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**INTERNATIONALIZATION OF THE SECURITIES MARKETS:
THE CHALLENGE AND THE PROMISE FOR THE 1990s**

Remarks of

**Richard C. Breeden, Chairman
U.S. Securities and Exchange Commission**

**Los Angeles World Affairs Council
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For most Americans the much discussed "internationalization" or "globalization" of the securities markets is probably as pure an abstraction as, say, the formula for rocket fuel. I hope to render the abstraction a bit more concrete this afternoon, and to consider with you some of the implications of changes in world capital markets for the U.S. economy in the 1990s.

Globalization

First, it is worth noting that the U.S. securities markets are among the largest and most fair markets in the world. Our securities industry is also extremely competitive. Eleven of the largest 25 securities firms in the world are American, while only one of the largest 25 banks in the world is American. Approximately a quarter of a million people are employed in the securities business in the U.S., including many of the world's most creative investment bankers. We also have one of the most

¹ The views expressed herein are Chairman Breeden's and do not necessarily represent the views of the Commission, other Commissioners or the Commission staff.

efficient clearance and settlement systems, which is the means for completing securities transactions by transferring ownership in exchange for payment. As a result, our economy has long enjoyed the benefits of an efficient and liquid market in which companies can raise the capital that they need to grow and prosper.

Our securities market was once a largely domestic market, but this is not the case today. Stocks of 70 major U.S. companies are now listed for trading in Tokyo as well as New York, and 185 U.S. companies are listed in London. More than 400 foreign companies have their stocks listed on U.S. exchanges or NASDAQ, and more than 1,100 others trade in the so-called "pink sheet" market. Foreign investors purchase and sell an enormous volume of both equity and debt securities in our market. Total volume of transactions -- purchases and sales -- in U.S. securities by foreigners (including U.S. government debt) last year was about \$4.7 trillion, a 2,300% increase in annual volume since 1980. Foreign transactions in equities alone were over \$400 billion. Similarly, U.S. pension plans and other institutions diversify their portfolios by buying securities around the world. Many individual U.S. investors participate in mutual funds oriented to foreign market areas, or particular countries, thereby distributing their personal portfolio around the world. Everyday, tens of billions of dollars in transactions flow back and forth across the Atlantic and Pacific, and also across borders within Europe and Asia.

The result of these trends is that the U.S. capital markets are influenced daily by developments in financial markets around the world. Systemic problems in a major foreign market, or the sudden failure of a large foreign firm, would unquestionably have an impact on U.S. markets.

Developments in Eastern Europe

Another facet of internationalization relates to the enormous changes that are occurring in Eastern Europe and the Soviet Union. One afternoon this past February, the SEC learned just how enormous these changes might be. We spent that afternoon with members of a high level team visiting us from the Soviet Union. The Soviets sought information about the structure and regulation of our securities markets, with a view toward establishing a securities market in the Soviet Union. They posed many questions -- about the SEC, our personnel, our budget, and our operating systems. They also asked how we detected fraud, and how we verified all the information filed with us. They said something about "trust but verify."

For those of us in the securities field, this was our Berlin Wall crumbling. A year ago, even I would not have dreamt that a Soviet delegation would ask to visit the SEC to consider how to establish free capital markets.

The Eastern European countries are also thirsting for free markets, and they are moving far more rapidly than the Soviets. However, establishing successful securities markets is a very difficult undertaking. It is not just a question of building a trading floor for stocks modeled after a U.S. stock exchange, or installing a computer-based trading system. Having a market also requires having securities to trade, trained sales personnel, people to oversee exchange operations, as well as the physical facilities for trading, clearing and settling.

Despite the difficulties, we expect to see a whole new set of markets in Eastern Europe before too long. After being closed for 48 years, Hungary is going to officially reopen the Budapest Stock Exchange next month, which will represent an enormous milestone on the road to political and economic freedom. Poland also plans to establish a stock market. The Poles have asked the SEC for technical assistance on many fronts, including trading systems, the clearance and settlement of securities transactions, the training, licensing and supervision of securities markets sales personnel and enforcement.

Creating effective market systems in these countries will be more difficult due to the rudimentary level of telecommunications facilities. Indeed, as of the mid-1980s, there were only approximately 12 telephones per 100 inhabitants in Poland and, 14 per 100 inhabitants in Hungary. In contrast, the U.S. had 79 or

so telephones for every 100 inhabitants. Lack of data processing capability and the absence of an established banking system capable of large-scale electronic transfers will also create obstacles.

While the SEC alone could not oversee the restructuring of whole economic systems in these emerging market economies, what we can do is to provide the advice and expertise in areas that we know the best. To this end, the SEC has formed an Emerging Markets Advisory Committee. This Advisory Committee will be composed of leaders of U.S. securities, auditing and other financial firms, as well as senior representatives of regulatory organizations, such as securities exchanges. The members of the Advisory Committee will be a resource as the SEC considers requests for assistance from emerging markets. Together the countries of Eastern Europe and the Soviet Union represent a market of 400 million people. Helping these countries create free economic markets is the right thing to do. It also makes good long term business sense for the U.S. to participate actively in helping to develop these markets.

Development of securities exchanges in Eastern Europe will facilitate the privatization of state-owned institutions, and will make it possible for privately owned organizations to raise working capital. These newly created securities markets can foster economic change in another way -- by providing a means for U.S. investors to invest in the development of private enterprise in

Eastern Europe. For example, mutual funds targeted for investment in private companies in a specific Eastern European country, such as Hungary or Poland, or the entire region, can provide a direct source of capital for new privately owned firms in the region. I envision this help as a sort of people-to-people foreign aid, and the opportunities for American business and American capital may be significant.

EC 92

In addition to the new Eastern European markets, we will see other important international developments in the 1990s. In just two years, the European Community will eliminate most economic barriers among 12 sovereign states in Europe. What was a group of smaller competing markets could become a powerful single market. For the EC securities markets, this could mean a lowering of the costs of raising capital in the European markets and more efficiency. If EC 92 is successful, a German bank will be able to sell shares of stock in Italy, France or the other EC countries solely under German registration and oversight. The ability to operate throughout the EC in banking, securities, and other financial products solely by complying with "home country" regulation will greatly reduce costs. It will also make a "single market" in Europe with enormously larger liquidity much closer to realization.

International Regulatory Framework

As the world's oldest and largest securities regulator, the Securities and Exchange Commission is trying to provide leadership in building a framework for cooperation among the securities regulators around the world. This cooperation needs to include coordination when there are market disruptions, sharing information for investigative and prosecutorial purposes, establishing consistent capital and disclosure standards and reducing risk in the clearance and settlement system.

In response to these dramatic international developments, we are working with regulators of many other countries to minimize the conflicts between different regulatory systems, and to strengthen the framework of cooperation. Inconsistent disclosure requirements, accounting principles and auditing standards between nations serve as obstacles to the offering of securities beyond national borders. The SEC is working actively with the International Organization of Securities Commissions (commonly called IOSCO) to facilitate international equity offerings, to develop capital adequacy rules for multinational securities firms and to harmonize international accounting and auditing standards.

Within our own authority here at home, the SEC is trying to minimize obstacles to the free flow of capital over international borders. Among these is a multijurisdictional disclosure system, proposed by the SEC last summer. This system would be based on the

concept of mutual recognition of each participating country's disclosure, accounting and auditing requirements. Eligible companies would be permitted to sell or exchange securities in any participating country using the disclosure document required by the company's home country.

Various other measures should also improve the flow of capital between countries. Just this past month, we adopted "Rule 144A," which should expand investment opportunities in the already thriving U.S. market for private placements -- securities that are usually offered to small numbers of sophisticated investors. At the same time, we approved Regulation S, which defines the reach beyond our borders of the requirements for the registration of securities with the SEC. Rule 144A will make it much easier for foreign companies to access the U.S. market, while Regulation S should allow U.S. companies to raise capital abroad in a more simplified and less costly manner.

We will make further changes as we go forward to promote the free flow of capital. However, one thing that should never change is our commitment to fair and honest markets. Investors will not want to participate in our markets unless they are free from fraud. We are determined to pursue those who break the securities laws.

Modern technology and the ease of international communications make it possible for people to violate the U.S. securities laws

without entering our country. Insider trading in New York can originate in Paris or London as easily as it can in Connecticut or New Jersey, and the illegal proceeds can be moved to any country. Boiler room operations are now international, with investors in many countries exposed to fraudulent schemes conducted from outside their national borders. Because the markets have become global, a single nation is no longer able to have complete control over the stability and integrity of its markets without international assistance.

I am extremely proud of our enforcement record, both internationally and here at home. The recent criminal and civil prosecutions of Dennis Levine, Ivan Boesky, Drexel Burnham Lambert, and Michael Milken resulted in the recovery of over \$1.3 billion for the U.S. Treasury and defrauded investors. Those who think it is acceptable to cheat their fellow citizens should know that we will seek to detect this conduct. When we find it, we will pursue violators of the law and attempt to recover every last stolen dollar for investors -- with interest. Stealing the value of someone's retirement savings, or defrauding an investor of his or her economic future, simply is not "o.k." Neither is conspiring to manipulate markets for your own personal profit -- because that conduct can expose millions of people to extraordinary risks and losses once the manipulated market collapses.

We will combat fraud, not only here at home, but on an international scale as well. To do so, we have developed agreements concerning information sharing and evidence gathering with a number of foreign regulators. These include Japan, the U.K., France and the Netherlands. We are currently working hard to refine new agreements with Mexico, the Scandinavian countries, Australia, Israel and several other nations. These agreements will help ensure that violators cannot use international borders as a shield from being caught and prosecuted under the securities laws.

Domestic Concerns

Looking back to the 1980s, it should be apparent why our country cannot afford to be complacent in the 1990s, notwithstanding the excellence of our capital markets. In the past decade, the U.S. equity market capitalization -- meaning the current value of all stock of U.S. companies publicly traded -- increased by over 140 percent. However, market capitalization rose by 1140 percent for the Japanese; and by 400 percent for the European Community. In 1980, the U.S. equity market was 4 times the size of the next largest market. In 1990, the U.S. and Japanese markets are nearly identical in size, while the EC as a whole is close behind. Thus, the dawn of the 1990s presents us with 3 roughly equivalent sized markets, and none of them is assured of predominance.

Although the 1980s were prosperous in terms of economic growth, the U.S. share of global equity market capitalization plummeted from 51 percent in 1980 to only 30 percent at the end of the decade. Indeed, during the 1980s the U.S. ranked only 16th among developed nations in terms of the growth in market capitalization. It is one thing to try to be number one and only achieve number two or even number three. There is still some pride in going for the gold but winning the silver or the bronze. Sixteenth, however, is not the number I tell my sons to set their sights on in any competition.

Competitiveness of the U.S. Markets

One of our disadvantages in competing internationally is that the basic structure of the U.S. financial regulatory system was created in the 1930s. This structure is beautifully crafted to solve the problems of the 1930s -- which, of course, have long since been replaced by totally different problems. When our current laws were designed, for example, we did not have to worry about the issue of whether program trading hurt market stability. At that time, there were no computers to run a program on, or a stock index futures market to cause rapid price movements either for that matter.

The Administration of President Bush has taken important steps to begin modernizing of this system. While the disposition of the S&L assets has not been going as well as many would wish, the

actual thrift legislation marked a serious step in returning sanity to our regulation of depository institutions. Following on this legislation we need to consider ways to significantly reduce the aggregate volume of federally insured deposits, as deposit insurance provided the fuel for the fire in the thrift disaster and could do so again.

Most recently, Treasury Secretary Brady has advocated a major market reform to abolish the fragmented system that separates the regulation of stock index futures and their derivatives from the regulation of the cash securities markets on which they are based. Abolishing the current system for regulating stock index futures would be an enormous step to reduce the vulnerability of our markets to a potential disaster, as well as to reduce costs and promote U.S. competitiveness.

This system of different regulators for functionally related markets is not found in any other industrialized country. Firms like Merrill Lynch or Shearson that want to offer customers products in stocks, options, and stock index futures must pay to maintain two entirely separate systems of regulation, and comply with the rulebooks of two entirely separate agencies. Nomura and Daiwa do not have to do that in Tokyo. Nor do S.G. Warburg and Morgan Grenfell in London. Thus, we alone suffer from a fragmented system that reduces effectiveness and raises costs -- just the opposite of what should occur.

Another reform that is in order relates to bank and securities regulation under the Glass-Steagall and Bank Holding Company Acts. These Acts impose arbitrary barriers to the entry of banks into securities activities and securities firms into banking activities. The effect is to stifle competition and innovation in the financial services industry in the U.S.

Our dual federal-state regulatory system also impedes efficient capital raising. In stark contrast to the unified market that is likely to emerge from EC 92, the states are erecting, rather than tearing down, roadblocks to capital raising. State anti-takeover laws enacted in Ohio, Pennsylvania and Massachusetts just within the past month make it less attractive for investors to buy shares of companies chartered in those states. Generally, these laws have the effect of diminishing shareholder rights when the corporation is facing a change of control. Of equal concern are the 50 different sets of blue sky laws, and 50 different corporate governance and professional licensing schemes. Practically speaking, this means that each of the 50 states can set different standards for the sale of securities within its borders. Unless this situation is reversed, in two years time, it may be easier to complete a distribution of stock by an Italian company from Portugal to Greece than for Morgan Stanley to do a comparable offering throughout the U.S.

The goal of changes to our regulatory structure should be to increase liquidity and to reduce the costs of capital. We need to try to eliminate domestic barriers to free flows of capital, and to eliminate legal complexities that drive up the cost of bringing new products to market. America's economic future is dependent on our efforts to create and maintain the most efficient possible means for raising capital. Making savings and investment attractive is not merely desirable -- it is essential to our future in a competitive world economy. Accomplishing our objectives will have to be done with international considerations very much in mind. However, if we have the vision and will, U.S. markets will remain a source of pride, economic strength and stability -- envy of the world.