Transnational Aspects Of United States Securities Regulation

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I Introduction—The Regulatory Pattern

A. The Scope of the United States Securities Laws

To state the obvious, the United States securities laws, federal and state. regulate transactions in "securities." What is not so obvious is that the definition of the term "securities" is extremely broad, encompassing a good many economic instruments that bear only a remote relationship to traditional corporate securities such as stocks and bonds. It includes limited partnership interests, some interests in oil and gas or mineral rights, and certain promissory notes. The statutory definition also encompasses "investment contracts," a general term including widely varied arrangements whereby a person invests in a common enterprise and expects to receive a return on that investment derived from the efforts of others. Courts have considered the definition of "security" in numerous contexts, and case holdings must be consulted for specific guidance.

An understanding of the federal securities laws is impossible without an understanding of their jurisdictional basis. The United States Constitution grants only limited powers to Congress. These powers do not include a general "police power" of the sort that would normally serve as a basis to regulate transactions in securities. The power of Congress over securities transactions (as over many other areas in which it has asserted authority) is instead based on its power to regulate interstate commerce. Under prevailing interpretations of the United States Constitution, this includes almost all modes of communication and transportation. Since some aspect of interstate commerce, even if only the telephone, is involved in virtually every securities transaction, the federal securities laws reach virtually every securities transaction in the United States.

It is important to note that "interstate commerce" includes commerce between any of the states of the United States and any foreign state. Consequently, the federal securities laws apply, at least in theory, to every transaction in securities in which some use is made of a means of communication or transportation between the United States and another country. It is almost inevitable that the "jurisdictional means" will be involved in any securities transaction between a party in the United States and a party in another country. Communication with the United States often plays a role in securities transactions between parties both of whom are located outside the United States; therefore the securities laws may theoretically apply to such transactions as well.

Thus the origins of what some have criticized as the overly broad extraterritorial reach of the United States securities laws are not found in some kind of economic or legal imperialism but in the peculiarities of United States constitutional law. In order to find a constitutional basis for the exercise of its power, the Congress was forced to draft the securities laws to regulate transactions in securities that involve interstate commerce. It was only an incident to this jurisdictional foundation that they also reach transnational transactions that involve communications with the United States

B. The Relationship Between State and Federal Regulation

Securities are regulated in the U.S. by a complex regime comprised of the federal securities laws, which are applicable throughout the United States, and state securities laws enacted by and applicable in each of the fifty–two United States jurisdictions (the fifty states, Puerto Rico and the District of Columbia).

There are five principal statutes that make up the federal securities laws:

(1) The Securities Act of 1933[1] (the "Securities Act") regulates the use of prospectuses in connection with public offerings; prohibits fraud in connection with the sale of securities; and requires the registration of offerings and sales of securities with the Securities and Exchange Commission ("SEC").

(2) The Securities Exchange Act of 1934[2] (the "Exchange Act") is a broad statute that regulates public trading markets in securities. It requires that publicly–traded securities be registered with the SEC and that the issuers of those securities make various periodic disclosures. The Exchange Act also prohibits various types of fraud and manipulation in securities transactions; regulates proxy solicitations, tender offers, and insider trading; and, regulates broker–dealers by requiring them to register and comply with certain standards of behavior and financial soundness.

(3) The Trust Indenture Act of 1939[3] (the "Trust Indenture Act") requires that publicly–offered debt securities be issued under a trust indenture that includes provisions for an independent trustee and controls the trustee's duties, responsibilities and liabilities.

(1) 15 U.S C. §§ 77a *et seq.*

(2) 15 U.S.C. §§ 78a *et seq.*

(3) 15 U.S.C. § 77aaa – 77bbbb

(4) The Investment Company Act of 1940[4] (the "Investment Company Act") requires the registration of investment companies (principally mutual funds) and imposes various substantive controls on their operations.

(5) The Investment Advisers Act of 1940[5] (the "Investment Advisers Act") requires registration of persons and firms that give advice on securities investments or manage investment portfolios for others. It also prohibits fraud and regulates certain advisory practices.

In addition to federal securities laws, each state has its own securities laws, often referred to as "Blue Sky" laws.[6] Many of the state statutes require registration of securities offerings, subject to various exemptions. Consequently, a multistate offering often entails the substantial task of surveying and complying with all applicable state requirements. Efforts to harmonize state Blue Sky laws have lead to the enactment in thirty–one states of the Uniform Securities Act. Nevertheless, there are still significant variations in both law and administrative practice that complicate the process of compliance. Most of the states also regulate broker–dealers, investment advisers and investment companies through statutory provisions that parallel federal law.

C. The Securities and Exchange Commission

The primary agency for administration and enforcement of federal securities laws is the Securities and Exchange Commission ("SEC" or "Commission"). The SEC is an independent agency which exercises a broad rule–making authority regarding securities. Its membership is comprised of five persons serving five–year terms who are appointed by the President subject to confirmation by the Senate. The staff of the Commission processes filings such as registration statements filed under the Securities Act, proxy statements and periodic reports required by the Exchange Act. It also conducts investigations that may lead to enforcement actions or sanctions, and supervises the self–regulatory authorities.

(4) 15 U.S.C. §§ 80a–1 - 80a–52

(5) 15 U.S.C. §§ 80b–1 - 80b–21

(6) This rather peculiar name supposedly derives from a remark made by a particularly flamboyant state legislator during debate on one of the first of these statutes. This legislator, from a midwestern state, is said to have urged his colleagues to vote in favor of the statute lest sharp securities promot rs from back East start selling naive investors "interests in the blue sky."

D. Self–Regulatory Organizations and Other Authorities

The United States regulatory scheme leaves much of the day–to–day regulation of broker–dealers and securities exchanges to various so–called "self–regulatory organizations" ("SROs") and membership organizations. The SROs are quasi–private membership organizations sanctioned by the SEC and subject to its oversight. Their principal responsibilities are the adoption of rules governing the activities of their members and the enforcement of those rules through disciplinary proceedings. Currently there are ten registered national securities exchanges that function as SROs, among them the American and New York Stock Exchanges. The National Association of Securities Dealers ("NASD") includes among its members virtually all broker–dealers, including those that are not members of an exchange. The NASD also operates the National Association of Securities Dealers Automated Quotation system ("NASDAQ"), which amounts to an electronic exchange for the trading of stocks not listed on a major exchange.

Under provisions of the Exchange Act, SRO's must adopt rules to prevent fraud and to protect investors and the public interest by ensuring a free open market. The rules must establish procedures for disciplinary actions against members if they violate the organization's rules or the Exchange Act. The SEC retains the power to review such disciplinary procedures.

Generally SRO's do not demand extensive disclosures or impose other substantive requirements for companies whose securities are issued and traded, but they do exercise control over which securities are listed on the exchanges. In that connection, they may impose obligations not required by the SEC, disclosure of material corporate developments on a timely basis, such as solicitation of proxies for stock registered in "street names," and, in some exchanges, substantive corporate matters including voting rights.

E. Registration of Securities Offerings

If securities are to be offered publicly in the United States by a company, generally the offering must be registered with the SEC under the Securities Act. Registration is intended to insure adequate disclosure to investors. It involves the preparation and filing with the SEC of a prospectus that describes the company, its business, and the securities offered. The prospectus must be distributed to prospective investors.

The SEC reviews and approves the adequacy and form of the information in the prospectus. It does not have power to approve or disapprove of the securities, the company or the offering. Preparing a registration statement for the SEC—which includes the prospectus—is a long and often difficult project requiring the services of company staff, attorneys, accountants, representatives of the managing underwriter and others. The scrutiny of the SEC staff and concern for the substantial liabilities that can arise from an inadequate or incorrect prospectuses, force the participants to pay extreme care to selection and presentation of the material included in the prospectus.

Compliance with state securities laws must also be ensured, including an analysis of which states will be included in the offering, the applicable requirements in each state, and preparation of the necessary forms and materials required to comply. In many states the process is simple, involving the submission of materials similar or identical to those going to the SEC; however, in others it may require additional information.

F. Exempt or Private Offerings

Certain securities offerings are exempt from the general registration requirement. Probably the most important exemption for typical corporate securities is the exemption for "private offerings." In general these are offerings to a limited group of investors that are sufficiently wealthy to be able to stand the risk of the investment in question and sufficiently sophisticated to be able to evaluate the offering. It is assumed that these investors are furnished adequate information about the offering or have the ability to obtain it. Investors that acquire securities in an unregistered private offering are usually limited in their ability to sell the securities. The SEC has promulgated rules that establish conditions under which purchasers can make such secondary sales, subject to stringent limitations.

G. Disclosure Requirements for Publicly–Traded Securities

Whereas the Securities Act requires a single set of disclosures in connection with public offerings of securities; the Exchange Act requires periodic disclosures after securities become publicly–traded. All companies that list securities on a national securities exchange or have more than 500 shareholders in the United States and $5 million in assets, must register their securities with the SEC. Issuers must file with the SEC an annual report, quarterly reports and reports of significant events as they occur. They must also distribute an annual report to their shareholders. They must also distribute a proxy containing specified information in connection with annual or special meetings of shareholders. The overall effect of the Exchange Act is that virtually all widely–held companies must register with the SEC and comply with the disclosure requirements of the Exchange Act.

H. Regulation of Exchanges and the Over–the–Counter Market

Regulation of securities exchanges and the over–the–counter market in the United States is accomplished by a combination of (i) the self–regulatory functions of the exchanges and NASD, as described above and (ii) the Exchange Act regulations requiring that securities listed on exchanges be registered under the Exchange Act and undertake the periodic disclosure requirements described in Part G above.

I. Regulation of Broker–Dealers

Broker–dealers are regulated under both federal and state securities laws. The Exchange Act requires that all broker–dealers must register with the SEC, except for a few who are exempt from registration requirements because they trade only intrastate or in exempted securities. Most state Blue Sky laws require the registration of broker–dealers that do business in the state. There are penalties or remedial sanctions that may be levied by both the SEC and the state securities commissions for violations of the federal or state laws by broker dealers, and registration may be revoked or denied. Broker–dealers must comply with the rules of the applicable SRO if their securities firm is a member, and all registered broker dealers must be members of the NASD, and comply with its rules, since it is the only registered association of securities dealers. Persons working for a broker–dealer must be licensed as "registered representatives" and must pass one or more examinations given by the NASD. Finally, the authorities that regulate broker–dealers require certain record keeping and reporting with regard to broker–dealer activities.

J. Investment Companies

Investment companies are entities that hold portfolios of securities of other companies. They are regulated by the SEC under the Investment Company Act. Investment companies must also comply with the Securities Act in selling their shares and are subject to the periodic reporting requirements and some other provisions of the Exchange Act.

K. Enforcement

The SEC is the agency principally responsible for enforcement of the federal securities laws. It has investigatory powers, including the power to compel the production of documents and testimony. The SEC's principal enforcement tools are administrative orders issued after quasi–judicial administrative proceedings and injunctions issued by federal courts in cases brought by the SEC. Administrative orders usually direct the respondent not to violate the statutory provisions in question in the future and often impose remedial measures. In serious cases, the registration of a broker–dealer or other registered person may be suspended or revoked. Injunctions obtained by the SEC also generally direct the defendant not to repeat the violation in question. The SEC also often asks for monetary sanctions in the form of orders that the defendant disgorge the fruits of his wrongdoing. Insider trading cases can also lead to the imposition of civil penalties.

There are criminal sanctions for willful violations of the securities laws, but the SEC lacks criminal powers; accordingly, criminal cases are investigated and prosecuted by the Department of Justice.

Most states have a Securities Commissioner or similar official responsible for the administration and enforcement of its Blue Sky laws. State criminal prosecutions are usually carried out by the state attorney general.

Finally, the SROs have power to discipline members for violation of SRO rules. Sanctions usually involve fines or suspensions, and may include other remedial measures.

L. Private Litigation

As an adjunct to the enforcement powers of federal and state authorities private litigants have standing to bring actions for damages or injunctions to remedy injuries they have sustained as a consequence of a violation. In some cases the remedies are expressly provided by statute. In others the courts have implied the existence of a private cause of action from the general statutory scheme. The threat of liability from a private lawsuit is an important concern in the ordering of private securities transactions.

II Transnational Offerings Of Securities

Recognizing the difficulties that foreign issuers would have in complying with the registration requirements of the Securities Act, the SEC has adopted a modified set of rules for "foreign private issuers."[7] It has similarly modified the rules governing reporting under the Exchange Act. Of course, if a public company ceases to qualify as a foreign private issuer, it becomes subject to the same requirements that apply to United States issuers.

A. Introduction

1. Registration Requirements Under the Securities Act

Under the Securities Act, each issuance of securities must either (i) be registered with the SEC or (ii) fall within one of the exemptions from registration requirements listed in Sections 3 and 4 of the Act.

To register an offering, the issuer must file a two-part registration statement containing, among other things, audited financial statements, detailed information about the issuer's business and a full description of the terms of the securities being issued. The first part of the registration statement consists primarily of the prospectus, copies of which must be delivered to offerees during the offering period prior to the consummation of the purchase and sale. The second part contains information that is not required to be in the prospectus, but is required to be provided to the SEC, principally a variety of "exhibits" – documents relevant to the issuer's business. The information

(7) A "foreign private issuer" is defined in Rule 405 under the 1933 Act and in Rule 3b–4(c) under the 1934 Act as "any foreign issuer other than a foreign government except an issuer meeting the following conditions: (1) more than 50 percent of the outstanding voting securities of such issuer are held of record either directly or through voting trust certificates or depositary receipts by residents of the United States; and (2) any of the following: (i) the majority of the executive officers or directors are United States citizens or residents, (ii) more than 50 percent of the assets of the issuer are located in the United States, or (iii) the business of the issuer is administered principally in the United States."

required to be included in the registration statement is dictated in part by the form according to which it must be prepared. Foreign private issuers offering securities for the first time in the United States must file on Form F–1.

After the registration statement is filed with the SEC in Washington, D.C., the staff determines whether it will be given a full review, a limited review or no review. Generally, registration statements for initial public offerings receive a full review. The process takes approximately a month, at the end of which the staff gives the issuer comments on the filing. The issuer generally responds by filing an amendment to the registration statement with an explanatory cover letter. The SEC staff may issue further comments on the amendment, which in turn leads to further amendments. The entire process, from the initial filing of the registration statement to the day the SEC staff declares it to be "effective"[8] (and the securities become "registered"), normally extends for six to eight weeks.

For most public offerings the underwriters are actively engaged in selling efforts, during the time between the initial filing and the effectiveness of the registration statement. The "preliminary prospectus" (in the form originally filed with the SEC) is their principal selling document. Although the members of the selling group may solicit offers to buy the securities, sales cannot be made until after the registration statement becomes effective. A copy of the final form of prospectus must be delivered to each purchaser not later than the time at which the sale is affirmed.

The SEC has consistently taken the position that media advertising or promotional brochures which advertise the issuer (rather than a product) are unauthorized offering materials if they are disseminated prior to or during an offering. Similarly, meetings with analysts or potential investors during this period can raise concerns. While there are a number of narrowly defined exceptions to these prohibitions, caution must be exercised from the outset to avoid infractions in this area.

Securities in an amount up to the amount registered can be sold in the manner described in the registration statement. Any future issuance of securities by the issuer (even securities of the

(8) Although the language used by practitioners suggests that the SEC "declares the registration statement effective," this is not technically what happens. Under the 1933 Act a registration statement becomes effective automatically 20 days after it is filed (with each amendment thereto starting a new 20–day period). As a practical matter, it is usually not possible for an issuer to wait 20 days after filing the "pricing amendment," which gives the price and final terms of the securities, before closing the sales. Accordingly, it is a practical necessity to obtain the SEC's consent to "accelerating" the effectiveness of the registration. It is this acceleration that amounts, in practical terms, to "declaring the registration statement effective." To obtain acceleration, the issuer must amend the registration statement to include disclosures requested by the SEC. Once the SEC is satisfied that all of its comments have been adequately addressed, it will, in coordination with the issuer, declare the registration statement effective.

same class as the securities registered) must be registered pursuant to a new registration statement (if such issuance is not exempt).

Rule 415 provides for the registration of securities (including securities registration Form F-3, discussed below) to be offered on a continuous or delayed basis. This registration procedure makes it possible to bring issues to market on a few hours notice by having them preregistered and "taking them off the shelf." Under the "shelf" procedure, a foreign private issuer is required to file unaudited interim financial statements as post-effective amendments to the shelf registration statement so that at all times during a continuous offering (or at the start of a delayed offering) not more than six months have elapsed since the date of the latest filed financial statements.

2. Registration of ADRs

Most securities of foreign private issuers are traded in the form of American Depositary Receipts ("ADR"), which are certificates evidencing ownership of a specified number of American Depositary Shares ("ADS"). This facilitates expeditious transfer between United States stockholders in United States dollars and dissemination of annual reports and other documents to United States stockholders. Each ADS represents a specified number of shares of the foreign private issuer, which are deposited with a custodian bank outside the United States. ADRs issued in this manner, at the issuer's request, are considered part of a "sponsored" ADR Program.

For United States securities law purposes, the ADS is a separate security from the underlying common shares. Consequently, the issuance of an ADS (evidenced by an ADR) must be registered under the Securities Act whether or not there is a transaction requiring registration of the underlying shares. The form for this registration is quite simple, and the registration process is a formality.

3. Consequences of Registration

In addition to annual and periodic reporting requirements under the Exchange Act, registrants become subject to proxy rules, insider trading and reporting rules, and tender offer rules. Both the Securities Act and the Exchange Act also impose civil and criminal liabilities on registrants. The SEC has taken the position that the anti-fraud provisions apply to all transactions in securities and all tender offers, respectively, subject to the limits of the extra-territorial scope of the United States law.

Foreign private issuers may also be subject to private civil liability under United States federal securities laws, although such provisions may not be enforceable by foreign courts.. The major private civil liability provision is Rule 10b–5 which extends to any materially misleading statements made with "scienter" (i.e., an intent to deceive, manipulate or defraud) in an Exchange Act filing or otherwise by a company in connection with a purchase or sale of a security using United States "jurisdictional means."

4. Exceptions to the Registration Requirements of the Securities Act

As discussed above, any offer or sale (broadly defined) of any securities in the United States or to United States residents must either be registered with the SEC or fall within one of the Securities Act's exemptions from such registration. Exemptions fall into two classes: exempt securities and exempt transactions. As a general matter the exemptions of various types of securities would seldom be relevant to a foreign issuer.

(a) Private Offerings

Section 4(2) of the Securities Act exempts from registration offers and sales of securities made "in transactions by an issuer not involving any public offering." This phrase is construed to refer to transactions by an issuer not involving any public offering in the United States or to United States residents or nationals. While the limits of this exemption are not well defined, the underlying principle is that the exemption should be available only in those cases in which the offerees and purchasers of the securities do not require the protection of Securities Act registration. The following factors are considered important:

(a) The number of offerees and purchasers must be limited.

(b) There must be no general solicitation or advertising.

(c) Information comparable to that which would have been provided by a registration statement and which is "material" to investors under the circumstances must be known by or provided to offerees and purchasers (generally in the form of a private placement memorandum).

(d) The offerees and purchasers must be capable of evaluating the merits and risks of the investment.

(e) There must be procedures designed to prevent resale by purchasers which would extend the initial limited offering into a broader distribution in the United States or to United States persons that would not qualify for the exemption.

Pursuant to Rule 506 of Regulation D, the SEC has established a "safe harbor" for exempt private placements whereby an issuer can sell a theoretically unlimited amount of securities so long as it sells to no more than 35 persons who are not "accredited investors," provides certain information to purchasers who are not accredited, places certain restrictions on resales of the securities, does not engage in a "general solicitation," and files a very brief form with the SEC notifying it of the transaction. Billions of dollars worth of securities are placed in reliance on this exemption every year.

Regulation D includes two other exemptions, one for offerings under $1 million and one for offerings under $5 million. In general, the differences between these exemptions and the exemption under Rule 506 are technical and not normally of great importance.

(b) Rule 701

Rule 701 provides an exemption for private companies from the registration requirements of the Securities Act for sales of securities pursuant to the terms of compensatory benefit plans or compensation agreements.[9] Securities issued in reliance on Rule 701 are "restricted securities" under the Securities Act, and therefore are not freely tradeable. Consequently, resales must be made pursuant to an effective registration statement or in a transaction that is exempt from registration.

(c) Other Exemptions

There is an exemption under Section 3(a)(11) for "intrastate offerings." This exemption is unavailable for transnational transactions, as it requires that the issuer be organized and conduct most of its business in a single state of the United States.

"Regulation A" provides an exemption for offerings of $1.5 million or less, although it is not available to foreign issuers except Canadian issuers. This "exemption" really provides for a sort of short-form registration.

B. State Blue Sky Laws

States also regulate the offer and sale of securities under their Blue Sky laws. Each state has its own set of regulations. Unlike the SEC, which does not attempt to evaluate the investment quality of the securities being registered, some states may reject the registration and sale of a security

(9) Such plans or agreements must be established by the issuer, its parent or majority–owned subsidiaries for the participation of their employees, directors, officers, consultants or advisors.

in the state if the responsible state officials consider the security too risky. Qualifying an issue under state laws is often complex and time–consuming, although there are in general no issues of such qualification that are particular to transnational offerings. In some states, however, foreign issuers may have greater difficulty obtaining an exemption from registration of an offering, even if it is exempt from registration under the Securities Act.

C. Registered Public Offerings by Foreign Issuers

There are very few differences between the process of registration under the Securities Act for a foreign issuer and that for a domestic issuer.

1. Registration Forms

The SEC has established a three–tiered registration system for foreign private issuers (Forms F–1, F–2 and F–3) that parallels the system for United States issuers and certain Canadian companies (Forms S–1, S–2 and S–3). The Forms are designed to work as a coordinated system of uniform disclosure requirements.

Although the basic registration statements, Forms S–1 and F–1, are the forms most frequently filed, alternate forms are permitted in certain limited circumstances. Since these alternative forms require less detail than Forms S–1 and F–1, they simplify the registration process. Forms S–2 and F–2 are available to issuers that have been registered under the Exchange Act for at least three years. Form F–2 is also available to so–called "world class issuers" (i.e., issuers whose voting stock held by non–affiliates has an aggregate value market value of at least U.S. $300 million) and to companies registering investment grade debt, providing in each case that they have already filed a Form 20–F with the SEC. Forms S–3 and F–3 require that the company have both the three year reporting history and a minimum market value, except that the market value requirement does not apply when the company is offering investment grade debt.

Forms S–2, S–3, F–2 and F–3 allow the use of a short–form prospectus which merely describes the securities being distributed and the plan of distribution, and incorporates by reference the issuer's most recent filing under the Exchange Act on Form 10–K or 20–F. Forms S–3 and F–3 are generally not subjected to SEC review and allow the issuer considerable flexibility in the timing of an offering. In the case of a Form S–2 or F–2 prospectus (but not the Form S–3 or F–3), if the company elects to incorporate by reference its annual report to shareholders or its latest Form 20–F, as the case may be, a copy of the document must actually be delivered with the prospectus.

2. Special Disclosure Problems

(a) Accounting Issues

Normally the financial statements of a foreign issuer are presented in the currency of the country in which the company is incorporated. In addition, financial statements filed as part of Form S–1 or F–1 may be based on the accounting principles followed by the registrant in reporting to its domestic security holders. However, if there are material differences between the foreign accounting principles and United States Generally Accepted Accounting Principles ("GAAP"), a reconciliation to United States GAAP and the provisions of Regulation S–X (the regulation governing the presentation of financial statements in SEC filings) must also be filed. If the issuer desires to use the "short form" registration Forms F–2 or F–3 for public offerings of its securities, it may be required to provide disclosure of all information required by United States GAAP and Regulation S–X, such as full segment information, pension data and various supplemental information (e.g., oil and gas reserve data).

Fiscal year financial statements required in either a registration statement or an annual report filed with the SEC must be audited by an independent public accountant. The independent accountant need not be licensed to practice in the United States, although the audit must be conducted substantially in accordance with United States generally accepted auditing standards.

D. Private Offerings by Foreign Issuers

The private offering exemption is just as available to foreign issuers as to domestic ones. The principal difference for transnational offerings is that the limitations upon resales by purchasers in a private placement need not extend to resales outside of the United States to non–U.S. persons. The only limitation is that any securities so sold are not then resold into the United States or to U.S. persons in a continuing distribution of the securities. The arrangements necessary to prevent "flow–back" into the United States may depend upon the extent to which there is an existing U.S. market for the securities.

E. Offerings Abroad by United States Issuers

Because the jurisdictional provisions of the United States securities laws are based on the use of the facilities of "interstate commerce," every foreign offering by a United States issuer is at least theoretically subject to the registration requirements of the Securities Act. The SEC has long recognized, however, that the primary purpose of the Act was to protect United States investors, and that it should not generally be applied in the context of foreign offerings. In 1964, prompted in large part by the increasing number of "Eurodollar" offerings by United States companies, the SEC issued Release No. 4708[10] to clarify the law governing such offerings. The release, and a series of subsequent SEC pronouncements in the form of "no-action letters," clearly established the principle that no registration under the Securities Act would be required if an offering was made exclusively to foreign residents who were not United States citizens and if the securities "came to rest" abroad. In order to meet this latter condition, issuers were required to take precautions to prevent "flow-back" of the securities into the United States for a period of three months to one year, depending upon whether the security was a debt or an equity security.

With the increasing volume of international securities transactions, the SEC has found it necessary to clarify and update the rules developed under Release 4708. The steps it has taken to do so are discussed below.

F. Efforts to Facilitate Internationalization

The internationalization of securities markets generally, as well as the global equity offerings associated with the privatization of various government-owned companies, have contributed to a growing number of multinational public offerings.

The SEC has been considering alternative regulatory approaches to harmonize disclosure and distribution practices for multinational offerings by non-governmental issuers since the issuance of a concept release on the subject in February of 1985. It has recently adopted two changes to its rules, Regulation S and Rule 144A, that should remove or alleviate some of the regulatory barriers to transnational offerings. It is continuing to consider changes in its rules and practices that would make further progress toward the goal of minimizing these barriers.

1. Regulation S

Regulation S consists of a series of rules that clarifies the application of Securities Act registration requirements to international transactions. It was adopted in April of 1990. Historically, the primary question in determining if registration requirements applied was whether the purchaser was a United States citizen or resident. In general, Regulation S provides that an offer or sale outside the United States is not subject to registration under the Securities Act if (i) it is made in an "offshore transaction," (ii) there are no "directed selling efforts" in the United States, (iii) it is unlikely, because of the nature of the securities or measures taken by the parties, that the securities will end up in U.S markets, and (iv) the parties justifiably expect that the transaction will be offshore.

(10) Securities Act Release No. 4708 (July 9, 1964).

Regulation S contains specific safe harbors for initial public offerings and for resales of securities. The regulation distinguishes three classes of offerings by issuers, each of which has different requirements for the safe harbor. For offerings as to which there is likely to be little or no U.S. market interest, there are no special requirements for eligibility for the safe harbor. Offerings by companies subject to the Exchange Act and offerings of debt or senior securities of foreign issuers are subject to a forty-day restricted period in which the securities cannot be sold in the United States. Additionally, foreign offerings by non-reporting United States companies and equity offerings of non-reporting foreign companies with a substantial United States market interest would be subject to restrictive procedures to guard against the flow-back of securities to the United States.

In addition to the "issuer safe harbor," there is a safe harbor for the resale of securities outside of the United States by persons not participating in a distribution during any restrictive period under the issuer safe harbor. Resales into the United States are permitted under the limited conditions of Rule 144A (discussed below). They are also permitted in retail transactions after the securities are "seasoned," pursuant to Section 4(1) of the Securities Act.[11] While ordinary investors would be able to resell any securities with no restrictions (other than the general conditions that the offer and sale be made offshore and without directed selling efforts), resales by dealers and other securities professionals would be subject to other restrictions. The "resale safe harbor" also would permit resales of any securities on established foreign securities exchanges and designated organized foreign securities markets.

2. Rule 144A

The SEC has recently adopted Rule 144A to encourage foreign issuers to use the United States private placement market by permitting secondary trading of privately placed securities among "qualified institutional buyers." In general this category includes institutions that have a securities portfolio valued at not less than $100 million. The rule applies only to "non-fungible securities," that is securities that are not of the same class as a security that is traded on a United States national securities exchange or quoted on NASDAQ.

The rule is available only if "reasonable steps" are taken to prevent further resales in the United States unless the securities are registered or an exemption from registration is available. Foreign issuers that do not file reports under the Exchange Act (other than those that are exempt

(11) This section exempts from registration sales by a person who is not an "issuer, underwriter, or dealer." Because of the statutory definition of "underwriter," this exemption is somewhat narrower than it might at first appear. The exemption would, however, generally permit resales by investors that purchased relatively small portions of an offering for investment purposes.

from Exchange Act reporting pursuant to Rule 12g3–2(b) are required to provide certain descriptive and financial information to a buyer upon request.

3. Multijurisdictional Disclosure

The SEC and the Ontario Securities Commission and the Commission des Valeurs Mobilières du Que'bec have released parallel proposals intended to facilitate cross–border securities offerings and tender offers. Qualified issuers (meeting specified market value, public float and reporting history tests) could use domestic offering materials, reviewed by their domestic securities administrators, to offer securities across the border. In specified circumstances, domestic disclosure documents could also be used in rights and offerings involving shareholders of the other country and for meeting the countries' proxy, insider trading and continuous disclosure requirements. The proposed multi–jurisdictional disclosure system would permit third party and issuer share exchange and cash tender offers to be made in compliance with the applicable regulations of the target's home jurisdiction where less than 20 percent of the securities subject to the offer are held of record by residents of the other jurisdiction.

In all cases, the regulatory provisions of the receiving jurisdiction which establish civil and criminal liability or misrepresentation, fraud or market manipulation would continue to apply and the securities administrators of the receiving jurisdiction would retain substantial authority with respect to the transaction.

The intention of the these securities administrators is to extend the proposed system by eliminating the market value and public float tests and that similar systems may be adopted with respect to the regulatory requirements of other jurisdictions.

III. Registration And Reporting Requirements Under The Exchange Act For Issuers Of Securities

A. Registration

The Exchange Act contains requirements for registration of securities distinct from the registration requirements of the Securities Act. Whereas the Securities Act calls for registration of the issuance of new securities even if securities of that class were registered previously, registration under the Exchange Act involves a one–time registration of an entire class of securities. Registration under the Exchange Act is generally required (1) for all securities traded on a United States national securities exchange; (2) for all securities included in NASDAQ;[12] and (3) for all issuers with $5 million in assets and a class of securities held by at least 500 persons. This requirement has been modified by Rule 12g–1 which exempts from registration the securities of any issuer (whether U.S. or foreign) which, on the last day of its fiscal year, has total assets of less that $5 million and, in the case of a foreign private issuer, is also not quoted on an automatic quotation system such as NASDAQ. In addition, Rule 12g3–2 exempts any class of a foreign private issuer's equity securities from registration if that class of securities has fewer than 300 holders of record who are residents of the United States (Rule 12g3–2(a)), and exempts all classes of a foreign private issuer's securities if it provides certain information to the SEC detailed in Rule 12g3–2(b). Such information is similar to that required of foreign private issuers (discussed below) except that an annual report is not required. Under Rule 12g–2(d)(3), this information–supplying exemption is not available for securities quoted on NASDAQ.

Under Section 12 of the Exchange Act, foreign private issuers subject to the Exchange Act must initially register the relevant class of securities under the Exchange Act by filing a Form 20–F. This form requires the disclosure of specific textual and financial information similar to that required in a Securities Act registration statement.

(12) Such registration, although not necessarily required under the 1934 Act, is effected pursuant to the provisions of Section 12(g) of the 1934 Act, which allows issuers to register equity securities voluntarily.

B. Reporting Requirements

The Exchange Act requires an issuer to file periodic reports with the SEC if it has filed a registration statement under the Securities Act[13] or has registered securities pursuant to either Section 12(b) or Section 12(g) of the Exchange Act. A foreign private issuer that is subject to the periodic reporting requirements of the Exchange Act is required to file an annual report, also on Form 20–F, within 6 months after the end of each fiscal year. In addition, a foreign private issuer is required to make periodic reports containing "significant" information that the foreign issuer: (1) is required to make public in its own country, (2) has filed with a non–U.S. stock exchange on which the issuer's securities are traded and which the exchange has made public or (3) has distributed to holders of its securities. More specifically, the issuer must disclose significant information that has been publicly disclosed and relates to:

(1) changes in management or control;
(2) acquisitions or dispositions of assets;
(3) bankruptcy or receivership;
(4) changes in certifying accountants;
(5) the financial condition and results of operations;
(6) material legal proceedings;
(7) changes in securities or in the security for registered securities;
(8) defaults upon senior securities;
(9) material increases or decreases in the amount outstanding of securities or indebtedness;
(10) the results of the submission of matters to a vote of security holders; or
(11) any other information which the issuer considers of material importance to security holders.

This information must be submitted to the SEC promptly after it is made public. The information must be in English and issuers must provide English translations of all information distributed to shareholders and all material press releases made by the company.

(13) Under Rule 12h–3(b)(2) of the 1934 Act, the filing requirements of Section 15(d) do not apply to any class of securities (i) which are held of record by less than 300 persons (or, in the case of a foreign private issuer, held by less than 300 U.S. residents) or (ii) held of record by less than 500 persons (or 500 U.S. residents for foreign private issuers) when the issuer's total assets have not exceeded $5 million on the last day of each of its three preceding fiscal years.

If a foreign private issuer's securities are quoted on NASDAQ, the issuer must also report any aggregate increase or decrease in the amount of a quoted class of securities which exceeds 5% of the last reported total number of that class of securities.

In addition to the specific reporting requirements discussed above, sound corporate practice and the anti–fraud provisions of the securities laws generally require that public companies promptly make full and prompt disclosure of any other corporate developments that would materially affect decisions by shareholders or investors.

If securities of a foreign private issuer are registered under Section 12 of the Exchange Act, certain other provisions of the Exchange Act and the related SEC rules become applicable. These include Sections 13(e) (imposing certain disclosure requirements when an issuer repurchases its own securities), 13(d) (imposing reporting obligation for holders of more than 5% of such securities) and 14(d) and 14(e) (governing third party tender offers for such securities). Foreign private issuers are, however, exempt from the rules governing proxy solicitations (Section 14(a) and the rules thereunder) and the recovery of profits made by "insiders" in "short–swing trading" (Section 16(b)).

IV International Aspects Of The Regulation Of Securities Markets

A. Regulation of Exchanges and Trading

1. Inter–Market Manipulation

The increased internationalization of the securities markets has provided a new potential for price manipulation. Because markets in different countries are increasingly linked by arbitrage, for example, a person can profit in one market from price manipulation in another. Inter–market manipulation can be difficult to detect and prosecute because of different regulatory regimes in each national market and the lack of an international system for surveillance and information sharing.

In the last several years, certain marketplaces have entered into agreements to make surveillance information available to their overseas counterparts, within the limits of what is permitted under their national law. These surveillance–sharing agreements, while they are encouraged by national regulators, are negotiated and entered into by the exchanges and similar marketplaces as private entities. They are thus separate from bilateral agreements entered into by national regulators to cooperate in securities–related investigation and enforcement matters.

In the United States, the SEC has strongly encouraged surveillance–sharing agreements on the marketplace level. The foremost motivating factors for these agreements have been (1) the establishment of electronic trading linkages between markets in different countries and (2) new listings by United States exchanges of index futures contracts based on overseas stock indexes.

To date, the SEC has conditioned its approval of trading linkages involving United States markets on, among other things, agreements for sharing surveillance information between the linked markets. As for trading futures on overseas stock indexes, United States law requires the SEC to certify that the proposed futures contract meets certain criteria before the Commodity Futures Trading Commission ("CFTC") can designate the market for trading the futures contract. One of the most important of these criteria is that the index not be "susceptible to manipulation." The SEC has interpreted this as requiring the United States market to obtain an agreement to share surveillance information with the foreign markets on which the underlying index stocks trade. In practice, this means that the United States market is required to enter into agreements with those overseas markets that together trade at least 75% of the index value of the contract, including any overseas foreign market that represents 10% or more of the value of the index.

Generally, surveillance-sharing agreements between marketplaces provide for access to trade information relevant to the market linkage or to the underlying index stocks or derivative securities, so long as national law does not legally obligate the marketplaces to keep such information confidential. The SEC has obtained written assurances from the Canadian exchanges that have linkages with United States markets, and from the Tokyo Stock Exchange, which has agreements with several United States markets, that any blocking or confidentiality requirements to which they are subject under their national laws will not prevent the exchange of information necessary for regulation of the United States markets.

All of the trading linkages between United States markets and markets in other countries to date include agreements to share routine surveillance information, as well as information that is specifically requested for investigatory purposes.

In connection with recent listings of futures and options on overseas indexes, the Chicago Board of Trade ("CBOT"), the Chicago Mercantile Exchange ("CME") and the American Stock Exchange ("Amex") have all concluded agreements with the Tokyo Stock Exchange. The CME and the Amex also have surveillance-sharing agreements with The Securities Association ("TSA"; the self-regulating organization of the International Stock Exchange in London). The Amex has a memorandum of understanding concerning surveillance sharing with the European Options Exchange ("EOE") with respect to transactions in options on the Major Market Index, which are traded on both the Amex and EOE.

2. Linkages between Exchanges

In the past several years, a number of electronic linkages have been established between markets in different countries. The type and degree of inter-market connections these provide is diverse. To provide a more accurate picture of recent developments, the description that follows covers not only linkages between marketplaces, but also connections designed to unilaterally project a market across international borders.

Some linkages merely enable a market to project its market quotations overseas, and do not provide execution capacity. In this category are two linkages between dealer markets established by the NASD. The first, instituted in 1986, is with the SEAQ system of the International Stock Exchange ("ISE") in London. The second, with the Singapore Stock Exchange's automated system, was instituted in 1988. Through the linkage with ISE, the NASD sends selected quotations from its automated quotation system, NASDAQ, to SEAQ for distribution to market-makers active in those stocks; the ISE likewise sends quotations in selected SEAQ stocks to the NASD for distribution to NASDAQ market-makers active in those SEAQ stocks or in ADRs on those stocks.

The NASD/Singapore linkage operates in much the same manner, but because of differences in time zones is limited to end-of-day quotation information on the selected stocks.

Another type of international linkage is order routing in dually-listed securities. The Boston Stock Exchange and the Montreal Stock Exchange reached such a linkage agreement in 1984, enabling members of the Montreal Exchange to transmit orders to Boston in designated stocks. Similarly, the Midwest Stock Exchange ("MSE"), in 1984, and the Amex, in 1985, established mutual order-routing linkages with the Toronto Stock Exchange for dually-listed stocks. However, the linkages with Toronto have had limited success and have been dormant since 1988 due to low levels of use.

Still another type of market linkage is the Amex's joint listing agreement with the EOE in Amsterdam, which provides for a "mutual offset arrangement" (i.e., a common clearing entity) for trading options on the Major Market Index. This licensing arrangement, reached in 1987, enables the EOE to trade options that are fungible with the Major Market Index options traded on the Amex.[14]

Proprietary electronic trading systems provide yet another way to expand markets internationally, though the function of such a system is not generally to establish trading links between existing exchanges, but to project a new or existing market across national borders. One of the more successful of such systems is Instinet;[15] also, a number of exchanges have been developing after-hours electronic trading systems to enable their market to be extended internationally. A recent ambitious proposal of this type is "Globex," the CME's system for automated, after-hours trading of futures and options on futures. The CME has been negotiating with a number of other exchanges in the United States and overseas for their participation as Globex partners. Contracts traded in "partner" markets can be listed for trading through Globex, but all clearing of Globex trades will be left to the local exchanges.

While talks have been delayed between the CME and the Chicago Board of Trade over a joint electronic system, the CME has already arranged in principle for links to be established

(14) In a like arrangement dating from 1984, the CME established a mutual offset linkage with the Singapore International Monetary Exchange ("SIMEX") for currency futures traded on the CME. Similar mutual offset linkages have been established between the Sydney Futures Exchange and the Commodity Exchange ("COMEX") and the London International Financial Futures Exchange ("LIFFE") for gold futures.

(15) Instinet is a U.S. proprietary electronic trading system that has expanded into international markets by becoming a registered broker with the U.K. Securities Investment Board; becoming a member of the International Stock Exchange, the European Options Exchange and the Toronto Stock Exchange; and becoming authorized by Japanese authorities to provide Instinet services in Japan.

between Globex and exchanges in London and Paris; also, U.K. regulators have agreed to permit Globex to operate in the U.K. However, there may be problems establishing linkages with other overseas exchanges. The Sydney Futures Exchange has suspended negotiations owing to cost, as well as to concerns about how regulatory control of the system will be handled. Concerns raised by regulators in Japan also threaten to delay installation of Globex terminals there. A principal uncertainty is whether the regulatory scheme advocated by the CME for Globex will be accepted by regulators in countries where terminals are proposed to be installed (*i.e.*, whether host countries other than the U.K. will accept regulation by the system's source (the CME) with respect to terminals located in the host countries).

To date, the exchange linkages that have been established are relatively modest in terms of their degree of inter–market integration. Some proposals for future linkages are more ambitious. Problems that will have to be addressed before there can be more elaborate linkages include integrating market data from "auction" and "dealer" markets; establishing more efficient international clearance and settlement systems; and achieving greater uniformity in rules and regulatory structures among national markets.

3. Clearance and Settlement

Systems for clearing and settling securities transactions across national borders have tended to be established as individual, private links between brokers and the clearing and settlement systems of the countries of execution. However, there are exceptions, such as the International Securities Clearing Corporation ("ISCC"), a wholly–owned subsidiary of the United States National Securities Clearing Corporation ("NSCC") intended to function as a bridge between the United States and the full services of overseas clearing organizations. For example, ISCC has established a link between London and United States clearing systems. Currently, however, as there are only a handful of international clearance and settlement linkages in place, clearance and settlement of international securities transactions has been a barrier to the flow of capital among international markets.

Of the linkages that have been established between national clearing organizations, many provide only for transactions in one direction. In addition, most linkages deal primarily with custody, and do not offer facilities for the full clearing and settling of international trades. Some of the problems limiting the establishment of direct clearing and settlement linkages between markets are the lack of uniform international standards for settlement cycles, payment procedures and transfer of ownership of securities. Many jurisdictions lack a central national depository with a book–entry system, a trade comparison system and netting facilities. While development of a centralized international clearing and settlement system is considered the ideal, the industry's focus has been limited to more *ad hoc* linkages between existing national systems because of these limitations.

In March 1989, the Group of Thirty (an international group of experts on clearance and settlement) issued a report on clearance and settlement making nine specific recommendations for harmonizing national systems. The recommendations that have received the most international attention have been to shorten the comparison period to T+1; to reduce the settlement cycle to T+3; and to adopt same-date funds settlement. Some of the other recommendations of the Group of Thirty were that each country should establish a central securities depository, a netting system, and a delivery versus payment system. Other recent reports on cross-border clearance and settlement have been issued by the International Society of Securities Administrators (ISSA) and by Jorg-Ronald Kessler for the European Commission, both of which came to conclusions similar to those of the Group of Thirty.

Also, in July of 1989, the Federation Internationale des Bourses de Valeurs (FIBV) issued its report on clearance and settlement, making four broad recommendations. First, it endorsed the recommendations of the Group of Thirty. Second, it called for links between national and international central securities depositories to cover a wide spectrum of services and securities. Third, it recommended that the international transfer of securities should be by book entry only. Last, it recommended that foreign listings should be in original form (*i.e.*, that stocks should be listed abroad rather than receipts, such as ADRs).

The clearance and settlement recommendations made by all of these groups have received much attention. A working group within the International Organization of Securities Commissions ("IOSCO") is currently studying specific measures that national regulators might take to improve international clearance and settlement linkages.

B. Regulation of Brokers and Dealers

1. Overview

The federal securities laws require that all entities in the business of buying and selling securities register as broker-dealers. Most state laws contain similar registration requirements for broker-dealers doing business in the state. This registration submits the broker-dealer to a complex scheme of regulation governing such matters as trading practices, record keeping, dealings with customers, internal supervision, and the amount of capital that must be committed to the business. A full discussion of these rules is beyond the scope of this paper. What is of particular concern is the limitations they impose on the ability of a foreign broker-dealer to conduct business in the United States.

A foreign broker may operate within the United States by establishing a subsidiary here which is registered with United States regulatory authorities and is treated identically with domestic registered broker–dealers. It is also theoretically possible for a foreign broker to operate through a branch by registering the foreign entity with the United States authorities. This approach often presents nearly insuperable practical obstacles, however.

The most difficult question is the extent to which a foreign securities firm can conduct operations within the United States or directed to United States investors without having to register. Until recently, that answer to that question was ill–defined. It has, however, been substantially clarified by a new SEC rule, Rule 15a–6, adopted in 1989.

The rule is a consequence of the SEC's recognition of the growing internationalization of the securities markets and the increasing desire of United States investors to participate in offshore markets. The Commission also recognizes that certain classes of United States investors do not require the same level of protection as other investors. The new rule is a step towards permitting greater access by foreign issuers and securities firms to United States markets. It permits foreign broker–dealers to "solicit" business in the United States, subject to certain conditions, without registering with the SEC as a broker–dealer.

2. Previous Exceptions From Registration

(a) The Unsolicited Call

The rule continues two existing exemptions from registration. The first permits a foreign broker–dealer to take a totally unsolicited call made directly to it from a United States person located in the United States and execute any securities order given to it by such United States person. A call, however, is only unsolicited if the foreign broker–dealer previously had not sent any research to the "unsolicited" purchaser, had not provided market making quotations to the unsolicited purchaser through a private quotation system and had not visited the unsolicited purchaser to provide general market information.

(b) Dealing With Market Professionals

The second category of exemption permits a foreign broker–dealer to freely deal with the following types of market professionals without fear of triggering a SEC registration requirement:

1. a registered broker or dealer (for both proprietary and agency transactions);

2. a bank acting in a broker or dealer capacity as permitted by United States law;

3. the African Development Bank, the Asian Development Bank, the Inter-American Development Bank, the International Monetary Fund and the United Nations, and their agencies, affiliates and pension funds; and

4. a foreign person temporarily present in the United States with whom the foreign broker or dealer had a bona fide relationship before the foreign person entered the United States

3. Direct Contacts With Institutional Investors

The rule provides that representatives of a foreign broker-dealer not registered in the United States may contact United States institutional investors[16] from outside the United States to solicit securities transactions provided that certain conditions are satisfied, including the following:

(a) Any resulting transaction must be effected through a United States broker-dealer.

(b) The representatives of the foreign broker-dealer who contact United States investors must not be subject to a disqualification from selling securities under United States law or any substantially equivalent foreign law.

(c) Each foreign broker-dealer that sells securities to United States institutional investors and each person who actually talks to United States persons must consent in writing to service of process for any civil action brought by or proceeding before the SEC or self-regulatory organization. A United States broker-dealer must be responsible for obtaining and maintaining these consents.

(d) The foreign broker-dealer must use its best efforts to provide information and assistance requested by the SEC relating to transactions with United States investors.

(e) A United States broker-dealer must be responsible for issuing all required securities confirmations and related reports, maintaining adequate capital, receiving delivery and safeguarding funds and securities on behalf of the United States institutional investor

(16) Paragraph (b)(7) of the Rule defines "U.S. institutional investor" to include registered investment companies, banks, savings and loan associations, insurance companies, business development companies, small business investment companies, employee benefit plans, and certain charitable organizations and trusts.

and maintaining in the United States all required books and records relating to the transactions (this requirement ignores the way in which institutional customers settle overseas transactions – and may be technically impossible to comply with).

The rule permits representatives of the foreign broker to visit institutional investors within the United States as long as the representatives are accompanied by an associated person of a registered United States broker–dealer. It requires that an associated person also participate in telephonic communications with investors in the United States[17] except for "major U.S. institutional investors," which are defined as institutions or investment advisors with at least $100 million under management.[18]

4. Research

The SEC has long taken the position that the provision of research to United States investors may constitute impermissible solicitation by a foreign broker–dealer. The new rule provides that foreign broker–dealers may distribute research reports to United States investors if (1) the reports are distributed through a registered United States broker–dealer that accepts responsibility for their content, and (2) any resulting transactions are effected through a United States broker–dealer.

The rule makes an exception for the distribution of research reports to "major U.S. institutional investors." This is permissible without the intermediation of a United States broker-dealer provided that (1) the research report must not recommend the use of the foreign broker–dealer to effect trades; (2) the foreign broker–dealer must not follow up on the research reports (*e.g.*, by telephoning the recipient) or otherwise act to induce purchases or sales of securities by the recipient; and (3) any transactions that result must be effected through the foreign broker–dealer's affiliated United States registered broker–dealer.

5. Investment Advisor No–Action Letter

When a foreign broker–dealer sends research (or arranges for such research to be sent) to United States investors in return for compensation, it would be considered an investment adviser

(17) As a practical matter, this represents an important relaxation of the previous SEC position, which required that an associated person of a U.S. registered broker participate in all oral communications, including telephone calls.

(18) To determine the total assets of an investment company under the Rule, a registered investment company may include the assets of any "family of investment companies" of which it is a part.

under the Investment Advisers Act of 1940.[19] Consequently, the foreign broker–dealer would need to register under the Investment Advisers Act unless an exemption from the registration requirements of that Act is available. The SEC has indicated, however, that it will grant specific requests for relief for foreign broker–dealers who (i) comply with the new SEC rule, (ii) provide research and any other investment advice only as an activity incidental to such foreign broker–dealers' brokerage business and (iii) do not charge a separate fee for the research or investment advice.

(19) Domestic broker–dealers would also be subject to this requirement but for an exemption from registration under the Investment Advisers Act for registered broker–dealers.

V. Enforcement and Private Litigation

A. Sources of Liability in General

1. Securities Act of 1933

Pursuant to Section 11 of the Securities Act, any person who acquired a registered security may bring suit if any part of the registration statement, at the time when it 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." The plaintiff may sue any of a lengthy list of specified persons, including the issuer's directors or partners, persons about to become directors or partners of the issuer, "experts" who have, with their consent been named in the registration statement as having prepared or certified part of the registration statement or a report or valuation used in connection with the registration statement and every underwriter. The plaintiff may also sue any person who signed the registration statement, which in any event must include the issuer, its principal executive officer, its principal financial officer, its principal accounting officer, a majority of its board of directors or persons performing similar functions, and for a foreign issuer, its duly authorized representative in the United States.

The liability of these potential defendants is joint and several, which is to say that each of them can be held liable for the entire amount of the damages. Generally, proof that the plaintiff relied on the registration statement is not a required element of a claim under Section 11. The issuer's liability is absolute unless it can show that the plaintiff knew of the untruth or omission at the time of the acquisition of the security. Other defendants will not be held liable if they can establish that they acted with due diligence.

Section 12(1) of the Securities Act is one of its most important civil liability provisions, because it serves as a strong mechanism to enforce the Act's registration provisions. A purchaser of a security sold in violation of the registration provisions may sue the seller to recover the amount paid for the security. This liability is absolute; it does not depend on whether the seller was defrauded or misled.

The latter problem is dealt with in Section 12(2), which creates a cause of action against any person who offers or sells a security by means of a prospectus or oral communication that is false or misleading. The defense of reasonable care is available if the suit is based on untrue statements or omissions.

Section 17(a) of the Securities Act makes it unlawful for any person in the offer or sale of any securities (regardless of whether the securities which are the subject of such offer or sale are registered), directly or indirectly (i) to employ any device, scheme or artifice to defraud, (ii) to obtain money or property by means of any untrue statement or omission, or (iii) to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser. With a few exceptions, however, the courts have held that Section 17(a) does not create a private cause of action. Its violation may generally only be remedied in a law enforcement proceeding.

2. Securities Exchange Act of 1934

The Exchange Act, and the rules promulgated under it, make unlawful a wide variety acts and omissions, and that Act contains several specific express remedies. The most important source of civil (and criminal) liability under the Act is Rule 10b–5. This rule generally prohibits the employment of any "device, scheme, or artifice to defraud," the use of any false or misleading statements, or the use of any "act, practice, or course of business which operates...as a fraud or deceit upon any person, in connection with the purchase or sale of any security." Although the Exchange Act does not expressly provide for any private right of action for persons injured by violations of Rule 10b–5, the courts have created such an action. A large body of jurisprudence has developed to fill out the contours of what is little more than a general prohibition against fraud in connection with securities transactions.

Rule 10b–5 applies to securities transactions generally, whether conducted face–to–face, over the counter, or on exchanges. It covers both private and public securities transactions, and applies to the purchase and sale of both registered and unregistered stock.

The Exchange Act also includes a myriad of provisions addressed specifically to particular types of fraud. For example, that Act contains prohibitions dealing with the manipulation of security prices, stabilizing of the market to facilitate a distribution, and anti–fraud provisions applicable to broker–dealers.

B. Jurisdiction

1. Generally

As a general matter, in order for a United States court to exercise jurisdiction over a case, it must have both personal and subject matter jurisdiction.

The exercise of personal jurisdiction is limited by the requirements of the due process clause of the Fourteenth Amendment to the United States Constitution. The due process clause does not contemplate that a state may make a binding judgment *in personam* against a defendant with which the state has no contacts, ties or relations.[20]

The exercise of personal jurisdiction over a party does not offend due process where the party has purposefully acted to create a "substantial connection" with the forum state.[21]

In other words, the party's contact with the forum state must not be an isolated occurrence and the exercise of personal jurisdiction must comport with traditional notions of fair play and substantial justice.[22]

The federal securities statutes contain broad statements of jurisdiction, which are based generally on transactions conducted through interstate or foreign commerce or through the mails. Thus, in addition to covering most wholly–domestic transactions (for which the use of the facilities of interstate commerce are almost inevitable in securities transactions), the federal securities laws have been extended to cover transactions initiated abroad and concluded in the United States as long as the transaction involved some use of the facilities of commerce with the United States.

The exercise of jurisdiction under the federal securities laws is limited in some instances by the willingness of other states to accept the exercise of United States jurisdiction in the specific

(20) *International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

(21) *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 475 (1985), quoting *McGee v International Life Insurance Co.*, 355 U.S. 220, 223 (1957).

(22) *World–Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286 (1980). *See also*, *Asahi Metal Industry Co., Ltd. v. Superior Court of California, Solano County*, 480 U.S. 102 (1987).

circumstances. The jurisdiction of United States law is, of course, also limited by principles of international law. Accordingly, the courts have held that a literal application of the jurisdictional provisions of the federal securities laws is too broad if there exists an insufficient relationship to the United States. In general, the courts will exercise subject matter jurisdiction under the securities laws only if the alleged wrongful conduct had significant "effects" in the United States or if significant "conduct" related to the wrong took place in the United States.

2. The Effects Test

The "effects" portion of the test for determining whether a court will exercise subject matter jurisdiction in the international context is based on the principle that a state's own laws may reach conduct taking place outside its borders if that conduct has significant effects within the state.[23] The effect in question may be on United States investors,[24] or it may be on United States markets.[25] The magnitude of the effects in the United States may be determinative of the exercise of jurisdiction.[26]

(23) *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir.,) *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968) (*en banc*), *cert. denied*, 395 U.S. 906 (1969). The case involved the common stock of a Canadian issuer that was registered for trading on the American Stock Exchange. The Canadian corporation's controlling shareholder (a non-U.S. company), bought shares of the Canadian corporation's common stock on the Toronto Stock Exchange. The complaint alleged that the controlling shareholder acquired its shares on the Toronto Stock Exchange while in possession of material undisclosed information concerning the Canadian corporation. The basis for the exercise of jurisdiction by the U.S. courts was that the fraud occurring outside of the United States could be reflected in lower bid prices for the Canadian issuer's shares on the U.S. market.

(24) See *Bersch v. Drexel Firestone. Inc.*, 519 F.2d 974 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975).

(25) *Des Brisay v. Goldfield Corporation*, 549 F.2d 133, 136, (9th Cir. 1977) The case upheld jurisdiction where the takeover of a foreign corporation effected abroad by an American corporation proximately caused the collapse of the American market in the American corporation's shares.

(26) *Internationalization of the Securities Markets, Report of the Staff of the U.S. Securities and Exchange Commission to the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Energy and Commerce*, July 27, 1987 ("SEC Report") at VII–17.

Although the federal courts have frequently asserted jurisdiction wher. they found "significant" effects, they have expressed an unwillingness to impose rules governing conduct throughout the world in every instance where an American investor bought or sold a security.[27]

3. The Conduct Test

The United States courts have generally been willing to assert jurisdiction over cases in which a fraudulent offer was made, or a securities transaction was fraudulently induced, within the United States, even if the transaction was ultimately consummated outside of the United States.[28] Again, the courts have focussed on the "significance" of the conduct; they have determined not to exercise jurisdiction where the conduct in the United States has been deemed relatively unimportant to the alleged misconduct.[29] However, the application of the United States securities laws may be triggered by "merely preparatory activities" when the injured parties outside of the United States are United States citizens.[30]

In cases where an offer for the sale of securities is directed outside the United States, the exercise of United States jurisdiction may depend on whether there was a "preponderance" of United States activity. For example, in one case, a London corporation with predominantly foreign (but some United States) investors sued a Bahamian corporation over transactions negotiated in the United States.[31] In that case the court determined that the exercise of its jurisdiction was proper since the fraud was "concocted" in the United States, and it was not intended by Congress that the United States be used as a base for fraud.[32]

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(27) *Leasco Data Processing v. Maxwell*, 468 F.2d 1326, 1334 (2d Cir. 1972).

(28) *SEC Report.*, at VII–9.

(29) *SEC Report.*, at VII–9, citing, *Bersch v Drexel Firestone*, 519 F.2d 974 (2d Cir.), *cert. denied* 423 U.S 1018 (1975). The United States activities consisted of repeated meetings among American lawyers, underwriters, accountants and the SEC, as well as some drafting of the prospectus and the opening of bank accounts in the United States. The prospectus was issued from foreign countries and only to purchasers outside of the United States.

(30) See, *Zoelsch v Arthur Anderson & Co.*, 824 F.2d 27 (D.C. Cir. 1987).

(31) *SEC Report.*, at VII–11, citing, *ITT v. Vencap Ltd.*, 519 F.2d 1001 (2d Cir 1975); *See also*, *Psimenos v. E.F. Hutton & Co.*, 722 F.2d 1041 (2d Cir. 1983).

(32) *Id.*

C. Secrecy Laws and Blocking Statutes

Enforcement of the United States securities laws in international matters, either by the SEC or federal criminal authorities or by private parties in civil suits, often causes conflicts with laws of other states restricting the availability of information. These laws are of two principal types: secrecy laws and blocking statutes.

1. Secrecy Laws

Secrecy laws generally provide that individuals may require others to keep certain information secret. These laws range in type from those "that create fiduciary relationships, subject to waiver only by the principal, to statutes investing private confidentiality with a state interest".[33]

Because of its role as an international financial center, the bank secrecy laws of Switzerland are of particular interest. Switzerland has laws that contain both civil and criminal provisions governing secrecy. Secrecy is an aspect of the fiduciary relationship between the bank and its customer under the civil law of Switzerland. The fiduciary obligation is owed with respect to all communications with the customer. If the customer waives secrecy, the bank is obligated to provide the customer with all information in the bank's possession for the customer to produce in foreign courts.[34]

Additionally, the Swiss Penal Code provides sanctions aimed at bank personnel who breach client confidentiality and against all individuals who disclose manufacturing or business secrets. While most of the criminal provisions characterize the interest in secrecy as being personal to the parties, one provision (applicable only where the principal is Swiss) describes the release of Swiss banking, manufacturing or business secrets to a foreign authority as an offense against the state.[35]

Bank secrecy laws can also be found in the Bahamas.[36] Persons associated with banks licensed in the Bahamas require the express or implied consent of the customer concerned to disclose to any other person information relating to the identity, assets, liabilities, transactions or accounts of a customer. Certain exceptions do exist (including compulsion by a court of competent jurisdiction). A violation of this law can result in criminal penalties.[37]

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(33) *SEC Report.*, at VII–34. Among the countries with secrecy laws are Switzerland, the Cayman Islands, the Commonwealth of the Bahamas, Liechtenstein and Panama.

(34) *Id.*, at VII–34

(35) *Id.*, at VII–35

(36) *Id.*, at VII–38, citing, The Bahamas Banks and Trust Companies Regulation (Amendment) Act. 1980.

(37) *Id.*

These statutes and others like them can obviously impede efforts by United States authorities or plaintiffs in United States courts to obtain information related to alleged violations of United States securities laws. In the most common situation, for example, a foreign bank subject to a secrecy statute executes a securities transaction in the United States for a customer of the bank. If the SEC has reason to believe that the transaction may have violated United States law, it may seek to ascertain from the bank the identity of its customer in order to pose questions to the customer. Under most bank secrecy laws, the bank would be prohibited from divulging the identity of the customer under normal circumstances.

2. Blocking Laws

Blocking laws permit foreign governments (through civil and criminal penalties) to control the dissemination of information outside the state.[38] Generally, blocking laws protect information that concerns international commerce or trade or national security. In several cases, countries have enacted blocking statutes to prevent United States authorities from obtaining information in ways perceived by such countries as unduly intrusive on their national sovereignty.

The Canadian Foreign Extraterritorial Measures Act permits Canadian authorities (i) to prohibit (through criminal sanctions) disclosure of certain information from Canada, (ii) to seize records, (iii) to require persons in Canada to give notice of foreign court compulsion, and (iv) to prohibit persons from complying with production orders of foreign courts. As a preliminary matter, the Canadian authorities must make a finding that a foreign state has taken or is proposing to take measures affecting international trade or commerce. It must be shown that these measures will adversely affect significant Canadian interests with respect to international trade or commerce that involves business carried on in whole or in part in Canada, or would otherwise infringe upon Canadian sovereignty.[39]

French law prohibits its nationals from communicating economic, commercial, industrial, financial or technical matters to foreign authorities except as permitted by treaty or international agreement. Furthermore, requests for the foregoing types information or documents to be used for proof in court or use in administrative tribunals are generally forbidden.[40] Statutes like these can also impede law enforcement efforts by United States authorities. Indeed, in some cases they were intended to do so.

(38) *Id.*, at VII-31. Countries with blocking statutes include France, the United Kingdom, Canada (Ontario), and Switzerland.

(39) *Id.*, at VII-32

(40) *Id.*, at VII-33

D. Agreements Regarding the Production of Evidence

In recent years, the growing volume of international securities transactions has brought about an increased awareness of the necessity for international cooperation in the enforcement of securities laws. Public and private efforts, some directed specifically at securities law and some of more general applicability, have lead to the establishment of a variety of agreements designed to overcome many of the more significant obstacles to enforcement of national law in transnational transactions. Among the types of agreements for the production of evidence in securities cases are private agreements, treaties and memoranda of understanding.

1. Private Agreements/Intermarket Linkages

Self-regulatory organizations, including securities exchanges, play a significant role in many countries in establishing and enforcing rules governing securities transactions. A number of intermarket linkages and agreements facilitating international trading have been established. Among these are links between the Montreal Stock Exchange and the Boston Stock Exchange, and the American Stock Exchange and the Toronto Stock Exchange. Other linkages are being negotiated. As part of the approval process for these intermarket linkages, the SEC has required the development of routine surveillance and information sharing agreements among the linked markets. The SEC has also attempted to obtain assurances that there would be no barriers to the exchange of investigatory information between the relevant foreign regulatory body and the SEC.[41]

2. Treaties

The United States has entered into various treaties to provide mutual assistance with respect to criminal matters with Switzerland, the Netherlands, Turkey and Italy.[42]

(41) *Id.*, at V–56. For example, in connection with the American Stock Exchange Toronto Stock Exchange linkage, the SEC was concerned about the possible adverse effect upon investigations that would be caused by the Canadian blocking statute. The SEC sought and received assurances that (i) the linkage agreement itself contained adequate sharing provisions, (ii) open channels of communications would be maintained and information and investigative resources would be shared, and (iii) the Canadian government would be unlikely to use the blocking statute.

(42) *Id.*, at VII–49. The U.S. has also signed, but not yet ratified, treaties with the Commonwealth of the Bahamas, Columbia, Morocco, Canada and the Cayman Islands.

(a) The Swiss Treaty

The Treaty between the United States and the Swiss provides for assistance in criminal matters, including assistance in locating witnesses, obtaining testimony of witnesses, production of records and service of judicial and administrative documents. Generally, for the treaty to be applicable, the subject offenses must have dual criminality (they must be of a criminal nature in both the requesting and the executing states). The Swiss criminal laws do contain several provisions which parallel the anti-fraud provisions of the United States securities laws. The Treaty provides that the assisting state may refuse cooperation to protect its sovereignty, security and similar other interests. Additionally, assistance may be refused if the request has been made with respect to a person who has already been acquitted on similar charges in the requested state. With certain limited exceptions, information received pursuant to the Swiss Treaty must be used as evidence in a criminal proceeding before it can be used in a civil proceeding.[43]

(b) The Netherlands Treaty

Unlike the Swiss treaty, the treaty between the United States and the Kingdom of the Netherlands does not generally require dual criminality. The assistance to be provided under the Treaty includes "locating persons, serving judicial documents, providing records, taking testimony, producing documents, and executing requests for search and seizure." Noncompliance with the Treaty may occur with respect to political offenses and instances where Treaty compliance would prejudice state security or other essential public interests.[44]

A recently executed agreement between the Netherlands and the U.S. establishes the framework for the dissemination of information between the two countries relating to civil securities law matters. All criminal matters continue to be governed by preexisting treaties.[45]

(43) *Id.*, at VII-50, citing, The Treaty on Mutual Assistance in Criminal Matters between the Swiss Confederation and the U.S., 27 UST 2019, done on May 25, 1973 (effective 1977).

(44) *Id.*, at VII-57, citing, The Treaty on Mutual Legal Assistance between the Kingdom of the Netherlands and the United States, done on June 12, 1981, T.I.A.S. 10734.

(45) Agreement between the Netherlands and the United States on Mutual Administrative Assistance in the Exchange of Information in Securities Matters, Securities and Exchange Commission Release No. IS-115, January 12, 1990, SEC Docket (CCH) Vol. 45, No. 7 January 30, 1990 at 464.

(c) The Turkish Treaty

The Treaty between Turkey and the United States applies to all offenses that are actionable within the jurisdiction of the requesting state. The activities to be performed under the Treaty include "locating persons, serving judicial documents, and effecting the taking of testimony, the production of documents, and the service of process compelling the appearance of witnesses before a court of the requesting state." Exceptions to compliance with the Treaty include instances of political or military offenses or where the performing state has determined that compliance will prejudice its sovereignty, security or other similar interests.[46]

(d) The Italian Treaty

The Italian Treaty provides for mutual assistance in criminal investigations and proceedings concerning many different offenses. One significant aspect of the treaty is that it provides, in certain circumstances, for persons in the requested state to be compelled to appear to testify in the requesting state.[47]

3. Memoranda of Understanding

Generally, on a nonbinding basis, Memoranda of Understanding ("MOUs") provide for "the sharing of information and assurances of cooperation in SEC and foreign agency investigations and litigations."[48] Unlike some of the bilateral treaties described above, MOUs do not require dual criminality with respect to the matter that is the subject of the request.[49]

The United States has entered into MOUs with the United Kingdom Department of Trade and Industry, the Japanese Ministry of Finance, the securities commissions of the Canadian provinces of Ontario, Quebec and British Columbia, the Brazil Comissao de Valores Mobiliaries and Switzerland. Additional MOUs are currently under negotiation.[50]

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(46) *SEC Report.*, at VII–57, citing, The Treaty on Extradition and Mutual Assistance in Criminal Matters between the United States and the Republic of Turkey, done on June 7, 1979, T.I.A.S. 9891.

(47) *Id.*, at VII–58, citing, The Treaty between the U.S. and the Italian Republic on Mutual Assistance in Criminal Matters, Sen. Ex. 98–25, 98th Cong. 2d Sess.

(48) Mann, Michael D. and Mari, Joseph G., *Developments in International Securities Law Enforcement*, U.S.–Canadian Business Issues, American Law Institute – American Bar Association, November 1989 ("Mann and Mari"), at 60.

(49) *Id.*

(50) *Id.*

(a) United Kingdom

The MOU between the SEC, United States Commodities Futures Trading Commission and the United Kingdom provides for assistance in matters involving insider trading, market manipulation and misrepresentations. Additionally, information relating to qualifications of investment businesses and brokerage firms can be exchanged.[51] On August 15, 1988, the SEC, NYSE, the NASD, the Chicago Board of Options Exchange, Inc. and the AMEX entered into a MOU with their counterpart agencies in the United Kingdom. Upon request, certain information concerning the financial condition of broker–dealers will be provided by the United States authorities to the U.K. authorities.[52]

(b) Japan

The MOU dated May 23, 1986 between the SEC and the Japanese Ministry of Finance provides that each agency shall facilitate the other's "respective requests for surveillance and investigating information on a case–by–case basis."[53]

(c) Canada

The MOU between the SEC and the Ontario Securities Commission, Commission de Valeurs Mobilieres du Quebec and the British Columbia Securities Commission, dated January 7, 1988 (the "Canadian MOU") is (along with the Brazil MOU, mentioned below) "the most comprehensive MOU entered into by the SEC to date."[54]

The Canadian MOU provides that assistance will be available in various cases including, among others (i) insider trading, (ii) fraud or misrepresentation in connection with the purchase or sale of a security, and (iii) duties of persons to comply with periodic reporting requirements. Assistance under the Canadian MOU includes (i) providing access to information in government files, (ii) taking the testimony of persons, and (iii) obtaining documents. Evidence is generally taken pursuant to the laws of the requested party. In addition, subpoena power is used on behalf of one another where necessary to ensure that the requested information is obtained.[55]

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(51) *Id.*, at 67.

(52) *Id.*, at 69.

(53) *Id.*

(54) *Id.*, at 64.

(55) *Id.*, at 65.

(d) **Brazil**

The MOU between the SEC and the Brazil Comissao de Valores Mobiliarios, dated July 1, 1988 is virtually identical to the Canadian MOU.[56]

(e) **France**

The Commission Des Operations de Bourse ("COB") (the French counterpart to the SEC) and the SEC have entered into an "Understanding" concerning the ability of the SEC and the COB to sanction persons and entities engaging in fraudulent practices and therefore to protect investors in the markets of each nation.[57] Pursuant to the Understanding the two nations are to combine their efforts to coordinate market oversight and resolve differences that may exist between the two regulatory systems.

The SEC and COB have also entered into an agreement that establishes a system for mutual assistance to foster better enforcement and to secure compliance with the laws and regulations of both nations.[58]

(f) **Switzerland**

The MOU between the SEC and Switzerland, dated August 31, 1982, was originally required because, at the time of its execution, insider trading was not a violation of Swiss Law. Consequently, the Swiss Treaty (described above) was not available for such cases. The Swiss MOU was terminated when the Swiss insider trading law went into effect in 1988.[59]

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(56) *Id.*, at 67.

(57) Framework for Consultations between the Securities and Exchange Commission and the Commission Des Operations de Bourse, SEC Release No. IS-116, January 12, 1990, SEC Docket (CCH) Vol. 45, No. 7 January 30, 1990 at 467.

(58) Administrative Agreement with Commission des Operations de Bourse and the United States Securities and Exchange Commission, SEC Release No. IS-117, January 12, 1990, SEC Docket (CCH) Vol. 45, No. 7 January 30, 1990 at 469.

(59) *Mann and Mari.*, at 61.

4. Case by Case Agreements

Where the SEC requires evidence from countries with which no formal understanding has been negotiated, it may approach the government of that country requesting assistance for a particular case.[60]

5. The Hague Convention

The Hague Convention on the Taking of Evidence Abroad is an additional tool which is available to the SEC to obtain information.[61] However, in reality, the Treaty has been of limited utility to the SEC because the convention can only be used in connection with litigation, not investigations.[62]

E. Other Forms of Cooperation Among Law Enforcement Authorities

1. Consents to Jurisdiction

On several occasions, the SEC has imposed on foreign entities seeking to register with the SEC or to be exempted from registration, the condition that they provide information when requested and subject themselves to the jurisdiction of the United States courts. For example, as a condition to granting an exemption from registration under the Exchange Act, the SEC has previously required a foreign broker–dealer to represent that information with respect to foreign trading activities will be provided to the SEC upon request. In addition, the SEC has required foreign broker–dealers and investment advisers to designate a United States entity as an agent for service of process under certain circumstances.[63]

(60) *SEC Report.*, at VII–64.

(61) The Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters, opened for signature March 18, 1970, 23 U.S.T. 2555, T.I.A.S. No. 744.

(62) *Mann and Mari.*, at 74. Most of the signatory nations have exercised their prerogative under the convention to refuse to execute letters rogatory for the purpose of the pretrial discovery of documents. Pretrial discovery of testimony may be had only if it is proven to be relevant to trial. This is an especially difficult burden to meet since a successful information request must identify specific documents and testimony to be sought. This may not be possible at the early stages of litigation. See also, *SEC Report.*, at VII–68.

(63) *SEC Report.*, at VII – 48.

2. International Organizations

The SEC is a member of several organizations concerned with the internationalization of the securities markets, including the International Organization of Securities Commissions ("IOSCO"). IOSCO includes as its members securities regulators from many foreign countries. IOSCO has several working groups including one the purpose of which is to foster the international exchange of information concerning the enforcement of the securities laws.[64]

The SEC has also participated in discussions at the Organization for Economic Cooperation and Development (the "OECD") concerning international evidence gathering and an examination of obstacles faced by foreign organizations seeking to participate in the financial services industry.[65]

3. Communique with Italy

On September 20, 1989, the SEC signed a Communique on Exchange of Information with the Commission Nazionale per Le Societa e la Borsa of Italy. Each agency has agreed to facilitate the exchange of information and to aid in the performance of certain of the other's administrative and enforcement functions relating to situations where information is located in the territory of the other party. The Communique is meant to be an interim measure, to eventually be replaced by a comprehensive MOU.[66]

4. International Securities Enforcement Cooperation Act of 1989

On September 25, 1989, the United States House of Representatives passed the International Securities Enforcement Cooperation Act of 1989 (the "ISECA").[67] The ISECA, as currently drafted, contains four elements. First, it grants the SEC an exemption from disclosing to the public (under the United States Freedom of Information Act) records provided to the SEC by foreign securities authorities under certain specified circumstances. Second, it grants the SEC greater authority to permit access to its enforcement files by domestic and foreign law enforcement

(64) *Id.*, at VII-75.

(65) *Id.*, at VII-77.

(66) *Mann and Mari.*, at 70.

(67) In order to become law, the ISECA still has to be passed by the Senate and signed by the President of the United States.

officials. Third, it permits the SEC to sanction securities professionals for violations of foreign securities laws. Fourth, it expands the authority of self-regulatory organizations (including the National Association of Securities Dealers) to exclude convicted felons from membership based on violations of foreign laws. Finally, it authorizes the SEC to accept reimbursement for expenses incurred on behalf of foreign governmental authorities in their investigations.[68]

VI. Conclusion

In a world of constant change, it is inevitable that the laws governing economic transactions are forever in pursuit of the commercial realities they mediate. The securities laws are no exception.

The last decade has seen accelerating change in the number and variety of securities transactions that cross international borders. It would be too much to expect for the securities laws of the United States or any other country fully to keep pace with this change; but it seems fair to say that the United States legal system — the SEC, the courts, and the legislature — has made tremendous progress in adapting to the new realities. And, given the current pace and direction of change in the United States securities laws, there is fair promise that they will continue to adapt at a rate that will minimize the inhibitions that the legal environment might cast in the face of economic progress. □

(68) Congressional Record–House, Monday, September 25, 1989, 101st Cong. 1st Sess. 135 Cong. Rec. 14, 5870. Vol. 135 No. 124. 48.