"Regulation S" and the Territorial Approach to Securities Regulation: Are They Effective? - A Study of United States Securities Regulation in Light of British and Chinese Securities Regulation

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“REGULATION S” AND THE TERRITORIAL APPROACH TO SECURITIES REGULATION: ARE THEY EFFECTIVE?

A STUDY OF UNITED STATES SECURITIES REGULATION IN LIGHT OF BRITISH AND CHINESE SECURITIES REGULATIONS

I. INTRODUCTION

Regulatory issues and problems are inherent in all securities offerings. However, there are different issues raised in securities offerings that take place within a country as opposed to those that take place wholly extraterritorially, i.e. those that are offered and sold outside a country. Under United States (“U.S.”) law, the extraterritorial offering poses serious challenges to defining the scope of section 5 of the Securities Act of 1933 (“Securities Act”). Section 5 requires an issuer to register its securities offering unless the offering falls within one of the standard exemptions provided in the Securities Act. If no such exemption is satisfied, section 5 prohibits the use of interstate commerce in the offering of unregistered securities. Section 2(7) of the Securities Act defines interstate commerce to include “trade or commerce in securities or any transportation or communication relating thereto . . . between any foreign country and any State, Territory, or the District of Columbia.” Because of this definition, the jurisdictional reach of section 5 is potentially quite broad. A literal reading of this provision would include within the scope of section 5 any offering by a U.S. issuer, regardless of the geographical location of the offering, if in the

4. 15 U.S.C. § 77e (1994); COX ET AL., supra note 1, at 326. These exceptions include, inter alia, Sections 3(a)(11) (intrastate offering exemption), 4(2) (private offering exemption), and Regulation D of the Securities Act of 1933.
process of selling the security abroad the U.S. mails had been used or telephone calls into the U.S. had been made. Similarly, a foreign offering by a foreign issuer where securities are shortly thereafter traded among U.S. investors in the U.S. market would also trigger section 5’s registration requirements.

Given section 5’s potential overbreadth and the increasing importance of international securities offerings, the U.S. Securities and Exchange Commission (“SEC”) took a series of interpretative and regulatory steps to lessen concerns regarding section 5’s application. The SEC’s initial step was Securities Act Release No. 4708 in 1964, which took the imprecise position that an offering sold extraterritorially in a manner reasonably designed to preclude distribution or redistribution within or to nationals of the U.S. did not require registration under section 5. For twenty-five years and pursuant to Release No. 4708, the SEC issued inconsistent and vague no-action letters in its attempt to set standards applicable to extraterritorial offerings.

Following this period of uncertainty, the SEC adopted Regulation S. It is based on a territorial approach to section 5 of the Securities Act and provides a registration exemption for wholly extraterritorial offerings. Because the Securities Act as a whole is intended to protect the U.S. markets and investors purchasing in the U.S. markets, whether U.S. or foreign nationals, Regulation S creates explicit safe harbors for extraterritorial

7. Id. at 329.
8. Id.
11. Id.
14. Id.
torial distributions and resales of unregistered securities. Through Regulation S, the SEC’s territorial approach to securities regulation recognizes the primacy of the laws in which the market and transaction are located rather than focusing on the nature of the securities or the nationality of purchasers, offerors, or issuers.

U.S. regulations dealing with extraterritorial offerings do not, however, operate in a vacuum. In an overseas offering, the securities regime of at least one other country will apply to the offering. The impact of the foreign securities regime varies with the specific requirements of the regime.\textsuperscript{15} Depending on whether the foreign regime provides adequate protection determines whether there is an adverse impact on the U.S. markets as a result of extraterritorial offerings not regulated by the SEC. This Note addresses various regulatory approaches to wholly extraterritorial securities offerings in order to determine if Regulation S is adequate in light of those other regimes and frameworks.

There are three basic models of securities regulatory framework: the American type, the English type, and a combination of the two.\textsuperscript{16} The American type is characterized by a comprehensive securities law that provides regulatory rules for both primary and secondary markets, and is applicable to issuers, underwriters, brokers, and investment advisors.\textsuperscript{17} The American type also has an independent regulatory body responsible for enforcing securities law so as to protect investors, and includes statutory rules and regulations that govern all aspects of investments, from disclosure to market manipulation.\textsuperscript{18} The English type, on the other hand, emphasizes listing requirements and the importance of self-regulation by securities participants.\textsuperscript{19} Securities laws are interspersed among other laws, such as company and banking law, rather than being separately codified in a comprehensive securities act.\textsuperscript{20}

\textsuperscript{17} \textit{Id}.
\textsuperscript{18} \textit{Id}.
\textsuperscript{19} \textit{Id}.
\textsuperscript{20} \textit{Id}.
securities regulatory framework combines the first two and creates a role for both a regulatory body and self-regulation.\textsuperscript{21} It establishes a comprehensive securities law, but aims at expansion of the capital markets rather than protection of investors.\textsuperscript{22}

Within the American type of regulatory framework, the U.S. takes a territorial approach to securities regulation. This territorial approach is not unique to the U.S. Even though the United Kingdom ("U.K.") regulatory framework is different, it utilizes a territorial approach to securities regulation and similar to the U.S. does not impose the same requirements for wholly extraterritorial offerings as it does for domestic offerings. Because of their different regulatory frameworks, however, the U.S. and U.K. focus on different aspects of the offering in determining whether it is wholly extraterritorial. The U.S. securities regulation focuses on the geographical location of the transaction itself, namely the geographical location of the offering and the place where the securities come to rest. In contrast to the U.S. focus on the transaction, the U.K. approach considers as determinative the "nationality" of the issuer, which is defined in part by location.\textsuperscript{23}

Beyond the differing territorial approaches in the U.S. and U.K., there are other diverse approaches to securities regulation around the world. These different approaches do not deal directly with extraterritorial offerings per se as they do not consider geographical factors. Chinese regulators utilize this approach and working within the combination securities framework, focus on the kind of security offered and the nationality of the purchaser, offeror, and issuer. Chinese regulators find the location of the transaction to be completely irrelevant to securities regulation.

This Note analyzes the U.S. approach to regulation of extraterritorial securities transactions in light of other regulatory frameworks and approaches to securities regulation. It goes on to offer improvements to the U.S. system by drawing from other regulatory frameworks and approaches. Part II begins by briefly addressing the problems the SEC faced, prior to Regulation S, considering the U.S. territorial approach to securities regulation and American regulatory framework. It further de-

\textsuperscript{21} Id.
\textsuperscript{22} Id.
\textsuperscript{23} See notes 124–147 and accompanying text for a full discussion.
scribes the purposes and provisions of Regulation S, which embodies the U.S. territorial approach to securities regulation, and also considers the problems created by this approach. Part III examines the Regulation S amendments adopted in 1998 in an attempt to remedy these problems while still utilizing the territorial approach to securities regulation. Part IV examines the U.K. territorial approach to securities regulation as modified by the English regulatory framework. It also compares the U.S. and U.K. systems, weighing their advantages and disadvantages. Part V discusses the Chinese regulation of foreign transactions based on notions completely separate from the territorial approaches utilized by the U.S. and U.K., as influenced by its combination framework, and compares the differing approaches to securities regulation. In Part VI, this Note concludes with a discussion of whether U.S. investors and securities markets would benefit by modifying or replacing the U.S. regulatory framework and territorial approach as embodied in Regulation S.

II. REGULATION S OF THE SECURITIES ACT OF 1933: HISTORY, PURPOSE, AND SPECIFICS

Section 5 of the Securities Act requires the registration of any offer or sale of securities involving the use of interstate commerce, unless there is an exemption. "Interstate commerce" is defined to include trade or commerce in securities between the U.S. and any foreign country. In 1964, the SEC attempted to specify the reach of the Securities Act registration requirements through Securities Act Release No. 4708 ("Release 4708"). In Release 4708, the SEC stated that the registration requirements of section 5 of the Securities Act were for the protection of investors in the U.S. markets and, therefore, the SEC would not take action when an issuer who sold to foreign investors...
abroad did not register its securities in accordance with the section 5 requirements.\(^{28}\)

With the development of international trading markets and the significant increase in wholly extraterritorial offerings, Release 4708 did not answer an increasing number of questions regarding securities laws.\(^{29}\) As a result, issuers and buyers were unsure when their transactions would be considered “offshore,” i.e. wholly extraterritorial, by the SEC, and thus whether they would be exempt from the section 5 requirements.\(^{30}\) In order to clarify the extraterritorial and international application of the registration provisions of the Securities Act,\(^{31}\) the SEC adopted Regulation S on April 19, 1990.\(^{32}\)

Regulation S created safe harbors for extraterritorial transactions that met its requirements. If a transaction met all the requirements of Regulation S, the issuer could be certain that it was exempt from the registration provisions of section 5 and thus not subject to civil or criminal liability for violations of section 5.\(^{33}\) In addition to providing certainty regarding exemption, Regulation S was promulgated to facilitate foreign securities offerings by U.S. issuers and to allow U.S. investors to provide financings in foreign capital markets.\(^{34}\) The regulation was also intended to increase U.S. competitiveness offshore and lower the cost of raising capital abroad.\(^{35}\)

\(^{28}\) Release 4708, supra note 10.


\(^{30}\) Proctor & Gamble Co., SEC No-Action Letter, 43 SEC Docket 364 (Feb. 21, 1985); Pan American World Airways, Inc., SEC No-Action Letter, 1975 WL 11264 (June 30, 1975). Violations of section 5, even without scienter, give rise to various forms of civil liability, including rescission of the sales transaction. See sections 11, 12, and 17 of the Securities Act of 1933.


\(^{33}\) Securities Act of 1933 § 5, 15 U.S.C. § 77e (2000). Each transaction in which the issuer or buyer seeks to enter must meet the requirements of Regulation S as it provides a “transaction” exemption, not an “entity” exemption.

\(^{34}\) Trachtman, supra note 32, at 292.

Regulation S takes a territorial approach to securities regulation. Its General Statement in Rule 901 states that offers and sales that occur outside the U.S. need not be registered under section 5. It effectively narrows section 5’s prohibitions regarding interstate commerce by creating exemptions for transactions involving foreign countries, thus restricting the protective reach of section 5 to investors that purchase securities within the U.S. markets.

The Regulation S approach is consistent with the general approach of the Securities Act. The SEC does not protect U.S. investors that acquire securities outside the U.S. since those investors have chosen to forego the protections of the U.S. securities registration requirements. Likewise, Regulation S states that “[a]s investors choose their markets, they choose the laws and regulations applicable in such markets.” Therefore, if the transaction takes place “in” the U.S., the securities must be registered under section 5; if the transaction takes place outside the U.S., the securities need not be registered under section 5.

Whether a transaction falls within Regulation S is determined by the location of the transaction rather than by the identity of the purchaser, although the purchaser’s identity may affect the complex determination of where the transaction takes place. Regulation S creates two safe harbors in Rules 903 and 904, both of which provide a manner in which investors can determine with certainty if their transactions are extraterritorial.

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40. Reg. S, supra note 12; see also Trachtman, supra note 32, at n.158. As a protection to the consumer, however, Preliminary Note 2 of Regulation S provides that the regulation’s exemptions are not available for “any transaction . . . that, although in technical compliance with the rules, is part of a plan or scheme to evade” the registration provisions of the Securities Act. This provision allows for enforcement by the SEC for any unintended uses of Regulation S. Jordan, supra note 38, at 64.
41. Reg. S, supra note 12. The SEC does not apply registration requirements to protect U.S. citizens purchasing securities abroad; such protection is not necessary to carry out the SEC’s principal purpose of ensuring a fair marketplace and consumer protection in the U.S.
42. Trachtman, supra note 32, at 295.
i.e. “outside” the U.S. 43 This extraterritorial location is also referred to as “offshore.”44

A. Rule 903: Issuer Safe Harbor

Rule 903 is the safe harbor applicable to sales by offshore issuers of securities and is often referred to as the “issuer safe harbor.”45 It applies to offers and sales by issuers, distributors, their affiliates, and any persons acting on their behalf. 46 It allows offshore offerings with much fewer restrictions, waiving the registration requirements of section 5. To fall within the issuer safe harbor, two general conditions must be met: (1) The offer and sale must be made in an “offshore transaction” and (2) No “directed selling efforts” may be made in the U.S. by the issuer, underwriter, or other distributor.47

The first general condition is met and the sale qualifies as “offshore” if it is not made to a person in the U.S. and, either (1) the buyer is outside the U.S. at the time the buy order originated or (2) the transaction is executed in, on, or through the physical trading floor of a foreign securities exchange.48 The second general condition required of all offers and sales is that there be no “directed selling efforts.”49 Directed selling efforts are those activities that could reasonably be expected to condition the market in the U.S. for any of the securities offered or sold in reliance on Regulation S.50

44. Id. § 230.902(h).
45. Id. § 230.903.
46. Id.
47. Id.
48. Reg. S, supra note 12, § 230.902(i). “Offshore transaction” is defined as “[a]n offer or sale of securities” that is “not made to a person in the United States; and, [[] either: (A) [a]t the time the buy order is originated the buyer is outside the United States, or the seller and any person acting on its behalf reasonably believe that the buyer is outside the United States; or (B) … the transaction is executed in, on or through a physical trading floor of a foreign securities exchange that is located outside the United States.” Id.
49. Id. §§ 230.903(b), 230.904(b).
50. Id. § 230.902(b)(1). For example, mailing printed materials to U.S. investors, conducting promotional seminars in the U.S., placing ads with radio or TV stations broadcasting into the U.S., or placing ads in publications with a general circulation in the U.S., any of which discuss the offering or condition the market for securities.
In addition to the two general conditions, Rule 903 imposes procedural safeguards to ensure that the securities “come to rest” outside the U.S.\(^{51}\) Such safeguards vary with the perceived risk that securities offered abroad will flow back into the U.S.\(^{52}\) Rule 903 is divided into three categories with varying procedural safeguards\(^{53}\) based on the type of issuer and security.\(^{54}\) There are no additional procedural safeguards for Category One transactions. Category One includes the securities of non-U.S. issuers, such as the securities of foreign issuers with no “substantial United States market interest” for their securities;\(^{55}\) securities offered and sold in “overseas directed offerings;”\(^{56}\) securities backed by the full faith and credit of a “foreign government;”\(^{57}\) and securities offered and sold pursuant to

\(^{51}\) Id. § 230.903.
\(^{52}\) Id.
\(^{53}\) Id. § 230.903(c)(1)–(3).
\(^{54}\) Id. § 230.902(n).
\(^{55}\) Reg. S, supra note 12, § 230.903(c)(1)(i)(A)–(D). A “substantial U.S. market interest” in foreign issuer’s securities is defined to exist where at the offering (1) the “securities exchanges and inter-dealer quotation systems in the United States in the aggregate constitute the single largest market for such securities in the shorter of the issuer’s prior fiscal year or the period since the issuer’s incorporation;” or (2) 20 percent or more of the trading in the class of securities took place in, on or through the facilities of securities exchanges and inter-dealer quotation systems in the United States and less than 55 percent of such trading took place in, on or through the facilities of securities markets of a single foreign country in the shorter of the issuer’s prior fiscal year or the period since the issuer’s incorporation.” Id. § 230.902(n)(i)–(ii).
\(^{56}\) Id. § 230.903(c)(1)(ii). An “overseas directed offering” is (1) “an offering of securities of a foreign issuer that is directed into a single country other than the United States to the residents thereof and that is made in accordance with the local laws and customary practices and documentation of such country;” or (2) “an offering of non-convertible debt securities,” asset-backed securities or non-participating preferred stock of domestic issuers directed to residents of a single foreign country “in accordance with the local laws, and customary practices and documentation of such country provided that the principal and interest of the securities . . . are denominated in currency other than U.S. dollars and such securities are neither convertible into U.S. dollar-denominated securities no linked to U.S. dollars . . . in a manner that in effect converts the securities to U.S. dollar-denominated securities.” Id. § 230.902(j).
\(^{57}\) Id. § 230.903(c)(1)(iii). A “foreign government” is “the government of any foreign country or of any political subdivision of a foreign country, provided that such government or subdivision would qualify to register securities under the [Securities] Act on Schedule B.” Id. § 230.902(e).
certain employee benefit plans established under the laws of a foreign country.\textsuperscript{58}

There are additional procedural restrictions called transactional restrictions for Category Two transactions.\textsuperscript{59} Under these restrictions, securities sold prior to the expiration of a mandatory 40-day restricted period cannot be offered to, sold to, or sold for the benefit of a U.S. person.\textsuperscript{60} Regulation S defines “U.S. person” as “any natural person resident in the United States.”\textsuperscript{61} Therefore, any domestic or foreign national resident in the U.S. is automatically considered a U.S. person for the purposes of Regulation S. Category Two safeguards apply to the equity securities of domestic reporting issuers, securities of foreign reporting issuers with a substantial market interest in

\textsuperscript{58} Id. § 230.902(c)(1). See also Jordan, supra note 38, at n.57.

\textsuperscript{59} Id. § 230.903(c)(2)(ii)–(iv). There are also offering restrictions. The first offering restriction requires that every distributor agree in writing to comply with the transactional restrictions and provisions of Regulation S. Id. § 230.902(h)(1). The second offering restriction requires that documents used in connection with transactions under Rule 903, i.e. sales and offers, must contain the following language: “to the effect that the securities have not been registered” and “may not be offered or sold in the United States or to United States persons.” Id. § 230.902(h)(2).

\textsuperscript{60} Id. § 230.903(c)(2)(iii). If these securities are sold within the restricted period, the purchaser must also be informed of the transactional restrictions. Id. § 230.903(c)(2)(iv). This section was drastically changed by the 1998 amendments, which extended the restricted period to one year. See notes 91–106, infra, and accompanying text.

\textsuperscript{61} Id. § 230.902(o)(1)(i). In determining a corporation’s residency, the place of incorporation generally controls. Id. § 230.902(o)(1)(ii). If, however, a corporation incorporated in a foreign jurisdiction was created for the purpose of investing in securities not registered with the SEC, it will be deemed a U.S. person for the purposes of Regulation S. Id. § 230.902(o)(1)(viii)(A)–(B).
the U.S.\textsuperscript{62} for their securities, and securities of non-reporting foreign issuers.\textsuperscript{63}

The Category Two procedural restrictions also apply to Category Three transactions.\textsuperscript{64} In addition, purchasers of Category Three securities must certify that they are not U.S. persons and are not acquiring the securities for the account or benefit of a U.S. person.\textsuperscript{65} The purchaser must also continue to resell securities under Regulation S rules.\textsuperscript{66} Category Three safeguards apply to the securities of all other issuers not covered under the first two categories.\textsuperscript{67}

**B. Rule 904: Resale Safe Harbor**

Rule 904, the “resale safe harbor,”\textsuperscript{68} provides for the offshore resale of unregistered securities by persons other than the issuer, distributor, or any of their respective affiliates or agents.\textsuperscript{69} Like Rule 903, it requires two general conditions: (1) the offer

\textsuperscript{62} Id. § 230.903(c)(2). A “substantial U.S. market interest” in foreign issuer’s securities is defined to exist where at the offering (1) the “securities exchanges and inter-dealer quotation systems in the United States in the aggregate constitute the single largest market for such securities in the shorter of the issuer’s prior fiscal year or the period since the issuer’s incorporation;” or (2) 20 percent or more of the trading in the class of securities took place in, on through the facilities of securities exchanges and inter-dealer quotation systems in the United States and less than 55 percent of such trading took place in, on through the facilities of securities markets of a single foreign country in the shorter of the issuer’s prior fiscal year or the period since the issuer’s incorporation.” Id. § 230.902(n)(i)–(ii).

\textsuperscript{63} Id. § 230.903(c)(2). Specifically, Category Two restrictions apply to debt securities, non-participating preferred stock, and asset-backed securities of non-reporting foreign issuers. Id. This section was drastically changed to exclude equity securities of domestic reporting issuers in the 1998 amendments. See notes 91–106, infra, and accompanying text.

\textsuperscript{64} Id. § 230.903(c)(3)(i).

\textsuperscript{65} Id. § 230.903(c)(3)(ii)(B)(4). There are also offering restrictions. The first offering restriction requires that every distributor agree in writing to comply with the transactional restrictions and provisions of Regulation S. Id. § 230.902(h)(1). The second offering restriction requires that documents used in connection with transactions under Rule 903, i.e. sales and offers, must contain the following language: “to the effect that the securities have not been registered” and “may not be offered or sold in the United States to United States persons.” Id. § 230.902(h)(2).

\textsuperscript{66} Id. § 230.903(c)(3)(iii)(B).

\textsuperscript{67} Id. § 230.903(c)(3).

\textsuperscript{68} Id. § 230.904.

\textsuperscript{69} Id.
and sale must be made in an “offshore transaction” and (2) no “directed selling efforts” may be made in the U.S. by the issuer, underwriter, or other distributor. To qualify as “offshore,” a resale must not be made to a person in the U.S. and, either (1) the buyer must be outside the U.S. at the time the buy order is originated or (2) the transaction must be executed in, on, or through the facilities of one of the designated offshore securities markets enumerated in the regulation. While the “directed selling efforts” requirements of Rule 904 are the same as in Rule 903, Rule 904 requires no additional procedural safeguards to ensure that the securities “come to rest” abroad.

C. Abuses of the Original Regulation S

Not long after Regulation S was adopted, market participants quickly identified and took advantage of significant loopholes in the regulation. Within one year of the adoption of Regulation S, the SEC filed its first enforcement action involving securities violations associated with the regulation. In some instances,

70. Id.
71. Id. § 230.902(i). “Offshore transaction” is defined as “[a]n offer or sale of securities” that is “not made to a person in the United States; and, [ ] either: (A) at the time the buy order is originated the buyer is outside the United States, or the seller and any person acting on its behalf reasonably believe that the buyer is outside the United States; or (B) ... the transaction is executed in, on or through the facilities of a designated offshore securities market.” Id.
72. Section 230.902(a) defines “designated offshore securities market” as:
(1) the Eurobond market, the Amsterdam Stock Exchange, the Australian Stock Exchange Limited, the Bourse de Bruxelles, the Frankfurt Stock Exchange, The Stock Exchange of Hong Kong Limited, The International Stock Exchange of the United Kingdom and the Republic of Ireland, Ltd., the Johannesburg Stock Exchange, the Bourse de Luxembourg, the Borsa Valori di Milano, the Montreal Stock Exchange, the Bourse de Paris, the Stockholm Stock Exchange, the Tokyo Stock Exchange, the Toronto Stock Exchange, the Vancouver Stock Exchange, and the Zurich Stock Exchange.
(2) any foreign securities exchange or non-exchange market designated by the Commission.
This section was changed by the 1998 Amendments to include later designated markets. See note 90, infra, and accompanying text.
73. See notes 51–52, supra, and accompanying text.
75. See Jordan, supra note 38, at 59.
issuers created offshore shell entities to sell unregistered securities back into the U.S.\textsuperscript{77} Other abuses included illegal resales within the restricted period after purchase,\textsuperscript{78} use of promissory notes in purchasing Regulation S securities when the expectation of repayment stemmed from the resale of securities back into the U.S.,\textsuperscript{79} and use of the resale safe harbor to “wash off” restrictions from otherwise restricted securities.\textsuperscript{80} These and other abuses\textsuperscript{81} tainted the reputation of Regulation S as an efficient means for raising capital overseas and frustrated its goal of protecting U.S. investors. These problems prompted the amendments of the regulation.

III. AMENDMENTS TO REGULATION S

Regulation S was amended in 1998\textsuperscript{82} “to stop the abusive practices in connection with offerings of equity securities purportedly made in reliance on Regulation S.”\textsuperscript{83} Because most


\textsuperscript{83.} Amending Release, supra note 82, at 9,632.
abuses of the regulation involved domestic issuers, the most drastic changes to the regulation were in the sections that apply to domestic issuers. In contrast, the changes that applied to foreign issuers were minimal. The most important change to the regulation was the amendment to Rule 903, which reclassified domestic reporting equity issuers from the second safe harbor category to the third category. Another important change was Rule 905, a new rule that categorized equity securities of both reporting and non-reporting domestic issuers as restricted securities within the meaning of Rule 144 of the Securities Act (“Rule 144”).

A. Amendments to the General Conditions

The two general conditions that must be met for a securities transaction to fall within the Rule 903 or Rule 904 exemption were very slightly modified. The first requirement, that any offer or sale must be made in an “offshore transaction,” did not change. The second requirement, prohibiting “directed selling efforts” in the U.S., only changed with respect to “designated offshore securities markets” so that Rule 904 now includes securities markets that were designated as such after the original regulation was adopted.

84. Id. at 9,632–33.
85. Amended Reg. S, supra note 82, § 230.904; Amending Release, supra note 82, at 9,633. The SEC did warn that it would still “monitor practices in this area” and “revisit the issue” should abuses occur. Id.
87. Amended Reg. S, supra note 82, § 230.905; Amending Release, supra note 82, at 9,636. See Rule 144, 17 C.F.R. §230.144 (2002). All securities under Rule 144 restricted securities status are subject to, inter alia, a one-year holding period.
89. Id. §§ 230.903(a)(1), 230.904(a)(1). See also id. § 230.902(h), where the definition of an “offshore transaction” has not changed.
90. Id. § 230.902(b). The additional exchanges that have been added to the definition of a designated offshore securities market include the Alberta Stock Exchange, the Bermuda Stock Exchange, the Copenhagen Stock Exchange, the European Association of Securities Dealers Automated Quotation (the European Equivalent to NASDAQ), the Helsinki Stock Exchange, the Irish Stock Exchange, the Istanbul Stock Exchange, the Mexican Stock Exchange, the Oslo Stock Exchange, the Stock Exchange of Singapore Ltd., and the Warsaw Stock Exchange.
B. Amendments to Rule 903, the Issuer Safe Harbor

There were amendments to Rule 903’s procedural safeguards imposed on the three different categories of securities in order to ensure that the securities “come to rest” outside the U.S. Category One of the issuer safe harbor was generally unaffected by the amendments.\(^{91}\) Category Two’s coverage of securities of foreign reporting issuers with a substantial market interest for their securities in the U.S. and non-reporting foreign issuers also remained changed.\(^{92}\)

Category Two of the issuer safe harbor was changed, however, so that it no longer includes equity securities of domestic reporting issuers; Category Three now covers such securities.\(^{93}\) This class of securities was hardest hit by the amendments since domestic reporting issuers no longer enjoy the benefits of a shorter 40-day holding period,\(^{94}\) but now must hold the equity securities for one year.\(^{95}\) While the amendments have greatly affected the type of securities covered by Category Two, the requirements under this category have remained the same, for the most part, with only a few minor changes to the terminology used in the transactional restrictions.\(^{96}\)

\(^{91}\) Id. § 230.903(b)(1). One class of securities covered by Category One has been affected. Securities of domestic issuers falling under this category that are sold to foreign resident employees pursuant to employee benefit plans governed by foreign law are now classified as restricted securities within the meaning of Rule 144 of the Securities Act. Id. Therefore, these securities are now subject to a one-year holding period before they can be resold in the U.S. Amending Release, supra note 82, at 9,634. See also Amended Reg. S, supra note 82, § 230.905. Prior to the amendments, these securities were not subject to any kind of holding restrictions or limitations other than those previously specified under Category One. See Reg. S, supra note 12, § 230.903(c)(1)(iv).

\(^{92}\) Amended Reg. S, supra note 82, § 230.903(b)(2).

\(^{93}\) Id. § 230.903(b)(2)–(3). See also Reg. S, supra note 12, § 230.903(c)(2).

\(^{94}\) Amended Reg. S, supra note 82, § 230.903(b)(2)(ii).

\(^{95}\) Id. § 230.903(b)(3)(iii)(A).

\(^{96}\) The terminology used to describe the holding period applicable to the Regulation S safe harbors (here the 40-day period) in the original Regulation S was “restricted period.” Reg. S, supra note 12, § 230.903(c)(2)(iii)–(iv). The amended Regulation S uses instead the term “distribution compliance period.” Amended Reg. S, supra note 82, § 230.903(b)(2)(i)–(ii). The SEC changed the term “restricted period” to “distribution compliance period” to avoid confusion between the requirements under the issuer safe harbor from those applicable under Rule 144, now included in the new Rule 905, which contains the term “restricted securities.” See id. § 230.905; see also Amending Release, supra note 82, at 9,635.
Category Three continues to be the residual safe harbor category, covering all securities not covered by Categories One or Two. Category Three now includes equity securities of domestic issuers, and foreign non-reporting issuers with a substantial market interest in the U.S. for their securities. The procedures for Category Three continue to be the most rigorous because the likelihood that the securities will flow back into the U.S. is greatest with these issuers.

The stringent transactional restrictions under Category Three were modified and are now divided between debt and equity securities. The transactional restrictions for debt securities are less stringent than those for equity securities and have not changed. Debt securities continue to be subject to a 40-day distribution compliance period. The transactional restrictions for equity securities, however, are now much more comprehensive. Category Three equity securities are subject to a one-year distribution compliance period. As in the original Regulation S, if an offer or sale is made within this distribution compliance period, the purchaser must certify that he is not a U.S. person nor acquiring the securities for the benefit of a U.S. person or acquiring the securities for the benefit of a U.S. person.

The offering restrictions under Category Two have not changed. Distributors must still agree in writing that all offers and sales made prior to the expiration of the distribution compliance period be conducted in compliance with the rules governing Regulation S. Amended Reg. S, supra note 82, §§ 230.903(b)(2)(i), 230.902(g)(1). Also, all offering materials and documents used in connection with offers and sales prior to the expiration of the distribution compliance period must include statements that the securities have not been registered and may not be sold in the U.S. or to U.S. persons, absent registration or an exemption. Id. §§ 230.903(b)(2)(i), 230.902(g)(2).

97. Id. § 230.903(b)(3).
98. Id. § 230.903(b)(3). These three groups of equity securities were previously in Category Two. See notes 59–63, supra, and accompanying text.
99. Amending Release, supra note 82, at 9,635.
100. Amended Reg. S, supra note 82, §§ 230.903(b)(3)(i) and (ii), respectively.
101. Id. § 230.903(b)(3)(ii)(A). Debt securities must also be represented “upon issuance by a temporary global security which is not exchangeable for definitive securities until the expiration of the 40-day distribution compliance period.” Id. § 230.903(b)(3)(ii)(B).
102. Id. § 230.903(b)(3)(iii)–(iv).
103. Id. § 230.903 (b)(3)(iii)(A). Distributors selling Category Three equity or debt securities prior to the expiration of the applicable distribution compliance period must provide notice to the purchaser that he is also subject to the same restrictions as the selling distributor. Id. § 230.903(b)(3)(iv).
The purchaser must also continue to resell securities under Regulation S rules. In addition, under the amendments, the purchaser must agree not to engage in hedging transactions with regard to these securities unless in compliance with the Securities Act.

C. Amendments to Rule 904 and the New Rule 905: Resale Limitations

While the resale safe harbor of Rule 904 has substantively stayed the same, the rules governing the effect of resales of domestic securities have been modified by new Rule 905. The SEC added Rule 905 to Regulation S “to clarify the legal obligations of purchasers of securities under Regulation S.” The rule provides that equity securities of domestic issuers acquired from the issuer, a distributor, or any of their affiliates in a transaction subject to Regulation S are “restricted securities” as defined in Rule 144. Because these securities are “restricted,” the resale safe harbor created by Rule 904 can no longer be used to avoid applicable restrictions. Instead, these securities are subject to the restrictions of Rule 144, including a one-year holding period before they can be resold.

Rule 905 also provides that restricted securities as defined under Rule 144 “will continue to be deemed ... restricted securities, notwithstanding that they were acquired in a resale transaction” under the resale safe harbor of Rule 904. As a result, the resale of restricted securities offshore under the Rule 904 safe harbor does not “wash off” the restricted status of those securities.

104. Id. § 230.903(b)(3)(iii)(B)(1).
106. Id. Category Three transactional restrictions continue to require that a legend be placed on the securities of domestic issuers stating that transfers in these securities are prohibited except in accordance with the provisions governing Regulation S. Id. § 230.903(b)(3)(iii)(B)(3). Under the amendments, this legend must now also contain a provision stating that hedging in these securities may not be conducted unless in compliance with the Securities Act. Id. The transactional restrictions continue to require the issuer to refuse to register any transfer of securities not made in compliance with Regulation S. Id. § 230.903(b)(3)(iii)(B)(4).
107. Amending Release, supra note 82, at 9,636.
109. Id. § 230.905.
110. 17 C.F.R. § 230.144(d)(1).
111. Amended Reg. S, supra note 82, § 230.905.
securities to allow them to be freely sold into the U.S. by the purchaser.\textsuperscript{112}

New Rule 905 has also had a dramatic effect on the use of promissory notes in the purchase of Regulation S securities. By deeming domestic equity securities to be restricted securities under Rule 144, the SEC effectively prohibited the use of promissory notes where the expected method of repayment was the resale of the securities via the Rule 904 resale safe harbor.\textsuperscript{113} Rule 905, in conjunction with Rule 144, tolls the one-year holding period unless the promissory note provides for full recourse against the purchaser of the securities and is secured by collateral, other than the securities purchased, having a fair market value at least equal to the purchase price of the securities.\textsuperscript{114} In addition, after the expiration of the one-year holding period, the promissory note must be paid in full before the Rule 144 restricted securities may be resold.\textsuperscript{115} This “ensures that the funds obtained through the Rule 144 resale” into the U.S. markets “will not be used to pay off the promissory note.”\textsuperscript{116}

\textbf{D. Post-Amendment Abuses of Regulation S}

The amendments appear to have deterred the abuses prevalent under the original Regulation S.\textsuperscript{117} These amendments have explicitly prohibited illegal resales within the distribution compliance period by deeming the securities restricted under Rule 144. Requiring compliance with Rule 144 automatically imposes the longer one-year waiting period during which time a considerable amount of information about an issuer may emerge. Therefore, foreign investors are unlikely to maintain any informational advantage over domestic investors.\textsuperscript{118} The amendments have also abolished the abuse involving promissory notes in purchasing Regulation S securities by explicitly prohibiting the use of promissory notes for such purpose and by imposing Rule 144 restrictions. Moreover, the use of the resale

\textsuperscript{112} Amending Release, supra note 82, at 9,637.

\textsuperscript{113} Id.

\textsuperscript{114} Id.

\textsuperscript{115} Id.

\textsuperscript{116} Id.

\textsuperscript{117} See Amending Release, supra note 82.

safe harbor to “wash off” restrictions from otherwise restricted securities has been remedied by the application of Rule 144 to the securities.

Nonetheless, through the Regulation S amendments, the SEC has taken two steps forward and one step back. While it has prevented abuses and extended protection to U.S. investors, it has frustrated the raising of capital abroad. Because the amendments have lengthened the distribution compliance period, they have hindered the ability to raise capital through foreign investments, one of the main purposes of Regulation S.119 Essentially, the amendments deter domestic reporting issuers from raising capital under Regulation S because it is more costly due to the expanded resale restrictions created by the amendments.120 This is because restricted shares normally must be sold at a discount relative to the price of shares that are freely tradable in the public markets.121 The size of that price discount reflects, at least in part, the compensation buyers receive for giving up the ability to readily resell the shares immediately in the public market.122 Thus, the size of the price discount has enlarged with the increase in time the shares must be held before they can be sold in the U.S. markets.123

Under the American-type regulatory framework, the SEC as the central regulatory body, has clearly been effective in regulating securities and protecting investors. As the amendments to Regulation S prove, the comprehensive securities laws of the U.S. provide a flexible means through which the SEC can adequately regulate and enforce. While the U.S. method is successful, it is unclear whether it is as effective as it could be. In order to determine if the U.S. system can be improved, it is important to consider the securities regulatory systems of other countries.

IV. THE UNITED KINGDOM’S REGULATION OF EXTRATERRITORIAL SECURITIES TRANSACTIONS

U.K. regulators work within the English-type regulatory framework, which emphasizes listing requirements and self-
regulation of securities participants. The U.K. Financial Services Authority (formerly the Securities and Investments Board) is the single direct statutory “super-regulator” responsible for making rules, regulations, and codes that govern the entire financial services industry. While the Financial Services Authority (“FSA”) relies heavily on self-regulation, it maintains power to review the particular rules of self-regulating organizations to ensure they are operating within the statutory framework and may impose individual mandatory rules on any self-regulating organization.


127. Fishman, supra note 126, at 293. The Secretary of State of the Department of Trade and Industry has power to regulate investments and securities. The Department of Trade and Industry delegated this power to the Financial Services Authority, which is considered a private agency. Financial Services Act 1986, ch. 60, § 114.
The Financial Services Act 1986\textsuperscript{128} and the Financial Services and Markets Act 2000\textsuperscript{129} (collectively the “Financial Services Acts”) govern investments and securities in the U.K.\textsuperscript{130} The Financial Services Acts are a comprehensive regime of investor protection\textsuperscript{131} intended to curb abuses and build public confidence in the financial services industry by providing more governmental oversight.\textsuperscript{132} They affect a much larger area than mere securities offering and trading, covering various types of investors, investments, and investment firms, as well as encompassing the general company law and banking provisions that embrace the entire range of the FSA, including banking, insurance, accounting, lawyering, and investing.\textsuperscript{133}

In adopting the Financial Services Acts, the U.K. authorities’ concern was mainly limited to the possibility that firms would go offshore as a result of complex and restricting regulations and transact their operations in the U.K. from a foreign office.\textsuperscript{134} The Financial Services Acts addressed this issue by requiring all self-regulating firms “within the U.K.” to be officially authorized.\textsuperscript{135} This authorization subjects the firm to regulation by the

\textsuperscript{128} Financial Services Act 1986, ch. 60 (repealed and replaced by Financial Services and Markets Act 2000), \textit{reprinted in} NORMAN S. POSER, \textsc{international Securities Regulation: London’s “Big Bang” and the European Securities Markets} app. (1990).


\textsuperscript{130} While the Financial Services and Markets Act 2000 replaced the Financial Services Act 1986, they are both important in the analysis regarding the purposes and methods of securities regulation in the U.K.

\textsuperscript{131} Financial Services and Markets Act 2000, ch. 8, §§ 5. \textit{See also} J.H. DALHUISEN, \textsc{the new U.K. securities legislation and the E.C. 1992 Program 1} (1989); ALCOCK, \textit{supra} note 129, at 54.

\textsuperscript{132} Financial Services and Markets Act 2000, ch. 8, §§ 3 and 6. \textit{See also} Creaven, \textit{supra} note 126, at 290.

\textsuperscript{133} DALHUISEN, \textit{supra} note 131, at 1; ALCOCK, \textit{supra} note 129, at 51–54.

\textsuperscript{134} DALHUISEN, \textit{supra} note 131, at 111. Of course, the U.K. authority had additional concerns, but they are beyond the scope of this note.

\textsuperscript{135} \textit{Id.} at 2–3; Financial Services Act 1986, ch. 60, sched. 1, Part II, § 13; Financial Services and Markets Act 2000, ch. 8, schd. 2, Parts I and II. Acting without authorization to engage in investment transactions leads to unen-
FSA. A firm is “within the U.K.” if it has its head office, or the office handling the issuance of securities, within the territory of the U.K.\textsuperscript{136} Thus, the FSA regulates all authorized firms, even offshore firms with their head offices outside the U.K. if any of the branch offices within the U.K. are issuing or selling securities.\textsuperscript{137} This leads to regulatory duplication since the foreign country in which the head office is located will also likely regulate the firm and indirectly that firm’s U.K. branch office.\textsuperscript{138}

The FSA has discretion to determine which, if any, U.K. regulations apply to the firm that is subject to dual regulation.\textsuperscript{139} The U.K. regulates offshore transactions by dealing directly with the issuer rather than also focusing on the transaction as in Regulation S.\textsuperscript{140} Unlike the SEC, the FSA does not consider where the securities “come to rest;” it only considers the location of the initial purchaser rather than the ultimate purchaser and imposes no mandatory holding period on the securities.\textsuperscript{141}

The FSA is more flexible than the SEC since it allows a foreign issuer to act through a domestic broker and still escape the authorization regulations, provided that the firm’s clients are not in the U.K.\textsuperscript{142} While this is an exception not allowed by the SEC, the underlying rationale of both the FSA and SEC is the same: foreign investors who transact with foreign issuers do not benefit from domestic investor protections.\textsuperscript{143} In this way and like the SEC, the FSA does not apply its regulatory restrictions to offshore offers to non-U.K. clients.\textsuperscript{144}

The U.S. and U.K. extraterritorial securities regulation regimes only differ slightly since both countries utilize a territorial approach. Nonetheless, the U.K. approach is easier to apply because it only emphasizes the location of the issuer, rather

\textsuperscript{136} Financial Services and Markets Act 2000, ch. 8, § 418.
\textsuperscript{137} \textit{Alcock}, supra note 129, at 55–56. The FSA may also develop further rules that regulate extraterritorial investments if that investment business is contrary to the U.K.’s international obligations. Financial Services Act 1986, ch. 60, § 48; Dalhuisen, supra note 131, at 111.
\textsuperscript{138} \textit{Alcock}, supra note 129, at 55–56.
\textsuperscript{139} \textit{Id.}
\textsuperscript{140} \textit{Id.} at 113.
\textsuperscript{141} See Financial Services and Markets Act 2000, ch. 8.
\textsuperscript{142} Dalhuisen, supra note 131, at 111.
\textsuperscript{143} Release 4708, supra note 10.
\textsuperscript{144} Dalhuisen, supra note 131, at 111.
than also considering the ultimate destination of the securities. The simpler system, however, is not always better. First, the U.K. system does not impose any restrictions on resales with the result that regulations can be easily circumvented and abused, much like the original Regulation S. As the original abuses of Regulation S proved, domestic investors are not protected when unregulated securities are sold back into the domestic market shortly after their exempt initial offering. On the other hand, Regulation S offerings are generally offered at a large discount because they involve restricted securities and such restricted securities can be resold only abroad. Under Regulation S, this discount only benefits foreign investors.

Second, at the same time that the U.K. approach does not protect its domestic investors, it also extends the extraterritorial reach of its securities laws too broadly and often infringes another country's securities regulation by regulating issuers outside the U.K. For example, if a U.S. issuer has a branch office in the U.K., it will be subject to U.K. regulations even if that issuer is only offering securities to investors located in the U.S. Because the U.S. issuer is offering to investors in the U.S., it is subject to SEC rules and regulations, e.g. registration. There is thus no need for the additional U.K. regulation of this type of extraterritorial transaction. Yet, the U.K. approach provides regulation.

In addition to the SEC’s effective territorial approach, the SEC regulatory scheme is more effective and enforceable because of its centralized regulatory body. This centralization provides easier application and enforceability than the U.K.’s heavy dependence on self-regulating organizations fulfilling their duty to report to the FSA. Moreover, there are the many disadvantages inherent in self-regulation, e.g. conflicts of interest, limited legal powers, lack of adequate public accountability, problems of jurisdiction in an increasingly global market, “old boy” network influences, and the need for a public agency element in the regulatory response to international securities

145. See notes 75–81, supra, and accompanying text.
146. For a thorough discussion regarding various reasons that neither price discounts nor restricted resales adversely affects U.S. investors, see Choi, supra note 118, at 678.
fraud. \footnote{George P. Gilligan, Regulating the Financial Services Sector 94 (1999).} Given these disadvantages, the U.S. territorial approach, implemented through a centralized regulatory body, is the more effective system as the SEC appropriately focuses on the whole transaction, considering the location of the buyer and securities, rather than focusing solely on the issuer’s location.

V. CHINESE REGULATION OF FOREIGN SECURITIES TRANSACTIONS

Once the home of the largest stock market in Asia, China’s Communist party eliminated securities market activities in 1949 when it implemented its highly planned economy. \footnote{Financial Regulation in the Greater China Area, supra note 124, at 103.} However, with economic reforms initiated in 1979, the Chinese government changed its approach by sanctioning and actively nurturing a controlled securities market in order to facilitate the mobilization of capital. \footnote{Id.} Because shares were associated with capitalism, however, they remained a sensitive topic subject to both political and economic debate. \footnote{Id.} Despite this debate, some enterprises, driven by a dire need for capital, issued shares to employees and state-owned enterprises, and soon found that share issuance was a convenient and effective way of raising much needed capital. \footnote{Id.} Thus, the securities markets were reborn in China.

China’s primary objective in securities regulation is to expand its capital markets and to control its companies, regardless of their geographical location, rather than to protect its investors. Issuance of shares in China operates within a combination framework based on numerous laws, regulations, and rules, including the Company Law of the People’s Republic of China of 1994, \footnote{Zhonghua Renmin Gongheguo Gongsi Fa [Company Law of the People’s Republic of China], translated in Legislative Affairs Comm’n of the Standing Comm. of the Nat’l People’s Congress of the People’s Republic of China, the Laws of the People’s Republic of China 1993, at 269–318 (1995) [hereinafter Company Law], reprinted in Materials on Corpo-
Share issuance is also controlled by a series of guidelines published by the China Securities and Regulatory Commission (“CSRC”), the regulatory body created by the State Council Securities Commission. The CSRC is responsible for drafting and enforcing securities-related legislation, as well as approving issuances of all shares to the public, both domestic and foreign.

The Company Law of the People’s Republic of China (“Company Law”) was formally adopted on December 29, 1993. In order to facilitate investment by foreigners and overseas investors in Chinese companies, the Company Law created a structure through which Chinese issuers are able to attract foreign capital. Companies may offer shares to overseas investors by listing on foreign stock exchanges if they satisfy all the regulations applicable to domestic issuances and obtain approval from both the CSRC and the State Commission for Restructuring the Economic System. Special regulations govern foreign issuances and are the only manner through which Chinese companies can issue shares to foreign shareholders. To facilitate China’s control over Chinese companies’ offerings even in a foreign market, a Chinese company may list shares issued to foreigners only on an exchange in a foreign country that has en...
tered into a Memorandum of Understanding with China in relation to joint supervision of the listing and issuing of shares.160 The CSRC focuses on maintaining control of its companies and markets and finds unacceptable the notion that a foreign exchange could regulate Chinese companies when they are listed on that foreign exchange.161 Accordingly, there is no equivalent to Regulation S that relaxes the regulatory requirements for foreign issued shares.162

The CSRC reaches further and regulates extraterritorially based on the nature of the shares and the nationality of the purchaser, rather than focusing on the geographical location of the transaction.163 Shares in China are generally grouped into categories solely for the ideological purpose of maintaining the leading role of government in the economy by compelling state and public organizations to hold the majority of shares.164 Each category has specific listing and offering restrictions as well as restrictions regarding the residence of the purchasers.165 Residency is determined by race; thus Chinese nationals residing overseas temporarily are considered residents of China for investment purposes.166

There are four categories of shares: A, B, H, and N. “A” shares include state shares, enterprise shares, employee shares, and public shares.167 They can only be subscribed for, traded in, and purchased by Chinese residents, who are not permitted to invest in foreign stocks.168 “B” shares are issued only to foreign investors and may not be purchased by Chinese residents.169 There are also “N” shares and “H” shares, both of which can be

160. Id. At present, these are Hong Kong, the U.S., Singapore, and the London Stock Exchange.
161. Id. at 84–85.
162. Id.
163. Id.
165. Tokley, supra note 155, at 84–85.
166. Id. at 82.
167. Financial Regulation in the Greater China Area, supra note 124, at 103.
168. Tokley, supra note 155, at 71.
169. Id.
purchased by foreign investors. The “N” shares are issued by Chinese enterprises and listed on U.S. stock exchanges; they are issued only to non-Chinese residents. “H” shares are issued by mainland Chinese enterprises and listed in Hong Kong. Cross-trading between the different share classes is not allowed. This share structure enables the Chinese government, wary of allowing foreign companies access to its domestic securities markets, to limit foreign investment and control its economy.

The Chinese regulatory system contradicts the SEC's stated intent not to regulate wholly extraterritorial securities transactions. While China is better able to control its companies because it has a tighter hold on its issuers, those issuers are also less able to raise foreign capital. Because China’s control may hurt its companies rather than facilitate economic success, it may in the future relax its regulation of completely foreign transactions and merge its separate domestic and foreign investments to facilitate company growth. Merging its separate shares – namely class “A” and “B” shares – would allow foreign investors immediate participation in China’s securities market and remove the hindrance created by the present segmentation of the market. While it may also be argued that due to the imperfections still within the Chinese markets a separate special share is necessary to facilitate the healthy growth of China’s securities markets, China should consider a gradual approach to merger of domestic and foreign shares. Then, when China has adequate and extensive securities laws, developed regulatory bodies, and strong and easily convertible Chinese currency, the shares can be easily merged.

171. Tokley, supra note 155, at 72.
172. Financial Regulation in the Greater China Area, supra note 124, at 104.
173. See Friedman, supra note 164, at 496.
174. See notes 28–41, supra, and accompanying text.
175. Tokley, supra note 155, at 80.
176. Financial Regulation in the Greater China Area, supra note 124, at 108.
177. Id.
178. Id.
179. Id.
If China seeks to experience continued economic growth, then it will likely be forced to open its market to greater privatization and less government interference. This will foster an economic structure in which the private sector, not the state, owns a majority interest in the nation’s enterprises.\textsuperscript{180} It will, however, require the CSRC to relinquish some of its tightly-held control over Chinese companies in order to promote foreign investment. China’s economy and markets could profit from a system more akin to the U.S. regulatory system where the benefits of regulation are furthered by a flexibility that can accommodate dynamic changes in the capital markets.\textsuperscript{181} Like Regulation S, this would enable issuers to raise capital abroad, exerting a positive influence over the domestic market.\textsuperscript{182} The Chinese regulatory scheme, however, thwarts this by dividing shares into separate domestic and foreign classes, thus bifurcating the market system and inhibiting foreign investment. If the Chinese government continues to pursue a policy of government interference, its securities markets may ultimately fail.\textsuperscript{183}

VI. CONCLUSION

Of the three securities regulatory systems this Note has analyzed, none is perfect. As long as there are regulations, there will be abuses and room for improvements. However, as compared to the British and Chinese systems of securities regulation, the U.S. system is best at balancing investor protection with the ability to raise capital. While it is more difficult after the Regulation S amendments to raise capital abroad, it is also more difficult to abuse the regulation. The SEC has thus struck a fine balance of regulation and freedom through its territorial approach and its improved Regulation S. This combination of regulatory scheme and regulation allows companies to prosper by raising foreign capital while providing adequate protection to the investor. China and the U.K. have, thus far, been unable to achieve this delicate balance.\textsuperscript{184}

\textsuperscript{180} For a thorough discussion, see Friedman, supra note 164, at 479–80.
\textsuperscript{181} See Integration of Abandoned Offerings, Securities Act Release No. 7943, 74 SEC Docket 571 (Jan. 26, 2001)
\textsuperscript{182} Choi, supra note 118, at 678.
\textsuperscript{183} See Friedman, supra note 164, at 480.
\textsuperscript{184} Of course, it may be argued, especially as to China, that they do not wish to strike such a balance.
Moreover, the U.S. territorial approach, as compared to the U.K. modified territorial approach, increases the SEC’s ability to effectively regulate the securities industry. The SEC’s focus on the offshore transaction itself in addition to the place of both the buyer and the seller is a more thorough regulatory scheme; and because the SEC operates within a centralized system, rather than a decentralized system heavily dependent upon self-regulation, like the U.K., it is better able to apply and enforce its regulatory scheme. Effective enforcement is the bedrock of investor protection. In this respect as well, the U.S. has been more successful than its international counterparts.

Nonetheless, the U.S. approach to extraterritorial regulation could be improved by modifying Regulation S to reflect some of the advantages of both the British and Chinese systems. For example, the Regulation S exemptions could be based in part on the geographic location of the offering similar to the way China regulates based in part on cooperation from the foreign country wherein the offering is made. This modification would also borrow from the U.K. system wherein it is left to the discretion of the regulatory body to determine if, and how extensively, an issuer offering abroad is subject to domestic regulation. This modification would advance the SEC’s goal to protect investors in U.S. markets by ensuring that inherently risky securities are not quickly sold back into the U.S. At present, the SEC achieves this goal by subjecting securities to U.S. registration requirements. This risk, however, would also be reduced just as effectively by ensuring that the country in which the offshore offering is made is adequately regulating securities offerings. Modifying Regulation S to consider the market in which the offshore offering is being made reduces the need for restricting resales. By removing the resale restrictions, the SEC would be eliminating the potential detriment to domestic investors due to the reduced price of the securities which can only be bought and sold abroad.

Such modifications to Regulation S would also promote international cooperation among securities regulators. This would act to strengthen the securities regimes of all countries as applied to their own issuers and would provide greater 185. FISHMAN, supra note 126, at 227. 186. China has memoranda of understanding with many foreign securities exchanges. See note 160, supra, and accompanying text. 187. Choi, supra note 118, at 743.
plied to their own issuers and would provide greater investor protection worldwide.188 Through this information exchange, regulators could also assist each other in collecting information on fraudulent activities and on better enforcement of securities regulations as a whole.189 A system of international securities cooperation would even promote seemingly adverse regulatory goals. For example, such cooperation would provide China with greater control over its own companies issuing abroad while at the same time promoting capitalistic markets. Not only would U.S. investors benefit from such a modification to Regulation S, but investors worldwide would experience increased protections. In time, such a regulatory scheme could become the most useful tool in today's global economy.

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