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INTERNATIONALIZATION: A PREDICTION HAS BECOME REALITY

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The views expressed herein are those of Commissioner Peters and do not necessarily represent those of the Commission, other Commissioners, or the staff.

Internationalization: A Prediction Has Become Reality

I. Introduction

I am very pleased to have this opportunity to address the 69th Annual Conference of the North American Securities Administrators Association. I thought it appropriate to focus my remarks on the subject which is the theme of this conference, the internationalization of the securities markets. This is a topic of great interest to federal as well as state regulators and to me personally.

A few years ago we used to speak of the capital markets as becoming international. Globalization was denominated "a trend". Currently available information shows that tomorrow has become today. The markets are internationalized and are becoming increasingly global. Available statistics certainly support that proposition. Foreign transactions in U.S. equities totalled $157.7 billion in 1985, up approximately 25% from 1984. Similarly, U.S. transactions in foreign stocks during 1985, which totalled $45.1 billion, were up 50% from 1984. Trends in the international financing arena are also instructive. For example, in 1985 U.S. companies sold almost $36 billion worth of Eurobonds and raised over $3 billion in what is now termed as "Euro-equity." In the first six months of 1986 alone, U.S. companies offered over $3.2 billion worth of Euro-equity. 1/

1/ Securities Industry Association, Securities Industry Yearbook (1986) at 668.

The twenty-four hour market has become a reality. Securities are now issued, listed and traded around the clock and around the world by way of electronic linkages between markets and traders in different countries. Currently, trading linkages exist between three United States exchanges and two Canadian stock exchanges. There is also a linkage between the London Stock Exchange and the NASD. The London-NASD linkage permits the exchange of quotes and other information on approximately 600 securities, both American and European. Moreover, I understand that discussions are pending that may result in four additional linkages in the near future, including one between the AMEX and the European Options Exchange in Amsterdam for trading options. 2/

The changes that have taken place in marketing and trading of securities during the last fifty years have been dramatic. What is even more significant is the pace of change. The developments of last year, or even yesterday, may well pale in comparison to the changes currently taking place in the securities markets and those which will occur in the next two years or even two weeks. There is no doubt that technology is propelling us towards global markets.

The speed with which changes occur and the ease with which they are accepted in our markets is one reason why I believe the driving force behind the workings of the capital market system transcends parochial, national interests. There is an amazing

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2/ Other possibilities include linkages between: the London and New York stock exchanges, the London and Philadelphia stock exchanges and the New York and Amsterdam stock exchanges.

lack of resistance, at least relatively speaking, to granting access to financial markets to foreigners these days. It appears to be easier to consummate a multinational currency swap than to increase the import quota of Italian shoes or Japanese cars. It is difficult to know whether this phenomenon is due to inherently different attitudes towards the import and export of money or whether technology in the financial markets has outstripped the ability of politicians and special interest groups (like us regulators) to prevent or control its expansion. It is a fact of our daily lives.

II. The Internationalization Process Raises Concerns About Our Ability to Compete in Global Markets and Our Ability to Regulate Them Adequately

The relationship between competition and the regulatory framework is expressly recognized in the Securities Exchange Act of 1934, as amended in 1975, wherein Congress directed the SEC to consider the competitive effects of its regulatory decisions. The legislative history of the 1975 amendments to the 1934 Act expressly recognizes that certain Sections of the 1934 Act, in particular Sections 19 and 23 require the Commission to evaluate its own regulatory proposals and those of self regulatory organizations in light of what is stated to be the "fundamental national economic policy of furthering competition." 3/ Even without that clear directive, it would be difficult to separate competitive

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3/ See S. Rep. No. 75, 94th Cong., 1st Sess. (1975) (accompanying S. 249, 94th Cong., 1st Sess. (1975), reprinted in Federal Bar Association Federal Securities Laws: Legislative History, Vol. III at 2686, 2687.

concerns from regulatory ones when considering international issues. Furthermore, each issue we address in this area has implications for competition and regulation in our domestic market. There are three specific issues currently before the Commission that illustrate the tension created by Congress' mandate to the SEC to be mindful of the impact of its regulatory initiatives on competition and also illustrate the direct impact international initiatives have on the domestic market. They are: (1) rule proposals by two stock exchanges and NASDAQ concerning listing standards for foreign companies, (2) potential changes in SEC disclosure requirements to accommodate for foreign issued stock and (3) bilateral enforcement agreements.

A. Listing Standards For Foreign Issuers

First, with respect to listings on U.S. markets for foreign issuers, as of year end 1985, there were two hundred and eighty-two foreign security listings on NASDAQ, one hundred and sixty-eight on the New York Stock Exchange and fifty-one on the American Stock Exchange. Those numbers are likely to increase in the not too distant future, particularly, since our markets are positioning themselves to take on new listings. I refer to the New York Stock Exchange and the American Stock Exchange proposed rule changes which would relax their respective listing requirements as they relate to foreign issuers. The NYSE and the AMEX propose to consider the laws and customs of a country in which a non-U.S. company is domiciled in evaluating that company's listing application. This would allow a non-U.S. company which conforms

to local practices in the country in which it is domiciled, with respect to such matters as shareholder voting rights and the election of independent directors, to be eligible for a waiver of existing exchange listing requirements under certain circumstances. The NYSE would consider, for example, waiving its quarterly interim reporting requirements if a foreign company's domicile only requires semi-annual reporting of earnings. Semi-annual reporting, however, would be the minimum level of disclosure allowed by the NYSE. Non-U.S. companies would also be required to disclose publicly any significant change in their earnings trends between semi-annual reports. Finally, they would be required to provide an English version of earnings and other reports.

It should be noted that the NYSE proposed rule does not address specifically all possible practices of non-U.S. companies which could require a waiver of the exchanges' listing standards, as has the Amex. The Exchange has reserved discretion to make further changes which could affect other listing requirements.

The NASD, on the other hand, has no existing corporate governance or shareholder reporting requirements. However last Thursday, the Commission authorized publication of a release seeking comment on NASDAQ proposed rules on corporate governance. These proposed rules deal with such matters as: (1) reports to shareholders, (2) independent directors and (3) audit committee requirements, etc. However, with respect to foreign issuers, the NASD's proposed reporting and governance provisions would not

apply if they would require the foreign issuer to do anything contrary to the law of any public authority exercising jurisdiction over the issuer or contrary to "generally accepted practices in the issuer's country of domicile."

There are clear competitive implications involved in these pending applications. The exchanges and NASDAQ will be competing for foreign listings just as much as they do domestically. For example, it would not be unreasonable to conclude that NASDAQ's rather liberal foreign issuer provision is designed to give it a competitive advantage over the NYSE and Amex in soliciting such listings. Speaking of competitive advantages or the converse, it is interesting to note that the NYSE's controversial decision to amend its listing requirements to permit the listing of shares with unequal voting rights has international ramifications. To my knowledge, the concept of one share, one vote is not one that prevails abroad and major exchanges such as the London, Tokyo, Amsterdam and probably Paris stock exchanges have no prohibitions against listing shares with unequal voting rights.

There is no doubt that competitive positions are at the heart of this one share, one vote issue. This was candidly acknowledged by the Chairman of the Amex in a recent letter to Chairman Shad announcing that the Board of Governors of the Amex will be requested at its November meeting to approve a recission of the Amex's existing restrictions on dual class stock issuances by Amex listed companies.

Moreover, there is no doubt that competition will continue to pressure the exchanges and NASDAQ into further modifications of their rules. For example, once double standards for listings are adopted to accommodate foreign issuers, can we expect the exchanges to maintain the listing standards currently applicable to domestic issuers?

If the SEC grants the pending applications to relax listing standards, there could be important ramifications for state regulators, particularly in light of the current structure of Blue Sky regulation. With listing standards changing to meet the exigencies of the moment, the self-regulatory organizations will to a large extent be determining, based on competitive pressures, which foreign issuers will issue securities in your states. This may cause certain state regulators some concern in that uncertain and changing standards over which you have no control may be used to determine which foreign offerings are subject to regulatory review.

In light of this phenomenon, one could question whether the current "status" exemption from Blue Sky Laws should be changed to an objective criteria standard. Status exemptions were arguably appropriate when the criteria used to determine the status was relatively certain and stable. The competitive pressure resulting from the success of the NASDAQ system, a success for which it is to be congratulated, has eroded the usefulness of listing standards as quality control devices. As regulators, we must recognize that

fact and act on it. My task (focused on disclosure) will be easier than some of yours; nevertheless, it should be done if there is to be a rational, fair approach to Blue Sky exemptions.

B. U.S. Disclosure Requirements

Competition between markets is not the only contest you can expect to see waged in the international arena. U.S. issuers are now, and to some extent will increasingly find themselves competing with non-U.S. issuers for capital in U.S. markets.

Until now, the ability to trade in most foreign securities apart from mutual funds specializing in foreign investments, has largely been limited to institutional investors, since they have better access to information about foreign issuers and can absorb the higher transaction costs of trading overseas. As globalization of the capital markets becomes less of an exotic trend and more of a fact of everyday life, the question naturally arises as to what should be done to permit public investors to participate in the investment opportunities created by the process and by the same token to facilitate foreign issuers' access to this country's capital base. The answers of course involve change.

Reduction of risk to investors is one of the primary focuses of U.S. securities laws. As a result, the protection afforded investors is founded on a system of detailed disclosure. It is said that compliance and other costs relating to the SEC's disclosure and reporting rules deter foreign issuers' participation in our markets. I know of no studies done to

test this hypothesis, but I have had enough people both here and abroad tell me this is a fact to conclude that, at a minimum, it is at least a perceived fact. In part, as a response to this perceived barrier to competition, the Commission's staff is currently formulating proposals to implement a reciprocal approach to facilitating multinational offerings. The staff has not yet made a recommendation to the Commission, but it is my guess they will recommend that any initial experimentation with reciprocal prospectuses be limited in terms of the participating countries. I also believe that the use of such prospectuses will probably be limited to debt offerings by world class issuers and rights offerings and exchange offers to persons already holding foreign stock.

Another important, indeed critical, disclosure issue is financial reporting. Historically, the Commission has regarded audited financial statements as the single most important element of the U.S. disclosure system. Accounting principles, auditing standards and auditor independence are at the heart of that system. These areas will be of prime concern in determining those jurisdictions with which a reciprocal approach may be most profitably pursued. They may well prove to be the limiting factors in making that determination. In addition to these issues, a host of other questions remain, including coordination of 1933 Act disclosure requirements with 1934 Act reporting requirements, the level of issuer and underwriter liability, and SEC authority

to prosecute a foreign issuer for violations of the U.S. securities laws and/or the provisions of the reciprocal prospectus treaty.

Of course, the existence of state regulation of securities offerings raises important issues with which we must deal in this process. Currently, many state authorities rely on SEC-mandated disclosure in public offerings. If the Commission changes its standards for foreign issuers, some state commissions may feel compelled to increase their regulation of disclosures. Therefore, if harmonization of disclosures through reciprocal prospectus agreements is to be effective, the Commission must work with the state authorities in this area and we intend to do just that.

How far the Commission is prepared to go to relax its rules for foreign companies remains an open question. However, the Commission's apparent willingness to modify its disclosure standards for foreign companies raises questions about consistency. One might well ask: if the Commission believes that investors will be adequately protected under a less complete disclosure system for foreign issuers, can it continue to require the current level of disclosure from U.S. issuers? The question can also be posed another way. That is, if Commission action to facilitate access to U.S. capital markets by non-U.S. issuers imposes a competitive disadvantage on U.S. issuers, is it not required to correct the imbalance? I believe the answer may ultimately be a reduction of disclosure requirements on domestic issuers. Such an eventuality would raise entirely new concerns for us all as regulators.

C. Enforcement And Policing The Market

As internationalization forces more and more relaxation of our disclosure rules, we must expect a profound impact on our regulatory framework. After thirty minutes of listening to what you can expect with respect to relaxation of the rules governing the capital raising process, you may ask whether there is any area where we are tightening regulation and increasing oversight. The answer is yes -- the trading markets.

I, as a regulator, have specific concerns about international trading of securities and they differ from the competitive concerns of market participants. They center on assuring adequate surveillance, free access to information and increased cooperation between regulators in enforcement efforts. These objectives must be given high priority, particularly, if one of our goals is to ensure that internationalization and the deregulation that will accompany it, will not adversely affect the integrity and fairness of our markets. In some way, increased monitoring of the markets may impose a burden on competition. But in my view, that burden is necessary and appropriate to achieve the purposes of the Act.

I am pleased that the linkage agreements in place between various exchanges do take these concerns into account. All linkage agreements between United States exchanges and foreign markets include covenants of cooperation. For example, the Boston and Montreal Stock exchanges as well as well as the AMEX and Toronto Stock exchanges have agreed to cooperate in the investigation of any suspicious trading activity and to share

investigatory information with each other and with the U.S. and Canadian securities regulatory agencies. The London Stock Exchange and the NASD have also agreed to share investigatory information and to cooperate on the surveillance of the securities markets. Furthermore, the Toronto Stock Exchange and the Ontario Securities Commission have represented to us that the Canadian blocking statute will not be a hindrance to cooperation between our two countries. For my part, I think such provisions should be included in all linkage agreements.

It is worth noting that much of the twenty-four hour trading appears to be over-the-counter, with wire houses passing "their book" from one overseas branch to another. 4/ Thus, to the extent that these international transactions are not executed through exchange-sponsored electronic linkages, bilateral agreements for the production of evidence will continue for this and other reasons to be an important means through which countries may cooperate in enforcement matters involving the securities markets.

The U.S. is a party to several bilateral agreements. The treaty between the U.S. and the Swiss Confederation on Mutual Assistance in Criminal Matters provides for broad assistance including cooperation in locating witnesses, obtaining testimony, documents, and business records, and in serving judicial and administrative documents.

4/ "Endless Dealing: U.S. Treasury Debt is Increasingly Traded Globally and Non-stop", Wall Street Journal, September 10, 1986 at 1.

In 1983, the United States and the Netherlands entered into a treaty whereby mutual assistance may be provided with respect to criminal matters, including locating persons, serving judicial documents, providing records, taking testimony, producing documents, and executing requests for search and seizure. Other treaties on mutual assistance in criminal matters exist between the U.S. each of the following: Canada, Italy, Great Britain, Nothern Ireland, the Cayman Islands and Turkey.

Facilitating cooperation in the civil context is also important. For example, pursuant to a Memorandum of Understanding with the Swiss government, the Commission may, under certain circumstances, obtain customer information from members of the Swiss Bankers' Association. In May 1986, the Securities Bureau of the Japanese Ministry of Finance and the U.S. Securities and Exchange Commission executed a memorandum in which they agreed to share surveillance and investigatory information in the area of securities regulation on an ad hoc basis. In September 1986, the Commission and Great Britain's Department of Trade and Industry executed a Memorandum of Understanding expressing their intent to cooperate on enforcement efforts in securities matters. The Anglo/American MOU details the manner in which this cooperation will take place. We intend to pursue negotiations on a broader treaty with Great Britain. Furthermore, it is worth noting that serious discussions on bilateral cooperation are also being pursued with France. I am pleased with the progress we have made in the area of bilateral agreements and am hopeful that with

increased globalization, there will be increased mutual assistance with a view to preserving the integrity of the international marketplace.

In conclusion, I would like to suggest that as we ready ourselves to deal with the fact of internationalization, we must remember it will be a time for flexibility and compromise. Moreover, as we focus our efforts on facilitating competition both nationally and internationally we should not lose sight of another statutory obligation, the protection of investors. Although frankly, I think our approach to that task may be quite different that it has been in the past.

If the traditional wisdom is correct and deregulation is necessary to remove competitive barriers in the area of international financing, then regulatory oversight -- particularly of our trading markets, is even more essential. The international markets are too large, complex and diverse and the players too numerous, disparate and dispersed for us not to establish rules by which the process will be monitored and the laws enforced.

Thank you for your attention.