

Garn Institute of Finance

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The Benefits and Challenges of the Increasing  
Internationalization of the Securities Markets

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Senator Garn, honored guests, ladies and gentlemen:

With the inspirational leadership of Senator Garn, the Garn Institute of Finance has the potential to make major contributions to the nation and the financial service industries.

Senator Garn has made monumental contributions in these areas.

The Institute will have the benefit of his far-sighted perspective and intellectual leadership, as well as the extensive experience of Richard Pratt and a distinguished advisory board and faculty.

A relevant topic for the Garn Institute to address is the rapidly increasing internationalization of the securities markets. Today I would like to highlight some of the benefits and challenges of the increasing internationalization of the securities markets, and then invite your comments and questions.

While there will continue to be recessions and serious market reactions, the present and future benefits of the increasing internationalization of the securities markets are enormous. The challenges are also great and immediate.

## The Benefits

Some of the principal benefits are a result of the dramatic increase in the international mobility of capital. High-speed, low cost telecommunications are enabling investors and corporations to shop worldwide for the most attractive investment opportunities and sources of capital at any moment in time.

Increasing competition and the growing breadth, depth and liquidity of these markets are reducing execution and financing costs for the benefits of investors, government and corporate issuers. All of which are facilitating greater participation in these markets, principally through mutual and pension funds and other institutional investors, which account for over 80% of the transactions in the international markets.

It is noteworthy in this regard that those free world countries which enjoy the broadest public ownership of securities, also enjoy the greatest political and economic stability - which in turn attracts additional investment, both from within and from abroad.

The United States has been a prime beneficiary of direct foreign investment for over two centuries. These trends have persisted to the present. Foreign investments in U.S. securities continue to exceed significantly U.S. investments in foreign securities.

### International Markets

The strong growth of the international securities markets has been both a product and a stimulator of the worldwide recovery from the 1982 recession. Other factors include the significant declines in the price of oil, interest rates and inflation, the reduction of regulatory impediments and the increasing privatization of industry abroad.

### International Bond Markets

The international bond markets have also benefitted from innovative new instruments that have reduced the cost and risks of such financings. Low-cost, bank guaranteed interest rate and currency swaps permit issuers to borrow in one currency and make interest and principal payments in another. Swap arrangements have grown phenomenally - from a billion dollars in 1981 to over \$230 billion in 1986. Approximately 60% of international bond offerings now include swap arrangements and nearly a quarter consist of floating rate issues.

The record \$230 billion of international bond offerings in 1986 was 39% more than in 1985 and over four times the 1981 volume. About 25% of such financings were used to refund existing debt. The \$170 billion balance is helping to create throughout the free world, millions of new jobs and homes, thousands of new factories, hospitals, schools, telecommunication systems, roads and highways, and to develop agricultural and natural resources.

### International Equity Markets

The Eurobond market has spawned the Euroequity market. In 1980 only four companies did Euroequity offerings totaling \$117 million. In 1986, 110 companies sold over \$12 billion of Euroequities. Canadian, British and other European corporations have pioneered the Euroequity market, but last year U.S. companies became a major factor in this market. They sold over \$1.7 billion of stock abroad - an extraordinary 12 fold increase over 1985. Also, foreign corporations sold a record \$1.3 billion of common stock in the U.S. - a 54% increase over 1985 and twice the 1984 volume.

Since 1981, foreign transactions in U.S. stocks have more than tripled to over \$270 billion last year and U.S. transactions in foreign stocks have increased fivefold to over \$95 billion. About 10% of the transactions on the New York Stock Exchange now originate abroad.

### International Linkages

There are presently about 500 companies that have shares trading actively in more than one country - a 100% increase since 1984. By the early 1990s we may well witness over a fivefold increase in the number of companies that have shares actively trading around the clock and the world, through a grid of international linkages.

All U.S. stock exchanges have been electronically linked since 1978. Five Canadian and U.S. exchanges are now linked. And during the past year, the London Stock Exchange and the National Association of Securities Dealers began the first transatlantic exchange of stock quotations; Reuters began making Instinet's U.S. stock execution facilities available in Europe; and the Interbourse System began providing major European exchanges with each others' current stock prices.

The deregulation of the British securities industry last October has already had significant ramifications. London has become the arena for the most intensive competition between the world's major investment and commercial banking firms, as each vies for leadership in that market, which is a bridge between the Tokyo and New York markets. Also, the German, Dutch and Swiss markets have reduced their regulations and more such moves are anticipated as international competition intensifies.

#### Privatization Programs

Led by the United Kingdom, many countries, are converting from government to private ownership of their major industries, including France, Italy, West Germany, Spain, Austria and others. The United Kingdom's program has included the very successful \$4.6 and \$7.9 billion multinational offerings of British Telecom and British Gas - by far the largest equity offerings in history.

### The International Stock Markets

Based on dollar volume, since 1982 the world has enjoyed the broadest and strongest stock, bond and new issue markets in history. All-time highs were established last year. The Morgan Stanley international stock market index rose 39% (in U.S. dollars) and U.S. stock markets posted their fifth consecutive annual gain. The Dow Jones Industrial Average rose 23%. It established an all-time high in early December and has gone on to new highs this past week.

The higher the markets, the greater the risks of major reactions. The mood among many institutional money managers is one of cautious optimism concerning the prospects for the economy, interest rates, inflation and the markets. Some expect a significant interim reaction, but believe we have not yet witnessed the broad scale speculative excesses that have characterized the final phases of past bull markets - when investors abandon traditional investment criteria and purchases securities indiscriminantly. This market has been driven primarily by the worldwide recovery from the 1982 recession and institutional demand for blue-chip securities. While there are many areas of concern, the more speculative over-the-counter stocks and unseasoned new issues have not kept pace with investment grade issues.

### Major Challenges

Yes, the rapidly increasing internationalization of the securities markets offers enormous present and future benefits. The challenges are also great and immediate.

The most important areas of international concern are the balances of trade and of payments, the international monetary system and debt restructurings by the less developed countries. Initiatives by Secretary James Baker, the Federal Reserve Board and others are addressing these concerns. The ballooning volume of off-balance sheet bank guaranteed swaps and other credits are coming under increasing scrutiny by the Federal Reserve Board, and other central bankers and bank regulators.

Also, Congressional hearings will be held shortly on related domestic matters, including the budget and trade bills, Glass-Steagall Act Amendments and non-bank banks, the regulatory structures of the financial service industries, the deposit insurance programs, leveraged buyouts and takeovers, high yield bond financings and insider trading.

International challenges being addressed by the SEC include securities clearance, settlement, disclosure, surveillance and enforcement systems and practices.

#### Clearance and Settlement Systems

The clearance and settlement of international securities transactions have not kept pace with the rapid increase in the volume of transactions. Electronic linkages and central book-entry systems are now operating in the U.S. and Canada and are being pursued abroad, but much remains to be done. Transaction settlement cycles range from two to five days in Canada, West Germany, Japan

and the U.S., to 14 days in the U.K., and up to a month or longer in Italy, France and most other countries. Some markets are unable to reconcile initially as much as 40% of their daily transactions and take months to deliver securities. The attendant high cost and serious risks are major impediments to the growth of such countries' capital markets, and may have serious international repercussions.

### Surveillance and Enforcement

The potential for international securities fraud has increased through the use of multiple nominee accounts in different countries, the leverage of stock options and futures, and the instant mobility of capital.

It is in the interest of all nations to expose and prosecute those fringe elements, who defraud investors. Criminals rarely invest in so-called "secrecy havens." They merely use them to conceal their illegal activities in other countries. All of us bear the cost of such abuse.

It takes years to build investors' confidence in the integrity of securities markets. Confidence that is shaken or destroyed by insider traders, market manipulators, false and misleading financial disclosures, Ponzi and other schemes. Such abuses are exacerbated if they can be conducted with impunity from behind foreign securities secrecy and blocking laws. The U.S. does not have such laws.



### Bilateral Agreements

The 1982 SEC Accord with Switzerland removed the haven of the Swiss bank secrecy laws from inside traders. During the past year, accords and understandings have also been reached with Canada, Japan, the UK and others. The logical extension of these bilateral agreements will be multi-lateral agreements among virtually all major markets.

Since 1981, with the support of the business and financial community, the Administration, Congress and the investing public, the SEC's ability to expose and prosecute securities frauds has been greatly enhanced by electronic market surveillance systems, heavy fines and growing cooperation from abroad. The 135 insider trading cases that have been successfully prosecuted since 1981, including the recent Boesky case, demonstrate that it has become increasingly difficult for inside traders to hide - at home or abroad - and that those who engage in such activities are assuming enormous risks of imprisonment, heavy fines, civil suits and disgrace. The profits Boesky and others have been siphoning off the markets are now flowing through to legitimate investors.

### Market Accessibility

Another challenge is to increase access to world markets by legitimate issuers, securities firms and investors, without compromising investor protections.

The SEC is considering permitting so-called "world class" corporations to do public offerings of investment grade debt in the U.S. and participating countries, under prospectuses which comply with such companies' domestic requirements, subject to certain minimum provisions. A similar approach is being considered for certain international rights and exchange offerings.

Last year's admission of foreign firms to the Toyko exchange has improved access to the world's second largest exchange.

#### Multi-National Efforts

To address the foregoing challenges, last July the 30 nation International Association of Securities Commissions formed multi-national committees to accelerate:

- ° the automation of international securities clearance and settlement systems;
- ° the sharing of enforcement information between nations;
- ° the access of foreign issuers, broker-dealers and investors to each others' markets;
- ° and the growth of developing nations' securities markets.

Much remains to be done, but progress is being made.

In conclusion, there are many barriers to the free flow of capital, but one of the millennia to which mankind can aspire is that great day when capital will flow with the ease of water into every nook and cranny of economic opportunity - first throughout America, next throughout the free world, and ultimately throughout the earth.

As our worldwide economic interests and dependencies are more closely bound together, all mankind will enjoy greater peace, prosperity and opportunity.

Thank you.