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IS THE SEC A BARRIER TO NEW YORK'S ROLE IN INTERNATIONAL FINANCE?

An Address By

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When I was first invited to participate in this Conference, I almost declined out of hand because of the dimmable impertinence of the question to which I was asked to address myself - - "Is the SEC a barrier to New York's role in international finance?" But on reflection, I got rather intrigued with the question itself and the possible intent of its draftsman.

Literally, I thought, the answer has to be no, because whatever role New York is playing in international finance obviously has not been barred by the SEC, but that could scarcely be what the draftsman had in mind. Considering the title of the whole conference, I decided that the question might be more aptly phased, "Is the SEC a barrier to New York's playing a greater role as a world financial center?" This seems closer to the point, although, of course, as officials of our federal government, we at the Commission must strive for neutrality and objectivity with respect to the aspirations of our several cities to attract international as well as other financial business. I presume that the draftsman of the question was merely accepting the fact of New York's continued preeminence as a financial center among our cities and was not trying to lure me into the dangerous waters of of appearing to be more concerned with New York than with Boston, or Philadelphia, or San Francisco, or Chicago, or any other of our cities whose financial institutions are seeking an increased role in international finance. So I rephrased the question again. "Is the SEC a barrier to any United States city, including, but not limited to, New York, playing a greater role in international finance?" That puts me on safer ground.

Having thus decided on my subject matter, I then asked why the question should be asked? We at the Commission are traditionally fond of the view, which I think is

supported by our history, that the federal securities laws, and the SEC which administers them, have served to strengthen our capital markets by generating confidence in their fairness among investors. We believe that the role of New York as well as our other cities as financial centers would be weakened, rather than strengthened, internationally as well as nationally, by the repeal of these laws and the abolition of our agency. I think most responsible financial men in our country share this view, regardless of how angry they may get at the Commission over particular matters.

Even if one were of a different view, the possibility of the SEC and the laws it administers simply going away is too remote to justify taking up your time and mine at a conference of this sort, so I take my question as intended to explain whether present and future policies and actions of the SEC will constitute such a barrier, and I take this to assume the continued existence of our present laws. While our federal securities laws do get amended from time to time, and proposed amendments are pending in the present Congress, any discussion of our policies relevant to international finance would tend to become too hazy and speculative if we start imagining different laws.

Now, having thus refined the question before us, I must tell you that I do not really propose to answer it. I propose to discuss the effect of our laws and policies on certain major aspects of international financing transactions, including some with respect to which we are currently in the throes of trying to determine policy, but I think it would presume too much for me to decide at this juncture whether over, say, the next decade, these laws and policies will or will not constitute a barrier and to what degree. In too many respects, whether or not the SEC and the laws it administers constitute a barrier,

and how formidable a barrier, depends upon the willingness of nationals of other countries to comply with them.

As a general proposition, we understand the policy of our government to be one of encouraging the free flow of capital among nations, and we do not feel ourselves under any mandate or even pressure to use our various powers to impede foreign investment in the United States or investment by United States citizens in foreign securities as a matter of deliberate policy. Our primary mandate is investor protection, and our primary policy consideration is to provide our investors when engaged in international transactions with protection equal as nearly as reasonably possible to those afforded when engaged in domestic transactions.

Simple and clear as this policy seems in concept, giving effect to it in specific instances is by no means easy. Differences in laws, business and accounting customs, and respect for national sovereignties, combined with the lack of clear guidance in our own laws, cause us to be faced with many quandries. It is also important for you to bear in mind that to a large extent for the last ten years or so we have been out of the international business in some important respects. When a problem is presented only occasionally and in a limited way, we are inclined to handle it in an ad hoc fashion, but when the same problem tends to become a regular and general matter, then we must think further and more broadly and consider adopting rules and forms or at least formal statements of policy. We cannot yet foresee the full effects of the removal of the interest equalization tax, the prospective removal of the withholding tax and other actual or possible international developments on our volume of business. We are aware, however, of the likelihood that the number and size of international transactions having some

involvement with our laws will increase sharply, and that we will be required to be more systematic in developing rules, forms and policies of general application.

As an obvious example, the SEC has never adopted a special form for the registration under the Securities Act of an offering by a foreign industrial company. There have never been enough such offerings to seem to require this. Instead, the foreign issuers and its United States counsel and investment bankers have worked with our staff to accommodate our general Form S-1 to the particular situation. This procedure has been, on the whole, adequate, but it will not continue to be if there is a significant increase in the number of such offerings.

With these general observations in mind, let me turn to some particular areas that are of present concern to us and where our attitudes might be regarded as imposing a barrier. These are the raising of capital in the United States by foreign companies; the acquisition of United States companies by foreign companies; establishing a public market in the United States for the securities of foreign companies, and access to United States securities markets by foreign brokers or dealers or banks directly or through domestic subsidiaries. There is not nearly enough time to explore any of these topics in detail, so I will confine myself to pointing out the major problems as we see them and, to the extent that I can, what positions we are apt to take.

For most of your purposes, it is well to keep in mind the basic dichotomy made by our federal laws; this involves, first, the registration of the sale of securities by a company to the public, and second, the obligations of that company and other publicly-held companies to keep future investors and present stockholders well-informed about the company's operations.

The first aspect is governed by our Securities Act of 1933, essentially a disclosure and antifraud statute; it does not authorize the Commission to bar access by any issuer to the public markets so long as such issuer complies with its registration provisions. The use of our mails or any means or instruments of interstate and foreign commerce in connection with offers and sales of securities can trigger the application of the registration requirements, whether such transactions are commenced here but completed abroad or take place outside the geographic territory of the United States but which have effects within this country.

While that Act contains a number of specific exemptions from the requirement of registration where Congress deemed such provisions unnecessary for the protection of investors, curiously enough, no exemption specifically covers securities issued by, or the transactions of, foreign issuers as such. However, the Commission traditionally has applied the registration requirements of the Securities Act to situations requiring primarily the protection of American investors. Offerings made exclusively to foreign nationals have not been required to register even when made by United States companies or their foreign subsidiaries and certainly not when made by foreign companies having no United States parent. Nor have we required foreign broker-dealers taking part in such distribution by United States companies to comply with the broker-dealer registration requirements of our laws, as long as their participation takes place abroad.

This sort of implied foreign offering exemption is based on the proposition that the offering is not in fact, whether so intended or not, an indirect offering within the United States because of sales to U.S. citizens by the initial foreign purchasers from the underwriters. This has led to the development of the concept of “coming to rest” abroad.

That is to say, resale to U.S. residents of securities made initially in a bona fide foreign offering do not result in loss of the exemption from registration under our Securities Act if, prior to the resales, the securities have come to rest abroad. This is an attractive conceptual solution to a practical problem which the Commission has faced because of the silence of our law on the subject, but it is not always so easy to give it effect. Now that the removal of the Interest Equalization Tax is increasing the temptation of U.S. citizens to purchase foreign securities, we are being urged to develop clearer guidelines for determining whose securities have come to rest.

The Commission has never defined specifically the "coming to rest" concept in terms of an objective time period, relying instead on the administrative flexibility provided by a case-by-case approach. However, in line with other recent efforts by the Commission to provide more objectivity and predictability into interpretations of the Securities Act, and the expected increased volume in this area, our staff presently is engaged in attempting to formulate objective standards for this "coming to rest" concept. Our primary concern is not to attempt to apply our laws extraterritorially, but to preserve the integrity of the registration provisions of the Securities Act in the interest of American investors. I expect that the Commission will, in the very near future, issue a release for comment, outlining our position in this area.

While the Securities Act provides no exemption from the requirement of registration for offerings of debt securities issued or guaranteed by foreign governments and their subdivisions, it does permit them to make different disclosures in fulfillment of the registration requirements from the disclosures required of foreign private issuers, and

they are exempt from our Trust Indenture Act and the financial statement requirements of our Regulation S-X.

On the other hand, foreign private or nongovernmental issuers are treated basically the same as domestic issuers when they make a public offering to U.S. residents. No special registration forms are provided, and substantial compliance with all of our disclosure standards are required. In fact, additional disclosures, pursuant to Rule 408, relating to various economic, political and legal considerations pertaining to taxation, expropriation risks, stockholder rights, currency devaluation risks and the like may be required depending on the particular country, industry or company involved. We also require disclosure of an opinion of counsel as to the enforcement in the foreign country of the civil liability provisions of the Act, by private investors, either directly or based on American judgments. These opinions are almost always negative. It was for this reason that Section 6(a) of the Securities Act requires not only the signature of the foreign issuers and its management on a registration statement, but also the signature of the foreign issuer's authorized representative in the United States. The purpose of this is to provide a means to enforce the civil liability provisions of the Securities Act in our courts, and to encourage full disclosure.

Nevertheless, the Commission has made some practical concessions to foreign issuers. In the nonfinancial area, the concessions have been limited essentially to the area of remuneration and similar benefits paid to or accrued for management. We have, and will, accept aggregate management figures in this area rather than disclosures of the monies paid to individuals where such information is not required or made pursuant to the custom and practices of the foreign country involved.

Similarly, the Commission has allowed some practical deviations from our standards for financial reporting. The accommodations we make in the financial statements we require to be filed with us are based strictly on the facts of each case and in the context of the general financial reporting environment existing at the time of each determination. For this reason, prior interpretations do not represent reliable precedents, especially in view of the rapid changes which are occurring in financial statement disclosures, not only here but throughout the world. We do not favor deviations in financial statements filed with us, and, as the movement toward fuller disclosure continues abroad, fewer concessions should be needed here.

Another area of prime concern for foreign issuers is our requirement of an independent audit for financial statements filed with us in registration statements. Our statutes do not specifically preclude foreign auditors from certifying financial statements filed with us. We do, however, require a showing by such auditors of familiarity with, and competence in applying, American auditing standards. The principal problem in the past, however, has not been the inability of foreign auditors to show competence in applying American auditing standards, but rather their inability to meet our standards of independence. We are most reluctant to alter our requirements in this regard, although we have done so infrequently where conflicts of interest have been minor and have been extinguished at the time of the audit and/or where minor conflicts of interest have existed on the part of auditors certifying to an immaterial segment of the complete consolidated financial statements. Disclosure of the underlying facts involving the conflicts of interest are, of course, required.

Once securities have been registered and distributed in the United States, or a public market within the United States otherwise comes about, the Securities Exchange Act of 1934 comes into play. It relates to the trading markets and picks up where the Securities Act leave off - - post distribution trading. This Act extends the disclosure approach of the Securities Act to the trading markets by requiring periodic disclosure of financial and other material information by most public companies, so that existing shareholders and potential investors will be able to determine regularly, the results of a public company's operations. Other provisions of the Exchange Act relate to take-over disclosures, disclosures of holdings of the issuer's equity securities by so-called insiders and liability for profits on so-called short swing trades therein, and the rules governing the solicitation of proxies.

A company whose securities are listed on a U.S. stock exchange must also register them with us under Section 12(b) of the Securities Exchange Act, and a company whose securities are not listed on an exchange, but which has assets if at least $1 million and an outstanding class of equity securities held by 500 or more persons, must register that class under Section 12(g) of the Act - - with special provisions for banks and insurance companies. When the number of holders gets below 300, the company may terminate its registration. Registration under either subsection brings the periodic reporting of those provisions of the Act into place.

Bearing the above in mind, let me review briefly the primary foreign registration and reporting forms. Form 18 is the registration form provided for the listing of the securities of foreign governments and subdivisions on an exchange. This form tracks substantially the information required by Schedule B to the Securities Act. The annual

up-date form for these entities as a result of listing is Form 18K. Unlike our requirements for domestic companies, no interim reports are required for foreign governments or their subdivisions.

Form 20 is the basic registration form for foreign private issuers and Form 20K is the annual up-date form. Form 6K, adopted in 1967, is the substitute for the periodic 8K and 10Q reports required of domestic issuers. This form, in essence, provides for the furnishing, not filing, of material investor information which the foreign issuer reports to its own government, to foreign stock exchanges or otherwise makes public to its securityholders. Form 20, 20K and 6K generally are not available to North American (essentially Canadian) issuers who have had prior Securities Act registration statement or who wish to list securities on an exchange. These issuers would be governed by the requirements applicable to domestic issuers.

The Forms 20 and 20K provide an interesting contrast to their Form 10 and 10K counterparts. The foreign forms do not require disclosure of share ownership by management or 10 percent stockholders but only the presence of direct control by a foreign issuer. Nor is disclosure required with respect to remuneration and similar benefits paid to or provided for individual members of management, transactions of management with issuer, pending legal proceedings, trading markets and recent issuances of securities. Form 20 by its terms requires only a "general" description of the character if the business and property of the issuer, a very skimpy requirement compared to Form 10 especially in regard to required information on results by lines of business and the competitive situation. Furthermore, all that is required by Form 20K is an indication of the changes that have occurred in the past year in contrast to the Form 10K which

requires an annual up-date of the complete description of business including sales and earnings by lines of business.

The Commission's continual efforts to improve disclosures to investors have resulted in rather frequent and material amendments to the registration and reporting forms for domestic issuers in the past several years. However, the foreign forms, principally Forms 20 and 20K, have not kept pace. It would appear that these particular forms could parallel more closely the domestic forms, certainly in the business disclosure area, without creating undue hardships on foreign issuers who in many instances are subject to more extensive disclosure requirements by their domicile countries. We are considering this prospect.

As far as financial statement reporting disclosures, basically the same general policies and practices of the Commission as I discussed in connection with the registration under the Securities Act are applicable to registration and reporting by foreign issuers under the Securities Exchange Act. Foreign issuers are expected to comply substantially with the same requirements applicable to domestic issuers.

Several other significant accommodations have been made for foreign issuers under the Securities Exchange Act. Registration under either Section 12(b) or 12(g) of the Act automatically triggers the provisions of Sections 14 and 16 of the Act. Section 14 generally provides for and regulates the solicitation of proxies and the nature and extent of information that must be furnished to securityholders in connection with such proxy solicitations. Section 16 regulates and, in essence, prohibits short-swing trading profits by management and others in the equity securities of the issuer. Although no specific exemption for foreign issuers is contained in either Section 14 or 16 of the Act, the

Commission, pursuant to broad exemptive authority otherwise given to it in the Act, adopted Rule 3a12-3 in 1935. This rule, in effect, exempts from the proxy and insider trading provisions of Sections 14 and 16 those securities for which the filing of registration statements on Forms 18 or 20 are authorized. This would include, of course, all foreign governments and most foreign private issuers. The only significant amendment in this rule occurred in 1966 when the exemption was removed for essentially American companies, - - that is, companies 50 percent owned, directly or indirectly, by American residents and whose business is either administered principally in the United States or 50 percent of whose Board of Directors are American residents. We have no present intention of removing or further restricting this exemption. Let me emphasize, however, in connection with Section 16, that the exemption applies only to the reporting and civil recovery for short-term trading provisions; it does not affect the liabilities resulting from the misuse of publicly undisclosed material information available to management and other insiders.

Another significant accommodation provided for foreign issuers is in the registration requirements under Section 12(g) for equity securities trading in the over-the-counter market in the U.S. Because of the usually passive role of foreign issuers in the development of such trading markets and for practical enforcement reasons, the Commission has exempted by rule most foreign issuers from these registration and the attendant periodic reporting requirements. Rule 12g3-2, adopted in 1967, provides, basically, a two part exemption. First, it exempts the equity securities of foreign issuers if such class of securities is held by less than 300 persons resident in the U.S. rather than the 500 securityholder world-wide test of Section 12(g). Second, notwithstanding the

number of total U.S. securityholders, the rule generally provides a complete exemption if the foreign issuer or a foreign government official on its behalf of the issuer furnishes, not files, to the Commission whatever material investor information the issuer reports to itw own government, to foreign stock exchanges or otherwise makes public to its securityholders. Other miscellaneous exceptions in the Rule are for American Depositary Receipts and temporary exemptions for most foreign issuers which are required to file periodic reports by reason of prior Securities Act or Securities Exchange Act registrations. Again, these exemptions are not available to essentially American companies although foreign formed or to certain North American companies.

Our federal securities laws also may regulate certain purchases, by foreigners, of outstanding American securities.

In general, no unique securities law problems are presented when citizens of foreign countries purchase outstanding securities of our domestic corporations. Under these laws, foreigners are free to participate as investors in our capital markets on a parity with American citizens. On the other hand, no concessions or exemptions are provided for foreigners. In broad terms, purchases of American securities by foreigners, as well as by United States citizens, trigger securities law provisions when they reach 5 percent of the class of securities outstanding or the purchaser plans to make a tender offer. At that point, Americans and foreigners are required to file certain reports with us. If the purchaser, foreign or American, is an officer, director or 10 percent stockholder he is also a company “insider,” in which case additional special reporting provisions of law also apply.

While, in the absence of 5 percent ownership, the federal securities laws may be silent, you should note that there may be problems under some other American laws. In addition to possible problems under the laws of some states, there are other special federal laws which may restrict foreign ownership for companies engaged in such endeavors as air transportation, communications and the like.

Section 13 of the Securities Exchange Act requires persons or groups of persons who, directly or indirectly, acquire beneficial ownership of more than 5 percent of a class of most equity securities, to file with the Commission certain specified information relating primarily to the identity and background of 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 initially filed, such as increases in the amount of securities held and changes in the purchaser's intentions, must be disclosed promptly in amendments.

Similar information must be disclosed in a report filed with the Commission where an actual tender offer is made. 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 material misstatement or omission 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 litigation between

General Host Corporation and Triumph American, Inc., and between Ronson Corporation and Liquifin Aktiengesellschaft, illustrates the problems confronting foreign offerors in acquisition contexts. In particular, these two cases demonstrate the need to disclose the possible impact of government regulations, even where such possible impact is disputed by opposing foreign law experts.

Sections 13 and 14 relating to acquisitions and tender offers are relatively new, and we are still learning. One area which may need revision and extended disclosure is the circumstance where the acquirer or tender offeror is a new, or relatively unknown, issuer, such as a foreign issuer. It may be that specific information should be required with respect to the business of such acquirors, including financial information. We also have difficult problems in the acquisition areas when foreign issuers are involved because of our lack of ready access to underlying facts through compulsory process. I am referring particularly to the prevalent use of bearer shares in foreign jurisdictions, the practice of foreign investors holding shares though banks and other institutions and, of course, to secrecy provisions with respect to holdings of securities provided by the laws of some other countries. The real parties in interest are often difficult to establish unless such parties voluntarily comply with our requirements. We are looking at these and other related matters at the present time.

You should also be aware that various bills have been introduced in Congress which would, if enacted, place restrictions on foreign ownership of American industrial companies. We, at the Commission, are at this point, more inclined toward traditional reliance on disclosure rather than on the imposition of direct restrictions on any investor. At this juncture, we have seen no evidence justifying the need for the imposition of such

restrictions. We have, however, supported legislation to require the disclosure of holdings and large trading transactions by certain institutional investors. While the effect of this legislation on foreign investors is uncertain at this point, disclosures of this type will be necessary, I believe, if more rigid controls on stock ownerships by foreign nationals are to be avoided.

Access to direct share ownership is not the only area of our common concern. Of late, we have become increasingly aware of the difficult problems raised by foreign entities seeking direct access to our securities markets without the need to deal through or with another securities professional. In view of the ever increasing interest of foreign investors in purchasing and selling U.S. securities, foreign brokers and foreign banks involved in the securities business have sought wider access to our securities markets.

What do we mean by "access"? The market for securities in the United States is comprised, in the first instance, by twelve active stock exchanges. There is also an over-the-counter market, for unlisted securities, and the so-called "third market" for over-the-counter trading of securities also listed on exchanges. Virtually all broker-dealers must register with the Commission if they wish to do business. If they also meet our disclosure and financial responsibility standards and join the industry self-regulatory body, the National Association of Securities Dealers, they can obtain direct access to the over-the-counter market, and to the third market as well. These broker-dealers can also obtain limited access to our exchanges through the 40 percent nonmember discount on commission rates fixed by exchanges to the public. With the forthcoming elimination of fixed rates on May 1, 1975, access to exchanges in this form will increase. Membership by foreign entities has been opposed by our primary exchanges - - the New York and

American Stock Exchanges - - and supported by some of our regional exchanges, most notably the Boston Stock Exchange.

The Commission itself has not distinguished between domestic and foreign, or foreign controlled, broker-dealers for purposes of registration with us, although we do require certain consents to service of process and provisions for the availability of records in the United States.

As to stock exchange membership, the Commission has not, to date, interfered with the positions taken by the several exchanges. We are now being urged to do so - - both ways. To help us in the development of a position in the matter, we have publicly requested the submission of views, and we have received sharply conflicting expressions, as we expected. Weighing the various considerations involved - - the desire for the elimination of artificial barriers to the flow of capital, the need for adequate regulatory supervision, the disparate roles of commercial banks here and abroad, and the possible effects of unfixed commission rates - - it will take some time for us to come to a reasoned conclusion.

On the whole, I doubt that the SEC should be considered a barrier to New York's role in international finance. Our securities markets are highly-regulated, but then, that may add to the attractions of investments in American enterprise. Foreign investors have, on numerous occasions, utilized our detailed regulatory scheme as the basis for the assertion of legal rights. And foreign issuers at least should be confident that American investors will be more inclined to purchase their securities if they have met our rigorous disclosure standards.

Our system of securities regulation has been unique, and it has contributed to the strength of our capital markets in contrast to those of other countries. Of course, our system is far from perfect, but we continually strive to improve it. With the growing international flavor of recent world-wide schemes to defraud investors, our system of pervasive regulation should prove increasingly attractive, and I think we are seeing evidence of developments in this direction.

Investor confidence is the key to strong capital markets, and full and fair disclosure is the principal avenue to such confidence. The rapid development of the Euro-markets which is used, essentially, by quality issuers and characterized by a high quality of disclosure attests to this premise. New York, prior to the imposition of American investment controls, beginning in 1963, was the acknowledged international capital market of the free world. The federal securities laws did not then, and should not now, prevent New York from retaining its preeminence. The challenges and opportunities for truly international markets are now before us. Our failure to meet and take advantage of them could be a free world disaster.