

STATEMENT OF THE HONORABLE RAY GARRETT, JR.,
CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION,
BEFORE THE SUBCOMMITTEE ON FOREIGN COMMERCE
AND TOURISM OF THE SENATE COMMITTEE ON COMMERCE
ON S. 2840, 93d CONG., 1ST SESS. (1973).

March 7, 1974

Mr. Chairman, I am pleased to appear before this Subcommittee today to testify on S. 2840, a bill which would authorize and direct the Secretary of Commerce to conduct a study of foreign direct and portfolio investment in the United States.

I am accompanied by Mr. Alan B. Levenson, Director of the Commission's Division of Corporation Finance, Mr. Ralph C. Hocker, Associate Director of that Division, Mr. Carl T. Bodolus, Chief of that Division's Office of International Corporate Finance, and Mr. Andrew P. Steffan, Director of the Commission's Office of Policy Planning. These gentlemen will be pleased to respond to any technical questions you may have with respect to my testimony.

The Securities and Exchange Commission believes the study proposed in this bill could serve useful public purposes and, if the bill is enacted, we look forward to cooperating with the Secretary of Commerce to the fullest extent possible.

Increased international participation in United States securities markets in recent years has raised important issues for the Commission with respect to our enforcement and administration of the federal securities laws.

For example, the establishment of foreign-controlled broker-dealers in this country has led to questions about the form in which foreign financial institutions should have access to United States securities markets as brokers and dealers. "Access," in this context, has a special meaning. If foreign firms cannot obtain access to our markets - - at least our markets on national securities exchanges - - then they must pay the full commission rate exchange members charge their customers for executing transactions on exchanges. In such a case, the foreign firm would either have to charge its customers more for its service (an amount equal to the commission the

foreign firm would be required to pay the exchange member, plus an additional charge to defray expenses and earn a reasonable profit), or look to the American exchange member firm for some other form of compensation to offset increased expenses, such as participating in an attractive underwriting. Another form of access for foreign firms is to qualify for the 40 percent discount exchange members are required to offer all bona fide brokers and dealers, on agency transactions, from the fixed commission rates exchange members are required to charge at present. In an effort to study these access questions, the Commission recently issued a request for public comment on issues concerning foreign access to the United States securities markets.¹

Similarly, shifts in currency rates and the depressed United States securities markets, among other things, have made shares of American corporations more attractive to foreign investors. Where foreigners acquire or make cash offers for more than five percent of the shares of publicly-held American corporations, they are required, as are American investors, to file certain pertinent information with the Commission. The Commission's staff informally has been monitoring the reports filed with us in connection with cash tender offers. Our tally indicates that, during fiscal year 1973, there were eight cash tender offers by foreign persons to acquire securities of United States corporations and that, in the first eight months of fiscal year 1974, there were eighteen such tender offers.

Although certain information with respect to foreign investors in securities of American corporations is contained in reports filed with the Commission, our information on foreign investments is less than complete; it is limited, for the most part, to investments made in publicly-held companies, and we generally receive no information until an investor has acquired, or intends to acquire, a beneficial interest in more than five percent of a class of equity securities. We cannot always be certain that required information in fact is filed, or that it is accurate. Moreover, our ability to segregate and compile meaningful information about foreign

¹ Securities Exchange Act Release No. 10634 (Feb. 8, 1974).

participation in our securities markets, or trends in foreign investment in the United States, is quite limited. Indeed, we are not aware of any source of reliable data on this subject. We believe, therefore, that the collection and analysis of information on foreign investment in the United States contemplated by this bill could prove useful to the Commission, in connection with our administration and enforcement of the federal securities laws, as well as to other government agencies, and to the Congress, in connection with their consideration of legislative proposals or policies concerning foreign investments in the United States.

I believe that it would be most helpful to the Subcommittee if I first describe briefly the way in which our federal securities laws apply to foreign investors in United States securities, and then outline the various types of information on investors, including foreign investors, presently required to be filed with the Commission, and what we do with that information. I will conclude my testimony by discussing how the information filed with the Commission might assist the Secretary of Commerce to meet the objectives of the study proposed by S. 2840.

The federal securities laws do not make meaningful distinctions based upon the nationality of issuers or investors, except in the case of foreign governments. Those accommodations in the administration of the federal securities laws to differences in nationality that do exist are the result of Commission policies rather than statutory edict, in most cases, and these accommodations primarily have facilitated offerings of securities by foreign issuers to United States investors, or the sale of securities overseas by United States corporations, rather than the purchase of securities of American corporations by foreign investors in this country. Under our federal securities laws, citizens of other countries may invest in our capital markets to the same degree and extent as United States citizens, subject, of course, to the same requirements applicable to American investors, including requirements to file reports with the Commission of certain types of transactions in the securities of virtually all publicly-held United States corporations.

Certain investors in securities which are required to be registered under Section 12 of the Securities Exchange Act of 1934 - - and this includes all corporations whose shares are listed on

any national securities exchange, and virtually all publicly-held companies of any size whose securities are traded over-the-counter - - are subject to reporting requirements pursuant to three provisions of that Act. Bear in mind, of course, that the owners of certain securities might, in fact, be exempt from these provisions if the company's stock is not held by very many investors or the issuer's assets are too small.

Section 13 of the Act requires any person, or group of persons, acquiring beneficial ownership of more than five percent of a class of equity securities to file with the Commission, on its Schedule 13D form, certain specified information, including:

- (1) the names and occupations of the purchasers;
- (2) the source and amount of funds, or other consideration, used in making the purchases;
- (3) the amount of securities held by the purchasers and their affiliates; and
- (4) the purpose of the transactions, 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.

A copy of this Schedule must be sent to each national securities exchange where the securities are traded, and to the issuer of the securities. Material changes in the information filed, such as increases in the amount of securities held or changes in a purchaser's intentions, must be disclosed in amendments to the Schedule.

Section 14 of the Act requires that similar information be filed with the Commission, also on our Schedule 13D form, by any person, or group of persons, intending to make a tender offer for any class of equity securities if, after consummation of the tender offer, that person or group of persons would, directly or indirectly, beneficially own more than five percent of those securities. The Schedule is required to be filed prior to the commencement of the tender offer.

Section 16 of the Act requires a beneficial owner of more than ten percent of any class of equity securities, and officers or directors of the issuer of such securities, to file with the Commission a statement of the amount of all equity securities of the issuer which he beneficially

owns, and further to report to the Commission, on a monthly basis, all changes in his ownership of such securities. This information is filed initially on our Form 3, and subsequent changes are filed on our Form 4. Reports on Form 3 and 4 also are required to be filed by beneficial owners of ten percent or more of any class of outstanding securities of closed-end investment companies pursuant to Section 30(f) of the Investment Company Act of 1940.

I have attached a copy of our Schedule 13D form as Exhibit 1 to my testimony, and copies of our Forms 3 and 4 as Exhibit 2 and 3. All information filed with the Commission on Schedule 13D and Forms 3 and 4 is available to the public.

The Commission also receives certain other information with respect to investors, including foreign investors, in United States securities from the issuers of such securities. Corporations which are required to register their securities under Section 12 of the Securities Exchange Act are required by the Commission, in registration statements on Form 10, annual reports on Form 10K, and proxy statements, filed under that Act, to identify those record and beneficial shareholders, known to the issuer, who own more than ten percent of any class of voting securities of the issuer. Similar identifying information with respect to large shareholders is provided by registered investment companies in annual reports required to be filed with the Commission pursuant to the Investment Company Act of 1940.

The Securities Act 1933 requires registration of a public offering of securities, including an offer to exchange securities for those of a publicly-held company. Most forms for registration under that Act call for information similar to that required in Securities Exchange Act registration statements and reports with respect to the identity of large shareholders and the amounts of the issuer's securities owned by them.

Broker-dealers and investment advisers required to register with the Commission, pursuant to the provisions of the Securities Exchange Act and the Investment Advisers Act of 1940, are required to file with the Commission the names of all beneficial owners of their equity securities, and the approximate proportion of the total outstanding equity securities owned. The information filed must be updated whenever changes occur.

In summary, substantial investors, both domestic and foreign, in publicly-held companies are generally required to report their holdings of securities of such companies to the Commission. In addition, once an investor has acquired ten percent or more of a class of equity or voting securities of an issuer, both the investor and the issuer may be required to report this information. Acquisitions of securities must be reported after they have been made, except, of course, in the case of cash tender offers or exchange offers for securities of publicly-held corporations, where information must be filed before offers are made. Nevertheless, from the point of view of someone seeking to study the influence of foreign investors on American markets, the nature of our reporting and registration requirements may result in the information provided to us being somewhat incomplete, and possibly inadequate.

The securities laws only require information to be filed relating to investments in certain publicly-held corporations, broker-dealers, investment companies, and investment advisers. The Commission would be unlikely to have any information relating to private investment or direct investment in plants and equipment in this country. In addition, the statutes we administer generally do not require any report to be filed until investors acquire or intend to acquire more than five percent of the equity shares of publicly-held companies. Smaller shareholders are not required to file reports with us, and neither are purchasers of debt securities.

There has been little reason for the Commission, in administering the federal securities laws, to segregate the data in reports filed with us according to the nationality or citizenship of investors. Recently, as I indicated earlier, the Commission's staff informally has been monitoring the Schedule 13D reports filed pursuant to Section 14 of the Securities Exchange Act, in connection with cash tender offers. But, we do not process reports of securities ownership, filed pursuant to Sections 13 and 16 of the Securities Exchange Act, in a manner designed to separate data relating to foreign investors from that relating to American investors.

Ownership reports filed with us in the past could be searched in order to segregate data on foreign investors, but the task would have to be performed manually, and would require a

significant expenditure of money and manpower. During the fiscal year ended June 30, 1973, for example, approximately 1,000 Schedule 13D's (excluding amendments), and 115,000 Forms 3 and 4 were filed with the Commission.

In the future, the Commission could process these filings to identify information concerning foreign investors, but the task might prove unduly time-consuming and expensive, and the data obtained would not necessarily be accurate and complete. Similar problems might be encountered in searching registration statements, periodic reports and proxy materials filed with the Commission, and the cost of such a search, in proportion to the value of the information obtained, likely would be prohibitive.

With regard to the specific objectives of the study proposed to be conducted by the Secretary of Commerce, set forth in Section 3 of S. 2840, information presently filed with the Commission may be helpful in the following areas, subject to the limitations I have already outlined:

Section 3(1) of the bill calls for a broad investigation of the nature, scope, magnitude and rate of foreign direct and foreign portfolio investment. Our data could be useful in identifying substantial foreign direct and portfolio investment in securities of publicly-held companies.

Section 3(2) and 3(3) of the bill direct a study of the processes and mechanisms through which foreign direct and portfolio investment flows, the reasons for foreign direct investment in the United States and the financing methods used, and the effects of such financing on American financial markets. Our information on tender and exchange offers may be helpful in this regard, particularly where a description of the source of funds and purpose of the offering is required.

With respect to Section 3(4) of the bill, our data should be helpful in determining the proportion of foreign investment involved in acquisitions and takeovers of publicly-held U.S. companies. However, our information is not likely to be helpful in determining the extent of foreign investment in new facilities or joint ventures with American firms, or the effect of this investment on domestic business competition.

I do not believe that information filed with the Commission would be particularly helpful in connection with the studies of the various economic impacts of foreign direct and portfolio investment in the United States, called for in Section 3(5), 3(6) and 3(7) of the bill.

Section 3(8) of the bill would direct the Secretary of Commerce to determine the effect of federal, state and local laws, regulations and policies on foreign investment in the United States. It is possible that federal securities laws operate in some manner to deter foreign investment, since our laws are more rigorous than those prevailing in many other countries. But our securities laws also serve to attract foreign investment, to the extent that they contribute to the integrity and liquidity of our markets.

Finally, Section 3(9) of the bill calls for a comparison of foreign direct investment activities in the United States with the investment activities of American investors abroad, and an appraisal of the impact of such American activities abroad on foreign investment activities and policies in the United States. While registration statements and reports filed with the Commission by United States corporations may contain certain information with respect to their material investment activities abroad, such information is scattered throughout various company filings with the Commission, and it would be impractical to attempt to segregate that information by searching our files.

The Commission would, of course, be pleased to make appropriate files and facilities available to the Secretary of Commerce. But, while certain of the information in our files would be helpful for the purposes of the study proposed by S. 2840, I wish to reiterate that searching reports filed with the Commission, particularly those filed in prior years, in order to segregate information relating to foreign investments would be a very burdensome process. It would also require a substantial expenditure of time and money, which the Commission, with its present budget limitations, could not afford, absent the enactment of Section 4(b) of S. 2840, which would authorize the Secretary of Commerce to reimburse the Commission for services provided in conjunction with the program authorized by the bill.

As I have indicated, the Commission supports the objectives of S. 2840 and believes that the study contemplated by the bill could provide a valuable source of information upon which the Congress and other _____ could draw in considering the various bills to regulate foreign investment in the United States which have recently been proposed or introduced.

Information collected in such a study also could assist the Commission in evaluating compliance with the reporting requirements applicable to foreign investors under the federal securities laws. While the Commission has no reason to believe that foreign investors do not generally comply with our disclosure and reporting requirements, the study proposed by S. 2840 would provide the Commission with a useful data base against which to measure compliance with our reporting requirements by foreign investors, and may well reveal problems with respect to our enforcement and administration of other provisions of the federal securities laws of which we have been unaware.

At the present time, we have little data with respect to foreign investment in the United States. We would like to know more about it.