"INTERNATIONALIZATION OF THE SECURITIES MARKETS -- PROBLEMS OF ADJUSTMENT AND RECOGNITION IN ACCOMMODATION OF FOREIGN LAW"

REMARKS OF JAMES R. DOTY,*
GENERAL COUNSEL, SECURITIES AND EXCHANGE COMMISSION,
TO THE ABA BUSINESS LAW SECTION'S
COMMITTEE ON STATE REGULATION OF SECURITIES

CHICAGO, ILLINOIS
AUGUST 7, 1990

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I. INTRODUCTION

This Committee's ongoing effort to analyze the efficacy of state merit regulation as market practices evolve is particularly timely in light of the many dramatic changes we have witnessed in our markets. There can be no doubt that a major instrument of change has been the increasing internationalization of the world's securities markets. My subject today will be the process of accommodation and harmonization of the rules governing the international securities markets and its implications for state regulatory systems.

In accordance with the SEC's traditional policy, I should point out that my remarks reflect my own views and not necessarily the views of the Commission or my colleagues on the staff of the Commission.

II. THE TREND TOWARD INTERNATIONALIZATION

While it was once possible to discuss our markets from a largely domestic viewpoint, this is no longer the case. Although the U.S. markets remain among the largest, most fair and

* The author wishes to express his appreciation to his colleagues, Diane Sanger and Richard Levine of the Office of the General Counsel, for their assistance in the preparation of this paper.

innovative in the world, we must recognize the great force of international trends in the financial services industry. As Chairman Breeden has had occasion to note, these international trends exhibit sobering patterns for our domestic financial services sector. A few examples are worth reviewing.

Stocks of 70 major U.S. companies are now listed for trading in Tokyo as well as New York, and 185 U.S. companies are listed in London. More than 400 foreign companies have stocks listed on U.S. exchanges or NASDAQ, and more than 1,100 others trade in the "pink sheet" market.

Foreign investors purchase and sell an enormous volume of both equity and debt in our markets. The total volume of transactions in U.S. securities by foreigners last year was about $4.7 trillion, a 2,300% increase in annual volume since 1980. Foreign transactions in equities alone were over $400 billion.

"Internationalization" has also involved our awakening to the growing appeal of foreign securities markets. In 1980, the U.S. equity market was 4 times the size of the next largest market; but, in 1990, the U.S. and Japanese markets are nearly identical in size, and the European Community as a whole is close behind. In 1992, the elimination of many existing barriers between the financial markets of the European Community will effectively transform the EC into a powerful single market. There is also increasing investor interest in the growth potential of the smaller world markets, and in the new emerging

markets that will result from the enormous changes occurring in the Soviet Union and Central Eastern Europe.

U.S. pension plans and other institutions have increasingly sought to diversify their portfolios by buying securities all around the world. Individual investors can participate in this trend through mutual fund investments. Driven by new technology, investor demand for access to foreign markets, and issuer demands for low cost capital, the trend toward globalization can only continue to grow.

Internationalization has presented new opportunities, but also new challenges. These challenges are two-fold. First, we must re-evaluate our regulatory structures in light of changing market conditions. We should seek the balance in our rules that will remove impediments to the free flow of capital, which may prevent our markets from remaining competitive, while protecting the integrity of our markets. Second, we must seek accommodation abroad for the useful elements of our regulatory structure, and must be willing to adjust our system to accommodate the useful elements of foreign systems.

III. RECENT SEC INITIATIVES

In 1987 the Commission issued a staff report on the Internationalization of the Securities Markets. [2] This report

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[2] Report of the Staff of the U.S. Securities and Exchange Commission to the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Energy and Commerce on the Internationalization of the Securities Markets (July 27, 1987).

represented a comprehensive examination of numerous issues relating to internationalization, including (1) the application of distribution, disclosure and accounting standards to international offerings; (2) the regulation of broker-dealers who operate in more than one country; and (3) the impact of global trading on jurisdictional issues and enforcement efforts.

In 1988, the Commission issued a Policy Statement on Regulation of International Securities Markets ("1988 Policy Statement").[3] This Policy Statement identified three key features of an effective regulatory system for international markets: (1) efficient market structures; (2) a sound disclosure system; and (3) maintainence of fair and honest markets. It emphasized that a critical element in the successful resolution of these issues was close cooperative regulatory efforts, designed to develop coordinated responses to global issues.

To this end, the Commission has intensified its efforts in the International Organization of Securities Commissions to achieve greater cooperation and uniformity in areas of common concern. Similarly, in response to the exciting developments throughout the world, including Eastern Europe and the Soviet Union, and countries such as Mexico and Thailand, the Commission has recently formed an Emerging Markets Advisory Committee to

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[3] Reprinted as International Rel. No. 1, 43 SEC Dkt. 128 (Mar. 28, 1989).

provide technical assistance in the development of free capital markets in these emerging market economies. [4]

Many of the issues addressed in the Commission's 1988 Policy Statement relate to disclosure requirements and to the registration of securities. The Commission stated that the goal in this area should be to minimize regulatory impediments without compromising investor protection. Noting that differences in disclosure requirements and accounting principles stand as the major impediments to multinational offerings, it is important that regulators try to accommodate and, to the extent possible, minimize these differences in order to facilitate transnational capital formation, while still ensuring adequate disclosure for the protection of investors.

The Commission's regulatory initiatives over the past couple of years represent efforts to implement these general principles. In April of this year, the Commission adopted Regulation S [5] and Rule 144A. [6]

Regulation S is based on a territorial approach to Section 5, and the principle that the registration requirements are

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[4] This is by no means the first time the Commission has been involved in technical assistance efforts: the Commission's efforts in Japan after World War II, in Latin American as part of the Alliance for Progress, and in Germany in the 1970's, being notable examples.

[5] Securities Act Rel. No. 6863, 46 SEC Dkt. 40 (Apr. 24, 1990).

[6] Securities Act Rel. No. 6862, 46 SEC Dkt. 23 (Apr. 23, 1990).

intended to protect the U.S. markets and investors purchasing in U.S. markets, whether U.S. or foreign nationals. It provides generally that offers and sales that occur within the U.S. are subject to the Securities Act registration requirements, and offers and sales that occur outside the U.S. are not subject to these requirements. The Regulation also provides two safe harbors for specified transactions.

Rule 144A provides a safe harbor exemption from Securities Act registration for resales of certain restricted securities to qualified institutional buyers. It is designed to achieve a more liquid and efficient institutional resale market for unregistered securities. While it is not directed solely at foreign issuers, the rule may have significant implications for them. Foreign issuers who wish to participate in our markets but have been reluctant to undertake the registration process, may now be encouraged to make greater use of the private placement market because of Rule 144A.

Another very important initiative involves the efforts of the U.S. and Canada to implement a multijurisdictional disclosure system. The Commission has proposed a multijurisdictional disclosure system that would permit certain Canadian issuers to register securities in the U.S. using disclosure documents prepared according to the requirements of Canadian authorities. [7] At the same time, Canada has proposed a multijurisdictional

[7] Securities Act Rel. No. 6841, 44 SEC Dkt. 71 (July 24, 1989).

disclosure system that would permit U.S. issuers to make offerings in Canada using disclosure documents prepared according to Commission requirements. This project directly responds to one of the major impediments to multinational offerings -- the need to comply with the disclosure requirements of two or more jurisdictions. It represents a first step towards meeting the needs of transnational securities offerings.

The Commission's proposed system would permit single-jurisdiction regulation of certain offerings and continuous reporting obligations, to encourage and to allow cross-border offerings by large issuers to be made more efficiently and at less expense. The disclosure document for an offering would be prepared in accordance with the requirements of the issuer's home jurisdiction. The system would also be available for certain rights or exchange offers by a broader class of issuers, on the theory that it is in the interest of domestic investors to facilitate the registration of such offers to encourage foreign issuers to extend them to U.S. investors. In addition, the system would allow tender offer bidders to comply with the provisions of the Canadian tender offer laws, rather than the Williams Act, where a limited proportion of the target securities is held in the U.S.

And just recently, in June, the Commission issued a release seeking public comment generally on the concept of allowing the use of foreign tender offer documents in the U.S. where U.S. shareholders of a foreign target own only a small percentage of

the target shares.[8] While foreign regulation might not provide all the protections of U.S. law, the release notes that in the absence of such an approach, foreign tender offerors might choose to exclude U.S. shareholders from the offer rather than submit to U.S. requirements. It may be preferable to adopt a regulatory approach that allows U.S. shareholders to share in such investment opportunities. The release also seeks suggestions for other approaches to facilitate extension of cross-border tender and exchange offers into the U.S.

IV. THE IMPORTANT ROLE OF THE STATES

While these specific initiatives have occurred at the federal level, it is clear that the states must play an important role in the partnership that will be necessary to meet the challenges of internationalization. If we are to achieve the goals of maintaining essential investor protection and facilitating cross-border capital formation, there must be full cooperation not only between the U.S. and foreign regulators, but between the federal government and the states as well.

As you are aware, the Commission has a history of working cooperatively with the states to address areas of mutual concern. There are numerous examples of projects in which successful cooperation between the SEC, NASAA, and state regulators have resulted in reduced costs and increased efficiency in the capital markets.

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[8] Securities Act Rel. No. 6866, 46 SEC Dkt. 655 (June 6, 1990).

* In the area of penny stock fraud, increased enforcement coordination, training efforts, and information sharing have been of great assistance in targeting and prosecuting abuses.
* The ULOE-Regulation D partnership has been ongoing for several years, and last year, following negotiations among the SEC, NASAA and the ABA, resulted in several amendments to Reg D that were adopted by the Commission and endorsed by NASAA.
* Over the past decade, NASAA, the Commission, and the NASD have developed uniform broker-dealer forms for registration and withdrawal, and a uniform adviser registration form, allowing registrants to complete one document for registration in virtually all U.S. jurisdictions.
* Progress has also been made in providing uniformity of federal and state regulation of investment companies.
* And, of course, the SEC and NASAA have been cooperating in the area of electronic filing and data gathering and retrieval.

The Commission looks forward to continuing cooperation with the states and the securities bar in addressing the new issues

presented by increasing globalization. And, based on the initial efforts in this area, there is good reason to believe that much may be accomplished through such a collaborative approach.

Of course, NASAA has also been actively studying the issues presented by internationalization over the past few years. Last year NASAA issued a resolution adopting a statement on internationalization which acknowledged the importance of the global changes affecting the securities markets, recognized its role in the international arena, and emphasized the crucial need for a coordinated approach in this area.

One area of particular interest to this Committee in which the coordination of federal and state efforts has already been very productive is the multijurisdictional disclosure system. NASAA has worked closely with the Commission and the Canadian authorities to facilitate use of the multijurisdictional disclosure process. Following issuance of the multijurisdiction release, NASAA passed a resolution endorsing the proposal, and recommending that NASAA members use their existing regulatory authority to accommodate offerings made pursuant to the multijurisdictional disclosure system. In June of this year, the NASAA International Corporation Finance Committee issued draft model rules to the Uniform Securities Act to accommodate such offerings in their initial issuance and in secondary market transactions. Among other things, these rules would more closely align the state's review period for registration statements with that used by Canadian authorities; clarify that financial

statements prepared in accordance with Canadian generally accepted accounting principles will be permitted in multijurisdictional offerings; and provide an exemption for secondary trading of securities sold in a multijurisdictional offering that has become effective with the SEC. These proposed rules, if adopted by the states, will go a long way towards facilitating Canadian offerings pursuant to the mulijurisdictional disclosure system.

This constructive experience lays the groundwork for future cooperative efforts in addressing the many issues that internationalization will continue to present. Before concluding, I would like to mention two particular projects that are currently on the Commission's agenda, which would certainly benefit from the same type of joint effort.

One is the Commission's concept release on multinational tender and exchange offers that I mentioned earlier. This concept release specifically asked for comment on the extent to which state regulation might impose impediments to the implementation of the proposed conceptual approach. We hope to receive comment letters on this subject, and to initiate a dialogue on any matters that may be raised.

The other project relates to the development of appropriate treatment for the regulation of foreign broker-dealers. This issue has arisen because of the growing interest of institutional investors in global trading, and the concommitant growth in the international scope of U.S. and foreign broker-dealer activities.

In response to these developments, the Commission has sought to call attention to existing federal registration requirements for foreign broker-dealers, but also to take appropriate steps to facilitate access by U.S. institutions to the valuable services foreign broker-dealers can provide. To this end, in July of 1989, the Commission adopted Rule 15a-6.[9] The rule creates conditional exemptions from registration for foreign broker-dealers that engage in certain limited activities in the U.S. These activities include, subject to various conditions, execution of unsolicited transactions, provision of research to U.S. institutional investors, the execution of transactions for U.S. institutional investors if effected through a registered broker-dealer, and the execution of transactions for registered broker-dealers and specified others without the use of an intermediary. As we gain experience with this rule, we hope to identify any issues under state law that may bear on the effectiveness of the exemption.

In conjunction with the adoption of Rule 15a-6, the Commission published for comment a concept release.[10] That release sought comment on a regulatory approach that would exempt from U.S. broker-dealer registration certain comparably regulated foreign broker-dealers who conduct a limited business from

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[9] Exchange Act Rel. No. 27017, 43 SEC Dkt. 2471 (July 11, 1989).

[10] Exchange Act Rel. No. 27018, 43 SEC Dkt. 2492 (July 11, 1989).

outside the U.S. with major U.S. institutional investors. The release was intended to provide a basis for further discussion of a cooperative international regulatory approach to the broker-dealer area. We hope that regulators and experts in the state securities law area will play an important role in developing the issues that this approach would raise.

This process of accommodation and harmonization has, I would emphasize, far-reaching implications for the continued health and competitiveness of our own financial services sector. As the Department of Commerce representatives have been saying to this Annual Meeting, it is our national policy that we extend a minimum of national treatment to the financial services industries of other countries, and we expect national treatment to be extended to our financial services firms abroad. As we head into a world in which a single European equity market will loom as large as our own, it is most important that we get on with the work referred to by Chairman Breeden, Commissioner Lochner, and others, and remove internal barriers to capital formation. We cannot afford to have our own system of national treatment nullified by a matrix of local rules. It is precisely that nullification of national treatment -- the threat of nullification of a "European passport" by local European rules -- that we will have the greatest stake in overcoming as we move beyond 1992.

V. CONCLUSION

It is inevitable that our capital markets will undergo many more changes during the 1990s. The increasingly competitive international climate will require all securities regulators to take steps to adapt their regulations to meet the changing needs of investors and the markets, and to maintain the integrity, strength, and attractiveness of the markets. As I have indicated, however, these are matters which will call for close cooperation not only between the U.S. and foreign jurisdictions, but also between federal and state authorities. The multijurisdictional disclosure system demonstrates the promise of such a collaborative effort. We must continue to work together to deal with future issues as they emerge.

Thank you.