Denver Journal of International Law & Policy

Volume 16
Number 2 *Winter/Spring*

Article 8

May 2020

International Securities Markets: Will 24-Hour Trading Make a Difference

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STUDENT COMMENT

International Securities Markets: Will 24-Hour Trading Make a Difference?

I. INTRODUCTION

Telecommunication advancement is having great impact on the international business world allowing transactions to take place in a matter of hours, and at times minutes, that in the past have taken days, weeks, or even months. We are an inter-connected world; no longer can we rely on the cushion of time from which to determine if our actions have been the correct ones. The capital and securities markets reflect these advancements fully; allowing international trading in securities markets instantaneously, permitting liquidity, increased volume and greater choice of investments.

The effect of these developments on international markets has been great; in 1981, the dollar volume of United States securities traded on the international markets was $75.5 billion.[1] The amount increased to $277.3 billion in 1986.[2] Investments in foreign equity securities by United States investors was $102 billion, with United States' pension funds holding $45 million in foreign assets in 1986.[3] Euro Bond Trading volume jumped from $2.2 trillion in 1985, to $3.2 trillion in 1986.[4] United States' issues raised $36.5 billion in 1985, increasing to $38.6 billion in 1986.[5]

Increased demand and capacity have led to longer trading hours. In October of this year, the Chicago Mercantile Exchange (the "Merc") approved the first 24-hour financial futures trading market in the United States using an automated trading system.[6] Many international exchanges have expanded or are considering expansion of trading hours. Twenty-four hour books are maintained by some of the larger firms, allowing for trading at all times.[7] With the advent of increased activity in the markets, in terms of time, volume and numbers of participants, the

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1. Mann & Sullivan, Current Issues in International Law Enforcement 2, International Bar Association, Section on Business Law, in London, England (Sept. 18, 1987).
2. *Id.*
3. *Id.*
4. *Id.*
5. *Id.*
6. Jouzaitis, *Merc Okays 24-Hour Trading*, Chicago Tribune, Oct. 7, 1987, § 3, at 7.
7. Mann & Sullivan, *supra* note 1.

adequacy of the securities laws to meet the increased demands must be considered. The potential for violation of regulations through manipulation, churning, insider trading and material misrepresentation, just to list a few, is in direct correlation with the increases of these influencing factors. A balance must be maintained between access to the international markets for the United States' investor allowing development of world economic growth, and making sure the investor has access to adequate information about the securities from which he is to make an investment decision.

This article will address the development of the international markets, their purpose and function in the international economic community as well as the United States securities laws and subsequent changes in response to the international markets both in terms of enforcement as well as regulation. Finally, it will consider potential problems and solutions in response to these developments especially in light of around-the-clock trading.

II. UNITED STATES SECURITIES REGULATIONS

The purpose of the securities laws and regulations is not to prevent the investor from making an investment, or a mistake in investment. Rather, the Securities and Exchange Commission ("SEC") has formulated certain minimal requirements a company wanting to raise capital by selling stock shares to the public must meet.[8] The company must also be willing to disclose fully, information about itself to the potential investor, resulting in an informed decision to invest.[9] The regulation of securities and investments is not new, nor did it originate in this country. Individual states had their own regulations a full generation prior to the passage of the 1933 Securities Act, and England had been controlling through legislation and the courts for centuries.[10] The earliest known English law was passed in the year 1285 under Edward I, authorizing the Court of Alderman to license brokers in London.[11]

Perhaps the most famous of the early regulations was the so-called "Bubble Act" of 1720, set up to control fraudulent stock promoters, and joint stock companies.[12] This Act was the result of England and France, as a means of paying public debt, allowing two companies, the Mississippi Company of Paris, which was set up to exploit the Louisiana Territory by the French Court, and the South Sea Company of London, given exclusive trading rights by the British government in the Pacific islands and South America to promote and sell stock to a non-suspecting public. In-

8. The requirements that an issuer must meet depends on the particular offering that is being made. *See*, Securities Act of 1933, 15 U.S.C. § 77(a) *et seq.* (hereinafter "Securities Act").

9. *See* Securities Act, §§ 7, 10.

10. L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 1 (1983).

11. *Id.*

12. 6 Geo. 1, c. 18.

vestors rushed to purchase the worthless stock, and in 1720, the bubble burst, resulting in financial ruin for investors and severe financial set backs for governments; France being the hardest hit. Its economy all but collapsed; with a Regent being forced out of office as a result.[13] The "Bubble Act", with striking similarities to the fraud provisions in current United States' securities regulations[14], was repealed in 1825.[15]

British Parliament passed the first prospectus requirement through the Company's Act in 1844. A little less than 50 years passed before the enactment of the Director's Liability Act of 1980.[16] This gave directors and promoters civil liability for untrue statements in the prospectus without the defrauding party having to prove scienter.[17]

The first United States statute dealing with securities regulation appeared about 1900.[18] However, the rapid growth of the American financial community in the late Nineteenth and early Twentieth century went almost unchecked.[19] Capital raised from individual investors was used to promote businesses resulting in broad diversity and absentee ownership of the entity, with very little or no protection for the people who invested.

The collapse of the stock market in 1929 was the "bursting bubble effect" on a world-wide scale. Prior to the crash, Wall Street had continued on its way with few legislative restraints. The crash shook the federal government from its securities regulations sleep, resulting in the passage of the Securities Act of 1933 (S.A.). The various states had securities reg-

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13. GAY, AGE OF ENLIGHTENMENT, GREAT AGES OF MAN 74, 75 (1971).

14. Securities Act, § 11; §§ 12(2), 17; Liability Provisions Covering Fraud or Misrepresentation in the Interstate Sale of Securities in General for Individuals Connected with the Initial Public Offering, Whether or Not the Offering was Registered with the SEC.

Securities Exchange Act of 1934,; Rule 10b-5. Probably the most well known of the Anti-Fraud Provisions of the Securities Act, this Section makes it unlawful for anyone to employ any devised scheme or artifice to defraud, or to make any untrue statement of material fact, or to omit to state a material fact necessary, or to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person. Rule 15(c)(1-2) and c 1-3. These are general anti-fraud provisions applicable to broker/dealers who are involved in interstate, over-the-counter securities transactions. Another liability provision of the Securities Exchange Act is § 16, which is known as the insider trading liability provision. This is designed to prevent corporate insiders from using inside information to realize profits on the short term purchase and sale of their corporations securities. Rule 10 b-5 is also applicable in this area.

15. 6 Geo. 4, c. 91.

16. L. LOSS, *supra* note 10, at 2-3.

17. *Id.*

18. *Id.* at 3.

19. The corruption and bungling in both the public as well as private sectors was notorious. A prime example was the cooperation of President Grant's Treasury Department with Jay Gould and John Fisk, enabling them to manipulate the government selling of bullion. Literally cornering the gold market for a short period of time in 1869, the two men forced anyone needing gold to deal with them, causing a panic in the money market. They personally profited very highly and when caught, little was done by the administration to punish the two; A. WEINSTEIN & R.J. WILSON, FREEDOM AND CRISIS, AN AMERICAN HISTORY 472 (1978).

ulations, but these were limited because of the individual state's sovereignty.[20] The federal courts had addressed the issue upholding state regulations on the basis of the Fourteenth Amendment and regulatory power under the Commerce Clause.[21]

With the passage of the 1933 Act, the Securities Exchange Commission (SEC) was created along with a subsequent barrage of federal regulation. From 1933 to 1940, no less than six complicated far-reaching statutes were passed; the seventh and most recent being the Securities Investor Protection Act of 1970, The various Acts have been modified through the years, with much of the most recent changes being made in the area of international regulations.

The SEC role in maintaining the securities market is complex and broad. It is an independent agency consisting of five members by presidential appointment, possessing executive as well as quasi-legislative and quasi-judicial powers. It oversees the application, modification and enforcement of the complex system of securities regulations. Additionally, it supervises the Self-Regulatory Agencies (SRO's) including the National Association of Securities Dealers (NASD), and the various stock exchanges.

A. Securities Act of 1933

The objectives of the Securities Act (SA) of 1933 are two; to insure full disclosure of information about the security to potential investors, and the prevention of fraud and misrepresentation in the inter-state sale of securities through its liability provisions.[22] If a business entity is planning to raise capital through an offering of equity securities to the public, it must register with the SEC unless an exemption is found.[23] The regis-

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20. Kansas was the first state to develop a strong securities control statute. It was passed in 1911, and is felt to be the first to coin the phrase "Blue Sky", Mulvey, *Blue Sky Law*, 36 CAN. L.T. 37 (1916). The regulation of securities is now in every state, the District of Columbia and Puerto Rico, forcing issuers to not only comply with the federal securities laws, but the various state regulations as well.

21. The Commerce Clause, U. S. CONST., art. I, sec. 8, cl. 3, grants Congress the power to "regulated commerce with foreign nations, and among the several states, and with the Indian tribes". Using the Fourteenth Amendment, § 1 and the Commerce Clause, the federal courts in cases involving securities transactions, applied the securities provisions of the Interstate Commerce Act; 49 U.S.C. § 1131. L. LOSS, FUNDAMENTALS OF SECURITIES REGULATIONS 26 (1988).

22. Securities Act, § 11, Issuer liability for misrepresentation or omission in the registration statement; § 12, Issuer or underwriter liability for the improper offer to a potential purchaser in the pre-filing period, including liability whether or not the securities were registered; § 17, Fraud liability provisions under the 1933 Act.

23. Securities Act; exemptions include:

A. Private offerings under Regulation D;

1. Rule 504 for small companies and exempting the offer and sale of up to $500,000 in twelve months.

2. Rule 505 exempts offers and sales of issuers other than investment companies of securities in an amount not excluding $5 million during a twelve month

tration process is a long and expensive procedure with numerous forms and difficult regulations to be complied with. The forms for the Initial Public Offering (IPO) vary somewhat depending on the size of the offering and related business, but all are lengthy and complicated. It is due in part to these complex and expensive requirements that many foreign corporations do not attempt registration in the United States. The SEC has responded to this problem by modifying the amount of information required from foreign issuers[24] but many firms, both here and abroad feel more leniency is required.[25]

In March of 1985, the SEC sought comments from the United States, United Kingdom and Canada as to the best way to coordinate registration procedures. The two approaches suggested were the "reciprocal prospectus approach" in which a prospectus in one country would be accepted in another country; and the "common prospectus approach" which would set uniform standards acceptable to all countries. The United Kingdom preferred the reciprocal approach, but recognized that a difference in requirements may be difficult to reconcile, especially in terms of accounting principals and financial statements needed. The Canadian reaction was that a common prospectus would be more easily accomplished between the United States and Canada than between the United Kingdom and either the United States or Canada. The United States' response was in favor of the common prospectus. As can be seen, resolution of the differences in international securities markets will be long in coming.[26] However, a pilot effort allowing the use of the reciprocal prospectus between the United States, United Kingdom and Canada is underway, but will probably initially be limited to investment-grade debt, because those securities trade primarily on yield and rating, therefore accounting and auditing requirement differences between the countries should not present a major problem.[27]

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period.

3. Rule 506 is available to all issuers under certain limitations and any amount of securities, with no limit on the number of accredited investor purchasers.

B. Private offerings under § 4(2) and § 4(6).

C. Broker exemption, § 4(4).

D. Intrastate exemption § 3(a)(11), Rule 147.

E. Sale of a business or business merger, Rule 145.

F. Resale of privately offered (restricted) securities, Rule 144.

24. Thomas, *Increased Access to the United States Cap. Markets: A Brief Look at the SEC's New Integrated Disclosure Rules for Foreign Issuers*, 1985 J. COMP. BUS. CAP. MARKET L. 5.

25. H. BLOOMENTHAL, INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION § 503(2), 5-16, Release No. 4-2/87.

26. J. Brooks, The Emerging Asia Dollar Market 44-54. Presentation at the Thirteenth Annual Securities Regulation Institute (Jan. 1986).

27. C. Cox, Commissioner, Securities and Exchange Commission, The Securities and Exchange Commission's Experience in International Capital Markets, Remarks to the Swiss-American Chamber of Commerce, Zurich, Switzerland (Aug. 1987).

B. Securities Exchange Act of 1934

The Securities Exchange Act (SEA) regulates the trading of securities in the market, subsequent to their initial distribution. Its purpose is to protect interstate commerce and national credit, and to insure a fair and honest market for the trading of securities. The SEA has three main themes; the regulation of the exchange of the over-the-counter market[28] the prevention of fraud and market manipulation;[29] and control of securities credit by the Board of Governors of the Federal Reserve System as part of its authority over the nation's credit.[30]

Companies whose stocks are listed on a National Exchange, or have assets of $5 million or more, and a cost of equity securities held by 500 or more persons must register its equity securities under § 12 of the SEA. This includes foreign issuers. Subsequently, all registered companies are required to make periodic reports to the SEC to be in compliance with the Act.

C. The Trust Indenture Act of 1939

This Act controls distribution of debt securities. With the exception of a few well-monitored companies, mostly Canadian, foreign issuers are not allowed to register under this Act.

A trust indenture is commonly used when a corporation floats bonds. The trust indenture document contains the obligations of the trustee, and rights of the beneficiaries of the trust. The Trust Indenture Act was designed to protect investors in large debt securities by creating certain provisions the trustee must comply with, and eliminating the ability to use certain exculpatory clauses. The trustee ordinarily has to be independent of the corporation issuing the bonds.

D. The Investment Advisor's Act and the Investment Company Act of 1940

Both the United States and foreign investment advisors are required to register under the Investment Advisor's Act. The same information is required of foreign advisors, as of their domestic counterparts. The Commission also requires that foreign investment advisors appoint the SEC as agent in case a complaint is filed.Under the Investment Company Act, registration of all non-exempt investment companies is compelled. Section 7(d) of the Act disallows registration, selling or delivering of securities of foreign investment companies, through the mails or interstate

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28. L. Loss, *supra* note 10, at 40. The major theme of the 34 Act is self regulation under the general supervision of the SEC. There are four types of self regulatory organizations: the National Securities Exchanges, the National Association of Securities Dealers, Inc., "N.A.S.D." registered clearing agencies, and the Municipal Securities Rule making Board.

29. *Id.*

30. *Id.* at 39.

commerce unless the Commission finds, by order, "it is both legally and practically feasible to enforce the provisions of the Act against the company".[31] Canadian companies have usually been found to meet the standards, but it is very difficult for other foreign companies to be approved.[32] The Commission is considering alternative means to allow these companies to register and sell their securities in the United States markets.[33]

III. EXTRA-TERRITORIAL APPLICATION OF THE UNITED STATES SECURITIES LAWS

With the increasing growth of international capital markets, come the complex problems of comity and conflicting application of each sovereigns laws in case of non-compliance with regulations. Under certain conditions, securities sold in the United States may be exempt from registration under the Securities Act of 1933, but the Anti-Fraud Provisions of the Securities Exchange Act of 1934 may apply.[34] This raises the complicated matter of jurisdiction. Both subject matter and in personam jurisdiction over defendants must be had before the United States can apply its securities laws.

A. Jurisdiction

1. *Subject Matter Jurisdiction*

International law recognizes five bases to achieve subject matter jurisdiction. Under the Restatement (Second) of Foreign Relations law of the United States subject matter jurisdiction may be had under the nationality principle in which a nation has jurisdiction over the conduct of its citizens, whether the conduct plays inside national borders or not; Section 10.

It can also be had under the passive personality principle, which permits a sovereign to exercise jurisdiction over conduct and activity injuring its citizens, no matter where the act occurred. It is related usually to criminal matters and is not recognized in the United States; Section 30. Under the protective principle, if the extra-territorial activity threatens national security or governmental operations, the government can promulgate laws granting itself jurisdiction to govern that activity; Section 33. The universal principle grants jurisdiction if a person commits an act, and the state has custody of that person; Section 34.

Sovereigns have jurisdiction to punish crimes committed within its territory, regardless of the nationality of the actor, under the territorial principle; this is further divided into the objective territorial principle and the subjective territorial principle; Section 10.

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31. D. Goelzer & K. McGrath, *The SEC Speaks in 1987*, II Practicing Law Institute 591-92.

32. *Id.*

33. *Id.*

34. Securities Exchange Act of 1934, *supra* note 14

Under the objective principle, as defined in Section 18 of the Restatement, jurisdiction is allowed a state to formulate a rule of law regarding conduct that occurs outside its territory but which has an effect within its territory if the effect within the territory is substantial, the conduct occurs as a direct and foreseeable result of the conduct outside the territory, the rule is not inconsistent with the principles of justice generally recognized by states that have reasonably developed legal systems, and the conduct and its effect are constituent elements of activity to which the rule applies.

The objective principle is known as "the effects" doctrine, and cases have distinguished between jurisdiction based on conduct and effect, as compared to effect alone in determining jurisdiction; *Schoenbaum v. First Brook.*[35] This case was the first case to consider jurisdiction based on effects alone; and established that jurisdiction could be had under these circumstances. This case involved domestic activity; however, the question remained as to whether jurisdiction could attach absent domestic conduct. *Bersch v. Drexel Firestone, Inc.*,[36] addressed the issue and upheld jurisdiction over a foreign accountant who had certified financial statements used in an offering in the United States. As required by the Restatement, the effects must be substantial, direct and foreseeable.

The subjective territorial principle is based on the conduct of the actor. The Restatement grants that nation jurisdiction over acts which occur within its boundaries, even if the effects of such conduct are felt only outside the nation's territory. Under *IIT v. Vencap, Ltd.*,[37] the court determined jurisdiction exists if the facts showed the United States had been used as perpetuation for the fraudulent acts themselves. This distinguishes perpetuation of the act, as opposed to preparation to commit the acts. Mere preparation may limit the SEC's power to sue.[38]

According to case law, subject matter jurisdiction is determined by four variables; the nationality or residence of the plaintiff, the nationality or residence of the defendant, the country in which the fraudulent activity occurred, and the country in which the fraudulent conduct was manifested.[39]

The court in *Bersch* distinguished United States residents, United States citizens residing abroad and foreigners; or persons who were neither United States Citizens nor United States residents. It determined that there could not be jurisdiction for foreign plaintiffs in cases "where

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35. Schoenbaum v. First Brook, 405 F.2d 200 (2d Cir. 1968), *revised on re-hearing on other grounds*, 405 F.2d 215 (2d Cir. 1968) *cert. den.* 395 U.S. 906 (1969).

36. Bersch v. Drexel Firestone, Inc., 519 F.2d 974 (2d Cir. 1975).

37. IIT v. Vencap, Ltd., 519 F.2d 1001 (2d Cir. 1975).

38. Loomis, *The U.S. Securities and Exchange Commission, Financial Institutions Outside the U.S. and Extra-Territorial Application of the U.S. Securities Laws*, J. COMP. L. & SEC. REG. 1, n. 47 (1975).

39. Morgenstern, *Extra-Territorial Application of the United States' Securities Laws: A Matrix Analysis*, 7 HASTINGS INT'L COMP. L.R. 4 (1983).

the United States' activities are merely preparatory to take the form of culpable non-feasance and are relatively small in comparison to those abroad".[40] Therefore, under *Bersch*, an American resident plaintiff needs to establish only minimum statutory requirements while a non-resident American asking the protection of the United States securities laws is required to show materially important conduct occurring within United States which significantly contributed to the foreign fraud.[41]

In later cases, the courts have granted jurisdiction over activities it determined to be preparatory. In *Zoelsh v. Arthur Anderson & Co.*[42] accountants from the United States made representation to a foreign auditor which were determined to be preparatory to a foreign offering made by a foreigner.[43] In looking to the substantial conduct of a defendant (brokerage firm) in the United States, the court in *Psimenos v. E.F. Hutton & Co.*[44] upheld subject matter jurisdiction where the United States was used as a based for fraudulent sales of United States commodity contracts to foreign investors.[45] In both objective and subjective jurisdiction, the main factor of the courts appeared to consider its the degree of impact on the United States interests and investors.

2. *Personal Jurisdiction*

In personam jurisdiction is fundamental to our legal process. One accused must have notice and opportunity for hearing. In order to achieve this basic due process, personal jurisdiction over the defendant is necessary. Section 27 of the Exchange Act provides for service of process "where ever the defendant may be found". In *Lesco Data Processing Equipment Corp. v. Maxwell*,[46] the court interpreted section 27 as extending personal jurisdiction to the fullest reach permitted by the due process clause.[47]

Sections 35, 36 and 37 of the Restatement (Second) of Conflict of Laws sets forth the boundaries of due process in case of a defendant absent at the time of service of process. Section 35 permits jurisdiction over persons doing business in a state; section 36 confers jurisdiction over persons committing an act in the state; and section 37 permits jurisdiction over persons causing effects in a state by accident elsewhere. Sections 47, 49 and 50, applies these principles to corporations allowing the court broad discretion in obtaining personal jurisdiction.[48]

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40. Loomis, *supra* note 38, at 9.
41. Morgenstern, *supra* note 39, at 22.
42. Zoelsh v. Arthur Anderson & Co., F.2d Law Rptr. (CCH) para. 93, 317 (D.C. Cir. No. 86-5351, July 17, 1987).
43. Mann & Sullivan, *supra* note 1, at 16.
44. Psimenos v. E.F. Hutton & Co., 722 F.2d 1041 (2d Cir. 1983)
45. Mann & Sullivan, *supra* note 1, at 16.
46. Lesco Data Processing Equipment Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972).
47. G. Loomis, *supra* note 38, at 14.
48. *Id.*

IV. THE INTERNATIONAL MARKETS

In April, 1985, the SEC, through SEC release 34-21958, sought comments from individuals and firms involved in the securities and capital markets on the internationalization of investments.[49] The comments were solicited in response to what the Commission termed the "accelerating movement towards global trading markets for certain securities and increasing flow towards national borders . . ."[50]

The various categories for comment included the relationship between securities trading in different countries; quotations for internationally traded securities; 24-hour trading, and linkages between different national markets; processing securities transactions; and international enforcement matters and related issues.[51]

The responses to the release came from six countries including Japan, Canada, the United Kingdom, Netherlands, the United States and Australia. The comments were wide-ranging and varied, but generally took a conservative stand regarding the extension of securities laws in the international markets. The commentators felt that the majority of trading was usually done by in-house market professionals, therefore, the private individual investor was not critically affected at this point, reducing the need for regulation. While cautioning that international markets should be allowed to develop on their own, the respondents did indicate that facilitation of international, inter market trading linkages and international clearance and settlement facilities should be addressed by the Commission.[52] They also suggested that the Commission might assume a negotiator's role in encouraging minimum standards for automated clearance and settlement systems among the active trading markets.[53]

Regarding trading in the 24-hour markets, Japan responded by saying that because of time zone differences, it saw no possibility of simultaneous trading by establishing market linkages between Japan and markets in New York and London. However, in October of 1985, the Chicago Board of Trade (SBT) and the London International Financial Futures Exchange signed a memorandum of intent to develop a yen futures contract based on a Japanese government yen bond. By allowing dealers to trade yen bonds in Chicago, London and Japan, trades can be done 24 hours a day.[54] Generally, there is support for around-the-clock trading among the international securities and investment markets.[55]

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49. J. Brooks, The Emerging Asia Dollar Market 56. Presentation at the Thirteenth Annual Securities Regulation Institute, San Diego, California (Jan. 1986).

50. Fed. Sec. L. Rep. (CCH) para. 83, 759, (Apr. 24, 1985).

51. Brooks, *supra* note 49, at 56.

52. Goelzer & McGrath, *supra* note 31, at 576-77.

53. *Id.*

54. Brooks, *supra* note 49, at 56-57.

55. Twenty-four hour markets are well-developed for trading foreign currencies and U.S. Treasury Securities, and are developing in the Eurobond market. However, the equity markets are still lagging far behind. Cox, *supra* note 27, at 7.

A. International Linkages

Market linkages between international exchanges to facilitate trading are being developed, with five currently operational. The first linkage established was the Boston Stock Exchange-Montreal Stock Exchange (BSE-ME) linkage. This allows for ME specialists to send orders for execution by BSE specialists and that small number of Canadian issues listed in the United States, and all of the United States securities listed on the inter market trading system.[56] It is contemplated in the future that the BSE and ME will jointly execute orders from the United States broker-dealers in Canadian national issues directly on the ME's automated small order execution system terminals (MORRE) placed in their order rooms. This phase has not been approved by the Commission.[57]

The American-Toronto Stock Exchange linkage (AMEX-TSE) currently only executes marketable limit orders of up to 1,000 shares at the best available "on the receiving exchange". This was the first linkage established between a primary market in the United States and a primary market in a foreign jurisdiction. Trading is done by each exchange is playing on its trading floor the quotes given by the other exchange in the seven duly listed stocks. It is anticipated the linkage will be expanded to include all issues. Orders are executed through the automated trading systems located on each floor.[58]

The Mid-West-Toronto Stock Exchange (MSE-TSE) linkage, established in March of 1986, operates in similar manners as the AMEX-TSE linkage with the exception of different stocks being listed.[59]

The International Stock Exchange-National Association of Securities Dealers (ISE-NASD) operates as a quotation exchange arrangement for approximately 300 securities listed on the National Association of Securities Dealers Automated Quotation System (NASDAQ) quoted on the ISE, with a reciprocal 300 securities listed on the ISE quoted on the NASDAQ. The system has been in operation since April of 1986.[60]

The American-European Options Exchange (AMEX-EOE) link open in August of 1987. It is the licensing agreement, approved by the SEC, permitting EOE to trade options on the major market index (XMI) that are fungible with the XMI contracts traded on the AMEX. The Dutch security and banking laws are very protective of the identity of account holders, however, in order to obtain SEC approval, the EOE now requires a waiver of the Dutch secrecy laws, allowing customer identification for surveillance purposes.[61]

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56. Mann & Sullivan, *supra* note 1, at 3. The intermarket trading system is the formal securities trading which occurs between the markets.

57. *Id.*

58. *Id.*

59. *Id.*

60. *Id.* at 4.

61. *Id.* at 4, 5. Other linkages currently being considered are:

The various linkages have resulted in dramatic increases in the United States trading of foreign securities; which has forced the SEC to consider questions of adequacy and need of the United States securities laws to deal with a developing foreign markets.

B. The Securities and Exchange Commission and International Markets

The SEC has recognized that accommodations for foreign issuers are necessary if the United States is to maintain its standing in the world securities markets. The aforementioned reciprocal prospectus agreement between the United Kingdom, Canada and the United States is one way in which the SEC is accommodating foreign issuers.

The SEC is also considering a territorial boundary, rather than a national boundary standard for enforcement of securities regulations. Under the application of the national boundary standard, registration requirements were applicable to any issuer who sold securities to any United States' citizen no matter their location. Under a "territorial approach", the registration requirements would be applicable to anyone who sold securities within the United States' territorial boundaries, no matter the nationality of the purchaser.[62]

The regulation of tender offers for companies which have United States investors is another concern of the SEC.[63]

The Commission realizes that potential problems in trying to maximize access to foreign markets for domestic investors, yet protect them, while at the same time not placing domestic issuers at a disadvantage.[64]

Put quite simply, according to Commissioner Charles Cox in his address to the Swiss-American Chamber of Commerce, in 1987, the Com-

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a. International Futures Exchange (Bermuda) Limited-Pacific Stock Exchange (INTEX-PSE); allowing for futures and options from financial news composite index to be traded simultaneously on the INTEX and PSE.

b. Futures NYSE-Amsterdam Stock Exchange (NYSE-ASE); with the ASE agreeing to trade United States' securities according to United States Securities Regulations data.

c. New York-London Stock Exchange (NYSE-LSE), would involve a joint venture in securities trading and reporting of trade data.

d. Ruters-Quadrex Securities Corporation Joint Venture. Ruters, a fully owned subsidiary of Insta-Net, has been granted exclusive rights to represent Insta-Net outside the United States.

e. AMEX-Quadrex Securities Joint Venture, Quadrex is a London-Based private corporation part. This joint venture if allowed by the SEC would permit private placement in the United States by foreign issuers, with resales limited to institutional investors. Companies involved would be allowed to by-pass the disclosure requirements of the U.S. Securities Regulations, and the facility would provide quotations and a settlement mechanism.

f. NASD-Singapore Stock Exchange-ISE. This would provide a 24-hour quotations system.

62. Cox, *supra* note 27, at 4.

63. *Id.* at 4-5.

64. *Id.* at 6.

mission sees its task as ". . . merely coordinate, develop, survey and police the world securities market".[65]

V. BARRIERS TO INTERNATIONALIZATION OF THE SECURITIES MARKETS

The promotion of the free flow of trade through internationalization of the capital market stands to benefit the world society as a whole. Resulting in a shifting of the concentration of wealth between nations.

For the investor, the broader market allows for greater portfolio diversity, decreasing investment risk. This diversity also allows for maximization of returns on the investment through the mixing of holdings.

For a corporation, it broadens its ownership base, thus allowing for greater capital stability. Tax incentives may be available, interest rates may be lower for borrowers, and foreign issuers generate foreign currencies to be used in local operations.[66] Other overall advantages include technology and information exchanges.

However, there are a number of barriers hindering the internationalization and free flow of the capital markets. Some, such as language, are relatively easy to deal with. Others are more complex. Protectionist impediments take various forms and are applied to both directly and indirectly. Foreign investment is restricted in certain types of industry, such as natural resources, and the communications field. Investment in that in which is deemed to affect national security will be prohibited in almost every country. Foreign taxes may be applied to dividend and interest payments, and admission to stock exchanges can be limited by regulations.

Compliance with each individual country's securities requirements can pose a more formidable obstacle. Foreign issuers wanting to enter the United States' market must comply with the SA (1933) and the SEA (1934) as well as any of the legislative regulations determined to be applicable. This can prove to be a major disincentive for foreign issuers due to the high cost, plus the conflicting requirements between what is demanded under their own country laws as compared to demands under the United States' laws. A specific problem area is the accounting information and the auditing procedures of financial statements.[67]

In October of 1982, the SEC promulgated an integrated disclosure system for foreign issuers; form 20-F. Under this system, an issuer wanting to put forth a new issue already would have a form 20-F on file. Pursuant to the requirements of the 1934 SEA, that issuer can incorporate by reference, information previously disclosed on the form 20-F.[68] This system is structured around the foreign registration documents; F-1, F-2 and F-3. These correlate with the requirements under forms S-1, S-2, and S-3

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65. *Id.* at 10.

66. Merlowe, *Internationalization of Securities Markets: A Critical Survey of U.S. and EEC Disclosure Requirements*, 8 J. COMP. BUS. CAP. MARKET L. 252 (1986).

67. Securities Act, § 7, Schedule B.

68. Thomas, *supra* note 24, at 3.

for domestic issuers. Factors determining which form to use include the type of offering, the reporting history, the amount of assets of the issuer, and the amount of voting stock held by non-affiliates.[69] Reaction to this system has ranged from viewing it as a small step in promoting world-wide markets;[70] to being much too permissive and adaptable.[71]

VI. INVESTIGATION AND DISCOVERY IN INTERNATIONAL SECURITIES CASES

This area of internationalization of securities is ripe for additional directives and information sharing. Protectionist laws can thwart even the most carefully conducted investigation. In particular, laws protecting the confidentiality of information given banks, blocking statutes used by foreign governments to prohibit or control distribution of information, and secrecy laws establishing rights individuals may use to compel others to keep certain information secret create barriers in gathering information.

The Restatement (Second) of Foreign Relations Law of the United States (1965) provides assistance in this area, and has given criteria for consideration when apparent conflict arises between two nation states as to discovery under foreign law. When there is concurrent jurisdiction, the existence of a foreign law which presents a conflict does not necessarily divest one state of jurisdiction. Each state is to consider the vital national interests of each of the nations; the extent and nature of the hardship inconsistent enforcement actions from the different nations would impose on the parties; the degree and extent of the necessary conduct to take place in the territory of the nation; the nationality of the party; and the extent to which action by either state is expected to achieve compliance with the regulations as set forth by that particular state. Restatement (Second) Foreign Relations Law § 40.

Through bilateral mutual assistance agreements,[72] memoranda of understanding (MOU) and agreements with foreign governments, the Commission has approved its ability to gain information from foreign sources. To date, three MOU's have been signed; the first in Switzerland in 1982.[73] Agreements with the United Kingdom Department of Trade and Industry, and most recently with the Japanese Ministry of Finance are also in existence. These agreements allow each of the government's mechanisms by which information related to the market surveillance and enforcement of their securities laws may be gained. If the offense is criminal in nature, the United States can use treaties it has with various countries to obtain the needed cooperation and information. Treaties are in effect in Switzerland, the Netherlands, Turkey, Italy, Canada, and the United Kingdom.[74]

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69. *Id.*
70. Merlowe, *supra* note 66, at 275, n. 69.
71. *Id.* at 275, n. 70.
72. Mann & Sullivan, *supra* note 1, at 42.
73. Cox, *supra* note 27, at 10.
74. Mann & Sullivan, *supra* note 1, at 55-57.

The Swiss agreement is unique in that it mandates a provisional arrangement to provide the SEC with information based on a private agreement between members of the Swiss Bankers Association.[75] The Agreement permits bank disclosure of information under certain circumstances, and grants an exception that such disclosure violates Swiss banking secrecy laws.[76]

Many of the recent cases involving foreign law and potential conflict of laws have revolved around insider trading, including *SEC v. Dennis Levine, et al.*, 86 CV 3726 (ro) (S.D.N.Y. 1986). In this case, the SEC alleged Levine had made millions in profit over a period of approximately six years by trading on material non-public information regarding tender offers, mergers, leveraged by-outs and other business-related information. During the investigation, the Commission was able to obtain information by working with the attorney general of the Bahamas in Bank LEU International (BLI) a Bahamian financial institution through which the SEC alleged Levine placed orders relating to these transactions. The orders were placed in either the name of two Panamanian corporations or by using code.

After being assured by the Bahamian attorney general that criminal charges would not ensue, BLI turned over the needed documents to the Commission, greatly assisting in their investigation.

Another agreement which facilitates investigation of securities transactions is the Hague Convention on the Taking of Evidence Abroad.[77] This is a multi-lateral treaty which provides a means for the taking of evidence in countries other than the one desiring to obtain the evidence.[78] Even though using the treaty is costly and time consuming, the Commission has resorted to it on occasion to obtain the needed information; most notably, *SEC v. Certain Unknown Purchasers of the Common Stock of and Call Options for the Common Stock of Santa Fe International Corporation*, 81 CV 6553 (S.D.N.Y. 1981); (the "Santa Fe" case) and *SEC v. Banca Della Svizzera Italiana, et al.*, 81 CV 1836 (MP. S.D.N.Y. 1981) also known as the "St. Joe" case.[79] However, because of the cost and time involved in using the Hague treaty, the Commission prefers to support and use the bilateral and multi-lateral assistance agreements.[80]

To further assist in case investigation discovery, the Commission has required foreign and domestic market places through market linkages to develop surveillance and information sharing agreements. Known as Self-Regulatory Organizations (SRO) they are expect to assure the integrity of trading through linkages they have developed with minimal SEC

75. *Id.* at 50.
76. Goelzer & McGrath, *supra* note 31, at 597.
77. Mann & Sullivan, *supra* note 1, at 58.
78. Goelzer & McGrath, *supra* note 31, at 601.
79. *Id.*
80. *Id.* at 603.

supervision.[81]

VII. THE GLOBAL MARKET AND 24-HOUR TRADING

A one-world securities market is no longer fantasy; it's reality. Due to advances in communications technology and travel, barriers that were so formidable 50 years ago have been dissolved. A recent article by Professor Peter F. Drucker[82] focussed on the changed world economy, and argued that the "world's economy is not changing, but has changed".[83] One of the fundamental reasons, according to Professor Drucker, is that movements of capital, rather than trade, have become the driving force behind the world's economy; that while the connection between the two has not been totally severed, it has been loose, creating instability in the economy.[84] He further refers to the world economy as being in control, rather than the separate nation-states, individually.[85] Nothing more clearly emphasizes this point than the present state of the securities and investment markets.

In soliciting comments about international trading in secondary markets from those who deal in the securities and capital markets, the SEC, through release number 34-21958,[86] in April of 1985, found general agreement among respondents that transnational trading will continue to increase.[87] However, there was disagreement as to the future structure of those markets and the role the SEC should play. Some felt trading around-the-clock would occur through a network of inter-connected exchanges, while others commented that 24-hour trading would be more likely through in-house trades by U.S. based and large foreign securities firms.[88] They also generally supported increased dissemination of quotation and information as well as development of inter-market linkages. The commentators considered these developments to be appropriate areas for Commission involvement, but cautioned generally that the markets should be allowed to develop on their own.[89] Because most rating is done by market professionals and international investors, the need for increased commission surveillance and regulation is decreased. The respondents did suggest that the SEC should play an active role in encouraging agreements between active trading markets in setting minimum criteria for an automated clearance and settlement system.[90]

As with any uncharted territory in which changes are occurring rap-

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81. *Id.* at 605.
82. Drucker, *The Changed World Economy*, 64 FOREIGN AFF. 768-91 (Spring, 1986).
83. *Id.*
84. *Id.*
85. *Id.*
86. Fed. Sec. L. Rep., *supra* note 50.
87. Goelzer & McGrath, *supra* note 31, at 602.
88. *Id.* at 576.
89. *Id.*
90. *Id.* at 577.

idly an numbers of participants are increasing, it is difficult for those charged with overseeing compliance to maintain pace with the changes. Part of what makes this so complex and difficult is the broad spacial area in which the transactions occur. The body of law encompassing securities regulation in the United States was written for defined number of players with a commonality of geographical space and legal understanding. In applying those laws to international transactions, consideration must be given to differing standards of regulation; i.e., only recently has Switzerland made insider trading illegal; as well as different legal systems. The European system of civil law can differ significantly in is application and procedure as compared to the common law systems of the United States, Great Britain and Canada.

The overriding concern of the Commission is the balance needed to facilitate and encourage the growth of the international economic markets while protecting the United States' investor. Of particular concern is the after-hours, over-the-counter (OTC) trade reporting, and the possible gap in information to the investor. However, most market respondents to the SEC's survey indicated that investors prefer to trade during regular business hours[91], so far creating less of a problem than anticipated.

Another consideration is the increase in the volatility of the markets due to the ability, through communication advances to respond more rapidly. A prime example of this was the "Black Monday Wall Street Crash" which occurred in October of 1987. This event emphasized the inter-dependence of the world's financial markets like no other. It created violent swings in stock prices as a daily occurrence on a world-wide scale. These swings were reflected in the apprehension of the people involved, not only the professionals in the market, but in the small individual investor planning to send his children to school on returns from his investment. Of greater far-reaching concern is the effect this type of reaction has on the world's economic stability, especially among the underdeveloped nations struggling to survive. Of some comfort is the knowledge that mechanisms were in place to allow appropriate responses to ward off a world-wide depression, in comparison to the 1929 crash.[92]

In considering 24-hour trading, most professionals in the securities market comment that the Commission is simply recognizing what it has been incurring for quite sometime.[93] As far as the need and ability of the SEC to deal with these changes, it is felt that methods to handle these changes are in place, but the ability on the part of the Commission to do

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91. *Id.*

92. Most notably was federal reserve Chairman Alan Greenspan's move to loosen the money supply. Inflation could have been the result, but the possibility of a depression loomed far greater if the national supply of money was not relaxed. The SEC also has the power to close the National Trading Exchanges if the trading volume becomes too rapid and too high over a limited period of time.

93. Interview with V. Baruttia, Registered Investment Advisor (October, 1987).

so is not.[94]

There is an inability of the current laws to properly govern multinational corporations and their foreign subsidiaries, as well as inadequate and improper supervision of broker dealers who deal in international securities.[95] A prime example of a developing problem is the off-shore fund.[96] Off-shore funds are those funds organized under the laws of a foreign county, selling its securities exclusively outside of the United States to non-nationals, then investing in American securities and real estate.[97] While no registration is required at this point, cases within the past few years have pointed at the ability of these funds to severely affect the United States' markets.[98] The Commission has imposed administrative sanctions on registered broker/dealers and investment advisors because of misleading information and prospectus disseminated to potential investors of off-shore funds.[99]

Obtaining jurisdiction over foreign issuers through broker/dealers remains a problem. The American Law Institute (ALI) is considering revisions of the Restatement (Second) Foreign Relations Law in the area of obtaining jurisdiction. It is looking to a "reasonableness test" as opposed to the "conduct-effect test" in determining when the United States' law will apply. The office of the general counsel to the SEC is opposed to the adoption of the reasonableness standard as being too vague and uncertain.[100] As a result, in May of 1986, the ALI conformed its jurisdictional standards for its revision to be more in line with the traditional concepts. Alternatives to the present standards are still being considered by the Commission.[101]

VIII. CONCLUSION

Internationalization of the securities and capital markets continue to be both boon and bane. As to affect the advent of 24-hour trading will have, it is generally felt it is too soon to tell. Because of the advancements in technology, the markets can do more in less time; and with around-the-clock markets, there is more time in which to do more, potentially creating more problems.

As is recognized by the Commission, there is a need for bilateral and multi-lateral agreements for cooperation between nations in the discovery process and the exchange of information concerning enforcement of securities laws. In July of 1986, a meeting of the International Organization

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94. Interview with G. Scott, Professor of Securities Law, Denver University College of Law (November 1987).

95. *Id.*

96. BLOOMENTHAL, *supra* note 25, at § 5.02(3), 5-13, Release No. 4-2/87.

97. BLOOMENTHAL, *supra* note 25, at 5-13.

98. *Id.* at 5-12.

99. *Id.* at 5-13.

100. Mann & Sullivan, *supra* note 1, at 35.

101. Goelzer & McGrath, *supra* note 31, at 605.

of Securities Commissions (IOSC) took place in Paris, France. Fifty-eight countries attended, excluding Japan,[102] and agreed to a proposal offered by the then SEC Chairman John Shad to form committees to consider such issues as the growth of developing nations, securities markets, acceleration in clearing and settlement systems, changing and modernizing prospectus requirements, access of foreign issuers, broker/dealers and investors to national markets and exchange of information concerning the enforcement of the securities laws.[103]

Subsequent to the meeting, the executive committee of the IOSC adopted a resolution to provide assistance on a reciprocal basis to obtain market over-sight and guard against fraudulent transactions, and to specify contact persons to assure processing of request for assistance from other members in a timely manner.[104]

The difficulty continues to be striking the balance between laws which are too restrictive in their application and inadequate protection of the United States' investor. There is no doubt that trans-national trading in capital markets will continue to increase. The question of the securities laws' ability to effectively grapple with this increase remains.

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102. L. Loss, *supra* note 10, at 55.
103. Mann & Sullivan, *supra* note 1, at 72.
104. *Id.* at 73.