. Taking this rationale one step further, the Commission might extend the modified segment disclosure at least to all debt offerings by foreign issuers. Moreover, by encouraging such transactions, the U.S. might attract some of the business it has increasingly lost to the London market.

Sixth, the Commission might extend its proposed rules to permit foreign issuers to submit financial statements that are audited in accordance with foreign auditing standards, rather than American generally accepted auditing standards ("GAAS"). It has been argued that compelling a foreign issuer to use financial statements audited in accordance with U.S. GAAS requires, in effect, that the issuer retain a U.S. accounting firm for an audit -- either directly or as consultants -- which substantially increases its audit expenses. To reduce this financial burden, the Commission might begin to accept financial statements audited in accordance with foreign GAAS, if the issuer discloses the principle dissimilarities in foreign and American auditing standards. In addition, the Commission could, and should, reserve the right to deny the use of any foreign financial statements which, as a result of a particular foreign audit procedure, raises substantial questions with respect to reliablity and accuracy.

Finally, the Commission might impose a moratorium -- perhaps 3 years -- on any further rule changes with respect to foreign issuers. Such an initiative would provide an important element of consistency to the rules affecting these issuers. In this regard, many issuers believe that the Commission frequently modifies its disclosure requirements and that as foreigners they would find it difficult to keep abreast of two nation's laws. Of even greater concern to foreign issuers is the belief that once they willingly enter our system and comply with existing regulations, they will be committed to continue, regardless of subsequent undesirable regulatory changes.

While this list is not exhaustive, and I stress the tentative nature of my suggestions, I believe that it demonstrates the range of options available to the Commission. The point is that there is much more that can be done to create a more hospitable environment for foreign issuers in U.S. markets with resulting tangible benefits to the U.S. economy, but without compromising investor protection.

IV. How Can the SEC Help American Companies Doing Business Abroad?

It is obvious that U.S. companies have much to gain by an enhanced access to foreign capital markets. As in the previous discussion, the constellation of issues raised by this matter goes well beyond the jurisdiction of the SEC. Nonetheless, the Commission can help. While the Commission does not have authority to require changes in foreign regulations and to require that foreign countries and regulators treat U.S. companies with the same deference that foreign issuers seek from the SEC, we are not without influence.

For example, let us examine recent initiatives taken by the Japanese. In January of 1982, the Japanese permitted Dow Chemical to issue $100 million of yen-based debt securities in the Japanese Samurai market, which was only the second such yen-denominated offering by a U.S. issuer since World War II. In order to make the Dow offering possible, the Japanese Ministry of Finance made a concerted and deliberate effort to accommodate some of the particular needs of Dow. Indeed, since the Dow deal, NCR Corporation has made a similar offering, and Procter & Gamble is scheduled to close one next month.

In addition, the Japanese are now in the process of changing their rules to permit American broker-dealers and other foreign securities firms to become members of the

Tokyo Stock Exchange. I must state parenthetically, however, that this change may be more apparent than real -- seats on the Tokyo Exchange cost approximately $5 million and, perhaps even more importantly, there are only 83 seats on the Exchange and none are for sale. On a more positive note, however, the Japanese have begun to increase the discounts on commissions for American broker-dealer branch offices located in Japan from 50% to 73%.

To be sure, these efforts by the Japanese to accommodate U.S. companies are, in large part, a response to the $18 billion American trade deficit with Japan, and to pressure by the U.S. government to reduce barriers for U.S. companies seeking to do business in Japan. Even so, my impression during a recent trip to Japan was that the Japanese are also trying to improve their posture with the SEC. They appear to believe that by accommodating U.S. issuers and broker-dealers seeking to do business in Japan, they will engender modification of some SEC disclosure requirements, such as full segment reporting, which have long been considered an anathema to Japanese companies.

The lesson of this experience is that there may be other situations where the SEC could negotiate reduced entry barriers for various sectors of the United States financial community seeking to do business in foreign countries. For example, perhaps we could be helpful to United States broker-dealers, whose ability to establish a presence abroad and compete on an equal footing with foreign broker-dealers may be somewhat restricted by foreign laws. American broker-dealers, to date, have not been offered memberships on the Australian or London Stock Exchanges. In countries such as France and Germany, it is difficult, largely as a result of foreign exchange controls, for U.S. broker-dealers to purchase or sell the securities of American companies for French or German customers.

In the Netherlands, foreign broker-dealers are prohibited from soliciting or taking any securities orders from Dutch nationals, other than members of the Amsterdam Stock Exchange Association. Similar restrictions apply to U.S. broker-dealers operating in Belgium. In Canada, before a foreign broker-dealer can establish a business, the Foreign Investment Review Agency must certify that the proposed operation will be of significant benefit to Canada. Finally, in Germany, all Deutsche mark offerings must be managed by a German institution.

Because these and many other restrictions placed upon the American financial community are part of complex regulatory schemes which may disadvantage, as well as in some ways benefit, U.S. companies, it is incumbent upon the Commission to determine which laws actually erect significant barriers to American business, and to seek to exercise its influence to alleviate some of these barriers. A low keyed expression of our views, coupled with a continued willingness to review other nations' problems with our regulations, seems entirely consistent with the Commission's new international posture. Indeed, such an approach may be the best way to ensure that SEC initiatives benefit the American economy, as well as American investors.

In this regard, I would sound one note of caution. Although the approach I have described -- informal, flexible negotiations -- is in many respects similar to the current Congressional examination of so-called "reciprocity" legislation, I am not calling for such a rigid approach in the area of international finance. Such steps could very well trigger a resurgent protectionism. We all know, based in part on the tariff barriers which preceded the Great Depression, that once that Pandora's box is opened, it will be difficult to close. Moreover, we would all lose if "trade wars" were to emerge. However, in view of the hour, I will leave a detailed analysis of the reciprocity issue to another day.

V. Conclusion

In conclusion, I believe the Commission can no longer avoid its growing international responsibilities. The internationalization of the world's capital markets is already in process. The vital question is whether the United States financial markets will continue to play a leading world role. Accordingly, we ultimately must reconcile our system of regulation to an increasingly interdependent world. Nevertheless, if such a reconcilation process is pursued in a thoughtful and deliberate fashion, I believe it will benefit the U.S. economy while maintaining a high level of investor protection. Here at the Commission, however, we have just begun to consider these matters, and we need your help.