Journal of Comparative Corporate Law and Securities Regulation 4 (1982) 55-62
North-Holland Publishing Company

REGULATION OF INTERNATIONAL SECURITIES MARKETS: TOWARDS A GREATER COOPERATION

Harold M. Williams and Lee B. Spencer, Jr.*

MR. MUNDHEIM: The presentations and discussions yesterday demonstrated the multinational aspect of the securities business. As we discovered in our discussion of the activities of banks, businesses with multinational aspects find a number of supervisory agencies with responsibility for or at least an interest in those activities. That fact inevitably leads to thinking about the desirability of and the obstacles to cooperation among the involved supervisory bodies. Such cooperation is the major topic of our discussion this morning. Lee Spencer is our keynote speaker on this subject.

1. THE INTERNATIONAL CHARACTER OF THE SECURITIES MARKETS

MR. SPENCER: As this gathering attests, the idea of a world securities market is receiving increasing prominence. Two current developments seem to be laying the foundation for such a world market. The first is the growing international market for primary offerings of debt securities--the Eurobond market--which has been maturing over the past two decades into a major, worldwide market for both long-term and short-term capital. It is a very innovative, constantly expanding market with a diverse mix of issuers, including corporations and governments.

The second development is the increasing interconnection of the major national markets. Rapid advances in communications and technology now make it possible to follow markets and virtually instantaneously to transfer money and securities throughout the world. Furthermore, the growth of multinational corporations with a worldwide investor following has served to heighten awareness and interest in foreign issuers.

Indeed, the emerging world market already is affecting the way many companies raise capital. It now is not unusual for corporations to make public offerings in foreign markets and to list their securities on foreign exchanges. In 1978, for example, Sears Roebuck made the first offering of debt securities in Japan by a foreign, non-governmental issuer since the pre-World War II era. Further, several privately-held natural resource companies from the U.S. are contemplating going public--not in the U.S. as might be expected, but in Vancouver, British Columbia, a world center for natural resource risk capital. Moreover, during the last decade the use of simultaneous primary offerings of securities through separate underwriting syndicates in several countries has emerged.

---

*The views herein are those of the authors and are not necessarily those of the SEC.

Business combinations are also assuming an increasingly international flavor--in large part due to the worldwide trend of removing currency exchange controls. As an illustration, within the past year, the first two registration statements relating to hostile exchange offers by a U.S. company for a foreign company have been filed.

In fact, even a combination of two companies from the same country may have international implications. For example, recently a merger of two foreign companies, which involved an issuance of securities, was postponed in order for a registration statement to be filed with the Commission; a substantial number of the shareholders of the target company were U.S. citizens or residents.

It should not be suggested, however, that an established world securities market system is yet an accomplished fact. Nor is its development necessarily within easy reach: the experience of the national market system in the U.S. suggests the difficulties faced in linking markets. Add to that important differences in language and customs and varying national disclosure, trading, and enforcement policies and interest, and one must conclude that establishing a world securities market system is a most ambitious endeavor.

It is, nonetheless, a most worthwhile effort. In a world securities market, corporations could broaden their ownership base and have a wider market for their securities. This market would also assist companies to raise funds in the various currencies that they may need for their global operations. Further, investors could benefit by having more investment choices. They could, in effect, select among different economies and different currencies as well as different industries and companies. The welfare of the world as a whole could additionally benefit. A properly functioning world securities market would permit the more efficient allocation of the increasingly scarce world resources.

Today, we will examine these market developments and highlight some of the implications they raise on regulatory policies. The point will be that the increasingly international character of the securities markets and securities professionals can, if not addressed by regulatory authorities in a thoughtful and coordinated manner, lead to costly economic misallocations and diminished investor protections. To this end, ideas will be offered for an International Committee of Securities Regulators to address, broadly and coherently, the regulatory issues raised by the emerging world securities marketplace.

2. IMPLICATIONS FOR REGULATORS

A. Regulatory Disparities

At the outset, it can be noted that securities regulation is not homogeneous throughout the world. Indeed, much of the international capital market is completely unregulated. And, while the domestic markets are generally regulated, the character of regulation may vary greatly. Some countries, such as Korea, use a form of merit regulation similar to the Blue Sky laws in this country. Other countries, such as the U.K., have a regulatory pattern based on disclosure similar to our federal securities laws.

Further, the identity of the regulatory authority differs from nation to nation. Few have an SEC-style national agency. In Canada, for example, the primary responsibilities for regulating the securities laws are left to political subdivisions such as provinces. In other countries, such as Japan, the securities regulators do not belong to an independent agency, but rather are part of the government--such as the Ministry of Finance. In yet others, a stock exchange or the central bank serves as the primary regulator.

As a result of these regulatory disparities, a company may be subject to inconsistent, duplicative, or even conflicting regulations. Let us take, as an example, the problems facing a hypothetical Canadian oil and gas company that is subject to both Canadian and U.S. disclosure requirements. Canadian law *requires* it to disclose probable reserves. But, SEC regulations *prohibit* the disclosure of this same information. If the company is involved in a proxy solicitation, therefore, it may need to prepare two sets of proxy material: one disclosing probable reserves for Canadian shareholders and another without such disclosure for U.S. shareholders. Is the U.S. prohibition meaningful? Possibly not. Sophisticated U.S. investors can easily obtain the information that is disclosed in Canada, though less sophisticated investors may not.

B. Disclosure Standards

Indeed, the lack of uniformity in accounting principles, auditing standards, and disclosure practices is usually the most troublesome problem that foreign issuers must face in making a registered offering in the U.S. Several such offerings have, in fact, aborted due to the refusal or inability of foreign issuers to comply with our disclosure standards--even as modified by the numerous accommodations that the Commission has made to foreign registrants. However, since the disclosure standards in the U.S. are more vigorous than those of most other countries, U.S. companies rarely seem to encounter similar difficulties when they offer their securities abroad.

More subtle--but often equally burdensome--consequences occur when different countries take only slightly different approaches to the same disclosure concerns. Thus, as an illustration, many countries require inflation accounting and segment or line of business disclosure. But, though the general thrust of the regulation is the same, the details of satisfying those requirements vary. The result is that a company may need to prepare slightly different segment data or revise its inflation accounting to meet the requirements of a number of nations. In other terms, the company may be required to incur the costs of disclosing substantially identical information in differing formats.

C. Rights Offerings

Other issues raised by the internationalization of the securities marketplace go beyond problems raised by disparate disclosure standards. For example, rights offerings to U.S. shareholders have historically created special difficulties for foreign companies. This is a major area of concern to many of these issuers; in some countries, these offerings are the only method a company may use to raise new equity capital.

Of course, since rights offerings permit shareholders to purchase additional securities, they must be registered under the

Securities Act of 1933 if made to U.S. shareholders. While such registration is *not* required if the U.S. shareholders are prohibited from exercising the rights and are permitted only to sell them abroad, some regulatory officials in these countries have objected when companies with a large number of U.S. shareholders exclude these shareholders from the offer. Although the Commission does permit foreign companies that file annual reports on Form 20-F to use Form S-16 to register the offering, this ameliorates rather than solves the problem.

D. Acquisitions

Conflicts in the regulations of several countries are similarly encountered in business combinations and acquisitions. For example, an exchange offer between two foreign companies may be required to be registered under the Securities Act of 1933 if the company being acquired has U.S. shareholders. To avoid registration, companies will often either exclude the U.S. shareholders from the offer or limit their consideration to cash only, in lieu of securities. The problem is compounded if foreign regulations require that the same offer be extended to all shareholders. And even more difficulties can be encountered if the exchange offer is hostile.

E. Equal Access

Another area of concern is whether securities professionals of one nation, particularly brokers and dealers, will be granted equal or direct access to the securities trading markets of other nations. The so-called equal access problem has been addressed, but only on an *ad hoc*, country-by-country basis. In 1975, for example, the U.S. Congress amended the Securities Exchange Act of 1934 to provide that a broker-dealer, regardless of whether it is foreign owned, may join U.S. stock exchanges so long as applicable qualification standards are met. The Commission's broker-dealer registration requirements do not bar the registration of foreign-owned broker-dealers, and U.S. regional stock exchanges and the National Association of Securities Dealers, Inc. have long admitted such firms to membership. More recently, the New York Stock Exchange (NYSE) has begun to accept as members foreign-owned firms. Nevertheless, U.S. broker-dealers too often are denied direct access to the markets of other nations.

F. Supervision

An issue closely related to equal access involves surveillance activities over multinational financial institutions. For example, should the NYSE conduct inspections of the books and records of a Swiss financial institution that owns an NYSE member? For many years, the NYSE believed that it should conduct such inspections, or should at least have the right to do so, in order to satisfy its own obligations under the U.S. securities laws. However, in some cases the secrecy laws of other nations simply do not permit the same kinds of inspections that the NYSE might conduct of a U.S. corporation that owned an NYSE member. If access barriers were to be lowered, some compromise had to be reached.

Recently, the Commission approved an NYSE rule that appears to be a sensible accommodation between, on the one hand, the need for effective surveillance of parent companies of member firms and, on the other, a recognition that the laws and customs of some countries differ from those of the U.S. That compromise--which provides for, among other things, limited, third party examinations of certain foreign based affiliates of NYSE members--was reached through a process of negotiation between the NYSE and interested NYSE members. But, as the Commission noted in its order approving the NYSE's rule, "Ultimately, the best solution to the problems of surveillance and enforcement that arise from the increasing international participation in securities markets, both here and abroad, may be an organized system of international cooperation and consultation among the governments of the affected nations."

3. POTENTIAL REGULATORY RESPONSES

Unfortunately, there presently is little such systematic coordination between the regulatory authorities of nations with free market economies. And the contact that is made often arises in the context of an *ad hoc* resolution to a particular regulatory concern. This type of problem-solving may be expedient, but it is not necessarily the most rational or optimal approach to the important and ever-growing area of international finance.

A. Competition

A lack of better coordination among regulators can not only unduly burden companies, but it can also undermine substantial investor protections. Regulatory disparities can allow, in effect, regulatory forum shopping--and this, in turn, can initiate international competition for the most lax regulation system.

One possible, but not preferable, regulatory response to this situation would be an attempt to assert extraterritorial jurisdiction. Unfortunately, this is too often the path being taken. In a sometimes misguided effort, regulators of particular nations may seek to extend their regulatory provisions as far as possible--both in the legal sense and the geographic sense. Generally, their motive is to protect investors in their own country, but competitive considerations may also apply. Domestic companies may complain of unfair competition if foreign companies are given too many accommodations or exceptions from the standards to which domestic companies are held accountable.

Emphasizing extraterritorial jurisdiction is not the best response to the challenges generated by a world marketplace. Along with the obvious economic costs it may generate, inflexible application of domestic regulation to foreign companies and undue assertions of extraterritorial jurisdiction can lead to conflicts with regulators from other countries. This, of course, can create unnecessary and counterproductive confrontations between regulators. Last year, for example, legislation was enacted in the United Kingdom in response to perceived efforts by U.S. regulatory officials to expand their jurisdiction over British companies. The purpose of this law is to provide British companies with protection from certain requirements, prohibitions, and judgments imposed under foreign laws. Although the British law responded primarily to the U.S. antitrust laws and regulations, perceived threats from the securities laws were also mentioned in the official release.

B. Cooperation

Cooperation, rather than confrontation, among regulators must be the rule. Cooperation increases mutual understanding of the goals and methods of the various regulatory schemes. It permits a beneficial exchange of ideas, information, and experiences. And, cooperative regulators can present a united, powerful front against fraud and can eliminate unnecessary regulatory differences and inconsistencies and other obstacles to an efficient system of international market finance.

Of course, cooperation has been long recognized as a desirable goal, and many organizations are presently considering matters such as harmonizing disclosure standards and developing international accounting principles. Among these are the International Accounting Standards Committee, the International Federation of Accounting, the European Economic Community, the United Nations Commission on Transnational Corporations, and the Organization for Economic Cooperation and Development. Yet other organizations are addressing issues relating to securities trading, stock exchange listing and other practices, and enforcement liaison. This list is long; it includes the Inter-American Conference of Securities Commissions and similar agencies. Most of the organizations are productive and serve useful purposes, and their work can be commended. In this vein, it should be emphasized that the proposal about to be made is not a criticism of these organizations--nor would its adoption make them redundant.

4. A PROPOSED INTERNATIONAL COMMITTEE OF SECURITIES REGULATORS

A. Organization

We recommend, first of all, the establishment of an International Committee of Securities Regulators. An informal Committee, in our opinion, could be established very expeditiously. After all, regulators from different countries have set up effective liaisons and committees in the past to produce cooperative enforcement efforts, such as in the IOS fraud. This Committee would serve as a clearing-house of information, promote the harmonization of the various national markets, encourage the interchange of ideas and experiences, and assist in the harmonization of diverse accounting and disclosure practices. Even these relatively limited steps could increase the regulators' mutual understanding and cooperation.

Eventually, and as a long-term goal, a multilateral treaty should be negotiated to establish the Committee formally. It could be expected that the treaty would require each signatory nation to designate a particular institution or agency as its securities regulator. The Committee, in turn, would be empowered to promulgate certain decisions that would be binding on the signatories with regard to the results to be achieved--although not as to the method of implementing them. In other words, the designated regulators would be bound to implement the Committee decisions by making them part of domestic law or regulations, but the regulator could select the method of implementation that best suits its national system of regulation and its own customs. In essence, the Committee's decisions would be similar in their effect to directives now issued by the European Economic Community. The decisions of necessity would be limited to areas where difference of national custom and philosophy would permit a consensus.

B. Advantages

This approach is preferable to the alternative of creating a supranational securities agency. First, enforcement would be more practical if sanctions exist under domestic law as well as international law. Under this proposal, Committee decisions would have the effect of local law and could be enforced by any regulatory authority. Further, the creation of a cooperative international committee for securities matters would not necessitate a large bureaucracy in addition to the staffs of the domestic regulators. Indeed, the Committee could be staffed adequately by the domestic regulators. Finally, as a practical matter, nations would be more likely to accede to the treaty if their own regulators can participate directly in the decisionmaking--the treaty would not require the surrender of their regulatory control to a supranational organization.

It is not contemplated that such a committee would involve itself with companies that do not participate voluntarily in world securities markets. Regulation of these companies would, and should, be left to domestic regulators. At the other end of the spectrum, however, for companies that truly are regular participants in the world securities markets, the Committee could establish procedures whereby these "world class companies" could list on any exchange or make an offering in any country provided they made certain agreed disclosures.

C. Potential Problems

Nonetheless, the problems of developing such a Committee should not be understated. Few nations have a single regulatory body. Instead many have several organizations or regulate at the state or federal level. Further, some nations do not have an established accounting profession or established accounting principles or auditing standards. And, of course, regulatory philosophies, principles of corporate structure, business customs, and legal systems often vary greatly from nation to nation.

Yet, while these differences create difficult problems, they are not insurmountable. In fact, the internationalization of the capital markets is, in itself, forcing *ad hoc* responses to many of the concerns raised today. The point is, however, that the expedient solution or the temporary amelioration may not always be the most rational or optimal solution over time.

To suggest that a cooperative framework can be quickly achieved would be unrealistic. Yet, one way or the other, events march on. One way or the other, markets will develop. And in consequence, one way or the other, regulators will respond. To act without coordination risks the creation of rigid regulatory constructs, which would stand as opposing fortresses rather than cooperative camps. It is far better to establish, now, the beginnings of a framework that can start to help direct the stream of regulation, if not commerce, into the greatest harmony practically achievable.

5. CONCLUSION

In conclusion, an international securities market is rapidly becoming more and more of a reality--and a necessity. Indeed, in view of the ever-diminishing resources of the world, it is essential that those resources be allocated in the most efficient manner. A properly functioning worldwide market system is a vital element in achieving that result.

The development of such a system is too important to everyone's welfare to be left to chance. Random, *ad hoc* regulation can have dysfunctional consequences. It can thwart potentially useful developments, create artificial impediments, and possibly prevent the development of an efficient market system. It is, as a consequence, imperative that serious thought and study be devoted to this topic immediately and that constructive efforts to encourage the cooperation of regulators be instituted. Implementing a world securities market system that meets the needs of the contemporary international economy will be one of the important requirements--and a crucial challenge--of this decade.