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News Release

Remarks to

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Financial Community

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"Peters vs Peters"
Internationalization: Are The Regulators Ready?

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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: Are The Regulators Ready 1/

Mr. Peters has sounded the theme for my remarks, raising issues which concern us all, regulators and businessmen alike.

The process we have labeled the "internationalization of capital markets" is rapidly changing the world of finance. Consider, for example, the increased participation in the U.S. markets by foreign investors in recent years. In 1985, foreign transactions in U.S. equities totaled $157.7 billion, up approximately 25% from 1984. Likewise, U.S. transactions in foreign stocks during 1985, which totaled $45.1 billion, were up 50% from the previous year. 2/

Of course, there has been some eastbound traffic in this process. Mrs. Fields Inc., a retailer of chocolate chip cookies, recently held its initial public offering of 29 million shares in London, England. The Utah-based concern is the biggest company on London's Unlisted Securities Market. 3/

Trends in the international financing arena are also instructive. 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."

1/ This address was prepared by Commissioner Peters with the assistance of Jacqueline P. Higgs, Counsel to the Commisioner and is based on remarks made by the Commissioner during an organized debate with Mr. Jaap F.M. Peters, President of AEGON.

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

3/ Steve Lohr, "A Lure to Go to Britain", N.Y. Times May 16, 1986 at D1.

In a recent speech, Chairman Shad of the U.S. Securities and Exchange Commission also noted the record growth in the international bond market, which is centered in Europe, and attributed this growth to new and innovative financing instruments such as interest-rate and currency swaps, floating-rate issues and the securitization of debt that have reduced cost and increased liquidity. 4/ As we are propelled forward with the internationalization process, it is time to consider what these markets will or should look like when fully developed, and, as Mr. Peters suggested, to consider what role regulators can or should play.

Mr. Peters implied that the U.S. capital markets are overregulated. However, as Chairman Shad frequently reminds us, our markets are enormously diverse, deep and liquid. Many factors have contributed to the vibrancy of our markets. Among them are: (a) competition among the marketplaces and the market makers for new listings, new products and more efficient trading and reporting methods, (b) the widespread participation by U.S. and non-U.S. investors in the U.S. capital market system which enhances liquidity 5/ and (c) judicious regulation of the capital markets through a two-tiered approach of self-regulation and

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4/ John Shad, "Regulators Must Help Improve International Securities Markets", Financier August 1986 at 53.

5/ There has been a decrease in the participation of small investors in U.S. capital markets. Nevertheless, the percentage of the total population that invests is still greater in U.S. than elsewhere.

oversight by the Securities and Exchange Commission. I expect that similar factors will enhance the diversity, depth and liquidity of international markets. However, Mr. Peters seems to suggest that regulation and regulators, particularly U.S. regulation and regulators, will hinder more than assist in the internationalization process. I respectfully disagree.

Of course, we in the United States recognize that times are changing, and that our regulatory scheme must adapt to the changing times. However, upon evaluating the experience of the U.S. markets during the past 50 years, I have concluded that regulation is necessary to ensure the integrity and fairness of capital markets, and thus, to instill and maintain investor confidence in the marketplace. In my view, this principle applies to global markets as well. The only question is how much regulation and what kind?

Perhaps we can find some guidance on what would be the most appropriate and desirable solutions to those questions from the mandate the U.S. Congress gave the SEC in 1975 when it directed the Commission to facilitate the development of a national market system. The Commission's objective has been to facilitate access to capital and eliminate barriers to competition. Its focus in trying to achieve a national market system has been to encourage automation, urge linkages between markets and demand development of improved surveillance techniques and technology. Clearly we should be just as interested in achieving these goals in global markets as in our national markets.

I fully expect that a call for freer access to capital in the global context will translate into a request for modification or elimination of some rule or regulation just as it usually does at home. Where appropriate, we may want to change and perhaps even eliminate some of our rules so that we do not stifle our domestic markets or lose out in the internationalization process. However, in my view, it would be counterproductive to discard all regulation. Therefore, regulators must determine the best course to take to preserve necessary safeguards while accommodating the globalization process.

In deciding which rules should be relaxed, or even eliminated, we must take into account: (1) the objective we hope to achieve and the basic philosophy of our respective securities laws, (2) the possible impact of such changes on domestic issuers, and (3) the costs that regulation imposes on the international market system and the benefits expected to be derived from such regulation. To those who suggest that we should do nothing and let the international markets develop as they will, I say such an approach would be ill-advised because the goals of issuers, market professionals and investors, while not incompatible with, are certainly not identical to those of regulators or society as a whole. The goal of market participants can be expected to be, in the short term, personal profit. That of the regulator should be to facilitate the development of open competitive markets which operate with integrity and fairness.

Mr. Peters indicates that compliance with United States' disclosure rules is a barrier to entry into our markets. In the United States, disclosure is a basic tenent of the securities laws and it is subject to detailed regulation as to its timing scope and nature. Nevertheless, there are proposals pending to relax some U.S. disclosure and listing requirements as they relate to foreign issuers, thus, facilitating access by non-U.S. issuers to U.S. capital and fostering competition for the U.S. investment dollar.

For example, the New York Stock Exchange ("NYSE"), and the American Stock Exchange ("AMEX") propose to modify their listing requirements for foreign companies. Under the NYSE proposal, a non-U.S. company applying for listing on the NYSE, that conforms to local practices in the country in which it is domiciled, would be eligible for a waiver of the existing NYSE listing requirements. The NYSE would consider, for example, waiving its quarterly interim reporting requirement if a foreign company's domicile only required semi-annual reporting of earnings. If the NYSE were to implement such a modified system, it would nevertheless, require that all non-U.S. members report earnings at least semi-annually. 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. 6/

6/ See Securities Exchange Release No. 34-23469 (Aug. 1, 1986), 51 F.R. 77618.

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 change in the Exchange's listing standards. The Exchange has reserved discretion to make further changes which could affect other listing requirements.

The AMEX, like the NYSE, would also allow consideration of the laws and customs of the country in which the company is located in evaluating a foreign company's listing application. Thus, the AMEX is prepared to defer to the laws and customs of the foreign issuer's domicile on such matters as shareholder voting rights and the election of independent directors, quorum requirements and quarterly reporting. The NASD, on the other hand, has no existing corporate governance or shareholder reporting requirements for NASDAQ securities. However, it proposes to adopt such requirements in certain areas. 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." 7/

As you may know, proposed rules or rule changes by self-regulatory organizations, must be submitted to the SEC for approval. 8/

7/ Id.

8/ Sections 19(b)(1)-(3) and Section 19(c) of the Securities Exchange Act.

The SEC published the NYSE, NASD and AMEX proposals for comment on August 1, 1986. The Commission may act on these proposals sometime this fall.

It is important to note that listing standards for exchanges are separate and distinct from the registration, disclosure and reporting requirements imposed by the Securities Act of 1933 or the Securities Exchange Act of 1934 and administered by the Commission. Naturally, the exchanges' listing standards must not be inconsistent with the requirements of the 1933 and 1934 Acts, but to satisfy the former does not automatically satisfy the latter. 9/ Personally, I think the Commission's action on the exchanges' pending proposed rule changes will signal the approach it is likely to take on other regulatory issues raised by the internationalization process, particularly, with respect to registration and reporting. I believe it is likely to be a liberal one.

Harmonization of disclosure rules both domestically and internationally is a difficult task. In this regard, last year, the Commission issued a release proposing two ways to simplify disclosure in connection with multinational offerings. The

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9/ "According to the NYSE, the proposed rule amendment is also consistent with the Commission's treatment of foreign issuers in that such issuers which register securities on Form 20-F or are exempt from registration pursuant to Rule 12g3-2 under the Act are permitted to provide less extensive disclosure and are not subject to the proxy and quarterly reporting provisions of the Act." See Securities Exchange Act Release No. 34-23469 (Aug. 1, 1986), 51 F.R. 77618.

reciprocal approach would require a participating country to accept an offering document used by an issuer in its country of domicile for use in connection with multinational offerings. The common prospectus approach would require participating countries to agree on uniform disclosure standards for an offering document that could be used within their respective borders.

The reciprocal approach was favored by a majority of the commentators. The SEC is now considering adopting a rule under which "world class" corporations would be permitted to make initial public offerings of investment grade debt issues in the U.S. and participating countries, under prospectuses which comply with the laws of such companies' domicile. The same approach may be applied to rights and exchange offerings. In my view, the reciprocal approach seems to be the most practical method of harmonizing disclosure rules. A proposal along these lines should be published for comment sometime this fall.

It is of course important to note that whatever changes are made by the SEC to facilitate access to capital in the international arena, issuers must also satisfy applicable state regulatory requirements.

Facilitating access to capital and eliminating competitive barriers is an international concern. However, another important matter, and perhaps the most important matter that should occupy our attention, is how international trading markets should be policed. We must keep at least one step ahead of those who would abuse the system. Securities are now issued, listed and traded

around the world and around the clock. As regulators take steps to facilitate that process, the opportunities for manipulation and fraud may increase. These are facts of life with which the United States markets and others are already dealing.

Three years ago, market participants were exploring the feasibility of electronically linking international markets. Today several linkages are already in place and from all indications, more are imminent. Currently, linkages exist between the Boston and Montreal stock exchanges, the American and Toronto stock exchanges, the Midwest and Toronto stock exchanges, and the London Stock Exchange and the National Association of Securities Dealers ("NASD"). As a result of the Boston-Montreal linkage, specialists on the Montreal Exchange may send orders for execution by Boston Stock Exchange specialists in a small number of Canadian issues also listed in the United States and approximately 200 U.S.-listed securities.

The AMEX-Toronto Stock Exchange linkage permits order flow in securities dually listed on the AMEX and the Toronto Stock Exchange. The Midwest-Toronto linkage operates in much the same way as the AMEX-Toronto linkage in that it allows two-way trading in six stocks listed on both exchanges. The London Stock Exchange and the NASD will exchange quotes and other information on approximately 600 American and European securities. For the time being, there will be no trading over this linkage. I understand that discussions are pending that may result in four additional linkages

between exchanges, one of which would be a linkage for trading in options between the American Stock Exchange and the European Options Exchange in Amsterdam. 10/

Clearly, the exchanges are moving forward with the tide. Of course, I, as a regulator, have my own concerns about international trading of securities. They center on surveillance, access to information and cooperation 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. I am pleased that the linkage agreements already in place take these concerns into account. For example, the Boston and Montreal stock exchanges 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 surveillance of the securities markets. Similar provisions have been included in all linkage agreements between U.S. markets and non-U.S. markets. Further, the Toronto Stock Exchange and the Ontario Securities Commission have represented to the Commission that the

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

Canadian blocking statute will not be a hindrance to the exchange of information between the 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. 11/ 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 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 serving judicial and administrative documents.

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 docu-

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

ments, 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, the Commission may, under certain circumstances, obtain information pursuant to a Memorandum of Understanding with the Swiss government which allows Swiss banks to disclose customer information to the Commission without violating Swiss secrecy statutes. 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 ("MOU") 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. Negotiations on a broader treaty with Great Britain are in progress.

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 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. Therefore, I disagree with those who suggest that "watchdog institutions", such as the SEC, are reactionary, backward-looking or anachronistic. In any event, the SEC's track record demonstrates that it is far from reactionary. It has been in the forefront of deregulatory efforts to facilitate competition and access to capital for many years. For example, in 1975, the SEC abolished all fixed commission rates on national securities exchanges in order to facilitate a more competitive and efficient marketplace. In 1982, the Commission took another step toward facilitating access to capital when it adopted Regulation D which is designed to simplify and expand exemptions from the registration provisions of the Securities Act of 1933 for limited offerings. Needless to say, these developments reflect a liberal and indeed forward-looking approach to regulation in the securities industy and I dare to say that the Commission has a few more surprises in store.

If regulatory agencies are an evil, they are a necessary one in today's markets. The 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 governed and for us not to maintain institutions to enforce those rules.

Thank you for your attention.