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News  
Release

HARMONIZATION OF SECURITIES REGULATION --  
WHERE ARE WE HEADING?

Remarks to

Conference on Internationalization -- Public  
Offerings in the United States  
Capital Market

Sponsored by

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The views expressed herein are those of Commissioner Cox  
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## I. INTRODUCTION

When I was asked to address this Conference the suggested topic was the "Harmonization of Securities Regulation -- Where Are We Heading?" I was taken with the phrase -- especially the concept of "harmonization". It is an idea that is particularly appropriate in this Olympic year. As you complete preparations for the Games which will take place here in Seoul this September, the rest of the world can appreciate the enormity of your task as hosting the Games presents a challenge of truly Olympian proportions. The infrastructural problems seem daunting to say the least. The thousands of participants have to be fed, housed, entertained, and sadly, even protected. Yet, none of these problems determines how fast participants can run, how high they jump, or how well they swim. Those skills are tested on the playing field. The same should be true in the economic arena. Investment decisions should be dictated by the economic merits of the transaction and not artificially and unduly affected by structural limitations. The Olympic Games are a tribute to the cooperative spirit that resides in peoples of all countries -- and in a sense, represent the epitome of an efficient marketplace.

This spirit of cooperation would serve us in the international economic arena as well. As the world's securities markets become increasingly interrelated, it is likewise increasingly important that the uniquely fungible commodity known as capital be allowed to move in a relatively unencumbered fashion between and among markets. In order to facilitate the free flow of capital, I believe it is the securities regulators' challenge, as overseers of securities markets, to ensure that artificial and inefficient impediments to the flow of capital, the lifeblood of growth and development, are eradicated. At the same time, we must ensure the integrity, safety and soundness of marketplaces, both from a national and international perspective, without detracting too much from the ability of participants to compete in these markets. We emphatically should not be in the business of creating a regulatory climate that unduly favors domestic capital markets at the expense of the efficient operation of international markets.

However, I fear that whenever this elemental proposition emanates from the mouth of a U.S. regulator, the rest of the world shudders and believes that we are trying to impose our securities law framework on everyone else. I would like to set the record straight on that unfounded notion. I do believe that the U.S. securities markets are the most sophisticated, open and developed in

the world, and thus serve as a useful model for other nations to study.

Nevertheless, as last October's market crash so vividly demonstrated, the world's securities markets, although related, do not operate in lock-step and are not wholly integrated. Furthermore, the U. S. Securities and Exchange Commission recognizes the different goals and policies of different nations or markets and understands that our disclosure, accounting and legal standards may not be appropriate in all, or even most, cases. The key, however, is harmonization -- the ability of distinct structures to work well together. It is incumbent upon all those who wish to participate in the world's securities markets to work together if the challenges presented by internationalization are to be successfully met.

The Securities and Exchange Commission has been trying to solve some of these problems by unilateral action and by entering into bilateral agreements designed to improve international securities markets. Many of the difficult problems facing us, though, escape unilateral, or even bilateral, solutions. A truly multilateral forum for addressing trans-systemic problems is necessary. In fact, there are a number of international forums in which the Commission actively participates such as the International Organization of Securities Commissions (IOSCO) and the Organization for Economic Cooperation and Development (OECD). I have had the pleasure of representing the Commission on IOSCO, which has been successfully promoting cooperation between securities regulators of different countries. We are heading in the right direction toward breaking down barriers to capital flows, but our continuing challenge is to keep pace with rapid financial and technological innovation while maintaining the integrity, safety, and soundness of our securities markets for investors.

In the time we have here today, it is impossible to discuss in depth the myriad issues facing us as we move toward a global securities market. Thus, I will touch upon some of the most important developments, including issuing securities multinationally, international enforcement, international accounting standards, market linkages, and the international takeover phenomenon, with emphasis on the efforts to harmonize securities regulations in these areas. Before proceeding to new developments, however, it will be useful to examine the recent trend towards internationalization of the securities markets, and the interplay between U.S. and other markets.

## II. INTERNATIONALIZATION OF THE SECURITIES MARKETS

For the past several years, we have witnessed the growth in international capital markets with a sense of awe. Several factors have contributed to this phenomenon such as general economic prosperity, reduced inflation, lower interest rates, enhanced technological capabilities, more sophisticated trading strategies, desires to diversify risk, institutionalization of markets, and fewer regulatory impediments.

The evidence is indeed dramatic -- in the debt market, the value of international bond issues increased nearly six-fold from 1980 to 1986 to \$225 billion (although the market slumped in 1987 to \$138 billion). The growth in the international equity markets was even more explosive with the value of Euroequity issues increasing sixty times from 1983 to 1986 to \$12 billion, and in the first half of 1987 totalled \$7.5 billion. During the twelve months prior to the market crash, Euroequity offerings of common and preferred stock averaged \$2 billion per month. Since then, this figure dropped to an average of only \$300 million per month through March.

At the same time that the world's securities markets were growing in size and scope, the relationship among them was becoming more complete and complex. While markets retain distinct characteristics as a result of unilateral, political, technological and regulatory differences, the world's securities markets are now, without a doubt, inextricably intertwined. This proposition was demonstrated rather vividly by the market crash of last October. According to an oft-used bromide, "when New York sneezes, Tokyo catches cold." Well, in this case, most of the world's securities markets caught the flu and several are still feeling a bit queasy because of it. These days however, I believe the adage overstates the case. The United States securities markets influence on other markets continues to be substantial but is no longer all-encompassing. Generally speaking, the U.S. markets remain the most innovative and open in the world. Yet other markets have undergone rapid maturation and can clearly stand on their own. In fact, other markets have grown much more rapidly in the recent past than has the U.S. capital market, although this is attributable in large part to the precipitous decline in the value of the dollar. What has become clear though is that decisions made in one nation or marketplace can have cross-market or border effects. We must all appreciate the need to create linked and coordinated, that is, harmonized, regulatory structures, if we're to deal effectively with the problems and opportunities posed by global trading markets.

Of course, securities regulators do not directly effect the capital formation process. Capital formation depends upon economic fundamentals such as saving rates and the willingness of people to work, factors outside regulators' control. However, securities regulations may be so onerous or restrictive so as to dissuade indirect investment. It is our responsibility to regulate markets for the transfer of capital in a manner which will not inhibit their use.

The goal is a compelling one because international securities trading potentially benefits all market participants. The free flow of international capital promotes a more efficient allocation of resources by increasing the depth and liquidity of capital markets and by providing improved opportunities for corporate planning and investment decision-making. Corporations and other issuers can broaden their ownership base and thus promote market stability and liquidity. International investors benefit because they have new opportunities to diversity investment risks and to seek higher returns. Broker-dealers benefit because they can broaden product lines offered to domestic customers and can attract new foreign customers or better service the wants of existing foreign customers. And marketplaces benefit because transnational trading and clearing linkages can result in increased potential order flow for both markets, increased price efficiency, more capital being available for market-making, improved trade clearance and settlement processing, and increased visibility.

There are, however, significant obstacles to further internationalization. In addition to direct obstacles to the free flow of capital such as taxes, exchange controls and investment controls, perhaps greater obstacles result from cultural and historic differences in various national approaches to capital formation. Disclosure, auditing and accounting principles, trade processing, trade and quote dissemination, market surveillance and enforcement are all affected by such differences.

With this framework in mind, let's look at recent efforts toward harmonization of securities regulation and the additional steps needed to overcome the obstacles I've just mentioned.

### III. SEC INITIATIVES WITH RESPECT TO MULTINATIONAL SECURITIES OFFERINGS

Judging from the Conference agenda, you will probably be getting a detailed primer on the dos and don'ts of securities issuance involving the U.S. markets. However, I

day quotation information with the Stock Exchange of Singapore. The Commission in recent years also has approved several trading linkages between U.S. and Canadian stock exchanges.

In addition, some private vendors offer securities information on an international basis, and even international execution capabilities in certain world class equities. One of the most ambitious projects is an automated order entry and execution system, planned by Reuters and the Chicago Mercantile Exchange, that would allow trading in financial futures around the world, during the hours that the CME is closed. Further on the horizon is the EEC's planned Interbourse Data Information System -- a network that will provide continuous price reporting and trading among the major European securities exchanges.

Even where no formal trading or information exchange is made, exchanges in different countries are using common technology. The Paris Bourse, for example, is using the technology from Toronto's Computer Assisted Trading Systems for its order routing system.

#### B. Clearance and Settlement

In addition, if the internationalization of the world's securities markets is to proceed, we must establish efficient and compatible national and international clearance and settlement systems. At present, there are wide ranging differences in settlement periods among world markets, from two business days in Belgium and five days in the United States, to one month in France. Although the United States has developed an automated depository and book entry clearance and settlement system, mature markets such as the United Kingdom and Japan are still in the developmental stages in clearing and settlement. Ultimately, we hope that all countries will have fully automated clearance and settlement systems. Currently, the lack of coordination among clearance and settlement systems in major world markets increases the costs and risks of global securities trading.

Even without compatible systems, it may be possible to develop clearing linkages among the major international markets. From the Commission's perspective, such linkages should facilitate cross-border settlements without compromising the essential soundness and integrity of the U.S. national clearance and settlement system. The Commission already has approved a number of linkages between U.S. clearing agencies and foreign clearing entities where we have been satisfied that adequate safeguards exist to reduce the risk of default.

The Commission will continue to encourage linkages between U.S. and foreign clearing entities to facilitate cross-border settlements. Notwithstanding such linkages, however, differences between the various national clearance and settlement systems continue to be an impediment to a truly global market. Part of the problem is that clearing and settlement systems generate substantial income and can be an element of competition among markets, adding an obstacle to cooperation in this area. Accordingly, we have been working with the securities regulators of other nations, in forums such as IOSCO, to develop compatible clearance and settlement systems. The Commission staff is also exploring the development of uniform time frames, central matching and settlement procedures, and multi-currency settlements on an international basis.

#### V. INTERNATIONAL ACCOUNTING AND AUDITING STANDARDS

While the enforcement issues that I will discuss in a moment may capture the lion's share of public attention, the harmonization of international accounting and auditing standards is even more crucial to global securities issuance and trading. Differences in accounting standards impose costs as a result of reconciling divergent financial information when laws or practices differ and make investment decisions more difficult due to the lack of comparable, timely financial information.

To address this problem, the accounting and auditing professions of the U.S. and various other countries have several projects to encourage voluntary harmonization, such as that of the International Accounting Standards Committee (IASC), of which Korea is a Board Member, which was formed with the express purpose of articulating international accounting standards and has issued 26 accounting standards and commenced six new projects and the review of two standards.

Implementation, however, is a problem. The IASC has no way to enforce compliance with its pronouncements. It must depend on the best-efforts undertaking of its member organizations to promote acceptance and compliance. So far, voluntary implementation has achieved some success. Many of the companies listed on the Toronto Stock Exchange have been persuaded to comply with IASC standards. In Europe, listed companies in Italy are required to follow IASC standards in the absence of local requirements and the listing requirements of the London Stock Exchange likewise call for compliance with IASC standards.

The International Federation of Accountants (IFAC), which Korea is also a member, is another organization whose

whose purpose is the development of a coordinated worldwide accountancy profession with harmonized standards. Like the International Accounting Standards Committee, IFAC depends on voluntary acceptance of its auditing guidelines. Both the United Nations and the OECD have also established intergovernmental working groups to harmonize accounting and reporting standards. These working groups, like the IFAC and the IASC, depend mainly on persuasion and member support for effectiveness.

The influence of the European Economic Community (EEC) on the harmonization process has been significant. Although its directives leave a number of options from which member countries may choose in the process of incorporating directive provisions into national law, member countries are bound by the Treaties of Rome to enact such provisions into their national law. Thus, unlike the private sector and intergovernmental bodies referred to above, the EEC has some ability to implement its pronouncements.

The Commission's staff is currently working with IOSCO to examine practical means of promoting the use of common standards in accounting and auditing. In the area of accounting standards, a working group of IOSCO is working with the IASC to revise international accounting standards. Among the tasks of this group is to address the problems of completeness and lack of specificity in some of the international standards and to eliminate many of the free choice options permitted in other standards. Where options cannot be eliminated, the group will specify one method as the benchmark for international filings. The working group envisions that in international filings, those adopting other methods would reconcile their results to those that would have been produced by the benchmark approach.

In contrast to accounting principles, differences in auditing standards are not susceptible to accommodation through reconciliation. Auditors around the world are subject to different independence standards, they perform different procedures, and they gather varying amounts of evidence to support their conclusions. Therefore, the Commission intends to continue its efforts to establish mutually agreeable auditing standards by participants in the IFAC auditing projects.

#### VI. RECENT INTERNATIONAL ENFORCEMENT DEVELOPMENTS

Crucial to the maintaining the integrity of all securities markets, is a vigorous enforcement program against those who violate established securities laws.



Persons who deliberately choose not to abide by the rules are able to obtain an unfair advantage over those who do abide by the laws and fair dealing practices. You can imagine the consequences if the participants played by their own rules in Olympic sporting events. From the Commission's perspective, the domestic and international pressure for increased participation in, and easier access to, the U.S. markets, necessarily results in increased enforcement responsibilities. A critical issue for the Commission in responding to changes in the international financial marketplace is how such changes will impact the Commission's enforcement efforts. The Commission is concerned that persons not be allowed to violate U.S. Securities laws from abroad. By the same token, the Commission does not want the U.S. to be used as a haven for those who violate the laws of other nations.

#### A. Developments in Market Surveillance

While the Commission encourages the development of transnational trading, the increased electronic linkage between securities markets complicates the surveillance and oversight of market activity. Without enhanced surveillance techniques, internationally-linked markets will be more susceptible to fraud.

When the Commission approved linkages between United States and foreign markets, it has insisted that adequate arrangements be made for market surveillance and information sharing regarding these linkages. These arrangements have involved private contractual agreements between the exchanges, as well as understandings directly between regulatory authorities. The linkages between the American and Toronto stock exchanges, Boston and Montreal stock exchanges, and American Stock Exchange and European Options exchanges are examples of these kinds of arrangements.

The Commission also encourages international participation in the Intermarket Surveillance Group, an organization through which many of the United States securities exchanges share surveillance information. International participation will allow regulators and stock exchange managers to adequately oversee internationally linked markets.

#### B. Developments in Investigations

The principal problem confronting the Commission in its efforts to police the internationalized U.S. securities markets is that relevant information regarding illegal securities activities is frequently located outside U.S.

borders and thus may not be subject to U.S. jurisdiction. Although U.S. securities laws have been construed to cover transactions initiated in the U.S. and consummated abroad, as well as those initiated abroad and concluded in the U.S., actually obtaining information located outside U.S. borders requires deference to the jurisdiction of another sovereign nation.

In order to address this problem, the Commission has a number of formal bilateral agreements related to information gathering for securities enforcement purposes. The first such agreement was the 1982 Memorandum of Understanding (MOU) between the U.S. and Switzerland. The SEC has since entered into MOUs with authorities in Japan, the United Kingdom and three provinces in Canada, and has had very positive experiences in utilizing these mechanisms. The Commission is currently negotiating MOU's with France, Italy, Australia and New Zealand. I would also note that these MOU's are specifically tailored to address the particular problems and concerns of the signing parties.

The MOU with the Canadian provinces, which was signed on January 7, 1988, is the most far reaching enforcement agreement. It covers the full range of offenses addressed by the U.S. securities laws. Further, this MOU is the first agreement whereby the Commission may request a foreign regulatory authority to employ its compulsory powers to require persons to give testimony or produce documents. Although the Commission currently does not have the authority to provide the same assistance to a foreign regulatory authority, it agreed to obtain that authority.

As a result, in May the Commission approved a legislative proposal which would provide it with the requisite authority. If enacted by Congress, the proposed legislation would let the Commission investigate securities violations on behalf of foreign regulators. It would also allow the Commission to maintain the confidentiality of documents received from foreign authorities. And it would let the Commission base sanctions against securities professionals on the findings of a foreign court or foreign securities authority. The Commission believes that passage of its legislative proposal would also facilitate mutual assistance agreements with additional foreign regulatory authorities.

In the multilateral area, the Commission has fostered enforcement cooperation through multinational forums. For example, the Commission participates in meetings sponsored by the U.K. Department of Trade and Industry (known

informally as the Wilton Park Group) to promote the exchange of information among securities regulators.

IOSCO is also evaluating existing constraints on information exchange and determining ways to facilitate the sharing of enforcement information. In November of 1986, I proposed the following enforcement resolution to the Executive Committee of IOSCO:

Now therefore be it resolved that the Executive Committee of the International Organization of Securities Commissions ("IOSCO") hereby calls upon all securities authorities:

(a) to the extent permitted by law, to provide assistance on a reciprocal basis for obtaining information related to market oversight and protection of each nation's markets against fraudulent securities transactions;

(b) to designate a contact person who will insure the timely processing of all requests for assistance. So far, 23 members of IOSCO have signed this undertaking.

## VII. THE INTERNATIONAL TAKEOVER PHENOMENON

The regulation of foreign corporate takeovers is actually an amalgam of distribution, disclosure, and accounting rules. I believe, however, that it warrants separate attention due to the increased incidence of foreign takeovers and their uniquely political ramifications.

There is an increasing amount of foreign investment in the United States. During the period from 1980 through September 1987, the total dollar volume of mergers and acquisitions by foreign entities increased from \$7.7 billion in 1980 to \$33.4 billion in the first three quarters of 1987. That investment may involve a number of different types of transactions. The tender offer, which has been an important technique for acquisition of publicly held corporations in the United States for a number of years, is becoming increasingly important in the foreign and international markets. The principal advantage of the tender offer is that, unlike other acquisition techniques, approval by the board of directors of the subject company is generally not required. In the last decade, an increasing number of foreign bidders have engaged in tender offers to acquire U.S. corporations, often on a hostile basis. For example, in 1987, 29 tender offers subject to Commission's rules were filed by foreign bidders for the securities of domestic corporations. In 1986, 24 such

tender offers were commenced and just four such offers commenced in 1985. The percentage of total U.S. tender offer activity, measured in terms of the dollar value of the subject company, that was engaged in by foreign concerns, increased from 7.1 percent in 1984 to 33.8 percent in 1987. In the first five months of 1988, there have already been 27 tender offers commenced by foreign bidders with a total value of over \$14 billion.

The increase in foreign buying of U.S. companies is primarily the result of the sharp decline in the value of the U.S. dollar vis-a-vis other currencies, which has made the acquisition of U.S. companies relatively cheap. The recent spate of foreign takeovers has been further fueled by the decline in market capitalization of companies as a result of the market crash. Underlying all this activity, however, is the fact that foreign buyers are subject to very few restrictions regarding ownership or investment in U.S. companies. For the most part, foreign and U.S. bidders are subject to exactly the same rules and regulations.

I firmly believe that the U.S. markets, including the market for publicly trading companies should be open to all potential investors, without artificial impediments based upon nationality of the investor. Nevertheless, I must alert you to an increasing concern on the part of U.S. legislators about foreign takeovers of U.S. companies. Some of this concern is the result of a general protectionist bent. However, much of the concern results from the fact that the takeover market is perceived, accurately I might add, as a one way street. U.S. companies simply do not have the same degree of access to foreign markets or ability to invest in foreign companies. Unless lawmakers and regulators in other countries recognize this, I fear that protectionist measures regarding the takeover market may undermine the entire internationalization process.

#### VIII. CONCLUSION

The internationalization of the world's securities markets is like an Olympic marathon -- a long and difficult journey -- and we've just left the starting line. In order to reach the finish line, we can't afford to be overwhelmed by the enormity of the task but must take things one step at a time. And the first step for us, as securities regulators, is to make sure our own house is in order -- that our markets are open and efficient conduits for securities trading. In this regard, I noted with interest the steps you have taken opening access to the Korean stock market -- for which I suspect there is considerable demand.

I applaud and encourage this development. The next step is to work together so that the internationalization phenomenon is managed efficiently and effectively for the benefit of all market participants, including the nations involved. With the proper cooperative spirit, I'm confident that the ongoing competition in the international securities arena will be as successful as these Summer Olympic Games you are hosting.