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Capital Neutrality and Coordinated Supervision: Lessons for International Securities Regulation from the Law of International Taxation and Banking

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INTRODUCTION

In international finance, the words globalization and internationalization describe the processes by which independent national financial markets become integrated into a single dominant world market. These processes are altering the assumptions upon which domestic securities laws are premised, particularly assumptions about the nature of the domestic market and the pertinence of foreign laws. One of the consequences of these processes is that market participants are able to surmount domestic regulatory restrictions with little difficulty. Globalized and internationalized markets therefore challenge securities authorities to enact regulations which are both cogent and operative. This article studies the experiences of international tax and banking law and extracts principles which may be applied when defining the appropriate relationship among United States securities laws, foreign securities laws, and a global economy.

Part I of this article provides some background on the legal forces which have influenced globalization and internationalization of the world's securities markets. Part II focuses on the international tax law principle of capital neutrality. Fundamentally, the principle of capital neutrality requires that regulations should not unintentionally direct the movement of capital. Part II analyzes the bases and parameters of the principle of capital neutrality, the experiences of international

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taxation in applying the principle to a globalizing economy, and the possibilities for applying the principle to international securities regulation.

Part III focuses on the international banking law principle of coordinated supervision. The principle of coordinated supervision is that no bank should go unsupervised, and that the supervision of banks must be adequate. Part III examines the historical impetus for coordinated supervision, the development of the principle, and its recent application to problems caused by globalization. Part III concludes with suggestions for the possible application of the principle to securities law.

I. BACKGROUND

A. Globalization and Internationalization

Securities regulators are currently examining the U.S. securities laws as they relate to the latest stage of development of international financial markets,[1] that of internationalization: the increasing participation of issuers and investors of one country in the securities markets of other countries.[2] While investment in foreign capital markets has long been practiced, the volume and frequency of international financial transactions since the 1960s is qualitatively distinct.[3]

In addition to economic, political, institutional,[4] and technological[5] forces,

1. *See* STAFF OF THE U.S. SECURITIES AND EXCHANGE COMMISSION, REPORT TO THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS AND THE HOUSE COMMITTE ON ENERGY AND COMMERCE ON THE INTERNATIONALIZATION OF THE SECURITIES MARKETS, (1987) [hereinafter SEC REPORT]. *Internationalization Report Sent to the Congress by SEC Staff*, 19 Sec. Reg. & L. Rep. (BNA) 1187 (August 7, 1987).

2. Of the many neologisms introduced in our living language, the creation of the words globalize, globalization, internationalize, and internationalization usefully describes the current changes in the political economy. The reason for creating the verbs globalize and internationalize from their root nouns is to contain in one word what would require many words to explain. Unfortunately, the words are also "vogue words", used as substitutes for any of several more precise words, and thus encapsulate many imprecise meanings as well as many concepts. FOWLER, MODERN ENGLISH USAGE at 389, 460, 684 (1983).

3. *See* Thomas, *Internationalization of Securities Markets: An Empirical Analysis*, 50 GEO. WASH. L. REV. 155 (1981).

4. Securities markets around the world are changing as foreign issuers expand their use of United States capital markets, domestic issuers access foreign markets, and both debt and equity offerings are made multinationally. Institutional changes in the market structure brought about by internationalization pose new regulatory problems for the Commission. United States distribution systems are distinct from those existing in other countries. *See* Langevoort, *Information Technology and the Structure of Securities Regulation*, 98 HARV. L. REV. 747 (1985) (describing institutional framework in the United States); Schneider, *Going Public: Practice, Procedures, and Consequences*, 27 VILL. L. REV. 1 (1981) (detailing steps in going public). Many variations of distribution techniques are found in the world's capital markets. *See* SEC REPORT, *supra* note 1, at Chapter III, Part IV (comparative analysis). The framework commonly used in Euromarket offerings is similar to that of

internationalization of the securities markets had been significantly fueled by regulatory forces.[6] The latest era in internationalization of the securities markets can be traced to the 1960s with the maturity of the Eurocurrency markets[7] and the emergence of the Eurobond markets.[8] Eurocurrency markets are markets for deposit liabilities denominated in currencies traded outside their respective economies. Eurocurrency deposits are not subject to U.S. banking regulations, and consequently they have flourished.[9] Eurobonds are bonds issued by borrowers outside of the restrictions that apply to domestic offerings.[10] Eurocurrency deposits formed a ready pool of capital to finance Eurobonds.

The Eurobond market emerged, at a time of fixed exchange rates, as a result of the Interest Equalization Tax of 1964,[11] the Voluntary Foreign Credit Restraint

the United Kingdom, though syndication structures change with new strategies and problems. *See* Grant, *Mapping a Route Through the Euromarket Chaos*, EUROMONEY, Jan. 1986, at 29. *See also* *Dual Approaches to Dual Tranches, Selling Equities to the World*, EUROMONEY & CORP. FIN. SUPP., Nov. 1986 at 25. Where simultaneous offerings are made, the incompatibility of systems of delivery (not to mention different regulatory requirements), require accommodation of the procedure of both systems. *See* Pryor, *Dual Public Offerings in the UK and the US*, INT'L FIN. L. REV., Mar. 1985, at 16.

5. Technological innovations reduce information and transaction costs, and enable the creation of new products. *See* Langevoort, *supra* note 4. *See also* TASK GROUP ON REGULATION OF FINANCIAL SERVICES, BLUEPRINT FOR REFORM (1984). [hereinafter TASK GROUP]. *See Information Technology: A Leap in the Dark?*, EUROMONEY SUPP., Aug. 1987.

6. *See* Fallon, Adams & Ollard, *The Great Deregulation Explosion*, EUROMONEY, Oct. 1984, at 55 [hereinafter Fallon]. The removal of restrictions on foreign participation by many of the world's securities markets is a primary influence.

7. The origin of the Eurocurrency markets is difficult to trace. Following World War II, European banks accommodated the Soviet Union's wishes to deposit its dollar holdings outside the U.S. HOUSE COMM. ON BANKING, FINANCE, AND URBAN AFFAIRS, 96TH CONG., 1ST SESS., THE OPERATION OF U.S. BANKS IN THE INTERNATIONAL CAPITAL MARKETS 7–8 (Comm. Print 1979). [hereinafter "Comm. Print"]. United States balance of payment deficits since the 1950s and higher interest rates abroad caused flow of the dollar overseas, providing a supply of dollars for the Eurocurrency market. *Id.* at 8. *See* Curtin, *Now It's Grown Up, It's Fierce*, EUROMONEY, June, 1984, at 64. *See also*, Sesit, *Prosperity and Peril in the Brave New Market*, Wall St.J., Sept. 29, 1986, at 40D.

8. *See* KERR, HISTORY OF THE EUROBOND MARKET (1984); Curtin, *supra* note 7.

9. U.S. banks avoided Regulation Q, 12 C.F.R. § 217 (1982), which put a ceiling on the interest rates U.S. banks could offer domestic depositors by taking deposits in their foreign affiliates. *International Bank Lending and the Securities Market*, WORLD BANK DEV. REP. 1985 (The World Bank) 114 [hereinafter DEVELOPMENT REPORT]. When, beginning in 1963, the U.S. imposed a series of exchange controls intended to limit the growth of foreign lending, the foreign branches, not subject to the ceilings, took deposits and lent on them.

10. Eurobonds are to be distinguished from foreign bonds, which are issued by foreign borrowers in a nation's capital markets and usually are denominated in that nation's currency. Salwen, *Terms of Investment for Novices in the Overseas Markets*, Wall St. J., Sept. 29, 1986, at 13D.

11. Pub. L. No. 88-563, 78 Stat. 809, (repealed 1974). The United States imposes a tax of 30% on dividends, interest, and other investment income received by foreign persons from U.S. sources. 26 U.S.C. §§ 871(a), 881 (1982). Because this tax is collected by withholding by the person making the payment to the foreign person, it is often called the withholding tax. 26 U.S.C. §§ 1441, 1442 (1982). Under the Interest Equalization Tax (IET) interest on certain debt obligations which were part of an

Program of 1965,[12] and the Credit Control Act of 1969.[13] These initiatives were designed to improve the U.S.'s balance of payments deficit by discouraging foreign and domestic issuers from raising money in the U.S., thereby reducing the outflow of capital.[14] In addition to the creation of the Eurobond market, many European capital markets were reopened or reinvigorated by U.S. demand for foreign capital.

When the U.S. allowed the value of the dollar to be determined by market forces following the collapse of the Bretton Woods system in 1971, the Interest Equalization Tax and other supporting methods were allowed to expire. Though Eurobond offerings decreased,[15] the Euromarkets played a significant role in

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issue with respect to which an election had been made for IET purposes were exempt from withholding tax. 26 U.S.C. § 861(a)(1)(G), *amended by* 26 U.S.C. § 861(a)(1)(C) (Supp. 1988); *Id.* § 4912(c) (as in effect before July 1, 1974) (repealed 1974). U.S. borrowers were able to secure an exemption from the withholding tax for foreign lenders by electing to have the U.S. obligation subject to the IET.

12. Act of Sept. 9, 1965, Pub. L. No. 89-175, 79 Stat. 672 (1965).

13. Pub. L. No. 91-151, 83 Stat. 376, (authority under the Act terminated 1982).

14. The securities laws also encouraged capital outflow. *See* Securities Acts Amendments of 1964, Pub. L. No. 88-467, 78 Stat. 564, (1964)(codified in scattered sections of 15 U.S.C. §§ 77, 78) (authorizing Commission to exempt securities of foreign issuers). *See also* Summary of the Securities Acts Amendments of 1964, Securities Act Release No. 4725, [1964–1966 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,127 (Sept. 15, 1964) (also released as Release No. 34-7425) (summarizing changes of the 1964 Act); Registration of Foreign Offerings by Domestic Issuers, Securities Act Release No. 4708, [1 Topical Index] Fed. Sec. L. Rep. (CCH) ¶¶ 1361–63 (July 9, 1964) (describing efforts to encourage foreign offerings) [hereinafter SEC Release No. 4708].

15. Previously U.S. companies were encouraged to borrow overseas by a change in the ruling policy of the IRS which encouraged foreign borrowing through finance subsidiaries, outlining standards which, if met, would assure that no withholding tax would apply to foreign borrowing. The IRS issued rulings recognizing certain entities and not applying withholding tax. Rev. Rul. 73-110, 1973-1 C.B. 454; Rev. Rul. 72-416, 1972-2 C.B. 591; Rev. Rul. 70-645, 1970-2 C.B. 273; Rev. Rul. 69-501, 1969-2 C.B. 233; Rev. Rul. 69-377, 1969-2 C.B. 231. These rulings were revoked, however, upon the expiration of the Interest Equalization Tax, Rev. Rul. 74-464, 1974-2, C.B. 46., causing considerable uncertainty in the availability of exemption from withholding and decrease in Eurobond offerings tax. Almost immediately, legislative proposals were offered which would have repealed the withholding tax on portfolio investments. *See* STAFF OF THE JOINT COMMITTEE ON TAXATION, 93D CONG., 2D SEES., U.S. TAXATION OF FOREIGN SOURCE INCOME OF INDIVIDUALS AND CORPORATIONS AND THE DOMESTIC INTERNATIONAL SALES CORPORATION PROVISIONS 7 (Comm. Print 1975).

It was argued that an exemption for bank deposits held by foreigners should be retained since amounts on deposits in bank accounts could very easily be transferred out of the U.S. into foreign bank accounts. This argument recognized the fungibility of money and the ease with which financial transactions can be diverted.

A further argument advanced in 1974 for exemption of interest and dividends was that it would encourage other recycling of OPEC dollars. Most oil dollars were owned by foreign governments, which could invest in the United States without paying tax under then existing law. A consideration for world stability is that the OPEC capital flows were widely disbursed among markets in the oil importing nations. The balanced pattern of the OPEC investments prevented any financial crises which could have resulted if the funds were not widely and broadly invested. This offers another recycling of petrodollars to assist the oil importing developing countries balance of payments.[16]

Significantly, though the Unites States financial regulations of the depression era of the 1930s remained as legal barriers to financial liberalization, the ease of access to the unregulated Euromarkets allowed *de facto* deregulation.[17] For example U.S. commercial banks, prohibited in the U.S. by the Glass–Steagall Act[18] from engaging in investment banking, could operate free from this restriction in the Euromarkets. The existence and success of the Euromarkets, therefore, has been a major catalyst of the deregulation of U.S. banking[19] and securities[20] laws.

The sovereign debt crisis of 1982 brought an end to the petrodollar recycling era and introduced securitization and globalization to financial flows.[21] The Euronote began to replace the syndicated loan as the chief vehicle of Euromarket short term finance, as investors shifted their funds away from interbank deposits and into securities issued by top quality corporate and government issuers.[22] The innovation of the Euromarkets in securitizing bank assets[23] and in designing

argument for nonpreferential treatment. *See* I.R.C. § 892; Rev. Rul. 75-298, 1975-2 C.B. 290 (broadening exemption for foreign governments). These arguments were ultimately unpersuasive to the Congress which merely made permanent the exemption on interest of foreign bank accounts.

16. Koenig, *Into the Maelstrom*, EUROMONEY, June 1987, at 67, 68. Curtin, *supra* note 7, at 66.

17. The fissure of the tax barriers to access to the Euromarkets by U.S. firms was the Netherlands Antilles Treaty. The U.S.-Netherlands Income Tax Convention, Apr. 29, 1948, United States-Netherlands, 62 Stat. 1757, T.I.A.S. No 1855, *modified and supplemented by* Protocol Respecting Double Taxation, June 15, 1955, United States-Netherlands, 6 U.S.T. 3696, T.I.A.S. No. 3366 and Protocol Respecting Double Taxation, Oct. 23, 1963, United States -Netherlands, 15 U.S.T. 1900, T.I.A.S. No 5665 (recently terminated). Article VIII of that treaty could be applied to claim exemption from U.S. withholding tax on the interest payments by the U.S. parent and affiliates of the Antilles finance subsidiary. U.S companies could establish financing subsidiaries which would receive favorable tax treatment on debt issued abroad. The debt could be issued without registration with the Commission under Release No. 4708, *supra* note 14.

18. 12 U.S. C. §§ 24, 378 (Supp. 1988).

19. Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. 96-221, 94 Stat. 132 (1980) (codified as amended at scattered sections of 12 and 15 U.S.C.(Supp. 1988)). The Act was designed to reduce regulation of U.S. financial institutions. *See* Clarke, *Regulations Handicap U.S. Banks in Global Market*, AM. BANKER, Nov. 13, 1986, at 4; Forrestal, *How Much Regulation Is Necessary for a Sound Financial System?*, AM. BANKER, Feb. 10, 1987, at 4; Corrigan, *Corrigan's Proposal to Reshape the Financial Services Industry*, AM. BANKER, Feb. 2, 1987, at 10.

Under existing regulations at least some regulation is necessary. Because deposits of many institutions are insured or protected by the government, regulations must be imposed by the government to prevent high risk activities that a truely free market would not support.

20. Securities Act Amendments of 1975, Pub. L. 94-29, 89 Stat. 97 (1975) (codified at scattered sections of 15 U.S.C. §§ 77, 78, 80).

21. Koenig, *supra* note 16, at 68. *See also From the Flames, A New Market*, EUROMONEY, Sept. 1987, at 71–72.

22. Shirreff, *The Euronote Explosion*, EUROMONEY, Dec. 1984, at 31.

23. *See* Logan, *The Securitization of U.S. Bank Activities in the Eurodollar Market*, 11 N.C.J. INT'L L. & COMM. REG. 539 (1986).

financing vehicles to suit issuers[24] assured the continued existence of the Euromarkets.

The U.S. regulatory changes significantly influenced changes in other countries. Throughout the 1980s many other financial centers have restructured their financial laws.[25] The simultaneous liberalization throughout the world of markets and institutions is resulting in the coalescing of the major capital markets of the world into one global market.[26] This process is known as globalization. No longer is the market measured by national boundaries.[27] The growth since 1983 of an international marketplace for equity financing (Euroequities) decisively marks the emergence of a truly global capital market.[28]

The political climate of the 1980s is in part responsible for the flourishing of globalization. It is possible that as the political climate changes protectionism might generate unpredictable countertides to globalization, inhibiting the free flow of capital across national boundaries.[29] One of the challenges of regulators is to resist protectionist pressures which could negatively impact the world economy.[30]

B. Regulatory Strategies in a Global Economy

Globalization and internationalization have important implications for national legal systems. The laws and policies of nations intersect in areas of international economic activity. Thus, as internationalization has progressed, nations in-

24. *The Eurobond Market: A Cradle of Creativity*, EUROMONEY SUPP., Jan. 1986.

25. Japan eliminated exchange controls, as did the U.K. Deregulation of commission rates in the U.S. (and the resultant reduction in transaction costs) exerted pressure on other markets directly, from enhanced competition, and indirectly, from examples of salutary results. *See* Fallon, *supra* note 6, at 57–59.

26. *Id.* at 55. *The One World Capital Market, The Euromoney Financing Guide*, EUROMONEY, Oct. 1984, at 106. Cohen, *Toward an International Securities Market*, in 10 INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION 2 (H. Bloomenthal ed. 1986 rev.). U.S. tax laws remain a partial obstacle to complete integration. *See* Newburg, *U.S. Companies and International Law*, 20 INT'L LAW. 765 (1986).

27. It is becoming increasingly clear that economic dynamics have decisively shifted from the national economy to the world economy. Prevailing economic theory considers national economies to be virtually autonomous from the world economy, and uses the national economy as the unit of both economic analysis and economic policy. One observer has attributed the economic success of Japan and West Germany to the priority their policymaking gives to the world economy rather than the national economy. Drucker, *The Changed World Economy*, 64 FOREIGN AFF. 768, 791 (1986) (also noting that government policies succeed when they try to harmonize capital movements with movements of goods and services).

28. *See generally Selling Equities to the World*, EUROMONEY & CORP. FIN. SUPP., Nov. 1986.

29. Koenig, *supra* note 16, at 67, 79. *See* Debs, *Globalization of Financial Markets: "What Is Happening and Why"*, 15 INT'L BUS. LAW. 198 (May 1987) (Trend is regulation, deregulation, self-regulation, re-regulation.).

30. Farnsworth, *Global Crunch: Can Nations Set Aside Their Parochialism in Time?*, N.Y. Times, Nov. 1, 1987, § 4, at 1.

creasingly have been confronted with the circumstance where two nations concurrently assert jurisdiction to regulate a single series of transactions but seek to apply differing and mutually inconsistent regulatory policies. The evolving concepts of jurisdiction[31] and limiting principles[32] have been shaped by internationalization.

Globalization also requires the evaluation of the current structure of securities regulation,[33] and suggests that the new realities should be addressed. Although the U.S. system of securities regulation currently is oriented toward a national market for securities,[34] economic dynamics appear to have shifted decisively

31. An early example of the relation of United States laws in a globalizing economy is the evolution of the effects doctrine. Early formulations of jurisdiction were strictly territorial. *See* The Schooner Exchange v. M'Faddon, 11 U.S. 478, 481, 7 Cranch 116, 136 (1812). In the post World War II era, as United States economic dominance emerged, the courts formulated the effects doctrine of extraterritorial jurisdiction, which extends United States jurisdiction to acts or conduct with effects in the United States, even though that conduct occurs outside the United States. *See* United States v. ALCOA, 148 F.2d 416 (2d Cir. 1945); Laker Airways v. Sabena, Belgian World Airways, 731 F.2d 909 (D.C. Cir. 1984).

32. Such as forum non conveniens. *See* Stewart, *Forum Non Conveniens: A Doctrine in Search of a Role*, 74 CALIF. L. REV. 1259 (1986).

33. *See* SEC REPORT, *supra* note 1. *See also* McLaughlin, *1933 Act's Registration Provisions: Is Time Ripe for Repealing Them?*, NAT'L L. J., Aug. 18, 1986, at 44 ("the developing internationalization of the securities markets has created tension between the regulation domestic market and the "unregulated" Eurodollar market").

34. One outmoded assumption is that the unit of regulation is a national versus a global market. Another assumption is the position of the United States as a capital importer or exporter. The experience of taxation suggests that the economic position of the United States must be considered. The United States currently faces a pressing external debt. Capital inflows should not be burdened by unnecessary regulation. The United States' repeal of the withholding tax on portfolio interest is a recognition of economic reality. The Commission's proposal of a more precisely and narrowly defined territorial approach may be understood as a correlative effort to facilitate access to international capital markets by United States issuers. Likewise, the Commission's difficulty in formulating an approach to facilitating access to United States capital markets by foreign issuers is analogous to the tax law's absence of encouraging foreign investment in a manner comparable to the repeal of withholding.

The economic position of the United States has had a significant impact on the contours of United States tax law in the past. In the late 1950s, the highly adverse U.S. balance of payments led to considerable pressure for revised international tax policy. *See generally* Note, *The U.S. As a Debtor Nation*, 23 STAN J. INT'L L. 1 (1987). The particular economic circumstances facing the Kennedy Administration gave the 1961 proposals their shape. The Kennedy Administration proposals were centered on the elimination of deferral for U.S. controlled foreign corporations (except for less developed country corporations). Not only did the 1962 Act make basic legislative changes, but its legislative history established the charter for administrative work that set the agenda for the Treasury Department for several years.

Economic circumstances again influenced the proposals for the revision of the tax treatment of foreign persons, principally with respect to U.S. source income, and resulted in the Foreign Investors Tax Act of 1966.

In that Act, Congress provided that the special treatment accorded to U.S. bank deposits of foreign persons should be terminated because there was no reason to treat the interest income on these from the national economy to the global economy.[35] To a great extent, changes in world markets already have outpaced the existing regulatory strategies, creating a distinctive set of problems to which the legal systems of the world must respond by employing new regulatory strategies.[36]

Regulatory solutions are made difficult by the nature of international capital flows. The volume of trading of financial instruments and the speed at which information is transmitted can undermine regulatory efforts. Unilateral attempts to restrict business result only in business being diverted.[37] For example, interest rate and currency swaps effectively arbitrage away currency restrictions and interest rate differentials between capital markets, loosening the control of central banks over domestic financial systems.[38] In fact, swaps actually exploit different regulatory and market conditions.[39] A recent proposal to impose a securities transfer tax was abandoned largely because the facility with which the identical transaction could be executed on a foreign exchange free from the tax.[40]

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deposits as not being from U.S. sources and thereby allowing the interest to escape U.S. taxation. At the same time, however, it was believed that an immediate elimination of the special rules for the treatment of these bank deposits might have a substantial adverse effect on the U.S. balance of payments. Consequently, congress decided to postpone the elimination of the special rules until the end of 1972. At the scheduled expiration, the U.S. balance of payments deficit continued. Congress decided to further postpone the removal of the special treatment provided for U.S. bank deposits of foreign persons until the end of 1975. Fears of massive withdrawals of foreign capital from U.S. banks prompted a permanent extention of this special treatment of interest paid foreigners. H.R. REP. No. 413, 91st Cong., 1st Sess., pt. 1 at 130 (1969).

35. Drucker, *supra* note 27.

36. For example since 1980, the Treasury Department has attempted to renegotiate the U.S. tax treaty with the Netherlands Antilles to prevent U.S. and foreign investors from abusing the current treaty and bank secrecy laws in the Netherlands Antilles. Similar negotiations with the British Virgin Islands concluded unsuccessfully in 1982, and Treasury subsequently terminated the BVI Treaty. Fearing that the termination of the Netherlands Antilles treaty was imminent, the U.S. borrowers confronted Congress with a major policy choice which reflected how it would respond to the existence of the unregulated Euromarkets. Congress accepted the arguments rejected earlier and decided to eliminate withholding tax on portfolio interest. Treasury later partially terminated the treaty. *See* Rosen, *Treasury's Blunder in Paradise*, N.Y. Times, Oct. 4, 1987 § 2, at 1. The great pressures involved illustrate the limits of power of regulators in a global economy.

37. Another example of unilateral action recently which has failed to become established is the SEC's "waiver by conduct" proposal. *See* Request for Comments Concerning a Concept to Improve the Commission's Ability to Investigate and Prosecute Persons Who Purchase or Sell Securities in the U.S. Markets from Other Countries, Exchange Act Release No. 21186, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,648 (July 30, 1984) ("waiver by conduct" concept). *See also* Fedders, *Interdependence & Cooperation: The SEC's "Waiver by Conduct" Concept Release*, INT'L FIN. L. REV., Sept. 1984, at 10.

38. Fallon, *supra* note 6, at 57. *See generally* Henderson, *An Analysis of Interest Rate and Currency Swaps*, 11 N.C.J. INT'L L. & COMM. REG. 497 (1986).

39. Ford, *Global Banking, Financial Integration Major Conference Themes*, FED. RESERVE BANK OF CHICAGO ECON. PERSP., Jul–Aug 1987, at 26. *See generally Swaps — New Moves*, EUROMONEY SUPP., July 1987; *The International Options Market*, EUROMONEY SUPP., June 1986.

40. Proposed recently by Representative Jim Wright.

Another aspect of the regulatory problems associated with globalization is that regulatory developments in one country affect regulatory developments in another country. For example, the elimination in 1984 by the U.S. of withholding tax on certain foreign investments led immediately to the abolition of the equivalent West Germany and Japanese withholding tax.[41] Nations whose regulations are out of step face losing the business. Thus there has been a competitive bid-down of regulations among nations to retain or attract the financing business.[42]

At a more fundamental level, the challenge that confronts regulators in response to further growth and integration of international securities markets is to develop a global regulatory framework that preserves the efficiencies associated with international capital mobility.[43] It widely recognized that financial markets play a critical role in the economic development of capitalist societies.[44] Inefficiencies in capital markets slow this development. As international finance has become a prominent part of national financial markets, pressure has increased on nations to reduce barriers to international capital movements.

Any regulatory strategy must recognize the existence of the global marketplace, and the constraints this places on regulatory strategies. The futility of unilateral regulatory efforts coupled with a progressive zeroing out of financial regulation is a strong impetus to harmonize national regulations.[45] Though the laws governing the securities markets of various countries are diverse in terms of nature, purpose, and degree of protection, harmonization of securities laws is in the common interest of nations. Recognition of the new problems confronting regulators in a global market offers the U.S. an opportunity to continue exercising leadership in international finance.[46]

41. *See* Fallon, *supra* note 6, at 59.

42. The dramatic swing in U.S. policy which has led to the repealing of withholding on Euromarket instruments is evidence of such a bid-down. A central justification for ending the tax is that the thereby forgone tax would be collected at the source of income by the foreign taxing entity. However, since a prominent feature of the Euromarket is investor anonynimity it is arguable that the tax is never collected at the source. If true, this evidence suggests national tax systems may be becoming zeroed out by international business. U.S. efforts to restrict the use of bearer shares are intended to recapture some regulatory control.

43. *See* Casey, *Internationalization of Capital Markets*, 1 SEC. REG. L.J. 252 (1973). In a rapidly changing environment, a retreat by regulators to oversimplicity or overreaction leads to instability.

44. *See* Clark, *The Four Stages of Capitalism: Reflections on Investment Management Treatises*, 94 HARV. L. REV. 561 (1981).

45. Historically, the United States has championed efforts to harmonize world tax systems. *See* Abbin, Gordon & Renfroe, *International Implications of a Cash Flow Consumption Tax*, 28 TAX NOTES 1127, 1129 (1985).

46. The important leadership role the United States plays in international policy includes initiating concepts such as the foreign tax credit (subpart F), anti-avoidance legislation, and the legislation designed to accomplish non-tax political goals such as anti-boycott rules and foreign corrupt practice rules. The most recent example of U.S. leadership is with respect to the elimination of the 30% withholding tax on portfolio interest. Though on balance the United States judgment has been sound, it has been marked to an extent by a certain provincialism.

C. Principles of Taxation and Banking

A system of securities regulation fundamentally requires the acceptance of certain economic theories and political choices. Though many issues in international securities regulation are newly emerging, certain of these issues bear resemblence to issues in the fields of international taxation and international banking—issues which have been addressed by the policies of capital neutrality and coordinated supervision. Because the common denominator of securities, tax, and banking regulation is that they direct international capital flows, the experiences of international taxation and banking may provide useful insights to the problems (and their resolutions) facing international securities regulation.

1. Capital Neutrality

The U.S. frequently has confronted the question of how its tax laws relate to those of other nations.[47] Since the beginning of the corporate income tax in 1909[48] and the general income tax in 1913,[49] the U.S. expansively has applied its taxes to world commerce. The U.S. has asserted tax jurisdiction over the worldwide income of U.S. citizens, residents, and domestic corporations, regardless of the source of that income. The U.S. has also taxed income of both U.S. and foreign taxpayers on U.S. source income[50] and certain foreign source income effectively connected with the U.S.[51]

If applied to the full extent, U.S. assertions of jurisdiction over non-U.S. source income could impede international capital flows by imposing double taxation. When the income producing activities of a U.S. citizen are conducted abroad, U.S. jurisdiction overlaps with the jurisdiction of the source country, and the income of the U.S. citizen can be taxed twice: once in the country in which it is earned and once in the home country, the U.S.[52] If neither jurisdiction yields, double taxation ensues.

Unrestrained or unguided taxation reduces worldwide welfare by channeling capital investments not in the direction of productivity but in avoidance of taxation. To maximize global welfare, the U.S. tax system employs a refined regulatory strategy based on the goal of capital-export neutrality and, to a lesser

47. The United States has exhibited both flexibility and rigidity in deciding to accommodate the U.S. tax system to other systems. For example, in 1966, the United States agreed to a partial abandonment of the "force of attraction" concept. On the other hand, certain United States initiatives, such as subpart F, and the repeal of withholding of portfolio interest have been embraced by other nations. Policy decisions however, are inconclusive because of the continually changing environment. Ross, *A Perspective on International Tax Policy*, 26 TAX NOTES 701, 702 (1985).

48. Tariff of 1909, Pub. L. No. 61-5, § 38, 36 Stat. 112 (1909).

49. Tariff of 1913, Pub. L. No. 63–16, §§ II(A)(1), II(G)(a), 38 Stat. 114, 116, 172 (1913).

50. Thus the differentiation of foreign source income from domestic source income is fundamental to the United States system of taxation.

51. Passive income earned from United States sources by foreign taxpayers is often reduced or eliminated by treaty.

52. In such circumstances, source-based jurisdiction is generally given primacy. Gann, *The Concept of an Independent Treaty Foreign Tax Credit*, 38 TAX L. REV. 1, 44 (1982).

extent, capital-import neutrality. Capital-export neutrality requires that the decision of a prospective U.S. investor to operate in the U.S. or abroad not be influenced by domestic tax law. Capital-import neutrality requires that foreign businesses operating the U.S. be taxed in the same manner as similarly situated U.S. businesses operating in the U.S. The concepts embody both equitable and efficiency principles which may be useful in measuring securities laws reforms.

The two most widely followed policies used to eliminate double taxation are the foreign-tax-credit method and the territorial method. Under the foreign-tax-credit method, a country seeks capital-export neutrality by including the worldwide income of its residents in its tax base, but allowing them credit for foreign taxes paid against the tax it would otherwise impose on their foreign source income. Under the territorial method a country seeks capital-import neutrality by exempting the foreign source income of its residents from its own tax base, so that enterprises operating in that host country are subject to the same total tax whether their residence is local or foreign.[53] The former approach was chosen in 1918 by the U.S. [54]

The U.S.'s securities laws are less integrated with other nations' laws than its tax laws. The Securities and Exchange Commission ("Commission") has not firmly resolved how its disclosure standards relate to those of other countries. One reason is that the rapid globalization of international capital markets confounds traditional understanding of the institutional framework within which international investments are made.[55] A second reason is that two conflicting principles apply to the analysis of the problem of determining appropriate disclosure standards. One principle common to U.S. policy toward foreign investment is that of neutrality. A second principle is that the Commission's rulemaking must advance the protection of investors and the public interest.[56] The interrelation of these two principles is at the center of the debate.[57]

Seeking neutrality avoids laws that unduly advantage foreign issuers over domestic issuers,[58] and promotes efficiency of capital markets.[59] One view of

53. A few highly industrialized countries (Belgium, France, and the Netherlands) exempt some foreign source income from taxation. None of the world's highly industrialized countries exempts all foreign source income from tax, so none has a pure territorial system.

54. Revenue Act of 1918, ch. 18, § 222(a), 40 Stat. 1057. *See* Isenbergh, *The Foreign Tax Credit: Royalties, Subsidies, and Creditable Taxes*, 39 TAX L. REV. 227, 229 (1984).

55. Drucker, *supra* note 27, at 768 ("it may be a long time before economic theories accept that there have been fundamental changes, and longer still before they adapt their theories to account for them.").

56. Securities Act §§ 7, 10, 15 U.S.C. §§77g, 77j (1981). *See also* Integrated Disclosure System for Foreign Private Issuers, Securities Act Release No. 6360, [1981–1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,054 (Nov. 20, 1981) (also released as Release Nos. 34-18,274 and 39-677) [hereinafter SEC Release No. 6360].

57. Spencer, *The U.S. Sees Problems*, INT'L FIN. L. REV. 9 (May 1985).

58. SEC REPORT, *supra* note 1, at III-311.

59. It has also contributed to the dominance of the United States market. Koenig, *supra* note 16, at 68.

neutrality is that foreign enterprises issuing securities in the U.S. should be subject of the same disclosure requirements as domestic issuers. This view of neutrality complements the idea that U.S. investors need the same type of information whether the issuer is domestic or foreign.

A second view of neutrality is the U.S. investors should have the same opportunities to invest overseas as investors of other countries. This view of neutrality complements the idea that the investing public is best served by being permitted to invest directly in a variety of securities.[60] To an extent, the two views of neutrality and public interest are mutually inconsistent. The Commission has yet to decide which should prevail.[61]

2. Coordinated Supervision

In the U.S., as in most countries, banks hold the largest portion of private financial assets, and have important roles in the payments system and in the implementation of monetary policy.[62] The integrity and soundness of the U.S. banking system, therefore, is of great national importance.[63] Because the world's financial markets are highly interconnected, the failure of one financial institution can rapidly impair the viability of numerous unrelated institutions throughout the world.[64] Thus the existence of an unregulated global market poses a direct threat to the U.S. banking system.

The response of banking regulators has been an international regulatory strategy which rests on two principles which derive from the common necessity of nations to supervise financial institutions. One is that no institution should go unsupervised. The other is that the supervision of institutions should be adequate. From this international regulatory strategy, known as coordinated supervision, a consensus is being reached on more specific issues.[65] The concept underlying coordinated supervision may have applications to international securities regulation.

The Commission is currently considering a regulatory response to interna-

60. Currently U.S. members may purchase foreign issues in foreign markets (that may offer less protection to investors than those provided in U.S. markets). In the Commission's view, permitting a number of foreign securities to be traded on U.S. regulated exchange markets may increase protection for U.S. investors. *See* SEC REPORT *supra* note 1, at V-77, n.157. *See also* SEC Release No. 6360, *supra* note 56; Spencer, *supra* note 57, at 9.

61. Spencer, *supra* note 57, at 9. Political forces also influence the choice of standards. Economic nationalism is antithetical to internationalization. Koenig, *supra* note 16, at 72. Reciprocity is discussed in this context. Though it has been a longstanding policy of the United States to ignore the national origins of financial firms in U.S. markets, (sometimes called "national treatment") economic nationalism supplements this policy by imposing the precondition to U.S. national treatment access by U.S. firms to foreign markets. *Id.* at 77–79.

62. TASK GROUP, *supra* note 5, at 35.

63. *Id.*

64. *Id.* at 34. *See also* Fingleton, *Will the System Tumble?*, EUROMONEY 111 (September 1986).

65. *See* Capital Maintenance; Revision to Capital Adequacy Guidelines, 52 Fed. Reg. 5119 (1987) (to be codified at 12 C.F.R. part 225) (proposed Feb. 12, 1987); Extension of Time to Comment, 52 Fed. Reg. 18,703 (1987).

tionalization of the securities markets. Two approaches have been suggested: common prospectus or reciprocal prospectus. Uniform standards have had a difficult history in securities regulation; noteworthy are the failures of the Uniform Securities Code and blue-sky law harmonization. The consensus is that reciprocal prospectus approach is best. Its implementation has begun. If the experience of international banking is a guide, this cooperation among supervisory authorities may lead to agreed upon disclosure standards.

II. International Taxation: Capital Neutrality, the Relationship between American and Foreign Laws, and Tax Policy and the International Capital Markets

A. *Principles of Capital Export and Import Neutrality.*

Though the primary end of taxation is to raise revenue, the means of raising revenue are traditionally measured against standards of equity and efficiency.[66] Some inefficiency is inherent in virtually all taxes,[67] so the efficiency criteria require the tax system to produce as little as unintended distortion in the economy as possible.[68] In theory, global welfare is maximized when investors are free to obtain the greatest possible return on their investments. An efficient tax system, from a worldwide point of view, does not interfere with the employment of capital where the before-tax return is the greatest. When a tax system does not interfere with or direct in any manner capital investment, it is said to be capital neutral.

66. The equity criteria requires that the revenue which is raised by the tax system be collected in a manner which is as fair as possible. Both vertical and horizontal measurements must be considered. Vertical equity involves the comparison of ability to pay for taxpayers with different amounts of resources. Horizontal equity requires that taxpayers with equal ability to pay taxes should pay equal amounts of tax and, correspondingly, in comparing any two taxpayers with different levels of ability to pay, the taxpayer with the greater ability to pay should pay more tax than the other. *CRS Publishes overview of Foreign-Source Income Tax Issues*, 20 Tax Notes 475, 480 (1983). Another goal is simplicity: making the tax system as simple to administer and understand as possible. In addition, certain provisions of the tax system have been enacted to encourage specific activities which Congress has felt should be promoted.

67. All forms of taxation are a departure from a perfectly efficient economic system for tax law causes some taxpayers to alter their investment and financing decisions. These distortions in behavior divert the flow of capital from the most productive investments, those investments offering the highest pre-tax rate of return to those offering the highest post-tax return. This allocation of resources in a free market economy, under certain conditions, ensures that available economic resources are arrayed in such a way as to produce the highest possible amount of consumer satisfaction. *Id.* at 480. Thus the benchmark of economic efficiency is the flow of capital which would occur in the absence of taxes. As a benchmark for economic efficiency in the securities context, the flow of capital absent securities regulation may serve as a valid bench mark. Such an environment exists in today's Euromarkets.

68. Virtually any tax which meets accepted equity criteria creates some interference with economic incentives. In order to have no such effect, a tax would have to be determined on the basis of some characteristic over which an individual has no control.

Tax systems are examined for capital neutrality (hence efficiency) from two points of view: neutrality in the export of capital and neutrality in the import of capital.[69] Export of capital from a country occurs when an investor (a capital supplier) from that country invests capital in another country. A tax system is capital export neutral if it does not influence the investor's decision of whether to invest in his home country or in another country. A tax system is capital-import neutral if it does not influence the borrower's decision of whether to borrow from a home country capital supplier or from a capital supplier from another country.

The principle of capital-export neutrality is applied as follows: if the foreign operations of a U.S. enterprise are conducted in a country that imposes the same effective tax rate as the U.S., the U.S., to achieve capital-export neutrality, would impose no tax on that foreign source income. The U.S. enterprise is therefore indifferent from a taxation standpoint whether the enterprise operates in the U.S. or abroad, as its tax burden is the same in either country. Similarly, if the foreign operations are in a country with a lower tax rate than the U.S., the U.S. would impose a tax at a rate equal to the difference between its rate and the source country's rate. If the foreign operations are in a country with a higher tax rate, then credit is provided for foreign taxes paid in excess of the U.S. rate.[70]

The principle of capital-import neutrality is applied as follows: The U.S. would impose no tax on foreign source income earned by any enterprise (U.S. or otherwise) regardless of whether foreign countries impose the same effective tax rate as the U.S., a higher tax rate, or a lower tax rate. By so doing, foreign businesses operating in the U.S. are taxed in the same manner as similarly situated U.S. businesses operating the U.S. For example, if the U.S. tax laws were capital-import neutral, a foreign lender lending to a U.S. borrower is taxed by the U.S. at the same rate as a U.S. lender lending to that same U.S. borrower. Viewed from a different perspective, U.S. tax laws would not influence a prospective U.S. borrower's decision of whether to borrow from a U.S. or a foreign lender.

Capital-export and -import neutrality are unilateral measures (adopted by one country without necessity for coordination with others) to improve economic efficiency; however, the tax systems of other countries influence the success of

69. Ross, *supra* note 47, at 702. Though the concept of capital export neutrality is primarily a theoretical concept, Ross believes that international U.S. tax policy generally reflects a balance between theory and reality. *Id.* at 702–703.

70. Most highly industrialized countries, and most major trading partners of the United States (including Canada, West Germany, Japan and the United Kingdom), tax worldwide income and allow a foreign tax credit, generally like the U.S., to avoid international double taxation.

71. One effect of this arrangement is the possibility that the credit invites foreign countries to raise their income taxes on United States firms to United States levels, as the additional tax would be borne by the U.S. Treasury, not the corporation, which receives a credit. Conversely, the credit frustrates incentives in the countries. Isenbergh, *supra* note 54, at 290–291. When the source jurisdiction tax rate is lower than the United States, jurisdiction based on citizenship neutralizes attempts by foreign

this policy.[71] For example, if one country's tax system is capital-export neutral, and another country adopts a tax system that is capital-import favorable (it favors foreign investment over domestic investment), that policy of the second country would create an incentive in the first country to export capital to the second country. In order to maximize global welfare, therefore, all the world's individual tax systems must be both capital-export and -import neutral (with equal rates), or must otherwise in concert produce what has been called "inter-nations" neutrality.[72] Inter-nations neutrality exists when the combined effect of taxation in the capital exporting country and taxation in the capital importing country do not favor investment in one of the two countries or in a third country.

These principles may be applied to U.S. regulation of international securities transactions, for economic efficiency is an implicit goal of our system of securities regulation. Federal disclosure standards are predicated on full disclosure rather, than on "fair, just, and equitable" standards, and are designed to promote informed investment decisions.[73] Underlying many policy decisions of the Commission is the recognition that the interests of the marketplace are best served by efficiency and the elimination of unnecessary regulatory barriers. One of the challenges of the Commission in internationalizing markets is to assure that U.S. capital markets are afforded the protection intended by Congress in the Securities Act and the Exchange Act while developing policies that are economically sound.[74]

countries to attract investment from the United States, because United States investments are taxed at the same high United States rate. The benefits of another country lowering its rates goes to the United States treasury, not to the United States companies. Thus our policy results to an extent in capital import adverseness in the foreign country.

When the source jurisdiction tax rate is higher than the United States rate, the difficulty is caused by the other jurisdiction. To maintain capital export neutrality, the United States must either subsidize the United States corporation through the credit mechanism or persuade the foreign country to lower its high taxes on income flowing to the United States in return for the United States lowering tax on income of the foreign country's citizens. *See generally* Gann, *The Cocept of an Independent Treaty Foreign Tax Credit*, 38 TAX L. REV. 1 (1982).

72. 69a CASHIERS DE DROIT FISCAL INTERNATIONAL, 102 (1984). Rate differences alone may nevertheless be components of a neutral system so long the cumulative effect of tax rates other factors relating to taxation (such as the benefits derived from use of a country's facilities which resulted from taxation) do not affect investment more favorably in one country.

73. *See Hearings Before the Senate Comm. on Banking and Currency on S. 875*, 73d Cong., 1st Sess. 89-90 (1933) [hereinafter *Hearings on S. 875*]; *Hearings Before the House Comm. on Interstate and Foreign Commerce on H.R. 4314*, 73d Cong., 1st Sess. 12-13 (1933) [hereinafter *Hearings on H.R. 4314*]. *See* Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 37 (1959). *See also* Anderson, *The Disclosure Process and Federal Securities Regulations: A Brief Review*, 25 HASTINGS L.J. 311 (1974); Seligman, *The Historical Need for a Mandatory Corporate Disclosure System*, 9 J. CORP. L. 1, 45–46 (1983); Langevoort, *supra* note 4, at 764.

74. *See* SEC REPORT, *supra* note 1, at III-311 (SEC objectives include facilitating direct access to United States capital markets by foreign issues and removing unnecessary impediments to transnational capital formation.).

B. Implementing Capital-Export Neutrality

U.S. securities regulations would adhere to the principle of capital-export neutrality if the disclosure requirements of foreign issuers issuing securities in the U.S. were equivalent to the the disclosure requirements of U.S. issuers. This is distinct from requiring that the same specific items of disclosure be required from foreign issuers as from U.S. issuers. What is required is that U.S. disclosure standards not influence a U.S. investor's decision of whether to invest in securities of a U.S. issuer or in securities of a foreign issuer.

The disclosure requirements applicable to primary offerings of securities in the U.S. largely satisfy the principle of capital-export neutrality. This occurrence is not the result of an express adherence to the principle of capital-export neutrality; rather, it is the product of a particular interpretation of the securities laws' mandate of investor protection.[75] That mandate is interpreted to require that U.S. investors receive disclosure of certain information regardless of the nationality of the issuer.[76] As a result of this policy, disclosure requirements for foreign private issuers[77] are essentially the same as the requirements for domestic issuers, thereby paralleling the principle of capital-export neutrality.[78]

The legislative history of the Securities Act evidences an intent to treat foreign private issuers the same as domestic issuers.[79] In implementing this directive, however, the Commission has recognized the possibility that imposing equivalent disclosure standards might discourage offerings of securities in the U.S. To allow U.S. investors the opportunity to invest in foreign securities, as early as 1964, the Commission reduced the degree of regulation and amount of disclosure required

75. Rules, Registration, and Annual Report Form for Foreign Private Issuers, Exchage Act Release No. 16,371, [1979–1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,363 (Nov. 29, 1979) [hereinafter "SEC Release No. 16,371]. *See* SEC REPORT, *supra* note 1, at III-322.

76. SEC Release No. 16,371, *supra* note 75.

77. Disclosure requirements distinguish domestic issuers from North American issuers, foreign government issuers, and foreign private issuers. The Commission's rules generally subject North American issuers to registration and reporting requirements applicable to domestic issuers. The primary exception is under §§ 12(a), 13(a) of the Exchange Act, 15 U.S.C. §§ 77*l*(a), 77m(a) (1981) under which North American issuers are treated similarly to foreign private issuers. Foreign government is defined as the government of any foreign country or of any political subdivision of a foreign country. 17 C.F.R. § 230.405 (1986); 17 C.F.R. § 240.3b-4(1986). For an excellent article on the securities of foreign governments see Greene & Adee, *The Securities of Foreign Governments, Political Subdivisions, and Multinational Organizations*, 10 N.C.J. INT'L L. & COMM. REG. 1 (1985). Foreign private issuers are companies other than those that: (A) are owned by a majority in interest of U.S. residents; and (B) (i) are operated principally from the United States, (ii) have a majority of their Board of Directors residing in the United States, or (iii) have more than fifty percent of their assets in the United States. 17 C.F.R. § 230.405 (1986). Rule 3b-4, 17 C.F.R. § 240.3b-4 (1986), defines foreign private issuer as any foreign issuer other than a government.

78. SEC Release No. 6360, *supra* note 56 ("the Commission has perceived its function as neither discriminating against nor encouraging foreign investment in the United States or investments in foreign securities"). *See* Pozer, *Disclosure and Trading in an International Securities Market*, 15 INT'L LAW. 84 (1981).

79. *Hearings on S. 875, supra* note 73; *Hearings on H.R. 4314, supra* note 73.

of foreign issuers whose securities were traded in the U.S.[80] The more voluntary steps the foreign issuer took to enter the U.S. capital markets, the more the degree of regulation and amount of disclosure approached the degree of regulation required of domestic registrants.[81] Because disclosure requirements were differentiated, the system was not capital-export neutral.

Prior to 1964, certain "involuntary" foreign private issuers were not required to file reports under the Exchange Act. In adopting the Securities Acts Amendments of 1964, however, Congress enacted § 12(g)(1), which required companies with over $1 million in assets and over 500 shareholders to report to the Commission.[82] Concerned with maintaining the existing markets in foreign securities, Congress also authorized the Commission to exempt a foreign issuer from § 12(g) if such action would be in the public interest and consistent with investor protection.[83] Those issuers not exempted by the Commission were required to file reports under Form 20 and Form 20-K, which required substantially less information than that required of domestic issuers filling Form 10 and Form 10-K.[84] The disparity in disclosure standards during this period arguably again varied from capital-export neutrality.[85]

Beginning in 1976, the Commission began considering increasing the disclosure required under the Exchange Act for certain foreign private issuers.[86] On

80. Notice of Proposed Amendments to Rules 3a12-3 and 13a-11 and Proposed Rules 12g3-2, 13a-5, 15c1-10, 15d-16 and 17a-10 under the Securities Exchange Act of 1934, Exchange Act Release No. 7746, [1964–1966 Transfer Binder] Fed. Sec. L. Rep. ¶ 77,301 (Nov. 16, 1965).

81. SEC Release No. 6360, *supra* note 56.

82. 15 U.S.C. § 78(l)(g)(1) (1981).

83. *Id.* at § 78*l*(g)(3). The Commission has exercised this exempting authority in Rule 12g3-2. 17 C.F.R. § 240.12g3-2 (1981). The reporting obligation for other foreign private issuers may be suspended. Reporting for securities not listed on an Exchange or traded on NASDAQ may be suspended (except for a fiscal year in which a registration statement under the Securities Act becomes effective or is required to be updated) if the class of securities is held by less than 300 United States residents or less than 500 United States residents where the total assets of the issuer have not exceeded $5,000,000 on the last day of each of the issuer's three most recent fiscal years, 17 C.F.R. § 240.12h-3. Periodic reports must be filed with the Commission under the Exchange Act by any foreign private issuer with securities listed on a national (i.e. United States) securities exchange or NASDAQ, and by issuers that have made a registered public offering in the United States. Non-Canadian foreign private issuers with securities quoted on NASDAQ prior to October, 1983 are exempt from this requirement. *See* SEC Release No. 7746, *supra* note 86 (proposed rules); Adoption of Rules Relating to Foreign Securities, Exchange Act Release No. 8066, [1966–1967 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,443 (Apr. 28, 1987) (final rules).

84. Adoption of Form 20-K and Repeal of Form 21-K, Exchange Act Release No. 8068, [1966–1967 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,445 (April 28, 1967).

85. Whether the difference in disclosure standards indicates a variance from capital-export neutrality depends on attendant foreign corporate and accounting practices, which influence a foreign issuers' decision of whether to issue securities in the United States. If there is a variance from capital-export neutrality, whether that variance favors capital export or whether it is adverse to capital export depends on the extent to which increased disclosure attracts investment, as information improves, and on the extent to which increased disclosure discourages investment, as costs of capital increase.

86. Means of Improving Disclosure by Certain Foreign Private Issuers, Exchange Act Release No. 13,056, [1976‰1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,830 (Dec. 16, 1976) (general

November 29, 1979, the Commission adopted amendments to registration statements, periodic reports, and annual reports required of certain foreign private issuers.[87] The amendments integrated the registration and annual report forms into a single new form, Form 20-F, which replaced Form 20 and Form 20-K. Form 20-F substantially increased the disclosure requirements of foreign private issuers, placing them on a level closer to that required of domestic registrants.

Recognizing the difference in national laws and accounting practices that govern foreign private issuers, the Commission reduced or modified disclosure requirements in financial reporting,[88] industry segment reporting,[89] time of filing requirements, and management remuneration.[90] Form 20-F continues to be the primary form used by Exchange Act registrants.[91] Though Form 20-F generally calls for a narrative disclosure less extensive than that required by Forms 10[92] and

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concept of substantially equivalent disclosure). Proposed Rules, Forms and Guidelines on Foreign Issuer Disclosure, Exchange Release No. 14,128, [1977–1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,361 (Nov. 2, 1977) (specific proposals).

87. SEC Release No. 16,371, *supra* note 75.

88. Financial statements must supply information similar to that required of domestic companies, though they need not be prepared in accordance with United States generally accepted accounting principles or Regulation S-X, the financial statement regulations, if they are presented in accordance with accounting principles generally accepted in the domicile country and a reconciliation of the difference in measurement items (the income statement and balance sheet amounts) is provided. A reconciliation of significant variations from United States GAAP and Regulation S-X is required. The reconciliation need only be of the differences in the measurement items (income statement and balance sheet amounts) in the annual reports of foreign private issuers. The same limited reconciliation may be used for offerings of certain non-convertible investment grade debt, securities issued upon exercise of certain rights, or warrants, pursuant to a dividend reinvestment plan, or upon conversion of outstanding securities. Full reconciliation of financial statements to United States GAAP and Regulation S-X is required for other offerings. *See* SEC Release No. 16,371, *supra* note 75. Financial statements are a difficult area for foreigners. *See, e.g.*, Corenco Corp. v. Schiavone & Sons, Inc., 362 F. Supp. 939, 948–50 (S.D.N.Y.), *aff'd in part*, 488 F.2d 207 (2d Cir. 1973).

89. Except for certain offerings of securities where a full reconciliation to United States GAAP is required, only revenue information must be broken into categories of activity and geographic markets ("segments"), unless the total operating profit from each segment materially differs from their respective contributions to total sales and revenue, in which case narrative disclosure is required. *See* SEC Release No. 16,371, *supra* note 75.

90. Compensation of directors and officers need be disclosed only in the aggregate unless the issuer discloses such information to its shareholders or otherwise makes this information public. *See id.*. Information regarding transactions with management is required, but need be presented only to the extent the registrant discloses such information to its shareholders or otherwise makes public the information. *See id.*

91. Foreign private issuers entitled to file annual reports on Form 20-F are not required to file the quarterly reports on Form 10-Q. 17 C.F.R. § 249.308a (1987), or current reports on Form 8-K, 17 C.F.R. § 249.308 (1987), as domestic issuers. Rather, such foreign issuers furnish Form 6-K reports which require disclosure of information and material to investors made public pursuant to foreign law, stock exchange regulations, or distributed to security holders. Form 6-K requires english translations, versions, or summaries only of information distributed to security holders and of material press releases.

92. 17 C.F.R. § 249.210 (1987).

10-K,[93] the disclosure requirements under the Exchange Act closely approach capital-export neutrality.

On November 20, 1981, as part of an effort to develop an integrated disclosure system, the Commission proposed the adoption of a new "F-series" of forms for foreign private issuers required to file Form 20-F.[94] As adopted on December 6, 1982,[95] the registration statements available for foreign private issuers making distributions in U.S. markets are Forms F-1, F-2, F-3, F-4[96], and F-6.[97] Form F-1

93. 17 C.F.R. § 249.310 (1987).

94. SEC Release No. 6360, *supra* note 56.

95. Adoption of Foreign Issuer Integrated Disclosure System, Securities Act Release No. 6437, [6 Listing Tables Binder] Fed. Sec. L. Rep. (CCH) ¶ 72,407 (Dec. 2, 1982).

96. Form F-4 is available for business combinations. Though beyond the scope of this paper, as the securities markets become internationalized, those seeking to acquire control of corporations with shareholders residing in a number of countries, must comply with the regulations governing tender offers of each country and political subdivisions which assert jurisdiction. The problems of a prospective tender offeror are compounded if the offer is an exchange offer, for the bidder must comply with the registration and distribution requirements in each country where the securities are offered. The United States substantive and disclosure provisions make some provisions for foreign bidders, but on the whole imposes requirements equal to those of domestic bidders.

For comparative analyses of tender offer regulations see SEC REPORT, *supra* note 1, at Chapter III. *See generally* INTERNATIONAL SECURITIES: LAW AND PRACTICE (J. Robinson ed. 1985).

Tender offers for the securities of companies reporting under the Securities Exchange Act of 1934 are regulated by the commission under the Williams Act provisions of the Act. *See* § 13(d), 15 U.S.C. § 78m(d) (1981) (reporting requirements for substantial acquisitions of equity securities); § 14(d), 15 U.S.C. § 78n(d) (1981) (information filing and dissemination); § 14(e), 15 U.S.C. § 78n(e) (1981) (antifraud). The regulations thereunder do not provide for special treatment of foreign bidders. *See* 17 C.F.R. § 240.3a12-3 (registered securities of foreign private issuers exempt from reporting and proxy rules of Exchange Act but not Williams Act). Additionally, exchange offers are subject to registration under the Securities Act of 1933. A number of states have also passed takeover statutes and, more recently control share statutes. Disclosure of material financial information is difficult. Disclosure of foreign law may be problematic, *see, e.g.*, Gen. Host Corp. v. Triumph Am., Inc., 359 F.Supp. 749 (S.D.N.Y. 1973), as may disclosing information about each person controlling the offeror. *See* Ronson Corp. v. Liquifin Aktiengesellschaft, 483 F.2d 846 (3d Cir. 1973) (special problems).

The United States antitrust laws, which apply to foreign companies if they do business in the United States or if their activities have an effect on United States commerce, can also pose restrictions to foreign bidders. *See* 16 C.F.R. § 802.51 (1986) (exemptions for acquisition by certain foreign companies of certain United States and foreign companies from waiting periods of Hart-Scott-Rodino Antitrust Improvement Act of 1976). Other investments in certain industries are restricted. *See* Fleischer & Feder, *Special Problems of Foreign Bidders in Acquisitions by Tender Offer*, 1 J. COMP. CORP. L. & SEC. REG. 349, 353 (1978). For the most part, however, the United States historically has encouraged foreign investment in this country. *See* Berger, *Applying Uniform Margin Requirements to Foreign Entities Attempting to Acquire U.S. Corporations*, 24 VA. J. INT'L L. 543 (1984).

97. Form F-6 is used for registration of American depositary shares evidenced by American Depositary Receipts. American depositary shares are shares issued by foreign issuers for sale in American markets. For an excellent article on American Depositary Receipts see Royston, *The Regulation of American Depositary Receipts: Americanization of the International Capital Markets*, 10 N.C.J. INT'L L. & COMM. REG. 87 (1985). Such shares represent beneficial ownership in the foreign securities and are issued to avoid problems inherent in the ownership of foreign securities, such as collection of dividends and transfer problems. Because the American depositary share is a

is used for initial public offerings. Forms F-2 and F-3 are available for foreign issuers that have previously registered securities under the Securities Act or the Exchange Act. Forms F-2 and F-3 permit incorporation by reference of reports filed under the Exchange Act, but Form F-2 requires delivery of those reports with the prospectus. Form F-3 is available only for issuers who have been reporting under the Exchange Act for at least 36 months and who are "world-class" issuers[98] or are offering investment grade securities, securities issued upon exercise of certain rights or warrants, securities issued pursuant to a dividend reinvestment plan or upon conversion of outstanding securities or securities issued in a secondary offering.

The flexibility with which the Commission has confronted the problems of foreign private issuers, without compromising investor protection or capitulating to the pressures to encourage offerings in the U.S. by foreign issuers, has resulted in a disclosure system which today approximates capital-export neutrality. Moreover, though the Commission has made some modifications in disclosure requirements to recognize home country laws and practices, the liabilities for such disclosure provided by the Securities Act and Exchange Act apply equally to foreign and domestic issuers.[99] The neutral overlay of the liability

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security separate from the underlying shares of the foreign issuer, it must be registered for sale in the United States.

98. A world class issuer is one who has an equity float of no less than $500 million, at least $150 million of which is held by U.S. residences, or that is registering investment grade debt securities. SEC Release No. 6360, *supra* note 56.

99. Section 11 of the Securities Act, 15 U.S.C. §77k (1981), provides that any person (without regard to nationality) who acquired a registered security may bring suit if any part of the registration statement (when that part became effective) contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading.

Section 12 of the Securtities Act imposes liability upon any person who offers or sells a security in violation of § 5, or who offers or sells a security by the use of the jurisdictional means by means of a prospectus or oral communication which includes misleading statements or omissions of material information.

Section 17(a) of the Securities Act makes it unlawful for any person in the offer or sale of any securities by use of the jurisdictional means directly or indirectly (1) to employ any device, scheme or artifice to defraud; (2) to obtain money or property by means of any untrue statement or commission; or (3) to engage in any transaction, practice or course of business which operates or would separate as a fraud or deceit upon the purchaser. Exchange Act § 10(b) and Rule 10b-5 make it unlawful to engage in this conduct in connection with the purchase or sale of any security.

Rules governing secondary market trading activity during an offering also are implicated by the internationalization of the securities market. Rule 10b-6 proscribes certain conduct by persons who are participating in a distribution. 17 C.F.R. § 240.10b-6 (1986). Rule 10b-7 governs stabilization of the price of a security to facilitate an offering. Because foreign methods of distribution differ substantially from those of the Untied States, certain foreign distribution activities directly violate Rules 10b-6 and 10b-7. *See* SEC REPORT, *supra* note 1, at V-17. The Commission in appropriate cases provides relief from these rules in order to reflect the realities of international offerings. For example, sections upon the disclosure requirement produce a substantially capital-export-neutral system.

In summary, the Commission views the needs of investors in the U.S. markets to be largely the same whether the issuer is domestic or foreign.[100] Thus, the disclosure requirements for foreign and domestic issuers selling the same type of securities to the same class of investors are roughly comparable.[101] Also, liability provisions apply with equal force to foreign and domestic issuers. Thus, the Commission's approach to internationalized securities markets largely comports with the principle of capital-export neutrality.

Nevertheless, currently foreign issuers are dissuaded[102] by U.S. initial and periodic disclosure requirements[103] and liability exposure,[104] and the Commission is considering measures to facilitate foreign offerings in the U.S.[105] The Commission is developing a proposal for the registration of specified securities based on the reciprocal approach.[106] The reciprocal registration statement forms would use the offering document required in an issuer's home country as the prospectus for offerings in the U.S. The offeror must comply with any state law requirements that may be applicable.[107] Limited rights offers and exchange offers may be permitted on these forms, to encourage the inclusion of U.S. investors in such offers by facilitating the registration process. The keys to implementation of the approach are appropriate accounting principles and auditing standards. If a reciprocal approach is used, these areas are central in determining which jurisdic-

the Commission recently issued two exemptive orders in global offerings to permit stabilizing bids to be placed in markets abroad and in U.S. markets based on the principal market for such securities where the principal market was not in the U.S. *See Commission Delegates Exemptive Authoruty for Rule 10b-7 to Staff*, 19 Sec. Reg. & L. Rep. (BNA) No. 22, at 784. Securities letters have provided that, under certain terms and conditions, stabilizing bids may be adjusted to reflect changes in currency relationships. *See. e.g., Relief Granted in International Offering of Spanish Bank Securities*, 19 Sec. Reg. & L. Rep. (BNA) No. 29, at 1068 (July 17, 1980).

100. SEC Report, *supra* note 1, at III-322.

101. *Id.*.

102. The Commission recognizes the reluctance of foreign issuers to enter U.S. markets. *Id.* at III-323.

103. Particularly in accounting principles and auditing standards. Foreign issuers must also consider the continuing reporting costs under the Exchange Act.

104. Many issuers are dissuaded by the litigious environment of the Untied States and submission to SEC oversight. The Commission hopes that these concerns will lessen as home country markets mature, home country regulatory bodies become more active and mutual surveillance and enforcement agreements are developed and used. *See* SEC Report, *supra* note 1, at III-323.

105. Recently, the Commission has taken steps to facilitate U.S. offerings of securities by foreign banks. *Id.* at VI-24.

106. *Id.* at III-324.

107. One important obstacle to overcome in facilitating foreign issuers' access to the United States capital markets is the myriad of blue sky laws. The Commission staff and representatives of state securities regulators have begun to discuss ways to coordinate the requirements applicable to foreign issuers entering the United States capital markets. *See id.* at III-327.

tions should be included[108] and what classes of issuers and types of securities should be permitted.[109]

Other rulemaking efforts, not directly targeted at international issues, also may facilitate foreign issuers' access to the market.[110] Small-issuer exemptions under § 3(b) of the Securities Act, in addition to helping small issuers in the U.S., may provide assistance to foreign issuers with U.S. employees or security holders.[111] Similarly, the Commission is considering exempting under § 3(b) of the Securities Act rights offerings and possible exchange offerings of less than $5 million made by non-reporting companies. Acting to clarify when institutions may resell unregistered securities to other institutions may reduce the cost of private placements.[112] This may encourage foreign issuers to access the U.S. through the private placement mechanism.

Care needs to be taken as an integral part of this effort to avoid accommodations to foreign corporate practices,[113] particularly where such accommodations represent variances from capital-export neutrality. The disclosure standards must be more closely tailored to the particular circumstances of foreign issuers[114] in order to remain capital-export neutral.

C. *Implementing Capital-Import Neutrality*

In contrast to capital-export neutrality, U.S. securities regulations would be capital-import neutral if the disclosure requirements of U.S. issuers issuing securities to U.S. investors were equivalent to the disclosure requirements of U.S. issuers issuing securities to foreign investors. The criteria that must be adhered to by the Commission in implementing capital import neutral policies is that U.S. disclosure standards not influence a U.S. issuer's decision of whether to issue securities to U.S. investors or to foreign investors.

U.S. disclosure requirements largely satisfy these criterion, and therefore are

108. The commission proposed initially to implement the reciprocal approach with the United Kingdom and Canada, because the disclosure and accounting practices of those countries are most similar to those of the United States, and because of familiarity with those countries, standards due to the frequency or their issuers' filings in the United States.

109. Initially, it will extend to world class issuers of investment grade debt, because those securities would trade, in large part, on yield and rating. Thus, reconciliation of accounting and auditing from the home country presentation would not be essential.

110. SEC REPORT, *supra* note 1, at III–326.

111. *See* Reporting by Small Issuers, 51 Fed. Reg. 25,360 (1986) (to be codified at 17 C.F.R. parts 230, 240, 249 and 260).

112. SEC REPORT, *supra* note 1, at III-327. *See Relief Granted in International Offering of Spanish Bank Securities, supra* note 99, at 1068 (important no-action letter for foreign issuers accessing U.S. markets).

113. SEC REPORT, *supra* note 1, at III–311.

114. *See* McLaughlin, *supra* note 33, at 45 (arguing repeal of registration to facilitate offerings in the U.S. by foreign issuers).

capital-import neutral. § 5(a) of the Securities Act of 1933[115] requires registration, unless exempt, of securities offered or sold by use of the jurisdictional means.[116] § 2(7) includes within the scope of the Securities Act "trade or commerce in securities or any transportation or communication relating thereto . . . between any foreign country and any State, Territory, or the District of Columbia."[117] Because the registration requirements apply to transactions within the jurisdictional ambit, without regard to the nationality of the issuer, they are capital-import neutral.

The U.S. has not chosen to assert the registration provisions of § 5 of the Securities Act extraterritorially to full extent of Act's jurisdictional reach. Instead, the Commission traditionally has taken the position that the registration requirements of § 5 of the Securities Act are primarily intended to protect U.S. investors,[118] thus the Commission has limited the application of the registration provisions of § 5 to circumstances involving U.S. persons or markets.[119] In Securities Act Release No. 4708, the Commission indicated that registration is not required if securities are "distributed abroad to foreign nationals even though use of jurisdictional means may be involved in the offering . . . [provided] the distribution is to be effected in a manner which will result in the securities coming to rest abroad."[120]

Though the release does not describe offering procedures the Commission considers reasonably designed to prevent distribution in the U.S., an array of no-action letters have expanded on the requirements.[121] Additionally, in certain circumstances, sales to non-U.S. persons made within U.S. markets have been considered beyond the scope of the registration provisions.[122] However, the de-

115. 15 U.S.C. § 77e(a) (1982).

116. Any means or instrumentality of interstate or foreign commerce. 15 U.S.C. § 77e (1982).

117. 15 U.S.C. § 77b (1981).

118. SEC Release No. 4708, *supra* note 14.

119. Statement of the commission concerning applicability of the Securities Act of 1933 to offerings of securities outside the U.S. and concerning applicability of § 15(a) of the Securities Exchange Act of 1934 to foreign underwriters as part of a program of the Presidential Task Force to reduce U.S. balance of payments deficit and protect U.S. gold reserves. *Id.* In that release, the Commission took the position that it would not take enforcement action if securities are sold under circumstances reasonably designed to prevent the distribution or redistribution of the securities into the United States or to United States person. *Id.* When such circumstances are not met, the SEC will take enforcement action. *See, e.g.*, Securities and Exchange Commission v. North American Research and Development Corp., 424 F.2d 63 (2d Cir. 1970); SEC v. Mono-Kearsarge Consolidated Mining Co., 167 F. Supp. at 248. *See also* 4 L. Loss, Securities Regulation 2407–08 (1969).

120. Securities Act Release No. 4708, *supra* note 14, at ¶ 1362. The theory underlying this release is being reexamined in light of the changing global securities markets.

121. *See generally* Evans, *Offerings of Securities Solely to Foreign Investors*, 40 Bus. Law. 69, 70–79 (1984).

122. *See, e.g.*, Israel Discount Bank, SEC No-Action Letter, (July 23 and Sept. 13, 1981) (available in SEC public files); Bank Leumi le-Israel, SEC No-Action Letter, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,233 (May 7, 1982).

marcation of the appropriate reach of § 5 has not been definitively determined. Nevertheless, for those offerings within the scope of § 5, the disclosure standards apply equally to offerings made to domestic and to foreign issuers, and are therefore capital-import neutral.

So long as the jurisdictional means are used, the antifraud provisions of the Williams Act apply whether or not an offering is exempt from registration.[123] Courts have evolved two tests to determine the extraterritorial application of the Williams Act: the conduct test and the effects test.[124] The conduct test focuses on the extent and substantiality of conduct occurring in the U.S. The effects test extends jurisdiction to acts performed abroad causing substantial and foreseeable harm to interests within the U.S. The effects test rests on the theory that Congress intended to protect U.S. investors from foreign transactions that artificially influence prices and trading volume, erode public confidence, and have other adverse effects on U.S. markets. Both tests may be viewed as merely expansive interpretations of jurisdiction based on territoriality, and therefore do not alter the capital-import neutrality of the antifraud provisions.

Several recent interpretive and no-action letters address issues raised by the transnational trading of securities and may refine the neutrality of the laws.[125] These developments take positions which allay fears of foreign issuers and prevent U.S. investors from being excluded from foreign offerings, including rights offerings, privatization offerings, and exchange offers.[126] These securities could be acquired by U.S. institutions and resold onto foreign national exchanges in the ordinary course of exchange transactions without inquiry as to the citizenship or residence of the purchaser. The rationale advanced by the Commission is that because of the limited U.S. investor participation on those exchanges such a resale would not be directed at U.S. persons. These measures would refine the capital-import neutrality of U.S. securities laws.

For U.S. issuers raising capital abroad, avoiding extraterritorial application of § 5 of the Securities Act requires complex and costly offering procedures de-

123. *See, e.g.*, 15 U.S.C. §§ 77*l*(2), 77q, 78j(b) (1982); 17 C.F.R. § 240.10b-5 (1984).

124. *See generally* Schoenbaum v. Firstbrook, 405 F.2d 200, 208–09 (2d Cir. 1968), *modified on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied* 395 U.S. 906 (1969); Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972); Bersch v. Drexel Firestone. Inc., 519 F.2d 974 (2d Cir. 1974), *cert. denied* 423 U.S. 1018 (1975); IIT, an Int'l Inv. Trust v. Cornfield, 619 F.2d 909, 918 (2d Cir. 1980); Plessy Co. PLC v. Gen. Elec. Co. PLC, 628 F.Supp. 477 (D. Del. 1986).

125. SEC REPORT, *supra* note 1, at III-321. *See, e.g.*, College Retirement Equities Fund ("CREF"), SEC No-Action Letter, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,420 (Feb. 18, 1987). *See also Bank Agency Gets SEC Staff Go-Ahead for Unregistered Foreign Offering*, 46 Wash. Fin. Rep. (BNA) 1131 (June 30, 1986).

126. College Retirement Equities Fund, SEC No-Action Letter, [Current (1987–88) Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,503 (June 4, 1987). *See* SEC REPORT, *supra* note 1, at III-321. French Privatization Program, SEC No-Action Letter, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,439 (Apr. 17, 1987).

signed to assure that registration provisions do not apply.[127] By design, U.S. persons are excluded from many offshore investment opportunities or must wait for a period after the offering.[128] Despite the capital-import neutrality of the laws, issuers, both domestic and foreign, have been dissatisfied with the complex procedures required to assure that securities sold abroad are not sold or resold to U.S. persons.

The determination of the appropriate reach of § 5 is complicated by the exemption for secondary trading.[129] Foreign issues of both foreign and domestic issuers potentially subject to § 5 at the time of issuance may be traded a few months later in U.S. secondary markets without U.S. securities laws implications. This is because, pursuant to the Securities Act, registration is generally required for offers or sales of new offerings of securities by issuers or affiliates, while secondary trades are exempt from registration under the Securities Act. Moreover, the periodic reporting requirements of the Exchange Act do not extend to foreign securities traded only in foreign markets.[130] U.S. investors have made purchases in offshore trading markets in great volume, resulting in many occurrences of this differing treatment of U.S. persons in primary and secondary markets.[131]

U.S. persons who have purchased securities of foreign issuers in the foreign secondary markets face difficulties in participating in or are excluded from rights or exchange offers. Foreign issuers may be reluctant to register the offerings in the U.S. Rather than register the securities, the foreign issuer will either exclude U.S. holders or provide them with cash in lieu of securities. U.S. investors have become discontent with their exclusion from investment opportunities caused by application of the securities registration requirements to foreign issues.[132]

A consensus is emerging that § 5 should be limited more territorially, as where the U.S. capital markets are more directly involved.[133] A territorial approach to

127. *See* Beller & Berney, *Eurobonds*, 19 REV. OF SEC. AND COMM. REG. 39 (1986); *See also Globalization of Financial Markets Report*, 15 INT'L BUS. LAW. 88 (Feb. 1987).

128. SEC REPORT, *supra* note 1, at III-311.

129. *See* Securities Act § 2(11), 15 U.S.C. § 77b(11).

130. Pursuant to the Securities Exchange Act §§ 12(b), (g), 15 U.S.C. §§ 78*l*(b), (g) (1982), issuers with securities registered on a national securities exchange, or engaged in interstate commerce, in a business affecting interstate commerce or with securities traded by use of any instrumentality of interstate commerce and with more than 500 shareholders of record and $5 million in assets, must register those securities under the Exchange Act. Foreign issuers with fewer that 300 United States security holders are exempt from the provisions of § 12(g). In addition, foreign issuers whose securities are not traded on an exchange or quoted on NASDAQ may claim an exemption from § 12(g) pursuant to Rule 12g3-2(b), 17 C.F.R. § 240.12g3-2(b) (1987), if they file with the SEC the documents they are required to make public in their home jurisdiction. Certain issuers whose securities were quoted on NASDAQ prior to October 5, 1983, may also rely on the exemption.

131. SEC REPORT, *supra* note 1, at III-314–316.

132. *Id.* at III-316.

133. For example, in February 1987, the Commission held a roundtable with representatives of the bar, issuers, investors and securities professionals to discuss internationalization of the securities markets. The participants favored the territorial approach.

the regulatory provisions of the Securities Act is consistent with the regulatory ambit of the Exchange Act and with comity principles.[134] A territorial approach gives primacy to the laws in which a market is located. As investors choose their markets they would choose the laws applicable to such markets. A territorial approach to registration would be complemented by extraterritorial application of the antifraud provisions of the Securities Act or the Exchange Act.

A territorial approach would reach to all participants in the U.S. capital markets, including foreign persons in the U.S. The disparate treatment of U.S. investors when they purchase in primary offerings and when they purchase in foreign secondary markets would be reduced as the primary consideration in applying U.S. disclosure regulations to sales in the primary and secondary markets would be whether the offer or sale is made within the U.S. To prevent circumvention, offshore offerings targeted at U.S. investors or intended to evade U.S. securities laws would be fully regulated. A territorial approach would therefore place great weight on the concept of an "offer or sale within the U.S."[135]

Both domestic and foreign issuers that offer securities abroad and have active U.S. trading would be subject to the periodic reporting requirements of the Exchange Act so that U.S. investors who buy securities offered abroad that flow back to the U.S. are provided the same information that would be provided by the registration process. The integrated disclosure system for domestic, as well as foreign, companies that file Exchange Act reports already permits certain companies to incorporate by reference Exchange Act reports into Securities Act filings.[136] The territorial approach would place even greater reliance on the periodic reporting system mandated by the Exchange Act. Whether a more restrictive

134. As a matter of comity, it is questionable whether United States laws should require foreign issuers making primary offerings in foreign markets in accordance with the laws of that foreign jurisdiction to take extensive precautions to assure the securities are not sold to United States persons, as often happens.

135. One of the important lessons from banking and taxation is that the national interest is best served when barriers and impediments to capital formation are removed. Moreover, the process of lowering those barriers must be gradual, and statements of national interests not relinquished or retracted.

The United States' success with the foreign tax credit method, whereby national interest is defined expansively and accomodations made to stronger competing claims, suggests that a narrowly defined territorial system should serve only as a transition until international disclosure levels are more harmonized. A territorial concept with disclosure levels higher than other systems, no matter how narrowly defined, invites circumvention, impairs the competitiveness of markets within the territory, and departs from inter-nations neutrality principles. A reciprocal approach coupled with harmonized laws is the equivalent of the foreign tax credit and supports broader assertion of jurisdiction requirement principles of coordinated supervision fill in details.

136. *See* Forms S-2, S-3, F-2, and F-3. 17 C.F.R. § 239.12, .13, .32, .33 (1987).

territorial system is preferable is questionable, but it does satisfy the principle of capital-import neutrality.[137]

D. Implementing Inter-Nations Neutrality

Though the U.S. systems of securities regulation when analyzed in isolation closely approaches capital-export and -import neutrality, when analyzed in concert with the securities laws of other countries, the U.S. system, largely because its disclosure standards are higher than those of other countries, favors the import of capital and is neutral to the export of capital. Because as with international taxation, lower disclosure standards abroad influence the direction of investments though domestic policies may be capital-neutral, the Commission should strive for inter-nations neutrality, whereby the combined effect of disclosure standards in the U.S. and disclosure standards in other countries do not favor investment in any one country.

The traditional method in taxation to resolve problems created by other countries is the use of international tax treaties,[138] which seek inter-nations neutrality,[139] but this vehicle has not been used in international securities. As detailed in the next section, harmonization of securities laws also has had little success. The U.S. also faces difficulty in achieving inter-nations neutrality because of the presence of the Euromarkets, the U.S.'s position as a debtor, and the need to foster competitiveness of U.S. capital markets, which present the danger that U.S. standards are reduced to lower standards than in the national interest. Retraction to a territorial approach for example, is explicable as necessitated by U.S. economic conditions, because the access to the Euromarkets by U.S. issuers is made more certain, while no similar concessions are made to U.S. investors. The strategy to avoid unwise concessions is to negotiate with other countries to reach a consensus. The process for reaching a consensus on disclosure standards may be derived from the experience of international banking in coordinated supervision.

137. McLaughlin, *supra* note 34 (territorial system "is certainly not likely to work where the only interest being served is preservation of the non-applicability of 1933 Act registration requirements that no longer withstand scrutiny under any reasonable cost-benefit analysis.").

138. Tax treaties may be a way to accomplish a goal which Congress is unwilling to accomplish by legislation. Surrey, *Current Issues in the Taxation of Corporate Foreign Investment*, 56 COLUM. L. REV. 815, 856 (1956). Treaty approaches can exert as significant pressures on foreign fiscal systems as the foreign tax credit. For example if one country offers tax concessions to attract foreign investment, and other countries did the same or were left out, the attractiveness of such concessions would disappear to that one country. Only the investor benefits. *Id.* at 857. This is one reason why treaties with developing countries are difficult.

139. *An Interview with Outgoing Counsel Stephen E. Shay: Part Two*, 36 TAX NOTES 843, 844 (1987).

III. International Banking Regulation and International Capital Markets: Coordinated Supervision, the Public Interest, and the Relationship between American and Foreign Laws

A. *The Principle and Process of Coordinated Supervision*

As with securities markets, internationalization of banking inevitably affects the U.S. financial system.[140] Transnational lending has an extensive history,[141] marked recently by cooperation in international banking as a result of strains on the international system. The two primary goals of financial regulation are stability of the financial system and the efficient delivery of financial services.[142] Stability is pursued by imposing upon financial institutions liquidity requirements,[143] deposit guarantees, lending limits, limits on loans to single borrowers,[144] capital adequacy ratios,[145] and bad debt reserves.[146] Foreign-exchange

140. *See, e.g.*, Breeden, *Reforming Regulation in Financial Services in the U.S.*, 20 INT'L LAW. 775, 776 (1986).

141. *See*, Mendelsohn, *The Long Historical Lure of Banking in Britain*, AM. BANKER, July 30, 1986, at 28.

142. In the United States, the goals of stability and efficiency are pursued by various agencies. Generally, the Office of the Comptroller of the Currency (OCC) supervises national banks, the Federal Reserve Board (FRB) supervises state chartered member banks of the Federal Reserve System and bank holding companies, the Federal Deposit Insurance Corporation (FDIC) regulates insured non-member banks, and state agencies regulate state chartered banks. Because banks may choose either state or federal charters, the system has been referred to as the "dual banking" system. *See* Scott, *The Dual Banking System*, 30 STAN. L. REV. 1 (1977). Overlapping jurisdiction also has lead to distinctive regulatory philosophies among the agencies. *See* Friesen, *The Regulation and Supervision of International Lending: Part I*, 19 INT'L LAW. 1059, 1069 (1985).

Foreign controlled banks located in the U.S. are subject to substantially the same requirements as other U.S. banks. For analyses of supervision of foreign offices of U.S. banks, see COMPTROLLER GENERAL OF THE U.S., DESPITE POSITIVE BENEFITS, FURTHER FOREIGN ACQUISITIONS OF U.S. BANKS SHOULD BE LIMITED UNTIL POLICY CONFLICTS ARE FULLY ADDRESSED, (1980), at 7-1 to 8-24; and Schockey and Glidden, *Foreign-Controlled U.S. Banks: The Legal and Regulatory Environment*, in COMPTROLLER OF THE CURRENCY, STAFF PAPERS (1980). U.S. banks are given legal authority to operate abroad. Federal Reserve Act §§ 25, 25(a), Bank Holding Company Act § 4(c)(13). Overseas branches and subsidiaries of U.S. banks generally must be authorized by the host country. For description of the role of U.S. monetary authorities in the supervision of foreign offices, see Final Rule Revision: International Banking Operations, 44 Fed. Reg. 36005–012 (1979); and COMPTROLLER GENERAL OF THE U.S., *supra*. Consumer protection is another of the principal purposes of government financial regulation. In liberalized markets governments nevertheless regulate disclosure of the specific terms and prices of financial products and services. Contract enforcement and fraud prevention are also traditional objects of government regulations.

143. Not through ratios but as part of examinations. Friesen, *supra* note 142, at 1078.

144. 12 U.S.C. § 84(a)(1) (1985). Rojc, *National Bank Lending Limits*, 40 BUS. LAW. 903 (1985).

145. 12 U.S.C. § 3907 (1988). Glidden, *Capital-Based Limits on International Banking*, 11 N.C.J. INT'L L. & COMM. REG. 465 (1986).

146. The object of bad debt reserves is to contain the failure of a single institution and prevent it

trading is not regulated in the U.S. although exchange transactions are reviewed by examiners as part of the routine supervisory process.[147] Bank portfolios are also examined for country specific risk factors.[148]

U.S. banking regulators early had to confront the decision of the relation between U.S. banking law and that of other nations. A reality of internationalization is that no major banking system can isolate itself completely from worldwide developments. Pressures to dismantle rigid financial systems, in the world derived from uncertainty brought on by many factors, including the move to a managed float exchange rate system in the early 1970s, worldwide inflation and high interest rates, and balance of payments problems of a large number of oil importing, developing debtor countries.[149]

The cost of deregulation and internationalization, however, is that the risks of systemic reactions to specific problems are increased.[150] A paradox is that the more efficient market mechanism is for transmitting information, the greater the potential for the market to overreact, or to react irrationally.[151] Deregulation has demanded effective bank supervision in order to make the competitive environment safe from systemic risk. The threat to bank safety and soundness from weakly regulated overseas banks, as well as the actual failure of several banks operating in the international marketplace in the early 1970s prompted bank supervisory authorities to improve the coordination among themselves.

The International Lending Supervision Act[152] directs the Federal Banking

from spreading into a more generalized crisis or collapse of public confidence in the overall financial system.

147. Revey, *Evaluation and Growth of the United States Foreign Exchange Market*, FED. RESERVE BANK OF N. Y. Q. REV., Aut. 1981, at 32, 34–5.

148. A supervisory system adopted by the Federal Reserve, the Comptroller of the Currency and the Federal Deposit Insurance Corporation and under the direction of the Interagency Country Exposure Review Committee (ICERC) went into effect in 1979. It applies to all U.S. banks involved in international lending operations. ICERC analyzes political, social, and economic forces which influence a country's ability to service external obligations. Bench & Sable, *International Lending Supervision*, 11 N.C.J. INT'L L. & COMM. REG. 427, 435 (1986). A major concern in the analysis of country risk and exposure is whether bank portfolios are sufficiently diversified across countries. In instances where exposure surveys and examination of individual banks reveal an inappropriate degree of exposure, an effort is made to encourage country lending practices that are more prudent. It is significant that the focus of U.S. authorities has been primarily on additional information and on supervision rather than on additional regulation. The establishment of rigid lending limits to foreign countries has been considered inappropriate. *See Proposed Solutions to International Debt Problems: Hearings Before the Senate Committee on Banking, Housing and Urban Affairs on S. 502 and S. 695*, 98th Cong., 1st Sess. 8–51 (1983) (statement by Paul A. Volcker, Chairman, Federal Reserve System).

149. Hultman, *U.S. International Bank Supervision & the Revised Basle Concordat*, MAG. BANK AD., Feb. 1985, at 76.

150. Gardener, *A British View of Bank Capital Adequacy in Europe*, ISSUES IN BANK REG., Spring 1986, at 23.

151. *Id.*

152. International Lending Supervision Act of 1983 § 901, 12 U.S.C. §§ 3901–3912 (Supp. 1988).

Agencies to coordinate international lending supervision.[153] The U.S. is a member of the Basel Committee, the Institute for International Finance, and other supervisory groups.[154] Since its inception in 1975, the Basel Committee has been the pre-eminent body in international financial cooperation. The Basel Committee is an advisory body of bank supervisors and central bankers representing Belgium, Canada, Federal Republic of Germany, France, Italy, Japan, Luxembourg, the Netherlands, Sweden, Switzerland, the United Kingdom, and the U.S. The first Basel Concordat was established in 1975 following the Herstatt Bank and Franklin National Bank failures in 1974.[155]

In 1975 the Basel Committee of Supervisors set out principles for the supervision of banks where those banks operated in more than one national jurisdiction.[156] In June 1983 the Committee published "Principles for the Supervision of Banks' Foreign Establishments" which restates[157] the principles of the original 1975 document but also incorporates the principle of consolidated supervision.[158] These two documents, known as the Concordats, are grounded upon two fundamental principles: first, that no foreign banking establishment should escape supervision; and second, that the supervision should be adequate. Thus the Concordats assign supervisory responsibility among the parent authority and the host authority. The Concordats also outline procedures to be followed to insure that each authority is properly supervising a banking establishment.

The Concordats assign and divide responsibility for supervising the liquidity and solvency of banking establishments between parent and host authority. Supervisory responsibility is assigned according to whether the banking establishment is a branch, a subsidiary, or a joint venture and according to the nature of the problem—liquidity or solvency—that must be supervised. Assigning supervisory authority in this manner may be called "coordinated supervision".

Assigning supervisory responsibility does not preclude gaps and inadequacies in supervision of banks' foreign establishments. For example, some host au-

153. *Id.* §§ 3901(a)(2), 3901(b).

154. The U.S. is a member of the Bank of International Settlements and the Institute of International Finance only through the membership of private U.S. banks in those institutions. *See* Hackney, *The Regulation of International Banking: An Assessment of International Institutions*, 11 N.C.J. INT'L L. & COMM. REG. 475 (1986).

155. Hultman, *supra* note 149, at 77.

156. Committee on Banking Regulations and Supervisory Practices, *The New Concordat — Principles for the Supervision of Banks Foreign Establishments*, ISSUES IN BANK REG., Summ. 1984 at 25.

157. The Restatement explicitly notes that it does not consider the question of lenders of last resort. This is an indication of what is not more properly addressed in this framework.

158. The text of the revised Basle Concordat is contained in *Revised Basle Concordat on Bank Oversight Clarifies the Division of Supervisory Roles*, 12 IMF SURV. 201, 202–3 (1983). The Basle Concordats do not bind the representative agencies, but rather serve as guidelines. A discussion of the Basle Committee (also known as the Cooke Committee) and the 1975 Concordat is provided in G.G. Johnson and Richard K. Abrams, *Aspects of the International Banking Safety Net*, WASHINGTON: INTERNATIONAL MONETARY FUND (March 1983) at 24–30.

thorities do not have the skills or resources to fulfil their supervisory obligations adequately with respect to all foreign bank establishments operating in their territories. Problems may also arise where the host authority considers that supervision of the parent institutions of foreign bank establishments operating in its territory is inadequate or nonexistent.[159] The Concordats address ways supervisory gaps can be prevented by providing that the responsibilities of host and parent authorities are both complementary and overlapping.[160] The Concordats also emphasize that adequate supervision requires close contact and cooperation among bank supervisory authorities. The Committee also recommended that host supervisors judge their counterpart's parent supervision,[161] and that the parent authority satisfy itself that it will receive regular information on the operation and condition of overseas offices before permitting their opening.[162] Though these measures were designed to ensure coverage of all gaps that might exist in the supervisory process, the possibility that overlapping authority may create difficulties was recognized.[163]

159. In such cases the host authority is expected to discourage or forbid the operation in its territory of such foreign establishments. Alternatively, the host authority may impose specific conditions governing the conduct of the business of such establishments. U.S. agencies solicit a general description of the powers and functions of home countries supervisors and require U.S. branches of foreign banks seeking insurance to identify: the frequency, scope, and purpose of supervisory examinations of banks in the parent country; the nature of lender-of-last-resort supporting existing in the parent country; and the parent's country's regulatory standards for capital adequacy, liquidity, foreign exchange exposure, risk concentration, and insider transactions. U.S. GOVERNMENT ACCOUNTING OFFICE, INTERNATIONAL BANKING: U.S. SUPERVISION AND INTERNATIONAL SUPERVISORY PRINCIPLES at 26 (1986) [hereinafter U.S. BANKING SUPERVISION].

160. Host authorities are responsible for the foreign bank establishments operating in their territories as individual institutions while parent authorities are responsible for them as parts of larger banking groups where a general supervisory responsibility exists in respect of their worldwide consolidated activities. The Concordats also emphasize that adequate supervision requires close contact and cooperation among bank supervisory authorities.

161. Host authorities are encouraged to contact the parent supervisory authority upon receipt of a bank's application to establish an office in its country, both to foster future cooperation in supervising the bank and its new foreign office, and to enable the host authority to ensure that the parent authority is aware of and has given formal authorization for the foreign office. Host authorities should also identify the means and extent to which the parent and its proposed office are supervised by the parent authority. United States banking practices are generally consistent with these principles. U.S. BANKING SUPERVISION, *supra* note 159.

162. If the supervisor of the country where the head office of a credit institution is established wished to verify information on a credit institution established in another Member State, he must request the competent authorities of that Member State to perform the verification. These authorities can comply with this request by either 1) performing the verification themselves, 2) allowing the foreign supervisor to verify the information or 3) allowing the verification to be performed by a chartered accountant or another expert. Muller, *A Legal Framework for International Supervision: The EEC Model*, ISSUES IN BANK REG., Summ. 1984, at 36, 39.

163. For example, efforts by the Federal Reserve System to secure consolidated information on U.S. located offices of foreign banks and the overseas parent company were considered by the supervisory authorities in other countries as being contrary to the Concordat.

One important component of coordinated supervision is the principle of consolidated supervision, which is that parent banks and parent supervisory authorities should evaluate the risk exposure of the totality of the banks of banking groups for which they are responsible wherever that business is conducted.[164] The principle rests on the understanding that banking supervisory authorities cannot be fully satisfied about the soundness of individual banks unless they examine the totality of each bank's worldwide business. The significance of adopting the principle of consolidation is the implicit understanding that operations emanating from one sector of the world banking market may affect stability in several other related markets. Though the implementation of the principle of consolidated supervision presupposes that parent banks and parent authorities have access to relevant information about the operations of their banks, foreign establishments, it also presupposes responsibility on the part of parent authorities.

From these general, aspirational principles, consensus on more concrete policy issues, particularly capital adequacy standards, has grown. The 1982 debt crisis was a major stimulating factor in the rapidly developing "loan-securitization" vehicles,[165] and other innovations in capital, balance sheet, and risk management policies. These innovations required a new view of how capital adequacy should be measured,[166] as banks eventually began to innovate around these constraints.[167] Regulators found difficulties, however, in arriving at a common standard of capital adequacy because the concept of capital adequacy is a product of different banking, accounting, and legal systems.[168] While there was some commonality, there were also marked differences in specific practices and concepts.[169]

The initial developments in harmonizing capital adequacy standards focused on common measurement schemes, based on defensible mathematical principles, that are generally accepted in an international context. A recent proposal for relating minimum capital requirements to risk profiles of banking organizations, developed jointly by representatives of the Bank of England, the U.S. Office of the Comptroller of the Currency and Federal Reserve Board, (and recently Japanese authorities) illustrates cooperation between governments that can enhance

164. Parental supervision on a consolidated basis is needed for two reasons: because the solvency of parent banks cannot be adequately judged without taking account of all their foreign establishments; and because the condition of the parent is influenced by the condition of their foreign subsidiaries.

165. Logan, *The Securitization of U.S. Bank Activities in the Eurodollar Market — Issues for U.S. Counsel*, 11 N.C.J. INT'L L & COMM. REG. 537 (1986).

166. *See generally* Gardener, *supra* note 150.

167. Another related problem is that sales of bank assets — taking assets off the balance sheet in order to help improve or consolidate capital ratios — invariably involve the least risky (most marketable) assets held by a bank. This may help capital ratios in the short run, but increase bank riskiness in the longer term.

168. Gardener, *supra* note 150, at 36–38.

169. *Id.* at 32–36.

global regulation of financial markets through the adoption of uniform rules.[170] The principles of this proposal were refined and recast by the members of the Basel Committee in December of 1987. It is anticipated that the initial proposals will benefit from additional fundamental and applied research on banking risk, and the development of new internationally accepted accounting disclosure rules for banks.[171]

B. Implementation of Coordinated Supervision

The process by which banking regulations have been harmonized may be used to harmonize securities laws.[172] Like banking regulators, securities regulators are confronted with the Euromarkets (a largely unregulated market) and a diversity of national laws in need of harmonization. The response to the Euromarkets need not be additional regulations, for though not directly regulated by a single national government, market requirements, exchange restrictions, and indirect regulations[173] create a minimum level of disclosure in the Euromarkets.[174]

However, because wholly unregulated capital markets fail to achieve some desired objectives for which there is an international consensus, and because of the possibility of degenerating into inadequately lax standards, a reduction in national barriers must be complemented by an increase in international cooperation.

The Commission has sought to harmonize the securities laws in order to reduce unnecessary barriers to the movement of capital.[175] One of the precondi-

170. The original proposal was released for public comment on January 24, 1986. *See* Capital Maintenance, *supra* note 65; Extension of Time to Comment, *supra* note 65.

171. Gardener, *supra* note 150, at 39.

172. The principles of coordinated supervision have immediate application to other problems confronting the commission. One of the important issues raised relating to internationalization of securities markets is supervision of U.S. broker-dealers operating in more than one national jurisdiction. *See* SEC REPORT, *supra* note 1, at V-38. The Commission lacks the authority to examine and regulate the activities of unregistered overseas affiliates of U.S. registered broker-dealers, and has found it extremely difficult to trace the movements of funds and securities necessary to reconstruct transactions between affiliates, and has taken measures to alleviate this problem. *See* Financial Responsibility Rules, Exchange Act Release No. 24553, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,132 (June 4, 1987). The problems of accommodating U.S. requirements to foreign broker-dealers might also be ameliorated by a system of reciprocal recognition of international broker-dealers with other national securities regulators. SEC REPORT, *supra* note 1, at V-49.

173. Each participant is subject to the securities laws of its country of residence or other countries asserting jurisdiction.

174. *See* SEC REPORT, *supra* note 1, at III-40. The comprehensiveness of this disclosure undoubtedly has been influenced by United States laws and policies. *See id.* at III-41.

175. The myriad blue sky laws presents a great challenge to harmonization. *See* Annual Conference on Uniformity of Securities Laws, Securities Act Release No. 6620, [1985–1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,957 (Jan. 21, 1986). The interaction of state and local tax systems is an analogous problem in tax laws. Most states and some localities impose an individual income tax, some more expansively than others. *See* Montgomery, *Worldwide Unitary Taxation: Federal and State Developments*, 20 INT'L LAW. 1049 (1986).

tions to more uniform international disclosure standards is an internationally accepted system of accounting to produce comparative financial statements and financial disclosure. Differences in accounting principles, auditing standards, and auditor independence standards are the major impediments to U.S. offerings by foreign issuers. Because the accounting principles and auditing standards are at the core of the disclosure system, accommodation of foreign standards and practice has been limited pending evolution of international accounting and auditing standards. Several private organizations, most notably the International Accounting Standards Committee (IASC), are working on such standards.[176]

The U.S. is a member of several organizations which are exploring the harmonization of disclosure and financial reporting standards.[177] The Organization for Economic Cooperation and Development (OECD) has recommended guidelines for multinational enterprises in "Minimum Disclosure Rules Applicable to all Publicly Offered Securities".[178] Though the U.S. is not a member, the European Economic Community (EEC) also has worked to harmonize disclosure law. The EEC guidelines include the Listing directive (intended to create uniform conditions for the admission of a security to stock exchanges), the Prospectus directive, and the Interim Reports directive (requiring regular publication of information about companies whose shares are listed).[179] The EEC has also issued guidelines on annual accounting ("fourth directive"–1978) and has proposed directives on group accounts ("seventh directive") and on auditing practices ("eighth directive").

The Commission staff has met informally with Japanese and Canadian securities regulators to discuss the possibility of reciprocal arrangements with foreign governments to allow mutual funds registered in one country to sell their shares in the other country without meeting additional compliance measures. As an alternative to negotiating a separate agreement with each interested nation, the Commission staff is exploring the possibility of achieving reciprocity for the sale of fund shares by an agreement with an international organization such as the EEC or the OECD.[180]

176. *See Acceptable Worldwide Accounting Standards Still Far Off*, 70 Daily Rep. for Executives (BNA) K-1 (Apr. 14, 1987).

177. Among them, the United Nations Commission on Transnational Corporations ("UN"). The UN proposals include a report of a group of experts on international standards of accounting and reporting. U.N. COMM'N ON TRANSNAT'L CORPS., INTERNATIONAL STANDARDS OF ACCOUNTING AND REPORTING FOR TRANSNATIONAL CORPORATIONS at 13, U.N. Doc. E/C.10/33, U.N. Sales No. E.77.II.A.17 (1977).

178. O.E.C.D. COMM. ON FIN. MKTS.,OECD MINIMUM DISCLOSURE RULES APPLICABLE TO ALL PUBLICLY OFFERED SECURITIES (1976).

179. Lorenz, *EEC Law and Other Problems in Applying the SEC Proposal on Multinational Offerigns to the U.K.*, 21 INT'L LAW. 795, 810–13 (1987).

180. *See* SEC REPORT, *supra* note 1, at VI-18. The EEC Council Directive 85/611/EEC "on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)" (the "Directive"), 28 O.J. EUR. COMM. (No. L 375) 3

Because of the rapidly expanding international securities markets,[181] in February 1985, the Commission published a concept release soliciting public comment on methods of harmonizing disclosure and distribution practices for multinational offerings by non-governmental issuers.[182] To help structure public comment, the Commission published two approaches designed to facilitate such multinational offerings: (1) an agreement that a prospectus accepted in an issuer's domicile would be accepted for offerings in participating countries if it meets pre-agreed standards ("reciprocal approach"); and (2) the development of a common prospectus which would be filed with each participating country's respective securities administrators ("common prospectus approach"). The Commission requested commentators to express their views regarding which of these approaches, or alternative approaches, would be practical and consistent with investor protection.[183]

Seventy commentators responded to the issues raised by the concept release. Substantially all of the commentators addressing the issue of the best approach to facilitate multi-national offerings favored the reciprocal approach, at least on an evolutionary basis. Twenty-one of the commentators considered the common prospectus approach ideal. However, the commentators were skeptical, believing that its implementation would be costly, subject to substantial time delays and, as a practical matter, difficult to achieve because of differences in standards, customs, and procedures.[184]

The Commission found little evidence to suggest that U.S. distribution costs,

(1986), and the "Standard Rules for the Operations of Institutions for Collective Investment in Securities" (the "Standard Rules") proposed by the OECD could serve as the basis for such a reciprocal arrangement. However neither the Directive nor the Standard Rules provide a regulatory framework directly comparable to that of the Investment Company Act. Therefore, any negotiations for a reciprocal agreements based on either the Directive or the Standard Rules would have to address the differences between those regulatory guidelines and the Investment Company Act. The SEC report suggests that any reciprocal treaty should seek to ensure that U.S. investors in foreign companies selling shares in the United States receive protection that is comparable to that received by investors in investment companies organized in the U.S. and operated in accordance with the ICA, and that U.S. investment companies are not placed at a competitive disadvantage to foreign investment companies, whether in the United States or abroad.

181. *See* Osborn, *The Rise of International Equity*, EUROMONEY, May 1984 at 63. *See also SEC Seeks Comments On Internationalization*, BANKING EXPANSION REP., Apr. 15, 1985, at 4.

182. Facilitation of Multinational Securities Offerings, Securities Act Release No. 6568, [1984–1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,743 (February 28, 1985). In April 1985, the Commission issued a release asking for comments on other aspects of the internationalization of the securities markets. Request for Comments on Issues Concerning Internationalization of the Worls Securitites Markets, Exchange Act Release No. 21,958 [1984–1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,759 (Apr. 18, 1985). To encourage consideration of ways of attaining the fairest and most efficient global secondary markets, the Commission solicited comment on what conditions and structures should characterize international trading markets and the comparison, clearance and settlement of resulting international trades. *Id.*

183. SEC REPORT, *supra* note 1, at IV-49.

184. *Id.* at IV-5O.

the U.S. reconciliation requirement, the segment profit and loss information requirement, or U.S. audit requirements constitute a serious impediment to foreign issuers raising capital in U.S. markets.[185]

The Commission has chosen to adopt the reciprocal approach initially. A noteworthy feature of the reciprocal approach is the adoption of the principle that a nation refrains from applying national regulations if the legislation in the other country is adequate, a principle underlying coordinated supervision.

With the experience of international banking as a guide, in the short term the experiences under the reciprocal approach, and the consultations among nations should provide the impetus for harmonizing legislation between the U.S., the United Kingdom, and Japan. The progress in uniform accounting standards should facilitate harmonization.

It is possible that empirical research in certain areas will be required to determine appropriate disclosure standards for the international securities markets. Without objective, empirical evidence on how to proceed, fear of compromising competitive positions can lead to compromise in standards causing regulation to degenerate to the level of the nation with the least stringent requirements. To prevent this scenario internationally recognized principles of securities regulation must be formulated and adhered to.

The experience of banking indicates that the best framework for cooperation is not a rigid system which binds each member nations but a loose, aspirational

185. *Id.* at IV-50–54. In January 1986, the Commission released a staff summary of the 30 comments received in response to the Global Trading Release. Summary of Comments on Concept Release Facilitation of Multinational Securities Offerings by the SEC Division of Corporate Finance, SEC Release No. 33-6568, S 7-9–85 (on file with the SEC). Commentators viewed the tendency for securities to be traded outside their market of origin and for investors to seek investment opportunities in foreign securities or markets as a positive development. Commentators also recognized that the Commission has an important role to play in the internationalization process, but generally cautioned that international trading markets should be allowed to develop further on their own without extensive involvement of the Commission at this point. Commentators did indicate, however, that the facilitation of intermarket trading linkages and international clearance and settlement facilities was an appropriate area for Commission action. Commentators also suggested that the Commission might play a useful role in encouraging agreement among the active trading markets regarding minimum standards for automated clearance and settlement systems. The Commission considered the Release and comment summary at a public meeting in May 1986, and endorsed the view of commentators that it should proceed cautiously in responding to the growth of transnational trading.

On February 17, 1987, the Commission conducted a Rountable Discussion on Internationalization. *Poor Stock Settlement Systems Seen Hampering International Stock Trading*, 19 Sec. Reg. & L. Rep. (BNA) 248 (Feb. 20, 1987). The participants concluded that: (1) international trading markets are expanding and are largely institutional, although home country markets will remain the primary and most liquid markets, particularly for equities; (2) the Commission should not impose regulatory solutions but should facilitate appropriate developments in the market; (3) international clearance and settlement is the largest single problem in this area; and (4) information and surveillance sharing among regulators and markets is crucial.

systems operating with informal consultations.[186] International banking authorities do not strive towards the creation of one supranational banking authority. The national authorities instead seek to achieve harmonization of the present forms of supervision, international cooperation between supervisory authorities and, as a result of the implementation of the principle of consolidation, supervision that transcends national borders.

The existence of overriding legal instruments, similar to EEC Directives,[187] are not necessary preconditions to integrated legislation.[188] It can, however, be anticipated that in the long term, consultations and cooperations will increasingly become formalized, to the point where nations agree to certain codified principles.

186. Basle Concordats do not have binding legal force, as they relate to an international banking system which is itself not governed by the provision of a single legal regime. This is an inevitable feature but one that does not weaken the commitment to the principles set out in the agreement. The members of the Offshore Supervisors Group representing all the major offshore centers worldwide were involved in the discussions leading up to the revised concordat and this Group was able to welcome and endorse its content at the time of its publication. Many other supervisory authorities have also done so since publication. The principles set out in the report are not necessarily embodied in the laws of the countries represented on the Committee. Rather they are recommended guidelines of best practices in this area, which all members have undertaken to work towards implementing, according to the means available to them. Article 6(a) of the Consolidation Directive, for similar reasons stipulates that the application of the principle of consolidation must be based on reciprocity in bilateral agreements between the competent authorities of the Member State and of a third country.

187. Under Article 189 of the EEC Treaty, Directives are instruments of the Community legislator which "shall bind any Member State to which they are addressed, as to the result to be achieved, while leaving to domestic agencies a competence as to form and means." Treaty Establishing the European Economic Community, March 25, 1957, 298 U.N.T.S. 11. *See also* Article 2, EEC Treaty (Objective of Treaty). This aim is complemented by Articles 52 to 66 of the EEC Treaty, which require liberalization of restrictions on establishment and services. *See also* the Council Directive of June 23, 1973 on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of self-employed activities of banks and other financial institutions. 16 O.J. EUR. COMM. (No. L 194) 1 (1973).

188. The first Council Directive of 12 December 1977 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions was an attempt to realize coordination through one all-embracing coordination directive. A draft for such a directive was presented to the Commission in 1972 but never made it to the EEC Council. Member States, disapproved of a system of concretely harmonized directives. From such a response, the Commission abandoned a comprehensive proposal and instead opted for gradual convergence of national directives on general principles. Progress was made fairly rapidly on the implementation of the principle of consolidated supervision. On June 13, 1983, the council of Ministers approved a Council Directive on the supervision of credit institutions on a consolidated basis, 26 O.J. EUR. COMM. (No. L 193) 18 (1973), which was confined to non-controversial general points of departure prescribes that the supervision of credit institutions that have a participation of more than 50% in another credit or financial institution should be on a consolidated basis. The Directive consequently requires the Member States to eliminate all legal obstacles to the exchange of information necessary for consolidation. *Id.* at 19–20.

Conclusion

The recent experience of regulators in globalized and internationalized capital markets ultimately illustrate the futility of unilateral measures. To succeed, regulation strategies must be predicated on harmonized approaches which do not interfere with efficient utilization of capital. In the transition to harmonized regulations, national policies should seek capital neutrality, particularly internations neutrality. By also following the process and principle of coordinating supervision in the Commission's implementation of the reciprocal prospectus approach, the resulting international cooperation will lead to formalized, codified principles of appropriate disclosure standards.