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# Securities Regulation in the International Marketplace: Bilateral and Multilateral Agreements

Daniel L. Goelzer\*  
Anne Sullivan\*\*  
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## INTRODUCTION

International securities markets will soon exceed the ability of any individual domestic authority to regulate them, and be accessible only to true international regulatory standards. The increase in international securities trading may be demonstrated in a few figures: in 1983, new international equity offerings amounted to only \$200 million;<sup>1</sup> by comparison, new equity issues on the domestic U.S. market in that year totalled over \$52 billion.<sup>2</sup> However, by 1986 equity offerings on the international market expanded to \$11.8 billion, compared to \$66.2 billion in domestic U.S. equity issues;<sup>3</sup> in September 1987 alone, new international equity offerings totalled \$6.6 billion.<sup>4</sup> Both the Securities and Ex-

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1. See STAFF OF THE U.S. SECURITIES AND EXCHANGE COMMISSION, REPORT TO THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS AND THE HOUSE COMMITTEE ON ENERGY AND COMMERCE ON THE INTERNATIONALIZATION OF THE SECURITIES MARKETS II-53 (1987) [hereinafter SEC STAFF REPORT]. Part of the information in this article concerning the activities of the Commission and its staff was obtained from this SEC Staff Report.

2. *Id.* at II-105.

3. *Id.* at II-53.

4. DIVISION OF MARKET REGULATION OF THE U.S. SECURITIES AND EXCHANGE COMMISSION, THE OCTOBER 1987 MARKET BREAK REPORT II-20 (1988) [hereinafter MARKET BREAK REPORT].

change Commission ("Commission" or "SEC") and foreign securities regulators have adjusted their regulation to this new reality. However, they have not yet fully needed to take the next step in regulation for an international securities market: fashioning workable consistent international norms for securities regulation.

Securities regulation in the international context entails legitimate interests of more than one state. Regulators must reconcile the tensions between possibly conflicting national goals and procedures, on the one hand, with the need for uniformity in international regulation, on the other. Differences between states may present very substantial obstacles to international cooperation, particularly where core values are involved.<sup>5</sup> Nevertheless, each securities market could now potentially compete with all markets in other countries, some of which profit from these regulatory variations. Rather than serving as a goad to lessening all regulation, however, this competition may highlight the fact that certain assurances are necessary to attract foreign investors to a market. For example, virtually all states seek in some fashion to assure depth and stability in their market through domestic regulation.<sup>6</sup> At the same time, as we shall discuss, the depth and liquidity of a domestic market to an increasing degree are affected by the actions of foreign traders. Thus, as in many other situations, the increasing internationalization of securities markets should be an impetus to regulatory cooperation. Securities regulators have only begun to explore how to construct international agreements for this cooperation.

This article examines the experience of the SEC in securities regulation with respect to the international securities markets, focusing first as background upon

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After the worldwide market crash of October 1987, the pace of international offerings declined considerably, amounting to only \$498 million for that month — which was still 250% of the annual total only four years previously. *Id.*; SEC STAFF REPORT, *supra* note 1, at II-53.

5. For example, the United States places an almost unique premium on the protection of the small investor. Related to this focus is the emergence of a potential new factor in foreign markets which may bring the policy purposes of foreign regulators closer to those of the United States: the increased role of the small investor in foreign securities markets. The U.S., with 47 million individual investors, has always had active market participation by small investors. *Stockmarket Brief*, THE ECONOMIST, Oct. 24, 1987, at 84. The recent international bull market in securities, along with the privatization programs of France and the United Kingdom, has attracted unprecedented numbers of small investors to those domestic markets: British stock ownership has boomed from two million individual British holders in 1980 to nine million in 1987, or roughly 20 percent of the adult population. *Id.* French stock ownership tripled by 1986, with about 15 percent, or 9.5 million, of the French population now holding stock. *Id.*; *French Flock to Buy Stocks*, N.Y. Times, Nov. 24, 1987, at D4.

6. See, e.g., the discussion of prerequisites for international securities trading in D. AYLING, THE INTERNATIONALISATION OF STOCKMARKETS 129–31 (1986). The author points out that markets need both sophisticated mechanisms and thorough and reliable regulation in order "to attract business of an international nature." See generally *id.* at 115–136, in which the author surveys world stock markets and at 196–211, in which the author concludes, *inter alia*, that "[t]here is increasing recognition of the need to provide information and services that are equally acceptable to domestic and foreign clients," (*id.* at 198), and, in reference to the capital markets, that "the future stability and safety of the world economy . . . [requires] a unified approach. . . ." *id.* at 210.

recent developments in those markets, and then on the actual regulation of issuer disclosure, the trading markets, and enforcement in general. In each of the latter three areas, the article will consider the Commission's direct domestic actions in response to international trade, and compare those with international approaches to establish standards in these areas. This comparison demonstrates that international cooperation can, and should, develop new protections and predictable, common themes of regulation, for disclosure, market regulation, and enforcement.

### BACKGROUND: RECENT DEVELOPMENTS IN THE INTERNATIONAL SECURITIES MARKETS

International securities trading today, while considerable and growing, is very likely only the shadow of things to come. For several reasons, it has not yet produced major disruptions of domestic patterns of securities regulation. First, the market is primarily institutional, and operates largely outside of domestic regulation; second, many current "international" transactions only involve two states, which can work together to regulate the transactions;<sup>7</sup> and finally—perhaps most importantly—the media for international trading are limited. Nonetheless, recent events presage important regulatory questions which may likely accompany the future development of the international securities market. Among the most significant are how to maintain depth and liquidity, and how to protect small investors in domestic markets from the vagaries of the global institutional market.

#### A. *Nature of the International Securities Market*

Internationalization has not yet fundamentally altered the structure or pattern of the major equities markets, which remain mostly domestic in nature.<sup>8</sup> Rather,

7. See generally SEC STAFF REPORT, *supra* note 1, at II-55 to II-58.

The most mature international market, the Eurobond market (see SEC STAFF REPORT V-4 to V-18), has begun to outgrow this bi-national description. Thus, two British authors describe a typical issue in the Eurobond market:

The mandate to issue a bond issue may be won by a firm's French operation. It would be launched in London, but might be sold mainly to Continental investors by a sales force outside London . . . [T]he swap transaction which actually makes the deal profitable for the issuing house might be arranged in Japan.

Nicoll and Wolman, *Picking up the pieces of financial freedom*, Fin. Times, Feb. 13, 1988, at 8, col.1.

8. See D. AYLING, *supra* note 6. This is illustrated by a suit recently filed by the Commission, SEC v. Zico Investment Holdings, Inc., No. 87-8487 (S.D.N.Y. filed Dec. 2, 1987). The defendants are a corporation in the British Virgin Islands, and another of unknown nationality with contacts in the U.K., a British citizen resident in the United States, a British citizen resident in the U.K., and a British citizen resident in France. The Commission alleged that the defendants placed orders from

in the securities context, "internationalization" is still basically a function of improved international communications. Thus, securities trading in any major world market responds to information from all quarters, foreign and domestic. At the same time, international institutions maintain traders in strategic cities (e.g., New York, London and Tokyo) specializing in the securities of one country, to trade "24-hour books," using improved international communications to obtain and monitor their diversified international portfolios.<sup>9</sup> This trading allows large individual and institutional investors to act upon information in any open market which trades the securities they follow.<sup>10</sup> Similarly, communication makes it possible for "world-class" issuers to distribute securities in countries other than their domiciliary states, because potential purchasers are assured that they will be able to keep up to date about the issuer.

While fundamental changes are still in the future, the impact of foreign trading on domestic markets should not be minimized. For example, "a third of the turnover in the ten main stocks in each of the continental European markets now takes place in London."<sup>11</sup> In 1987, foreigners owned about one-third of the securities traded on the Hong Kong market;<sup>12</sup> a one-week closure of the Hong Kong market that fall directly produced heavy selling of securities listed in Hong Kong on the nearby markets of Australia and Singapore.<sup>13</sup>

Unfortunately, in comparison to the free flow of information, many of the

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France, through an account in London, in order to manipulate the price on the American Stock Exchange of the shares of a U.S. issuer. In this fact pattern, the issuer was registered in the U.S. and its equity securities were traded on a U.S. exchange. Despite the variety of nationalities and residences, the only significant international element is one of communications arising from the location of the defendants — and the logistical problems in pursuing an action against them.

Formidable as it may be to investigate and prosecute an action such as this one over which the United States clearly has jurisdiction, but where the evidence may be outside our borders, it does not raise the whole broad range of legal questions which lurk in the concept of internationalization of the securities markets along the lines described *supra* note 7 with respect to the Eurobond market.

9. *Global Traders*, Wall St. J., Nov. 9, 1987, at 1, col. 6; Hunter, *The Status and Evolution of Twenty-four Hour Trading: A Trader's View of International Transactions, Clearance, and Settlement*, 4 B.U. INT'L L. J. 15 (1986) contains a particularly informative description of trading the 24-hour book.

10. See Ruttel, *Slicing Up the Globe*, INVESTMENT DEALERS' DIGEST, Dec. 14, 1987, at 16, describing transactions of hundreds of millions of dollars executed on the international markets by large investment firms.

11. *Stockmarket Brief*, *supra* note 5. This was recently accentuated when domestic traders were unable to execute on the continental European markets during the crash, and moved their business, particularly for French and Japanese equities, to London. Forman, *London Market for Non-British Stocks Is Growing Rapidly in Time of Turmoil*, Wall St. J., Nov. 2, 1987, at 39, col.1. See also Lascelles, *Bank takes firm line on market discipline*, Fin. Times, Mar. 1, 1988, at 12.

12. Kristof, *Plunge Unnerves Hong Kong*, N.Y. Times, Nov. 2, 1987, at D1, col.3.

13. Ryan, *Sapped in Sydney*, INSTITUTIONAL INVESTOR, Feb. 1988, at 173; Witcher and Patrick, *Australian Stocks Take A Worse Beating Than Most as Overseas Investors Get Out*, Wall St. J., Nov. 2, 1987, at 49, col.2; Berthelsen, *Singapore Suffered Asia's Sharpest Drop, But Lessons of Past Help Market Survive*, Wall St. J., Nov. 4, 1987, at 32, col.1.

mechanics of the international securities marketplace are inadequate at best. With at least ten percent of the floor trading in New York, London, and Tokyo effected for foreign securities investors,<sup>14</sup> improved international quotation, trading, and settlement mechanisms are essential. Nonetheless, delays and inconsistencies in international settlement procedures have become major obstacles to international securities trade. One report notes that while local settlement rules vary from one day (Hong Kong) to one month after the trade (France), 40 to 60 percent of international security transactions routinely fail to clear within the time limits of the exchange's home country.<sup>15</sup>

### *B. International Regulatory Issues Highlighted by the October 1987 Market Break*

The worldwide market break of October 1987 underscored just how fragile international securities trading can be. One of the most alarming matters to come to light is the sudden lack of liquidity available for international trading.<sup>16</sup> In October 1987, when the brokerage firms and banks through which most international trading is done were unwilling to provide the international markets more capital,<sup>17</sup> foreign investments were repatriated.<sup>18</sup> On October 19, 1987, American broker-dealer Charles Schwab Corp. was caught short when a Hong Kong trader could not meet margin calls on trading losses of \$84 million. Schwab was forced

14. Burgess, *Sun Never Sets on the World's Linked Markets*, Wash. Post, Nov. 1, 1987, at H1, col.4.

15. *Bottleneck for Foreign Stock*, N.Y. Times, Nov. 7, 1987 at 37. See *Hong Kong's Exchange, After the Fall*, Wall St. J., Nov. 3, 1987, at 34, col.2. In another example, two recent articles in the AMERICAN BANKER point out that unsettled deals in all transactions on the International Stock Exchange (ISE) in London as of July 1987 amounted to 679 million pounds, or over \$1 billion. Rowe, *Spiraling Trading Volumes* and Roman, *High Tech Clogs Clearing System*, AM. BANKER, Dec. 18, 1987, at 16. Even so, the MARKET BREAK REPORT quoted news articles that the ISE experienced only its usual 15% level of failures to clear on the first settlement day after the crash of October 19, 1987. MARKET BREAK REPORT, *supra* note 4, at 11-9 n.28.

The very nature of the fortnightly British settlement system is, as the governor of the Bank of England has observed, potentially destabilizing in the event of another sharp fall in prices because parties to a transaction would have to wait up to a full two weeks to settle while the market may continue to fall. Wolman, *Bank Governor calls for reconsideration of SE account system*, Fin. Times, Feb. 12, 1988, at 1, col.3. In fact, the Chairman of the ISE has now suggested that this system needs change. Wolman, *London SE chief backs account system criticism*, Fin. Times, Feb. 25, 1988, at 19.

16. Lohr, *Investors Retreating From Foreign Markets*, N.Y. Times, Dec. 16, 1987, at A1; Jenkins, '88: *A Year of Global Investment*, Wash. Times, Dec. 29, 1987, at 1C.

17. Smith and Ricks, *Stock Swings Blamed on Dealer Caution*, Wall St. J., Jan. 5, 1988, at 6.

18. See, e.g., Ryan, *supra* note 13; Hinden, *Market Plunge Cooled Foreign Investment*, Wash. Post, Feb. 11, 1988, at D10, col.2; see also Roth, *Exchanges See Plans Ruined Across Europe in Crash's Wake*, Wall St. J., Jan. 4, 1988, at 8B; Short, *Funds sold overseas holdings after crash*, Fin. Times, Mar. 24, 1988, at 10; *Confidence remains distant memory*, Fin. Times, Apr. 18, 1988, at 36.

to take a \$22 million after-tax charge.<sup>19</sup> Jeffries Group, Inc., the parent of an American registered broker-dealer, reported a \$9.7 million pre-tax loss for October as a result of a default by a British investor.<sup>20</sup> The loss of liquidity in the international market after the market break compels world regulators to consider today how to assure liquidity in the main trading markets in the future.<sup>21</sup>

The domestic financial and political implications of the worldwide break have been equally important. For example, the French government delayed a privatization offering of the securities of *Compagnie Financiere de Suez* because the October break had depressed London grey-market prices on the security well below the government offering price.<sup>22</sup> The British, on the other hand, despite a drop in British Petroleum share prices, could not afford to stop their privatization offering of British Petroleum securities without significant harm to the national budget for the next three years.<sup>23</sup> This drop left the international (U.S., Canadian, and Japanese) underwriting syndicate for that offering locked into a price estimated to be as much as \$1.2 billion over the prevailing market.<sup>24</sup> Ultimately, the British government agreed to purchase any shares at the price prevailing on the offering date. Pursuant to that agreement, it purchased under 2 percent of the shares offered.<sup>25</sup> Subsequent privatization efforts were, however, temporarily postponed.<sup>26</sup> The U.K. plans its first privatization offering since the break for some time after the fall of 1988.<sup>27</sup> France has announced plans to "resume privatization" in May of 1989.<sup>28</sup>

Of particular importance to the U.S. is small investors' vulnerability to the risk of the international institutional markets, demonstrated amply by the break. Major U.S. institutional traders began to sell their holdings overseas before the U.S. markets opened on October 19,<sup>29</sup> and continued to make decisions which

19. *Investor Linked to Schwab Loss Named in Papers*, Wall St. J., Nov. 2, 1987, at 3; MARKET BREAK REPORT at 5-6.

20. Miller, *Kaiser Tech Sues Its Chairman, Clore, For Alleged Securities-Law Violations*, Wall St. J., March 2, 1988, at 16.

21. Gerth, *A Push for International Market Rules*, N.Y. Times, Nov. 23, 1987, at D3.

22. Greenhouse, *Stocks Fall Sharply Abroad*, N.Y. Times, Nov. 11, 1988, at D1, D11, col.3. The grey market trades an issue in advance of the offering date at discount prices. SEC STAFF REPORT, III-38 to III-39, n.67.

23. *Resolute London*, Wall St. J., Oct. 30, 1987, at 1, col.1.

24. The resulting crisis illustrated, and resulted from, differences in U.S. and U.K. underwriting practices. In the U.K., placements are made immediately after an offer is open; in the U.S., underwriters are required to make the offering for a period of time until the offer becomes effective and the securities can be placed. See Plapinger and Morrissey, *U.S. and U.K. Underwriting Mechanics: A Comparison*, 2 INSIGHTS 2 (Apr. 1988).

25. *Bank of England to Buy 39 Million BP Shares*, Wall St. J., Jan. 8, 1988, at 24, col.3.

26. MARKET BREAK REPORT, *supra* at 11-20.

27. Raines, *Privatisation Faces Test in Britain*, N.Y. Times, Feb. 29, 1988, at D13, col.1.

28. Graham, *Balladur Plans Quick Start to Privatisation*, Fin. Times, Mar. 3, 1988, at 3.

29. One U.S. institution sold \$90 million of foreign stocks in London before the New York Stock Exchange opened that day. Lambert, *Two Days in October*, Fin. Times, Feb. 13, 1988, at FT-I, col.2.

controlled the U.S. market's performance in the next few days. In contrast, it appears that the activities of small investors made no difference to the behavior of the U.S. markets, both because they were unable to get their orders executed and because, once executed, their orders did not affect the market in the same fashion.<sup>30</sup> Foreign observers of the U.S. markets remarked that as a consequence, "[t]he individual investor [who account[s] for about 60 percent of investment in the U.S. equity market] simply disappeared."<sup>31</sup>

### C. Post-Break Proposals on International Regulation

Although it is still difficult to predict how the international securities market will develop and, in particular, what changes will result from the break, it is becoming apparent that international agreement in certain areas is essential. As mentioned above, recent experience strongly underscores the need for international agreements and guarantees on quotation, trading, clearance and settlement, and capital adequacy.<sup>32</sup>

Many of the points made about the October break are equally valid in the U.S. domestic and the international markets. Commentators on the U.S. market after the crash focused on mechanisms for quotation, trading, liquidity, and clearance. They criticized both the U.S. exchanges and the over the counter market for the unreliability of quotations entered into the intermarket media, and the unavailability of market makers to enter into trades. Similar criticisms have been levelled at the International Stock Exchange (ISE) in London.<sup>33</sup> Regional U.S. stock exchanges were unable to obtain timely quotations or trade information from the New York Stock Exchange (NYSE) on the automated intermarket

30. Coll, *Fidelity Executives Angered By Report of Oct. 19 Selloff*, Wash. Post, Feb. 7, 1988, at H4, col. 1.

31. Bush, *Suddenly, individuals count*, Fin. Times, Feb. 6, 1988, at FT-III. Accord, Power, *Indexes, Buffeted by Investor Dearth, Fall Nonetheless*, Wall St. J., March 15, 1988, at 47; *Confidence remains a distant memory*, *supra* note 20. This phenomenon is most apparent in the U.S., since less average foreign household wealth is invested in securities in the foreign markets than in the U.S. See *supra* note 5.

32. MARKET BREAK REPORT, *supra* note 4 at 11-21 to 11-22. The Report observes that "without effective . . . [clearance and settlement systems and linkages], all firms engaging in international securities business will be exposed to greater risk." *Id.* at 11-21 (footnote omitted). In addition, the Report calls for international trade and quote reporting mechanisms and adequate financial oversight systems, as well as enforcement and surveillance arrangements.

33. Trades in that marketplace often have to be placed by telephone, and critics complained that brokers were not answering their telephones. See MARKET BREAK REPORT *supra* note 4 at 11-9 to 11-10. In a report issued in February, 1988, the ISE concluded that charges that ISE brokers were not answering telephones on October 17 were "basically unfounded", but acknowledged that ISE securities dealers could not handle the volume of trading that week. Lohr, *Index Arbitrage is Backed*, N.Y. Times, Feb. 11, 1988, at D13. London market makers were also allowed to reduce their exposure by significantly limiting the number of shares any quotation they put into quotation media committed them to buy. MARKET BREAK REPORT *supra* note 4 at 11-10 to 11-12.



trading system, and complained that they could not effect trades through NYSE specialists. Indeed, trade volume may have shifted from the less-automated but more heavily capitalized NYSE to the more-automated, less-capitalized, regional exchanges.<sup>34</sup> The New York Stock Exchange has since imposed significantly higher capital requirements on its specialists, who perform as market makers.<sup>35</sup> The report of the President's Task Force on Market Mechanisms, the "Brady Report", called for the unification of all stock and futures clearance in one agency to reduce credit risks.<sup>36</sup> To bring the matter full circle, the Director of the Commission's Division of Market Regulation observed that insufficient capital of both NYSE and London market-makers was a significant contributor to market imbalances in U.S. securities during the break.<sup>37</sup>

The governor of the Bank of England has responded to all these charges by calling for increased international coordination of securities regulation.<sup>38</sup> *Business Week* also called for international securities regulators to "harmoniz[e] the various national laws governing disclosure and enforcement."<sup>39</sup> The *New York Times* decried a lack of "adequate supervision and understanding of the global markets", and urged "[c]loser coordination, more unified trading systems and more standard trading practices . . . ."<sup>40</sup>

In a recent speech to a business group in Tokyo, the Chairman of the SEC joined the call for international coordination, with particular respect to disclosure standards, guarantees of market fairness, quotation and price information, clearance and settlement, broker-dealer standards, capital adequacy standards, and enforcement measures. He also mentioned auditing and accounting standards, insider trading, market manipulation, misrepresentation, broker-dealer conduct standards, and market surveillance. He called on regulators "to adapt the best rules and policies of each nation to new market structures and trading strategies."<sup>41</sup>

Thus, the need for international regulation in the securities markets is growing,

34. Flynn, *Regional Exchanges Grumble*, N.Y. Times, Nov. 19, 1987, at D1, col.3.

35. Widder, *NYSE market makers must beef up capital*, Chi. Trib., Apr. 8, 1988, at 1. The concern with capital is highlighted by the fact that the crash drove 10% of the index and option traders in the Chicago Mercantile Exchange out of the market. Kreca and Laderman, *If You Think New York Has It Bad, Take A Look At Chicago*, BUS. WEEK, Nov. 30, 1987, at 132.

36. *Branding the Guilty*, THE ECONOMIST, Jan. 16, 1988, at 70.

37. Vise, *Studies Aim to Clear Muddy Waters of Stock Market Plunge*, Wash. Post, Nov. 29, 1987, at H1, col.2; see also Ferry, *London Exchange Official Calls for Unified Regulation*, Wash. Post, Feb. 12, 1988, at H3, reporting that, while the Bank of England concluded that U.K. brokers were net buyers of securities on October 19, U.K. fund managers complained that they could not effect transactions on the ISE that week, and thus directed their business to the NYSE.

38. *Global Bank Rules to Limit Securities Risks Are Urged*, Wall St. J., Feb. 2, 1988, at 43.

39. *Securities Rules Need To Go Global*, BUS. WEEK, Dec. 28, 1987, at 248.

40. Cash, *A New Urgency for Reforms in Policing Securities Trades*, N.Y. Times, Dec. 17, 1987, at A1, D4.

41. D. Ruder, *The October Market Break: A Stimulant to United States-Japanese Cooperative Securities Regulation*, Speech before Keidanran in Tokyo (Feb. 18, 1988).

while many of the interests individual states would seek to further are becoming similar. In this context, the prospects for international cooperation in the regulation of issuer disclosure, and the trading markets, as well as in enforcement efforts in general, appear favorable. As will be seen, the Securities and Exchange Commission has attempted a variety of independent domestic initiatives on these three fronts.<sup>42</sup> Although the Commission has made important accommodations to international securities trade in this fashion, this approach is limited. The Commission's Division of Market Regulation recently observed that "securities regulators around the world [must now] cooperate to ensure the integrity of our markets . . . ." <sup>43</sup>

### ISSUER DISCLOSURE IN THE U.S.; INITIAL DISTRIBUTIONS, SECONDARY MARKETS, AND THE INTERNATIONAL SECURITIES MARKET

One of the threshold questions presented to a U.S. regulator by the internationalization of the securities markets is how to reconcile foreign issuer disclosure practices with the disclosure requirements of U.S. law. Issuers of securities registered in the United States have broad, and recurrent, disclosure obligations under federal law, often broader than required by either practice or law in other countries. These U.S. issuer disclosure standards are central to the scheme of the federal securities laws.

In some respects, the Commission has unilaterally adapted U.S. disclosure requirements and investor protection to accommodate conflicting foreign practice or law. The ultimate development of uniform international standards for issuer disclosure on a multilateral basis—endorsed by many observers—will have to continue to accomplish this in a unified fashion while fulfilling the Commission's overarching obligation to protect U.S. investors.

#### A. Current U.S. Regulation

Under the federal securities laws, any issuer that uses United States jurisdictional means<sup>44</sup> to sell its securities is obligated to register those securities with the Commission. In addition, an issue traded in interstate commerce that crosses a threshold number for the size of its U.S. securities market and for the company's assets,<sup>45</sup> is obligated to register its securities with the Commission.<sup>46</sup> In design

42. For a brief overview of internationalization and U.S. regulation, see Longstreth and Randolph, *Internationalisation of Capital Markets*, 16 INT'L BUS. LAW. 20-24 (Jan. 1988).

43. MARKET BREAK REPORT, *supra* note 4, at 11-21.

44. The jurisdictional means are defined in the securities laws as interstate commerce and the mails. See Securities Act § 5(a), 15 U.S.C. § 77e(a) (1982).

45. See Securities Exchange Act § 12(g), 15 U.S.C. § 78l(g) (1982).

46. The issuer of any class of securities registered under the Securities Exchange Act must then make periodic reports in order to ensure the timeliness of publicly available data.

and in practice, however, this comprehensive scheme permits certain exceptions from registration where the U.S. is deemed to have a minimal interest in dictating the necessary disclosure.<sup>47</sup> Some of these exceptions are particularly relevant to the international securities market, and the Securities and Exchange Commission has relied upon these concepts in fashioning some of its initiatives to accommodate U.S. registration requirements to the increased international trade in securities.

### *1. Registration Requirements and International Transactions Exempt from Registration*

A broad range of offers or sales of securities is subject to the registration requirements of U.S. law. In general, registration is required under the Securities Act of 1933 whenever any person directly or indirectly "make[s] use of any means or instruments . . . of interstate commerce or of the mails to sell such security . . . ."<sup>48</sup> Interstate commerce includes "trade or commerce in securities or any transportation or communication relating thereto . . . between any foreign country and any State, Territory, or the District of Columbia . . . ."<sup>49</sup> In addition, whenever an issuer's securities are listed on a registered securities exchange, and the issuer has over five million dollars in assets and a class of securities held by more than 300 U.S. persons, it must register the security pursuant to the Securities Exchange Act of 1934.<sup>50</sup>

As mentioned above, the statutory concept of registration envisions that certain sales of securities through the jurisdictional means need not be registered. In this vein, issuers that offer or sell to a limited number of sophisticated investors may not have to register the securities under the 1933 Act.<sup>51</sup> Fundamentally, an issuer

47. Many exceptions, for example, embody notions of comity. Thus, the Securities Act provides that intrastate offerings, presumably regulated by the states, are exempt from registration. Securities Act § 3(a)(11), 15 U.S.C. § 77c(a)(11) (1982). Similarly, securities issued by banking institutions subject to state or federal regulation need not be registered. Securities issued by municipalities, states, and the federal government, or pursuant to certain provisions of the Internal Revenue Code, are also exempt from registration. Securities Act § 3(a)(2), 15 U.S.C. § 77c(a)(2) (1982).

48. Securities Act § 5(a), 15 U.S.C. § 77e(a) (1982).

49. Securities Act § 2(7), 15 U.S.C. § 77b(7) (1982).

50. Securities Exchange Act § 12(b), 12(g), 15 U.S.C. §§ 78l(b) and 78l(g) (1982); Rules 17g-1 and 12g3-2, 17 C.F.R. §§ 240.12g-1 and 240.12g3-2 (1987). The National Association of Securities Dealers also requires the issuers of securities which are to be traded in its NASDAQ over-the-counter system to register those securities with the Commission.

51. The concept of a sophisticated investor is long-recognized in the scheme of the federal securities laws, which have always allowed certain transactions with sophisticated investors to be exempt from registration. One definition of a sophisticated investor is contained in Rule 506 of Regulation D under the Securities Act of 1933, 17 C.F.R. § 230.506 (1987). Rule 506(b)(ii) provides that: "the issuer [in certain exempt transactions] shall reasonably believe immediately prior to making any sale that each purchaser who is not an accredited investor . . . has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment;" *see, e.g.,* Wolf v. S.D. Cohn & Co., 515 F.2d 591, 612 (5th Cir. 1975) (defining "sophisticated investor" as an individual capable of evaluating the merits and risk of the

who engages in the "sale of an issue of securities to . . . a limited group of experienced investors . . ." <sup>52</sup> is not required to satisfy the particularized disclosure protections of the securities laws. The issuer would, however, still be subject to the antifraud liability imposed by the federal securities laws. Other securities transactions on the secondary market are exempt from registration if they meet the standards of a concept dubbed as "Section 4(1½)", referring to two provisions of the Securities Act of 1933 which provide for exempt transactions. <sup>53</sup>

In addition to securities that are exempt from registration under the Securities Act by design, certain other securities in the international marketplace may, pursuant to Commission policy, be offered without registration. The Commission has long taken the position that securities offered or sold to non-U.S. persons in such a manner that they "come to rest" abroad—even if through interstate commerce (and thus within the scope of the registration provisions of the Securities Act)—need not be registered with the Commission. The Commission will not take enforcement action whenever securities are sold under circumstances reasonably designed to prevent the distribution or redistribution of the securities into the U.S. or to U.S. persons. <sup>54</sup>

prospective investment); *see generally* L. LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 382–92 (1983) (discussing offeree qualifications in private placements).

A concept similar to "sophisticated investor" is "accredited investor." Section 2(15) of the Securities Act provides a two part definition of "accredited investor." First, Section 2(15)(i) sets forth various financial institutions that are "accredited investors." Second, Section 2(15)(ii) provides the relevant criteria for determining when an individual is an "accredited investor." The rule states that an "accredited investor" is any person who, based on such factors as financial sophistication, net worth, knowledge, experience or amount of assets, qualifies as an accredited investor under rules and regulations which the Commission shall prescribe. Securities Act § 2(15), 15 U.S.C. § 77(b)(15) (1982). *See also*, Gilberg, *Regulation of New Financial Instruments Under the Federal Securities and Commodities Laws*, 39 *VAND. L. REV.* 1599 (1986) (discussing the definition and significance of accredited investors).

52. Landis, *The Legislative History of the Securities Act of 1933*, 28 *GEO. WASH. L. REV.* 29, 37 (1959).

In many instances, international securities transactions which use United States jurisdictional means involve transactions which are exempt from registration under the Securities Act, particularly private sales to sophisticated investors, *see supra* note 51 and accompanying text. However, as the international securities markets grow, increased U.S. trading in unregistered foreign issues could trigger the registration requirements of the Securities Exchange Act, which relate to the size of the U.S. trading market for the security.

53. *See* Vaughn, *The Section "(4 1/2)" Phenomenon: Private Resales of "Restricted" Securities*, 34 *BUS. LAW.* 1961 (1979).

In addition, individuals who obtain restricted securities as defined by Rule 144 under the Securities Act may engage in limited resales of those securities without the need to register them. Rule 144, 17 C.F.R. § 230.144 (1987), allows the resale of unregistered securities with certain restrictions. The Rule depends, among other things, upon the public availability of adequate current information of the sort required by the Commission's periodic reporting rules.

54. 29 *Fed. Reg.* 9828, *Securities Act Rel. No.* 4708 (July 22, 1964). The release specifically refers to a U.S. issuer, but it would apply to a foreign issuer as well.

Another situation which may legitimately avoid the reach of the U.S. securities laws occurs when

In response to this policy, the securities bar has developed standard procedures to prevent securities from coming to rest in the United States, and to allow for limited registration by individual shareholders of "flow-back securities" purchased in unregistered offerings overseas and resold in the U.S.<sup>55</sup> While this accommodation is helpful to issuers in the international markets seeking to avoid running afoul of U.S. registration requirements, it does not address the fact that, in some cases, U.S. investors have been excluded from purchasing securities in foreign offerings. The anomaly is that U.S. persons interested in obtaining these securities products are able to obtain the same product on a secondary market (foreign or even U.S.) after a waiting period—often on less favorable terms.<sup>56</sup> The unfairness of such a state of affairs is highlighted in the case of rights offerings made to everyone but U.S. persons.<sup>57</sup>

To meet this sort of objection, the Commission and its staff have expanded the concept of non-integration which was first introduced in 1964, *i.e.*, that essentially foreign distributions need not be registered, even where there are sales to sophisticated investors in the U.S.<sup>58</sup> In particular, the staff has recently issued several no-action letters<sup>59</sup> indicating that it would not recommend enforcement action with respect to specific foreign offerings contemporaneous to private placements in the U.S. In one letter, the staff indicated, in effect, that those

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foreign bidders in tender offers for primarily foreign securities with a small secondary market in the United States sidestep the jurisdictional means and U.S. investors. Thus, a tender offeror who is not a citizen or resident of the United States and uses no means or instrumentalities of interstate commerce or U.S. exchanges is not subject to the U.S. requirement that it extend its offer to all security holders who own shares of the security subject to the offer. 51 Fed. Reg. 32630 (1986); *see Plessey Co. PLC v. General Electric Co. PLC*, 628 F. Supp. 477 (D. Del. 1986). *See generally*, The Extraterritorial Application of U.S. Securities Law in the Absence of Fraud Charges: *Plessey v. GEC*, 18 L. & POL'Y INT'L BUS. 649, 655-64 (1986) (observing that the United States courts are more likely to extend U.S. jurisdiction extraterritorially in instances of fraud than in purely regulatory ones, like registration).

55. For a general description of these practices, see Adeo, *Flow-back Registration Statements*, 2 INSIGHTS 10 (Apr. 1988).

56. *See* SEC STAFF REPORT, *supra* note 1 at III-315 to III-317, VB-25.

57. In a no-action letter to the College Retirement Equities Fund dated June 4, 1987, the Division of Corporation Finance took the position that the exercise of preemptive rights by U.S. institutional investors that had originally purchased a foreign offeror's securities in a U.S. private offering would not be integrated with an unregistered foreign offering. Thus, the Commission's policy in that instance made it possible for the U.S. investors to participate in the rights offering made to foreign investors without requiring the issuer to implement the standard procedures designed to prevent "coming to rest" in the U.S. *See* College Retirement Equities Fund, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,508; (June 4, 1987).

58. *See* Securities Act Rel. No. 4708, *supra*, note 54.

59. A no-action letter is an indication from the Commission staff, based upon a particular set of facts described to it by a member of the public, whether it would recommend enforcement action if presented with that situation. *See generally*, Lemke, *The SEC No-Action Letter Process*, 42 Bus. Law. 1019 (1987).

specific foreign offerings made to non-United States persons would not be integrated with separate private placements in the U.S. which are exempt from registration, even though a secondary market in the security existed or might come into existence in the United States. The issuers were, therefore, not obligated to take any precautions other than those that would be required in the absence of a U.S. private offering, to prevent securities sold in the foreign offering from coming to rest in the United States.<sup>60</sup>

In another letter, the staff agreed, for instance, that those offerors would not be required to take additional affirmative precautions to prevent the development of a U.S. market, and that the U.S. purchasers in concurrent U.S. private placements would be able to resell their securities on the French Bourse without any obligation to prevent further sales to U.S. purchasers. Those letters allowed a small number of sophisticated U.S. investors to purchase unregistered securities in a private placement which were simultaneously subject to a public offering outside the United States, without registration of the security in the U.S.<sup>61</sup> However, the staff has since refused to issue similar assurances with respect to transactions in London, Toronto, and Vancouver.<sup>62</sup> In one unique situation, the Commission's staff took a no-action position with respect to French privatization transactions. In that situation, a small number of U.S. institutional investors would receive securities through private placements in the U.S. At the same time, French law required that offers to purchase the securities be made to all residents of France without regard to citizenship. The staff stated that the U.S. private placements would not be integrated with the French offerings, and that, in view of the requirements of the French law, the staff would not recommend action even though sales in that offering might be made to U.S. citizens resident abroad.<sup>63</sup>

The Commission's 1964 release which sets forth the circumstances in which issues through United States jurisdictional means that do not come to rest in the U.S. need not be registered is reportedly under review by the Commission staff.<sup>64</sup> The staff is reported to be considering a "safe harbor" for offers or sales made wholly outside U.S. territory. This would look to whether the issuer is a reporting company, whether there is an active U.S. market in its securities, and whether its securities can be registered on Commission Forms S-3 or F-3.<sup>65</sup>

60. College Retirement Equities Fund, SEC No-Action Letter (Feb. 18, 1987); (available in SEC files) College Retirement Equities Fund, SEC No-Action Letter *See also supra* note 57.

61. *See* Chubb and Kelly, *SEC No-Action Letter Relaxes the Market*, 6 INT'L FIN. L. REV. 21 (Apr. 1987).

62. *ALI-ABA Panel Discusses Insider Trading Developments*, 20 Sec. Reg. & L. Rep. (BNA) No. 4, at 132, 135 (Jan. 29, 1988) [hereinafter *ALI-ABA*].

63. French Privatization Program, SEC No-Action Letter, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,439 (April 17, 1987).

64. Securities Act Rel. No. 4708, *see supra* note 54 and accompanying text.

65. *See ALI-ABA, supra* note 62, at 134.

## 2. Disclosure Requirements for Foreign Issuers

The situations discussed above concern those in which foreign securities need not be registered in the United States. The issuer of securities which must be registered in the United States, whether foreign or domestic, must disclose certain information both in the registration statement and in periodic reports designed for regular and timely updating.<sup>66</sup> Periodic disclosure generally includes annual and quarterly reports, as well as special reports of material events. The Commission has undertaken a number of steps to accommodate the breadth of U.S. disclosure requirements to the particular problems of foreign issuers of securities which must be registered in the United States.

In specific, the Commission's registration forms for foreign issuers have been modified to reduce the cost of producing United States-style financial information. The Commission allows foreign issuers to provide substantially similar general information as domestic companies, but to present their financial statements in the form generally accepted in their domicile state, provided they reconcile variations from United States accounting and regulation.<sup>67</sup> In addition, foreign issuers may in certain offerings provide less information than domestic ones regarding such disclosure items as industry and geographic segments, compensation to management, and transactions with management.

Form 6-K, for periodic disclosure, requires only that issuers disclose in the U.S. any information that they must, or they have, made public abroad. Form 20-F for annual disclosure is modeled on the annual disclosure required of a domestic issuer, but a foreign issuer may present foreign financial statements with a reconciliation to U.S. rules.<sup>68</sup> Similarly, a foreign bidder making a tender offer for securities registered in the United States may use financial statements in compliance with Form 20-F.<sup>69</sup>

66. See Haseltine, *International Regulations of Securities Markets: Interaction Between United States and Foreign Laws*, 36 INT'L & COMP. L.Q. 307, 308 (1987). See, e.g., Securities Act § 5, 15 U.S.C. § 77e (1982), and Securities Exchange Act §§ 13 and 15(d), 15 U.S.C. §§ 78m and 78o (1982).

67. Form 20-F, Items 17 and 18, [vol.4] Fed. Sec. L. Rep. (CCH) ¶ 29,701, at 29,724 (Dec. 13, 1982). See Form F-1 for initial private offerings, Forms F-2 and F-3 for previously registered securities, Form F-4 for business combinations, and Form F-6 for registration of American Depositary Shares. [Vol.2] Fed. Sec. L. Rep. (CCH) ¶¶ 6951, 6961-7001 (July 13, 1983). Audits conducted for SEC filings must meet U.S. standards. However, audits conducted in accordance with the standards of Canada, the U.K., Australia, and New Zealand are generally considered to meet U.S. standards.

68. For a discussion of Form 20-F, see Seligman, *The Internationalization of the Securities Markets: Preface to a Symposium*, IX MICH. Y. B. INT'L LEGAL. STUD. 1 (1988).

69. See Rule 14d-6(e)(ix) under the Securities Exchange Act, 17 C.F.R. 240.14d-6(e)(ix) (1987). A foreign bidder has certain additional disclosure obligations arising out of its citizenship. It must disclose, in its offering materials, any foreign regulations which might restrict the future conduct of business. Similarly, where an offer for a registered foreign security is subject to foreign laws restricting control of the issuer, the offering materials must contain adequate disclosure of those laws. See Item 10(b) of Schedule 14D-1 under the Securities Exchange Act, 17 C.F.R. § 240.14d-100 (1987); SEC STAFF REPORT, *supra* note 1, at III-306 to III-307.

The disclosure required of certain foreign issuers has also been affected by other Commission initiatives. The Commission has significantly adapted its overall disclosure system to allow incorporation by reference to information filed in periodic reports in registration documents for issuers which meet general requirements of size and reporting history.<sup>70</sup> Although this does not simplify the issuer's periodic disclosure obligations, it does simplify registration under the 1933 Act. The Commission will also, in certain circumstances, allow continuous or delayed offerings of securities based on a single registration statement.<sup>71</sup> These important structural changes in U.S. disclosure obligations extend to foreign issuers and thus relieve part of the registration burden on qualifying foreign issuers.<sup>72</sup>

In a similar vein, the Commission recently approved the accommodation of listing requirements for foreign issuers by U.S. securities exchanges and the National Association of Securities Dealers. The American Stock Exchange, the New York Stock Exchange, and the National Association of Securities Dealers' NASDAQ system rules now permit the listing of foreign issuers which meet U.S. listing criteria for size and share distribution, but which may be required by the law of their domiciliary states to provide fewer shareholders rights than are available to shareholders of U.S. domestic companies.<sup>73</sup>

## *B. Current Proposals Regarding Registration and Disclosure Requirements*

A number of proposals regarding registration and disclosure requirements and the international securities marketplace are currently under discussion. The Commission has discussed both bilateral and multilateral approaches to registration and disclosure for international capital formation in a concept release.<sup>74</sup> Other initiatives currently being pursued focus on the creation of international standards which will be acceptable to a number of states. While there may be more that the United States can do in this area individually, the future for disclosure requirements in the international securities markets lies with international efforts towards a common, uniform standard of disclosure.

### *1. Registration Requirements*

Two current proposals regarding U.S. law would formalize the circumstances under which unregistered international securities may be traded in the secondary

70. See Forms S-2, S-3, [vol.2] Fed. Sec. L. Rép. (CCH) ¶¶ 7141, 7151 (Aug. 19, 1987); 17 C.F.R. §§ 239.12, 13 (1987).

71. Rule 415 under the Securities Act, 17 C.F.R. § 230.415 (1987).

72. Forms F-2, and F-3, 17 C.F.R. §§ 239.32 and 239.33 (1987), provide that certain foreign issuers may incorporate periodic disclosures by reference in the registration of securities.

73. Securities Exchange Act Release. No. 24634, 52 Fed. Reg. 24,230 (1987). See Reita and Lobrano, *New U.S. Listing Procedures for Non-U.S. Issuers*, 6 INT'L FIN. L. REV. 11 (Sept. 1987).

74. Facilitation of Multinational Securities Offerings, 50 Fed. Reg. 9,281 (1986) [hereinafter *Multinational Offerings Release*].



market through United States jurisdictional means without triggering U.S. registration requirements. Both these approaches reflect the largely institutional character of the players in the international securities market.

One approach would create a formal market for these transactions. Press reports describe plans by the American Stock Exchange and the National Association of Securities Dealers to request no-action letters from the SEC staff to establish exchanges which would provide "marketplaces" for unregistered international securities.<sup>75</sup> Reports on these facilities suggest that they would allow U.S. institutional investors to trade foreign securities that, though unregistered with the SEC, would meet exchange standards for disclosure and ownership reports. The facilities would provide clearance and settlement by book entry.

A second approach discussed in the press entails an exemption from registration for certain securities traded on the institutional block market, including foreign issues traded in these transactions. The Director of the Commission's Division of Corporation Finance has stated that the Commission staff is considering rule changes which would regularize a secondary market in unregistered securities which would also cover securities traded primarily in international contexts.<sup>76</sup> The change, known for purposes of discussion as Rule 144A, would permit resales of securities initially issued in a private placement without registration under the Securities Act, in one of two general patterns. Qualified investors could be limited to institutions, as defined by rule or by size, and the securities limited to nonconvertible investment grade debt, or preferred securities. Alternatively, a more restricted group of qualified institutions would be able to trade freely in any security whose issuer already provides disclosure on a periodic basis under the Securities Exchange Act, or whose issuer would be willing to provide certain data upon request.<sup>77</sup>

75. The American Stock Exchange filed a proposal for that market, an electronic market dubbed SITUS, with the Commission on December 23, 1987. Cowan, *Amex Seeks New Network*, N.Y. Times, Dec. 28, 1987, at D1, col. 1; Parker, *2 Exchanges in Works in Foreign Securities*, 15 PENSIONS FOR INV. AGE, 73-74 (1987). Among other things, the Amex proposal might allow U.S. banks to trade on the exchange through securities subsidiaries. Clough, *Amex Off-Shore Exchange Could Weaken Glass-Steagall Walls*, INVESTMENT DEALER'S DIGEST, Feb. 15, 1988, at 8.

76. See, e.g., ALI-ABA, *supra* note 62; SEC Staff to Work on Developing Safe Harbor Rule for Foreign Offerings, 19 Sec. Reg. & L. Rep. (BNA) No. 38 at 1444 (Sept. 25, 1987); see also 19 Sec. Reg. & L. Rep. (BNA) No. 33, at 1242, 1245-6 (Aug. 14, 1987).

77. In order to allow the issuers of unregistered securities trading in this fashion to ensure that they do not unwittingly acquire an obligation to register their securities under the Securities Exchange Act, the Commission could allow issuers whose securities are traded on this market an exemption from registration otherwise required under Securities Exchange Act § 12(g), 15 U.S.C. § 78l(g) (1982), where the number of non-qualified institutional holders does not exceed a number set by rule. See *Insider Trading*, *supra* note 76, at 1246.

The Commission would have to consider any other disclosure obligations separately, since issuers which are not required to register their securities would not necessarily be subject to the periodic disclosure requirements of Section 15(d) of the Act, 15 U.S.C. § 78o(d) (1982). Compare Commission Rule 12g3-2(b), 17 C.F.R. § 240.12g3-2(b) (1987), which provides an exemption from registration under the Securities Exchange Act for the securities of foreign private issuers who make available

## 2. International Disclosure Standards

As noted above, one limitation to the growth of the international securities market is the absence of common international standards for disclosure. The Commission has issued a "concept release" to explore the possibility of international disclosure norms and regulations. In its Multinational Offerings Release,<sup>78</sup> the Commission proposed two alternative approaches to international registration. The first alternative would permit the reciprocal registration of certain securities. Each participating country could allow the use of the offering document required in the issuer's home country without requiring extensive reconciliation of accounting and auditing information.<sup>79</sup> The release proposed initiating this reciprocity with the United Kingdom and Canada. Registration would be available primarily to world class issuers of investment grade debt which are traded less on their issuer's reported financial position, and more on their current yields and ratings. Alternatively, the release proposed a common prospectus approach, essentially an attempt at standardization with those two countries. This would entail an agreement that an offering document meeting certain disclosure standards could be used in two or all of the three countries.

A majority of commentators applauded the Commission's initiative. Even though many believed the common prospectus approach to be the ideal, a majority observed that some type of reciprocal approach was more practical because it was most easily implemented.

The Multinational Offerings Release is only one of several current initiatives concerning international disclosure standards. All of these initiatives have to overcome the same obstacle: the need to reconcile different, and possibly conflicting, national policy priorities.<sup>80</sup> This can be done in either of the two ways

to the Commission any information they had filed for or made public with their domiciliary state, to their shareholders, or to a stock exchange on which their securities are traded.

78. Multinational Offerings Release, *supra* note 74.

79. The release also contemplated that the procedure might be available for limited rights offers and exchange offers.

80. For example, one previous international initiative toward multilateral securities regulation faltered because the United States failed to modify conflicting law. The United States did not adopt the "Standard Rules for the Operations of Institutions for Collective Investment in Securities," issued in 1972 by the Organization for Economic Cooperation and Development ("OECD"), setting forth minimum requirements for the investment management and marketing practices of collective investment institutions. Released for comment by the Commission in Investment Company Act Release. No. 8596, 5 SEC Dkt. 640 (Dec. 2, 1974). These rules would have required the Commission to accept the registration of investment companies that might not meet the standards of the Investment Company Act. 15 U.S.C. 80b-1 to 80b-21 (1982). After declining to adopt the OECD's "Standard Rules," the Commission issued a release outlining the minimum standards for a foreign investment company to register with the Commission under the Act. 7 SEC Dkt. 1002 (Sept. 26, 1975). *See generally*, SEC STAFF REPORT, *supra* note 1, at VI-9 to VI-13.

Other legal and regulatory limitations to cooperation are embodied in regulation by some countries designed to control and insulate domestic markets and currencies. *See* D. AYLING, *supra* note 6, at 32-37.

proposed by the Multinational Offerings Release, by harmonizing different domestic standards so they are not inconsistent with one another, or by creating new standards acceptable as a whole to all the participating states. Those international organizations that have addressed the problem<sup>81</sup> have generally opted for harmonization.

The European Economic Community has begun an ambitious effort to harmonize the corporate and securities laws of its member states, focusing initially on disclosure.<sup>82</sup> Since 1978, the EEC's Council of Ministers has issued a series of Directives concerning collective investment products (such as mutual funds), exchange listing requirements, accounting and auditing standards, and mutual recognition of listed security prospectuses. Laws implementing the EEC's accounting and auditing standards<sup>83</sup> have been adopted by most of its members. Similarly, most member countries have also complied with the Directives on listing requirements.<sup>84</sup> Member countries are expected to comply with the Direc-

81. Both the OECD and the United Nations have surveyed the accounting and auditing practices, as well as the securities regulation, of member states. (The OECD has 26 members, including the United States, Japan, Australia, and European states.) The International Organization of Securities Commissions ("IOSC") has set up five working groups to study multiple listings of securities and multinational equity offerings; accounting and auditing standards; financial standards for securities intermediaries; domestic constraints on the international exchange of information; and regulation of international off-market trading. The members of the IOSC are the securities regulators of Australia, Canada, France, Hong Kong, Italy, Japan, The Netherlands, Sweden, Switzerland, the United Kingdom, and the United States.

82. See Merloe, *Internationalization of Securities Markets*, 8 J. COMP. BUS. & CAP. MKT. L. 299, 256-61 (1986).

83. Council Directive of 25 July 1978, 21 O.J. EUR. COMM. (No. L 222) 11 (1978), sets minimum standards for balance sheets, profits and loss account, and rules for the contents and notes of annual reports. This was followed up by Council Directive of 13 June 1983, 26 O.J. EUR. COMM. (No. L 193) 1 (1983), which sets minimum standards for the layout and contents of reports, and by Council Directive of 10 April 1984, 27 O.J. EUR. COMM. (No. L 126) 20 (1984), which provides standards for the testing of auditors and qualification of auditing firms. These EEC standards are not consistent with similar U.S. standards.

84. Council Directive of 5 March 1979, 22 O.J. EUR. COMM. (No. L 66) 22 (1979), requires member states to limit stock exchange listing to companies in compliance with their domestic law, and having a certain minimum capitalization and three years of published or filed financial reports. The Directive also sets certain minimum requirements for debt offerings and limits the listing of convertible debt and warrants to companies whose underlying securities are listed on a recognized exchange. Finally, the Directive requires disclosure to shareholders of annual accounts and material recent events. Council Directive of 17 March 1980, 23 O.J. EUR. COMM. (No. L 100) 1 (1980), sets minimum standards for information required from the issuers of listed securities, including a provision for the publication of material information. The Directive also lists seven areas which must be covered by publication. In addition, the Directive requires prior approval by competent authorities for publication, and a delay between publication and the effectiveness of the listing. Council Directive of 15 February 1982, 25 O.J. EUR. COMM. (No. L 48) 26 (1982), requires the publication of so-called "interim" information by the issuers of securities listed on an exchange.

tive on minimum standards for disclosure regarding collective investment products and their management by October 1988.<sup>85</sup> The Directive on Mutual Recognition of Prospectus of Admission to the Stock Exchange of June 22, 1987,<sup>86</sup> calls for mutual recognition of foreign prospectuses not only within the Common Market, but also with other states, and is scheduled to become effective January 1, 1990. The most recent disclosure initiative discussed as of the date of this writing (May 1988) concerns disclosure, and antitrust regulation, of tender offers and mergers.<sup>87</sup>

International standards for disclosure regulation, as opposed to minima for harmonization, face a heavier burden in being implemented by the various states, since they would replace, rather than simply modify, existing regulation. Thus, for example, efforts to propose and adopt guidelines for international accounting and auditing principles have proceeded slowly. The International Accounting Standards Committee (IASC), whose members include 100 organizations from 74 countries, has issued 26 accounting standards in recent years, dealing with the measurement of assets, liabilities, equity, revenue, and expenses.<sup>88</sup> These independent standards are not inconsistent with U.S. practices. However, they differ from United States generally accepted accounting principles (GAAP) in that they are more limited than U.S. GAAP in certain ways. At the current time, they are used only on a voluntary basis, except in Italy and on the International Stock Exchange, where listed companies are required to apply IASC standards or explain their deviation from the standards.

The International Audit Practices Committee of the International Federation of Accountants has issued 24 auditing guidelines, as well as guidelines on professional ethics and training. The auditing guidelines, again, differ from United States generally accepted auditing standards (GAAS), but do not conflict with U.S. GAAS. Since the guidelines were only issued in 1987, it remains to be seen how they will be accepted.

As this discussion of U.S. issuer registration and disclosure demonstrates, any domestic securities policy will have to change to meet expanding international trade, but at some point, the regulation of that trade demands international coordination. Harnessing the constructive forces of international capital markets in a unified way, while safeguarding the domestic policy imperatives underlying disclosure and registration requirements like those of the U.S., will remain one of the most challenging areas of internationalization of the securities markets.

85. Directive of December 20, 1985, 28 O.J. EUR. COMM. (No. L 611) 3 (1985). The Directive also addresses financial stability of issuers and annual reports from issuers.

86. 30 O.J. EUR. COMM. (L 185) 81 (1987).

87. Paltrow, *Despite Recent Mergers, Takeover Bids, Progress Toward EC-wide Rule is Slow*, Wall St. J., Feb. 18, 1988, at 14, col. 3.

88. In 1984, the IASC merged with the International Federation of Accountants (IFAC).

### III. REGULATION OF BROKER-DEALERS AND SECURITIES EXCHANGES IN THE INTERNATIONAL MARKETPLACE

As with disclosure, the United States statutory framework for the regulation of broker-dealers and exchanges begins with a broad statement of jurisdiction. Just as it has done with respect to issuer disclosure, the Commission has accommodated its administration of the federal securities laws in this area to the increased internationalization of securities trading. This aspect of securities regulation, however, has lent itself more readily to international agreements. International agreements allow each domestic regulator to depend on its foreign counterparts to provide adequate regulation, and adequate enforcement assistance, when matters fall within their jurisdiction.

#### A. Regulation of Broker-Dealers

Securities Exchange Act Section 15(a)<sup>89</sup> makes it unlawful for any broker or dealer<sup>90</sup> to make use of the mails or interstate commerce "to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security" unless that broker or dealer is registered with the Commission. Registration in turn subjects the broker-dealer and persons associated with it to comprehensive regulations designed to protect investors and ensure the integrity of the U.S. markets. These regulations require investment intermediaries who solicit U.S. securities transactions to satisfy basic competency, capital and reporting standards, to comply with customer protection requirements, and to consent to jurisdiction for purposes of SEC enforcement actions.<sup>91</sup> The Commission staff has traditionally interpreted the registration requirement strictly, and continues to take the position that any action by a foreign broker-dealer which may be construed as soliciting trades from a U.S. investor subjects that broker-dealer to U.S. jurisdiction.<sup>92</sup>

The Commission staff has accommodated some specific aspects of U.S. regulation to the business of broker-dealers operating in more than one country. For example, the underwriters of a distribution of securities are normally prohibited, during the distribution's pendency, from entering into transactions in the security (other than the distribution itself) as market makers.<sup>93</sup> U.S. underwriters par-

89. 15 U.S.C. § 78o(a) (1982).

90. The terms broker and dealer are defined in Securities Exchange Act §§ 3(a)(4) and 3(a)(5), 15 U.S.C. §§ 78c(a)(4) and (5) (1982).

91. See SEC STAFF REPORT, *supra* note 1, at V-41 to V-42.

92. *E.g.*, the staff has indicated that placing advertisements in U.S. newspapers or hosting an investment seminar in the U.S. would subject a foreign broker-dealer to U.S. registration requirements. See Hugh Seymour, Hoare & Govett, Ltd., SEC No-Action Letter (September 28, 1973) (available in SEC files).

93. See *e.g.*, Plapinger and Morrissey, *supra* note 24. In general terms, a market maker is a dealer that holds itself out as ready to buy or sell particular securities for its own account on a regular or

ticipating in global distributions must still comply with the U.S. regulatory prohibition on active market-making activities in the U.S., but the staff has agreed that the non-U.S. part of the distribution may, subject to certain conditions, proceed in the ordinary course of business without complying with U.S. law.<sup>94</sup> The staff relies on regulatory safeguards in the U.S. augmented by foreign regulation, assurances of access to necessary information in the event of an inquiry, and other restrictions appropriate to the individual offering, to provide a minimum level of protection. The conditions for this no-action policy limit the investment advice foreign underwriters give their clients, and require that market prices be set by independent third parties. In one instance, the Rhone-Poulenc distribution, the Commission also required compliance with a 9-day "cooling off period" in light of a concurrent U.S. distribution of 20% of the shares.<sup>95</sup>

In other cases where the principal market is not in the U.S., the staff has permitted market makers to base any stabilizing bids they place in foreign and U.S. markets on prices set in the principal market.<sup>96</sup> All of these actions were premised upon a representation that the underwriter or affiliate would maintain records of purchases and make them available to the Commission on request.

In an extension of these approaches, the Commission staff recently agreed to permit ISE market makers in United Kingdom securities to engage in what was

continuous basis. Securities Exchange Act § 3(a)(38), 15 U.S.C. § 78c(a)(38) (1982) defines a market maker as any specialist permitted to act as a dealer, any dealer acting in the capacity of block positioner, and any dealer who, with respect to a security, holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis.

Specifically, Rule 10b-6 under the Securities Exchange Act, 17 C.F.R. § 240.10b-6 (1987), forbids persons participating in a distribution of securities, including underwriters, to enter into or induce others to enter into transactions in the offered security, or a related security, for a period of 2 or 9 business days before the beginning of the distribution, until the distribution is ended. Rule 10b-7, 17 C.F.R. § 240.10b-7 (1987) prohibits market makers who underwrite the offering from entering into transactions in the secondary market for the security which stabilize that market's price for the security, except as provided by the rule.

94. See Bartos, *U.S. Market Regulation and Global Offerings with a U.S. Tranche*, 6 INT'L FIN. L. REV., (July, 1987), at 16.

95. Rhone-Poulenc S.A., SEC No-Action Letter, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,444, at 77,455 (Mar. 13, 1987); see also, Banco de Santander S.A., SEC No-Action Letter, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,523, at 77,684 (July, 28, 1987); C.H. Beazer (Holdings) PLC, SEC No-Action Letter [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,664, at 77,855 (May 27, 1987); and British Petroleum Company Ltd., SEC No-Action Letters (June 14, 1987) (Oct. 31, 1979), (July 2, 1981), and (Sept. 15, 1983) (available in SEC files); Louis Vuitton, S.A., SEC No-Action Letter (June 21, 1984) (available in SEC files); Compania Telefonica Nacional de Espana, S.A., SEC No-Action Letter (June 11, 1987) (available in SEC files); Banco Central, S.A. SEC No-Action Letter (June 30, 1987) (available in SEC files).

96. See Banco de Santander, *supra* note 95. See also Tokio Marine and Fire Insurance Co., SEC No-Action Letter, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,519; Phillips N.V., SEC No-Action Letter, [1987 Transfer Binder] Fed. Sec. L. Rep. ¶ 78,449; Barclays PLC, 38 SEC Dkt. 661 (May 19, 1987).

termed "passive market making," during a distribution of securities to areas including the United States.<sup>97</sup> ISE member market makers are required by ISE rules to maintain a "continuous and competitive two-way price," regardless of the pendency of any securities distribution. Moreover, ISE market makers that cease to perform that function are barred from resuming it for three calendar months. Recognizing the dissonance between Commission and ISE rules, the Commission exempted ISE members that trade in so-called Alpha and Beta securities<sup>98</sup> from the Rule 10b-6 and 10b-7 prohibitions on certain conditions. The conditions are that the price must be set by transactions which do not include a statutory underwriter, that the market maker may not create or, for a limited period of time, solicit active trading in the security, and that the firm will notify both U.S. and U.K. regulators of its intent to engage in possible market making and make its records available to those authorities on request. The most recent and ambitious of offerings along these lines involved the shares of British Petroleum in October 1987.<sup>99</sup>

The Commission staff has also provided guidance to registered U.S. and foreign broker-dealers regarding U.S. regulatory requirements for unregistered affiliates. Ordinarily, a registrant would be required by the Commission's recordkeeping and net capital rules,<sup>100</sup> to maintain reserves against all receivables from its foreign unregistered affiliates. However, if the affiliate's books and records are available for inspection by the Commission or by a self-regulatory organization registered with the Commission, the reserve requirement will be waived. Similarly, the Commission exempted a registered broker-dealer's unregistered foreign affiliates from registration, despite the fact that they routed orders in securities in which their registered affiliate made markets. This action included provisos that, among other things, the U.S. broker-dealer would obtain any information requested by the Commission regarding the trading activities of its foreign affiliates.<sup>101</sup> Finally, the Commission staff has permitted contacts between a U.K. broker-dealer, its registered U.S. broker-dealer affiliate, and

97. International Stock Exchange of the United Kingdom and the Republic of Ireland Limited, SEC No-Action Letter (September 29, 1987) (available in SEC files).

98. Securities with six or more market makers from issuers whose market capitalization exceed 50 million pounds and whose previous quarter's share turnover was at least 10 million pounds. Topic Services, Inc., 1987 Global Trading Information 7; Bartos, *London Stock Exchange-SEC Agreement on Market Making*, 7 INT'L FIN .L. REV. 32, 33 (Jan. 1988). See MARKET BREAK REPORT, *supra* note 4, at 11-11, n.35; and SEC STAFF REPORT, *supra* note 1, at V-35, n.82.

99. British Petroleum Company p.l.c., SEC No-Action Letter, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,660 (Oct. 13, 1987); see also British Petroleum Company, p.l.c., SEC No-Action Letter, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,661 (Nov. 5, 1987).

100. Rules 17a-3 and 17a-4 under the Securities Exchange Act, 17 C.F.R. §§ 240.17a-3 and 17a-4 (1987) (recordkeeping), and 15c3-1 under the Securities Exchange Act, 17 C.F.R. § 240.15c3-1 (1987) (net capital).

101. Vickers da Costa Securities, Inc., SEC No-Action Letter (Aug. 14, 1985) (available in SEC files).

U.S. customers concerning research produced by the U.K. firm without registration of the U.K. firm.<sup>102</sup>

### *B. Regulation of Trading Markets*

While there is some room for the Commission to act unilaterally in adjusting its administration of the securities laws to broker-dealers in the international context, that room virtually disappears with respect to actual international trading. Any act in the U.S. by a financial intermediary inviting U.S. participation in foreign securities transactions triggers the registration requirements of the Exchange Act. The Commission's compromise of these provisions has required significant assurances of reliability, consistency, and uniformity from its foreign regulatory counterparts. The thoroughness of U.S. regulation of this aspect of the securities market, as with the issuer disclosure requirements, is a direct response to the relatively high proportion of individual investors in the U.S. market.<sup>103</sup> The very comprehensiveness of U.S. regulation of securities markets has been, however, in some respects, a catalyst for detailed international cooperation. Because the Commission's discretion in making unilateral adjustments to the administration of U.S. regulations in response to international trade is limited, securities regulators have made significant progress in coordinating and even standardizing international regulation.

The approval of trading linkages between U.S. and foreign securities exchanges requires an active effort toward uniformity in regulatory and business practices.<sup>104</sup> The Commission has approved linkages between Canadian and U.S. exchanges<sup>105</sup> on the condition that the Canadian exchanges conform their audit trails to U.S. practices and that they assure the Commission access to their records, and those of their governing bodies, in spite of the Canadian "blocking"

102. Chase Manhattan Corporation, SEC No-Action Letter, [1987 Transfer Binder] Fed. Sec. L. Rep. ¶ 78,518 (July 28, 1987).

103. While individual investors have traditionally been few in number in most industrialized countries (*see supra* note 5) individual securities investment is and has always been comparatively common in the United States, *see* P. STONHAM, *GLOBAL STOCK MARKET REFORMS* 52-55, 117 (1987). This phenomenon of extensive individual investment explains why comprehensive regulations backed by the antifraud provisions are the hallmark of U.S. securities regulation. Loomis and Grant, *The U.S. Securities and Exchange Commission, Financial Institutions Outside the U.S. and Extraterritorial Application of the U.S. Securities Law*, 1 J. COMP. CORP. L. & SEC. REG. 3, 21-23 (1978).

104. European linkages have encountered similar logistical difficulties. *See* discussion of German links with Dutch, Swiss, French and Austrian markets in Kubler, *Regulation Problems in Internationalizing Trading Markets*, 9 U. PA. J. INT'L BUS. L. 107, 114 (1986).

105. Boston Stock Exchange-Montreal Stock Exchange link, approved, 49 Fed. Reg. 49,575 (1984); 50 Fed. Reg. 14,480 (1985); American Stock Exchange-Toronto Stock Exchange link, approved, 50 Fed. Reg. 39,201 (1985); Midwest Stock Exchange-Toronto Stock Exchange link, approved, 51 Fed. Reg. 11,854 (1985).



statute.<sup>106</sup> The Commission recently entered into a Memorandum of Understanding relating to the enforcement of the U.S. and Canadian securities laws with securities regulators in Ontario, Quebec and British Columbia.<sup>107</sup>

Similarly, a trading link between the International Futures Exchange (Bermuda) Ltd. ("Intex") and the Pacific Stock Exchange is conditioned on Intex's agreement to provide information to the Pacific Stock Exchange for surveillance and regulatory purposes, and the assurance of Bermuda's Minister of Finance that Bermuda's blocking and secrecy statute, the Protection of Trading Interest Act of 1981, would not frustrate the sharing of information for surveillance and regulation.<sup>108</sup>

Even the approval of international quotation mechanisms requires bilateral assurances of assistance in enforcement, in order to guard against market manipulation. The Commission has approved an international quotation mechanism between the ISE and the National Association of Securities Dealers ("NASD") for the dissemination of current stock quotations—upon which trades may be executed by other channels—without requiring the executing firm to register in the United States as a broker-dealer, as the law would otherwise compel.<sup>109</sup> The Commission approved this arrangement in the context of the recent reorganization of securities regulation in the U.K., under the Financial Services Act 1986, Ch. 6<sup>110</sup> and of the execution of a Memorandum of Understanding between the

106. A blocking statute prohibits citizens of the enacting state from producing evidence to a foreign tribunal or authority without prior permission of the government. The Commission has received the assurance of the Ontario Securities Commission that it is "extremely unlikely" that Canada's Foreign Extraterritorial Treasures Act, Can. Stat. C. 49 (1985) would "prohibit the exchange of information between the [Ontario Securities Commission] and SEC." Letter from the Ontario Securities Commission to the SEC (Sept. 24, 1985).

107. Memorandum of Understanding between the United States Securities and Exchange Commission and the Ontario Securities Commission, Commission des Valeurs Mobilières du Québec, and British Columbia Securities Commission (Jan. 7, 1988), SEC News Digest (Jan. 6, 1988). For a discussion of this agreement, see *infra* note 180 and accompanying text.

108. 51 Fed. Reg. 41,884 (1986). Letter from Mansfield H. Brock, Jr., Financial Secretary for Bermuda Ministry of Finance, to Pacific Stock Exchange, Oct. 20, 1986.

The Commission has also agreed not to object, for a trial period of 18 months, to the offer of a future based upon the price-weighted index of 225 stocks traded on the Tokyo Stock Exchange. The Chicago Mercantile Exchange offers this index, the Nikkei Stock Average, to U.S. investors through a linkage with the Singapore International Monetary Exchange, Inc. ("SIMEX") which is ordinarily subject to CFTC supervision. Singapore International Monetary Exchange, Inc., CFTC Interpretive Letter No. 86-6 (Dec. 5, 1986). For a discussion of the mechanics of this linkage, which are far more extensive than the straightforward equity linkages approved by the SEC, see Comment, *Extraterritorial Application of United States Commodity and Securities Laws to Market Transactions in an Age of Intercontinental Trading Links*, 7 Nw. J. INT'L L. & Bus. 351-379 (1985).

109. International Stock Exchange-National Association of Securities Dealers, Inc., Securities Exchange Act Release No. 24,979, 52 Fed. Reg. 37,684 (Oct. 15, 1987).

110. For general discussions of the Act, see Brayno, *The U.K. Financial Services Act 1986*, 20 Sec. & Comp. Reg. 51 (Mar. 25, 1987); and Abrams, *The U.K. Financial Services Act 1986*, 3 Fin. Serv. Reg. 101 (June 3, 1987).

Commission and the Commodity Futures Trading Commission, in the United States, and the Department of Trade and Industry in the United Kingdom on September 23, 1986.<sup>111</sup> That Memorandum provides the Commission with access to surveillance and regulatory information in the United Kingdom, and the U.K. Department of Trade and Industry with access to similar information in the U.S.<sup>112</sup>

On March 14, 1988, the Commission approved a second quotation linkage between the NASD's NASDAQ quotation system and the Singapore Stock Exchange.<sup>113</sup> That linkage provides for NASDAQ to provide closing quotations, last sale, and volume information at the close of the trading day for 35 NASDAQ-listed securities.<sup>114</sup>

International clearance and settlement<sup>115</sup> demands even closer cooperation. In an arrangement for the mutual trading of a European market index, known as the XMI, between the American Stock Exchange and the European Options Exchange, the European Options Exchange made arrangements to clear trades through the Options Clearing Corporation, a clearing agent registered under the federal securities laws.<sup>116</sup> In addition, the European Options Exchange adopted a rule requiring a waiver of Dutch secrecy laws which otherwise provide a privilege against production of customer information for surveillance purposes.

The approval of clearing linkages requires the most extensive effort towards

111. Memorandum of Understanding on Exchange of Information Between the United States Securities and Exchange Commission and the United Kingdom Department of Trade and Industry in Matters Relating to Securities and Between the United States Commodity Futures Trading Commission and the United Kingdom Department of Trade and Industry in Matters Relating to Futures (Sept. 23, 1986), 25 I.L.M. 1431 (1986). The U.K. Financial Services Act took effect April 29, 1988.

Pursuant to its provisions, the U.K. Department of Trade and Industry approved the NASD as an exchange under British law, because its NASDAQ automated quotation system provides the medium to share quotations in some 700 securities. The ISE and NASD plan to expand the linkage to include clearance and settlement functions. *Battle of the U.S. exchanges moves to London*, Fin. Times, Apr. 20, 1988, at 11, col. 3; *NASDAQ Receives Approval to Continue U.K. Trading*, Wall St. J., Apr. 20, 1988, at 37, col. 6.

112. See Grundfest, *Regulating the International Capital Markets*, Speech given at Butcher Hall, London, England (Nov. 11, 1987) (copy on file with the Michigan Journal of International Law).

Instinet Corporation ("Instinet"), a subsidiary of Reuters Holding PLC, is also operating an automated quotation and execution system that functions internationally. See Instinet, SEC No-Action Letter (August 8, 1986) (available in SEC files), stating that the Division would not recommend enforcement action should Instinet operate the system without registration under Sections 3(a)(1), 5, 6, and 17A of the Securities Exchange Act of 1934.

113. Securities Exchange Act Release No. 25,457, 53 Fed. Reg. 9,156 (Mar. 21, 1988).

114. 52 Fed. Reg. 42,167 (1987) (proposed Oct. 7, 1987).

115. For an explanation of clearance and settlement techniques in the United States, see D. WEISS, *AFTER THE TRADE IS MADE* 311-29 (1986). See also SEC STAFF REPORT, *supra* note 1, at V-61 to V-71 for a discussion of international clearance and settlement.

116. Approved, 52 Fed. Reg. 16,469 (1987); 52 Fed. Reg. 19,942 (1987); 52 Fed. Reg. 32,368 (1987).

uniformity of practice.<sup>117</sup> Typically, foreign clearing entities have either joined U.S. clearing agencies or agreed to be bound by the U.S. agency's rules, including financial standards and safeguards.<sup>118</sup> Where a foreign blocking statute might prohibit the foreign clearing agency's full compliance with U.S. law or investigations, the Commission has obtained the agency's representation that it will provide any information requested by a participant in the transactions.<sup>119</sup> In addition, the Commission staff has issued a no-action letter to allow a United States registered clearing agency, the International Securities Clearing Corporation, to clear and settle transactions on the International Stock Exchange for U.S. brokers and dealers.<sup>120</sup>

### *C. Recent Initiatives*

In view of all this, the Commission issued a second "concept release" to consider issues regarding the regulation of the securities markets themselves in the international context, the Global Trading Release.<sup>121</sup> That release contained a series of questions on how to proceed in adjusting U.S. regulation to the expansion of international securities trading. Some foreign respondents stated that they considered particular protections afforded under their local law and regulation

117. Uniformity of practice does not necessarily require the unity of all clearing organizations. As one writer has observed, efficiency and uniformity can be attained by a number of different organizations operating under the same law; this would allow each organization to adjust to the particular requirements of various financial products, or of various types of financial intermediaries. Weinberg, *Unsettled Question*, *Barron's*, Feb. 15, 1988, at 16, col. 1. The author suggests that clearing agencies should establish an "intermarket coordination and crisis-management group" to perfect coordinated intermarket surveillance and to share financial, operational, and credit information.

118. Depository Trust Company-Bankers Trust Company agreement to hold for Nominee Amsterdam Stock Exchange N.V., approved by letter of July 25, 1980; Trans Canada Options, Inc.-National Securities Clearing Corporation agreement to settle options for Canadian exchanges, approved by letter of Aug. 18, 1987; Canadian Depository for Securities-National Securities Clearing Corporation agreement to clear and settle U.S. securities for Canadian members, SEC No-Action Letters (Oct. 24 and Nov. 26, 1984) (available in SEC files); Midwest Clearing Corporation & Midwest Securities Trust Company-Vancouver Stock Exchange agreement to clear and settle U.S. and Canadian securities, SEC No-Action Letter (Sep. 12, 1985), extended to the Stock Exchange, SEC No-Action Letter (March 21, 1986), and to the ISE SEC No-Action Letter (June 25, 1986) (available in SEC files); OEO-Options Clearing Corporation to clear and settle XMI options on a fully fungible basis, 52 Fed. Reg. 16,469 (1987).

119. Midwest Securities Trust Company and Midwest Clearing Corporation-Societe Interprofessionnelle pour la Compensation des Valeurs Mobiliers ("SICOVAM"), SEC No-Action Letter (July 22, 1987) (available in SEC files). French law prohibits French citizens and companies from disclosing evidence "with a view to foreign judicial or administrative proceedings or in connection therewith." French Penal Code Law No. 80-538, art. 1 *bis*, (July 16, 1980). This blocking statute contrasts with a secrecy law, such as the bank secrecy provisions of Swiss law, which operates like a legal privilege. See *infra* notes 169 and 170 and accompanying text.

120. Application to register, 51 Fed. Reg. 29,184 (Aug. 6, 1986). SEC No-Action Letters (Sept. 10 and Dec. 10, 1986, and Oct. 29, 1987) (available in SEC files).

121. Securities Exchange Act Release No. 21,958, 50 Fed. Reg. 16,302 (Apr. 18, 1985).

essential.<sup>122</sup> Thus, although they were attracted by multilateral arrangements, many respondents cautioned that they believed bilateral arrangements were more likely to preserve these essential local differences.<sup>123</sup> Nonetheless, commentators on the proposal and participants in the SEC's Internationalization Roundtable, held on February 17–18, 1987, agreed that multilateral agreements and uniform standards must be developed some day to establish uniform international standards for the quotation of current transaction and quotation information, and for clearance and settlement.<sup>124</sup>

The U.S. is not alone in seeking to expand market linkages. Indeed, ambitious steps toward the development of international markets and regulation are taking place abroad. The European Economic Community is proposing an electronic quotation link between markets in member countries, including London, Amsterdam, and Paris.<sup>125</sup> Germany has explored linkages with four other European states.<sup>126</sup> The Netherlands has also opened up a trading link in 24 Japanese stocks with the Tokyo Stock Exchange.<sup>127</sup> The ISE has agreed to develop a price index on the Tokyo and London prices of Japanese shares traded in London.<sup>128</sup> SICOVAM, the French securities clearing system,<sup>129</sup> is linked to markets in Amsterdam, Belgium, and Tokyo.<sup>130</sup> Moreover, numerous direct trading links have been forged between commodities exchanges.<sup>131</sup>

As part of its plan to form a single common market in goods and services by 1992, the European Economic Community has focused significant efforts on the securities markets. Thus, the disclosure guidelines discussed above<sup>132</sup> are only part of a broad-scale analysis of European regulation designed to “open . . .

122. SEC STAFF REPORT, *supra* note 1, at VA-10, VA-16, VA-17, VA-23, VA-25 (Toronto, Tokyo, and Amsterdam Stock Exchanges).

123. *Id.* at VA-15 (Merrill Lynch support for intermarket linkages); VA-26 (U.S. and Australian respondents' support for bilateral and multilateral law enforcement accords); VA-18 to VA-19 (comments from U.S., Amsterdam, and Toronto that clearance links must be established on a reciprocal basis); VB-9 (American Stock Exchange President's observation that common backgrounds help surveillance sharing); VB-77 (Toronto Stock Exchange executive's observation that bilateral, “book-based” linkage is the most efficient for global trading).

124. *See generally*, SEC STAFF REPORT, *supra* note 1, at VA-1 to VB-36. The current international securities market is primarily institutional and conducted over the counter. *See id.* and Kubler, *supra* note 104, at 107. In such a market, current transaction and quotation information may be difficult to obtain.

125. Quinn, *Europeans Tie the Knot*, INSTITUTIONAL INVESTOR, Dec. 1987, at 85.

126. *See* Kubler, *supra* note 104 at 114.

127. Shapiro, *Amsterdam Takes on the Triad*, INSTITUTIONAL INVESTOR, Dec. 1987, at 211, 212.

128. Wall St. J., Apr. 14, 1988, at 42.

129. *See supra* note 119.

130. D. AYLING, *supra* note 6, at 88.

131. *See generally*, Cox and Michael, *The Market for Markets: Development of International Securities and Commodities Trading*, 36 CATH. U.L. REV. 833 (1987). The authors note that, ironically, intermarket links have generally preceded market demand. *Id.* at 835.

132. *See supra* text accompanying notes 82–87.

frontiers to [financial] services from other parts of the community.”<sup>133</sup> While the general approach has been to “harmonize” the domestic laws,<sup>134</sup> the EEC will be faced with resolving some very important questions which could make its experiences a model, or a lesson, for other efforts in international securities regulation. The U.K. has already insisted that domestic securities authorities retain control over the various European markets—at least “until other EC markets . . . introduce equivalent regulation” to its own.<sup>135</sup>

Among the most ambitious of these plans is the EEC’s recently proposed electronic intermarket link for price reporting, trading and settlement, the Interbourse Data Information System (IDIS).<sup>136</sup> It is to begin in the fall of 1988 with current quotations over high-speed telecommunications lines between the exchanges in London, Amsterdam, Copenhagen and Paris. Ultimately, it is planned to include the exchanges in Lisbon, Athens, Frankfurt, Milan, Dublin, Luxembourg, Madrid and Brussels. This endeavor will necessarily entail standardizing many trading practices. Even the first stage will involve coordinating London’s electronic Stock Exchange Automatic Quotation (SEAQ) quotation and execution system, SAEF automatic execution system,<sup>137</sup> and electronic settlement systems Sequel,<sup>138</sup> and Talisman,<sup>139</sup> with the only partially automated systems on the other exchanges. Moreover, quotations of last-done prices, which were the norm in Amsterdam and Paris in 1985,<sup>140</sup> will not be comparable to SEAQ’s display of two-way market maker quotes, best bid and ask data, volume, and last trade information.<sup>141</sup> The ultimate achievement of intermarket quotation, trading, and settlement will depend on the development of one consistent standard in all of those twelve markets.

Another type of problem the EEC faces is reconciling “national discrepancies and barriers,” ranging from domestic differences in bank lending and tax systems to different degrees of investor protection.<sup>142</sup> Thus, at the same time that the U.K. will implement its Financial Services Act, requiring significant investor protections, the EEC will implement moves to open up domestic markets with minimal investor protections. U.K. law now requires financial intermediaries to register in the U.K., directs brokers to give customers their “best advice,” and allows customers to obtain compensation for losses through self-regulatory or-

133. de Jonquieres, *1992: Countdown to Reality*, *Fin. Times*, Feb. 19, 1988, at 18.

134. Merloe, *supra* note 82.

135. de Jonquieres, *The City of London wakes up to the realities of 1992*, *Fin. Times*, Mar. 1, 1988, at 2.

136. Quinn, *supra* note 125, at 185.

137. Wolman, *U.K. automated dealing*, *Fin. Times*, Jan. 28, 1988, at 19.

138. This system provides execution and confirmation for trades in non-British equities, *Wall St. J.*, Jan. 19, 1988, at 52.

139. See P. STONHAM, *supra* note 103, at 109–113.

140. Comment, *Internationalization of Stock Markets*, 7 *Nw. J. INT’L L. & BUS.* 532, 558 (1986).

141. Topic Services, Inc., 1987 Global Trading Information 2.

142. de Jonquieres, *supra* note 133.

ganizations, compensation funds, or legal process in the courts.<sup>143</sup> Foreign firms in London have complained of the costs of compliance with the U.K.'s new rules.<sup>144</sup> However, it is unclear whether some of the reorganizations and computerizations at issue would have been necessary in any case to meet increased competition as much as increased regulation.<sup>145</sup>

In defense of the U.K.'s legislation, commentators point to the quadrupling of small shareholders in the U.K. since 1979 and the "breakdown of the ethos of a small 'self-regulating' club" as factors which compel increased regulation and consumer protection.<sup>146</sup> These same factors, in fact, will be inherent in any true "Europeanization" of the securities markets, and could produce legislation in the EEC or the other EEC member states equivalent to the U.K.'s Financial Services Act.<sup>147</sup> Indeed, it is possible that insufficient regulation, and consequent increases in risk, could be a competitive disadvantage.<sup>148</sup>

#### IV. ENFORCEMENT OF U.S. SECURITIES REGULATION: BILATERAL AGREEMENTS

Commensurate with the broad jurisdiction afforded it under the federal securities laws, the Commission has occasionally attempted to act unilaterally in enforcing its securities laws in the international context. Despite some success in this approach, however, the Commission has focused most of its efforts in the recent past on developing bilateral international agreements to coordinate securities law enforcement.

##### A. *The Unilateral Extension of U.S. Jurisdiction*

United States courts have subject matter jurisdiction to entertain a suit under the antifraud provisions of the federal securities laws which alleges facts occurring outside the United States, if the allegations meet one of two tests: (1) conduct in this country, or (2) significant effects in the United States.<sup>149</sup>

143. Wolman, *A rush to keep to the rules*, Fin. Times, Feb. 27, 1988, at IV.

144. See Blackwell, *Financial Services Act worries commodity trade*, Fin. Times, Feb. 26, 1988, at 32.

145. Norman, *Britain Appoints New Chief Regulator for Increasingly Upset Securities Firms*, Wall St. J., Feb. 29, 1988, at 36. Indeed, the SAEF automated execution system is expected to cut the costs of execution by half. Wolman, *supra* note 137.

146. Wolman, *supra* note 143.

147. As one European investment banker put it, "the ultimate success of globalization will depend on the political will of all the governments to adjust their policies and to coordinate their economic and monetary policies in a way that will allow us to talk about one capital market." *Euromarket: No Pain; No Gain*, INSTITUTIONAL INVESTOR, Feb. 1988, at 186.

148. See Perry, *The Markets Need Stricter Regulation*, N.Y. Times, Feb. 28, 1988, at F2.

149. These tests, which are not contained in the federal securities laws, are set forth in the Restatement (Second) of Foreign Relations Law of the United States, which provides, in Section 17, for subject matter jurisdiction arising from conduct in the state, and, in Section 18, for subject matter

Under the case law for the conduct test, the U.S. conduct must be more than “merely preparatory.”<sup>150</sup> However, the courts will not “allow the United States to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners.”<sup>151</sup>

The effects test requires an effect injurious to the American securities market.<sup>152</sup> Where the effects are merely “generalized,” they will not support U.S. subject matter jurisdiction.<sup>153</sup>

Given the expansive reach of U.S. jurisdiction and the increasing internationalization of securities markets, the Commission now more frequently finds itself investigating possible violations of the U.S. securities laws in situations in which a witness or evidence is located abroad. In those cases the Commission is not infrequently confronted with foreign blocking and secrecy laws.<sup>154</sup> Blocking statutes prohibit even voluntary disclosure to foreign states of certain types of

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jurisdiction arising from effects in a state. *Leasco Data Processing v. Maxwell*, 468 F.2d 1326, 1333–39 (2d Cir. 1972); *see also Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27, 30 (D.C. Cir. 1987).

150. *Bersch v. Drexel Firestone*, 519 F.2d 974, 987 (2d Cir. 1975), *cert. denied*, 423 U.S. 1018 (1975).

151. *IIT v. Vencap*, 519 F.2d 1001, 1017 (2d Cir. 1975). In this regard, the recent opinion of the Court of Appeals for the District of Columbia Circuit in *Zoelsch v. Arthur Anderson & Co.*, *supra* note 149, misconstrues the case law. The court suggests in *Zoelsch* that there are two competing “standards” for subject matter jurisdiction arising from conduct in the United States, one a “restrictive” standard deriving from *Bersch supra*, note 150 and the other a “permissive” one it finds in a series of cases which it characterizes as allowing subject matter jurisdiction merely because some conduct in furtherance of the scheme occurred in the United States. *Id.*, at 30–31.

The dichotomy between these cases is nonexistent. As the court pointed out in its decision in *SEC v. Kasser*, 548 F.2d 109 (3d Cir. 1977), cited as an exemplar of the “permissive” approach, its determination was that the “defendants’ conduct occurring within the borders of this nation was essential to the plan to defraud,” *id.* at 115 (emphasis added). In another “permissive” case cited by Judge Bork, *Continental Grain, Etc. v. Pacific Oilseeds, Inc.*, 592 F.2d 409 (8th Cir. 1979) the decision noted that the fraud “was devised and completed in the United States.” *Id.* at 420. Obviously, the courts concluded that the conduct in these cases met a higher standard than the one attributed to them by the majority in *Zoelsch*.

152. *Schoenbaum v. Firstbrook*, 405 F.2d 200, 208–209 *rev’d on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied*, 395 U.S. 906 (1969). *See also Des Brisay v. Goldfield Corporation*, 49 F.2d 133, 136 (9th Cir. 1977).

153. *Bersch*, 519 F.2d at 988.

With some limitation (e.g., it does not fully recognize the analysis of *Schoenbaum*), the theories developed in these cases have been recognized in the RESTATEMENT (REVISED) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 416 (Tent. Final Draft 1985).

154. *See, e.g., SEC v. Certain Unknown Purchasers of the Common Stock of, and Call Options for the Common Stock of Santa Fe Corporation*, 81 Civ. 6553 (S.D.N.Y. 1986) (WCC) *aff’d* 817 F.2d 1018 (2d Cir. 1987), *cert. denied* 56 U.S.L.W. 3568 (Feb. 16, 1988); *SEC v. Tome*, 638 F. Supp. 596 (S.D.N.Y. 1986), *aff’d*, 833 F.2d 1086 (2d Cir. 1987), *cert. denied sub nom. Lombardfin S.P.A. and Trasatlantic Financial Co., v. SEC.*, 56 U.S.L.W. 3790 (May 16, 1988); *SEC v. Levine*, 86 Civ. 3726 (S.D.N.Y.) (RO), insider trading suits in which defendants tried to hide evidence of their activities behind foreign secrecy statutes.

information, usually related to international trade, national security and economic matters, and typically provide for civil and criminal penalties.<sup>155</sup> Secrecy laws, on the other hand, establish rights or privileges which allow individuals to require others to maintain the confidentiality of certain types of information, e.g., financial records.<sup>156</sup>

Where the United States has personal jurisdiction over a foreign party, or its agent, the Commission has often been successful in the U.S. courts in compelling compliance with its efforts to obtain evidence.<sup>157</sup> In *SEC v. Banca Della Svizzera Italiana, et al.*,<sup>158</sup> the court ordered the nominal defendant, a Swiss bank which had effected securities purchases that the Commission alleged were made with inside information, to reveal the names of its customers, despite the contrary prohibition of Swiss banking law. The court concluded that: "it would be a travesty of justice to permit a foreign company to invade American markets, violate American laws if they were indeed violated, withdraw profits and resist accountability for itself and its principals by claiming their anonymity under foreign law."<sup>159</sup>

In response to its increasing encounters with foreign secrecy and blocking laws, the Commission's Division of Enforcement proposed in 1984 that the Commission announce that it would deem any purchase or sale of securities on a U.S. market to be a waiver of the protections otherwise afforded by foreign secrecy laws.<sup>160</sup> Most comments on this "waiver by conduct" proposal were negative, and the Commission did not act on it.

### *B. International Efforts to Coordinate Securities Law Enforcement*

Obtaining official foreign assistance in the Commission's enforcement efforts, on the other hand, requires patient efforts on both sides to reconcile differing legal concepts. The United States and Switzerland were at loggerheads for a decade in trying to share information regarding insider trading, and were only able to reach the beginning of an effective accommodation after Switzerland

155. See, e.g., French Penal Code Law No. 80-538, *supra* note 119, which forbids any French subject from using or complying with foreign judicial or administrative evidence-gathering regarding "economic, commercial, industrial, financial or technical" information, except as provided by treaty.

156. See, e.g., The Bahamas Banks and Trust Companies Regulation (Amendment) Act, 1980, which provides for the secrecy of bank records.

157. See *SEC v. Minas de Artemisa, S.A.*, 150 F.2d 215, 217 (9th Cir. 1945) compelling production of records of a Mexican company because administrative subpoena had been served upon its American president in the U.S.

158. 92 F.R.D. 111 (S.D.N.Y. 1981).

159. *Id.* at 119. See also *United States v. Bank of Nova Scotia*, 691 F.2d 1384 (11th Cir. 1982), *cert. denied*, 462 U.S. 1119 (1983) (court required foreign bank to comply with grand jury subpoena in drug investigation).

160. 49 Fed. Reg. 31,300 (1984).



entered into a tortuous examination of its law in order to define insider trading as a violation of Swiss law.<sup>161</sup>

An even more extreme exercise in reconciliation is demonstrated by the Commission's experience with the Hague Convention on the Taking of Evidence in Civil and Commercial Matters. The Hague Convention was designed to reduce international frictions by regularizing information-gathering procedures. In fact, while the Convention has its uses, it has become apparent over the years that the states which entered into the agreement had very different expectations from it. These differences arose from fundamental differences in national legal systems. In particular, United States style discovery is generally unknown outside this country. Thus, while the Commission was accorded numerous courtesies in other states under the Convention, it was fully successful in obtaining evidence under the Convention only in a country with a legal system similar to the United States—the United Kingdom.<sup>162</sup>

161. See Rapp, *Recent Developments in United States Insider Trading Prohibition and Swiss Secrecy Laws: Towards a Definitive Reconciliation?* 5 INT'L TAX BUS. LAW. 1, 28–32 (1987).

The EEC has also adopted a directive requiring member states to prohibit insider trading by December 31, 1990. Lightburn, *Insider Trading in France*, 8 INT'L FIN. L. REV. 23, 24 (Jan. 1988). A bill clarifying U.K. law on insider trading has already been submitted to Parliament. *Insider Curb in British Bill*, N.Y. Times, Feb. 13, 1988, at 48. Similar legislation was enacted in Belgium and the Netherlands. Dawkins and Dixon, *EEC proposes action on insider dealing*, Fin. Times, April 29, 1987, at 48.

Outside the EEC, several other countries have recently proposed laws banning or clarifying a ban in insider trading. New Zealand has proposed such a law, N.Z. plans insider trading law, Fin. Times, Mar. 24, 1988, at 20; and Norway's stock exchange has stepped up its enforcement of insider trading prohibitions, Froli, *Oslo in insider trading move*, Fin. Times, Mar. 3, 1988, at 18. The Japanese government is also preparing a legislative proposal which would expand the legal definition of insider trading and introduce criminal penalties. See *Tokyo unveils 'insider' proposals*, Fin. Times, Feb. 18, 1988, at 21. Only one defendant has been forced to return profits from insider trading under the current Japanese law. Schoenberger, *Japan Will Beef Up Insider Trading Laws*, L.A. Times, Feb. 24, 1988, at 1. Indeed, changing the law may not be so difficult as changing a reported Japanese perception that insider trading to benefit a company — as opposed to an individual — is harmless. Wagstyl, *Insider trading law traverses Japanese culture and ethics*, Fin. Times, Feb. 22, 1988, at 23.

162. In Commission enforcement actions involving requests for court-ordered disgorgement, which would be paid to private parties, courts in the United Kingdom, Guernsey, France and Italy have afforded the Commission standing to invoke the Convention to obtain evidence. In re Evidence (Proceedings in Other Jurisdictions) Act 1975 (Guernsey) Order 1980, (Stat. Inst. 1980 No. 1956); In re Testimony of Constandi Nasser, Trib. Admin. de Paris, 6<sup>eme</sup> section — 2<sup>eme</sup> chambre, No. 51546/6 (Dec. 17, 1985). The Commission's use of the Convention has had mixed results: in the United Kingdom, in particular, the Commission has been able to effectively use the Convention to obtain evidence. In re Evidence (Proceedings in Other Jurisdiction) Act 1975 (Q.B. Feb. 23, 1984) (Drake, J.), *reprinted* in 23 I.L.M. 511 (1984). But since the Convention does not obligate foreign states to provide any greater discovery than available under their own mechanisms, the Commission has also been entirely denied requests for documents, and partially denied access to testimony, on various grounds. Statement on the Examination of Witnesses as Requested by a Foreign Letter Rogatory (Pret. Milano, Italy Oct. 2, 1985).

Partially in light of these limitations, the Supreme Court recently decided, in *Societe Internationale Industrielle Aerospatiale v. U.S. Dist. Ct. S. D. Iowa*, 107 S. Ct. 2542 (1987), that, as a matter of

After this experience, the Commission turned to bilateral agreements with foreign authorities for the sharing of enforcement and surveillance information. While bilateral arrangements have limitations, they are more specialized than multilateral approaches. Among the limitations are the fact that most governments (the United States included) will not use their compulsory power to investigate an act which is not a violation of their own law,<sup>163</sup> and that foreign governments are sometimes reluctant to cooperate with the SEC for fear that the Commission would ultimately allow access to their enforcement information by private U.S. plaintiffs.<sup>164</sup> These limitations are outweighed by the fact that a bilateral agreement can squarely address substantive and procedural differences between the signatories.

### 1. Mutual Assistance Treaties

The United States has entered into four criminal treaties,<sup>165</sup> and completed negotiations on four more,<sup>166</sup> for the exchange of information regarding poten-

U.S. law, the use of the Convention is not mandatory for discovery against foreign litigants of evidence located abroad.

163. One exception is the Quebec Securities Commission, which is empowered under the Securities Act, Que. Rev. Stat. Ch. V-1 (1977), to order an investigation regarding violations of the laws enforced by another legislative authority. Charter and Beck, *Problems of Enforcement in the Multinational Securities Market*, 9 U. PA. J. INT'L BUS. L. 467, 473 (1987).

On May 5, 1988, the SEC approved a staff proposal to submit draft legislation to Congress which would enable the Commission to use its compulsory investigative powers to assist foreign securities regulators regardless of whether a likelihood exists that U.S. law has been violated.

164. This problem turns on the prevalence of private securities suits in the United States. While the United States, like Australia, the United Kingdom and Canada, provides for private enforcement of its securities laws, the United States is alone in allowing them to be brought as class-action suits. Thus, private securities cases are more common in the United States than in other common law countries.

Moreover, such suits are generally unheard of in civil law countries, and, indeed, the existence of private securities remedies in the United States is alarming to some foreign commentators. See generally, Note, *Barriers to the International Flow of Capital: The Facilitation of Multinational Securities Offerings*, 20 VAND. J. TRANSNAT'L. L. 81, 107-09 (1987). Japan, a civil law state, allows for private actions; however societal factors have made such actions almost unknown. See Pillai, *Securities Regulation in Malaysia: Emerging Norms of Governmental Regulation*, 8 J. COMP. BUS. AND CAP. MKT. L. 39, 47 (1986). France also allows for civil actions, but only a few have been recently initiated. Lightburn, *supra* note 161, at 25.

165. Treaty on Mutual Assistance in Criminal Matters, May 25, 1973, United States-Switzerland 27 U.S.T. 2019, T.I.A.S. No. 8302 (entered into force Jan. 23, 1977); Treaty on Extradition and Mutual Assistance in Criminal Matters, June 7, 1979, United States-Turkey, 32 U.S.T. 3111, T.I.A.S. 9891 (entered into force Jan. 1, 1981); Treaty on Mutual Legal Assistance, June 12, 1981, United States-Netherlands, T.I.A.S. 10734 (entered into force Sept. 15, 1983); Treaty on Mutual Assistance in Criminal Matters, Nov. 9, 1982, United States-Italy, 24 I.L.M. 1539 (1985) (entered into force Nov. 13, 1985).

166. Treaty on Mutual Legal Assistance in Criminal Matters, Mar. 18, 1985, United States-Canada, (pending Canadian ratification); Treaty Concerning the Cayman Islands and Mutual Legal Assistance in Criminal Matters, July 3, 1986, United States-United Kingdom, 26 I.L.M. 536 (1987) (pending

tially criminal conduct, which are broad enough to include securities law violations. General-purpose agreements like the mutual criminal assistance treaties, however, may have some drawbacks when used for securities law enforcement.<sup>167</sup> The Commission's efforts to use the Swiss treaty to obtain information about insider trading illustrate how differences between legal systems can hamper sharing information relevant to securities regulation under a conventional mutual assistance treaty.

The Swiss mutual assistance treaty covers various forms of fraud, but the Swiss courts construed it not to be expressly available to the Commission for limited evidence gathering concerning insider trading.<sup>168</sup> This is because the Swiss treaty, like many others, provides for "dual criminality"—the requirement that it be used only for a matter under investigation in the United States which would, if proven to violate U.S. law, also violate Swiss law—and insider trading as understood in the U.S. was until recently not fully subject to criminal sanctions under Swiss law. Bank secrecy, on the other hand, has long been highly valued under Swiss law.<sup>169</sup> This put the SEC in the position of making some of its requests under the treaty for banking information on insider trading in opposition to a significant protected domestic interest.<sup>170</sup>

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U.K. and Cayman ratification); Treaty on Mutual Legal Assistance, Aug. 20, 1980, United States-Columbia, (pending Colombian ratification); and Convention on Mutual Legal Assistance, Oct. 10, 1983, United States-Morocco (pending Moroccan ratification).

167. Mutual assistance treaties are available to all federal governmental inquiries. Recently, for example, the Special Prosecutor investigating the sales of arms to Iran was successful in overcoming Swiss court challenges by Albert Hakim to the use of the Swiss mutual assistance treaty to obtain access to his Swiss bank records, and those shared with General Richard Secord. In a related case, the United States Court of Appeals for the District of Columbia held that a U.S. prosecutor may serve a subpoena on a U.S. entity which controls evidence in Switzerland without first resort to the treaty. In re Sealed Case, No. 87-5256, slip op. at 28-32 (D.C. Cir. Nov. 6, 1987).

168. Swiss courts have construed the fraud language in the treaty not to reach insider trading by persons who had obtained inside information by legitimate means, i.e., as corporate directors. See *infra* note 175. This is contrary both to Congressional expectation, (see Exec. Doc. F, 94th Cong., 2d Sess. Feb. 18, 1976) and to the understanding of the Swiss government at the time the treaty was signed and ratified. *Id.*

169. Rapp, *supra* note 161, at 7-10; Comment, *The Conflict Between United States Securities Laws on Insider Trading and Swiss Bank Secrecy Laws*, 7 NW. J. INT'L L. & BUS. 318, 332-35 (1985); Honegger, *Demystification of the Swiss Banking Secrecy and Illumination of the United States-Swiss Memorandum of Understanding*, 9 N.C. J. INT'L COM. REG. 1, 1-9 (1983). Ironically, both signatory governments believed that the inclusion of language in the criminal assistance treaty relating to fraud and false business practices overcame this impasse. See Exec. Doc. F, 94th Cong., 2d Sess. Feb. 18, 1976.

170. As one Swiss commentator opined, "even if the Treaty is applicable [to SEC requests], the Swiss banking secrecy can be superseded only if the prosecuted act is a crime in Switzerland as well. But insider trading, i.e., securities transactions executed while in possession of material nonpublic information, is not prohibited explicitly under Swiss law." Honegger, *supra* note 169, at 18 (footnotes omitted).

## 2. Memoranda of Understanding

The Commission has therefore entered into more specialized agreements with foreign securities counterparts which are specifically tailored to securities law investigations. These memoranda of understanding (“MOUs”) have been signed with the government of Switzerland,<sup>171</sup> the United Kingdom’s Department of Trade and Industry,<sup>172</sup> the Ontario, Quebec and British Columbia Securities Commissions,<sup>173</sup> and the Japanese Ministry of Industry and Trade (MITI).<sup>174</sup>

The MOU between the Commission and Switzerland, supplemented by an exchange of letters, was expressly designed to improve the exchange of information about insider trading between Switzerland and the Securities Exchange Commission. The principal component of these letters was the recognition that certain Swiss criminal statutes paralleled the antifraud provisions of the securities laws, and that the Commission’s function in investigations and litigation is in the nature of criminal enforcement.<sup>175</sup> The agreement provided for its execution by the membership of a private group of Swiss bankers, which required their customers to waive Swiss bank secrecy as a condition of conducting securities transactions in the U.S.

171. Memorandum of Understanding to Establish Mutually Acceptable Means for Improving International Law Enforcement Cooperation in the Field of Insider Trading, Aug. 31, 1982, United States-Switzerland, 22 I.L.M. 1 (1983).

172. See *supra* note 111. The Commodities Futures Trading Commission is also a party to the U.K. MOU.

173. See *supra*, note 107.

174. Memorandum of the U.S. Securities and Exchange Commission and the Securities Bureau of the Japanese Ministry of Finance on the Sharing of Information, May 23, United States-Japan, 25 I.L.M. 1429 (1986). The Japanese MOU merely agrees to cooperation between the regulators. However, the Securities Bureau of MITI and the Commission have since agreed to encourage self-regulatory organizations in the two countries to develop procedures “for the exchange of financial, surveillance and investigatory information. . . .” Securities Bureau-SEC Press Release (Feb. 17, 1988) (copy on file with the Michigan Journal of International Law).

175. At roughly the same time that the MOU was signed, the Commission obtained two important decisions recognizing some uses of the mutual assistance treaty for insider trading investigations in the Swiss courts. Judgment of Jan. 26, 1983, Tribunal federal 109 Arrêts du Tribunal federal suisse, Recueil official Ib 47 (1983) (Santa Fe I), summarized at 22 I.L.M. 785 (1983); Judgment of May 16, 1984, Tribunal federal (Santa Fe II), reproduced in 28 ETUDES SUISSES DE DROIT EUROPEEN 316 (1984). During these proceedings, the Swiss government informed the court that it believed the U.S. concept of insider trading to be wholly within the scope of the treaty.

The two opinions were issued in response to oppositions to SEC access filed in Switzerland by Swiss account holders, in a case bought by the Commission in the federal district court for the Southern District of New York, *SEC v. Certain Unknown Purchasers*. See *supra* note 154. The opponents argued that the Commission failed to demonstrate the requisite dual criminality to use the Treaty. The thrust of these two decisions is that the Commission may obtain access under the Treaty when it can demonstrate that it seeks information regarding the actions of tippees, who would not legitimately have come into possession of insider information. For a complete discussion of these two decisions, and the implications under Swiss law, see Rapp, *supra* note 161, at 21–24.

After considerable debate, the Swiss parliament has now adopted a law prohibiting insider trading. The drafters of this legislation had to develop concepts of insiders, materiality, prohibited benefits, scope of regulation, and even definitions of securities in order to fit the idea of insider trading into the framework of Swiss law.<sup>176</sup> The United States and Switzerland then entered into a diplomatic note agreeing that, since insider trading can now be termed criminal in both states, the SEC could use the treaty to investigate Swiss bank accounts implicated in insider trading cases, even for U.S. civil or administrative actions.<sup>177</sup>

This decade-long excursus demonstrates how memoranda of understanding may be tailored to the particular legal or procedural difficulty presented by an SEC request in the receiving country, or by a foreign request in the United States.<sup>178</sup> Thus, the Swiss MOU relied upon an undertaking in a private agreement among Swiss bankers to obtain waivers from their customers of Swiss banking secrecy, and to submit any Commission request which applies defined standards for suspect trading to a Swiss bank. In return for their waiver of Swiss legal protection and inhibitions, the Swiss retained the final authority to reject the request. Similarly, the MOU with the United Kingdom provides the SEC with the investigative and enforcement assistance of British authorities, but limits the types of requests which the Commission may make and the use to which it can put information it receives through the MOU.

Moreover, the Commission's experience with MOUs illustrates their effectiveness in securities enforcement. For instance, the Swiss MOU has enabled the Commission to trace and seize assets which were heretofore untouchable.<sup>179</sup>

In contrast to the earlier MOUs, the MOU between the SEC and the securities commissions of Quebec, Ontario and British Columbia is broader in scope in two

176. Rapp, *supra* note 161, at 26-33.

177. The U.S.-Switzerland Mutual Assistance Treaty enables the parties at their discretion to extend the treaty mechanisms to administrative functions, such as those performed by the SEC. See Goelzer, Riesenberg, and Sullivan, *International Markets Hamper Enforcement*, N.Y.L.J. (Dec. 7, 1987); and Haymann, *Swiss Outlaw Insider Trading*, INT'L FIN. L. REV. 30 (Oct. 1987) for general discussion of these matters. The notes establish that compulsory treaty mechanisms are available for "offenses that involve the purchase or sale of securities by persons in possession of material non-public information," language which is expressly designed to include Commission investigations and civil suits.

178. For a more comprehensive listing of the merits of an MOU, see Pitt, Hardison and Shapiro, *Problems of Enforcement in the Multinational Securities Market*, 9 U. PA. J. OF INT'L L. 375, 435-37 (1987).

179. Since the operation of the MOUs is not generally a matter of public record, few details of this cooperation are available for discussion in this article. However, one case under the Swiss MOU is in the public record, and is instructive. In *SEC v. Harvey Katz, Marcel Katz, Elie Mordo, and Fred Aizen*, Civil Action No. 86 Civ. 6088 (S.D.N.Y. 1986), the Commission sought injunctive relief and disgorgement against a group of people who it alleged had traded in the securities of RCA Corporation on inside information about its upcoming merger with General Electric. In its investigation of this trading, the Commission was able to identify one defendant, Elie Mordo who traded through a Swiss bank, and to obtain a freeze of his assets in the bank.

respects: it is not limited by dual criminality, and it provides for the use of compulsory measures even when no violative conduct occurred in the receiving state. The MOU states that the signatories will provide the fullest mutual assistance to facilitate securities market oversight and the conduct of investigations, litigation or prosecution where information is sought to determine whether, or to prove that the laws or regulations of the requesting state have been violated. Thus, the MOU does not refer to the receiving state's law to limit the scope of conduct concerning which information may be sought.<sup>180</sup> The Canadian MOU requires only a general description of the matter subject to the request and the legal provisions pertaining to that matter.

The signatories to the Canadian MOU specifically recognize that they may not at present possess the legal authority to provide the legal assistance contemplated by the terms of the MOU. Rather, they pledge to use all reasonable efforts to obtain the necessary authorization to provide the assistance described. The MOU states that "assistance" includes providing information already in the possession of the requested state, as well as taking evidence and obtaining documents. One example of a situation in which investigatory authority might currently be lacking would be when the SEC is requested to provide information relevant to conduct where, although the evidence exists in the U.S., the potential violation occurred entirely outside the U.S. and had no effect on U.S. markets. Presumably, congressional action is required to authorize the Commission to investigate such conduct at the request of a foreign regulator.<sup>181</sup>

### CONCLUSION

The future development of international markets hinges in large part on creating satisfactory international regulatory agreements in a number of areas. These areas range from enforcement interest, to the regulation of broker-dealer and market functions, where uniform international regulation is taking on increased importance. In addition, although many of the Commission's initial steps have been unilateral, certain registration and periodic disclosure requirements will eventually have to be conformed to international standards.<sup>182</sup>

180. The agreement defines the term "laws and regulation" as including, without limitation, certain areas concerning securities regulation such as insider trading, misrepresentation, periodic reporting, financial responsibility and customer protection. The MOU also provides that a state may deny a request "on grounds of public interest."

181. Legislation has been introduced which would provide the Commission with such authority. Section 202 of H.R. 2668 submitted to the 100th Congress provides that an investigation undertaken at the request of a foreign government may be considered an investigation that is "necessary and proper to the enforcement of the federal securities laws." See Goelzer, Riesenbergs and Sullivan, *supra* note 177. The Commission has also now approved a more comprehensive legislative proposal of its own to the same end. See *supra* note 163.

182. Even developing securities markets with adequate domestic regulation can participate in the development of international regulation. A Singapore legal writer observes that the principal purpose

As securities trading evolves from transactions among business acquaintances to transactions through anonymous electronic links, the pressures for consistent international standards of business practice, as well as consistent legal ones for protection and enforcement, will increase. The international response to that pressure will be shaped, at least in part, by the interests which the participating states seek to protect, whether they are the safety of small investors or of local banks, or the integrity of domestic markets. This article has attempted to put competing interests in context with current efforts of the SEC, and to suggest some areas where future efforts at cooperation may be fruitful.

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of securities regulation should be disclosure and investor protection. He continues that, in his opinion, the government must take a more interventionist stand to achieve those ends than in countries like the U.K and the U.S. in a country whose markets do not have institutional capacity. He defines institutional capacity along Western models as private and governmental ability to screen and supervise issues and broker-dealers and, in the U.S., the availability of securities class action suits). Pillai, *supra* note 164, at 47.