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THE INTERNATIONALIZATION OF OUR SECURITIES MARKETS

An Address By

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Tonight I wish to discuss with you the impact of the growing internationalization of our securities markets on the role and responsibilities of the Securities and Exchange Commission. Boston is a particularly appropriate place for me to make this address, since Boston was an early international marketplace of what became the United States. In addition, Boston's Stock Exchange, which we commemorate tonight, has been a leader in encouraging foreign participation in our securities markets. I understand your membership includes more U.S. affiliates of foreign firms than all other exchanges combined. Therefore, this audience should be well aware of the rapidly growing internationalization of financial transactions and the implications of this for the United States securities market.

These developments are a result of new technology, principally important changes in methods of transportation and communication, and of the long post-war period of peace and relative prosperity for the developed countries. This has led to the emergence of huge multi-national corporations, based both in the United States and overseas, with substantial long-term investment programs and sizable cash balances in various foreign currencies. These companies have become, in many cases, a force independent of, and equal to, the economic systems of the countries in which they operate.

Prior to the mid-1960's, the U.S. securities market was the center of international finance and the source of capital for the free world. The emergence of strong, growing economies in Europe and Japan and the financial demands of the multi-national corporations have led to the development of sizable capital markets overseas. Perhaps equally important in stimulating the growth of foreign capital markets were the steps taken by the U.S. to reduce its balance of payments deficit. I am referring, of course, to the Interest Equalization Tax, which increased the cost to foreigners of raising capital in the U.S. market and to the Foreign Direct Investment Program which forced U.S. corporations to raise capital in foreign markets for their overseas investment programs.

While the Commission has been actively concerned with the development of overseas markets, particularly those involving dollar denominated issues, and with the growing interest of foreigners in U.S. securities, the underlying questions have, in many cases, not been resolved. We have relied upon the Interest Equalization Tax to restrict the possible flow of unregistered foreign offerings into our marketplace. Furthermore, the Interest Equalization Tax has effectively reduced the economic appeal of foreign securities for U.S. investors.

The apparent favorable turn in the U.S. balance of payments deficit in recent years may well lead to the repeal of the Interest Equalization Tax and to the lifting of other restrictions Combined with recent devaluations and the painfully sharp decline in the prices of many U.S. securities, these developments are likely to stimulate both the interest of U.S. citizens in foreign securities and the interest of foreign investors, foreign corporations and foreign investment bankers in our marketplace.

Perhaps the most telling facet of these developments is that this nation's capital markets do not serve any longer, if ever they did, as the sole province of American investors. This is not a time for encrusted parochialism, but rather, it is a time for clear-thinking awareness of reality. Just as foreign markets have become increasingly attractive to American investors and institutions, our capital markets are in the throes of a resurgent popularity for foreign investors.

The Commission's traditional role in policing this country's securities markets has been for the protection of investors, and has been accomplished through the prophylaxis of disclosure and the telling impact of comprehensive regulation. But the

Commission's mandate is more sweeping than this traditional concept of its functions would suggest. We are also charged, in performing our regulatory operations, with insuring that changes in, and pressures on, our capital market structure, whatever their origin, do not too severely disrupt the capital-raising functions our markets are intended to serve. Regulation and disclosure, therefore, particularly in the face of changing international developments, can significantly influence our economy. If our administration of the federal securities laws (as they presently exist) is conducted with a heavy hand, and an unbecoming shortness of sight, we may dissuade foreign investments in American enterprise and choke off a useful source of capital; of course, if we should become oblivious of the practicalities involving, and consequences of, the internationalization of our own markets, we may impair the existence of necessary protections for all investors. In this context, I should stress that the laws which we administer talk about the protection of "investors" as well as the "public interest." But they significantly omit any specific reference to Americans in that context, perhaps evidencing a degree of foresight, rather than oversight, on the part of the framers of these legislative enactments.

While an international system of securities regulation complementing international monetary rules and regulations certainly appears to be a long-term goal to be pursued earnestly by the international community, the ultimate effectuation of such a system could only provide a partial response to the international factors and pressures relating to our securities markets we all have been witnessing. Many of the problems that have arisen surely will require international coordination and cooperation, but they also will necessitate an informed and decisive national approach as well. Events in this area, as in so many financial areas, threaten to outpace the rational development of the law, unless we are prepared to grapple promptly with the issues before us. Among the areas under active scrutiny by the Commission at this time, problems I should briefly like to discuss with you tonight, are questions involving the activities of international investment companies, programs of international corporate finance, the impact on our securities markets and national economy of foreign investors and, perhaps most important, questions concerning the extent to which, and the terms upon which, foreign financial firms should be granted access to this nation's securities trading markets.

International Investment Companies

In this country, we have taken for granted the development of companies whose primary or sole reason for existence is the accumulation of pools of individual investor resources permitting participation in a far-ranging investment program by a number of persons whose resources are otherwise too small to utilize existing securities markets capably. It is a phenomenon which has been regulated closely by the Commission for the last thirty-five years. But, as is true of any good idea, the United States has no monopoly on the creation of investment companies.

With the advent of the IOS complex of funds, we have witnessed a burgeoning development in the international money markets of investment companies and investment advisers actually or purportedly serving the interests of investors all over the world. This development of international investment companies has much to commend it. The vehicle of an international investment company can serve the broad range of interests of a massive number of individual investors and can tie together, as perhaps no other single force can, the securities markets of various countries.

Unfortunately, our experience with international investment companies and investment advisers has not always been wholly satisfactory. I will not recount the gory details of the massive frauds the Commission has uncovered in connection with the operations of some of these companies. The IOS saga, of which a chapter recently was closed when the district court in New York stated that it would enter preliminary injunctions and appoint a receiver for a number of the complex's funds in various countries around the world, has alone filled innumerable volumes. Our approach in this area has been twofold.

First and, at least from a news point of view, foremost, has been an increased effort on the part of our staff to enforce the federal securities laws when they are violated by international investment companies. Our jurisdiction in this regard is both appropriate and well established. Wrongful acts that are channeled from this country, by Americans, using American facilities, to investors all over the world are an appropriate interest of the Securities and Exchange Commission. This is true in much the same way that this country would be offended by, and would take action against, an American citizen who shoots and kills a Canadian citizen residing in Canada, from a vantage point just across the border in the United States. I should stress here, of course, that our concern is not with foreign

entities or foreign investors, per se, but rather is simply a recognition of the fact that impurities that are allowed to exist in our own system of securities distribution and in our facilities and instrumentalities of interstate commerce will impair the ability of our own markets to attract foreign capital. Our assertion of jurisdiction also rests, in part, upon the Commission's view that action taken by foreign entities or persons occurring outside the territorial limits of this country nevertheless requires Commission intervention if the actions involved concern American citizens, wherever they may be located, or American markets and the securities traded on those markets.

Our enforcement efforts, of course, have required cooperative activities on the international level of the highest order. In our recent attempts to preserve the assets of IOS, which we believed would have been dissipated by a large number of defendants in our lawsuit without the imposition of some judicial restraints, the governments of Canada, Great Britain, and Luxumbourg, which had been notified previously of the Commission's intentions, acted to impound IOS monies held within their jurisdictions. Commission officials offered their assistance in the marshalling of funds in these countries to make sure that these funds would be placed outside the reach of the defendants.

But our activities with respect to foreign investment companies have not been restricted to those of an enforcement nature. Together with the Treasury Department, the Commission has suggested legislative proposals to amend both the Internal Revenue Code and the federal securities laws. The thrust of the legislative proposals we have suggested is to permit the formation of investment companies registered in this country which could offer tax and other advantages previously available only from nonregistered "off-shore" funds to foreign investors. We are confident that legislation of this type ultimately will be enacted and shall continue our efforts to produce this type of accommodation to the interests of sound regulation and attention to the needs of public investors wherever they may be situated.

Related efforts on our part involve United States investment companies which operate overseas. At least two United States-based companies have registered under our Securities Act offerings in Japan. The Commission has cooperated with the request of the Ministry of Finance of Japan to facilitate this registration process, and we expect more activity of this nature in the future.

International Corporate Finance

The Commission's role is not to discourage any legitimate form of international capital investment. However, we must be certain that if and when the Interest Equalization Tax barrier to foreign issuers is raised, Americans investing in foreign securities have the information and the safeguards to which they are accustomed.

I recognize that foreign issuers may consider our registration requirements burdensome and, perhaps, discriminatory, since the rules under which U.S. corporations offer their securities in European markets are minimal. However, we have required no more from foreign issuers than we do from domestic companies and, in several cases we have interpreted our requirements in such a manner as to accommodate foreign registrants. For example, disclosure of management remuneration has generally not been required to the extent that our basic registration form -- Form S-1 -- sets forth. And foreign entity financial statements do not have to conform exactly to Regulation S-X as long as material variations are indicated and reconciled.

We have accepted statements certified by foreign accountants which operate under slightly different standards than the independent U.S. accountants, so long as no material question of independence is involved.

Furthermore, foreign issuers with shares trading over-the-counter in this country are exempted from the reporting requirements of Section 12(g) of the Securities Exchange Act if the issuer furnishes to the Commission material information required or made public in the issuer's country of domicile. This material is not even required to be in English and is not deemed "filed" for the civil liability provisions of Section 18 of the Act. Over 100 foreign issues trade under this exemption. Presumably, lifting the IET could lead to far more issues trading under the 12(g) exemption. Furthermore, U.S. securities exchanges may consider modifying their listing requirements to encourage listing by foreign corporations. The Commission's staff is reviewing the information available to U.S. investors in foreign corporations in view of the likelihood of increased activity.

The staff must also review its position on the need for the registration of Eurodollar issues by U.S. corporations with securities trading in the U.S. marketplace, issues which have been administratively exempted since 1966. Whether the elimination of the Interest Equalization Tax will expose U.S. investors to unwarranted risks seems unlikely; however, the Eurodollar marketplace clearly must not be used as a means of evading the registration requirements of the Securities Act.

On a long term basis, international standards for offering and trading securities should be established to facilitate, for example, the simultaneous offering of securities in several capital markets. The Commission is participating actively in efforts to accomplish this. The head of our Division of Corporation Finance is working with senior officials from foreign countries under the auspices of the Organization for Economic Cooperation and Development to establish minimum standards and the Commission's Chief Accountant is participating in the work of the American Institute of Certified Public Accountants and various international accounting groups to resolve the important differences in financial reporting around the world.

Foreign Investors

Foreign investors in the U.S. securities markets find themselves today in a position similar to that which faces institutional investors. Actively courted and encouraged for a number of years, these investors are now being viewed with grave concern just as they were rising to the invitation. In both cases, Congress has raised the question of whether ownership and trading by these investors should not be restricted.

As you may know, Congressman Dent has introduced H.R. 8951, the Foreign Investors Limitation Act, which speaks to the concern expressed by several Congressmen that takeovers of domestic companies by dollar-rich foreigners may make corporate management even more unresponsive to the will of American shareholders. The Commission is more inclined toward reliance upon disclosure than the imposition of restrictions on any form of public investor which might violate the free and open spirit which has traditionally characterized the securities markets of the United States.

We intend to enforce as best we can, with regard to foreign investors, provisions of the Securities Exchange Act of 1934, including requirements for disclosure by those intending to make a tender offer for shares of a publicly traded company. I might also add that the bill Senator Williams has introduced, S. 2234, calling for disclosure of holdings and large trades by certain institutional investors, would certainly apply to a number of foreign institutions. The Commission supports the objectives of this disclosure bill, although some of its specific provisions do cause us some concern. We shall be forwarding to Congress within the next month our proposal for legislation of this nature.

Foreign Financial Institutions

Since 1960, foreigners have purchased more U.S. securities than they have sold in all but two years; the total net investment for the 12 years through 1972 is estimated at almost $10 billion. Needless to say, the foreign securities firms, which may have established U.S. operations primarily to assist their clients in raising American capital, have been actively involved in the investment programs of foreigners.

Although somewhat limited as to their role in the U.S. brokerage community, and specifically excluded from membership on the New York Stock Exchange, foreign brokers have been able to channel a significant part of foreign investment dollars through their own offices. Since they cannot trade directly on the New York or American exchanges, foreign firms have commission business to direct to exchange members, often in return for other types of business. One of the more ingenious systems they have employed has resulted in giving foreign firms underwriting participations in return for their commission business. At the same time, foreigners are aggressively seeking direct access to all trading markets to reduce the amount of commission dollars they or their customers must pay to U.S. firms. The NYSE and the AMEX prohibit such access; we have the matter under study.

I would like to outline certain key questions which we will be addressing in considering this problem of foreign access to U.S. securities markets, or, more properly, to the U.S. brokerage business:

First, are the problems of surveillance and enforcement presented by permitting foreign brokers themselves to have access to U.S. markets capable of solution, especially in view of the laws of their respective jurisdictions of origin (including "secrecy" laws)? These problems involve access to information abroad to determine, among other things, whether foreign broker transactions are for their customers or themselves, the policing, where appropriate, of foreign broker relationships with customers to insure compliance with applicable U.S. laws, such as suitability and custody rules, and the extent to which foreign courts would honor judgments rendered by U.S. courts against foreign brokers doing business here.

Second, while there are still fixed commission rates, should the question of the availability of the non-member discount be treated differently from the question of

membership on U.S. exchanges in the case of foreign brokers or foreign-owned U.S. brokers? In this connection we must consider how the Commission's recent conclusions with respect to commission rates, heralding an introduction of fully negotiated rates in April of 1975, affect the question of foreign access.

Third, should all exchanges be required to effect resolutions of the foregoing questions in a uniform manner, or should exchanges be permitted to formulate separate resolutions of the foreign membership and access problems, subject only to general parameters established by the Commission?

I wish that I could provide you this evening with definitive answers to these complex questions, but I cannot. Still, certain principles applicable to this difficult area seem clear:

1. At the least, foreign brokers and foreign-owned U.S. brokers should not receive more favorable treatment under U.S. securities laws than is afforded to U.S.-owned, domestic brokers.

2. It should not be possible for rules affording exchange access or membership by foreign entities to be utilized in a manner which permits or encourages evasion of our securities laws.

3. If special surveillance or enforcement burdens are created by foreign access and membership, the costs of discharging those burdens should not be passed on to American investors who utilize the services of domestic brokers, and any foreign entity seeking access or membership should be prepared to demonstrate that the laws of its jurisdiction of origin will not unduly interfere with its compliance with, or with proceedings against it to enforce, U.S. laws designed to protect the legitimate interests of the investing public and our professional securities community.

Our analysis of these questions relating to foreign access can be completed only with the help of the international investment community and its unique knowledge of the practical aspects of the international brokerage business. While consideration of certain broader aspects

of exchange membership and access and of commission rates in recent months has prevented us from giving to foreign broker problems as much attention as they deserve, we do anticipate issuing a release in the near future requesting public comment on a number of issues we believe are crucial to resolution of those problems.

An additional problem raised by the question of foreign access, in which the Commission has little direct involvement, however, is the application of the Glass-Steagall Act to foreign financial institutions operating in this country. Many foreign firms are permitted to operate as commercial banks as well as underwriters and broker-dealers under the laws of their countries. At the same time, Edge Act subsidiaries of U.S. commercial banks underwrite corporate securities overseas and U.S. underwriters have interests in foreign lending institutions. Today's ease of communication and capital movement makes possible the indirect, perhaps unintentional, violation of the spirit of Glass-Steagall and ultimately may concern us as we regulate the securities markets.

These, then, are some of the areas of SEC involvement in what might loosely be called the internationalization of the securities business. I see no reason why, with competition, our markets cannot remain as strong as they have been. Competition and liquidity built our markets into the premier securities business of the world; even with renewed and strengthened competition from the London market, to which has been added the resources of the Common Market, and Japan, I believe that the United States securities market can remain preeminent, and continue to supply the world with capital and the American investor with golden opportunities.