

## COMMENT

### INTERNATIONAL FINANCIAL MARKETS AND REGULATION OF TRADING OF INTERNATIONAL EQUITIES

#### INTRODUCTION

Money and capital markets are important because they provide a forum for investors and borrowers to pursue their financial interests.<sup>1</sup> The capital market is comprised of stock exchanges, over-the-counter markets, financial intermediaries, institutional investors, individual investors, brokers, dealers, investment advisers, and borrowers.<sup>2</sup> The government is ultimately responsible for the stable and efficient operation of the market.<sup>3</sup> Since there is as yet no single superior decision-making force in the international financial market, it can be argued that the global trading of securities<sup>4</sup> is subject to exploitation.

Until the late 1950s, money markets were essentially national;<sup>5</sup> any degree of solidarity among them was due primarily to compensation for variations among interest rate levels by the foreign exchanges. Globalization of financial markets began in the 1960s with the internationalization of the foreign exchange markets.<sup>6</sup> Then came the globalization of markets dealing in debt and the securitization of debt. Now we are witnessing the beginnings of a world

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1. D. GEDDES, *SYSTEMS OF SECURITIES REGULATION: A COMPARATIVE STUDY WITH RECOMMENDATIONS FOR AUSTRALIA* 1 (1975).

2. *Id.* at 10-12.

3. *Id.* at 27.

4. Securities are evidence of debt or of property. They include, but are not restricted to, evidence of indebtedness such as bonds, and representations of ownership of a corporation such as shares of stock. BLACK'S LAW DICTIONARY 161, 1215, 1233, 1269 (5th ed. 1979) [hereinafter BLACK'S].

5. P. EINZIG & B.S. QUINN, *THE EURO-DOLLAR SYSTEM; PRACTICE AND THEORY OF INTERNATIONAL INTEREST RATES* 3 (1977).

6. J.J. Phelan Jr., Remarks to the Vienna Stock Exchange, *Securities Markets: Going Global* 4-5 (Aug. 22, 1986).

equities market.”<sup>7</sup>

Domestic and international equities markets serve essentially the same purposes, and investor confidence is a prerequisite for the effective functioning of both markets. Investors and potential investors must be sufficiently confident in the accuracy of information, fairness, and efficiency of the equities markets to enable them to trust their own assessments of the risks. Only then can these markets attract adequate amounts of capital to ensure their optimal functioning.

Within domestic markets, investor confidence is developed through the formation and enforcement of securities regulations and laws. Bodies such as securities commissions and stock exchanges are primarily responsible for administering and enforcing these laws and regulations. They also develop and update supportive rules and policies. Although securities commissions often have significant degrees of discretion, in many cases their decisions are subject to review by courts within their jurisdictions. Thus, there is usually a set of mechanisms within domestic financial markets to thwart transactions and practices that create unfair advantages for one of the parties to a transaction.<sup>8</sup>

In the international equities market, however, regulation of practices which undermine investor confidence is rendered extremely difficult by the variation in securities laws and other relevant legislation between nations. These difficulties can be compounded by countries' unwillingness or hesitation to cooperate with other nations in the enforcement of national legislation as it applies to transactions in the international equities market.

Because of the fragmented nature of securities legislation throughout the world, nations must be prepared to collaborate. Regardless of whether financial markets continue to expand or contract, they will continue to exist in one form or another. Therefore, it may be desirable to establish a global network to regulate activities in the international market, ensuring that international trading of equities is not exploited as a forum for evasion of national laws. This Comment shall examine the nature of these problems, and

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7. *Id.* at 5. For example, in August of 1986, fifty-four foreign companies were listed on the New York Stock Exchange, and foreign listings are expected to increase substantially. *Id.*

8. It may be argued that these mechanisms do not operate sufficiently at the national level, or that they are not adequately enforced to deter or punish perpetrators in an adequate number of cases. However, a rigorous analysis of such allegations is beyond the scope of this Comment.

some of the steps which have been taken so far to address them.

## I. OVERVIEW OF INTERNATIONAL FINANCIAL MARKETS

### A. Money and Capital Markets

Money markets and capital markets are two categories of financial markets. Geddes asserts that money and capital markets can be distinguished by the fact that 1) the duration of the transactions involved varies and 2) money markets do not issue securities.<sup>9</sup> He states that the capital market is the broader of the two, thereby encompassing the money market, and that the money market is concerned primarily with the provision of short-term funds.<sup>10</sup>

Credit markets form a subcategory of capital markets and can be broken down into domestic, foreign and external markets. Within each of these latter three types of markets there are intermediary markets and direct markets. Intermediary markets consist of "financial intermediaries who attract funds from savers by issuing their own claims and in turn lend the funds to those who borrow to purchase real goods and services."<sup>11</sup> Direct markets consist primarily of "organized securities markets" in which savers buy securities issued by the ultimate borrowers themselves.<sup>12</sup> Thus, while eurocurrency markets<sup>13</sup> fall within the category of intermediary, external credit markets, eurobond<sup>14</sup> and international equity markets are direct, external credit markets.

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9. D. GEDDES, *supra* note 1, at 5-6.

10. *Id.*

11. G. DUFÉY & R. MIRUS, *INTERNATIONAL FINANCIAL INTERMEDIATION* 1-4 (1987).

12. *Id.*

13. The eurocurrency market is characterized by deposits of currencies outside their countries of origin. For example, the acceptance of Japanese yen is known as the euro-yen market, acceptance of deutsche marks is the euro-deutsche mark market, and of U.S. dollars the euro-dollar market. Within the eurocurrency market a structure of international interest rates has emerged that is distinct from, and often independent of, national interest rates. It is outside the direct control of any national central bank, and is a free, competitive and flexible market dealing only in large amounts, and has become one of the world's largest markets for short-term funds. On one hand, the prefix "euro" is appropriate given the European origin of the market, the fact that most euromarket activity occurs in Europe, and London's development as the center of the market. On the other hand, the term is somewhat misleading because banks accepting eurocurrency are located outside of Europe as well. P. EINZIG & B.S. QUINN, *supra* note 5, at 2-3; A. GILPIN, *DICTIONARY OF ECONOMIC TERMS* 74 (1973); J.S. LITTLE, *EURODOLLARS: THE MONEY-MARKET GYPSIES* 13, 18-21 (1975).

14. Whereas the eurocurrency market is a source of short-term funds, the eurobond market is a source of long-term capital. These bonds are usually issued by a consortium of issuing houses and banks. Given the U.S. government's attempt to limit foreign investment by American firms, eurobonds are especially useful to American firms seeking to establish subsidiaries or branches abroad. A. GILPIN, *supra* note 13, at 74; J.L. HANSON, *A DICTIONARY OF ECONOMICS AND COMMERCE* 175 (1974).

## II. FINANCIAL INSTRUMENTS

Money market instruments include short-term tax-exempt securities, bank commercial paper, bankers' acceptances,<sup>15</sup> commercial paper,<sup>16</sup> treasury securities,<sup>17</sup> and negotiable time certificates of deposit.<sup>18</sup>

Negotiable certificates of deposit (CDs) are deposit media which were developed by First National City Bank of New York in 1961. They are similar to savings deposits but have specified maturities and are evidenced by certificates rather than passbook entries. Transfer of legal title from one person or entity to another may be accomplished through delivery of the certificate.<sup>19</sup>

Another instrument in the international financial market is the medium-term dollar note.<sup>20</sup> It may be issued publicly or placed privately, but since the cost to the borrower of a five- or seven-year note issue is much the same as for a fifteen-year bond, it may be more attractive to obtain medium-term money, such as a eurocurrency credit, which gives the borrower greater flexibility.<sup>21</sup>

Capital market transactions tend to involve corporate stocks and bonds, personal and corporate notes and government obligations. Nonetheless, these instruments may also be utilized effectively in the money market.<sup>22</sup>

### *A. Bonds and Equities in the International Financial Market*

Some of the dominant instruments in the international financial market are foreign bonds, eurobonds, euroequities, convertible is-

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15. A banker's acceptance is a formal written document in which a creditor draws an order for the payment of a certain sum against his debtor, payable at a definite future time. It is a short-term credit instrument, "most commonly used by [parties] engaged in international trade . . . and may be sold on the open market" for an amount reduced from the original debt. BLACK'S, *supra* note 4, at 133, 149, 719.

16. Commercial paper is a formal written document evidencing a right to the payment of money. Some examples are bank checks, promissory notes, and bills of exchange. BLACK'S, *supra* note 4, at 245, 719.

17. Treasury securities are securities purchased or otherwise acquired by the corporation that originally issued them, and which are not retired but are kept as assets in the corporation's treasury for future use. *Miners Nat'l Bank v. Frackville Sewerage Co.*, 157 Pa. Super. 167, 169, 42 A.2d 177, 179 (1945).

18. D. GEDDES, *supra* note 1, at 2.

19. J.S. LITTLE, *supra* note 13, at 22.

20. A note is a legal written document "containing an express and absolute promise of the signer (i.e. maker) to pay . . . a definite sum of money at a specified time." BLACK'S, *supra* note 4, at 719, 956.

21. B.S. QUINN, *THE NEW EUROMARKETS* 65 (1975). An issue is a block of securities of a corporation which is offered for sale at a particular time. BLACK'S, *supra* note 4, at 746.

22. D. GEDDES, *supra* note 1, at 3.

sues,<sup>23</sup> and warrant issues. Although in practice the distinction between foreign bonds and eurobonds can be subjective, in theory they are distinguished on the basis of underwriting method, governing rules, and interest rates. Interest rates on foreign bonds are generally only slightly higher than those on domestic issues since the foreign bond issues are underwritten by a domestic syndicate and are subject to the rules of that country's issuing authorities.<sup>24</sup>

### 1. Eurobonds

Compared to euroequity issues, eurobond issues seem to predominate. This may be attributed to a number of factors, such as the desire to maintain close share ownership, an insufficient amount of information for equity holders, and the lack of an attractive difference between international and domestic equity issues. Furthermore, in order to induce foreigners to purchase equity issues, it has been necessary to offer a discount. This latter condition produces arbitrage opportunities,<sup>25</sup> creating "flow back" to the domestic market, which, of course, frustrates the intention of the international issue.<sup>26</sup>

Due to favorable conditions such as lack of a queuing system, an absence of limitations on frequency or size of issues and a lack of prospectus requirements<sup>27</sup> (unless stock exchange listing is desired),

23. A convertible security is a bond, debenture or share which the owner may exchange for another security, generally of the same company. BLACK'S, *supra* note 4, at 301, 746.

24. B.S. QUINN, *supra* note 21, at 32. An underwriting contract is an agreement to sell stocks or bonds to the public, or to furnish the money necessary to sell the underwritten securities to the public and to purchase those which cannot be sold. BLACK'S, *supra* note 4, at 1369. A syndicate is a group of investment bankers formed to underwrite and distribute the securities. *Id.* at 1300.

25. Arbitrage is the gaining of profit from price differences in two markets. A security, commodity, or currency may be purchased in the lower priced market and simultaneously sold in the other. This process is generally carried out in large volume because the profit is very small in an individual transaction. The effect of arbitrage is to eliminate such price differences. BLACK'S, *supra* note 4, at 95; D.T. CLARK & B.A. GOTTFRIED, *DICTIONARY OF BUSINESS AND FINANCE* 18 (1957).

26. B.S. QUINN, *supra* note 21, at 47-49. Although the general objective of distributing securities internationally is to have them traded in markets other than the domestic one, substantially all the securities may end up being sold back to traders in the domestic market. This is called flow back. The operation of arbitrageurs is just one reason why flow back may occur. Also, traders may be unwilling to risk keeping securities of a firm with which they have little familiarity, and this may contribute to flow back.

27. A prospectus is a document that enables a potential investor to evaluate the merits of an investment. The information contained in a prospectus generally encompasses the material facts about a company and its operations. Usually domestic law requires that a prospectus be provided in a primary issue to a prospective investor before the purchase. BLACK'S, *supra* note 4, at 1100.

the dollar has been the dominant denomination of eurobonds. Dollar bonds are generally characterized by: size flexibility; a shorter maturity than domestic market bonds; a more active sinking fund<sup>28</sup> activity than for domestic market bonds; a borrower's option to increase sinking fund payments by an amount no greater than the size of the mandatory sinking fund payment; a borrower's right to redeem after a certain number of years; rare granting of security; a negative pledge;<sup>29</sup> and a flexible issue price.<sup>30</sup>

The process of issuing a dollar bond issue involves preparing the required documents,<sup>31</sup> normally done by the "buying side" of the managing underwriters, and organizing the underwriting syndicate and the selling group, usually done by the managing underwriter's "selling side." After the documentation is prepared, underwriters are invited to join the underwriting syndicate, a press release announcing the issue is published, and the final terms of the issue are fixed and approved.<sup>32</sup> The underwriting syndicate of a eurobond issue is typically composed of approximately one hundred banks. In addition to the lead underwriter, who is authorized to act on behalf of all syndicate members and with whom the borrower generally deals, there may also be co-managers. The selling group helps place the issue and is normally comprised of underwriters and other banks. Although listing on stock exchanges is not required,<sup>33</sup> it widens the scope of potential investors. The commission paid by the borrower is composed of the management fee for the managing underwriter and the co-managers, the underwriting commission for each underwriter, and the selling commission for members of the selling group.<sup>34</sup>

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28. A sinking fund involves the accumulation of periodic payments, with the objective of retiring or extinguishing long-term debt when it becomes due. Frequently the payments themselves are invested and the income earned is added to the fund. D.T. CLARK & B.A. GOTTFRIED, *supra* note 25, at 327.

29. A negative pledge is an agreement "whereby the borrower agrees not to secure any other debt without at the same time granting the same security to the eurobond issue." B.S. QUINN, *supra* note 21, at 55.

30. A flexible issue price allows the yield to the investor to be varied in accordance with changes in the market before agreement on the final terms is reached. *Id.* at 56-57.

31. Although there are no legally required contents for the prospectus, in order to avoid selling difficulties adherence to market norms should be maintained. *Id.* at 58.

32. In addition to the preliminary preparations, other expenses incurred include advertising, stabilization, legal and auditing fees, and printing and bond preparation. *Id.* at 62.

33. To list a security on a stock exchange a firm enters into a contract with the stock exchange to trade the securities of that firm on the exchange. In order to enter into the contract, the firm must meet certain requirements of the stock exchange, such as the submission of financial reports and consent to supervision. BLACK'S, *supra* note 4, at 840.

34. B.S. QUINN, *supra* note 21, at 62.

Convertible issues which give the holder the option to convert the securities into shares at some future date allow firms unable to make a straight bond issue, to nonetheless raise funds in the eurobond market.<sup>35</sup> Investors seem to be willing to purchase bond issues which have equity features when they view the stock market's prospects optimistically. The number of convertibles increased dramatically after 1968, largely because of increased interest rates in the straight bond market and the flow back problem with equity issued outside of the United States.<sup>36</sup> Warrants, which give the holder the "right to subscribe to the shares of a company at some future date at some stated price,"<sup>37</sup> have also been issued in the eurobond market.<sup>38</sup>

Although eurobonds have been popular instruments for years, advancements in communications and other technology, loosening of practical and regulatory constraints which limit transfer of capital among countries, and increased competition among banks, have inspired innovations in financial markets and created a variety of new instruments. Examples in the debt market are BONUS, Euro-commercial paper, Grantor Underwritten Note (GUN), Note Issuance Facility (NIF), Revolving Underwritten Facility (SNIF), DINGO, Naked Warrant, Shogun, Startrek, and Sushi Bond.<sup>39</sup>

## B. *International Equity*

### 1. *Terminology*

In comparing eurobonds to international equity, it must first be noted that there is no generally accepted meaning of the term "euroequity." It has been used to describe depositary receipts,<sup>40</sup> off-

35. A. GILPIN, *supra* note 13, at 39.

36. B.S. QUINN, *supra* note 21, at 66-67.

37. A. GILPIN, *supra* note 13, at 228.

38. B.S. QUINN, *supra* note 21, at 67-68. In the case of convertible issues or warrants, where the shares are denominated in a different currency than the bond, "it must be decided whether to give the possible benefits of a revaluation to the bond holder, or to protect the company against the greater dilution which would result." *Id.* at 69-70.

39. For a glossary of these and other innovative eurobonds and euronotes, see *Innovation in the International Capital Markets*, EUROMONEY 128-29 (Supp. Jan. 1986).

40. If a government does not permit the stock of a domestic corporation to be owned by foreigners, the stocks of the corporation may be traded on foreign stock exchanges through the use of the depositary receipt. The company's shares are deposited with a domestic trust company or bank. A correspondent or affiliated bank in the foreign country issues depositary receipts for the shares, and the receipts are then sold to foreign investors. Although ownership of the stock technically remains in the domestic country, the depositary receipts are traded on stock exchanges abroad in a manner similar to normal shares, and depositary receipt holders receive any dividends paid on the stock. D.T. CLARK & B.A. GOTTFRIED, *supra* note 25, at 117.

shore convertible preferreds,<sup>41</sup> eurobonds with warrants, convertible eurobonds, and other types of share issues, yet it can be argued that some of these are not really euroequities. Obviously, eurobonds with warrants and convertible eurobonds are eurobond rather than euroequity instruments. Depositary receipts merely simplify foreign share transactions. Ordinary shares deposited with a depositary company are represented by a bearer certificate which allows the shares of a company of one country to be traded in another country, often more cheaply. Convertible preferred stock can probably be correctly classified as euroequity.<sup>42</sup>

To identify a euroequity, *Euromoney* uses two criteria. First, only pure equities count—convertibles and bonds with warrants are not included. Second, *Euromoney* distinguishes between international and foreign equities. Equities must be syndicated to two or more foreign national markets to be international; an equity placed in only one foreign market is a foreign equity.<sup>43</sup> A euroequity offering uses marketing techniques normally used for eurobond issues.<sup>44</sup> One definition which has developed to describe international equity markets is a functional one: “the underwriting and distribution of equity securities to investors in a number of markets outside a company’s home market by a syndicate of international banks and securities houses.”<sup>45</sup> However, a distinction can be drawn between “equities traded overseas” and “international equity trading.” The latter involves trading equities outside their country of origin. Such trading does not take place on any exchange, and usually takes place during hours when the exchanges in the company’s home country are closed.<sup>46</sup>

For purposes of this Comment, the terms euroequity and international equity are used interchangeably to refer to equity traded in at least one market outside of the company’s home market and

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41. Depending on the terms of the issue, preferred shares generally entitle the shareholder to claim dividends up to a limited amount before dividend payments are made to holders of common shares. Preferred shareholders also may claim assets of the company prior to common shareholders, but after bondholders, upon distribution of the assets of the corporation. Convertible preferred shares may be exchanged for common shares or other securities pursuant to the terms of the sale. BLACK’S, *supra* note 4, at 301, 1061, 1271.

42. B.S. QUINN, *supra* note 21, at 71-74.

43. *The International Equity League*, EUROMONEY 70 (P. Fallon ed. 1985).

44. Allen-Jones & King, *How Euromoney Offered its Shares to the Public*, INT’L FIN. L. REV. 10 (Oct. 1986).

45. *The International Equity Market; CSFB*, EUROMONEY & CORP. FIN. 54 (N. Osborn ed.) (Supp. Nov. 1986).

46. Altschul, *Policing Off-Shore Dealing in U.S. Securities*, INT’L FIN. L. REV. 35 (Mar. 1986).

which may be, but is not necessarily, traded in the firm's home country as well.

## 2. *Advantages*

One advantage of issuing euroequity rather than eurodebt is that unlike eurobonds, where the principal must be repaid within a relatively short period of time, equity is of a "permanent nature" and often remains outstanding for a significantly greater period of time. Second, issuing equity abroad may be less expensive than issuing convertible or other debt internationally.<sup>47</sup> Euroequity issues may also help companies meet objectives such as broadening their shareholder base, increasing their stock price, enhancing public awareness of their firm, hampering hostile takeovers,<sup>48</sup> acquiring additional strength to undertake an acquisition,<sup>49</sup> and avoiding stock exchange disclosure rules.<sup>50</sup> Also, some companies have found that they benefit from being compared to equivalent firms in the same industry in other countries.<sup>51</sup> To illustrate: the Danish pharmaceutical company, NovoIndustri A/S, was able to increase its competitive status by issuing an American Depository Receipt in 1981 in New York. Investors in New York and London were willing to pay three times the amount paid in Denmark.<sup>52</sup>

The investor may benefit from the ability to convert bearer depository receipts<sup>53</sup> at no charge or premium, and the lack of withholding tax from dividends.<sup>54</sup> In addition, investors may invest in

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47. B.S. QUINN, *supra* note 21, at 71-74.

48. In a takeover a party assumes control or management of an ongoing organization through the exchange of stock and/or purchase of the firm. It does not necessarily involve transferring absolute title, and is not necessarily effected amicably. BLACK'S, *supra* note 4, at 1304; D. BROWNSTONE, I. FRANCK & G. CARRUTH, *THE VNR DICTIONARY OF BUSINESS AND FINANCE* 262 (1980) [hereinafter BROWNSTONE]; J. ROSENBERG, *DICTIONARY OF BUSINESS AND MANAGEMENT* 432 (1978).

49. *Sharing in the Global Trend*, EUROMONEY & CORP. FIN. 2 (N. Osborn ed.) (Supp. Nov. 1986)

50. *Choosing the Stock Market that Fits*, EUROMONEY 125 (B. Cohen ed.) (Supp. Jan. 1986). Exchange disclosure rules require filing of annual, quarterly, and other reports revealing financial, operational and other data in order to inform investors. For example, in the United States, pursuant to the Securities Exchange Act of 1934, all companies having securities listed on exchanges must register with the SEC and submit particular reports. J. ROSENBERG, *supra* note 48, at 189-90.

51. *Tapping Overseas Investors*, EUROMONEY 114 (B. Cohen ed.) (Supp. Jan. 1986).

52. *Id.* at 121-22.

53. A bearer instrument, bearer document of title, or bearer security is one which may, according to its terms, be paid to the person in possession of it. No specific owner is designated and there is no need for registration of ownership or for a formal deed of transfer. BLACK'S, *supra* note 4, at 140; A. GILPIN, *supra* note 13, at 14.

54. B.S. QUINN, *supra* note 21, at 71-74.

euroequities to diversify their stock portfolios in terms of geography, industry, currency and type of stock in order to limit risk and maximize returns.<sup>55</sup>

Another benefit for a firm listing its shares outside of the domestic market is the ability to choose among countries with differing listing requirements. Some are more onerous than others, creating undue expense, and forcing the company into disclosing information that it considers commercially vital to keep to itself.<sup>56</sup> For instance, many Swiss companies feel that quarterly reports distort the picture of the company's performance. The United States Securities and Exchange Commission's (SEC) stipulation that companies disclose conditions, terms, prices and names of contracts entered into by firms has been described as "commercially dangerous," with the potential to impair companies' competitive advantages in bidding for future contracts.<sup>57</sup> A Pennsylvania-based packaging manufacturer, Klearfold, chose to list in London rather than in the United States to keep its competitive edge, believing a U.S. listing would require too much disclosure concerning the development of its process.<sup>58</sup>

Another point of contention is the substantial legal fees and other costs incurred in complying with regulatory paperwork. Indeed, in the early 1980s the defense contractor, International Signals and Control, chose to fund an acquisition of a U.S. company by listing in London rather than in New York, partly because the cost of listing in New York is three to six times as much as in London. This is due, in part, to the comparatively burdensome listing and disclosure requirements imposed by the SEC.<sup>59</sup>

### C. Growth of International Equities Transactions

Trading in international equities has been referred to as the "new 24-hour market in global equities."<sup>60</sup> It has progressed from a sporadic series of block deals to a trading network of regular market-makers.<sup>61</sup> Indeed, rarely does a company issue a large number of shares without considering selling overseas.<sup>62</sup> For example, even ex-

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55. *Sharing in the Global Trend*, *supra* note 49, at 2.

56. *Id.*

57. *Choosing the Stock Market that Fits*, *supra* note 50, at 125.

58. *Id.* at 126.

59. *Id.* at 125.

60. *The Global Equity Market*, EUROMONEY 5 (P. Fallon ed. May 1985).

61. *Id.*

62. *Tapping Overseas Investors*, *supra* note 51, at 114.

cluding the annual multi-fold increase in issues of convertible eurobonds and eurobonds with equity warrants, straight euroequity offerings are estimated to have increased from \$200 million in 1983 to more than \$7.9 billion in 1986,<sup>63</sup> and to approximately \$20 billion in 1987.<sup>64</sup> *Euromoney's* list of companies whose shares were traded daily in markets other than their home markets increased from 236 in May 1984 to more than 410 a year and a half later.<sup>65</sup> Although international equity offerings declined to an average of \$300 million per month after the market break in October 1987 (compared to approximately \$2 billion per month in the preceding twelve months), that rate still represents a significant increase above the 1983 level.<sup>66</sup>

Some of the reasons for this striking increase are shifts in the world's capital flow, changes in the global industrial power structure, technological advances, privatization, and financial market deregulation.<sup>67</sup> A general trend towards increased integration of financial markets throughout the world is evidenced by companies seeking the least expensive ways to raise new debt and equity in markets outside their home country.<sup>68</sup> The risk of flow back has been reduced considerably by the increase in the proportion of funds devoted by institutional investors to investment in equities overseas.<sup>69</sup> Banks capable of absorbing risk capital in large amounts are helping create a huge primary issue market for equity. European universal banks provide first hand access to the international equity market.<sup>70</sup> Furthermore, the amount of time required to raise equity on the international market has decreased to weeks or days, whereas previously at least one and a half to two months were required. Finally, companies have found that the costs of raising funds abroad are not as substantial as originally believed.<sup>71</sup> In fact, there has been such a wide swing from debt back into equity that supply has been unable to keep up with demand.<sup>72</sup>

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63. *Sharing in the Global Trend*, *supra* note 49, at 2.

64. Securities Act Release No. 6779, Fed. Sec. L. Rep. (CCH) para. 84242, at 89127 (June 22, 1988).

65. *Tapping Overseas Investors*, *supra* note 51, at 114.

66. Securities Act Release No. 6779, *supra* note 64.

67. *Sharing in the Global Trend*, *supra* note 49, at 1-2.

68. J.J. Phelan, Jr., *supra* note 6, at 6.

69. *Sharing in the Global Trend*, *supra* note 49, at 2.

70. *Id.* The primary issue market consists of the demand for the initial sale of a company's securities from that company's treasury. In contrast, the secondary issue market refers to stock previously sold to the public and traded through any channel of distribution.

71. *Tapping Overseas Investors*, *supra* note 51, at 114.

72. *Supply of Equity Fails to Meet Demand*, *EUROMONEY* 123 (B. Cohen ed.) (Supp.

In meeting the growing demand for equity and circumventing legislation, corporate constitutions, or minority shareholding rights, which constrain primary issues of common stock,<sup>73</sup> instruments resembling common stock have been developed.<sup>74</sup> They include convertible bonds, American Depositary Receipts, and hybrid securities<sup>75</sup> or quasi-equity instruments such as the *Azioni di Risparmio*, *titres participatifs*, *certificats d'investissement*, *Genussschein*, and Swiss participation certificates.<sup>76</sup> It is expected that the factors contributing to the increased demand for equity and international financial instruments will further fuel the euroequity market.

#### D. Method of Issue of International Equities

Euroequities can be issued in the same manner in which eurobonds are issued. On June 21, 1985, Nestle, S.A. issued Swfr 373 million of non-voting equity through the distribution of 300,000 bearer certificates.<sup>77</sup> It was the first large equity issue to be fashioned along Eurobond lines and distributed entirely through the Eurobond system.<sup>78</sup> In placing stock for multinational companies,

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Jan. 1986).

73. Stock is an equity and a security, representing an ownership interest in the assets of a company. It is distinguished from debt obligations such as bonds or notes, which do not represent ownership interests and are not equity. Generally, upon distribution of the assets of the company, holders of debt instruments such as bondholders and creditors can claim assets before shareholders can do so. Among shareholders the priority they have to claim the remaining assets upon distribution of assets and to dividends (earnings) declared during the life of the corporation depends on the types of shares issued and upon the terms of the issue.

Depending on the terms of the sale, common shares generally entitle the shareholder to vote on corporate matters such as the composition of the board of directors, and to receive a proportion of corporate profits when the board of directors declares dividends. On the other hand, preferred shares generally entitle the shareholder to claim dividends up to a limited amount before dividend payments are made to common shareholders. They also allow the preferred shareholder to claim assets of the company prior to common shareholders (but after creditors or holders of debt instruments) upon distribution of the assets of the corporation. BLACK'S, *supra* note 4, at 1061, 1269-71; L.S. ROSEN & M.H. GRANOF, CANADIAN FINANCIAL ACCOUNTING: PRINCIPLES AND ISSUES 44-45 (1980).

74. *Supply of Equity Fails to Meet Demand*, *supra* note 72, at 124.

75. A hybrid security is an instrument evidencing an obligation of the issuer or property in an enterprise, and contains some features of equity stock and some features of indebtedness. BLACK'S, *supra* note 4, at 668, 1216-17.

76. For a discussion of these developments see *Supply of Equity Fails to Meet Demand*, *supra* note 72, at 123-24.

77. A share certificate is a written document entitling the possessor to a particular number of shares. The adjective "bearer" generally means that there is no indication of the particular person who owns it and that, therefore, it belongs to the person who is in possession of it. BLACK'S, *supra* note 4, at 140, 719, 1233. For more information regarding methods of issuing euro-equities, see *Dual Approaches to Dual Tranches*, EUROMONEY & CORP. FIN. 25 (Supp. Nov. 1986) (N. Osborn ed.); see also Muehrig, *The Looming Battle in International Equities*, INSTITUTIONAL INVESTOR 104 (Oct. 1986).

78. Katz, *Growing Competition Challenges Swiss Conservatism*, EUROMONEY 27

the international syndicate, comprised of ten to fifteen banks, accelerates commitment, decreases the syndicate's margins, eliminates delays and secures good share prices.<sup>79</sup> The role of underwriters has also evolved. Instead of selling shares internationally only if the domestic market would not take them, underwriters are now the dominant actors in placing shares of issues considered too big for the domestic market to handle alone.<sup>80</sup>

### III. TECHNOLOGICAL INNOVATION

Technological advances facilitate 24-hour global trading in equities and opportunities in international equities investment. One illustration of the extent of technological advances is the development of trading off the floor of stock exchanges.<sup>81</sup> The chairman of the Sydney Stock Exchange, James Bain, expects to see "trading floors phased out well before the end of the century."<sup>82</sup>

Brokers at the Tokyo exchange can use terminals in their offices to place orders for business. However, except in the over-the-counter market, network operators, such as Instinet, have found it more worthwhile to cooperate with stock exchanges than to fight them.<sup>83</sup>

An overview of automated trading networks includes network op-

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(Supp. Jan. 1986).

79. *Tapping Overseas Investors*, *supra* note 51, at 114, 121.

80. *Id.*

81. Trading off the floor is distinguished from trading on the floor. In reference to securities, the "floor" generally refers to the area in organized exchanges where the actual agreements for the purchase and sale of securities are made by floor traders. A floor trader is a broker acting on the trading floor for other brokers and for his customers. A transaction consummated in such open trading is made *on* the floor. Transactions arranged by private negotiation are made *off* the floor. Computer and telecommunication advancements have increased the efficiency and ease of trading off the floor. BLACK'S, *supra* note 4, at 577; D.T. CLARK & B.A. GOTTFRIED, *supra* note 25, at 154, 362.

82. *The World's Traders Get Off the Floor*, EUROMONEY 154 (P. Fallon ed. May 1985).

83. *Id.* The terms "over-the-counter market," "third market," and "off-board" generally refer to transactions that take place off the floor. See *supra* note 81. Trading of listed stocks that does not take place on a securities exchange may be referred to as the "third market" and may be described as "off-board." The term "off-board" may also be used to describe the trading of securities not listed on a securities exchange. The term "over-the-counter market," however, generally refers only to the trade of unlisted shares. It does not take place on an organized exchange and is transacted nationally and internationally directly between buyers and sellers or their representatives. In the United States, prices of securities traded over-the-counter are quoted on an automated information network called the National Association of Securities Dealers Automated Quotations (NASDAQ). BROWNSTONE, *supra* note 48, at 199; D.T. CLARK & B.A. GOTTFRIED, *supra* note 25, at 253; A. GILPIN, *supra* note 13, at 163; J. ROSENBERG, *supra* note 48, at 296, 310, 311, 441 (quoting Don Unruh of the Toronto Stock Exchange).

erators like Telerate, Instinet, and Reuters.<sup>84</sup> Leading proponents of automated trading systems include the National Association of Securities Dealers (NASD),<sup>85</sup> the Toronto Stock Exchange (TSE),<sup>86</sup> and the Tokyo Exchange.<sup>87</sup>

These advances allow stock exchanges to trade shares among themselves. The TSE trades a list of stocks with the Midwest Stock Exchange in Chicago and the American Stock Exchange in New York; there is a 24-hour link between the Sydney Stock Exchange and the Vancouver, Montreal, and Amsterdam exchanges. There is also speculation regarding a proposed joint venture between Tokyo, London and New York to trade in high quality equities. The development of technology makes it possible to instantaneously acquire information about activity throughout the world and to transfer large amounts of money around the globe.<sup>88</sup>

#### IV. THE NEED TO REGULATE SECURITIES TRANSACTIONS GENERALLY AND EQUITIES TRANSACTIONS SPECIFICALLY

Probably the fundamental reason to regulate securities markets is to protect investors. This objective is derived from a number of factors. First, a sense of fairness or equity motivates the belief that investors should be protected from unscrupulous persons or organizations seeking to raise money by offering securities which are ultimately worthless. Second, the principle of caveat emptor cannot be applied in full force to the securities market. Capital markets are integral to the health of an economic system, be it national or international, and as such investor confidence in the integrity of the market must be nurtured in order to attract optimal amounts of capital. Taken to its extreme, such reasoning could lead to the conclusion that the greatest number of investors could be obtained if a positive return was guaranteed on each security purchased. Yet, it must be noted that the pursuit of efficient capital market operation

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84. *The World's Traders Get Off the Floor*, *supra* note 82, at 154. See also Arnott, *Renters Aims at Global Investor Service*, Financial Post, Feb. 16, 1987, at 38.

85. NASD is the operator of the automated quotation system, the National Association of Securities Dealers Automated Quotations (NASDAQ). NASDAQ "is a computerized communications network that links investors electronically with brokers and dealers; technically, companies traded via the NASDAQ system are not listed, but merely quoted." *To List or Not To List*, EUROMONEY & CORP. FIN. 43 (N. Osborne ed.) (Supp. Nov. 1986).

86. The TSE operates the Computer Assisted Trading System (CATS). *The World's Traders Get Off the Floor*, *supra* note 82, at 154-55.

87. The Computer-assisted Order Routing and Execution System (CORES) in Tokyo is modelled on CATS. *Id.* at 158-59.

88. J.J. Phelan, Jr., *supra* note 6, at 8.

requires that some risk be borne by the investor, as no venture sought to be financed through capital markets is completely free of risk.

In order to optimize the efficiency of the international trading of equities, it is necessary to formulate a common set of rules regarding price, reporting, settlement, accounting standards, trading practices, and the trading system itself.<sup>89</sup> The creation of these rules will be market-driven, rather than imposed by legislation.<sup>90</sup>

Although 1985 saw between forty and fifty brokers make markets in cross-border equities, it is not a foregone conclusion that a global market will develop as a unique entity. The president of the NASD, Gordon Macklin, outlined four prerequisites: sufficient demand for participation in the international market; systems which are automated and technologically capable of linking into a separate global market; reduced communication expenses; and solutions to the regulatory and legal difficulties encountered in global trade.<sup>91</sup> It is relatively clear that the first three of these elements exist; the number of market-makers in the global market is increasing, most of the top stock markets operate computerized trading systems, and technology and competition in the telephone and telecommunications industry fosters efficiency, and thereby reduces costs.<sup>92</sup>

The question of regulatory problems, however, is more complicated. The normative motivating rationale for the pursuit of effective control over international trading of securities in general, and of equities in particular, is convincingly expressed by J.M. Fedders: "No nation should permit itself to be used as a base for persons to perpetrate frauds upon their neighbors, particularly when such persons purposefully and voluntarily engage in fraudulent conduct within another country."<sup>93</sup> This is not to say that the incidence of such conduct is necessarily high, but it stands to reason that in order to foster confidence in the fairness and equitable nature of the international equities market, there must be enforceable mechanisms in place to punish, and hopefully deter, potential and actual perpetrators.

J.P. Bunting, President of the Toronto Stock Exchange (TSE),

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89. *The Global Equity Market*, *supra* note 60, at 5.

90. *Id.*

91. *The World's Traders Get Off the Floor*, *supra* note 82, at 158-59.

92. *Id.*

93. Fedders, Wade, Mann & Beizer, *Waiver by Conduct—A Possible Response to the Internationalization of the Securities Markets*, 6 J. COMP. BUS. & CAP. MKT. L. 24-25 (1984) [hereinafter Fedders].

warned that “[a] growing proportion of the activities of domestic dealers and institutions occurs on international markets that are almost totally outside the control of national regulators and at financial risks that are underestimated or unknown to them.”<sup>94</sup> John Phelan, Chairman of the New York Stock Exchange (NYSE), similarly warned that “the growing globalization of markets means that a future failure could hit financial centers around the world.”<sup>95</sup> The extent to which financial markets are linked is unprecedented. A decline in prices at the NYSE in September 1986 triggered heavy selling at exchanges in other financial centers.<sup>96</sup> The global stock market “crash” of October 1987 is probably the most dramatic manifestation of the interrelationship of markets around the world. Furthermore, in the absence of a lender of last resort at the global level, good will between governments must be relied on. Good will can be in short supply in times of international stress.<sup>97</sup> Finally, Richard O. Scribner, Executive Vice President of Legal and Regulatory Affairs of the American Stock Exchange (AMEX), in a letter to the Secretary of the SEC, asserted that “the Exchange fully shares the Commission’s underlying concern that the international markets which do emerge be fair, efficient, and accessible to all investors.”<sup>98</sup>

A case which illustrates the potential for unfair conduct in the international trade of equities is *Straub v. Vaisman & Co.*<sup>99</sup> In *Straub*, it was alleged that a U.S. securities broker induced foreign nationals to purchase shares of a U.S. corporation by making misleading recommendations and providing alleged sales figures. The plaintiffs in another case, *Travis v. Anthes Imperial, Ltd.*,<sup>100</sup> alleged that fraud occurred in the sale of stock to a Canadian investor.<sup>101</sup>

The characteristic of the international equities market that provides the most compelling argument in favor of a formal mode of regulation is the wide extent of informal flows of information. In the domestic market, a continuous flow of information may circu-

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94. J.P. Bunting, Speech delivered in Paris, Regulation and International Market Structures, at 3 (1986).

95. J.J. Phelan, Jr., Remarks at the Conference on Globalization of Financial Markets, at 15 (Oct. 20, 1986).

96. *Id.*

97. *Id.* at 19-21.

98. R. Scribner, Letter to John Wheeler, Secretary of the SEC, at 1 (Dec. 13, 1985).

99. 540 F.2d 591 (3d Cir. 1976).

100. 473 F.2d 515 (8th Cir. 1973).

101. *Id.* at 518-19.

late informally, often by word of mouth. But in the international market, that informal network no longer works as well and a more formal approach is needed.<sup>102</sup> The need for formal regulation of even national markets exists despite the more effective flow of information. The necessity for regulation in the international markets dictates the formulation of express objectives for an international regulatory system.

## V. OBJECTIVES OF AN INTERNATIONAL REGULATORY SYSTEM

The central goals for national and international markets are to attain fairness, accessibility, and efficiency.<sup>103</sup> The preamble to the OECD Minimum Disclosure Rules recognizes that the “[p]rogressive development of capital markets, both nationally and internationally requires: (a) . . . continuous investor protection . . . ; (b) public confidence in issuers of securities and in the securities industry; and (c) co-ordination of methods and facilities for raising capital and for trading in securities.”<sup>104</sup> Indeed, confidence in the fairness and integrity of the international equities market must be maintained if global trading is to continue to grow and develop.<sup>105</sup>

### A. Fairness

Fairness refers essentially to investor protection. Protection is required not as much for institutional firms and market professionals as for passing public investor orders.<sup>106</sup> In order to optimally protect investors within the international market, it is necessary to coordinate laws, rules, policies, and other regulatory instruments. Effective surveillance, sharing of surveillance data, and education of markets regarding surveillance systems would contribute towards coordinated international enforcement.<sup>107</sup> In addition, it is necessary that an effective method for resolving disputes be considered, that reciprocity among jurisdictions be implemented and that strong enforcement machinery be put into place.<sup>108</sup>

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102. *Cutting Off the Flowback Menace*, EUROMONEY & CORP. FIN. 51 (N. Osborn ed.) (Supp. Nov. 1986).

103. SEC, Request for Comments on Issues Concerning Internationalization of the World Securities Markets, 17 C.F.R. Part 240, at 14-15, Release No. 34-21958, File No. S7-16-85 (Apr. 1985) [hereinafter Request for Comments].

104. OECD Committee on Financial Markets, OECD Minimum Disclosure Rules Applicable to All Publicly Offered Securities, preamble (1986).

105. J.P. Bunting, *supra* note 94, at 30.

106. Request for Comments, *supra* note 103, at 14.

107. R. Scribner, *supra* note 98, at 8-9.

108. J.P. Bunting, *supra* note 94, at 22.

### B. Accessibility

Accessibility refers primarily to broker-dealer access to markets.<sup>109</sup> Another related issue is competitiveness; restricting access to markets to favored nations through bilateral agreements, for example, will limit participation in the global equity market, and hence attenuate competition. Competition for business should not promote protectionist rules that favor one competitor over the other.<sup>110</sup> Furthermore, it is important to ensure that markets are hospitable to foreign participants and thus avoid unnecessary regulatory burdens.<sup>111</sup>

### C. Efficiency

One issue relating to efficiency is the quality of clearing systems; processing of international securities transactions must be safe and fast.<sup>112</sup> Second, competitive price quotations and improved operational procedures should be encouraged,<sup>113</sup> and regulatory burdens must exist only when necessary.

## VI. PARTICULAR PROBLEMS FACED BY REGULATORS IN CONTROLLING INTERNATIONAL EQUITIES TRANSACTIONS

### A. Regulatory Sources

The fundamental barrier facing any attempt to regulate the international trading of equities is the nonuniformity of national laws and regulations. Constitutional differences frame each country's regulatory approach. The most significant areas in which legislation varies among countries are in the regulation of distribution,<sup>114</sup> securities markets, brokers, dealers, investment advisers, continuous disclosure,<sup>115</sup> and insider trading. In addition, there is inconsistency

109. Request for Comments, *supra* note 103, at 15.

110. J.J. Phelan, Jr., *Emerging Global Markets: Financial Statesmanship or Rube Goldberg?*, Remarks at University of California Securities Regulation Institute, at 11 (Jan. 23, 1986).

111. R. Scribner, *supra* note 98, at 6.

112. Request for Comments, *supra* note 103, at 11-12.

113. J.P. Bunting, *supra* note 94, at 33-34.

114. Distribution of securities generally refers to the offering of securities to the public by an underwriter or by the corporation whose securities are being offered. BLACK'S, *supra* note 4, at 426-27.

115. Continuous disclosure refers to the requirements imposed by securities and corporate legislation on an issuer to provide information after distribution has ceased. There are two categories of continuous disclosure. First, regular disclosure must be made at predictable fixed intervals. This includes annual financial statements and interim financial reports. Second, irregular disclosure must be made when the affairs of the issuer change materially. For

with respect to the organization of administrative bodies, the powers of such entities, and their decision-making patterns.

It may also be stated that there are similarities among national laws. England, Canada and the United States have similar securities laws.<sup>116</sup> Disclosure philosophy, fraud provisions, broker-dealer registration requirements and self-regulation are characteristics common to the three countries, and indeed, judicial precedents are to a considerable extent interchangeable.<sup>117</sup>

Nonetheless, there are differences which are due at least in part to constitutional variation.<sup>118</sup> It is precisely because of the differences in standards and philosophical orientations of nations that difficulties arise in enforcing legislation in the international trading of equities.

### 1. Constitutions

Constitutional restrictions have caused variations among countries with respect to the levels of government responsible for the regulation of securities.

#### a. United States

In the United States, the Federal Securities Act of 1933 (1933 Act) has been upheld on a number of constitutional grounds. The commerce power was held to be a valid base for this Act in *Jones v. SEC*.<sup>119</sup> In *SEC v. Crude Oil Corp.*,<sup>120</sup> the decision affirming the constitutionality of Section 5(a) of the 1933 Act was also based on

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example, disclosure may be required when a subsidiary is incorporated, a take-over bid is made, property is damaged, a labor dispute develops, or a lawsuit is commenced. The objectives of continuous disclosure requirements are to inform potential and present investors, and to create accountability, thereby encouraging efficient management and deterring fraud. D. JOHNSTON, CANADIAN SECURITIES REGULATION 240 (1977).

116. Loss, *Foreward* to J. WILLIAMSON, SECURITIES REGULATION IN CANADA at v (1960).

117. Self-regulation refers to the responsibility imposed upon stock exchanges and other organizations in the securities industry to stipulate requirements for membership in their organizations and to oversee and control the conduct and performance of their members. *Id.*

118. *Id.*

119. 79 F.2d 617 (2d Cir. 1935), *rev'd on other grounds*, 298 U.S. 1 (1936).

120. 93 F.2d 844 (7th Cir. 1937). Both the mails and commerce powers were held to be bases for the constitutionality of parts of the Securities Act of 1933 in *SEC v. Torr*, 15 F. Supp. 315 (S.D.N.Y. 1936), *rev'd on other grounds*, 87 F.2d 446 (2d Cir. 1937), and *Coplin v. United States*, 88 F.2d 652 (9th Cir.), *cert. denied*, 301 U.S. 703 (1938). Similarly, in *Newfield v. Ryan*, it was held that the Securities Act of 1933 was within the constitutional jurisdiction of the federal government. 91 F.2d 700 (5th Cir.), *cert. denied*, 302 U.S. 729 (1937).

the commerce power.

The federal Securities Exchange Act of 1934 was held not to invade state jurisdiction to regulate intrastate commerce in *Wright v. SEC*.<sup>121</sup> It is also argued that the United States Supreme Court's broad interpretation of the commerce power in upholding the National Labor Relations Act may be extended, by analogy, to the 1933 and 1934 securities legislation.<sup>122</sup>

#### b. Canada

In Canada, the Constitution Act, 1867 outlines the division of power between the provincial and federal levels of government. Federal jurisdiction includes the regulation of trade and commerce, the borrowing of money on public credit, the postal service, banking and criminal law.<sup>123</sup> In addition, the federal government is empowered to legislate for the Peace, Order, and Good Government of Canada.<sup>124</sup> The provinces are provided with jurisdiction over the incorporation of companies with provincial objects, property and civil rights and over all matters of a merely local or private nature within the province.<sup>125</sup> Although there are decisions in the area of federal-provincial relations affecting other lines of commerce that suggest that grants of power to the federal government could be relied upon as constitutional bases for federal securities legislation, securities acts remain provincial.<sup>126</sup>

Indeed, the lack of a central body regulating securities transactions, even within the country of Canada, complicates the process involved in executing national issues. For example, it is necessary to contact lawyers in each province in order to get their opinions on specific questions. Despite the existence of "uniform" legislation, the Securities Commissions vary in their interpretation.<sup>127</sup> Geddes asserts that "[t]he duplication of effort and expense involved in such procedures constitutes . . . a strong argument for an effectively uniform system of federal regulation."<sup>128</sup> As analogous costs of a greater magnitude are incurred at the international level, there is, *a fortiori*, a compelling argument for the creation of an integrated

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121. 112 F.2d 89 (2d Cir. 1940).

122. D. GEDDES, *supra* note 1, at 298-300.

123. CAN. CONST. §§ 91(2), 91(4), 91(5), 91(15) & 91(27).

124. *Id.* at § 91.

125. *Id.* at §§ 92(11), 92(13) and 92(16).

126. J. WILLIAMSON, *SECURITIES REGULATION IN CANADA* 189 (1960).

127. D. GEDDES, *supra* note 1, at 305.

128. *Id.*

system to regulate international trading of equities.

c. United Kingdom, Japan, Hong Kong

Unlike the constitutional frameworks in the United States and Canada, the unitary political systems of the United Kingdom, Japan and Hong Kong have facilitated a uniform system of securities regulation in each of those jurisdictions. In the United Kingdom, this achievement is also a result of the role played by the former Federation of Stock Exchanges and the current National Stock Exchange.<sup>129</sup> In Japan, the codified legal system and the dominance of the Tokyo Stock Exchange have contributed to uniformity.<sup>130</sup>

d. European Community

In 1951, Germany, Belgium, France, Italy, Luxembourg and the Netherlands created the European Coal and Steel Community.<sup>131</sup> In 1957, these six countries created the European Economic Community,<sup>132</sup> and the European Atomic Energy Community.<sup>133</sup> In 1965, the same six countries established the Council of the European Communities, taking the place of the Special Council of Ministers of the European Coal and Steel Community, the Council of the European Economic Community and the Council of the European Atomic Energy Community.<sup>134</sup> In the same instrument, these countries created the Commission of the European Communities to take the place of the High Authority of the European Coal and Steel Community, the Commission of the European Economic Community and the Commission of the European Atomic Energy Community.<sup>135</sup>

In 1972, Denmark, Ireland, Norway, and the United Kingdom signed treaties allowing them to join the European Economic Com-

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129. *Id.* at 313-14.

130. *Id.*

131. Treaty Establishing the European Coal and Steel Community, Apr. 18, 1951, arts. 1, 100, 261 U.N.T.S. 140, *reprinted in* TREATIES ESTABLISHING THE EUROPEAN COMMUNITIES 15 (1978).

132. Treaty Establishing the European Economic Community, Mar. 25, 1957, arts. 1, 248, 298 U.N.T.S. 11, *reprinted in* TREATIES ESTABLISHING THE EUROPEAN COMMUNITIES 203 (1978) [hereinafter EEC Treaty].

133. Treaty Establishing the European Atomic Energy Community, Mar. 25, 1957, arts. 1, 225, 298 U.N.T.S. 167, *reprinted in* TREATIES ESTABLISHING THE EUROPEAN COMMUNITIES 577 (1978).

134. Treaty Establishing A Single Council and A Single Commission Of the European Communities, arts. 1, 39, *reprinted in* TREATIES ESTABLISHING THE EUROPEAN COMMUNITIES 785 (1978).

135. *Id.* at art. 9.

munity and the European Atomic Energy Community.<sup>136</sup> The Council of the European Communities agreed to allow these nations to join the European Coal and Steel Community.<sup>137</sup> Norway did not deposit the required instruments of ratification and accession, thus the European Communities grew to include only nine nations.

In 1975, the nine heads of government decided to meet three times a year as the European Council. As to Community affairs, the European Council is the Council of the European Communities meeting at a higher level.<sup>138</sup> Greece signed a treaty allowing it to join the Communities in 1979.<sup>139</sup>

Most of the constitutional law of the Community is contained in the Community Treaties concluded between States. The provisions are equally binding upon the member States and the Community institutions.<sup>140</sup>

## 2. *Laws Affecting the Securities Industry*

### a. United States

Due to the federal political system in the United States, and the historical development of its legislation, there are laws regulating securities at both the federal and state level. Indeed, forty-seven states were regulating the securities industry within their territorial boundaries before the first comprehensive federal statute in the securities field was introduced in 1933.<sup>141</sup>

The state legislation, also referred to as “blue sky laws,” revolve primarily around combatting fraud, and specifying the registration requirements for the securities industry.<sup>142</sup> Originally the states were concerned with secondary market trading, rather than with

136. Treaty Concerning the Accession of the Kingdom of Denmark, Ireland, the Kingdom of Norway and the United Kingdom of Great Britain and Northern Ireland to the European Economic Community and to the European Atomic Energy Community, arts. 1, 3, *reprinted in* TREATIES ESTABLISHING THE EUROPEAN COMMUNITIES 981 (1978).

137. Decision of the Council of the European Communities Concerning the Accession of the Kingdom of Denmark, Ireland, the Kingdom of Norway, and the United Kingdom of Great Britain and Northern Ireland to the European Coal and Steel Community, art. 1, *reprinted in* TREATIES ESTABLISHING THE EUROPEAN COMMUNITIES 971 (1978).

138. THIRTY YEARS OF COMMUNITY LAW 9 (Commission of the European Communities ed. 1981).

139. Bernhardt, *The Sources of Community Law: The Constitution of the Community*, in THIRTY YEARS OF COMMUNITY LAW 71 (Commission of the European Communities ed. 1981).

140. *Id.* at 71-74.

141. D. GEDDES, *supra* note 1, at 103.

142. *Id.*

requiring full disclosure of all information in order to allow the investor to make an informed decision.<sup>143</sup> Despite the fact that a Uniform Securities Law has been adopted in whole or in part by more than thirty-five jurisdictions, state regulation of securities still lacks uniformity to a substantial degree. By 1985, blue sky laws had evolved to the point where sixteen states had full disclosure statutes ignoring the risk factors provided, and thirty-four states had “fair, just and equitable” statutes utilizing the criteria of investment merit and issuer quality.<sup>144</sup>

Although various forms of federal securities legislation existed in the United States since the 1800s, detailed federal regulation of the securities industry was catalyzed by the stock market crash of 1929. The Securities Act of 1933 is primarily a disclosure statute and is designed to ensure that every issue of new securities sold in interstate commerce is accompanied by full publicity and information.<sup>145</sup> Indeed, President Roosevelt asserted that “[t]he purpose of the legislation [was] to protect the public with the least possible interference to honest business.”<sup>146</sup>

In contrast to the initial distribution of securities, post-distribution or secondary trading is regulated at the federal level primarily through the Securities Exchange Act of 1934. This Act attempts to limit speculation such as short selling<sup>147</sup> and margin trading;<sup>148</sup> and to curb manipulative practices such as pool operations,<sup>149</sup> fictitious

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143. *Id.* at 104. Secondary market trading refers to the buying and selling of securities on securities exchanges, among investors or their representatives, or on the over-the-counter market, after the original sale of the securities by the issuing enterprise.

144. Stoakes, *Harmonizing Prospectuses: The SEC's Proposal*, INT'L FIN. L. REV. 8 (May 1985).

145. D. GEDDES, *supra* note 1, at II:19.

146. *Id.*

147. In short selling a profit is earned by selling a security and then purchasing it at a price lower than the selling price. Thus a short sale is a contract for the sale of shares that are not yet owned by the vendor. The vendor expects the price to fall before the securities are due to be delivered. He may borrow securities, on which interest must be paid, to deliver to the purchaser when they are due to be delivered. However, delivery must be made at some time to those from whom the securities were borrowed. Of course, if at the time of eventual purchase, the price of the securities sold short is higher than that at which they were sold, the short seller suffers a loss and may be in what is referred to as a “short squeeze.” BLACK'S, *supra* note 4, at 1237; BROWNSTONE, *supra* note 48, at 248; J. ROSENBERG, *supra* note 48, at 406-07.

148. Margin trading refers to the purchase of securities when only a percentage of the purchase price is paid. The percentage of the total price paid is the margin and the difference between the margin and the total purchase price is, in effect, a loan. The security is the collateral and interest must be paid until the purchaser pays the balance owing or sells the security at a price sufficient to cover this amount. Legislation now sets the minimum margin payable at over fifty percent. D.T. CLARK & B.A. GOTTFRIED, *supra* note 25, at 222; J. ROSENBERG, *supra* note 48, at 274.

149. A pool is an organization of persons such as traders and brokers, which attempts

trading, wash sales,<sup>150</sup> and the use of false information to influence price movements.<sup>151</sup> In addition, the 1934 Act attempts to publicize corporate affairs by requiring periodic reports, registration statements, and reports by corporate officers, and by regulating the use of proxies.<sup>152</sup> Further, the Act governs the registration of exchanges<sup>153</sup> and operators, and imposes controls on the over-the-counter market. It also creates the Securities and Exchange Commission (SEC).<sup>154</sup>

Another significant aspect of the United States securities industry is self-regulation. The National Association of Securities Dealers (NASD) regulates the over-the-counter market and is registered with the SEC. The Investment Bankers Association, the Association of Stock Exchange Firms, the Investment Company Institute, and the stock exchanges themselves also perform self-regulatory functions.<sup>155</sup>

#### b. Canada

In Canada each of the ten provinces has legislation that regulates specific areas of the securities markets. The Quebec and Ontario

to manipulate securities prices. J. ROSENBERG, *supra* note 48, at 338, 397.

150. The purchase and sale of a stock by the same party at the same time is a wash sale. This creates the appearance that the security is being traded more than it actually is, and is intended to manipulate the price of the security by pushing it upward. Generally, this practice is prohibited by law. BROWNSTONE, *supra* note 48, at 282.

151. D. GEDDES, *supra* note 1, at 112.

152. When a shareholder owns shares carrying voting rights, a proxy is a written statement by the shareholder legally authorizing an individual or individuals to exercise the shareholder's voting rights at corporate meetings. J. ROSENBERG, *supra* note 48, at 354.

Bodies that constantly review the regulatory process include the SEC, the Subcommittee on Commerce and Finance of the Committee on Interstate and Foreign Commerce of the House of Representatives, and the Subcommittee on Securities of the Committee on Banking and Currency of the Senate. D. GEDDES, *supra* note 1, at 113.

153. An exchange may or may not be incorporated and is an association, organization, or group of persons providing a meeting place for the purchase, sale or trade of securities or commodities. It includes the facilities and marketplace that the exchange maintains. A stock exchange is an exchange providing a market for the trading of stocks and bonds. An investor wishing to purchase or sell securities must do so through a broker; usually only exchange members may do the actual trading. They do so on behalf of customers and for their own account. In order for securities to be admitted for trading on the stock exchange, stringent requirements must be met. BLACK'S, *supra* note 4, at 505; BROWNSTONE, *supra* note 48, at 255; J.L. HANSON, *supra* note 14, at 438-39.

154. D. GEDDES, *supra* note 1, at 112. The SEC's mandate to administer securities legislation was extended to encompass the Investment Company Act of 1940, the Public Utility Holding Company Act of 1935, the Investment Advisers Act of 1940, and the Trust Indenture Act of 1939. Two other provisions that affect securities regulation in the United States are chapter 11 of the bankruptcy statute, and the Securities Investor Protection Act of 1970. JAPANESE SECURITIES REGULATION 6-11 (L. Loss, K. Yazawa & B. Banoff eds. 1983).

155. D. GEDDES, *supra* note 1, at 114.

Securities Commissions are the country's leading securities regulatory organizations. At the provincial level, legislation affecting the securities industry includes the Corporations Information Act, Investment Contracts Act, Securities Act, and Company Act of each province. In addition, the policy statements of the Securities Commissions provide guidelines for the securities industry. Canadian provincial securities laws are in between the United States federal "full disclosure" concept and the United States blue sky "regulation" concept.<sup>156</sup> The various provincial securities commissions administer the relevant provincial legislation and supervise self-regulatory bodies such as dealers' associations and stock exchanges.<sup>157</sup>

Some of the most significant federal legislation affecting the securities market are the Canada Corporations Act,<sup>158</sup> which governs federal companies, and the Criminal Code.<sup>159</sup>

### c. United Kingdom

In the United Kingdom, the most important regulatory mechanisms are the stock exchanges, the companies legislation,<sup>160</sup> and the Financial Services Act, 1986. The Companies Act, 1985 contains provisions on the prospectus and addresses such issues as dating, expert consent, registration, civil and criminal liability for misstatements, allotment,<sup>161</sup> and the extent of permissible deviation from the terms of contracts to which reference is made.<sup>162</sup> However, under the newly enacted Financial Services Act, the Companies Act prospectus requirements will be revised.<sup>163</sup>

The Financial Services Act is significant for equities trading because it shifts the focus from prospectuses to advertisements and

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156. *Id.* at 116.

157. *Id.* at 117.

158. CAN. REV. STAT. ch. C-32 (1970).

159. CAN. REV. STAT. ch. C-34 (1970).

160. D. GEDDES, *supra* note 1, at 358.

161. Allotment refers to the apportioning of a securities issue among underwriters, or among applicants who have responded to a public offer of shares. Applicants will be allotted fewer shares than they applied for if the issue is over-subscribed. D.T. CLARK & B.A. GOTTFRIED, *supra* note 25, at 14; J.L. HANSON, *supra* note 14, at 13; J. ROSENBERG, *supra* note 48, at 20.

162. D. GEDDES, *supra* note 1, at 358.

163. McCormick, *The Financial Services Act, 1986*, INT'L FIN. L. REV. 26 (Jan. 1987). The Prevention of Fraud (Investments) Act, 1958 covers issues such as dealer licensing, penalties for fraudulently inducing people to invest, requiring a prospectus to accompany a placement, and the distribution of circulars. D. GEDDES, *supra* note 1, at 361-62. (A circular is a notice sent to investors to inform them in a timely manner of any material changes in the corporation's circumstances.) However, certain sections of this Act will also be replaced by the Financial Services Act. McCormick, *supra*, at 27-28.

uses the word “offer” broadly.<sup>164</sup> In addition, the expression “secondary offers” “has been given a new statutory meaning, at least for unlisted securities.”<sup>165</sup> A new class, “international securities,” is also introduced.<sup>166</sup>

United Kingdom companies legislation deals primarily with disclosure.<sup>167</sup> The Financial Services Act’s “Article 4” requirement of full disclosure applies to all offerings (whether or not listed) and overrides any specific requirements of prospectus rules.<sup>168</sup> However, euromarket issues do not require that a detailed prospectus be filed, unless a London listing is desired.<sup>169</sup>

Stock exchange listing requirements deal in part with disclosure rules. The listing requirements for the London Stock Exchange<sup>170</sup> were consolidated in 1973.<sup>171</sup> Section 1 of the Borrowing (Control and Guarantees) Act, 1946 stipulates that an entity must obtain the consent of the Treasury in order to raise more than 10,000

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164. *Id.* “It is not . . . necessary for there to be an ‘offer’ in the technical sense: ‘invitations to treat’ would certainly be caught.” *Id.*

165. *Id.*

166. *Id.* at 26-28. The Protection of Depositors Act, 1963, 11 & 12 Eliz. 2, ch. 16, governs the issuing of invitations to deposit funds with a firm. D. GEDDES, *supra* note 1, at 361-62.

167. *Id.* at 361.

168. McCormick, *supra* note 163, at 26. Article 4 is derived from article 4 of the EEC Listing Particulars Directive. These disclosure requirements can be cumbersome. Share market prices established by investors buying and selling a company’s shares generally reflect information provided in the financial statements of the company. For accounting purposes, in order to disclose as much information as possible, explanatory notes may be added to financial statements. This is because the numbers, being concerned primarily with measurement, do not reveal all relevant information. For instance, a change in the method or timing of recording revenues may have an impact on the numerical “bottom line,” thereby creating an illusion of change in financial status. However, this procedural change may not come to the attention of investors unless a note explaining it is added to the statement. Although ideally financial statements should disclose all information needed by actual and prospective investors, this full disclosure is only an ideal to strive for. The preparation, auditing, printing, distributing, and interpreting of the information required for full disclosure costs money. Indeed, disclosure itself “can create false impressions.” L.S. ROSEN & M.H. GRANOF, *supra* note 73, at 62, 221.

For the purpose of regulating securities trading, full disclosure principles extend to additional types of information, such as securities trading by insiders of the corporation. An additional matter is the policy question of the role of regulators of the securities industry. On one hand, they could have a paternalistic role, prohibiting the trading of shares issued by high-risk companies. On the other hand, a laissez-faire approach may be taken, such that regulators merely ensure that disclosure of information has been as complete as realistically possible, and investors retain the responsibility for actually evaluating the merits of the enterprise. *Id.*

169. McCormick, *supra* note 163, at 27.

170. The name of the London Stock Exchange has been changed to the International Stock Exchange. Behrmann, *London Market Bids for Global Role*, *The Financial Post*, Mar. 30, 1987, at 37.

171. D. GEDDES, *supra* note 1, at IV:11.

pounds sterling within a twelve month period.<sup>172</sup> Sections 8, 10 and 30 of the Exchange Control Act, 1947 specify those situations in which approval of the Treasury must be obtained to issue bearer securities or to transfer control of the firm to persons outside the jurisdiction.<sup>173</sup> Of course, the securities market is also subject to the common law.<sup>174</sup>

In addition, the standards of conduct and morality maintained by the issuing houses in London constitute an important factor in the level of investor protection provided.<sup>175</sup> The issuing houses are primarily merchant banks, and are governed by the rules adopted by the Issuing Houses Association.<sup>176</sup>

#### d. Japan

Prior to World War II, the large business conglomerates, *Zaibatus*, controlled financial sources and received governmental concessions and were thereby able to dominate Japanese commerce. There were few if any investment opportunities available to those not within the *Zaibatus*' scope of operations. Nor was there any movement to impose controls on those operations.<sup>177</sup> After World War

172. *Id.* at 364.

173. *Id.* at 365.

174. Other legislation regulating the U.K. securities market includes the Stock Exchange (Listing) Regulations, 1984; the Stock Transfer Act, 1963, ch. 18; the Finance Act, 1965, ch. 25; the Monopolies and Mergers Act, 1965, ch. 50; the Trustee Investments Act, 1961, 9 & 10 Eliz. 2, ch. 62; and the Company Securities (Insider Dealing) Act, 1985. Deal, *Policing Securities and Commodities Markets*, INT'L FIN. L. REV. 21 (Jan. 1987).

The securities industry in the United Kingdom is also regulated by the City Code on Take-Overs and Mergers, and by the rules of the Federation of Stock Exchanges in Great Britain and Ireland. The latter body was created on July 1, 1965, and deals with payments to clients upon a member's default, branch offices, and security quotations. In March 1973, a United Stock Exchange came into being. D. GEDDES, *supra* note 1, at 97.

175. *Id.* at 365-66.

176. Merchant banks are a European form of banking, performing a combination of commercial banking, investment banking, and securities-related functions. They generally specialize in international trade finance. In most cases, merchant banks began as merchants that specialized in trading in particular geographical areas, thereby acquiring valuable knowledge of the financial status of merchants located in those areas. Their success in accepting, for a fee, bills of exchange drawn on merchants with whom they are familiar allows their financial operations to be separated from their normal trading activities.

The two kinds of merchant banks are (1) acceptance houses, which accept bills of exchange, provide investment advice, and undertake normal banking business; and (2) issuing houses, which make all arrangements necessary to issue or float new securities for companies, municipalities and governments. These arrangements include contracting with underwriters and advertising prospectuses. Many foreign merchant bankers found it convenient to move their headquarters to London due to its development as the global center of commerce and finance. BROWNSTONE, *supra* note 48, at 178; A. GILPIN, *supra* note 13, at 2, 13, 118, 142; J.L. HANSON, *supra* note 14, at 28, 322.

177. D. GEDDES, *supra* note 1, at 120.

II, however, the United States occupation authorities prohibited the *Zaibatsus*, and their enormous holdings were dispersed. Due to the resulting increase in the number of institutional and individual shareholders, the nature of Japanese investment markets changed radically; concern for investor protection spawned regulation of the securities markets. The Securities and Exchange Law, 1948<sup>178</sup> is the central Japanese legislation regulating securities markets, and is patterned after the U.S. Securities Act of 1933 and the Securities Exchange Act of 1934.<sup>179</sup>

Although Japan at one time restricted the activities of foreigners through legislation such as the Law Concerning Foreign Investment<sup>180</sup> and the Law Concerning Foreign Securities Dealers,<sup>181</sup> it has relaxed these policies substantially.<sup>182</sup> Indeed, since 1979, all international securities transactions have been liberalized except for some transitional restrictions.<sup>183</sup>

The Bureau of Securities within the Ministry of Finance is the Japanese version of the United States SEC,<sup>184</sup> and is the primary body responsible for administering securities regulation throughout Japan.<sup>185</sup>

#### e. Hong Kong

In Hong Kong, the Securities Ordinance, 1974 is the central legislative instrument in the regulation of the securities industry. It deals with the Securities Commission, a disciplinary committee, the Commissioner for Securities, the Federation of Approved Stock Exchanges, client compensation upon dealer default, dealer regulation, registration, and improper trading practices.<sup>186</sup> This ordinance extends the government's power considerably and deals predomi-

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178. Law No. 25 of 1948, *reprinted in* 6 EHS LAW BULLETIN SERIES MA 1 (F. Nakane ed. 1971); JAPANESE SECURITIES REGULATION, *supra* note 154, at 233.

179. D. GEDDES, *supra* note 1, at 122. The Securities Transfer Tax Law, the Law on Foreign Securities Firms, Law No. 5 of 1971, the Corporate Reorganization Law, the Secured Debenture Trust Law, the Securities Investment Trust Law, Law No. 198 of 1951, *reprinted in* JAPANESE SECURITIES REGULATION, *supra* note 154, at 377, the Civil Code, and the Commercial Code, Book II, arts. 52-100, also contain provisions affecting the regulation of securities.

180. Law No. 163 of 1950.

181. Law No. 5 of 1971.

182. JAPANESE SECURITIES REGULATION, *supra* note 154, at 69.

183. *Id.*

184. *Id.* at 24.

185. D. GEDDES, *supra* note 1, at 122.

186. M. HIGGINS, SECURITIES REGULATION IN HONG KONG 1972-1977, 79-144 (1978).

nantly with the secondary market.<sup>187</sup> The issuing of securities is governed mainly by the Companies Ordinance,<sup>188</sup> which deals with prospectuses, transfer of securities, allotment, evidencing of title, discounts, and commissions.<sup>189</sup>

As Hong Kong progressed economically after World War II and changed from an entrepôt trade economy to a manufacturing economy, activity in the securities markets increased.<sup>190</sup> This increased activity was accompanied by a growing concern for investor protection. In 1971 and 1972, speculative activity forced the security markets in Hong Kong to unprecedented heights.<sup>191</sup> In 1971 the Companies Law Revision Committee presented its Report on the Protection of Investors.<sup>192</sup> The amendments to the Companies Ordinance which took effect in March 1973 were based on the recommendations of this report.<sup>193</sup>

#### f. European Community

In the European Community, the free movement of persons, services and capital is essential to achieving the ultimate goals of economic union and political harmony among member states.<sup>194</sup> The EEC Treaty states that “[t]he Community shall have as its task . . . to promote . . . a harmonious development of economic activities.”<sup>195</sup> The Treaty also stipulates that “to the extent necessary to ensure the proper functioning of the common market, Member States shall progressively abolish between themselves all restrictions on the movement of capital belonging to persons resident in Member States and any discrimination based on the nationality or on the place of residence of the parties or on the place where such capital is invested.”<sup>196</sup> One of the original directives provided for the goals of “unconditional and irreversible freedom for sale and

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187. D. GEDDES, *supra* note 1, at 148. A related piece of legislation, the Protection of Investors Ordinance, 1974, contains provisions respecting fraud, misrepresentation, civil rights of action, presumptions, and police powers. M. HIGGINS, *supra* note 186, at 144-47.

188. 2 LAWS HONG KONG, ch. 32 (1964), *amended by* Companies (Amendment) Ordinance, 1970, No. 24 & Companies (Amendment) Ordinance, 1972.

189. D. GEDDES, *supra* note 1, at 142.

190. *Id.* at 141-44.

191. *Id.*

192. COMPANIES LAW REVISION COMMITTEE, REPORT ON THE PROTECTION OF INVESTORS 41 (June 24, 1971). The committee was originally appointed by the government in 1962.

193. D. GEDDES, *supra* note 1, at 146.

194. THIRTY YEARS OF COMMUNITY LAW, *supra* note 138, at 285.

195. EEC Treaty, *supra* note 132, at art. 2.

196. *Id.* at art. 67.

purchase of stocks and shares quoted on the Community's stock exchanges [and] conditional freedom with regard to the issuing and placing of stocks and shares on capital markets, and for the purchase of unquoted stocks and shares."<sup>197</sup>

However, restrictions on the transfer of capital have not yet been completely removed in all member states.<sup>198</sup> Coordination of administrative and legislative provisions governing securities markets within the Community is hampered by differences in the control and supervision of commercial activities, such as nonuniform tax systems (with the risk of double taxation), exchange rate uncertainties, and the freedom to establish financial institutions.<sup>199</sup>

The requirement of the EEC Treaty to abolish restrictions is limited "to the extent necessary to ensure the proper functioning of the common market."<sup>200</sup> Member states have been left free to adopt different regulations for operations which are purely financial in nature.<sup>201</sup> In 1972, the Council issued a directive<sup>202</sup> regulating international financial movements and providing for exemptions from the goal of moving towards liberalization. In response to pressures exerted by the eurodollar market, these provisions attempted to eliminate adverse affects upon internal liquidity. At the beginning of the 1970s, activity in the eurodollar market had placed a heavy burden on member states' foreign exchange markets.<sup>203</sup>

Thus, the nonuniformity in regulation of securities markets within the Community means that international trading of equities involving member states is not yet simplified. Nonetheless, there is clear evidence of a desire to remedy this situation. In 1977, a code of conduct pertaining to securities transactions was recommended by the Commission,<sup>204</sup> and in 1979, a Council Directive<sup>205</sup> providing for coordination of the conditions for admission of marketable securities to stock exchanges in community member States was issued.<sup>206</sup> Although such steps hardly take the place of global regula-

197. PAXTON & WALSH, INTO EUROPE 151 (1972).

198. R. PLENDER, A PRACTICAL INTRODUCTION TO EUROPEAN COMMUNITY LAW 56-57 (1980).

199. RESS, *Free Movement of Persons, Services and Capital*, in THIRTY YEARS OF COMMUNITY LAW 321 (Commission of the European Communities eds. 1981).

200. EEC Treaty, *supra* note 132, at art. 67(1).

201. RESS, *supra* note 199, at 319.

202. *Council Directive 72/156/EEC*, 15 O.J. EUR. COMM. (No. L 91) 18.4 (1972).

203. RESS, *supra* note 199, at 319-20.

204. *Commission Recommendation 77/534/EEC*, 20 O.J. EUR. COMM. (No. L 212) 20.8 (1977).

205. *Council Directive 79/279/EEC*, 22 O.J. EUR. COMM. (No. L 66) 16.3 (1979).

206. RESS, *supra* note 199, at 321.

tion of securities markets, to some extent they do mitigate the complexities involved in the trading of international equities.

### *B. Insider Trading*

The definition of insider trading differs subtly in the legislation of different countries. The underlying philosophy is that a trader's use of nonpublic information gained purely through an intimate connection with a company gives that trader an unfair advantage, and erodes the efficient operation of the securities market. In the United Kingdom, the Company Securities (Insider Dealing) Act, 1985 regulates insider dealing. Individuals connected with a company cannot deal in or assist others to deal in its listed securities on a recognized stock exchange when they are in possession of unpublished price-sensitive information about those securities.<sup>207</sup>

In the United States, prohibitions on insider trading include the misappropriation theory and the disclose-or-abstain rule. The misappropriation theory concerns a party who obtains information from a source with which the party is in some way related.<sup>208</sup> The disclose-or-abstain rule is based on Rule 10b-5 of the Securities Exchange Act of 1934, under which insiders must forego trading if they do not disclose nonpublic, material information.<sup>209</sup> Regulation of insider trading in other countries varies from no restrictions to recently introduced prohibitions.<sup>210</sup>

One difficulty with combatting insider trading, even within national markets, is the ease with which it can evade detection. Trading is scanned by computer to identify anomalous patterns that can't be explained by normal market events.<sup>211</sup> Indeed, there may

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207. Stoakes, *The Insider Trader's Global Guide*, EUROMONEY 160 (July 1986).

208. *Id.* For instance a bank employee who misappropriates information obtained from the bank.

209. *Id.*

210. *Id.* Switzerland has not regulated insider trading. However, a prohibition against exploiting confidential information has been proposed for addition to the Criminal Code. There is no explicit prohibition in Luxembourg. Although Hong Kong has not created a criminal offense, a tribunal established by the Securities Ordinance to investigate alleged occurrences is intended to discourage insider trading. Insider trading codes have recently been introduced in the Netherlands and Norway. Although there are no explicit prohibitions in Venezuela, India, Indonesia or Austria, there are laws in these countries that address some aspects of wrongdoing. In Venezuela, regulations ban insider trading of listed, as opposed to unlisted, securities. In India there is a general prohibition against company officers using inside information to their advantage and to the shareholders' detriment. Under the Banking Act in Austria, a bank employee who uses information provided to the bank to his or another's advantage commits a criminal offense.

211. Mathias, *Pushing to Police the New Global Financial Village*, *The Financial Post*, Jan. 5, 1987, at 23, col. 3.

be some reason to believe that the most important SEC cases are opened by informants, flukes and unconnected events,<sup>212</sup> and an investigation is underway to determine whether the NYSE and the SEC are equipped to battle insider trading effectively.<sup>213</sup>

In the international securities markets, insider trading is even more difficult to detect. Stanley Beck, Chairman of the Ontario Securities Commission, stated that “[t]he Toronto Stock Exchange, like U.S. exchanges, has had real problems tracking down insider trading when it takes place offshore.”<sup>214</sup>

Another complication in the fight against insider trading is not only the differing perceptions, but also the different attitudes towards it. Compared to the U.S. definition, the U.K. definition is extremely difficult to meet.<sup>215</sup> These varying approaches correspond to the timing of the regulations. Although insider trading was legally defined in the United States in 1934, it was not until 1980 that it was defined in the United Kingdom.<sup>216</sup>

Currently the United States and the United Kingdom have endorsed a set of bilateral agreements to swap information on insider trading.<sup>217</sup> This memorandum of understanding extends to other market wrongdoings as well. The United States also has information-sharing agreements with Japan, Switzerland, Canada, the Cayman Islands, Turkey, Italy, and the Netherlands. The U.K. and Japan are currently negotiating a pact.<sup>218</sup>

### C. *Stock Manipulation*

Stock manipulation is another threat to the fair and efficient operation of the international equities market. Essentially, stock manipulation involves trading a stock for purposes other than legitimate investment, in order to influence the price.<sup>219</sup> As with insider trading, there is no certainty as to exactly how much of it actually occurs, even within national markets.

Buying a stock at the close of trading to cause its price to remain

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212. *Id.*

213. *Id.*

214. *Canada Grapples on the Border*, EUROMONEY & CORP. FIN. 18 (B. Cohen & I. Verchere eds.) (Supp. July 1986).

215. Many believe that only a confession will lead to a conviction. Mathias, *supra* note 211, at col. 6.

216. *Id.*

217. *See infra* note 316 and accompanying text.

218. Behrmann, *Global Stock-trading Regulation Gets Closer*, *The Financial Post*, Dec. 22, 1986.

219. Mathias, *supra* note 211, at cols. 3-4.

above a level that would trigger an option unfavorable to the trader, is one form of manipulation that is illegal in some countries. It is not clear, however, whether trading in an undervalued stock in order to raise its price falls within the scope of illegality.<sup>220</sup> Such complexities are magnified in the international arena. Dennis Shea, Assistant Director, Division of Market Regulation at the SEC, observed that “[i]f there were a stock and an option involved in a manipulation, and the option was held offshore it would be very hard to deal with.”<sup>221</sup>

#### D. Boilershops

Another type of international market abuse is known as “boilershops.” This term describes a situation in which the price of junior stocks listed on foreign exchanges is inflated and high-pressure sales tactics are employed to sell the artificially high-priced stock to unsuspecting investors in yet another country.<sup>222</sup> Boilershops are able to exist because regulators are not concerned with anything that occurs outside of their jurisdiction.<sup>223</sup> This merely emphasizes that increased cooperation among countries is required for a fair international equities market.

#### E. Secrecy Legislation

One of the types of laws that complicates a nation’s attempt to deter and punish market wrongdoers is secrecy legislation. Traders employing institutional intermediaries domiciled in countries with such statutes may be able to conceal their identities and thereby impede investigations of their transactions.<sup>224</sup> Bank secrecy laws prohibit the disclosure of bank customers’ identities, and details concerning bank accounts. They stem from a tradition of confidentiality in the bank-customer relationship and are viewed as a facet of the right to privacy.<sup>225</sup>

One of the most significant precedents for bank secrecy in the common law was *Tournier v. National Provincial & Union Bank of England*.<sup>226</sup> That case held that “the banker will not divulge to

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220. *Id.* at cols. 4-6.

221. *Id.* at col. 4.

222. *Id.* at col. 5.

223. *Id.*

224. Fedders, *supra* note 93, at 3.

225. *Id.* at 30.

226. [1924] 1 K.B. 461 (C.A.).

third persons, without the . . . consent of the customer . . . information relating to the customer . . . unless the banker is compelled to do so by order of a court, or the circumstances give rise to a public duty of disclosure, or the protection of the banker's own interests requires it."<sup>227</sup>

Protection of bank customers from other countries' hostility is another motivating objective for secrecy laws. In Switzerland, a 1934 statute designates undertakings contrary to secrecy legislation as criminal offenses.<sup>228</sup> Some countries introduced secrecy legislation in order to codify traditional bank secrecy rules, while others have enacted bank secrecy laws in an attempt to attract foreign capital and to establish a position in international finance and banking.<sup>229</sup>

In some countries, such as certain jurisdictions of the West Indies and the Caribbean, confidentiality between a bank and its customer has traditionally been observed although it has not been introduced as legislation. Furthermore, in some countries, actions against breaches of bank secrecy may arise out of tort, contract or legislation not dealing exclusively with bank secrecy.<sup>230</sup> Thus, protection from investigation of wrongdoing in the international trade of equities may arise from a variety of legal sources related to bank secrecy.

There are exceptions to bank secrecy laws. In some countries, such as Switzerland, a customer may waive the protection, either explicitly or tacitly. In some criminal and civil cases procedural rules compelling disclosure may take precedence over bank secrecy legislation. There are also significant exceptions recognized in the 1982 Memorandum of Understanding (MOU) between the United States and Switzerland, in the 1977 Treaty between the two countries, and in Convention XVI.<sup>231</sup> Nonetheless, these exceptions can be weak. In Panama, for example, the exception is territorial, and

227. 3 HALSBURY'S LAWS OF ENGLAND § 97 (4th ed. 1973).

228. Swiss Banking Law art. 47.

229. Kelly, *United States Foreign Policy: Effort to Penetrate Bank Secrecy in Switzerland from 1940 to 1975*, 6 CAL. W. INT'L L.J. 211, 214 (1976).

230. For example, contravention of bank secrecy practices may violate certain sections of the Swiss Penal Code. Fedders, *supra* note 93, at 32.

231. *Id.* at 34. "Convention XVI between the Swiss banks under the auspices of the Swiss Bankers Association . . . enables a special commission in Switzerland to investigate the banking records of suspected insiders. Only if it decides that U.S. insider trading laws have been infringed will the information be handed over." Stoakes, *supra* note 207. Indeed, the 1982 Memorandum was recently applied in *SEC v. Harvey Katz*, 86 Civ. 6088 (S.D.N.Y. 1986) [1986-1987 Decisions] Fed. Sec. L. Rep. (CCH) para. 92, 867, in which the MOU was used to identify the purchaser and freeze profits of over \$1 million.

bank secrecy will not be lifted if the exception-triggering offense occurred outside of the country. Nor will it be lifted if the exception applies only after the information sought is no longer needed.<sup>232</sup>

Regulators have attempted to obtain information despite international investment banks' trading confidentiality by freezing offshore orders. For example, in March 1986, the Ontario Securities Commission (OSC) suspected insider trading when the market price of Genstar shares increased from Can\$12 per share to Can\$55 during the week before Imasco made a public bid for Genstar shares; the OSC wondered whether there had been a leak of the decision of Genstar's largest shareholder to sell its position to Imasco. After Imasco's bid was announced, the OSC ordered Canadian investment banks acting as domestic registrants for foreign purchases to freeze the funds of any offshore client who, the previous week, either purchased more than 1,000 Genstar common shares or more than ten call options.<sup>233</sup>

Undoubtedly, increased cooperation among nations in sharing the information required to investigate similar situations would help avoid such indirect, costly and inefficient means of securing information.<sup>234</sup> One way to deal with the abuse of secrecy legislation is to change the legislation. Recent changes in the U.S. tax laws and internal rules adopted by Swiss Bank Corporation have made it unattractive for U.S. citizens who are most likely to gain access to insider information to purchase U.S. securities through Swiss banks.<sup>235</sup> In addition, the SEC's recent proposal of an International Securities Enforcement Cooperation Act would create an exception to the Freedom of Information Act.<sup>236</sup> This would authorize the Commission to withhold from disclosure documents obtained from a foreign authority if disclosure would be contrary to the laws of the foreign country.<sup>237</sup> The SEC anticipates that such a provision

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232. For example, this can occur in the Bahamas, where a court order to lift bank secrecy generally will be issued only if it can be shown that an offense has actually been committed. Fedders, *supra* note 93, at 35.

233. *Canada Grapples on the Border*, *supra* note 214, at 19.

234. For instance, the SEC relied upon the cooperation of the Nassau branch of Bank Leu in the Bahamas in establishing the charge against Dennis Levine in May 1986. *Caught in the Middle*, INT'L FIN. L. REV. 2 (C. Stoakes ed. July 1986).

235. Altschul, *supra* note 46, at 36.

236. Under the Freedom of Information Act, unless documents fall within specified exemptions, they must be disclosed. Memorandum of the SEC in Support of the International Securities Enforcement Cooperation Act of 1988, Fed. Sec. L. Rep. (CCH) para. 84240, at 89115 (June 15, 1988) [hereinafter Memorandum of the SEC].

237. *Id.* at 89116.

will address foreign authorities' concerns and allow the Commission to obtain otherwise unobtainable confidential documents from foreign countries for law enforcement purposes.<sup>238</sup>

#### F. Blocking Legislation

Another type of law which hinders attempts to thwart wrongdoers in the international trade of securities is blocking legislation. Even if foreign broker-dealers and foreign banks want to cooperate with the enforcement of another country's laws regarding abuses of the international trading system, they may be prevented from doing so by blocking laws.<sup>239</sup> Generally, the main objective of blocking statutes is to combat perceived invasions of sovereignty.<sup>240</sup>

There are two categories of blocking legislation. "Discovery" blocking statutes inhibit the investigatory stages of a case. They "prohibit compliance with requests for documents and information from foreign courts, investigatory agencies or private parties."<sup>241</sup> The enforcement stages of a case are affected by "judgment" blocking statutes. These statutes stipulate that the country enacting the legislation will not recognize the decisions of foreign courts or administrative agencies under the circumstances specified in the statute.<sup>242</sup>

#### G. Application of National Laws to Equities Transactions Undertaken in Part Extraterritorially

Another issue in the regulation of international equities transactions is the identification of which nation's laws apply to an international transaction. International law recognizes a State's jurisdiction over the conduct of its nationals, wherever it occurs. It also recognizes a State's jurisdiction over any conduct occurring outside of its territory that threatens the state's security. Hence, the recognized jurisdiction of a state is very broad.<sup>243</sup>

238. *Id.* at 89115.

239. Fedders, *supra* note 93, at 7.

240. *Id.* at 36. Blocking legislation has been passed in many countries, including Great Britain. The United Kingdom's blocking statute is the Protection of Trading Interests Act, 1980. Deal, *supra* note 174, at 22. Switzerland, France, Sweden, . . . and the Netherlands also have blocking legislation. Often the goal is to inhibit what is perceived as "invasive" extraterritorial application of U.S. Law. In 1948, the Canadian provinces of Ontario and Quebec were the first to enact . . . was issued for documents located within Canada. Fedders, *supra* note 93, at 35-36.

241. *Id.* at 36.

242. *Id.*

243. Larose, *Conflicts, Contacts and Cooperation: Extraterritorial Application of the*

In the United States, case law and legislation seem to apply two tests in deciding whether U.S. securities laws apply to an international transaction. The first is the conduct test, which asks whether any conduct has occurred within the United States. For example, when fraudulent conduct, such as the drafting of a misleading prospectus, preparation of a fraud, or misrepresentation inducing the sale or purchase of a security, has occurred within the United States, antifraud provisions of the Exchange Act are held to apply to foreign transactions.<sup>244</sup>

The second test, the effects test, seeks to determine whether or not U.S. securities markets or U.S. investors have been materially affected. For example, foreseeable and substantial injurious effects in the United States arising from a decreased value of shares listed on a U.S. stock exchange and held by U.S. investors, will pass the effects test and allow application of the antifraud provisions to foreign securities transactions.<sup>245</sup>

In June 1988, the SEC published a proposed regulation to clarify the extent to which registration provisions under Section 5 of the Securities Act of 1933 are to apply extraterritorially.<sup>246</sup> Generally, any offer or sale occurring within the United States would be subject to Section 5, while any distribution taking place outside of the United States would not be subject to its provisions. The factors to be considered in determining whether a transaction is inside the United States are: the locus of the elements of the transaction; the presence or absence of directed efforts to sell in the United States; the possibility of flow back; and the parties' expectations. The transactions of distributors, issuers, affiliates, and investors who meet the requirements under the safe harbor provisions of the proposed regulation would be treated as taking place outside of the United States. The proposed regulation would apply only to registration requirements, not to other provisions such as antifraud legislation.

Through the application of the conduct and effects tests, the antifraud provisions have been broadly applied to protect investors,

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*United States Securities Laws*, 12 SEC. REG. L.J. 102-03 (1984).

244. *Id.* This is exemplified in *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975).

245. Larose, *supra* note 243, at 102-03. This is exemplified in *International Inv. Trust v. Cornfeld*, 619 F.2d 909 (2d Cir. 1980).

246. *Offshore Offers and Sales*, Securities Act Release No. 6779, Fed. Sec. L. Rep. (CCH) para. 84242 (June 10, 1988). Investment companies required to register under the Investment Company Act of 1940 would not be covered by the proposed regulation.

and the SEC states that they “should be broadly interpreted to rectify the damage suffered as a result of any fraudulent conduct.”<sup>247</sup> However, one of the criticisms directed toward the application of the conduct and effects tests is the lack of consideration given to other countries’ interests in the transactions. To remedy this, an approach based on conflicts of law principles and calling for an interests analysis or balancing test has been advocated. As formulated by former SEC Commissioner Barbara Thomas, United States securities regulations should apply when the interests of the United States in the transaction are not superseded by the interests of other affected nations.<sup>248</sup>

#### H. Trading of Unlisted Shares

Even though international trading in equities has increased phenomenally within the last four years, there has not been a parallel increase in listing on external exchanges. Indeed, the increase in foreign listings on the New York, London, Tokyo, Paris, Frankfurt, Zurich and Amsterdam stock exchanges over the past two years has been only approximately three percent.<sup>249</sup> This incongruence is explained by the rapid growth in the number of companies choosing to be quoted on a trading system rather than to be listed on a stock exchange.<sup>250</sup> Indeed, the growth in trading volume and issues quoted on the NASDAQ system has significantly exceeded that of the New York and American stock exchanges.<sup>251</sup>

The over-the-counter markets cater to the equity needs of small companies with very little history, which nonetheless are potentially profitable.<sup>252</sup> Furthermore, according to a release by the SEC,

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247. *Id.* at 89129-30.

248. Larose, *supra* note 243, at 107-08.

249. *To List or Not To List*, *supra* note 85, at 43.

250. *Id.* at 45.

251. The main reason for this trend is technological advancements, which now make it possible to trade without the use of the traditional trading floor. This diminishes the need for a firm to seek a foreign listing. Of course this development has been nothing more than a catalyst; the underlying factors creating the preference for “upstairs trading” are the costs, onerous disclosure requirements, and discrepancies among accounting methods involved in meeting the criteria for becoming listed on a stock exchange. There are certain perceived advantages in being listed, such as prestige, increased foreign investor awareness, dissemination of company information, acquisition of “an international aura,” availability to investors who are legally prohibited from investing in unlisted shares, and impeding unwelcome takeover attempts. Nonetheless, listing does not seem to significantly augment the actual volume of trading of shares. *Id.* at 43-45.

252. The European over-the-counter market, trading the shares of fewer than 1000 companies in 1986, is substantially smaller than the American NASDAQ, which caters to more than 6000 companies. As of January 1986, “[a] research project funded by nearly a

“[e]xperience has shown that foreign companies have been reluctant to list on an exchange because they find it difficult or impossible to comply with certain exchange standards that are either inconsistent with, or contrary to, their own country’s laws and practices.”<sup>253</sup> In fact, legislation can actually have the effect of encouraging trading on the unlisted markets. For example, it was brought to the attention of the SEC in 1985 that “procedural registration requirements under the Securities Exchange Act of 1934 . . . [discriminate] in favor of those Canadian issuers registering under Sections 12(g) of the Act in order for their securities to be quoted on NASDAQ and against those Canadian companies that are required to be registered under Section 12(b) of the Act in order for their securities to be registered on a national securities exchange.”<sup>254</sup> Other factors encouraging unlisted trading are cost and time. In 1986, the initial listing fee for the New York Stock Exchange was approximately US\$300,000 and this was scaled upwards in accordance with the size of the issue. The NASDAQ fee, however, was only approximately five percent of this amount,<sup>255</sup> and in Canada, there is no fee for a listing on the Canadian Over-the-Counter Automated Trading System (COATS).<sup>256</sup> Furthermore, the over-the-counter markets trading hours are longer than those of the stock exchange.<sup>257</sup>

A significant number of people expect off-exchange markets to dominate international equities trading.<sup>258</sup> However, off-exchange markets are difficult to monitor, and do not guarantee that the other party will honor the trade.<sup>259</sup> Adoption of an automated confederation of stock exchanges would counter the appeal of off-floor trading systems to those parties who want the convenience of trad-

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dozen venture capital companies and banks in Europe [was] about to complete a project on the feasibility of forming a European securities dealers association that [would] form the nucleus of an international market in [over-the-counter] stocks.” Of course established stock exchanges perceive that such a “European-style NASDAQ” would threaten the monopoly that they have traditionally held over securities dealing. *Choosing the Stock Market that Fits*, *supra* note 50, at 126.

253. American Stock Exchange, Form 19b-4; Proposed Rule Change, File No. SR-Amex-86-6, at 3 (1985).

254. R. Scribner, *supra* note 98, at 7.

255. *Supply of Equity Fails to Meet Demand*, *supra* note 72, at 124.

256. Hemeon, *More Investors Willing to Try on COATS For Size*, *The Financial Post*, Mar. 30, 1987, at 34, col. 1.

257. *Supply of Equity Fails to Meet Demand*, *supra* note 72, at 124.

258. J.P. Bunting, *supra* note 94, at 7. This observation was based on responses to surveys by the SEC and the Toronto Stock Exchange.

259. *Id.* at 27.

ing during their normal business hours.<sup>260</sup> A need exists to actively discourage the development of more off-market trading than is necessary to meet the requirements of those parties denied access to exchanges.

### I. Settlement and Clearing Procedures

Another difficulty in international trading is the set of procedures involved in settling transactions. In some markets, clearance and settlement<sup>261</sup> are handled manually. Furthermore, most transnational trades still settle outside of organized clearance systems, largely via Telex and physical deliveries of certificates.<sup>262</sup> The greatest risk for international investors has been the lack of a coordinated payment and settlement system.<sup>263</sup> A consistently efficient system of settlement is integral to securing investor confidence. Investors need to be assured that they can place an order for any international stock, have it executed without problems and receive the shares in exchange for payment without delay and at low cost. Under such conditions, international equities trading will rapidly expand.<sup>264</sup>

Despite the current sub-optimal systems, development of low-cost, reliable and efficient clearing and settlement systems for international equity transactions appears possible in the near future. As a result of the competitive pressures exerted by deregulation,<sup>265</sup> and by the general expansion of international trading in equities, brokerage firms will have to meet the dual objectives of decreasing costs and increasing (or indeed establishing) reliability and speed in their clearing operations. If developments in the United States after fixed commissions were abolished are indications of what can be expected in London and other centers experiencing degrees of de-

260. *Id.* at 15.

261. Generally, clearance refers to the approval of transactions. Settlement means determining and balancing the amounts owing between the parties to transactions, in particular the payment for and delivery of securities. Thus the phrase "clearing and settlement" refers generally to the finalizing of securities transactions. See Comment, *International Securities Trading: The United States and Great Britain Develop Clearing and Settlement Procedures for a New Age*, 19 CAL. W. INT'L L.J. 129 (1989).

262. SEC, Briefing Memorandum; Internationalization Roundtable Participants and Discussion Topics 4 (Feb. 1987) [hereinafter Briefing Memorandum].

263. *Clearing the Way for Easy Trading*, EUROMONEY & CORP. FIN. 59 (N. Osborn ed.) (Supp. Nov. 1986).

264. *Id.*

265. A vivid example of such pressure is the termination of fixed commissions in London, as a result of "the Big Bang" in October 1986. See Comment, *supra* note 261, at 140-42.

regulation, it is likely that brokerage firms will delegate the functions of settling and clearing transactions to specialists.<sup>266</sup> Indeed, companies in London are beginning to specialize in clearing. Furthermore, proliferation of cross-border trading is being facilitated. New systems are being designed, and international links are being developed by clearing houses in various jurisdictions. The Euromarket clearing firms of Cedel and Euroclear are adapting their operations to handle international equities.<sup>267</sup>

A risk to investors of one country may arise when clearing agencies of that country become members of foreign clearing agencies. This exposes the agencies (and ultimately the investors) of the first country to regulatory requirements and financial risks that could be very different from those encountered in the first country.<sup>268</sup>

### 1. *Effects of Clearing Systems on the Regulation of International Equities Transactions*

Competent clearing systems perform some of the functions targeted by securities legislation. By simultaneously exchanging cash for securities, as is done by systems such as Euroclear and Cedel,<sup>269</sup> clearing organizations assume a significant amount of risk, thereby enhancing investor protection. Of course, clearing firms will not be willing to assume the risks of firms and securities unless they have established a system of screening, and trade reporting and confirmation. However, it is unlikely that clearing systems alone will be able to completely replace a formal regulatory system in establishing the level of investor protection and confidence required to sustain continued growth and efficient operation of international trading in securities.

Indeed, efficient and speedy clearing and settlement systems are necessary to achieve the regulatory goals of cost effectiveness and operational efficiency.<sup>270</sup> "Some people with the instincts of an explorer have organized services to guide transactions through the international clearance and settlement process. Understandably, they do not all use the same map . . . [and] before the territory gets carved up into unruly fiefdoms, international clearance and settle-

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266. *Clearing the Way for Easy Trading*, *supra* note 263, at 59, 62.

267. *Id.* at 59.

268. Request for Comments, *supra* note 103, at 30.

269. *Clearing the Way for Easy Trading*, *supra* note 263, at 64. See also *Clearing the Way to Globalization*, EUROMONEY 268 (P. Fallon ed. Oct. 1985).

270. J.P. Bunting, *supra* note 94, at 33.

ment procedures need to be made much more orderly and effective.”<sup>271</sup>

## J. Simultaneous International Offerings

### 1. Varying Practices

There are various ways to accomplish multinational stock offerings. For instance, there may be one underwriter,<sup>272</sup> or the issue may be underwritten separately in more than one country. Multinational offerings may also vary along the dimension of the time at which the initial sale of the shares takes place. They may be issued in more than one country at different times<sup>273</sup> or they may be issued at the same time on a coordinated basis. The latter is a simultaneous offering in two or more countries.<sup>274</sup> The issuing of shares simultaneously in more than one country often involves time-consuming and costly coordination of activity in the attempt to comply with conflicting legislation.<sup>275</sup> This is due to differing laws among nations regarding matters such as liability, disclosure and prospectus requirements, publicity, and distribution practices. Other factors include varying practices such as timing of pricing, underwriting, length of the offering periods, restrictions regarding territorial selling, dealers' and underwriters' compensation, and the utilization of over-allotment and stabilization procedures.<sup>276</sup>

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271. J.J. Phelan, Jr., *supra* note 110, at 9.

272. One underwriter was used in the sale of ordinary shares by Cadbury Schweppes in the United States in September 1984, and the sale by Alcan of shares in the United States, Canada and Europe in March 1984. Pryor, *Ironing Out the Legal Intricacies; The U.S. Perspective*, EUROMONEY & CORP. FIN. 66-67 (Supp. Nov. 1986).

273. “There are . . . numerous examples of Scandinavian and Japanese companies selling shares in the U.S. or the U.K. but not in both places at the same time.” *Id.* at 67.

274. The simultaneous offering is exemplified by the U.K. government's offering of British Petroleum shares in 1977, the offering in June 1984 by Reuters Holdings and the December 1984 sale of British Telecom (BT) shares by the U.K. government. Each of these was separately underwritten in the U.S. and the U.K. markets. BT was also underwritten in Canada and Japan. *Id.* at 66-67. Another example of a simultaneous offering was the 1986 issue of eight million shares by the Swedish manufacturer Electrolux in nine countries: the U.K., West Germany, Japan, the Far East, Canada, Italy, France, Austria and Switzerland. *Deals; Euro-Equities; Electrolux's Multi-country Simultaneous Offering*, INT'L FIN. L. REV. 25 (C. Stoakes ed. 1986).

275. This is in contrast to “offerings from one market to another.” Pryor, *supra* note 272, at 67.

276. Henderson, *Ironing Out the Legal Intricacies; The U.K. Perspective*, EUROMONEY & CORP. FIN. 74 (Supp. Nov. 1986).

## 2. *Liability*

The liability of issuing companies for statements and omissions made in documents such as prospectuses varies between countries. For instance, in the United Kingdom, directors and other parties responsible for the contents of prospectuses generally are not strictly liable.<sup>277</sup> Pursuant to the Companies Act, a defense is available if the defendant can show that he had reasonable grounds to believe the relevant statement in the prospectus was true. In the case of the listing particulars, a defense is also available if the defendant can show he was unaware of a matter not disclosed or that any other breach of the regulations arose from an honest mistake of fact.<sup>278</sup> Under common law, liability would depend on successful establishment of the elements of negligent misstatement. Apart from the likelihood that directors would be liable since the Stock Exchange requires that they make responsibility statements, liability under the Stock Exchange (Listing) Regulations, 1984 has yet to be construed. Liability is not expressly imposed on any specific parties by these regulations.<sup>279</sup>

In the United States, however, directors generally have recourse to a defense of due diligence, but strict liability is attached to the issuing companies themselves, even on a secondary offering.<sup>280</sup> This applies to 1) untrue statements of material fact; 2) the omission of material facts; or 3) the omission of information necessary to make the statements made not misleading.<sup>281</sup>

Canada introduces even greater complexity into the process of international compliance. There is no single national regulatory body and the standards vary among provinces.

## 3. *Prospectus and Disclosure Requirements*

A related set of standards pertain to disclosure requirements. In the United States, regulations specify in detail the information and analysis regarding forecasts and past performance of the business which must be provided in prospectuses and other reports.<sup>282</sup> Given the strict liability in the United States, it is strongly recommended that any optimistic or favorable statement as to the future pros-

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277. Stoakes, *Seeking Harmony for Euro-Equities*, EUROMONEY 177 (May 1985).

278. Henderson, *supra* note 276, at 74.

279. *Id.*

280. *Id.* at 75.

281. *Id.*

282. Stoakes, *supra* note 277, at 177.

pects of the company be omitted. United States courts have tended to impose liability for the non-fulfillment of these statements even though they were not negligently made.<sup>283</sup>

In the United Kingdom and Canada, however, legislation provides only general guidelines. In fact, in the United Kingdom investors expect prospectuses to contain favorable statements and optimistic predictions,<sup>284</sup> and the merchant bank sponsoring the issue will be pressing hard for the inclusion of such statements as essential to successful marketing of the shares.<sup>285</sup> Even though markets may have widely different practices and requirements regarding prospectuses, lawyers may decide that it is less risky to make the prospectuses as identical as possible. This would avoid providing information for only one market and would prevent presentation of the same facts in different manners to different markets.<sup>286</sup>

Another respect in which disclosure in the United States and the United Kingdom differs regards risk factors. In the United States, the caution shown in this area is so extreme that the relevant document will probably discuss, in detail, issues such as competition, which the reader would likely assume anyway.<sup>287</sup> Profit forecasts are unusual in U.S. prospectuses, although they commonly appear in U.K. prospectuses.<sup>288</sup>

One of the challenges of simultaneous offers, especially those involving the United States and the United Kingdom, is to publish prospectuses that blend the varying approaches such “that a man from Mars can pick up [all] prospectuses and recognize the same company as described in each.”<sup>289</sup> Such a goal is being actively sought. Some limited use of profit forecasts is now permitted by the SEC, and contrary to current practice in the United Kingdom, a somewhat detailed discussion of recent operations and financial conditions is likely to be included in U.K. documents for simultaneous issues, since it is a statutory requirement in the United

283. Henderson, *supra* note 276, at 75.

284. Stoakes, *supra* note 277, at 177.

285. Henderson, *supra* note 276, at 75. The difficulty posed by differing disclosure requirements is illustrated by John J. Phelan's comments regarding preferences for U.S. quarterly reporting requirements over Japanese and European semi-annual reporting practices. “Talking to the Japanese or Europeans about changing to quarterly disclosure is like talking to U.S. firms about going to monthly reporting. . . . On the other hand, convincing [Americans] to go from four to just two reports a year will be about as easy as getting Ralph Nader to take a cross-country ride in an old Corvair.” J.J. Phelan, Jr., *supra* note 110, at 5.

286. Pryor, *supra* note 272, at 74.

287. Henderson, *supra* note 276, at 75.

288. *Id.*

289. *Id.*

States.<sup>290</sup> The SEC is also considering allowing British and Canadian firms to use their own prospectuses for deals offered in the United States, rather than create new ones.<sup>291</sup>

#### 4. *Underwriting and Distribution Practices*

Differences in distribution practices between countries can create barriers to simultaneous sales of shares in more than one country. For example, the offering period in the United Kingdom is generally shorter than the period of time necessary for the SEC to approve the filed prospectus.<sup>292</sup> Without concessions, the actual sale of shares may be finalized in the United Kingdom before the prospectus is even approved in the United States.<sup>293</sup> Another difference is that in the United Kingdom the underwriters' standby liability is taken on without previously obtaining indications of interest from the public, as is done under the U.S. procedure.<sup>294</sup>

#### 5. *Current Handling*

In order to achieve a successful simultaneous issue in the United States and United Kingdom, it is necessary to address three primary differences: clearing of the prospectus, timing of pricing, and length of each offering period. First, in order to avoid delay or abandonment of the U.S. market after the issue is already underway in the United Kingdom, and because any changes made in the U.S. prospectus after distribution of the U.K. prospectus cannot be reflected in the U.K. prospectus, it is essential that the SEC pre-clear certain portions of the prospectus most likely to be com-

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290. "In the U.K., an accountant's report for the last five financial years is required, but there is no . . . requirement for detailed discussion." *Id.*

291. Clough, *Angels on a Pin*, INVESTMENT DEALERS' DIGEST 64 (Mar. 16, 1987).

292. In the United States, pursuant to the Securities Act of 1933, a company first files a registration statement and a prospectus. The prospectus is circulated to prospective investors while being reviewed by the SEC staff. During this period of review, underwriters may receive indications of interest from potential investors but may not finalize sales. This can last from three to six weeks or more. The SEC staff then communicates its comments to the issuer, which can result in extensive revisions to the prospectus. Whereas it is only at this point that the issue is underwritten and priced in the United States, in the United Kingdom these two procedures take place at the beginning of the offering period. Furthermore, in the United Kingdom there is "far less flexibility for acceleration or delay of the offer due to the necessity of remaining in the offering queue." Pryor, *supra* note 272, at 67.

293. Stoakes, *supra* note 277, at 177.

294. For this reason, "the U.K. underwriting market considers its risk to represent true underwriting." Henderson, *supra* note 276, at 76. Standby liability arises in the event that sub-underwriters fail to take up their balance of shares not applied for by the end of the offering period.

mented upon and changed.<sup>295</sup>

Second, differences in timing of pricing can be handled in a number of ways. "In the [British Petroleum] offering . . . , the U.S. price was agreed to on Allotment Day as a minimum price and the final purchase price was fixed in relation to the U.S. market near its close in New York later the same day. . . . The Reuters offering was done by a minimum tender price with the striking price set . . . at the time of allotment. The [British Telecom] offering was done at a fixed price set on Impact Day, subject to adjusting the U.S. price based on the conversion rate between sterling and the U.S. dollar on Allotment Day."<sup>296</sup>

Third, the differences in the offering periods can be resolved by shortening the U.S. offering period or lengthening the U.K. period or both, such that a reasonable compromise is reached. In the case of British Petroleum, the U.S. offering period was shortened and the U.K.'s was lengthened. In the offerings for British Telecom and Reuters, the U.K. offering period was extended to the length of the U.S. offering period.<sup>297</sup> In the case of the British Telecom issue, the differences in the U.S. and U.K. underwriting practices were handled in a novel manner. Approximate adherence to the normal timing and procedures in each country was effected largely because of the role assumed by the Bank of England. It acted as the initial underwriter of a portion of the shares allocated to the overseas offerings and then effectively transferred this liability to the overseas underwriters when they were ready at the end of their offering period.<sup>298</sup>

### K. Other Problems

Additional differences among countries involve compensation for underwriters and dealers,<sup>299</sup> standards for accounting practices, restriction of territorial selling, and handling of stabilization and over-allotment procedures.<sup>300</sup> Legislation regarding publicity also varies. In the United States, the SEC rules on publicity are strict and limit the issuer to the barest type of announcement of the offering, even excluding the name of the managing underwriter. The

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295. Pryor, *supra* note 272, at 67.

296. *Id.* Generally, Allotment Day refers to the time at which the new issue is apportioned among the underwriters.

297. *Id.*

298. Henderson, *supra* note 276, at 76.

299. Pryor, *supra* note 272, at 74.

300. *Id.*

offering is to be made by means of the prospectus.<sup>301</sup> Approaches to installment sales differ as well. Although in the United Kingdom securities are occasionally distributed on a partly paid basis, as illustrated with the British Telecom offering, in the United States it is necessary to obtain special approval to do so.<sup>302</sup>

Also, the availability of market information varies among countries. Some securities markets (e.g., the NYSE) require that transactions be reported on a real-time basis, while others (e.g., the LSE) compile neither transaction nor volume reports for individual stocks.<sup>303</sup> Therefore, data pertaining to transaction sizes, sale prices, and quotations are not consistently available. Moreover, information regarding securities that trade in more than one national market is not consolidated on a global basis.<sup>304</sup>

Legislation regarding the abilities of foreign securities firms to trade within countries is not uniform. This could make it difficult for securities dealers in one country to trade in other countries. Exchange risk may also arise. In underwriting syndicates involving firms of more than one country, exchange rates are likely to fluctuate during the distribution period.<sup>305</sup>

## VII. CURRENT APPROACHES TO THE PROBLEMS

Attempts are being made to overcome these national regulatory differences in the global securities markets. The discussion which follows focuses primarily on some of the issues affecting trading of international equities.

### A. Clearance and Settlement Procedures

In order for international clearance and settlement linkages to be facilitated, the International Securities Clearing Corporation was formed.<sup>306</sup> Since 1980, United States clearing agencies have been establishing links with foreign clearing agencies.<sup>307</sup> For example, the Canadian Depository for Securities Limited became a member

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301. *Id.*

302. *Id.*

303. Request for Comments, *supra* note 103, at 20. The parameters of a transaction reported in real time are computed during the same time that the transaction takes place. This allows the transactions to be guided by immediate feedback. J. ROSENBERG, *supra* note 48, at 368-69.

304. Briefing Memorandum, *supra* note 262.

305. Request for Comments, *supra* note 103, at 31-36.

306. Briefing Memorandum, *supra* note 262. The ISCC is a wholly-owned subsidiary of the National Securities Clearing Corporation.

307. Request for Comments, *supra* note 103, at 11-12.

of the National Securities Clearing Corporation in New York. In addition, the Canadian Depository for Securities, the Vancouver Stock Exchange Service Corporation, the Midwest Clearing Corporation/Midwest Securities Trust Company, and the International Stock Exchange are now linked.<sup>308</sup> Processing links, which do not require a clearing agency to join another country's clearing agency, are exemplified by the arrangement between the Depository Trust Company in New York City and the Amsterdam Stock Exchange.<sup>309</sup> Another useful procedure is the SEC permitting foreign clearing agencies to establish automated securities processing links with their U.S. counterparts, without registering as clearing agencies in the United States.<sup>310</sup> This helps ensure that international securities transactions get processed more safely and efficiently.

### B. *Forums for Discussion*

The SEC believes that forethought and cooperation between the securities industry and national regulatory bodies can help make the evolving global markets more fair, efficient, and accessible.<sup>311</sup> There are a number of arrangements which facilitate such cooperation. For example, the International Federation of Stock Exchanges and the International Association of Securities Commissions have been established.<sup>312</sup> The discussion of regulation of international financial markets was facilitated by a study mandated by the U.S. government. In 1985, the SEC was directed by the Committee on Energy and Commerce to conduct a study and submit a report on the accelerating internationalization of the securities markets.<sup>313</sup>

### C. *Enforcement Mechanisms and the Sharing of Information*

A substantial number of arrangements mitigate the adverse impact of blocking legislation, securities laws, and other barriers to obtaining the information required to successfully punish or inhibit

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308. Briefing Memorandum, *supra* note 262.

309. Request for Comments, *supra* note 103, at 13.

310. Report of the SEC to the House Committee on Energy and Commerce on the Internationalization of the Securities Markets; Interim Progress Report 6 (Oct. 9, 1986) [hereinafter Report of the SEC].

311. Request for Comments, *supra* note 103, at 2.

312. J.P. Bunting, *supra* note 94, at 39.

313. Report of the SEC, *supra* note 310, at 1. On July 27, 1987 the report was formally completed. See Internationalization of the Securities Markets, Report of the U.S. SEC to the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Energy and Commerce (July 24, 1987); see also Memorandum of the SEC, *supra* note 236, at 89111 n.1.

market misbehavior. In Europe, a Preliminary Draft Convention on Insider Trading aimed at member States of the Council of Europe has been drawn up. In establishing market linkages, the SEC has insisted on agreements between the parties assuring the exchange of information required to pursue surveillance and enforcement objectives.<sup>314</sup> As of 1985, there was also a proposal to coordinate market information obtained by the NYSE and the London Stock Exchange (LSE).<sup>315</sup>

In another information-sharing instrument, the SEC and the United Kingdom Department of Trade and Industry signed a Memorandum of Understanding (MOU),<sup>316</sup> which can be used on a reciprocal basis to obtain information required for regulatory purposes. The MOU provides for assistance in investigations involving misrepresentation, market manipulation, and insider trading. It also allows regular market oversight of the operation and financial status of brokerage firms and investment businesses.<sup>317</sup>

Another type of international agreement that applies to securities transactions is known as a mutual assistance treaty. The United States and Switzerland have signed the Treaty on Mutual Assistance in Criminal Matters. Although the SEC has not had many opportunities to use it, the Swiss Parliament has nearly concluded

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314. R. Scribner, *supra* note 98, at 8-10. In fact, the Boston Stock Exchange and the Montreal Exchange "agreed to 'cooperate fully' in the investigation of any questioned trade." Request for Comments, *supra* note 103, at 39.

315. *Id.* at 10.

316. The MOU was signed on September 23, 1986. Although both treaties and memoranda of understanding are international agreements, a memorandum of understanding generally is not binding in international law. Arrangements between government departments facilitate international cooperation but "[i]n Canadian practice, arrangements or understandings between the governments of two or more states, no matter what form they take (e.g., a Memorandum of Understanding or an Exchange of Notes or Letters) create commitments of a political and moral character and are not binding in, or governed by, international law." H. KINDRED, *INTERNATIONAL LAW: CHIEFLY AS INTERPRETED AND APPLIED IN CANADA* 120 (1987).

317. Memorandum from Gary Lynch, Director, Division of Enforcement, & Michael Mann, Chief, Office of International Legal Assistance, Division of Enforcement, to Chairman Shad, at 1 (Feb. 6, 1987) (re: roundtable briefing paper relating to SEC efforts to negotiate information sharing agreements) [hereinafter Lynch & Mann].

On May 23, 1986, the SEC signed a Memorandum of Understanding with the Securities Bureau of the Japanese Ministry of Finance. The agencies "agreed to facilitate each agency's respective requests for surveillance and investigatory information on a case-by-case basis." *Id.*

A Memorandum of Understanding between Switzerland and the United States was signed on August 31, 1982. The Memorandum of Understanding provides for Convention XVI, a separate private agreement among members of the Swiss Bankers' Association. This convention requires a Commission of Inquiry to be appointed to deal with requests by the SEC and provides for the freezing of "relevant customers' accounts up to the amount of the profit realized in the transaction." Lynch & Mann, *supra*, at 2.

examination of proposed legislation which would change the classification of insider trading to that of a criminal offense. This would bring many more SEC requests within the scope of the treaty.

In another arrangement, the Ontario Securities Commission and the SEC exchanged letters providing for mutual assistance between the two bodies during investigations and in overseeing the Toronto and U.S. markets. The OSC letter formally assures that it is "extremely unlikely" that the Canadian blocking statute would ever be invoked to block cooperation with an SEC investigation.<sup>318</sup>

On January 7, 1988, the SEC signed a Memorandum of Understanding with three Canadian provinces (British Columbia, Quebec and Ontario) in which they agreed to attempt to secure legislative authority permitting them to investigate violations of securities laws upon the request of foreign authorities. The SEC submitted to Congress a legislative proposal in June 1988. The proposed law, known as the International Securities Enforcement Cooperation Act of 1988, would allow the SEC to assist foreign authorities' investigations, to prevent parties who have miscondacted themselves in other countries from participating freely in U.S. securities markets, and to accord confidential treatment to records produced under certain arrangements.<sup>319</sup> The SEC believes that the proposed legislation would promote the negotiation of mutual assistance agreements, which in turn would enhance the Commission's ability to obtain evidence for investigation and prosecution of securities law violators operating in or through foreign countries.<sup>320</sup>

Within the Organization for Economic Cooperation and Development (OECD), there is a Working Group on International Investment Policies of the Committee on International Investment and Multinational Enterprises. A survey of member countries concerning cooperation and mutual assistance in enforcement matters in the securities industry is currently underway.

Another body facilitating multilateral sharing is the International Organization of Securities Commissions (IOSC). Thirty regulatory organizations from around the world are members. In order to promote international cooperation in such matters as enforce-

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318. *Id.* at 3. The letters were exchanged on September 24, 1985. Other mutual assistance agreements signed by the United States include: a treaty with Canada on March 17, 1985; a treaty with the Cayman Islands on July 3, 1986; a June 1979 agreement with Turkey; an August 1983 agreement with the Netherlands; and a November 1985 agreement with Italy. *Id.* at 3-4.

319. Memorandum of the SEC, *supra* note 236, at 89109-22.

320. *Id.*

ment, multinational committees were formed at the Organization's July 1986 meeting. There is also an IOSC working group on the exchange of enforcement information. The Executive Committee adopted a proposal in November 1986, which provides that each member commission provide other members with assistance, to the extent permitted by law and on a reciprocal basis, in obtaining information related to market oversight and protection of each nation's markets against fraudulent securities transactions.<sup>321</sup>

In 1985 the International Securities Regulatory Organization (ISRO) was established as a self-regulatory body for firms trading international securities. In late 1986, the LSE agreed in principle to merge with the ISRO. The resulting Securities Association would be responsible for authorizing U.K. firms to operate in the domestic and international securities markets.<sup>322</sup> On December 24, 1986, the ISRO officially merged with the LSE. The merger subsequently split to become the Securities Association and the International Stock Exchange of the United Kingdom and the Republic of Ireland, Ltd.<sup>323</sup>

#### *D. Market Structure: Matching the Benefits Provided by Over-the-Counter Trading*

Due to time and money factors, listing on an exchange is no longer as important as it once was. However, because the exchange markets are easier to monitor, greater investor protection is likely to result from encouragement of exchange listing as opposed to over-the-counter trading. There have been steps taken in this direction. For example, in 1985 the American Stock Exchange (AMEX) proposed an amendment to modify exchange listing requirements for foreign issuers in order to eliminate some of the disincentives to listing and to recognize foreign issuers' domestic practices and customs.<sup>324</sup> An electronic trading link between the Toronto Stock Exchange (TSE) and AMEX was established.<sup>325</sup> Some other examples of intermarket trading linkages are those between the Midwest Stock Exchange and TSE, and between the Montreal and Boston

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321. Lynch & Mann, *supra* note 317, at 4-5.

322. *Preliminary Approval for London Stock Exchange—ISRO Merger*, COMMON MKT. REP. No. 563, at 6.

323. Memo from the International Stock Exchange, Public Affairs (July 1988).

324. American Stock Exchange, Form 19b-4; Proposed Rule Change, File No. SR-Amex-86-6, at 2-3 (1985). The amendment applies to section 110 of the AMEX Company Guide.

325. R. Scribner, *supra* note 98, at 3.

Stock Exchanges.<sup>326</sup> In addition, the NYSE changed its foreign listing standards to adopt a home-country practice recognition for non-U.S. companies, including dual class capitalization, frequency of financial reporting, and other corporate governance matters.<sup>327</sup> There have also been talks about linkages between exchanges that would extend trading around the globe on a 24-hour basis.<sup>328</sup>

### *E. Disclosure and Prospectus Requirements*

Groups of countries have attempted to standardize disclosure and prospectus requirements. In 1976, the Council of the OECD adopted a Recommendation that member countries adhere to the OECD Minimum Disclosure Rules.<sup>329</sup> The EEC has issued three directives to harmonize new issue procedures and continuing disclosure obligations for listed companies in the European Community.<sup>330</sup> Once a country adopts these directives, it can not waive the disclosure rules. To the extent that there is a need to change, there would have to be agreement among the EEC partners, which could be a lengthy process.<sup>331</sup> In addition, in 1985, the EEC attempted to harmonize member States' legislation regarding the issuance of securities.<sup>332</sup>

### *F. Exchange Risk*

Underwriting syndicates in multinational firm commitment offerings encounter exchange risks. In order to facilitate accounting for dollar exchange rate fluctuations incurred during the period of distribution, the SEC has granted permission to these syndicates to adjust their stabilizing bids in compliance with Rule 10b-7 of the Exchange Act of 1934.<sup>333</sup>

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326. Briefing Memorandum, *supra* note 262, at 2.

327. J.J. Phelan, Jr., *supra* note 6. Capitalization refers to the total value of the securities which a corporation has issued. BLACK'S, *supra* note 4, at 190.

328. J.J. Phelan, Jr., *supra* note 6.

329. OECD Committee on Financial Markets, OECD Minimum Disclosure Rules Applicable to All Publicly Offered Securities, preamble (1976).

330. The U.K. adopted these directives, effective January 1, 1985. Peck, *The U.K.'s Reservations*, INT'L FIN. L. REV. 12 (May 1985).

331. *Id.*

332. Lutringer, *Letter to the Editor: Prospectus Requirements*, INT'L FIN. L. REV. 6 (July 1985).

333. Request for Comments, *supra* note 103, at 36.

### G. Accessibility

The access of securities firms to foreign markets has been augmented in some cases. For instance, the Tokyo Stock Exchange has provided four seats to U.S. firms. Also, access of foreign broker-dealers to the U.K. and Canadian markets has opened up. Furthermore, the SEC and the Division of Market Regulation recently have indicated that, subject to certain conditions and limitations, foreign entities may engage in specific securities activities in the United States without being subject to broker-dealer registration requirements.<sup>334</sup>

### H. Reporting, Quotations and Flow Back

A quotation mechanism has been implemented by the NASD and the International Stock Exchange (formerly the LSE).

The SEC indicated that it would not pursue enforcement action against a firm that had failed to register under the Securities Act, if the securities in question "came to rest" at home after having been issued abroad solely to foreign investors.<sup>335</sup>

## VIII. POSSIBLE ALTERNATIVES AND IMPROVEMENTS

There are a number of alternatives for improving upon and adding to the steps already undertaken to introduce safeguards and some degree of uniformity into the process of trading international equities.

### A. Clearance and Settlement Procedures

Links between clearing agencies from different countries could be developed incrementally or could be effected through a supranational depository or clearing entity.<sup>336</sup>

### B. Enforcement Mechanisms and the Sharing of Information

It may be possible to create an international group similar to the Intermarket Surveillance Group (ISG) in the United States.<sup>337</sup> An-

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334. Briefing Memorandum, *supra* note 262, at 5, 9.

335. *Id.* at 2, 6.

336. Request for Comments, *supra* note 103, at 29.

337. R. Scribner, *supra* note 98, at 8. The Intermarket Surveillance Group (ISG) was formed in 1981 by the NASD and the eight securities exchanges. In the United States, the NASD and the exchanges perform most of the trading market surveillance to detect unethical and illegal activity; possible violations are often referred to the SEC. Computers are used

other alternative may be the sharing of databases patterned on ISIS<sup>338</sup> and ASAM.<sup>339</sup> Also, the SEC posed the question of whether it would be feasible to reach bilateral or multilateral agreements on securities law enforcement, possibly through the aegis of a coordinating body of national regulatory entities.<sup>340</sup>

The International Securities Enforcement Cooperation Act of 1988 as proposed by the SEC certainly would be a step towards effective regulation of international securities markets.<sup>341</sup> However, the signatories to the MOU leading to the proposal of this legislation were the administrative bodies themselves, not the governments empowered to enact the statutes that would provide the authority required to investigate infringements of foreign securities laws at the request of foreign organizations. If a government withdraws from the cooperative scheme by removing the statutory authority of the administrative body, then cooperation with that country's authorities would suffer. Although this sanction serves as a strong deterrent to withdrawal, the signing of the treaties would be preferable. Unlike an MOU, a treaty is binding under international law.

### C. *Market Structure: Matching the Benefits Provided by Over-the-Counter Trading*

The SEC is considering proposals for a free-trade zone and for an exchange that would allow qualified foreign issuers to become listed without having to adhere to SEC reporting requirements.<sup>342</sup> The free-trade zone would allow institutional trading of unregistered securities.<sup>343</sup>

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to capture, sort and analyze clearing, trade and quotation data. Since none of the organizations surveying the markets has, by itself, sufficient information to fully monitor the conduct affecting its market, the ISG was formed to facilitate the sharing of relevant surveillance data. "It has also established protocols and procedures for conducting coordinated investigations of certain 'intermarket violations conditions' . . ." Scribner, *The Technological Revolution in Securities Trading: Can Regulation Keep Up?*, at 6, 11, 12 (unpublished manuscript).

338. ISIS is the Intermarket Surveillance Information System. This system, developed by the New York Stock Exchange, assists in matching particular trades with the actual participants. *Id.* at 10-11.

339. J.J. Phelan, Jr., Remarks to the American Bar Association 6-7 (Aug. 12, 1986) (re: preventing insider trading). ASAM is short for Automated Search and Match. This system electronically cross-checks information on customers and public data on companies and executives. It is designed to locate connections that might indicate insider trading, such as corporate links or civic and social affiliations.

340. Request for Comments, *supra* note 103, at 40.

341. Memorandum of the SEC, *supra* note 236. See also *supra* text accompanying 236.

342. Clough, *supra* note 291, at 65.

343. Briefing Memorandum, *supra* note 262.

#### D. *Disclosure and Prospectus Requirements*

Two alternative ways to deal with the varying prospectus requirements between countries are the reciprocal and common prospectus methods. The reciprocal approach involves each country accepting the offering document used by the issuer in its own country. The common prospectus approach involves development of one offering document to be used by more than one country.<sup>344</sup> Many commenters replying to the SEC's request for input believe that a significant cost factor attached to the common prospectus approach would make the reciprocal approach more attractive.<sup>345</sup>

#### E. *Reporting, Quotations and Flow Back*

Nonuniformity of reporting requirements and of quotation systems can be remedied through the establishment of global consolidated reporting and quotation systems. In addition, pricing disparities may be combatted with arbitrage activity or through such mechanisms "as intermarket linkages to permit orders to be routed to the market with the best price."<sup>346</sup>

#### F. *Regulatory Systems*

Some alternative forms of regulatory systems are: (1) a formal supranational body; (2) the establishment of multilateral agreements; and (3) a series of bilateral agreements. There is also the question of whether control should be in the hands of governments or of other parties.<sup>347</sup>

As J.J. Phelan, Jr., Chairman and CEO of the NYSE, points out, "[W]e are far from having a truly integrated international trading system. . . . Many of the legal and regulatory elements of our trading system are still structured essentially along nationalistic lines."<sup>348</sup> In developing a more coordinated international regulatory system, a model bilateral agreement would balance the need for uniformity of direction with the flexibility required to adapt to widely varying national circumstances. One or more model bilateral treaties would be preferred over model bilateral agreements or memoranda of understanding since the treaties would be legally

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344. Stoakes, *Harmonizing Prospectuses: The SEC's Proposal*, INT'L FIN. L. REV. 8 (1985).

345. Report of the SEC, *supra* note 310.

346. Request for Comments, *supra* note 103, at 20-25.

347. J.P. Bunting, *supra* note 94.

348. J.J. Phelan, Jr., *supra* note 95.

binding under international law. The United States and the United Kingdom have agreed in principle to attempt to negotiate a treaty, and this could serve as a model.<sup>349</sup>

### CONCLUSION

In the trading of international equities, there are undisputed advantages. Investors, firms, and nations find diversified sets of consumers and suppliers in the international market. On the other hand, the risks are also magnified, and to the extent that variation exists among national regulatory systems, the uncertainty and costs associated with decisions may be prohibitive. Furthermore, such inconsistency expands opportunities for unethical, anticompetitive behavior to exist undetected and uninhibited; this can seriously erode the fairness, efficiency, and accessibility required for the optimal growth and success of the international equity market.

It is not sufficient for each nation to introduce regulatory measures in isolation from other countries. A hodgepodge of rules, laws and practices fashioned along national lines leads to reduced efficiency,<sup>350</sup> waning accessibility, and eroded investor protection. The promptness with which these issues must be addressed is underlined by the risks inherent in international markets, by the lack of uniform settlement and clearing standards, by the uncertain legal consequences of cross-border transactions, and by the proliferation of new, widely-employed, sophisticated financial instruments for which there are no records of past performance.<sup>351</sup> In the words of J.J. Phelan, Jr.: "There is no stopping the expansion of global trading. If we are going to come up with the best concepts and structure for international trading, we have to work together with a sense of urgency."<sup>352</sup>

*Margaret Maureen Samuel\**

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349. Deal, *Policing Securities and Commodities Markets*, INT'L FIN. L. REV. 21-23 (Jan. 1987).

350. J.J. Phelan, Jr., *supra* note 95.

351. *Id.*

352. J.J. Phelan, Jr., *supra* note 110.

\* Bachelor of Laws candidate, University of Alberta. M.B.A. 1987, B.A. 1984, University of Alberta.

I would like to dedicate this Comment to my mother, and to thank Professor Raworth, Professor Leitch and Professor Ivankovich for their encouragement.