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News Release

THE GLOBAL EQUITY MARKET--AN ENFORCEMENT PERSPECTIVE

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The Global Equity Market--An Enforcement Perspective

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I. GROWTH OF INTERNATIONAL EQUITIES MARKET

It is a pleasure to be here today to offer my thoughts on some of the regulatory and enforcement issues that have accompanied the explosive growth of the world's equity markets.

My remarks today are based on two fundamental premises. First, the internationalization of the equity markets has been a positive development for the capital accumulation process and for investors, and thus its growth and development should be facilitated. Second, equity markets will attract investors to the extent that they are viewed as being efficient and fair. Put another way, the continued success of the international equity marketplace is dependent on potential investors and current shareholders receiving important information from issuers in a straightforward and timely fashion, and on the exposure and prosecution of persons who abuse their shareholders, their customers or their positions of trust. In my view, these two principles should be the guideposts for regulation of the world's markets in the late 1980's and beyond.

Let me highlight some recent trends which demonstrate the rapid growth of the primary and secondary global equity markets.

Euroequity offerings by American companies have amounted to $3.21 billion during the first six months of this year compared with $3.18 billion for all of 1985. 1/ Foreign corporations have increased their equity financings in the U.S. from $900 million in 1985 to $1.063 billion in the first six months of the year. 2/

In 1985, foreign purchases and sales of U.S. stocks totalled $159 billion. 3/ From January through June of this year, foreign purchases and sales of U.S. stocks have already added up to $132.6 billion. 4/ It can safely be assumed that the 1985 total was exceeded during the third quarter of this year. American investors purchased approximately $45 billion of foreign stocks during the first six months of 1986, approximately the same amount they purchased during all of 1985. 5/

From the U.S. perspective, there has been a rapid increase in the establishment of multinational bases of operations. U.S. brokerage firms now have over 250 branches in 30 foreign countries, exclusive of Canada and Mexico. 110 foreign firms currently have branches in the U.S. 6/

As these firms expand, so does the multinational nature of their business. In April, one U.S. firm distributed $350 million of KLM Royal Dutch Airlines equity throughout the Far East, Europe and the U.S. 7/ In June, an investment banking subsidiary of a major Swiss bank broke new ground in the United States by serving as either the sole or lead underwriter for fixed income securities issued by the Allied-Signal Corporation and the Transamerica Financial Corporation. 8/

We have also been given a preview of the large block trading transactions which will occur frequently in London after "Big Bang" financial deregulation takes place. During the past few months, two such institutional equity block trades involving London Stock Exchange ("LSE") listed firms were executed. In mid-August, an American securities firm combined with a British firm to purchase $159.9 million of British Petroleum PLC stock from Guiness PLC in a transaction negotiated away from the exchange. 9/ Approximately one month later, another American securities firm effected an even larger block trade, purchasing a $294.4 million stock portfolio directly from the British Printing & Communications Corp. 10/

Finally, the major securities markets of the world have undertaken a number of measures to promote their international integration. Six foreign firms were recently admitted to the Tokyo Stock Exchange. 11/ Although foreign entities are now limited to 29.9% ownership in LSE member firms, the deregulation attendant to Big Bang Day will permit foreign entities to fully own member firms or apply directly for membership with the LSE. 12/

Securities markets are also developing electronic trading linkages which permit inter-market trading in equity securities. The Boston Stock Exchange and the Montreal Stock Exchange have established a linkage which allows Boston and Montreal specialist firms to expose their orders on both floors for execution at the best price. 13/ Subsequently, the American Stock Exchange and the Toronto Stock Exchange established a linkage which allows orders for dually listed issues to be transmitted between the trading

floors. 14/ On April 22, 1986, the NASD and the London Stock Exchange commenced a two year stock quotation sharing pilot program. 15/ This pilot program is expected to be the precursor for a linkage which will be utilized to execute inter-market trades in NASDAQ and LSE stocks. 16/

A final operational obstacle which still must be overcome for the global equity market to flourish is the development of more efficient clearance and settlement procedures for securities transactions. The economic incentives to overcome these obstacles are so large that a rapid resolution of these problems can be anticipated.

There are three principal factors which will continue to fuel the growth we are observing in the global equity market. First, corporations have the desire to tap new sources of equity capital and broaden their shareholder bases at the same time. 17/ Second, the imperfect correlation between stock price movements of the various world securities markets allows investors to reduce the risk of their portfolios to a greater extent by diversifying globally rather than through domestic diversification only. Private pension fund investment managers in the U.S. have taken advantage of this risk-reduction benefit by increasing their international investment commitment from 0.5% of total financial assets under management to 3.7% of their total assets during the past six years. 18/ The third and possibly the most significant factor contributing to the development of global equity trading is the improvement in the technologies for the transfer of information

and funds between markets. 19/ It is now possible to monitor on a real-time basis the price movements of a multitude of stocks that trade in one or more markets which may be separated by thousands of miles and a number of time zones. It will soon be possible to scan all the price quotations for an internationally traded stock and thereafter to instantaneously execute a transaction in the market offering the best bid or ask price.

II. REGULATORY DEVELOPMENTS

There is a divergence of views as to what will constitute the future structure of the international equities market. Several exchanges have predicted that the global trading of world class securities will occur through a network of inter-connected exchanges. Other commentators believe that an upstairs interdealer market will provide the structural framework for the global equities market. Thus far, it appears that the international integration of the securities markets is proceeding in accordance with both of the separate views expressed by the commentators. Exchanges are establishing electronic linkages to make inter-market trading possible. Concurrently, international securities firms are making upstairs markets around-the-clock in debt and equity instruments, passing their orders from office to office in different time zones.

In my view, governmental authorities should not attempt to determine the market structure of the developing global equities

market. Rather, regulators should focus their efforts upon ensuring that their respective laws are responsive and relevant to maintaining fairness in the evolving markets, whatever their structure.

The glowing testimonial I have given to the recent breakthroughs and advances in the integration of international equity markets must be tempered by the realization that the quest for an efficient global equity market is just beginning. The Commission has recently begun to examine its current disclosure requirements with a view to facilitating if possible the public distribution of securities by foreign companies in the United States.

The Commission issued a concept release in February 1985 addressing the regulatory issues raised by multinational offerings in which two approaches for facilitating such offerings were discussed - development of a common prospectus among participating nations and reciprocal recognition and use of home country disclosure documents. The United Kingdom and Canada were viewed in the release as the most likely partners in such harmonization efforts because of the similarity of their disclosure requirements to those in the U.S. and because issuers from their markets have already made frequent use of the American primary capital markets.

Of all the issues raised by multinational offerings, the most difficult are those presented by the financial statements. Accounting principles, auditing standards and auditor independence are at the heart of the United States disclosure system and should

be central to all disclosure systems. These are areas that are key factors in determining those jurisdictions with which a reciprocal approach may be explored.

The Commission staff is currently in the process of developing a reciprocal prospectus approach to be explored with Canadian and British regulators. Given the less difficult disclosure issues raised by debt offerings, it is likely that initial proposals will focus on debt offerings of world class issuers. Extension of reciprocity to equity offerings as well as to disclosure documents prepared under the requirements of countries other than the United Kingdom and Canada will require greater familiarity and comfort with the presentation of financial statements and the soundness of the applicable auditing process.

Whichever approach is ultimately adopted, it is clear that investors demand a certain minimum quantity and quality of disclosure. The problems associated with the recent international syndication of the Fiat equity issue emphasize the importance investors attach to disclosure, particularly in equity offerings. As reported in the press, the recent Fiat international equity offering was poorly received for a variety of reasons; the most significant of which from a U.S. perspective was the lack of disclosure of material information about the company itself. By contrast, in the U.S. regulatory framework -- where disclosure is the heart of the American system -- information clearly moves capital.

III. COMMISSION INVESTIGATIONS

I would like to make the major thrust of my speech today a discussion of the overall objectives of the SEC in protecting the internationalized U.S. markets, the challenges posed by that international integration, the steps taken to meet those challenges, and the remaining hurdles which need to be overcome in order to safeguard the integrity of American markets.

Let me briefly describe the framework for regulation of the securities markets in the U.S. The Securities and Exchange Commission ("Commission"), established in 1934, is the principal agency responsible for oversight of the markets. It is assisted in these efforts by the various stock exchanges and the NASD, which the Commission in turn regulates.

The central purpose of the securities laws is to facilitate the disclosure of relevant investment information. The Commission does not pass upon or even express an opinion about the merits of an investment. However, by requiring full disclosure, the securities laws insure that the public has the ability to make informed investment decisions. Accordingly, the majority of enforcement actions which the Commission institutes involve cases of false or misleading disclosure, accounting fraud, market manipulation, insider trading, and misrepresentations by brokers and investment advisers.

To properly police markets located in our jurisdiction, it sometimes becomes necessary to gain access to information located

outside of our territorial boundaries. This does not mean that the Commission extends the enforcement of U.S. law extraterritorially. However, a person located abroad who trades in violation of U.S. law on U.S. markets is not insulated from our enforcement efforts. Obtaining this information in a manner which is consistent with foreign laws has been one of the greatest challenges faced by the Commission.

IV. PROBLEMS WITH GATHERING INFORMATION

Two landmark cases demonstrate the approaches the Commission has taken in gathering extraterritorial information.

In SEC v. Banca Della Svizzera Italiana, et al. (the "St. Joe" case), 20/ certain individuals purchased through a Swiss Bank, Banca Della Svizzera Italiana ("BSI"), St. Joe Minerals Corp. ("St. Joe") stock and options the day before the announcement of a cash tender offer for all of St. Joe Corp.'s stock at a $14 premium over market value. The Commission requested certain documents in the possession of BSI pertaining to these transactions. BSI refused to release the information claiming that such a disclosure would violate Swiss secrecy laws and subject it to civil and criminal liability.

After ascertaining that assistance was not available under any existing agreements, the Commission took the serious and unprecedented steps of serving a subpoena on an American subsidiary of BSI and seeking a court order compelling BSI to disclose its

customers' identities. A federal district court judge granted a Commission request ordering BSI to disclose its customers' identities or risk substantial sanctions, including fines of $50,000 for each day of noncompliance and a ban on trading in U.S. markets. BSI obtained a waiver of the Swiss bank secrecy laws from its customers and produced the requested information.

On June 3, 1986, over four years after we ascertained the identity of the purchasers, a federal district court held that one of BSI's customers, Guiseppe B. Tome, together with an Italian business associate, had engaged in insider trading. Approximately $2 million of their illegal profits have been recovered through BSI.

At almost the same time the SEC was seeking a court order in the St. Joe case, the Commission filed SEC v. Certain Unknown Purchasers et al. (the "Santa Fe" case). 21/ In that case, the Commission alleged that certain unknown investors purchased call options and common stock of the Santa Fe International Corporation ("Santa Fe") immediately before the announcement that Santa Fe had agreed to merge with Kuwait Petroleum Corporation. The purchases were made through Swiss banks for their omnibus trading accounts.

In light of the St. Joe precedent and after consultation with the banks involved and the Swiss government, the Commission determined to seek the identities of the unknown purchasers through the submission of an application for assistance pursuant to the 1977 treaty on Mutual Assistance in Criminal Matters Between Switzerland and the U.S. This was the first case in which the

Commission sought and obtained assistance from the government of Switzerland pursuant to this treaty.

The Commission made its initial request for information in March 1982. Thirty months later and after the expenditure of an enormous amount of Commission resources, the Swiss Federal Tribunal released the identities of the persons who traded in the Santa Fe stock and options through Swiss banks. On February 26, 1986, the Santa Fe case was settled with the disgorgement by defendants of $7.8 million in illegal profits and accumulated interest.

V. COMMISSION RESPONSES TO INFORMATION GATHERING PROBLEMS

Mostly out of frustration with its inability to overcome the obstacles presented by foreign secrecy laws and in an effort to gather extraterritorial information more expeditiously, the Commission, at the urging of my predecessor, issued for comment a release in which he proposed the "waiver by conduct" approach as a possible response to these problems. Under that concept, which would have required the enactment of legislation in the U.S., the purchase or sale of securities on a U.S. market would constitute a waiver of the protection that would otherwise be afforded by foreign secrecy laws.

The release was issued to elicit proposals for solutions to the problems created by transactions originating in one nation that affect the securities markets of other nations. The release provoked comment from all over the world, nearly all of which was

very unfavorable. Three general themes were expressed by the commentators. They stated that "waiver by conduct": (1) represented an extraterritorial extension of American law to nationals who conduct transactions through foreign banks and brokers; (2) would be unenforceable under most foreign laws and therefore would not resolve the conflict which presently exists; and (3) would drive investors away from U.S. markets in favor of markets with less regulation.

In light of the hostile reception given "waiver by conduct", the Commission has vigorously pursued the negotiation of bilateral information sharing agreements. I am pleased to report that the climate for international cooperation in enforcement matters has warmed during the period since the proposal of the "waiver by conduct" concept. Mutual assistance is becoming the norm rather than the exception.

This evolutionary development is illustrated by the list of international accords pertaining to securities law violations which have been successfully negotiated. They include memoranda of understanding with the government of Switzerland and with the U.K. Department of Trade and Industry, an understanding with the Japanese Ministry of Finance, treaties with Canada and the Cayman Islands, and cooperative agreements with the Ontario Securities Commission and the Quebec Securities Commission.

Just last month, the Commission and the U.K. Department of Trade and Industry entered into a Memorandum of Understanding ("MOU") which, on a reciprocal basis, will provide assistance in

obtaining records which are in the hands of the other or which can be obtained through the best efforts of the parties to the MOU.

The MOU is intended to enhance international enforcement of both countries' securities laws by providing assistance for investigations of violative conduct within each authority's jurisdiction as well as for regular market oversight. Specifically, the MOU makes assistance available in matters involving insider trading, market manipulation and misrepresentations relating to market transactions. The MOU also provides for exchange of information in matters relating to the oversight of the operational and financial qualifications of investment businesses and brokerage firms. The MOU will provide the U.S. Commodity Futures Trading Commission with similar assistance.

The MOU is the first accord negotiated by the Commission which provides assistance for a broad range of matters relating to market conduct and regulation of investment businesses. Use of the information received under the agreement is generally limited to prosecuting securities offenses or to a general charge (i.e., mail and wire fraud) related to an underlying securities law violation.

The MOU provides special safeguards to ensure that assistance is not abused by either party. Requests must be made with particularity. When questions arise as to the MOU's operation, consultations between the parties are mandated by the agreement. Finally, at the conclusion of the matter in question and to the extent permitted by law, all documents not previously made public will be returned to the other authority.

The MOU establishes the first working arrangement among securities regulators in the U.S. and the U.K. It is an interim arrangement which both parties see as a first step in their efforts to establish a comprehensive understanding to provide bilateral cooperation relating to securities regulation. Indeed, the MOU expressly provides for the initiation of such negotiations within the next twelve months.

The Commission's cooperative agreements with other countries have helped the Commission achieve some spectacular successes in enforcement actions involving international participants in our securities markets. In addition to the Santa Fe case, two other cases were concluded this year which illustrate how such agreements help the Commission to guard U.S. markets from fraudulent transactions initiated offshore.

On May 12, 1986, the Commission instituted its largest insider trading case to date against Dennis Levine, at that time a managing director of a major U.S. investment banking firm. The Commission alleged that Levine learned of over 50 impending takeover transactions through his employment as an investment banker or through "tips" from associates at other investment banking firms or law firms. After learning this information, he traded in the securities of the target corporations. Levine placed his orders to purchase and sell securities through the branch of a Swiss bank located in the Bahamas. The Commission has recovered nearly $16 million from Levine and his confederates. The case was broken open when the Attorney General of the Bahamas agreed that the disclosure

of Levine's identity by a Bahamian bank would not violate the law of the Bahamas.

On August 7, 1986, the Commission filed and simultaneously settled an enforcement action against Harvey Katz and his father-in-law, Elie Mordo. The Commission alleged that Katz learned in advance of the impending takeover of RCA Corporation through his son who was employed by one of the investment banking firms involved in the deal. As alleged in the complaint, Katz and Mordo purchased RCA stock and options after receiving this information. Mordo's purchases were made through a Swiss bank account. The SEC used the 1982 Memorandum of Understanding with the government of Switzerland to freeze Mordo's illegal profits in the Swiss bank and thereafter to obtain Mordo's identity. This was the first enforcement action brought by the Commission where we learned the identity of the purchaser through the operation of the Swiss MOU. Katz and Mordo disgorged their profits of approximately $2.1 million in settlement of the Commission's charges and Katz paid a penalty of an additional $2.1 million.

VI. MISPERCEPTIONS OF THE COMMISSION'S OBJECTIVES

The successes that we have been achieving lately in gathering extraterritorial information may be unfortunately reinforcing the misperception that the SEC is attempting to become the global policeman of the international securities markets. While we are committed to assisting other nations in protecting investors from

fraud, the sole focus of the Commission's investigative efforts is on suspicious conduct which affects U.S. markets.

The integrity of our markets is threatened when investors located outside of our territorial boundaries fraudulently trade in U.S. securities markets or when issuers headquartered abroad provide materially misleading financial information to investors in our markets. No nation condones fraud committed in any form. However, foreign secrecy and blocking laws can be and have been utilized to simultaneously serve as a shield to obstruct SEC investigations and as a sword to encourage purveyors of fraud to plunder U.S. capital markets with impunity.

Today's global equity market cannot be described as a single unified market where the participants are subject to the same rules and regulations no matter where they choose to distribute securities or execute transactions. That market is an ideal which may one day come into being. Until that day arrives, the global equity market will more closely resemble a quilt in which clearly distinct markets are stitched together through various linkages which are in the process of being formed. While operating within this framework, each market has a reciprocal interest in preventing its participants from being exposed to dual standards of protection - a higher standard for wholly domestic transactions and a lower standard for transactions in which one of the participants is located outside the market's host country.

I firmly believe that the best means of providing investors with the protection they deserve in the world's capital markets is

through the negotiation and utilization of cooperative agreements. These agreements minimize the necessity for and expense of litigation and the chances that two countries' legal systems will come into conflict. In addition, they permit regulatory authorities to expeditiously gain access to information which was previously unattainable.

VII. CONCLUSION

The Santa Fe, Levine, and Katz cases are examples of the excellent results which have been achieved through increased cooperation among international regulatory authorities. The world is becoming a more dangerous place for purveyors of securities fraud and a safer place for investors. Secrecy and blocking statutes, the swords and shields that have been used to injure investors and obstruct investigations, can no longer be relied upon for protection by securities law violators.

The internationalization which has occurred to date has proceeded largely independent of governmental intervention. To the extent government initiatives have been relevant to the process, it has been the government's removal of impediments which unnecessarily restricted the movement of capital that has encouraged the growth that has occurred. I realize that regulators sometimes leave the impression that they have discovered a brave new world of internationalization and now beckon back for traders, bankers, and investors to follow. The truth is, that at least from

where I sit, the challenge for regulators is not to fall so far behind the developments in the world's markets that we can not see and address problems when they are still relatively small, before they grow so large that their eruption will set back or even destroy the incredible growth that has occurred.

I hope that I have put to rest the myth that vigilant enforcement and market oversight will inhibit the growth of the global equity market. Investor protection and growth in the trading of equities on a global basis are not mutually exclusive objectives. These objectives are, in fact, in harmony with each other, but require the cooperation of governments and the investment community if they are to be attained.

NOTES

1/ See Lohr, Turning to Europe for Equity, N.Y. Times, August 21, 1986, at D1.

2/ See SEC Monthly Statistical Review, Table M-375, September 1986 at 26.

3/ See Department of the Treasury, Treasury Bulletin, Table CM-V-1, 3rd quarter, at 62.

4/ Id.

5/ See Department of the Treasury, Treasury Bulletin, Table CM-V-2, 3rd quarter 1986, at 62.

6/ The Internationalization of Capital Markets, Hearings Before the Committee on Banking, Housing, and Urban Affairs, 99th Cong., 2nd Sess. 37-40 (1986) (statement of Gordon S. Macklin, President, National Association of Securities Dealers, Inc.).

7/ See Roth, Battling For Survival, Wall Street Journal, at 32D. Merrill Lynch Capital Markets managed the KLM Royal Dutch Airlines equity offering.

8/ See Sesit, UBS Securities Again is Manager OF U.S. Offering, Wall Street Journal, at 44.

9/ See Winkler & Hemp, Guiness Sale of BP Shares Gives London A Preview of How Deregulation Works, Wall Street Journal, August 15, 1986, at 19. Salomon Brothers International and Hoare Govett jointly negotiated this block transaction with Guiness PlC.

10/ See Putka, Goldman Buys Portfolio in Britain's Biggest Off-Exchange Transaction Ever, Wall Street Journal, September 19, 1986, at 34. Goldman Sachs & Co. negotiated this transaction with British Printing & Communications Corp.

11/ See McGoldrick & Rafferty, The Tokyo Breakthrough, Institutional Investor, March 1986, at 230.

12/ See, e.g., Ollard & Shale, The Death Throes of the London Stock Exchange, Euromoney, December 1985, at 16.

13/ See Securities Exchange Act Release No. 21925 (April 8, 1985), 50 FR 14480.

14/ See Securities Exchange Act Release No. 22442 (September 20, 1985), 50 FR 39201.

15/ See Securities Exchange Act Release No. 23158 (April 21, 1986), 51 FR 15989.

16/ See 1985 Annual Report, National Association of Securities Dealers, Inc., at 7.

17/ See Turning to Europe for Equity, supra note 1.

18/ See Goldman Sachs, Anatomy of World's Equity Markets, Table VI.6, at 143.

19/ See The Internationalization of Capital Markets, Hearings Before the Committee on Banking, Housing, and Urban Affairs, supra note 6.

20/ 92 F.R.D. 111 (S.D.N.Y.)

21/ 81 Civ. 6553 (WCC) (S.D.N.Y.)