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A SOUTH-OF-THE-BORDER PERSPECTIVE ON THE  
INTERNATIONALIZATION OF THE CAPITAL MARKETS

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The views expressed herein are those of Commissioner Peters and do not necessary represent those of the Commission, other Commissioners, or the staff.

A SOUTH-OF-THE-BORDER PERSPECTIVE ON THE  
INTERNATIONALIZATION OF THE CAPITAL MARKETS

Good morning ladies and gentlemen. I am truly delighted to have this opportunity to speak to you today. This occasion involves a number of "firsts" for me. This is my first visit to beautiful Quebec City and having had a chance to explore it this weekend -- I assure you it is not my last. It is the first time I have had the privilege of addressing the annual meeting and conference of the Investment Dealers Association of Canada. It is also the first time I will attempt to speak to a public gathering in French. 1/ I thought it would enliven things to put the translators to an unexpected test. Frankly, I also could not resist practicing my French, rusty as it is, on a captive audience.

The theme for IDA's conference this year is "The Beginning of a New Era". Indeed, that theme does not overstate where we are today in 1985 -- at the center of a rapidly changing world and poised on the brink of a new century. We all are quite naturally concerned with what this new era holds for us. From my vantage point it looks like a time of opportunity for all. Of course, in the present day and age expanded opportunities are certain to bring about increased competition. This phenomenon is already reflected in what has been happening in the financial services industry during the past 20 years or so. I hope that

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1/ I gave part of this speech in French and part in English. The French version of the speech is available from either my office or the Investment Dealers Association of Canada, Suite 350, 33 Yonge Street, Toronto, Ontario M5E 1G4.

our encouragement of competition will give us some insight into how best to approach the increasing internationalization of the capital markets. Distilled to their essence, global markets represent the epitome of opportunity and competition.

I was speaking of opportunity and competition. The volatile capital markets in recent years are in part responsible for today's increased competition. Inflation in the late 1970's and early 1980's caused disruption in the financial services industry in the U.S. Institutions from different segments of the world of finance began competing directly against one another. Cash management accounts and money market funds, for example, brought investment dealers and banks into direct competition for savings dollars, while discount brokerage activities of banks in the U.S. have put these same institutions in competition for investment dollars. Responding to the volatile markets, many financial institutions have become wary of narrow specialization and have sought wider powers. 2/ This phenomenon, I understand, has been as noticeable in Canada as in the U.S. I am told that the bright lines that once separated the traditional four pillars of the Canadian financial community -- chartered banks, life insurance companies, trust companies and investment dealers -- have grown increasingly dim.

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2/ See Department of Finance, Canada, The Regulation of Canadian Financial Institutions; Proposals for Discussion 9 (April, 1985) (hereinafter referred to as "Discussion Paper").

In both our countries, a regulatory system created for insular financial service industries may not be up to the task of regulating the present business environment. Your Ministry of Finance has published a discussion paper which proposes, among other things, relaxing the standards regulating ownership of financial institutions by other types of financial institutions. 3/ This proposal would permit financial institutions to diversify so that they can weather changing business conditions such as double-digit inflation and prolonged bear markets.

Let me describe briefly a few reforms proposed in the U.S. One such reform is a rule proposed by the SEC to provide a "level playing field" for all parties engaged in the investment industry. 4/ Proposed Rule 3b-9 would require banks engaging in certain types of investment activities to register as broker-dealers. If adopted, the rule would subject such banks to the same regulatory system that now applies to traditional investment firms. The proposed rule is quite controversial, being strongly supported by the investment industry and strongly opposed by certain banks (mostly smaller regional banks).

Another noteworthy initiative in the U.S. is the Treasury Department's proposed legislation that would require banks conducting certain investment activities, such as underwriting public offerings,

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3/ Discussion Paper, supra note 2.

4/ SEC Securities Exchange Act Release No. 34-20,357 (Nov. 8, 1983) (proposed Rule 3b-9).

to conduct all of their investment activities through affiliated entities as part of a holding company structure. 5/ Among other benefits, a mandatory holding company structure would insulate depositories from the risks of securities activities. Moreover, the affiliated securities firm would be required to register with the SEC and would be regulated in the same manner as traditional securities firms (namely by the SEC).

The Treasury Department's proposal is similar to one made by your Ministry of Finance in its discussion paper. The Ministry's proposal would allow the combination of bank and non-bank institutions under the umbrella of a financial holding company. The discussion paper argues that "these new arrangements would enhance competition among financial institutions and result in improved services for users and the greater efficiency of financial markets." 6/ As we begin this new era, our respective governments in many ways seem to be thinking alike.

The volatility in the capital markets unleashed another force that has put considerable pressure on our regulatory systems -- the internationalization of the capital markets. Let me describe briefly the startling growth of those capital markets.

Beginning with the emergence of the Eurobond market in 1963, debt instruments have been the most prominent element of the international securities market. For example, total issues in the

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5/ The Financial Institutions Deregulation Act, S. 1609, 98th Cong., 1st Sess. (1983).

6/ Discussion Paper, supra note 2, at 2.

Eurobond market roughly doubled from \$26.5 billion in 1981 to \$45 billion in 1983, and mushroomed to \$180.3 billion in the first eleven months of 1984. 7/ The U.S. government and several quasi-governmental entities have made direct offerings of debt instruments to foreign investors totalling over \$14.35 billion since 1984. 8/

At the same time, foreign public and private issuers of debt have increasingly tapped U.S. capital markets. Nineteen foreign private issuers raised \$2.3 billion through deb offerings in the U.S. in 1983, and foreign government issuers offered \$3.1 billion in debt in the U.S. in 1984. 9/ The growth of the international debt market has allowed widely followed issuers to be able to switch between domestic and foreign markets, depending on where they can offer their debt securities on the most favorable terms.

Although debt instruments have been the leader of the international capital market, there has been growth in the equity side also. In 1983, for example, two Canadian companies, Alcan Aluminum and BelCanada Enterprises, each offered equity securities simultaneously in Canada, Japan and the U.S. Most recently, we all followed with keen interest the British Telecommunications

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7/ SEC Securities Exchange Act Release No. 34-21,958 (April 18, 1985) at 3 (50 FR 16,302 (April 25, 1985)).

8/ Id.

9/ Id.

offering, which was an initial public offering of over three billion common shares at an offering price roughly equivalent to \$4.5 billion in the United Kingdom, Japan, Canada and the U.S. 10/

Another sector of the capital markets that has become increasingly international is the secondary trading market. One recent study identified approximately 236 issuers as having an active international trading market in their equity securities. 11/ Of these, 84 are U.S. corporations and 12 are Canadian corporations. Foreign purchases of U.S. equities increased from \$3.9 billion in 1982 to \$5.2 billion in 1983; total transactions by foreign investors in U.S. equities totalled \$134.3 billion in 1983. At the same time, U.S. institutions now hold \$10 to \$13 billion in foreign stocks, compared to \$1 to \$2 billion five to ten years ago. 12/

I'll cite no more statistics for fear you will all succumb to an immediate and terminal case of sleeping sickness. But I would like to point out that these figures suggest that issuers and investors alike see great opportunities for profit in foreign markets and are turning to these markets more and more frequently. This, in and of itself, generates additional opportunities. For example, the recent international interest in

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10/ SEC Securities Act Release No. 33-6,568 (Feb. 28, 1985) (50 FR 45 (March 7, 1985)).

11/ Yassukovich; "The Rise of International Equity," Euromoney, May, 1984 at 63.

12/ Release, supra note 7, at 4-5.

trading foreign equities has caused many stock exchanges to consider ways of extending their trading hours, as well as ways of cooperating with each other through electronic linkages. As all of you know, the Boston Stock Exchange and the Montreal Exchange currently operate a link between their markets. Although the order flow over this linkage has not as yet been massive, the potential benefits of this linkage, and others like it, are clear. Specialists in Montreal can now send orders in Canadian national issuers also listed in the U.S. for execution by Boston Stock Exchange specialists. It is anticipated that Boston Stock Exchange members will one day have access to the Montreal Exchange's automated small order execution system. Other exchanges are contemplating similar linkages. For example, a proposal involving an electronic linkage between the Toronto Stock Exchange and the American Stock Exchange has been filed with the SEC. 13/

The internationalization of the primary and secondary trading markets raises a number of interesting issues and some difficult problems, particularly the need for all competitors to have reasonable access to the markets. What are some of those problems? I would like to highlight four we should be addressing sooner rather than later.

An obvious one that has become more apparent in the wake of the increasing number of multi-national primary offerings is the duplication of effort required by the different laws establishing filing requirements of various countries. Moreover,

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13/ Release, supra note 7, at 8-9.



in federal governments such as our own, issuers have to comply not just with the central government's laws, but with the varying securities laws of provinces and states as well. Finally, following many public offerings, periodic reports, proxy statements and other documents must be filed or sent to security holders in each jurisdiction, and those reports and statements must comply with the laws of each jurisdiction.

One recent matter considered by the Commission illustrates the difficulties faced by an international issuer. 14/ TransCanada Pipelines Limited, a Canadian company, files periodic reports under the U.S. Securities Exchange Act because in 1957 it sold stock and debentures in a public offering in the United States. The number of its U.S. shareholders has decreased steadily, however, from the 4,675 U.S. residents to whom it sold securities in 1957. Today, of its approximately 22,500 shareholders, only 1,800 are U.S. residents. 15/ TransCanada filed an application for relief from various provisions of the Exchange Act, arguing that the cost of complying with U.S. proxy solicitation, periodic reporting, and other requirements outweighed any benefit to U.S. shareholders, who would be given the same information given to Canadian shareholders under Canadian law.

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14/ See In re TransCanada Pipelines Ltd., Order Denying Application for Exemption from the Provisions of Sections 12(g) and 15(d) of the Securities Exchange Act of 1934 (Feb. 13, 1985) (File No. 81-711).

15/ There are, in addition, 419 U.S. residents who hold TransCanada's debentures.

The Commission denied TransCanada's application for relief from U.S. reporting requirements, but virtually all Commissioners were sympathetic with TransCanada's plight. Indeed, at the meeting the Commissioners were assured that the SEC staff was preparing to recommend a rule that would provide some relief for Canadian issuers who have come to the U.S. capital markets at some point in the past, and who are still required to comply with both U.S. and Canadian securities laws, even though a relatively small percentage of their securities holders are from the U.S. and even though those U.S. securities holders are protected by Canadian securities laws.

When we solve the problem of multiple and varying filing and reporting requirements, several other significant obstacles to an efficient international capital market will test our patience and ingenuity. For example, there are significant differences between the generally accepted accounting principles (GAAP) of the United Kingdom, those of Canada and those of the U.S. Research and development costs, industry segment and geographic financial information, and interest cost associated with long-term construction and inventories are treated differently under the accounting principles of these countries. <sup>16/</sup> The International Accounting Standards Committee has issued 20 international accounting standards, but their utility is limited

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<sup>16/</sup> Release, supra note 10, at 13.

since they are non-binding. 17/ It is no easy chore even within the borders of the U.S. to reach a consensus on what are GAAP, or what GAAP should be in the face of changing conditions. 18/ To arrive at an international consensus on binding accounting principles will be even more difficult, but certainly not impossible. With the growing interest among issuers in becoming "world class" companies, there is an incentive to harmonize accounting standards.

Third, disclosure standards also differ among our jurisdictions. In a recent meeting between the Commission and several of your representatives, the differences in disclosure of management remuneration were highlighted. Unlike U.S. reporting companies, Canadian companies are not required to disclose the individual compensation of each of the five highest paid executives; instead, disclosure is required of the remuneration of the highest paid executives as a group. It was noted that the U.S. requirement that this sensitive information be disclosed discourages many Canadian companies from availing themselves of the U.S. capital markets. Clearly, an efficient international capital market will require some meeting of the minds on disclosure issues such as this one, and I think that such a meeting of the minds can be reached.

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17/ Hemp, "Where Boards and Governments Have Failed, The Market Could Internationalize Accounting," Wall Street Journal, May 8, 1985, at 34.

18/ Id. (quoting Donald J. Kirk, Chairman, U.S. Financial Accounting Standards Board: "Harmonization even within the U.S. is difficult, so I have to be a pessimist about international prospects.")

Finally, an area that requires our attention is regulation of the trading markets. As a practical matter, different laws apply to investors in the same trading market, depending on where the investor is domiciled. In response to this situation, the SEC issued a concept release discussing the idea of "waiver by conduct". 19/ The effect of this concept would have been to require investors who choose to trade in the U.S. capital markets to waive foreign secrecy laws, and submit to the jurisdiction of U.S. courts. This admittedly unilateral effort to impose one set of rules on traders in our markets, no matter where they are located, was not warmly received by foreign countries. Your Embassy, for example, highlighting Canada's long history of cooperation with SEC law enforcement programs, argued that cooperation among interested countries was preferable to unilateral action. 20/

It is my personal opinion that SEC-type regulation of a trading market is not the death knell of that marketplace. The U.S. secondary trading market, for example, has thrived since the Securities Exchange Act was passed in 1934. Nevertheless, it is difficult to enforce the rules providing for fairness and integrity

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19/ See Securities Exchange Act Release No. 34-21,181 (July 30, 1984); 16 BNA Sec. R. L. Rep. 1305 (Aug. 3, 1984).

20/ Letter from Anthony F. Burger, Counsellor (Economic) Canadian Embassy, to George A. Fitzsimmons, Secretary, U.S. Securities and Exchange Commission, dated December 1, 1984.

in that market to investors domiciled in foreign countries. As a result, situations have developed in which investors in different countries are playing by materially different rules, and a lack of basic fairness sometimes results. Such fundamental unfairness may ultimately lead to a lack of confidence in our market and yours, which would be to the detriment of us all.

Many problems exist of course, and new problems surely will arise, but you can rest assured that the SEC is sensitive to the issues involved in the internationalization of the capital markets, and is trying to respond in a way that encourages efficient capital formation on a global scale while protecting investors and helping to maintain the integrity of the capital markets. In 1979, for example, the Commission promulgated Form 20F, 21/ which accommodates certain foreign disclosure obligations for foreign private issuers filing periodic reports with the Commission. The Commission's current initiatives on the various methods of facilitating multi-national offerings, such as the "reciprocal" and "common prospectus" approaches, are also noteworthy. 22/ The Commission is also sensitive to, and has issued a release seeking comment on, solutions to the multi-national secondary trading markets. 23/ We are looking forward to receiving your comments on those releases.

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21/ SEC Securities Exchange Act Release No. 34-16,371 (Nov. 29, 1979); 44 FR 70,132.

22/ Release, supra note 10.

23/ Release, supra note 7.

If efficient internationalization is to become a reality, every country will have to recognize that broader, riper opportunities lie beyond narrower national interests. For example, there will be much less impetus for unilateral proposals such as the "waiver by conduct" concept if other countries outlaw trading on inside information as, for example, the Swiss are doing as a result of negotiations with the SEC. To take another example, the U.S. already recognizes the opportunities created by competition between U.S. and foreign investment firms. Foreign investment firms are welcome in the U.S. and on U.S. exchanges. However, U.S. investment firms have restricted access to most foreign markets. In this regard, I was disappointed to see that the discussion paper of the Ministry of Finance endorses ownership restrictions on the extent of foreign involvement in the Canadian securities industry as a means to preserve Canadian control over Canadian capital markets. 24/ The paper notes further that most of Canada's investment industry believes the present 25% limitations are appropriate. 25/ In my opinion, a more encouraging approach to internationalization, and one which I applaud, is reflected in Canada's proposed amendment to FIRA, which would relax the review process for foreign firms acquiring or establishing Canadian businesses, and which would establish a more reciprocal standard for U.S.

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24/ Discussion Paper, supra note 2, at 87.

25/ Id.

and Canadian firms wishing to expand across our common border. 26/  
I do not mean to imply that there are not valid reasons for seeking to maintain Canadian control over the Canadian capital markets, for indeed there are. My point is that if we want to realize the benefits of internationalization, all countries will have to make concessions on a reciprocal basis. That is where our future lies.

Whether we like it or not, the age of internationalization is upon us. We are indeed at the beginning of a new era and it is our challenge to work together to forge a regulatory and business environment in which artificial barriers to international capital mobility can be eliminated, while at the same time not losing sight of our primary goals, that is to protect investors and to maintain the integrity of our capital markets.

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26/ See Release, "Government Introduces Legislation to Encourage Investment in Canada," Canadian Embassy, Public Affairs Division, Washington, D.C., dated December 7, 1984.