FOREIGN INVESTMENT IN U.S. AND U.S. SECURITIES LAWS

INTRODUCTION

The other speakers in this symposium have discussed the problems of foreign investment in the United States from the point of view of governmental economic and monetary, social and political policy. I understand that our mission this afternoon, in this concluding program, is to be somewhat more technical - - to restrict our discussion primarily to the application of our federal securities laws to foreign investments.

In general, the statutes which set forth our federal securities laws do not themselves make meaningful distinctions based upon the nationality of issuers or investors, except in the case of foreign governments. Most accommodations under the securities laws with respect to differences in nationality have come about through Commission actions in adopting rules and policies. As you know, with increasing awareness of the effects, good and bad, of foreign investment, more legislative attention is being paid to this specific aspect of our capital markets. One bit of pending legislation related to this field I will discuss later.

Since foreign professional access to our stock exchanges will be discussed by Lee Pickard, I would like to cover three general topics: offerings abroad by U.S. corporations, purchases by foreigners of outstanding U.S. securities, and the proposed Foreign Portfolio Sales Corporations.

OFFERINGS ABROAD BY U.S. CORPORATIONS

The Securities Act of 1933 requires generally that for a corporation to make a public offering of its securities, the securities must be registered under that Act with the Securities and Exchange Commission. Section 5 of the Act, which sets forth this general requirement, says nothing about whether the corporate issuer is or is not incorporated in the United States, nor whether the offering is made to United States residents or to others.

The many exemptions for securities and transactions set forth in Sections 3 and 4 of the Act, likewise say nothing about the nationality of the persons to whom the offering is to be made. By long-standing interpretation, however, the SEC has read into the Act the proposition that its registration requirements were intended primarily, if not exclusively, for the protection of American investors, and that therefore an offering made exclusively to citizens of other countries is exempt from registration. We have also agreed that foreign broker-dealers, participating in distributions of the securities of American issuers need not comply with the broker-dealer registration requirements of U.S. laws if their participations are placed abroad and not in the U.S.

Over the years, the problems in this area have principally centered on the question whether the securities being offered abroad to foreigners would stay abroad, so to speak, at least until they had "come to rest", in our favorite term, rather than find their way promptly back into U.S. markets through resales to Americans by the initial foreign purchasers.

The early techniques devised by issuers and their counsel to satisfy themselves and the SEC that a foreign public offering was indeed foreign, and not susceptible of becoming an indirect device for any reoffering in the United States, were largely replaced ten years or more ago by the adoption of the Interest Equalization Tax. That tax made it unattractive for American citizens to purchase foreign offerings, both initially and in the aftermarket, and we largely relied upon this disincentive for assurance that foreign offerings would not become indirect domestic offerings. The removal of the IET has compelled our staff to re-examine the situation, to determine anew what, if any, assurances by way of covenants, representations, or otherwise, the staff will be willing to rely upon in continuing this implied foreign exemption from Securities Act registration.

This is the basic problem with respect to foreign offerings by U.S. industrial companies. The situation is somewhat different with respect to foreign offerings by investment companies registered under the Investment Company Act of 1940, which we

also administer. Based upon our jurisdiction conferred by Investment Company Act registration, we have not accepted the idea that the shares of such investment companies are exempt from Securities Act registration, even though made exclusively to foreign investors. Here, the Commission's policy has been to insist that the offerings be registered, and that they not discriminate against foreign investors in the nature and scope of information and protections provided. We have, however, permitted and encouraged use of prospectuses by such registered investment companies for foreign offerings which conform to the customers, usages, and laws of the countries in which the offering is to be made.

PURCHASES BY FOREIGNERS OF OUTSTANDING U.S. SECURITIES

In general, no unique securities law problems are presented by citizens of other countries purchasing outstanding securities of domestic corporations. Foreigners are free to participate as investors in our capital markets on a parity with U.S. citizens. On the other hand, no concession or exemption is provided for foreigners when their purchases or holdings of U.S. securities reach a point at which U.S. citizens, in the same circumstances, would be required to take further action. In broad terms, therefore, purchases of U.S. securities by foreigners, as well as by U.S. citizens, encounter securities law problems only when they reach five percent of the class of securities outstanding or the purchaser plans a tender offer. This assumes that the foreign purchaser is not an "insider" (meaning officer or director or a ten percent stockholder) within the meaning of Section 16 of the Securities Exchange Act, in which case special provisions apply, although they are not differentiated according to citizenship of the purchaser, and that the purchaser is not possessed of any non-public material information, which would get him into trouble under the general fraud provisions of our Rule 10b-5.

Parenthetically, I should say that there may be problems under some other U.S. laws, based on aggregate holdings by non-U.S. nationals. The State of Texas has such a provision with respect to corporations organized under its laws, and so do federal laws with respect to airlines, communications companies, and certain others.

The provisions of the federal securities laws brought into play by holding five percent or more of an outstanding class of securities, or by planning a tender offer, are in fact limited to securities of a class registered under Section 12 of our Securities Exchange Act. Since this includes all corporations whose shares are listed on any securities exchange, and virtually every company actively traded in the over-the-counter market, one may accept these provisions as having broad, if not universal, application. In this discussion, I will not constantly qualify my remarks by referring to the possibility that a class of equity securities might, in fact, be exempt from these provisions because it is not publicly held by a sufficient number of investors or the issuer is not large enough.

Section 13 of the Securities Exchange Act requires persons who, directly or indirectly, acquire beneficial ownership of more than five percent of a class of equity securities, to file with the Commission certain specified information in a Schedule 13D. The information required relates primarily to the identity and background of the purchasers, sources and amounts of funds used in connection with the purchases, the amount of securities held by the purchasers and their affiliates, and the purpose of the purchases, including whether control of the issuer is being sought and whether any changes in the corporate structure, assets, policies or management of the issuer are planned. Material changes in the information filed, such as increases in the amount of securities held and changes in the purchaser's intentions, must be disclosed in amendments to the Schedule.

Similar information must be disclosed in a report on a Schedule 14D filed with the Commission in the case of tender offers. The disclosures required in soliciting materials in connection with tender offers can be quite complex for foreign investors in

view of Section 14(e) of the Securities Exchange Act. Section 14(e) provides that it is unlawful to make any untrue statement of a material fact or to omit to state any material fact necessary under the circumstances to make the statements made not misleading in connection with any tender offer. The material facts required to be disclosed by a foreign offeror, for example, often involve a detailed discussion of the impact of foreign laws on the operations of the offeror, such as government exchange controls, or other regulations which might affect the operations or assets of either the offeror or the target company. The tender offer litigations between General Host Corporation and Triumph American, Inc., and between Ronson Corporation and Liquifin Aktiengesellschaft, illustrate the problems confronting foreign offerors in acquisition contests. In particular, these two cases demonstrate the need to disclose the possible impact of foreign government regulations even where such possible impact is disputed by opposing foreign law experts.

FOREIGN PORTFOLIO SALES CORPORATIONS

I have also been asked to say a few words about the joint SEC-Treasury Department legislative proposal to enable creation of a new investment vehicle, to be known as a Foreign Portfolio Sales Corporation, a form of mutual fund for investments in securities of U.S. issuers, which would be organized in the United States, and registered with the Commission under the Investment Company Act of 1940, but intended for sale only to non-residents and non-citizens of the United States. This proposal was developed by an inter-agency Offshore Funds Task Force, comprised of representatives of the Commission, the Treasury Department, the State Department, and the Federal Reserve Board. The Task Force was assembled at the Commission's request as a result of recommendations in the Commission's 1971 Institutional Investor Study. In that study, the Commission expressed the view that foreign investor confidence in offshore mutual funds which invest in American securities could be improved significantly if foreign investors in such funds were afforded the protection of the U.S. securities laws. The

Commission pointed out that the tax benefits provide to offshore funds by the Foreign Investors Tax Act of 1966 gave such funds a competitive advantage over registered U.S. investment companies, which may seek to sell their shares in foreign markets, and suggested that these tax advantages should be equalized in order to enable registered U.S. investment companies to compete effectively with unregulated offshore funds. The inter-agency Task Force concluded that offshore funds could be attracted to the United States, and would be willing to register with, and be regulated by, the SEC, if they were permitted to retain their existing tax benefits.

The legislative proposal submitted to the Congress is in two parts. The first part, an amendment to the Investment Company Act of 1940, would add a new section to that Act specifically providing for the registration and regulation of domestic investment companies organized for the sale of their securities to foreigners. The second part of the proposal, which would follow favorable action on the first, would amend the Internal Revenue Code to permit U.S. mutual funds, registered with the Commission, which sell their shares exclusively to foreign investors, to obtain tax benefits comparable to those afforded offshore funds under the Foreign Investors Tax Act of 1966. The proposed tax benefits would include an exemption from tax on capital gains at the corporate level, a tax exemption for dividends and interest from foreign securities held in the fund's portfolio, although not more than 25 percent of the fund's portfolio could consist of foreign securities, an exemption for the shareholders of a Foreign Portfolio Sales Corporation from U.S. estate taxes, and the elimination or modification of withholding tax on payments of dividends or interest to such foreign shareholders.

Unfortunately, this proposal has not been greeted with much enthusiasm by the Congress. I believe, however, that this proposal would improve foreign investor confidence in investing in U.S. securities through mutual funds, particularly in view of the recent well-publicized difficulties experienced by certain unregulated offshore funds,

would help to insure the integrity of the U.S. securities markets, and, perhaps, would benefit the U.S. balance of payments.

CONCLUSION

Over the years, and today, it has been the SEC's assumption that U.S. foreign policy favored the free flow of capital among nations, except when explicitly restricted by special legislation, such as the IET. The recent public remarks of Secretary Schultz indicate that this assumption is still correct. Accordingly, unless and until there is some change in U.S. policy or in the legislation affecting our jurisdiction, we do not propose to use the federal securities laws as indirect devices to impede foreign investment in U.S. companies. On the other hand, we are faced with the problem of equal enforcement. We do not read our laws as making concessions for foreign investors. As indicated by my previous discussion, this is no problem so long as the investments of foreigners are limited to modest amounts in the ordinary trading markets. It becomes a problem only where a foreign investor, or a group of foreign investors, accumulates a significant amount of stock in American companies or proposes to acquire a significant block of stock or control of a company through a tender offer. Here our problems become somewhat more difficult because of our lack of ready access to underlying facts through compulsory process. I refer particularly, of course, to secrecy provisions with respect to the holdings of securities provided by the laws of some other countries. Our efforts, however, will be devoted, as they have been in the past, to providing U.S. investors with the same information with respect to major stockholders and tender offerors that they would receive if those other persons were U.S. citizens. In colloquial terms, foreign nationals who wish to play the control game in our ballpark have got to play by the same rules. This is not meant to be discriminatory, but only equalizing. In our view, these rules contribute to the attractiveness of U.S. investments and therefore are in the best interest of foreign investors as well as our own.