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News Release

THE SECURITIES AND EXCHANGE COMMISSION AND INTERNATIONALIZED MARKETS

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REMARKS OF

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GENERAL COUNSEL
U.S. SECURITIES AND EXCHANGE COMMISSION

INTERNATIONAL FINANCIAL CORPORATION SPECIAL CONFERENCE
ON
UNITING THE MARKETS OF THE AMERICAS:
NEW BUSINESS & FINANCIAL STRATEGIES FOR A MORE COMPETITIVE
LATIN AMERICA

NEW YORK, NEW YORK

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Let me express at the outset Chairman Breeden's regrets that he is unable to be here with you today. As you are probably aware, Chairman Breeden has great interest in the development of securities markets throughout Latin America. He has devoted a significant amount of time to working with his counterparts in Mexico and Argentina and throughout Latin America and has great respect for their accomplishments.

Considering the near 60-year history of the Securities and Exchange Commission, one is struck by the fact that the Commission is almost continually called on to explain, to justify, and to refine standards and means. The articulation of standards of commercial conduct that the Commission applies and the study of the appropriate regulatory means to achieve those

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standards is an almost continuous activity of the agency. That focus on standards and means appears particularly relevant as the Commission faces the complexities of an internationalized securities marketplace.

The internationalization of the securities markets has been occurring for some time, but its pace in the last several years has been especially dramatic, as events in Latin America demonstrate. During 1991, Argentina's stock market capitalization increased a phenomenal 397% measured in dollar terms. This growth by Argentina puts it at the head of a growing pack of emerging markets. Also during 1991, Colombia's market capitalization increased 192%, Brazil's 173%, Mexico's 107%, and Chile's 99%. These figures are remarkable examples of the turn-around in the economies and the securities markets of Latin American countries. The capitalization of the six largest equity markets of the region (Argentina, Brazil, Chile, Colombia, Mexico, Venezuela) more than doubled in 1991, increasing from $76 billion to $206 billion. Billions of dollars of foreign capital have flowed into the region. This has been a major factor behind the remarkable performance of the Latin American markets.

I. The Complexity of the Regulatory Task

The Commission was created by Congress to help ensure that United States markets are fair and efficient and that United States investors are treated fairly. That original Congressional mandate remains in place. Of course, fraud and manipulation, described by Professor Loss as "problems as old as the cupidity

of sellers and the gullibility of buyers," transcend national borders. Nations, however, have not always agreed on what constitutes fraudulent conduct, or on what should be done about manipulation. U.S. standards of commercial conduct are not taken for granted in other markets.

The issues confronted by the Commission in an era of internationalization, therefore, have an additional level of complexity that they did not have when our markets were more insular. In order to regulate domestic markets and protect United States investors, today's Commission must be concerned with both (i) the effects on domestic markets and United States investors of actions taken abroad by private parties and foreign regulators, and (ii) the international ramifications of the Commission's actions, and how those international ramifications, in turn, will affect domestic markets and United States investors.

The standards of conduct applied by the Commission have become matters of significant international, as well as domestic, policy. Not surprisingly, they can become matters of controversy. The application of Commission standards in domestic markets can become controversial because this application has heightened significance in an internationalized marketplace -- affecting, for example, the ability of foreign issuers and securities firms to participate in U.S. markets and the ability of U.S. markets and securities firms to compete with foreign markets and securities firms.

Commission standards can also become controversial as other nations scrutinize those standards, with a view towards considering whether they are appropriate for application in those nations. Because of the long tenure of the Commission, and the fairness and efficiency that characterize the U.S. markets, Commission standards are frequently studied by other countries' regulators as a model or starting-point for rulemaking abroad. Securities regulation is a difficult process -- underregulation may lead to a fraudulent marketplace while overregulation may lead to an inefficient marketplace -- and different countries' markets at different points in time have different regulatory needs. Accordingly, regulation appropriate to the U.S. market may well not be appropriate in all respects to another country's market. Indeed, the Commission itself continuously evaluates its own standards to make certain that they remain appropriate to U.S. markets -- in this process, the Commission can learn from the study of standards used abroad.

Notwithstanding the sometimes controversial nature of Commission standards, there are three areas in which a sharp focus on standards is of particular, current importance for the Commission, and for the future of securities markets throughout the Americas. The specifics of the standards appropriate to various countries in each of these areas may vary, but, in my view, some regulation will be necessary in each of these areas to ensure that markets are both fair and efficient.

First, there is the matter of the transparency -- or secrecy -- of the market, and the related matter of the willingness -- or reluctance -- of law enforcement officials to cooperate to foster transparency and to address fraudulent or manipulative conduct.

Second, the stability of our linked markets may well depend on the capital adequacy of market participants, and upon some consensus among regulators on both the purposes and the content of capital standards. Market access is a related issue here.

Third, the standard of disclosure to the marketplace, required of issuers seeking to raise capital in our markets, continues to be of major concern.

II. Transparency; Enforcement

A. Transparency

"Transparency" is the degree to which real-time trade and quotation information are available to market participants. Transparency is important to fair and efficient markets for a variety of reasons. By providing market participants with current market data, transparency helps participants to assess the value of securities in order to make informed investment decisions. Transparency eliminates a situation where "insiders" enter into transactions on the basis of current market data, and "outsiders" enter into transactions on the basis of stale information. Transparency enhances market integrity and investor confidence. Transparency enables investors to determine whether they are charged fair prices by their brokers, or whether they are charged excessive markups or markdowns. The availability of

quotation and transaction information also enables market participants to assist regulators to detect insider trading and manipulation. Transparency promotes competition among markets and market makers, contributing to more efficient pricing.

The Commission supports transparency of securities markets, but this view is not universally shared around the globe. Indeed, transparency has been one of the stumbling blocks to agreement by the European Community on an Investment Services Directive. As the markets of Central and South America grow, transparency will be critical to both their fairness and efficiency -- and, therefore, to their ability to attract investors.

Transparency is an interesting issue for the Commission, where its domestic and international interests converge. At the same time that debates continue over transparency in other countries' markets, progress remains to be made with respect to transparency in this country's markets. Events disclosed in the summer of 1991 regarding unauthorized bidding by Salomon Brothers in the market for U.S. government securities have focused attention on the fact that reforms are necessary in that market. Although the U.S. equity markets have achieved a high degree of transparency, significant improvements are required in the transparency of the government securities markets. Consistent with its commitment to transparency in the securities markets, the Commission supports legislation to provide greater transparency in the government securities markets, including

back-up governmental authority to assure maintenance of an acceptable level of transparency in the government securities markets if industry efforts do not result in sufficient transparency.

B. Enforcement

Just as transparency depends on the timely delivery of information to the market, the fairness and integrity of the market also requires an enforcement response when individuals attempt to take unfair advantage of opacity or engage in other fraudulent practices. Just as there are differences of international opinion about transparency, there are also divergent views among nations about enforcement response.

The internationalized marketplace has created new opportunities for fraud crossing national boundaries, limited only by the creativity of its perpetrators. Fraud can be perpetrated from within one country on investors in another country -- the Commission's International Swiss Investments enforcement action, for example, involved boiler room operations established in Latin America to sell securities to U.S. investors. As readers of James Stewart's Den of Thieves, you would know that fraud can be perpetrated from within one country on investors of that country, using bank accounts or corporate entities in a second country to evade detection. Or the perpetrators of fraud in one country can secrete their assets in another jurisdiction to evade enforcement of a judgment. Despite these difficulties posed by globalization of the

marketplace, the Commission employs means of law enforcement that are available both domestically and through international cooperation.

Judicial decisions in the United States have established that the Commission may bring enforcement actions with respect to transactions that have extraterritorial aspects, provided that either an "effects" test or a "conduct" test is satisfied. Notwithstanding this expansive extraterritorial view of the application of the federal securities laws, the Commission has placed increasing emphasis on international cooperation.

One of the greatest difficulties of investigating illegal conduct that spans the boundaries of more than one country is gathering evidence. Accordingly, international cooperation in enforcement investigations is crucial to successful prosecution of cross-border fraudulent activities. Commission efforts to obtain evidence from abroad can involve the expenditure of substantial time and resources, and, particularly where blocking or secrecy laws are involved, may be unwelcome by governmental authorities in other countries. For these reasons, the Commission has embarked on a highly successful program of negotiating bilateral memoranda of understanding that facilitate the exchange of information. The Commission has entered into more than 10 such memoranda of understanding and other enforcement cooperation understandings, and is engaged in negotiating a number of additional enforcement understandings.

The Commission has entered into a number of enforcement understandings with nations in the Americas -- Brazil, Mexico, Costa Rica, Argentina, Canada. Through such understandings, the Commission and its counterparts throughout the Americas should be able to help ensure that the markets of the Americas are free from fraud and manipulation.

III. Capital Adequacy

Securities markets involve the transaction each day of a multitude of transactions by a variety of parties. Many of these transactions are interdependent, in the sense that failure by one party to settle a transaction would have the effect of causing the counterparty to be unable to settle a second transaction and so on, causing a chain reaction of failures to settle. For this reason, it is crucial to the effective functioning of a securities market that the participants have confidence in each other's ability to settle transactions. Capital adequacy standards have as their goal encouraging such confidence and helping to ensure that a securities firm could wind down its business in an orderly fashion, without causing loss to its customers or other participants in the securities markets and without causing chaos or loss of confidence in the securities markets.

The United States has long had capital adequacy rules for securities firms. In a world of globalized markets, however, the failure of a major securities firm in one nation could have deleterious effects on the markets throughout the world, causing

losses to investors around the globe and impairing confidence in all of the world's markets. For this reason, regulators around the world can no longer afford to establish and maintain capital rules for their own countries without regard to the worldwide consequences of their actions. The problem of capital standards in a world of globalized markets is complicated by the fact that banks, as well as securities firms, are engaged in securities activities, but that banks, as in this country, may be subject to an entirely different regulatory apparatus than securities firms.

Two weeks ago, the Technical Committee of the International Organization of Securities Commissions ("IOSCO"), which is chaired by Chairman Breeden of the SEC, and the Basle Committee on Banking Supervision, which is chaired by President Corrigan of the Federal Reserve Bank of New York, met in Geneva in a joint session (two international committees, banking supervisors and securities regulators). The meetings considered the capital requirements needed to cover market risks entered into by commercial banks and securities firms in major industrialized countries and were a matter of some public attention.

What issued from the Geneva meetings was a joint statement of IOSCO and the Basle Committee containing preliminary understandings on minimum capital standards. These standards would apply to all of the securities positions of securities firms, but only to the trading books of banks. One issue at the Geneva meetings was the fact that U.S. securities firms maintain capital cushions under the Commission's "comprehensive" standard

-- the so-called 15% haircut rule for equity positions. A number of countries favored the "building block" approach. This approach would permit lower capital cushions for long equity positions offset by unrelated short equity positions. The Geneva understandings recognize that regulators such as the Commission may continue to apply a "comprehensive" standard when that results in capital requirements at least as high or higher than the building block approach. The Geneva understandings leave members free to set high, but workable, standards of capital maintenance for securities firms. The challenge for the future will be to avoid having capital standards diluted in a "gamblers' market" play for exchange volume, on the one extreme, or employed as a trade barrier to entry, on the other. The linked securities markets of the world have an enormous stake in the maintenance of appropriate standards of capital adequacy.

Closely related to the Commission's efforts to establish and maintain appropriate capital standards is the effort to gain access for U.S. firms to foreign markets. Standards are sometimes improperly invoked as a means to raise barriers to entry and restrict competition.

In the GATT negotiations and in the negotiations with Canada and Mexico regarding a Free Trade Agreement, the United States is committed to reducing trade barriers and opening markets to international competition. Indeed, open markets are competitive and efficient markets. The use of standards to erect trade barriers is, in my view, at odds with moving towards open markets

and enhanced competitiveness and efficiency. Such trade barriers -- for example, laws and regulations that have as their purpose restricting the access of foreign securities firms to markets or limiting the ownership interest or voting rights that foreign investors may hold in corporations -- cannot be legitimated simply by labelling them standards.

Nonetheless, it is important that real standards be preserved in the process of opening markets. For this reason -- in both the GATT and free trade negotiations -- preservation of the principle of "prudential regulation" of financial service providers is critical. Through "prudential regulation," regulators take measures to protect investors and to ensure the integrity and stability of the financial system notwithstanding agreements to open markets. Commission standards have been essential to the protection of U.S. investors and U.S. markets. In negotiations with respect to permissible "prudential regulation," mutual respect and goodwill will be important.

IV. Disclosure

Disclosure has always been at the heart of our system of federal securities regulation. The Commission has, in my view, shown considerable flexibility, seeking to minimize the financial and bureaucratic burden on transnational securities offerings by recognizing home-country disclosure where systems can be reconciled. Recently, however, the Commission's disclosure standards have been made a cause celebre by U.S. exchange

officials seeking to list the securities of certain foreign issuers on their exchanges.

When foreign issuers make public offerings of securities to U.S. retail investors, the Commission requires that the issuers provide the same disclosures that are required of U.S. issuers. This includes reconciliation of the issuer's financial statements to U.S. generally accepted accounting principles ("GAAP"). The Commission's insistence on comparable disclosures by foreign and domestic issuers selling in the public retail market reflects the determination that this facilitates informed investment decisions. Unlike sophisticated institutional investors (covered by Rule 144A), retail investors are not presumed capable of fending for themselves in obtaining the information needed to make investment decisions. In addition, U.S. issuers could be disadvantaged in our own markets if foreign issuers were allowed to list on our exchanges without complying with U.S. disclosure requirements.

In recent years, there have been calls for a relaxation of U.S. disclosure standards, particularly U.S. GAAP, in order to attract major European stocks to seek listing on U.S. exchanges. Proponents of such relaxation argue that foreign issuers are deterred from U.S. listing by the associated high regulatory costs and by the requirement to reconcile financial statements to U.S. GAAP. Reconciliation has been resisted, in particular, by German issuers. The Commission's adherence to its standards -- its insistence on compliance with U.S. regulatory requirements -

- is alleged to drive trading in foreign securities offshore, making the U.S. markets less competitive.

On closer examination, however, cracks appear in the proponents' argument for lower standards. What is presented as a global problem, the ostensible "walling off" of U.S. investors and markets from a universe of foreign stocks, appears in fact to be a problem peculiar to a clutch of issuers who find it unattractive to disclose the portion of currently reported earnings attributable to the liquidation of hidden reserves. Indeed, a large and growing universe of foreign issuers, including several issuers from Central and South America, provide that disclosure, and list upon our exchanges.

And here, the Commission has a very clear duty. It is to uphold the law, to enforce the federal securities laws. Unless Congress or the courts tell us, once and for all, that the portion of earnings attributable to liquidation of hidden reserves is per se not material, the Commission will, I suggest, be unmoved on this issue.

V. Conclusion

Today, markets throughout Latin America are thriving. It is an exciting time holding great promise -- provided that those markets develop adequate standards for investor protection. The Commission stands ready to provide technical assistance to the countries of Central and South America as they work to construct those standards. In 1990, Chairman Breeden formed the Emerging Markets Advisory Committee ("EMAC"), whose members represent a

broad cross section of the U.S. securities industry, to assist the Commission in rendering technical assistance to emerging securities markets. And in the Spring of 1991, the Commission held the first annual session of the International Institute for Securities Market Development, attended by representatives of over 30 countries, including 15 representatives of 9 Central and South American countries. The Institute was formed by Chairman Breeden to promote capital formation, and to contribute to the building of sound regulatory structures, in countries engaged in restructuring their financial sectors. Through means such as EMAC and the Institute, the Commission will continue to work to ensure that markets throughout the Americas share the fairness and efficiency for which the U.S. markets are respected throughout the world. And through such means, the Commission will also learn from its counterparts throughout the Americas in a process that should assist the Commission in its continuous process of refining its own standards.