U.S. Securities and Exchange Commission
Washington, D.C. 20549 (202) 272-2650

News Release

Remarks of

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Before the World Affairs
Council of Philadelphia

Philadelphia, Pennsylvania
May 19, 1988

THE CHALLENGES OF INTERNATIONALIZATION OF THE SECURITIES MARKETS

The views expressed herein are those of Chairman Ruder and do not necessarily reflect those of the Commission, other Commissioners, or the staff.

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I. INTRODUCTION

It is a pleasure to speak before such a distinguished group as the World Affairs Council of Philadelphia. I have had several opportunities during my tenure as Chairman of the Commission to speak on the subject of the internationalization of the securities markets. The tenor of those speeches has been that the world's markets are increasingly linked and that we must seek coordinated international solutions to the issues globalization poses. That message was brought home during the October market break last year. Never before have events in one market so dramatically affected other world markets. The market break certainly demands that international market regulators pay increasing attention to the need to create interlinked and coordinated market regulatory structures.

The challenges in creating a truly global marketplace fall into three categories. First, more efficient trading and clearing linkages among all active markets must be developed. Second, world regulators must structure a level of information sharing and enforcement cooperation to deter international securities law violations. Third, we must address the significant dissimilarities among the world's markets, ranging from differences in registration and reporting standards to differences in the structures of trading and settlement mechanisms. We have a great deal of work to do to achieve compatibility among these various regulatory structures. As I

will discuss later in greater detail, the Commission has approached these issues by encouraging and accommodating initiatives by participants in U.S. markets and by working with our foreign counterparts, both on a bilateral basis and in various international forums.

A. Growth of International Markets

International markets for securities have grown tremendously in recent years. International debt markets have burgeoned the most. Between 1980 and 1986, offerings in the international bond markets, including the Eurobond markets, grew from $38 billion to $227.1 billion. International bond trading volume in 1986 was more than $3.5 trillion. 1/ Although certain segments of the Eurobond market -- notably floating rate notes and fixed-rate bonds -- experienced liquidity difficulties in 1987, 2/ and the market as a whole has been in a slump for some time, total international bond offerings equalled $138 billion in 1987. 3/

International equity markets, long the junior sibling to the debt markets, also showed remarkable growth before the October 1987 market break. Euroequity offerings grew from $200

1/ See Report of the Staff of the U.S. Securities and Exchange Commission to the Senate Committee on Banking, Housing and Urban Affairs and House Committee on Energy and Commerce (July 27, 1987), ("SEC Staff Study"), Chapter II.

2/ See "Hard Times for the Euromarkets," New York Times, September 20, 1987, at F-1.

3/ See "Euromarket Sags, Crimping High Finance and also High Living," W. St. J., March 29, 1988, at 1.

million in 1983 to almost $12 billion in 1986, 4/ and in the first half of 1987 totalled $7.5 billion. Trading between markets also was increasing significantly before the market break.

International trading on all markets may also provide an indication of the potential for global trading. By some estimates, the pre-break dollar volume of equities traded worldwide exceeded $6 trillion per year. 5/ This is not only a reflection of increased volume, but also of enormous increases in value. For example, the rise in the market indices for the 19 largest markets in the world averaged 296 percent for the bull market beginning in 1982. 6/

Regulators around the world have a common goal. All of us wish to assure the integrity of markets, which at the same time will provide the capital necessary to promote worldwide economic health. It has become quite clear that the decisions regulators make for their own markets can significantly affect other world markets. For these reasons, I believe that we must look to the future and redouble our efforts to develop a coherent and coordinated approach to market regulation.

4/ See SEC Staff Study, Chapter II.

5/ See "Stock Exchanges Strong in Quarter," New York Times, October 5, 1987, p. D-12.

6/ Report of the Presidential Task Force on Market Mechanisms (January 1988), Study I.

II. INTERNATIONALIZATION ISSUES AND COMMISSION INITIATIVES

The increased internationalization of the markets, including increased automation linkages between markets, has presented the Commission with new regulatory challenges. The Commission is currently developing initiatives to deal with the major internationalization issues.

A. Clearance and Settlement Systems

If the internationalization of the world's securities markets is to proceed, one of the most important international goals must be to establish efficient and compatible national and international clearance and settlement systems. At the present time, there are wide ranging differences in settlement periods among world markets. Although the United States has developed an automated depository and book entry clearance and settlement system, mature markets such as the United Kingdom and Japan are still in the developmental stages in clearing and settlement. Ultimately, we hope that all countries will have fully automated clearance and settlement systems that permit paperless book entry movement of all broker-dealer and institutional securities positions. Currently, the lack of coordination among clearance and settlement systems in major world markets increases the costs and risks of global securities trading.

Even if comparable systems are not in place, it may be possible to develop clearing linkages among the major international markets. From the Commission's perspective, such

linkages should facilitate cross-border settlements without compromising the essential soundness and integrity of the U.S. national clearance and settlement system. The Commission already has approved a number of linkages between U.S. clearing agencies and foreign clearing entities where we have been satisfied that adequate safeguards exist to reduce the risk of default and, in the event of default, to contain potential losses. 7/

In the near term, the Commission will continue to encourage sound linkages between U.S. and foreign clearing entities to facilitate cross-border settlements. Notwithstanding such linkages, however, differences between the various national clearance and settlement systems continue to be an impediment to a truly global market. Accordingly, we have been working with the securities regulators of other nations, in forums such as the International Organization of Securities Commissions (IOSCO), to develop compatible clearance and settlement systems. The Commission staff is also exploring the development of uniform time frames, central matching and

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7/ See, e.g., Letters from Jonathan Kallman, Assistant Director, Division of Market Regulation, SEC, to Karen L. Saperstein, Assistant General Counsel, International Securities Clearing Corporation ("ISCC"), dated October 10, 1986, and December 10, 1986 (link between ISCC and International Stock Exchange); and letter from Jonathan Kallman to Michael Wise, Associate Counsel, Midwest Clearing Corporation/Midwest Securities Trust Company ("MCC/MSTC"), dated March 21, 1986 (link between MCC/MSTC and Canadian Depository for Securities).

settlement procedures, and multi-currency settlements on an international basis.

B. Trading and Quotation Linkages

The trend toward greater internationalization of the world's securities markets has been led by increasing development and reliance upon automated securities information systems within national markets. These advances in securities information technology have made possible a number of international linkages between markets for the exchange of quotation information and even for trading. For example, the Commission last October approved a two-year pilot for the exchange of quotation information between the National Association of Securities Dealers' automated quotation system ("NASDAQ"), and the International Stock Exchange in London. 8/ This arrangement allows subscribers to NASDAQ in the United States to receive up-to-the-minute quotation information for selected securities from London and allows participants in the London market to receive similar quotation information for a group of NASDAQ stocks. The National Association of Securities Dealers also has a pilot underway for the exchange of end-of-day quotation information with the Stock Exchange of Singapore. 9/

8/ See Securities Exchange Act Release No. 24979 (October 2, 1987).

9/ See Securities Exchange Act Release No. 25457 (March 14, 1988).

The Commission in recent years also has approved several trading linkages between U.S. and Canadian stock exchanges. 10/

In addition to these arrangements between markets, private vendors offer securities information on an international basis, and even international execution capabilities in certain world class equities. 11/ One of the most ambitious projects to date is an automated order entry and execution system, planned by Reuters and the Chicago Mercantile Exchange, that would allow trading in financial futures around the world, during the hours that the Chicago exchange is closed. Further off on the horizon is the European Community's planned Interbourse Data Information System -- a network that would provide continuous price reporting and trading among the major European securities exchanges.

Even where no formal trading or information exchange is made, exchanges in different countries are using common technology. The Paris Bourse, for example, is using the

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10/ The first international stock trading linkage was established between the Montreal and Boston Stock Exchanges in 1984 (Securities Exchange Act Release No. 21449 (November 1, 1984)). Since then, trading linkages also have been established between the American and Toronto Stock Exchanges (Securities Exchange Act Release No. 22442 (September 20, 1985)), and the Midwest and Toronto Stock Exchanges (Securities Exchange Act Release No. 23075 (March 28, 1986)).

11/ See the Instinet trading system, described in a letter from Richard G. Ketchum, Director, Division of Market Regulation, SEC, to Daniel T. Brooks, Cadwalader, Wickersham & Taft, dated August 8, 1986.

technology from Toronto's Computer Assisted Trading System (CATS) for its order routing system.

C. Operations of Multinational Broker-Dealer Firms

The multinational character of many large U.S. brokerage firms and foreign financial institutions raises several regulatory concerns, perhaps the most important of which relates to the financial integrity of these firms. The Commission's net capital rule 12/ provides safeguards for customers by requiring the broker-dealer to have liquid assets greater than obligations to customers. The rule contains a number of safeguards aimed at preventing a broker-dealer's assets from being used to assist an affiliate in financial difficulty. On the other hand, the default of a major unregistered affiliate can dramatically affect a broker-dealer. For this reason, the net capital rule was amended last year 13/ to require U.S. broker-dealers to make subtractions from net capital with respect to transactions with unregistered affiliates, including foreign affiliates, unless the affiliate opens its books and records to regulatory examiners. In addition, the Commission is reviewing whether it should propose legislation to Congress which would provide it with limited authority to review the activities of major unregulated

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12/ Rule 15c3-1 under the Securities Exchange Act. Rule 15c3-1 specifies minimum levels of net capital to be maintained by a registered broker-dealer, based on the nature of the broker-dealer's business.

13/ See Securities Exchange Act Release No. 24553 (June 4, 1987).

affiliates which may pose substantial risks to the financial condition of the broker-dealer.

The Commission also is working closely with securities and banking regulators in other countries in efforts to improve capital adequacy standards in order to provide greater stability and liquidity in national and international markets. For example, the Commission and U.S. self-regulatory organizations are discussing with the Securities Investment Board, or SIB, of the United Kingdom, an information-sharing arrangement that would permit the SIB to use U.S. regulators' oversight of U.S. firms. Under current plans, the SIB will monitor the financial condition of United Kingdom branch offices of U.S. firms by relying on Commission oversight of the U.S. firms and their branches. This agreement may be a first step toward achieving the exchange of financial information on affiliated broker-dealers among regulators in major securities markets.

Of course, foreign broker-dealers participating in U.S. markets should be, and are, required to register under U.S. securities laws. In applying U.S. broker-dealer registration requirements to foreign broker-dealers, we have tried to be flexible, while at the same time carrying out our primary mandate of protecting U.S. investors. For instance, we have taken the position that the mere provision of quotes by foreign brokers to U.S. customers, via the linkage arrangements that I have described to you, does not require registration.

Moreover, the staff has taken interpretive positions to facilitate U.S. institutional access to research and analysis from foreign broker-dealer affiliates on the condition that a U.S. broker-dealer be actively involved in any such conversations with the institution and that any resulting trade be consummated with the U.S. firm. More generally, I expect the Commission to address questions relating to foreign broker-dealer registration this summer in rulemaking proceedings.

D. Disclosure and Distribution Issues

The increasing internationalization of the securities markets has also created challenges in the disclosure area, particularly for capital raising on a global basis. The Commission is meeting these challenges by attempting to remove unnecessary impediments while assuring that those who buy securities in U.S. markets continue to receive the protections intended by our laws.

Disclosure Requirements for Foreign Issuers

In 1979, the Commission began to develop a separate reporting system for foreign private issuers which parallels the system for domestic companies but recognizes, to some extent, the different reporting customs and disclosure standards in foreign countries. Under the resulting Commission rules, 14/ accommodations have been made in the disclosure requirements for management remuneration, transactions with management, and segment reporting. Financial statements may be

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14/ Securities Act Release No. 16371 (November 29, 1979).

prepared in accordance with generally accepted accounting principles in the home country, but they must be reconciled to U.S. Generally Accepted Accounting Principles (GAAP). 15/ Additionally, in 1982, the Commission adopted an integrated disclosure system for foreign issuers which enables them to make use of periodic reports they have filed in the United States in connection with public offerings made here. 16/ The Commission is continuing its efforts to ease registration and reporting burdens resulting from differences in national disclosure standards, but much remains to be accomplished.

Reciprocal Prospectus

In 1985, the Commission issued a concept release which requested public comment on ways to accommodate multinational securities offerings and to harmonize the prospectus disclosure standards and securities distribution systems of the United States and other countries. 17/ The United Kingdom and Canada were identified as the most likely partners in any initial effort because of their frequent use of our markets and the similarity of their accounting principles and disclosure requirements. 18/

Comment was sought on two possible approaches -- a reciprocal approach and a common prospectus approach. Under

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15/ 17 CFR 240.4-01(a)(2).

16/ Securities Act Release No. 6437 (November 19, 1982).

17/ Securities Act Release No. 6568 (February 28, 1985).

18/ Id.

the reciprocal approach, each of the jurisdictions would accept the disclosure documents prepared in the issuer's domicile. Under the common prospectus approach, the jurisdictions would agree to use common disclosure standards.

The majority of commentators favored the reciprocal approach, primarily because of the ease of implementation. The Commission's staff is currently working with foreign regulators to plan an experimental approach utilizing the reciprocal concept. The experiment will probably involve offerings of world class issuers and initially will utilize investment-grade debt offerings because trading in such debt focuses in large part on yield and rating, rather than upon issuer information. Rights and exchange offers will probably form another part of the experiment because U.S. investors frequently are denied the ability to participate in such offerings by foreign issuers who are unwilling to incur the cost of registration.

Financial statements and related financial disclosure are critical to the integrity and credibility of our disclosure system. Thus accounting principles, auditing standards, and auditor independence will be key factors in determining the countries with which a reciprocal approach is feasible.

The Commission's staff is working with the International Organization of Securities Commissions to examine practical means of promoting the use of common standards in accounting and auditing. In the area of accounting standards, a working group of IOSCO is working with the International Accounting

Standards Committee (IASC) to revise international accounting standards. Among the tasks of this group is to address the problems of completeness and lack of specificity in some of the international standards and to eliminate many of the free choice options permitted in other standards. Where options cannot be eliminated, the group prefers to specify one method as the benchmark for international filings.

Auditing standards differences are not as susceptible to accommodation through reconciliation. Auditors around the world are subject to different independence standards, they perform different procedures, and they gather varying amounts of evidence to support their conclusions. Accordingly, efforts to establish mutually agreeable auditing standards must continue. In furtherance of this goal, the Commission's staff is participating in a project by the International Federation of Accountants (IFA) to expand and revise international auditing standards.

Application of Registration Requirements to Foreign Offerings

The Commission is also examining questions regarding U.S. registration of transnational offerings. While the registration provisions of the Securities Act are broad enough to encompass any offering in which there is some contact with the United States, in 1964 the Commission stated 19/ that it would not take enforcement action if United States companies offered securities outside the United States to non-United

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19/ See Securities Act Release No. 4708 (July 9, 1964).

States investors in a manner that resulted in the offering coming to rest outside the United States. 20/ The concepts in this release have been applied to foreign issuers as well.

The Commission's staff is revisiting the appropriate reach of the registration requirements and is developing a safe harbor rule for Commission consideration which would set forth specified non-exclusive conditions under which the Commission would not seek to apply the registration provisions. In general, a territorial approach would be followed. Under this approach, the registration provisions would apply only when an offer and sale takes place in the United States.

Other Initiatives

The Commission's staff is currently developing a rule proposal to provide a non-exclusive safe harbor from the registration requirements for resale of securities to institutional investors, if certain conditions are met. Among the factors that may be incorporated in the rule's conditions are the reporting status of the issuer, the credit rating of the security, and the size and nature of the institutional purchaser.

Additionally, the American Stock Exchange has requested Commission approval of its proposed system for institutional

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20/ The Commission's staff has considered the term "coming to rest" in no-action letters. Such letters have indicated that if steps are taken to assure that the securities will not be sold in the United States or to United States persons for 90 days in debt offerings and for one year in equity offerings, the securities will be deemed to have come to rest.

trading of unregistered securities (SITUS). 21/ If approved, SITUS will provide an organized marketplace in the United States for certain sophisticated investors to trade unregistered securities of large, high-grade, non-reporting foreign issuers. Both debt and equity securities of qualified foreign private issuers and debt securities of qualified foreign government issuers would be eligible for trading in SITUS. The National Association of Securities Dealers also has announced that it is considering a proposal to develop a similar system.

E. Investment Companies

In the investment company area, regulatory barriers in the U.S. and foreign markets have significantly restricted cross-border sales of mutual funds and other investment company products. Section 7(d) of the Investment Company Act of 1940 prohibits a foreign investment company from publicly offering securities unless it first obtains a Commission order reciting, among other things, that the provisions of the Act can be effectively enforced against the foreign fund. This standard has been especially difficult for funds organized in civil, as opposed to common law countries. Investment companies organized in the U.S. also have encountered problems in offering their shares abroad because of substantive restrictions imposed by some countries on foreign investment companies and because of currency, tax, and other restrictions

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21/ See File No. SR-Amex-87-32 (December 28, 1987).

that provide a disincentive for citizens of those countries to invest in foreign issuers.

If cross-border sales of investment company shares are to be facilitated, cooperative efforts by regulators and foreign governments will be required. The most promising approach seems to be one based on notions of harmonization and equal competitive opportunity. In 1984, the Commission recommended legislation to amend Section 7(d) to permit the Commission to grant orders to foreign investment companies where strict compliance with 1940 Act requirements would be unduly burdensome and investor protections comparable to those of the 1940 Act were provided by the foreign law under which the company operated or by specific conditions to which the company agreed. 22/ This legislative proposal has not been introduced. The staff is considering recommending a renewed effort to amend Section 7(d) that emphasizes the benefits of equal competitive opportunity both here and abroad. Additionally, the Commission is exploring informally with Canada and members of the European Economic Community the possibility of bilateral treaties for the reciprocal sale of investment company shares, a concept favored by the European Federation of Investment Companies and also of interest to the Japanese.

22/ See Memorandum of the Securities and Exchange Commission in Support of the Operating Foreign Investment Company Amendments Act of 1984, submitted to Congress with the approval by the Commission in conjunction with the issuance of Investment Company Act Release No. 13691 (December 23, 1983).

F. Enforcement Issues

As access to the U.S. markets by foreign brokers, issuers and securities traders has increased, the Commission's need for access to information about foreign trading activity and the operations of foreign companies raising capital in the U.S. has expanded. The goal of international securities regulators should be to promote market fairness, including prohibitions against insider trading, market manipulation, and misrepresentations to the marketplace. Pertinent information and evidence regarding such activities frequently is located outside of the United States and may not be subject to U.S. jurisdiction. The Commission's response is to develop international surveillance and enforcement arrangements that are sensitive to national sovereignty concerns.

During the past five years, the Commission has negotiated memoranda of understanding (MOUs) with Canadian securities regulators, the United Kingdom Department of Trade and Industry, Switzerland, 23/ and the Japanese Ministry of Finance. The most comprehensive of these, was signed on

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23/ Additionally, the United States and Switzerland exchanged Diplomatic Notes on November 10, 1987, in which they agreed that under certain circumstances, the 1977 Treaty on Mutual Assistance in Criminal Matters between the Swiss Confederation and the United States, could be used to provide assistance in SEC investigations relating to serious violations of U.S. securities laws. The Diplomatic Notes ensure that, when insider trading is made expressly illegal in Switzerland and the Swiss MOU therefore goes out of effect (scheduled for July 1988), the SEC can obtain and use information under the Swiss Treaty in insider trading cases.

January 7, 1988, between the Commission and the securities commissions of Ontario, Quebec, and British Columbia. Each party to this MOU agreed to conduct investigations and gather evidence on behalf of the other parties, using subpoena power where necessary. The parties agreed to seek legislation to provide them with this authority to investigate at the request of a foreign regulatory authority. 24/ On May 5, 1988, the Commission approved a legislative proposal which would provide it with the requisite authority. If enacted, the proposed legislation would also clarify the Commission's ability to share information in its files with both domestic and foreign regulatory authorities. Additionally, it would allow the Commission to maintain the confidentiality of documents received from foreign authorities under certain limited circumstances. Finally, it would provide that the Commission may base sanctions against securities professionals on the findings of a foreign court or foreign securities authority. The Commission believes that passage of its legislative proposal would facilitate the execution of further mutual assistance agreements with foreign regulatory authorities.

Trading and quotation linkages discussed earlier also require enforcement attention. Before approving such linkages between U.S. and foreign markets, the Commission has insisted that the markets proposing the linkages have appropriate surveillance and information sharing arrangements in place.

24/ Quebec already had enacted such legislation.

Information sharing arrangements between linked markets are crucial to the ability of the Commission and its international regulatory counterparts to detect and prosecute transnational securities fraud.

III. NEED FOR INTERNATIONAL COORDINATION

The ability of the Commission to address fully the issues raised by internationalization of the securities markets will depend greatly upon our ability to work with other market regulators throughout the world in reaching mutually agreeable solutions. There can be no doubt, particularly since the market break, that we must work together diligently to ensure that all markets operate within sound regulatory frameworks that enhance the vitality of our capital markets.

Regulators around the world have already made strides in developing coordinated responses to the important issues we face. There are several international forums in which Commission representatives regularly participate, such as IOSCO and the Organization for Economic Cooperation and Development (OECD). These groups provide regulators with the opportunity to meet with their international counterparts to work toward achieving greater uniformity in areas of particular concern such as: (1) capital adequacy and financial responsibility standards; (2) harmonizing domestic clearance and settlement systems and fostering links among those systems; (3) considering whether reciprocal treatment should be accorded other markets' broker-dealer registration qualifications and

conduct requirements; (4) establishing mechanisms to share financial surveillance and enforcement data; (5) adopting reciprocal disclosure mechanisms and promoting the use of common auditing and accounting standards; (6) promoting market fairness, including prohibitions against insider trading, market manipulation and misrepresentations to the marketplace; and (7) enhancing quotation and price data availability.

Although we have made some progress toward the goal of reaching common understandings, the tasks ahead are difficult. Major differences remain among world market regulatory structures, even among the most mature markets. Thus, while we are seeking common solutions to the issues that face us internationally, we must be mindful of and respect our existing regulatory frameworks.

The European Economic Community already has undertaken to address the diversity in its member nations' markets through a number of measures aimed at creating a unified, internal market in goods and services in the European Economic Community by the end of 1992. Among other things, these measures are intended to enable financial institutions to establish offices or provide services in any member state and to provide a coordinated approach to supervision throughout the European Economic Community and some level of equivalent consumer protection regulation. 25/

25/ Letter from Jeffrey R. Knight, Chief Executive, The Stock Exchange, to Mark Fitterman, Associate Director, Division of Market Regulation, dated January 12, 1988.

Another example of international cooperative effort is the work of the Cooke Committee, a committee established under the direction of the Bank for International Settlements for the purpose of developing uniform, international bank capital requirements. The Cooke Committee has drafted a set of proposed uniform standards for evaluating the adequacy of commercial bank and holding company capital and is now seeking comment from members of the banking industry. The new risk-based capital proposal focuses almost wholly on credit risk because such losses have been the dominant factor in most banking problems. IOSCO has already established liaisons with the Cooke Committee and intends to develop a dialogue between securities and banking regulators on the issue of uniform capital standards.

IV. CONCLUSION

Resolution of the issues I have discussed today requires a great deal of careful consideration and great effort by all concerned. The events of last October underscore the need for the world's securities regulators to arrive at solutions to these regulatory challenges. The Commission is playing a leadership role in world securities regulation and will continue to be active in seeking resolutions to the many challenges of securities market internationalization.