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# Overview of International Securities Regulation

by  
Aulana L. Peters†

I have been asked to set the stage for the other participants in this symposium by providing you with an overview of securities regulation in the global market. The topic I will address is as vast as the world's securities markets are numerous and as complex as they are complicated. Moreover, there have been enough new developments in the international securities markets during the past five years to provide material sufficient for a semester course. Thus, the principal problem I faced in preparing these remarks was to decide how to condense current developments into a forty minute address.

Therefore, I shall not spend time reciting the statistics usually offered to demonstrate the extent to which the securities markets have become international.<sup>1</sup> I am assuming that most people do not question the fact of securities market internationalization. However, some do question the need for regulation of global securities markets. Commentators in the United States and abroad have suggested that regulation and regulators, particularly U.S. style securities regulation and regulators, will hinder rather than assist the internationalization process.<sup>2</sup> I respectfully disagree. Regulators are uniquely situated to keep a close watch on the developing global markets and to intervene, when necessary, to maintain a balance between the competing interests of market participants: issuers, market professionals, and investors.

Issuers are primarily interested in the securities markets as a source of capital. Naturally, their view of how markets should operate is colored by their need for access to capital. Freer access to capital usually translates into fewer rules and regulations. On the other hand, investors generally wish to place their savings at the least risk consistent with the greatest return. Their

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† Commissioner, United States Securities and Exchange Commission; J.D. University of Southern California, 1973; B.A. College of New Rochelle, 1963. The views expressed herein are those of the author and do not necessarily represent those of the Commission, other Commissioners, or the staff of the Commission.

1. For a comprehensive overview of pertinent data, see the STAFF OF THE UNITED STATES SECURITIES AND EXCHANGE COMM'N, REPORT TO THE SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS AND THE HOUSE COMM. ON ENERGY AND COMMERCE ON THE INTERNATIONALIZATION OF THE SECURITIES MARKETS II-1 to 88 (July 27, 1987) [hereinafter *Internationalization Study*] (report on file in the offices of the *International Tax & Business Lawyer*).

2. Individuals have made this suggestion in off-the-record conversations with Commissioner Peters.

expectations are not always realistic. In between the users and providers of capital are the market professionals—brokers, dealers, investment bankers, and investment advisors—who service both, often simultaneously, for a fee. The potential for conflicts of interest under circumstances where these professionals operate as agents for both sides of a transaction is further complicated when they also operate in the dual capacity of agent and principal.

The competing interests of market participants in the securities area require game rules and a policy maker/referee to ensure that the game is played fairly. That is the role of regulation and regulators. From my evaluation of the U.S. markets during the past fifty years, I have concluded that securities regulation has played an integral role in ensuring the integrity and fairness of our capital markets and in instilling and maintaining investor confidence in the marketplace. This principle applies to global markets as well.

Most regulators recognize that regulatory schemes must adapt to changing times. We at the Securities and Exchange Commission [hereinafter Commission] are prepared to do that. Therefore, the question is not whether to regulate, but rather, how much to regulate and what kind of regulation is appropriate. This brings me back to my assigned topic and two concepts which I believe underlie, to some extent, most regulatory initiatives in today's global markets: 1) that the elimination of barriers to entry or, put another way, the liberalization of access to the marketplace enhances the efficiency of those markets; and 2) that internationalization results in market interdependence.

These concepts have resulted in three readily identifiable regulatory trends in the global market. First, there is a trend toward harmonization of rules with a view toward facilitating the transnational movement of capital and services. Second, there is an increased willingness on the part of regulators from different nations to enter into formalized cooperative agreements to facilitate enforcement of national regulations. Third, the concept of reciprocity regularly and consistently surfaces in international regulatory initiatives. With the emphasis on harmonization, cooperation, and reciprocity, one can realistically hope that a cohesive but flexible regulatory framework is developing to deal with our global markets.

The concepts of harmonization and reciprocity play a significant role in regulation by several nations of the international trading markets, as well as of the international capital raising process. In the European Community [hereinafter EC], several directives relating to securities regulation have adopted minimum standards based on regulatory schemes prevailing among member states of the EC. These directives require member states to accept persons, securities, and transactions that meet the minimum standards. For example, a series of EC directives establishes minimum standards for listing securities on stock exchanges in EC member countries. These directives dictate, among other things: 1) levels of capital and reserves, 2) shareholder

voting rights, and 3) disclosure requirements. Most importantly, the directives provide that, if a security meets the standards specified, an application for a listing on an exchange in a member state must be accepted if it has previously been approved by another member state and the second application is contemporaneous with the first.<sup>3</sup> By harmonizing standards and mandating reciprocity, EC directives make it possible to use a single text (translated into the appropriate language) for the simultaneous listing of a security throughout the EC.<sup>4</sup>

In the United States, the Commission is harmonizing many of its requirements with those of other nations. The Commission recently approved amendments to New York Stock Exchange [hereinafter NYSE] and American Stock Exchange [hereinafter AMEX] rules that permit the two exchanges to waive certain of their listing requirements for foreign issuers.<sup>5</sup> The NYSE and the AMEX have discretion 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 the local practices of its domicile with respect to such matters as shareholder voting rights or the election of independent directors, to be eligible, under certain circumstances, for a waiver of NYSE and AMEX listing requirements. For example, the NYSE would consider waiving its quarterly interim reporting requirements if a foreign company's domicile only requires semi-annual reporting of earnings.<sup>6</sup>

Public offerings is another area in which there is an ongoing attempt, both in the United States and abroad, to harmonize rules. Multinational offerings are occurring more and more frequently. To date, the bulk of these offerings, at least the larger ones, involve issues by sovereigns privatizing and securitizing national assets.<sup>7</sup> There is every reason to expect that this trend

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3. See 22 O.J. EUR. COMM. (No. L 66) 21 (1979); 23 O.J. EUR. COMM. (No. L 100) 1 (1980); 25 O.J. EUR. COMM. (No. L 48) 26 (1982). The directives cover, respectively, listing standards, disclosure standards for companies that are to be listed, and periodic reporting requirements for companies that have been listed. Member states were obliged to generally conform their laws to the terms of these directives by June 30, 1983. Over four years after that deadline, Portugal and Belgium still had not done so. Internationalization Study, *supra* note 1, at III-77.

4. See Fitchew, Director General for Financial Institutions and Company Law, Commission of the European Communities, *The European Community's Legislation on Securities and Securities Markets*, European Stock/OTC Markets Conference, New York, N.Y. (Oct. 1, 1987), at 14-15 [hereinafter Fitchew Address] (address on file in the offices of the *International Tax & Business Lawyer*).

5. Exchange Act Release No. 24,634, 52 Fed. Reg. 24,230 (1987). The Commission also approved the National Association of Securities Dealers', [hereinafter NASD] new transaction reporting plan for over-the-counter securities, which provides foreign issuers with similar waivers of the plan's periodic reporting and corporate governance requirement. See *id.* at 24,231 n.9 and Exchange Act Release No. 24,633, 52 Fed. Reg. 24,234 (1987).

6. Exchange Act Release No. 24,634, 52 Fed. Reg. 24,230 (1987).

7. For example, the three largest multinational offerings to date—the \$8 billion British Gas, the \$5 billion British Telecom, and the \$2.3 billion Rolls Royce Common stock offerings—were privatizations. See Sacher, *Going Private*, FIN. WORLD, Jan. 20, 1987, at 112-16; Feder, *Rolls Jet Engine Maker Soars in Initial Trading*, N.Y. Times, May 21, 1987, at D1, col. 6. The

will continue as more private issuers take advantage of the opportunity to raise capital simultaneously in a number of different markets worldwide.

The European Parliament and the Council of the EC are currently considering proposals which would harmonize member state prospectuses used in connection with initial public offerings.<sup>8</sup> According to the Director General for Financial Institutions and Company Law at the EC Commission, the purposes of the contemplated directive would be to insure that all investors are provided the information they need to properly assess the risks associated with an investment, that there is equal treatment of all investors as regards access to such information, and that it is easier for a corporate entity issuing and listing securities to treat the EC as a single market. In view of the third reason, the proposed directive is expected to contain a provision, similar to that contained in the EC's stock exchange listings directives, requiring member states to accept a public offering prospectus approved by another member state if the EC's minimum standards are met.<sup>9</sup> Further, it is anticipated that another proposal, requiring the mutual recognition of initial public offering prospectuses, will soon be adopted by the EC Council of Ministers.<sup>10</sup> If these proposals are adopted, the result should be to reduce the cost of simultaneous issues and, thus, to encourage corporate borrowers to tap the savings of the entire EC market.

In the 1970s, long before globalization became the watchword of the securities industry, the Commission took steps to harmonize its disclosure rules relating to public offerings with those prevailing abroad in order to facilitate foreign issuers' access to U.S. capital markets. The result of that effort was the adoption of Forms F-1 through F-4 and Form F-6 for raising capital, and Form 20-F for periodic reporting. These forms are essentially abbreviated versions of the registration statements required to be filed by U.S. issuers. They require disclosure of basic financial information but make some accommodations for different accounting practices.<sup>11</sup>

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British Petroleum multinational offering, which at \$12 billion was the largest ever, is also the result of privatization. See Marcom, *Britain Uses a Hard Sell on BP Offering*, Wall St. J., Oct. 15, 1987, at 45, col. 1.

8. 25 O.J. EUR. COMM. (No. C 226) 4 (1982). See also 23 O.J. EUR. COMM. (No. C 355) 39 (1980).

9. See Fitchew Address, *supra* note 4, at 14-15. See also notes 3-4 and accompanying text.

10. See Fitchew Address, *supra* note 4, at 15. As of March 1988, the EC Council had yet to make a final determination.

11. See Internationalization Study, *supra* note 1, at III-65 to 71, IV-15 to 21. The eligibility requirements for Forms F-1, F-2, F-3, F-4, and F-6, respectively, are set forth in 17 C.F.R. § 239.31, 239.32, 239.33, 239.34, 239.36 (1987). Those for Form 20-F are in 17 C.F.R. § 240.220f (1987). The texts of the various forms and more detailed discussions of the integrated disclosure system for foreign issuers are contained in the respective adoption releases. For Forms F-1, F-2, and F-3, see Securities Act Release No. 6,437, 47 Fed. Reg. 54,764 (1982). For Form F-4, see Securities Act Release No. 6,579, 50 Fed. Reg. 19,010 (1985). For Form F-6, see Securities Act Release No. 6,459, 48 Fed. Reg. 12,346 (1983). For Form 20-F, see Exchange Act Release No. 16,371, 44 Fed. Reg. 70,132 (1979).

Currently, the Commission is considering a proposal for the use of reciprocal prospectuses in connection with multinational offerings. The proposal would permit an issuer in a multinational offering which includes the United States to use a prospectus meeting the standards of its domicile and certain minimum standards, as long as the other participating nations accord U.S. issuers the same privilege. The minimum standards concept is reflected in the Commission's stated intention to limit this experiment initially to countries, such as Great Britain and Canada, which have disclosure rules similar to those of the United States.<sup>12</sup> Unfortunately, the Commission has not decided upon a specific rule proposal, even though we have been considering the reciprocal prospectus concept since 1985. The difficulty in finding the right approach to harmonization of the disclosure requirements of the Securities Act of 1933 [hereinafter 1933 Act]<sup>13</sup> with those prevailing in other markets lies not in the Commission's unwillingness to liberalize disclosure rules, but rather in the Commission's inability to devise an acceptable compromise that conforms with U.S. financial reporting rules.<sup>14</sup>

At present, issuers wishing to offer securities in the United States or to list their shares on a U.S. exchange must reconcile their financial statements to U.S. Generally Accepted Accounting Principles [hereinafter GAAP].<sup>15</sup> Moreover, they must be audited by firms that are knowledgeable about U.S. Generally Accepted Auditing Standards [hereinafter GAAS]. These firms also must meet Commission standards for auditor independence.<sup>16</sup> Imposition of such requirements, of course, translates into an unwritten but stringent requirement that foreign issuers wishing to raise capital in our markets engage the services of accounting firms already practicing before the Commission.<sup>17</sup> There is a difference of opinion as to whether the financial reporting requirements of the U.S. securities laws constitute a major barrier to foreign issuer access to the U.S. capital markets.<sup>18</sup> Opinions are expressed with equal conviction on both sides of the issue.

Burdensome or not, the Commission historically has regarded audited financial statements as the single most important element of the U.S. disclosure system. Auditing standards and auditor independence are at the heart of our disclosure system. Therefore, to the extent that the concept of reciprocal

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12. See Securities Act Release No. 6,568, 50 Fed. Reg. 9,281 (1985). See also SEC DIVISION OF CORPORATION FINANCE, SUMMARY OF COMMENTS ON CONCEPT RELEASE: FACILITATION OF MULTINATIONAL SECURITIES OFFERINGS (Jan. 10, 1986) [hereinafter Summary of Contents] (summary on file in the offices of the *International Tax & Business Lawyer*).

13. 15 U.S.C. §§ 77a-mm (1982 & Supp. IV 1986).

14. See Internationalization Study, *supra* note 1, at III-323 to 325.

15. See *id.* at IV-15 to 21.

16. See *id.* at IV-29 to 30.

17. See *id.* at IV-29 to 31.

18. See Summary of Comments, *supra* note 12, at 6-7, 30-37. Compare Naylor, *Executive Calls U.S. Securities Laws a Hinderance in World Capital Markets*, AM. BANKER, Feb. 28, 1986, at 2, with Internationalization Study, *supra* note 1, at IV-51 to 54 ("little evidence to suggest that the reconciliation requirement has provided a serious obstacle").

prospectuses necessitates a departure from these principles, the Commission has been cautious in moving toward their use in connection with multinational offerings.<sup>19</sup>

It is difficult to harmonize diverse and disparate disclosure standards, particularly in the area of financial reporting. However, to label a task difficult is not to say it is unsolvable. Some help in this regard may be forthcoming from the International Federation of Accountants [hereinafter IFAC].<sup>20</sup> The International Audit Practices Committee of the IFAC has issued guidelines on, among other things, auditing standards, which address in depth the standards comprising GAAS. However, the guidelines are merely "examples" of what an auditor *may* do,<sup>21</sup> whereas U.S. GAAS are compulsory. Thus, while the IFAC's efforts are impressive, they do not yet provide an objective measuring stick to determine which countries may participate in the reciprocal prospectus project and similar undertakings. If these guidelines become the subject of an EC Directive making them mandatory, they may.

Compliance with U.S. financial reporting rules is generally perceived as a barrier to entry into U.S. capital markets. The Commission is still looking for a solution to this problem. A partial answer would be to provide a means for appropriate offerings to occur outside the registration provisions of the 1933 Act. Such an approach is the focus of an interesting project in which the Commission's Division of Corporation Finance is currently engaged. This project would provide a Rule 144<sup>22</sup> exemption to permit the immediate trading of restricted securities among institutional investors.<sup>23</sup> The creation of an immediate trading market for unregistered securities should create significant financing opportunities, particularly in the international markets. Although the exemption would be limited to institutional investors, this limitation should not be overly restrictive in practice, because such investors provide a significant portion of the capital in our markets. Also, if investors have the option of immediately trading foreign issued securities, those securities should become doubly attractive investments. Thus, foreign issuers and institutional investors would meet more frequently in the private placement arena. The Division of Corporate Finance hopes to present a proposal on this rule to the Commission in the near future.

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19. See Internationalization Study, *supra* note 1, at III-323 to 325, IV-16, IV-51 to 54.

20. See Jayson, *IFAC's Travelling Salesmen*, MGMT. ACCT., Oct. 1986, at 22; Internationalization Study, *supra* note 1, at IV-21 to 24.

21. See *Acceptable Global GAAP Still Far Off. Audit Rules Moving Already*, Sampson Says, 19 Sec. Reg. & L. Rep. (BNA) 529, 530-31 (1987); Internationalization Study, *supra* note 1, at IV-31 to 36.

22. Rule 144 under the 1933 Act sets forth the circumstances under which securities acquired in a private placement may be resold. 17 C.F.R. § 230.144 (1987).

23. See Address by Linda C. Quinn, Director, SEC Division of Corporation Finance, *Redefining "Public Offering or Distribution" for Today*, Federal Regulation of Securities Committee Annual Meeting, Washington, D.C. (Nov. 22, 1986) (address on file in the offices of the *International Tax & Business Lawyer*). See also Clough, *Angels on a Pin: The SEC Takes the Lead on Designing Global Markets*, INVESTMENT DEALERS' DIG., Mar. 16, 1987, at 64.

A project to develop a trading system within which unregistered securities could be traded by institutional investors was launched last year as a joint venture between the AMEX and a securities firm named Quadrex.<sup>24</sup> Their objective was to develop a new price quotation and clearance system to facilitate the trading by U.S. institutional investors of unregistered debt and equity securities of foreign issuers. Recently, Quadrex announced its withdrawal from this project, but the AMEX will continue it. The National Association of Securities Dealers [hereinafter NASD] has initiated a similar proposal.<sup>25</sup>

One could legitimately question the wisdom of future deregulation of the disclosure process at a time when our markets are becoming more global and more complex. However, it should be borne in mind that the contemplated exemption for free trading of unregistered securities by institutions is consistent with the philosophy underlying existing exemptions to the registration requirements of the 1933 Act.<sup>26</sup> Moreover, as other recent regulatory initiatives have demonstrated, the elimination or reduction of 1933 Act disclosure requirements is justifiable in circumstances where the market receives information through the disclosure requirements of the Securities Exchange Act of 1934 [hereinafter 1934 Act].<sup>27</sup>

It is worth noting that, even though the Commission has not been able to find a quick solution to perceived problems created by the 1933 Act disclosure requirements, multinational offerings of world class securities are occurring nevertheless, to a certain extent spurred by the drive to privatization.<sup>28</sup> Interestingly, these offerings seem to raise more market regulation problems than disclosure problems. For example, in order to facilitate international offerings this year, the staff has issued ten exemptive or no-action letters excusing compliance with Rules 10b-6 and/or 10b-7 under the 1934 Act.<sup>29</sup> The

24. See Dutt, *Unprecedented Global Exchange in the Works*, INVESTMENT DEALERS' DIG., Feb. 16, 1987, at 6.

25. See Parker, *2 Exchanges in Works for Foreign Securities*, PENSIONS & INVESTMENTS AGE, Sept. 7, 1987, at 3; Clough, *Quadrex to Pull Out of Joint Venture with AMEX*, INVESTMENT DEALERS' DIG., Oct. 5, 1987, at 73.

26. Congress carefully exempted from the 1933 Act "certain types of securities and securities transactions where there is no practical need for its application or where the public benefits are too remote." H.R. REP. NO. 85, 73d Cong., 1st Sess. 5 (1933). The 1933 Act exemptions are contained in sections 3 and 4. 15 U.S.C. §§ 77c-d (1982). Consistent with the 1933 Act's focus on public offerings, these sections operate to exempt both small offerings and private placements of newly issued securities, *id.* §§ 77c(b), d(2), as well as secondary trading of already issued securities, *id.* § 77d(1), (3).

27. 15 U.S.C. §§ 78a-kk (1982 & Supp. III 1985). The integrated disclosure system and shelf registration are two such initiatives. The former permits periodic reports filed pursuant to the requirements of the 1934 Act to be incorporated by reference into certain 1933 Act registration statements. See Securities Act Release No. 6,383, 47 Fed. Reg. 11,380 (1982). See also Securities Act Release No. 6,235, 45 Fed. Reg. 63,693 (1980). Shelf registration under Rule 415 permits securities to be offered on a continuous basis. 17 C.F.R. § 230.415 (1987). See Securities Act Release No. 6,499, 48 Fed. Reg. 52,889 (1983).

28. See *supra* note 7 and accompanying text.

29. 17 C.F.R. § 240.10b-6, b-7 (1987). Rule 10b-6 is an antimanipulative rule generally prohibiting persons engaged in a distribution of securities from bidding or purchasing or inducing purchases of that security just before or during the distribution, and Rule 10b-7 provides a



requests for relief came from nine non-U.S. issuers and from the International Stock Exchange [hereinafter ISE],<sup>30</sup> and may be viewed as a tacit recognition by the applicants of the SEC's position on the extra territorial effect of Rules 10b-6 and Rule 10b-7. What is even more significant is that the applications demonstrate a cooperative spirit and an awareness of the interdependence of markets world-wide.

Before moving on to the second part of my discussion on the trend toward cooperation, another area of harmonization deserves mention, namely the harmonization of rules governing the marketing of collective investment vehicles, most of which are mutual funds.

On December 20, 1985, the Council of Ministers of the EC adopted a directive "on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities" [hereinafter UCITS].<sup>31</sup> The purpose of the directive was to facilitate cross-border marketing of certain investment products, while assuring relatively uniform investor protection throughout the EC.<sup>32</sup> The Investment Company Institute [hereinafter ICI], an American trade association whose members include investment companies and investment advisers, has taken the position that the UCITS directive creates an opportunity to negotiate with the EC a bilateral treaty providing for reciprocal sale of collective investment products in the United States and in the EC. The ICI has stated that the EC, as well as the ICI's members, are interested in such a bilateral treaty.<sup>33</sup>

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safe harbor from this prohibition for transactions that stabilize the price of a security to facilitate the distribution. The rules apply to affiliates. *Id.* § 240.10b-6(c)(6).

30. See *The British Petroleum Co., p.l.c.*, SEC No-Action Letter, (Oct. 13, 1987) (LEXIS, Fedsec library, Noact file); *The International Stock Exchange of the United Kingdom and the Republic of Ireland Limited*, SEC No-Action Letter, (Sept. 29, 1987) (LEXIS, Fedsec library, Noact file); *Tokio Marine and Fire Insurance Co.*, SEC No-Action Letter, (Sept. 30, 1987) (LEXIS, Fedsec library, Noact file); *Banco de Santander, S.A.*, SEC No-Action Letter, (July 28, 1987) (LEXIS, Fedsec library, Noact file); *Banco Central, S.A.*, SEC No-Action Letter, (June 30, 1987) (LEXIS, Fedsec library, Noact file); *Compania Telefonica Nacional de Espana S.A.*, SEC No-Action Letter, (June 11, 1987) (LEXIS, Fedsec library, Noact file); *Barclays, p.l.c.*, Exchange Act Release No. 24,487 (May 19, 1987) (LEXIS, Fedsec library, Noact file); *Philips, N.V.*, Exchange Act Release No. 24,486, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,449 (May 12, 1986); *Rhone Poulenc, S.A.*, SEC No-Action Letter, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,444 (March 13, 1987); *C.H. Beazer (Holdings), p.l.c.*, SEC No-Action Letter, (May 27, 1987) (LEXIS, Fedsec library, Noact file). See also Internationalization Study, *supra* note 1, at V-77 to 85.

31. See 28 O.J. EUR. COMM. (No. L 375) 3 (1985). See also Internationalization Study, *supra* note 1, at VI-18 to 21. Member states generally must adopt and implement this directive by October 1989, but there is no guarantee that the deadline will be met. It is at best a goal. The delays in implementing the listing, disclosure, and reporting directives are illustrative. See *supra* note 3.

32. 28 O.J. EUR. COMM. (No. L 375) 3 (1985).

33. Letter from David Silver, President of the Investment Company Institute to John S.R. Shad, Chairman of the Securities and Exchange Commission (Jan. 2, 1986)(letter on file in the offices of the *International Tax & Business Lawyer*).

In outlining the scope of these remarks, I mentioned a second regulatory trend discernible in the globalization process, i.e., negotiation of formal international cooperation agreements designed to facilitate enforcement of national securities laws. As noted previously, the Rule 10b-6/10b-7 no-action requests highlight the fact that increased market interdependence necessitates both greater cooperation between regulators and the harmonization of regulatory systems, particularly with respect to the policing of international trading markets.<sup>34</sup> Underlying the accommodations sought and granted in connection with the 10b-6/10b-7 no-action requests is the recognition that stock activity in one market may impact another market. In fact, the increased likelihood that stock activity in one market can directly and significantly impact on other markets is reportedly taken into account currently by market professionals.<sup>35</sup>

International agreements for cooperative law enforcement efforts are not novel. Mutual assistance treaties [hereinafter MATs] have been in existence for some time.<sup>36</sup> Moreover, regulatory agencies, such as the Commission, may obtain access to information through the Hague Convention on the Taking of Evidence Abroad.<sup>37</sup> Unfortunately, use of MATs and the Hague Convention, particularly the latter, is cumbersome, time consuming, and inefficient. These problems create special frustrations, as global markets develop and as market surveillance, access to information, and cooperation in enforcement efforts at the international level become critically important. Consequently, efforts to increase international cooperation in the areas of surveillance and information sharing are given high priority by the Commission and its staff.

Since 1982, the Commission has negotiated with foreign governments and other securities regulators several bilateral reciprocal information sharing agreements which relate specifically to the securities markets.<sup>38</sup> In addition,

34. See generally *supra* notes 29-30 and accompanying text.

35. See, e.g., Glynn, *A Day — and Night — in the Life of the Global Market*, INSTITUTIONAL INVESTOR, Apr. 1986, at 293.

36. The first mutual assistance treaty [hereinafter MAT] was the Treaty on Mutual Assistance in Criminal Matters, May 25, 1973, United States-Switzerland, 27 U.S.T. 2019, T.I.A.S. No. 8302 (entered into force 1977). MATs also are in effect with the Netherlands, Turkey, and Italy, and have been negotiated with Colombia, Morocco, Canada, and the Cayman Islands. See Internationalization Study, *supra* note 1, at VII-49 to 60.

37. See Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters, Mar. 18, 1970, 23 U.S.T. 2555, T.I.A.S. No. 7444, 847 U.N.T.S. 231; see also Internationalization Study, *supra* note 1, at VII-68 to 75. The U.S. Supreme Court has rejected the argument that the Hague Convention provides the exclusive means for obtaining evidence abroad. *Société Nationale Industrielle Aerospatiale v. United States Dist. Court for the Southern Dist. of Iowa*, 107 S. Ct. 2542 (1987).

38. The Commission has entered into bilateral information sharing agreements with authorities in the United Kingdom, Japan, and Switzerland. See Understanding on Exchange of Information in Matters Relating to Securities and Futures, Sept. 23, 1986, United States-United Kingdom, — U.S.T. —, T.I.A.S. No. —, reprinted in 25 I.L.M. 1431 (1986); Understanding on the Sharing of Information, May 23, 1986, United States-Japan, — U.S.T. —, T.I.A.S. No. —, reprinted in 25 I.L.M. 1429 (1986); Understanding on the Means for Improving International

the Commission has required that clauses providing for the sharing of information and for cooperation in surveillance and investigations be included in every inter-exchange linkage agreement subject to the Commission's approval.<sup>39</sup> However, surveillance and cooperative enforcement efforts effected through exchange-sponsored linkages are just the beginning of the effort needed to ensure adequate policing of the international markets. To the extent that trading is off the floor of an exchange or is not conducted through an exchange sponsored electronic linkage, additional measures must be taken to ensure accountability of traders and brokers operating in the global market.

Current international cooperation agreements depend on the voluntary cooperation of witnesses and others who have control over pertinent evidence. Under existing law, the Commission lacks the authority, absent a domestic jurisdictional basis, to compel either testimony or production of documents on behalf of a foreign securities authority. Currently, 28 U.S.C. section 1782 is the only statutory basis upon which the U.S. government can compel evidence from a person within the United States on behalf of a foreign law enforcement authority. Under that code provision, a federal district court is authorized to compel testimony or the production of evidence if it is requested by a "foreign or international tribunal." Federal courts, however, have found that the phrase, "foreign international tribunal," is limited to adjudicatory bodies and, thus, does not extend to agencies which conduct investigations unrelated to pending judicial or quasi-judicial controversies.<sup>40</sup>

The present limitation on the Commission's power to compel the production of evidence significantly impedes the agency's ability to access information or to provide it. The Division of Enforcement, with the assistance of the Divisions of Market Regulation and Investment Management, is drafting proposed legislation that, among other things, would enable the Commission to compel testimony or the production of documents on behalf of a foreign regulatory authority and to make reciprocal agreements providing the United States with the same assistance. The proposed legislation expands the Commission's investigative authority under Section 21 of the Exchange Act<sup>41</sup> to

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Law, Aug. 31, 1982, United States-Switzerland, — U.S.T., —, T.I.A.S. No. —, reprinted in 22 I.L.M. 1 (1983); see also Internationalization Study, *supra* note 1, at VII-60 to 68.

39. The Commission has approved trading linkages between three U.S. exchanges and two Canadian exchanges. See Exchange Act Release No. 23,075, 51 Fed. Reg. 11,854 (1986) (Midwest-Toronto); Exchange Act Release No. 22,442, 50 Fed. Reg. 39,201 (1985) (AMEX-Toronto); Exchange Act Release No. 21,925, 50 Fed. Reg. 14,480 (1985) (Boston-Montreal). The Commission also has approved an arrangement between the AMEX and the European Options Exchange in Amsterdam for trading fungible options. See Exchange Act Release No. 24,831, 52 Fed. Reg. 32,368 (1987), Exchange Act Release No. 24,832, 52 Fed. Reg. 32,377, (1987), as well as a quotation-sharing linkage between the NASD and the ISE. See Exchange Act Release No. 23,158, 51 Fed. Reg. 15,989 (1986); Exchange Act Release No. 24,979, 52 Fed. Reg. 37,684 (1987). See also Internationalization Study, *supra* note 1, at V-49 to 55, VII-47 to 48.

40. See *Fonseca v. Blumenthal*, 620 F.2d 322 (2d Cir. 1980); *In re Letters of Request to Examine Witnesses from the Court of Queen's Bench for Manitoba, Canada*, 488 F.2d 511 (9th Cir. 1973).

41. 15 U.S.C. § 78u (1982).

cases in which a foreign authority has indicated that it is conducting an investigation to determine whether a violation of its laws has occurred, is occurring, or is about to occur. The proposal brings into play the full range of investigative procedures and remedies at the Commission's disposal, including the issuance and enforcement of subpoenas. The proposal would also give the Commission discretion to grant or deny assistance, thus allowing the Commission to refuse assistance to an agency or self-regulatory organization of dubious authority, or in situations involving an unreasonable or ill-founded request.

Finally, securities regulation among nations is no longer the rather insular area of endeavor it once was. Rules governing market activity, at least in the secondary market, are being changed in order to conform to increasingly prevalent transnational notions of what such regulation should entail. Interestingly enough, while the United States liberalizes its market rules, recent regulatory initiatives adopted in other countries seem to be patterned on the traditional U.S. system. The free-wheeling markets abroad are being reined in with U.S. style regulation, thus harmonizing U.S. and foreign rules governing the trading markets. For example, the much heralded "deregulation" of the London market in October 1987 involved as much regulation as deregulation. Although future competition in the London market was enhanced by the unfixing of commission rates and the merging of broker and dealer activities, the United Kingdom's broker-dealers became subject to the detailed rules of the new Financial Services Act governing market activity.<sup>42</sup> France also made changes in 1987, requiring the automated reporting of quotations and transactions on the Bourse,<sup>43</sup> for the first time ensuring the French Market the benefits of real-time reporting long enjoyed by the U.S. exchange markets.<sup>44</sup> Finally, during the past five or six years, a number of countries have adopted laws prohibiting insider trading,<sup>45</sup> an activity once expressly prohibited only in the United States. In fact, the EC is considering, and is likely to adopt in the near future, a directive outlawing insider trading.<sup>46</sup> Each of the foregoing regulatory developments demonstrates an

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42. See Abrams, *The U.K. Financial Services Act 1986*, 3 REV. FIN. SERVICES REG. 101 (1987); see also *Flinging Open the Doors of Change*, EUROMONEY (Big Bang Supp.), Aug. 1986, at D2, col. 1.

43. See, e.g., Greenhouse, *France's 'Big Bang' is Next*, N.Y. Times, Oct. 12, 1987, at D1, col. 3.

44. See Simon & Colby, *The National Market System for Over-the-Counter Stocks*, 55 GEO. WASH. L. REV. 17, 23-24 (1986).

45. Insider trading has been outlawed, for example, in the United Kingdom, France, Sweden, and the Netherlands. See Rundfelt, *Insider Trading: Regulation in Europe*, 1 J. ACCT., AUDITING & FIN., Spring 1986, at 125; Grass, *Insider Trading in the U.K.*, SEC. TRADERS' MONTHLY, Jan. 1987, at 14; Fouquet, *Europe Studying Ways to Fight Insider Profiteering*, Wash. Post, Mar. 5, 1987, at E3. One chamber of the Swiss parliament has approved an insider trading prohibition, and final approval from the other chamber is anticipated soon. Haymann, *Swiss to Outlaw Insider Trading*, INT'L FIN. L. REV., Oct. 1987, at 30.

46. See Fitchew Address, *supra* note 4, at 16.

awareness not only that certain regulations enhance the perception of a marketplace's integrity and fairness, but also that the less disparate the world's regulatory systems are, the more likely a national market is to integrate itself into an efficiently functioning global marketplace.

If one of our goals is to ensure that internationalization and accompanying deregulation will not adversely affect the integrity, fairness, and soundness of our markets, we cannot lose sight of the importance of surveillance, access to information, and cooperation in enforcement efforts. Furthermore, in light of the increased interdependence of the international securities markets, the time may be ripe to give serious thought to cooperation in the area of substantive rulemaking with respect to subjects such as financial responsibility and supervision of market professionals.

The globalization of the securities markets presents new and special challenges for market participants and regulators alike. One challenge arises from the increasingly far-flung operations of securities firms, whose business previously was confined largely within national borders. It is not difficult to imagine the market dislocation that would occur if activities in a foreign subsidiary caused the bankruptcy of a Merrill Lynch or a Salomon Brothers. Although the theoretical harm might only be temporary, the total impact could be severe. In one analogous situation, illicit activity by two small, unregistered government securities broker-dealers caused the collapse of several major savings and loans associations. In another instance, similar activity by a subsidiary caused the demise of the parent firm and other firms.<sup>47</sup> The potential consequences of these problems suggest that regulators world-wide should focus their cooperative efforts on instituting international standards for financial responsibility of broker-dealers and investment bankers and for the inspection and surveillance of firms.

The potential problems that could result from the collapse of a single, albeit major, broker-dealer are relatively minor compared to the difficulties that would result if a major stock market "took a tumble." We had a preview of what could happen, on a lesser scale, in 1985 when the Singapore exchange suffered a sharp decline and went into a slide, significantly affecting its sister market in Kuala Lumpur. The financial turmoil spilled over to Hong Kong, with effects felt even in London.<sup>48</sup> Recently, experts and commentators have started to ask what would happen to U.S. markets if the Tokyo market went into a skid. If one looks at the level of Japanese investment in the United States, considers the impact that Japan's purchase or non-purchase of U.S. Treasury Bills has on U.S. interest rates, and compares movements of the

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47. For a discussion of these incidents, see REPORT BY THE SECURITIES AND EXCHANGE COMMISSION TO THE HOUSE SUBCOMM. ON TELECOMMUNICATIONS, CONSUMER PROTECTION AND FINANCE OF THE COMM. ON ENERGY AND COMMERCE 10-13 (June 20, 1985)(specific pages of the report on file in the offices of the *International Tax & Business Lawyer*).

48. See, e.g., *Suspended in Singapore*, Wall St. J., Dec. 6, 1985, at 30, col. 1.

Nikkei Index (Japan's major stock index) and the Dow Jones Industrial average, it is difficult not to conclude that the hearts of the two markets are closely linked.<sup>49</sup>

As the examples given above demonstrate, most of the problems we face in the securities, or rather the financial services, industry are of global and not merely domestic dimensions. Thus, a logical question is to what extent the dangers identified can be eliminated or limited by the coordination of regulatory initiatives at the international level. Any definitive answer to this question will require intensive study and thought, but there can be little doubt that regulation will play a significant and beneficial role in establishing and maintaining the integrity and fairness of international markets.

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49. See, e.g., *Why New York's Eyes Are Glued to the Tokyo Market*, BUS. WK., Aug. 3, 1987, at 70.