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WILL CONVERGENCE OF FINANCIAL DISCLOSURE STANDARDS CHANGE SEC REGULATION OF FOREIGN ISSUERS?

*By Roberta S. Karmel**

I. INTRODUCTION

The challenges of globalization, competition and the Internet are shaking the foundations of U.S. regulatory policy toward foreign issuers. Traditionally, the Securities and Exchange Commission (SEC) has taken the position that foreign issuers wishing to access the U.S. capital markets should comply with the disclosure regime applicable to U.S. issuers, but has acceded to practical and jurisdictional problems, and has adopted a modified national treatment standard, including exemptions crafted for foreign issuers. In more recent years, however, the SEC has become a player in international harmonization initiatives and has begun to adapt its standards for foreign issuers to a regime of harmonization, continuing generally to eschew mutual recognition. The pace of this change has been slow, but globalization has not waited for regulatory recognition. Further, the SEC approach of combining modified national treatment with some harmonization, some mutual recognition and some exemptions may be pragmatic, but it makes continued insistence on national treatment as a doctrinal principle problematic.

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The number of issuers and investors involved in international activities has increased significantly over the past decade.[1] A growing number of companies raise capital or list their shares on foreign exchanges. From 1985 to the middle of 1996, the number of foreign reporting companies listed on U.S. securities exchanges grew from 189 to 808, and by mid-1996, the London Stock Exchange had 518 listings of foreign companies.[2] By the end of 1999, there were 1,200 foreign companies reporting to the SEC under the Securities Exchange Act of 1934 (Exchange Act).[3] By the end of 1999, there were 394 foreign issuers listed on the New York Stock Exchange, Inc. (NYSE), 429 foreign issuers listed on the Nasdaq Stock Market, Inc. (Nasdaq) and 449 foreign issuers listed on the London Stock Exchange.[4] In addition, many U.S. investors purchase foreign securities in foreign markets and these securities are not registered with the SEC under the Exchange Act. Cross-border merger and acquisition activity also has increased. For example, the number of cross-border mergers and acquisitions in Europe increased from 1,434 in 1991 to 1,648 in 1997.[5]

Over the past decade, the SEC has taken a leadership role in two important harmonization initiatives designed to facilitate multijurisdictional offerings, including cross-border merger and acquisition activity. These are the single disclosure document standards of the International Organization of Securities Commissions (IOSCO) and the international accounting standards (IAS) project of the International Accounting Standards

1. *See* Uri Geiger, *The Case for the Harmonization of Securities Disclosure Rules in the Global Market*, 1997 COLUM. BUS. L. REV. 241, 248 (1997).

2. *Id.*

3. International Accounting Standards Concept Release, Securities Act Release No. 7801, 65 Fed. Reg. 8896, 8899 (Feb. 23, 2000) [hereinafter IAS Concept Release].

4. *See* Market Information Quick Facts at the NYSE's website, *at* http://www.nyse.com/marketinfo.html (last visited Oct. 15, 2000); the list of Nasdaq international companies, *at* http://www.nasdaq.com/about/nonUSoutput_A0.stm (last visited Oct. 15, 2000); and Secondary Market Fact Sheet for the London Stock Exchange, *at* http://www.londonstockexchange.com/stats/stats.asp. Europe outpaced the United States in the total value of mergers and acquisitions transactions as of the end of the third quarter of 1999, accounting for $369.2 billion in 2,470 transactions as compared to $315.5 billion in 2,470 transactions. *Europe Outpaces U.S. in Mergers*, STRAITS TIMES (London), Oct. 2, 1999, *available in* 1999 WL 8263428.

5. *See* Cross-Border Tender Offers, Business Combinations and Rights Offerings, Securities Act Release No. 7611, 63 Fed. Reg. 69136, 69138 n.23 (Dec. 15, 1998).

Committee (IASC). Both of these projects have recently come to fruition, and the SEC is in the process of adapting its foreign issuer disclosure standards to permit foreign issuers to comply with these international standards instead of the disclosure standards applicable to U.S. issuers. In the meantime, the SEC has fashioned certain exemptions for foreign issuers accessing the U.S. capital markets. In particular, the SEC recently adopted foreign issuer exemptions for cross-border tender and exchange offers.[6]

The U.S. stock exchanges have been among the interest groups long pressuring the SEC to relax its disclosure standards for foreign issuers, on the assumption that once foreign issuers are not required to comply with U.S. requirements, and in particular, reconciliation of financial statements to U.S. Generally Accepted Accounting Principles (U.S. GAAP), many more foreign issuers will list on U.S. exchanges.[7]

Internet trading and competition from foreign stock exchanges may challenge this assumption, however. If the SEC should permit foreign exchanges to place terminals in the offices of broker-dealers in the U.S. and trade the securities of any issuer that conforms to SEC disclosure requirements (including the new international standards), an exchange listing may not be a necessary prerequisite for foreign issuers to access U.S. capital markets.

Alternatively, foreign exchanges may affiliate with U.S. exchanges.[8] Such affiliations only will be meaningful if U.S. exchanges can trade securities listed on foreign exchanges when such foreign exchanges are closed, including securities of issuers not reporting in U.S. GAAP, but in IAS. But U.S. securities exchanges have followed the SEC's lead in fashioning a regime of modified national treatment for foreign issues listings. Mov-

6. *See* Cross-Border Tender and Exchange Offers, Business Combinations and Rights Offerings, Securities Act Release No. 7759, 64 Fed. Reg. 61382 (Nov. 10, 1999) [hereinafter Cross-Border Adopting Release].

7. *See* Richard A. Grasso, Chairman & CEO, NYSE, *Equity Market Globalization: A View From 11 Wall Street*, Jan. 13, 1997, *at* http://www.nyse.com/search/search.html (last visited Oct. 15, 2000) (reconciliation with GAAP keeps international companies from entering the U.S. marketplace); James L. Cochrane, *Are U.S. Regulatory Requirements for Foreign Firms Appropriate,?* 17 FORDHAM INT'L L.J. S58, S61 (1994) (chief economist of the NYSE states burdensome SEC regulation prevents foreign companies from listing on U.S. exchanges).

8. *See The Battle for Efficient Markets*, ECONOMIST, June 17, 2000, at 69.

ing to a regime of mutual recognition in order to fully implement international exchange alliances would require harmonization of exchange listing standards.

This article will outline SEC disclosure requirements for foreign issuers, explain the relationship between SEC disclosure requirements and listing standards, and then outline NYSE, NASDAQ and American Stock Exchange, Inc. (AMEX) listing standards applicable to foreign issues. Then, the article will set forth some of the exemptions available to foreign issuers in multinational offerings, particularly in merger and acquisitions transactions. Finally, the article will raise questions about the importance of stock exchange listings for foreign issuers in the future.

The article will suggest that while harmonization may be displacing national treatment as the doctrinal underpinning for SEC regulation of foreign issuers, changes in regulatory policy are lagging behind market place developments. Further, much of the regulation of foreign issuer disclosure has been developed in response to external pressures and when the SEC is unable to reconcile foreign issuer regulation with its regulation of national issuers, it tends to fashion special exemption rules. The author will recommend that the SEC continue to harmonize international financial disclosure standards so that limited mutual recognition can be employed to foster global integration of the capital markets.

II. FOREIGN ISSUER DISCLOSURE REQUIREMENTS

A. *Historical Regime*

The federal securities laws establish mandatory disclosure of the business and financial affairs of public companies. The SEC has developed rules and regulations for disclosure pursuant to the Securities Act of 1933 (Securities Act) and the Exchange Act. The Securities Act covers initial distributions of securities and requires that securities issuances be registered with the SEC prior to sale or that an appropriate exemption from registration exists.[9] The Exchange Act regulates post-

9. *See* 15 U.S.C. § 77e (1999).

distribution trading in securities and requires publicly traded companies to file annual and periodic reports with the SEC, including audited annual financial statements.[10] The Exchange Act also regulates proxy solicitations[11] and the conduct and disclosure of tender offers for shares of public companies.[12] Foreign issuers, however, are exempted from SEC proxy solicitation regulations and certain other Exchange Act requirements even if their securities are registered with the SEC.[13]

The federal securities laws apply to issuers that offer, sell or trade securities between the United States and any foreign country.[14] The jurisdictional reach of these laws is very broad. The SEC could potentially impose its disclosure obligations on any foreign company that sells shares to U.S. nationals.[15] Similarly, the SEC could require any foreign issuer with more than 500 shareholders worldwide, of which 300 are U.S. investors, and which has $10 million in assets to register its equity securities pursuant to the Exchange Act.[16] But the SEC has refrained from exercising its powers this expansively.

The SEC generally requires foreign issuers that publicly raise capital or list their shares on a U.S. securities exchange or Nasdaq to comply with the registration requirements of the securities laws. Pursuant to Regulation S under the Securities Act, however, the SEC permits foreign issuers to sell securities abroad to U.S. investors.[17] A foreign issuer may also make a

10. *See* 15 U.S.C. § 78m (1999).

11. *See* 15 U.S.C. § 78n (1999).

12. *See* 15 U.S.C. §§ 78m(e), n(d) (1999).

13. Exchange Act Rule 3a12-3 provides an exemption for foreign issuers from the proxy regulations and short-swing insider transaction reporting requirements. *See* 17 C.F.R. § 240.3a12-3 (2000). Some scholars have criticized these exemptions. *See* John C. Coffee, Jr., *The Future as History: The Prospects For Global Convergence in Corporate Governance and its Implications*, 93 NW. U. L. REV. 641, 706-07 (1999); James A. Fanto, *The Absence of Cross-Cultural Communications: SEC Mandatory Disclosure and Foreign Corporate Governance*, 17 NW. J. INT'L L. & BUS. 119 (1996).

14. *See* 15 U.S.C. §§ 77b(7), 78c(17) (1999).

15. *See* Europe and Oversees Commodity Traders, S.A. v. Banque Paribas London, 147 F.3d 118 (2d Cir. 1998), *cert. denied*, 525 U.S. 1139 (1999) (holding that the Securities Act only applies when both the offer and sale are made in the U.S.); Consol. Gold Fields v. Minorco, S.A., 871 F.2d 252, *modified*, 890 F.2d 569 (2d Cir. 1989). *See generally* Roberta S. Karmel, *The Second Circuit's Role in Expanding the SEC's Jurisdiction Abroad*, 65 ST. JOHN'S L. REV. 743 (1991).

16. *See* 15 U.S.C. §78l (1999).

17. *See* 17 C.F.R. §§ 230.901-905 (2000). Initially Regulation S applied to both

U.S. private placement pursuant to the traditional private placement exemption,[18] or to "qualified institutional buyers" (QIBs) under Rule 144A.[19] An exemption from Exchange Act filing requirements is available for foreign issuers that do not trade any securities on a U.S. securities exchange or Nasdaq if the issuer is a "foreign private issuer" that has over 300 U.S. shareholders and agrees to furnish the SEC with copies of material information made public in its home country or sent to foreign securities holders.[20] The SEC recently has narrowed the scope of this exemption by changing the definition of a "foreign private issuer." Previously, the SEC considered only record ownership of an issuer's securities. Now, the SEC "looks through" banks, broker-dealers and other nominee holders of an issuer's securities to determine whether the beneficial owner of securities is a U.S. resident.[21]

Foreign issuers not eligible for a Securities Act or Exchange Act exemption have long been subject to special securities registration and disclosure requirements. These requirements have been a variation of the national treatment regime, relaxing some of the rigors of the registration requirements for the benefit of foreign issuers. This special treatment dates from 1935 when the SEC designed Forms 20 and 20-K as registration and reporting forms for foreign issuers.[22] Form 20-F, adopted by the SEC in 1979, was then a replacement for earlier foreign company forms. It has since served as the combined

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U.S. and foreign issuers, but when abuses by U.S. issuers led to amendments to restrict this exemption, distinctions were drawn between foreign and U.S. issuers. *See* Securities Act Release No. 7505, 63 Fed. Reg. 9632 (Apr. 27, 1998).

18. *See* 15 U.S.C. § 77d(2) (1999).

19. 17 C.F.R. § 230.144A (2000).

20. 17 C.F.R. § 240.12g3-2(b) (2000).

21. A foreign private issuer includes any foreign company incorporated under the laws of a non-U.S. jurisdiction unless (i) more than 50 percent of its shares are directly or indirectly owned of record by U.S. residents and (ii) the majority of its directors or executive officers are U.S. residents or citizens, its business is principally administered in the U.S., or more than 50 percent of its assets are located in the U.S. 17 C.F.R. § 230.405, 17 C.F.R. § 240.3b-4 (2000). All shares deposited in an American Depositary Receipt (ADR) facility will be presumed held by U.S. residents unless information provided by the depositary demonstrates otherwise. International Disclosure Standards, Securities Act Release No. 7745, 64 Fed. Reg. 53900, 53905 (Oct. 5, 1999) [hereinafter IDS Adopting Release].

22. *See* Exchange Act Release No. 445 (Class A) (Dec. 20, 1935). For a history of these forms *see* Roberta S. Karmel & Mary S. Head, *Barriers to Foreign Issuer Entry into U.S. Markets*, 24 LAW & POL'Y INT'L BUS. 1207, 1210-14 (1993).

Exchange Act registration and annual reporting form authorized for use by foreign issuers, and the core document of the SEC's integrated disclosure system for foreign issuers, whereby Exchange Act documents can be incorporated by reference in Securities Act registration statements.[23] In October 1999, the SEC amended the foreign issuer disclosure forms to substantially replace the non-financial disclosure requirements in Form 20-F with disclosure standards endorsed by IOSCO.[24] Further, the SEC may in the future permit foreign issuers to reconcile their financial statement disclosures to IAS instead of U.S. GAAP. These are significant developments not only in terms of practical compliance by foreign issuers with U.S. requirements, but also in terms of SEC doctrine and theory. The SEC finally has recognized that it cannot compel all issuers to conform to U.S. disclosure requirements, but rather, that it can best protect U.S. investors by taking a lead in developing and enforcing acceptable international disclosure standards.

B. Amended Disclosure Standards

IOSCO's non-financial disclosure standards took a decade to develop. IOSCO is a non-profit association of securities regulatory organizations with approximately 135 members.[25] IOSCO actions are not binding on members and must be implemented by national laws. When the SEC implements an IOSCO standard through a new regulation, or determines that existing regulation conforms to an IOSCO standard, it gives credibility to the work of IOSCO and helps to implement IOSCO's policies. Although IOSCO is a truly international organization, it operates through committees that differentiate between the needs of mature and emerging markets. IOSCO's Technical Committee is composed of 16 regulatory agencies, including the SEC, that regulate the world's largest, most de-

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23. *See* Short Form Registration for Rights Offerings, Exchange Act Release No. 16371, 44 Fed. Reg. 70132 (Nov. 29, 1979). The SEC also promulgated Forms F-1, F-2 and F-3 as special foreign issuer disclosure forms under the Securities Act. Adoption of Foreign Issuer Integrated Disclosure System, Securities Act Release No. 6437, 47 Fed. Reg. 54764 (Dec. 6, 1982).

24. *See* IDS Adopting Release, *supra* note 21, at 53903.

25. *See* SEC, REPORT ON PROMOTING GLOBAL PREEMINENCE OF AMERICAN SECURITIES MARKETS 7, *at* http://www.sec.gov/news/studies/acctg.sp.htm (last visited Oct. 15, 2000) [hereinafter PROMOTING GLOBAL PREEMINENCE].

veloped and most globalized markets. Working Party No. 1 on Multinational Disclosure and Accounting is a working group that reports to the Technical Committee.[26]

In 1989, Working Party No. 1 published a report that described the broad characteristics of international equity offers and related regulatory problems. It found that differences in legal structure, market development, national goals other than investor protection, and even cultural differences, resulted in differing offering procedures, regulatory requirements and timing.[27] The Working Party expressed the view that these variations caused significant practical problems and undermined the efficiency of capital raising in a global market. Its report recommended that regulators be encouraged, where consistent with their legal mandate and the goal of investor protection, to facilitate the use of a single disclosure document, whether by harmonization, reciprocity or otherwise.[28] The next year IOSCO endorsed the development or recognition of standards that would facilitate the evolution of a single-disclosure document for cross-border offerings and listings.[29] Members of the Technical Committee then compared their existing national disclosure requirements to identify areas of commonality and worked to develop a consensus on high quality disclosure standards. Following a formal consultative document, in September 1998 IOSCO endorsed the Technical Committee's "Disclosure Standards to Facilitate Cross-Border Offerings and Listings by Multinational Issuers" and recommended that IOSCO members take steps in their home jurisdictions to accept documents in accordance with the standards.[30]

In adopting IOSCO's disclosure standards for foreign private issuers, the SEC significantly changed the form of the disclosures required by annual reports on Form 20-F and registration statements on Forms F-1 though F-4. The SEC nevertheless claimed that most of the revised disclosure requirements closely correspond to previous disclosure requirements.[31] In at least one respect the new SEC forms go beyond

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26. *See id.*
27. *See id.*
28. *See* IOSCO, COMPARATIVE ANALYSIS OF DISCLOSURE REGIMES 1 (Sept. 1991).
29. PROMOTING GLOBAL PREEMINENCE, *supra* note 25, at 5.
30. IDS Adopting Release, *supra* note 21, at 8707.
31. *See id.* at 53908.

the IOSCO standards in that they contain instructions which follow each item. Some other changes which may be viewed as an added burden on foreign issuers are set forth below. First, information about major shareholders has been reduced from 10% to 5% shareholders of any class of voting securities.[32] Second, additional information is required concerning the nature of the trading market for the issuer's securities, including new information about preemptive issues and trading suspensions or any lack of liquidity for the issuer's securities.[33] Third, additional and more detailed information is required about the compensation of directors and officers, and the interest of management in certain transactions.[34]

Another way in which the new forms are more rigorous than prior requirements relates to the permitted age of financial statements. Under the amendments, issuers can no longer file audited financial statements reported on Form 20-F that are older than 15 months at the "time of the offering," which means the effective date of the registration statement. This contrasts with repealed Rule 3-19 of Regulation S-X, which permitted the SEC to declare a registration statement effective with audited financial statements as old as 18 months.[35] Also, the audited financial statements in a foreign issuer initial public offering (IPO) no longer can be older than 12 months at the time the offering is filed. This stricter rule does not apply to a foreign issuer that is offering securities for the first time in the United States, but is already a public company in its home country. If the age of the registration statement is more than nine months after the end of the foreign issuer's last fiscal year, the registration statement must include interim financial statements (including information required by U.S. GAAP) covering at least the first six months of the issuer's fiscal year. The interim reports may be unaudited.[36]

In discussing any new burdens imposed upon foreign issuers by its new forms, the SEC justified the changes by pointing

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32. *See id.* at 53904. This puts the required disclosure in line with Item 403 of Regulation S-K. If the issuer's home country requires disclosure at an even lower percentage of ownership, the foreign issuer must disclose such ownership.

33. *See id.* at 53920.

34. *See id.* at 53917.

35. *See* IDS Adopting Release, *supra* note 21, at 53902.

36. *See id.* at 53918-19. Interim financial statements could be as old as 10 months under the prior rule 3-19 of Regulation S-X.

out that some of the new disclosure requirements are not triggered unless the Form 20-F filer has a similar disclosure obligation under foreign law. Moreover, according to the SEC, some foreign private issuers already disclose voluntarily the information that is required by the amendments.[37] Some commenters, concerned about these burdens and the uncertainties inherent in complying with new disclosure requirements, urged the SEC to evaluate the extent to which other jurisdictions would accept IOSCO's disclosure standards before revising U.S. regulations, and make the new disclosure standards available as an optional, alternative disclosure system. The SEC rejected these suggestions in order to demonstrate strong support for high quality international standards by moving quickly, and thus encouraging other jurisdictions to follow suit. Moreover, according to the SEC, some of the more developed capital markets, including the London Stock Exchange, had agreed to accept, or were planning to accept, disclosure documents prepared in accordance with international standards. Also, other jurisdictions, including Argentina, Italy and Mexico, had adopted the standards for domestic purposes.[38]

C. Accounting Standards

The new SEC international disclosure standards do not affect SEC prescribed accounting disclosure. However, the SEC has issued a concept release requesting comments to determine under what conditions it should accept financial statements of foreign private issuers that are prepared using IASC standards.[39] Although this is a significant step forward in the direction of SEC recognition of international accounting standards, it does not appear that the SEC is prepared to accept financial statements prepared in accordance with IASC standards for filed documents any time in the near future.

Before describing the SEC approach, three important doctrinal points should be noted. First, the SEC continues to reject a mutual recognition approach, with the exception of its multijurisdictional disclosure system with Canada.[40] Second,

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37. *See id.* at 53908.
38. *See id.* at 53902.
39. *See* IAS Concept Release, *supra* note 3, at 8896.
40. *Id.* at 8896 n.38. *See also* Multijurisdictional Disclosure and Modifications

the SEC does not intend to adopt a process-oriented approach to IASC standards, recognizing them as "authoritative."[41] Rather, it intends to continue a product-oriented approach, assessing each IASC standard after its completion. This is a slow and cumbersome procedure that is unlikely to satisfy those issuers disinclined to reconcile their financial statements to U.S. GAAP and who are pushing the SEC to recognize international accounting standards. Third, the SEC will continue to insist on U.S. Generally Accepted Auditing Standards, including auditor independence requirements.[42]

Currently, financial statement requirements for foreign private issuers parallel those for U.S. domestic issuers, except that foreign private issuers may prepare financial statements in accordance with either U.S. GAAP or another body of standards (including IAS), and then reconcile their financial statements to U.S. GAAP.[43] However, there are a few exceptions to this reconciliation requirement. In 1992 and 1993, the SEC approved the use of IASC standards on cash flow statements, business combinations and the effects of changes in foreign exchange rates.[44] The SEC then decided to suspend this approach of recognizing one standard at a time and decided instead to consider all IASC standards as a whole after IASC completed its "core standards work program."

The IASC harmonization project proceeded in tandem with IOSCO's non-financial disclosure standards project over the past decade. Unlike IOSCO, which is an organization of government regulators, the IASC has operated as a private sector body whose membership included all the professional accountancy bodies that are members of the International Federation of Accountants (IAFC). IAFC has more than 140 members from

to the Current Registration and Reporting System for Canadian Issuers, Exchange Act Release No. 29354, 56 Fed. Reg. 30096 (June 13, 1991) [hereinafter Reporting System for Canadian Issuers]. The SEC had proposed to abandon this regime of mutual recognition, indicating a preference for international harmonization over bilateral arrangements. However, protests from Canadian issuers led instead to a renegotiation of the agreement. *See U.S. - Canada Working to Preserve Agreement on Cross-Border Offerings*, 32 Sec. Reg. & L. Rep. (BNA), June 12, 2000, at 769; *Canadians Urge SEC to Reconsider Plan to End Bilateral Prospectus Approval*, 31 Sec. Reg. & L. Rep. (BNA), Oct. 15, 1999, at 1367.

41. IAS Concept Release, *supra* note 3, at 8903 n.33.

42. *See id.* at 8898.

43. *See id.* at 8899.

44. *See id.*

over 100 countries. The IASC had the dual objectives of formulating international accounting standards (and promoting their acceptance and observance), and working generally for the improvement and harmonization of accounting standards.[45] Until recently, the business of the IASC had been conducted by a board of directors with 16 voting delegations, including the United States, and five non-voting observer delegations with the privilege of the floor, including IOSCO.

In 1993, IOSCO wrote the IASC detailing the necessary components of a reasonably complete set of standards to create a comprehensive body of principles for enterprises undertaking cross-border securities offerings. In 1993, the IASC completed a project to improve the comparability and usefulness of financial statements prepared in accordance with its standards. In 1994, IOSCO completed a review of the revised IASC standards and identified a number of issues that would have to be addressed, as well as standards that the IASC would have to improve, before IOSCO could consider recommending IASC standards for use in cross-border listings and offerings. In July 1995, IOSCO and the IASC agreed that the proposed "core standards work program" would, if completed successfully, address all the issues that required resolution before IOSCO would consider endorsement. Further, if the resulting standards were acceptable to IOSCO's Technical Committee, that group would recommend endorsement of the standards for cross-border capital raising and listing documents.[46]

As of March 2000, the core standards in the IASC work program were completed. The IOSCO Working Party and the SEC staff participated in the IASC program but did not evaluate each completed standard. Rather, it was understood between the IASC and IOSCO that the Working Party would assess the completed standards, individually and as a group, once the IASC completed all of the core standards. This assessment of the core standards is now underway. As of May 2000, IOSCO had assessed all thirty core standards in the IASC work program.[47] It recommended to its members that multi-

45. *See id.* at 8907.

46. *See id.* at 8907-08. *See generally* Marc I. Steinberg et al, *The Development of Internationally Acceptable Accounting Standards: A Universal Language for Finance in the 21st Century*, 27 SEC REG. L. J. 324 (1999).

47. *See International Accounting Standards Committee Standards Press Re-*

national issuers use the core standards, "supplemented by reconciliation, disclosure and interpretation where necessary."[48]

The SEC's Concept Release on International Accounting Standards (Concept Release) is a part of this assessment process in that the SEC has requested comments in order to determine under what conditions the SEC should accept financial statements of foreign private issuers that are prepared using IASC standards.[49] In the release, the SEC acknowledged that in April 1996 it indicated that once the IASC completed its core standards project the SEC would consider allowing use of the resulting standards in cross-border filings by foreign issuers offering securities in the United States. Therefore, the SEC requested the views of foreign and domestic issuers, underwriters, broker-dealers, analysts, investors, accountants and attorneys involved in the registration process on whether IASC standards: "(1) Constitute a comprehensive, generally accepted basis of accounting; (2) Are of high quality; and (3) Can be rigorously interpreted and applied."[50] It is apparent from the SEC's Release that the SEC's staff is a long way from being persuaded that the answers to these questions are in the affirmative. Yet, Congress has prodded the SEC to participate in the establishment of a high quality comprehensive set of Generally Accepted International Accounting Standards to facilitate international financing activities and enhance the ability of foreign corporations to access and list in U.S. markets.[51]

The SEC does not seem to be quarreling with the comprehensiveness of the core standards project, except as to specialized industry issues.[52] Other areas seem more troublesome. In the SEC's view, high quality accounting standards are standards that result in relevant, reliable information useful for those who make capital allocation decisions. The SEC noted that it has raised concerns about particular IAS standards.[53] In addition, the SEC is concerned that differences between IAS

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lease, (May 17, 2000), *at* http://www.iosco.org/press/presscomm00517.html.

48. *Id.*

49. *See* IAS Concept Release, *supra* note 3.

50. *Id.* at 8900 n.22.

51. *See id.* at 8900.

52. *See id.* at 8907 n.52. One such industry, notably, is banking.

53. Specifically, IAS 1, 16, 19, 22, 36, 38, and 39. *See id.* at 8901.

and U.S. GAAP might undermine the transparency and comparability provided to U.S. investors under U.S. GAAP.[54] The SEC also questioned whether the IASC standards can be rigorously interpreted and applied. It criticized IASC standards for failing to provide a sufficient level of implementation guidance.[55] In its concept release, the SEC also suggested a need for an improved financial reporting infrastructure.[56] These criticisms were already being addressed by the IASC and resulted in a restructuring of the organization and the adoption of a new constitution for the IASC in May 2000.[57] The main features of the new structure are that IASC is now established as an independent organization with two main bodies, the Trustees and the Board, as well as a Standing Interpretations Committee and Standards Advisory Council.[58] The Trustees appoint the Board Members, exercise oversight and raise the funds needed, whereas the Board has sole responsibility for setting accounting standards.[59] The Chairman of the Nominating Committee established for the purpose of selecting the initial Trustees for the restructured IASC was SEC Chairman Arthur Levitt, Jr.[60] The Chairman of the new body of Trustees is Paul A. Volcker, Former Chairman of the U.S. Federal Reserve Board.[61]

This restructuring addresses the SEC's views about the need for an improved infrastructure for IAS reporting that includes interpretative guidance. However, the SEC also is concerned about the lack of generally accepted international auditing standards, including rigorous independence requirements. This may be the next item on the SEC's agenda for improving international financial reporting.[62] The restructur-

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54. *See* IAS Concept Release, *supra* note 3, at 8901-02.
55. *See id.* at 8902.
56. *See id.*
57. *See* Restructuring IASC, *at* http://www.iasc.org.uk/frame/cen4_6.htm (last visited Oct. 15, 2000).
58. *See id.*
59. *See* Press Release, IASC, Shaping IASC for the Future: IASC Nominating Committee Selects Initial Trustees of Restructured IASC, at 3 (May 22, 2000) (on file with author).
60. *See id.*
61. *See* IASC News, at 2, (June 3, 2000), *at* http://www.iasc.org.uk/news/cen8_096.htm (June 3, 2000).
62. *See* James L. Craig, Jr. et al., *The Best Kept Secret in North America*, CPA J., June 2000, at 21.

ing is designed to integrate the roles of the IASC and those of national standard setters, which is probably essential to obtain further support from the U.S. Financial Accounting Standards Board (FASB).[63]

In its Concept Release, the SEC has set forth four possible approaches to recognition of IASC standards for cross-border offerings and listings.[64] These are: (1) maintaining the current reconciliation requirements in all respects; (2) removing some of the current reconciliation requirements for selected IASC standards, including specifying acceptable treatment when alternatives are permitted by IAS; (3) relying on IASC standards for recognition and measurement principles, but requiring U.S. GAAP and SEC supplemental disclosure requirements for footnote disclosures and the level of detail for line items in financial statements; and (4) accepting financial statements prepared in accordance with IASC standards without any requirement to reconcile to U.S. GAAP.[65] Options one and four seem like non-starters. The SEC has been an important player in the IASC core standards project, and it would be politically unacceptable for the SEC to maintain the current reconciliation regime. It seems equally unlikely from the tone of the Concept Release that the current SEC will accept financial statements prepared in accordance with IASC standards without any reconciliation to U.S. GAAP. The SEC's evaluation of the many strongly worded comments on the Concept Release and a variety of domestic and international political pressures will determine whether the SEC chooses options two or three set forth in the Concept Release. Whatever choice the SEC makes probably will be an interim solution, however.

While many of the comments submitted to the SEC in response to its Concept Release favor international harmonization of accounting standards and support the IASC and SEC recognition of IAS,[66] other commenters oppose SEC recognition of IAS on the grounds that permitting foreign issuers to sell securities to U.S. investors without a GAAP reconciliation

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63. *See* IAS Concept Release, *supra* note 3, at 8903 n.32.

64. *See id.* at 8904.

65. *See id.*

66. *See, e.g.*, Comments of Arthur Anderson, D.C. Potter, Chairman, IAFEI Committee for International Accounting Standards, Professor Trevor S. Harris, Columbia Business School, SEC File No. 57-04-00.

requirement will disadvantage U.S. domestic issuers and U.S. investors.[67] For the time being, IOSCO has given the SEC leeway to continue to require reconciliation of certain items, to require additional narrative disclosure and to specify which alternatives in an IASC standard must be chosen.[68] But IOSCO and the IASC may not continue to have patience with the SEC's slow paced acceptance of international harmonization.

Professor James D. Cox has suggested that the SEC's decision to accept IAS will be political rather than empirical.[69] He urges the SEC to consider, on a pilot basis, permitting world class issuers to file with the SEC on the basis of IAS, but also to permit world class U.S. issuers to report according to IAS rather than U.S. GAAP.[70] However, since it cannot be expected that IAS and U.S. GAAP will be identical, issuers reporting in IAS should, under this proposal, be required to discuss (but not reconcile) the areas of difference between IAS and U.S. GAAP.[71]

The capital markets are globalizing rapidly and technological change is making it easier for investors to ignore national regulatory regimes. Thus far, the SEC has been able to influence the IASC by promising to eventually recognize its standards. Further, foreign investors thus far have been willing to comply with SEC disclosure requirements in order to list on U.S. exchanges. But the IASC could decide it has accommodated enough to the demands of the SEC and foreign issuers could decide they can attract enough U.S. capital without listing on a U.S. exchange. The SEC then could find itself upholding its standards but losing relevance and influence as a regulator in international circles.

67. *See, e.g.*, Comments of Securities Industry Association, Pricewaterhousecoopers, SEC File No. 57-04-00.

68. *See IOSCO Urges Members to Allow Use of IASC Rules With Reconciliation*, 32 SEC Reg. & L. Rep. (BNA), May 22, 2000, at 692.

69. *See* James D. Cox, *Regulatory Duopoly in U.S. Securities Markets*, 99 COLUM. L. REV. 1200, 1245 (1999).

70. *See id.* at 1248.

71. *See id.* at 1250.

III. EXCHANGE LISTING REQUIREMENTS

The primary markets for foreign companies who want to offer equity securities in the United States are the NYSE, Nasdaq, and the AMEX. Each is called a self regulatory organization (SRO) because it individually polices its members with SEC oversight. In addition to meeting SEC registration requirements, issuers must also comply with listing requirements established by the SROs.[72] The SROs have both quantitative (*i.e.*, market size and financial criteria) and qualitative (*i.e.*, corporate governance) standards set out in listing agreements that companies must agree to in order to list their securities. Exchange listing standards are submitted to the SEC for review and approval.[73] It is unclear, however, how much authority the SEC has to impose corporate governance requirements on public companies by changing listing standards.[74]

A. NYSE Listing Requirements

Foreign companies that wish to list on the NYSE must meet either the foreign issuer listing standard or the domestic issuer listing standard.[75] Along with capital distribution requirements, to qualify under the domestic listing standard a company must have at least 2,000 U.S. "round-lot" shareholders (holders with 100 shares); while under the foreign issuer standard, a company must have at least 5,000 round-lot shareholders worldwide. Foreign companies and their investment banks must enter into a letter of understanding with the NYSE that states whether or not the company has orders to purchase from institutional and sophisticated investors totaling 2,000 U.S. round-lot holders. If met, then a foreign company must list under the domestic listing criteria, which generally has less stringent quantitative requirements than the foreign issuer standard.[76]

72. *See* EDWARD F. GREENE et al, I U.S. REGULATION OF THE INTERNATIONAL SECURITIES AND DERIVATIVES MARKETS § 2.03(2) (4th ed. 1998).

73. *See* Exchange Act Rule 19b-4, 17 C.F.R. § 240.19b-4 (2000).

74. *See* Business Roundtable v. SEC, 905 F.2d 405 (D.C. Cir. 1990).

75. *See* NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL, § 103.00 [hereinafter NYSE LISTED COMPANY MANUAL].

76. *See* Telephone Interview with Carlos Urueta, International & Research

Foreign companies can get a waiver from many NYSE corporate governance requirements if an independent counsel licensed in the home country opines that its practices are not prohibited by the laws of the issuer's domicile. This means, in effect, the laws in the home country are silent on the matter or explicitly do not require it.[77] This waiver is available to foreign companies irrespective of whether they list their shares under the domestic or foreign standard. A company must agree to a confidential eligibility review before its application is accepted by the NYSE.[78] The NYSE charges a one-time original fee and continuous fees for shares listed on it. The NYSE imposes both initial listing requirements and continuous listing requirements for its members. A company may be delisted from the exchange if it fails to comply with the continuous listing standards.

1. Foreign and Domestic Issuer Quantitative Standards

Under the foreign standard, a non-U.S. issuer must have a minimum of 5,000 round-lot holders and 2.5 million publicly held shares having at least a $100 million market value. The non-U.S. issuer must also fit into one of three minimum financial standards: (a) have aggregate pre-tax income for last the three years of $100 million together with minimum pre-tax income in each of the two most recent years of $25 million; (b) for companies with market capitalization (worldwide) not less than $500 million and revenues (in most recent 12 months) of $200 million, aggregate cash flow for the last three years of $100 million, together with minimum cash flow of $25 million in each of the two most recent years; or (c) market capitalization of $1 billion (worldwide) and most recent fiscal year revenue of $25 million.[79]

Under the domestic listing standard, an issuer must meet one of two minimum distribution and size criteria: (a) have at least 2,000 U.S. round-lot holders or 2,200 total shareholders, together with an average monthly trading volume for the most recent 12 months of 100,000 shares; or (b) have at least 500

Desk, NYSE (Feb. 7, 2000).

77. *See* NYSE LISTED COMPANY MANUAL, § 103.00.

78. *See id.* at § 104.00.

79. *See id.* at § 103.01.

total shareholders, together with an average trading volume for the most recent 12 months of 1 million shares. Domestic issuers also must have at least 1.1 million public shares outstanding and a market value of publicly held shares of $100 million for public companies or $60 million for IPOs, spin-offs or carve-outs. As for the minimum financial criteria, a domestic issuer must have at least (a) $2.5 million in its latest fiscal year and $2 million in each of the least two years, or (b) $6.5 million total for the last three years, $4.5 million in the last year and all three years must be profitable or, (c) for companies with $500 million or more in market capitalization and $200 million in revenues in the most recent fiscal year, $25 million of adjusted net income aggregated over the last three years and all three years must be profitable.[80]

2. NYSE Qualitative Listing Requirements

It is generally required under NYSE rules that listed companies have: (a) at least two independent directors on its board; (b) an audit committee composed of independent directors; and (c) an appropriate quorum requirement for shareholders meetings, which is generally recommended to be at least a majority of the outstanding common shares.[81] For foreign issuers, these requirements can be waived if the home country laws do not require them.

While domestic companies generally must follow a "one-share, one-vote" policy,[82] this may be waived for foreign issuers if their voting policies are not prohibited by home country laws. The NYSE also requires issuers to provide the shareholders with annual audited financial statements within three months of the close of its fiscal year and at least 15 days before

80. *See id.* at § 102.01.

81. *See id.* at §§ 303.00 and 310.00(A).

82. In 1994, the SEC approved the adoption of a voting rights policy brought to it by the NYSE, Nasdaq and AMEX designed to prohibit the continued listing of companies that disenfranchise common stock shareholders. *See* SROs, AMEX, NASD and NYSE; Order Granting Approval to Rule Changes Relating to the Exchange's and Association's Rules Regarding Shareholder Voting Rights, Exchange Act Release No. 35121 (Dec. 27, 1994). This was the end of a long saga in which the SEC's efforts to articulate a one-share, one-vote standard was vacated by the courts. *See* 905 F.2d at 406.

its annual shareholders' meeting.[83] Issuers must publish quarterly financial statements as soon as they become available.[84] Additionally, the NYSE requires companies to solicit proxies from shareholders before the annual shareholders' meeting.[85] However, once again, foreign issuers may be able to obtain a waiver from these requirements if their home country laws do not require the same or, as for proxy solicitation requirements, if compliance with the rule is impossible or impracticable.

The NYSE does, nonetheless, set certain corporate governance standards that cannot be waived. Such requirements include requiring that companies: (a) maintain an audit committee or other similar entity to monitor corporate insider transactions;[86] (b) hold an annual shareholders' meeting;[87] (c) avoid defensive tactics against takeovers that discriminate among shareholders;[88] (d) employ an "equal opportunity rule" for all tender offers made by a company for its own shares or for a target corporation's shares;[89] (e) promptly notify the NYSE if it plans to redeem, partially or fully, any listed class of securities;[90] and (f) avoid excessive concentration of the company's shares in any one or more affiliated holders.[91]

B. NASDAQ Listing Requirements

Companies that are interested in listing on Nasdaq must meet either the Nasdaq National Market or the Nasdaq SmallCap market standards.[92] To list on Nasdaq companies must, at a minimum, have at least 1 million "publicly held" shares worldwide. Excluded from this 1 million figure are shares held by officers and directors of the company and any holder with more than 10% of the outstanding shares as such shares are deemed not publicly held. Alternatively, companies

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83. *See* NYSE LISTED COMPANY MANUAL, *supra* note 75, § 203.01.
84. *See id.* at § 203.02.
85. *See id.* at § 402.04.
86. *See id.* at § 307.00.
87. *See id.* at § 302.00.
88. *See* NYSE LISTED COMPANY MANUAL, *supra* note 75, at § 308.00.
89. *See id.* at § 311.03.
90. *See id.* at § 311.01.
91. *See id.* at § 305.00.
92. *See* NASD Marketplace Rules 4300 & 4400, NASD MANUAL (CCH).

can list if they have at least 100,000 American Depositary Receipts (ADRs) issued. Nasdaq distinguishes its listing requirements between U.S. domestic and Canadian issuers and non-Canadian foreign issuers. Issuers must pay an initial listing fee up to a maximum total fee for any 24-month period. It also has initial listing requirements and continuous listing requirements. Nasdaq may delist companies that fail to continue to meet its listing requirements.

1. Nasdaq SmallCap Market Quantitative Standard

Foreign issuers must have: (a) at least 1 million publicly held shares worldwide or at least 100,000 ADRs issued (shares held by directors and officers or any holder with greater than 10% of the shares are deemed not publicly held); (b) 300 record holders (not applicable for ADRs); and (c) three registered market makers for the shares or ADRs. The issuer must also have either a market capitalization of $50 million or net tangible assets of $4 million or net income of $750,000 as of the end of its last fiscal year (or two of three of its most recently completed fiscal years).[93]

2. Nasdaq National Market Quantitative Standard

For the Nasdaq National Market, issuers must choose from one of three listing standards. Under each of these, issuers must have at least 1.1 million publicly held shares worldwide and 400 record holders and an initial bid price of $5 per share.[94] Under the first alternative, the market value of the publicly held shares must be at least $8 million and there must be at least three registered market makers for the shares. The issuer also must have minimum net tangible assets of $6 million and pre-tax income of at least $1 million at the close of its most recent fiscal year (or two of three of its most recently completed fiscal years). Under the second alternative, the market value of the publicly held shares must be at least $18 million and there must be at least three registered market makers for the shares. The issuer must also have minimum net tangible assets of $18 million and a two year operat-

93. *See id.* Rule 4320.
94. *See id.* Rule 4420.

ing history. Under the third alternative, the market value of the publicly held shares must be at least $20 million and there must be at least four registered market makers for the shares. The issuer must also have either a market capitalization of $75 million or total assets and total revenues of at least $75 million each at the close of its most recent fiscal year (or two of three of its most recently completed fiscal years).[95]

3. Nasdaq Qualitative Listing Requirements

Under Nasdaq rules, issuers (if not exempt) are required to (a) distribute annual and interim reports to shareholders (and foreign shareholders must distribute Form 6-K material it filed with the SEC); (b) have at least two independent directors; (c) have an audit committee, a majority of whom must be independent directors; (d) hold annual shareholders' meetings, prepare and solicit proxies and establish a quorum of at least 33 1/3% of all outstanding common shares; (e) conduct a review of corporate insider transactions; and (f) obtain shareholder approval for stock option plans and issuance of convertible securities. However, as is the case with NYSE listing standards, foreign issuers may be able to obtain an exemption from these requirements.[96] Foreign issuers listing on Nasdaq also must comply with the "one-share, one-vote" policy unless counsel opines that local laws in the home country do not prohibit the voting policies of the foreign issuer.

C. AMEX Listing Requirements

1. AMEX Quantitative Listing Requirements

The AMEX no longer applies strict numerical standards to determine if a foreign issuer is eligible. Instead, it suggests that companies meet certain guidelines.[97] AMEX has an initial fee and continuous listing fee structure similar to the one used at the NYSE, but at a substantially lower cost. The AMEX recommends that foreign companies have at least (a) 800

95. *See id.* Rule 4320 & 4420.

96. Prior to 1987, the NASD only required that companies disclose to the NASD and the public any material information that may impact the value of its securities. *See* Designation of National Market System Securities, Exchange Act Release No. 24635, 52 Fed. Reg. 24149 (June 29, 1987).

97. AMERICAN STOCK EXCHANGE COMPANY GUIDE § 110.

round-lot holder and (b) 1 million publicly held shares with a minimum market value of at least $3 million. Foreign companies also can qualify under the domestic listing standard, which requires at least (a) 500,000 shares held in the U.S. by 800 holders (or 400 holders if the average U.S. daily trading volume is 2,000 shares or greater during the last six months) or 1 million shares held in the U.S. by 400 holders and (b) an aggregate market value of $3 million and a per share price of $3. Additionally, an issuer must have $4 million of stockholders' equity and pre-tax income of $750,000 for the last fiscal year or two of its prior three fiscal years.[98]

2. AMEX Qualitative Listing Requirements

Basically, the same rules that apply for Nasdaq listings also apply to the AMEX. Namely, issuers (if not exempt) are required to (a) distribute annual and interim reports to shareholders; (b) have at least two independent directors; (c) have an audit committee, a majority of whom must be independent directors; (d) hold annual shareholders' meetings, prepare and solicit proxies and establish a quorum of at least 33 1/3% of all outstanding common shares; (e) conduct a review of corporate insider transactions; and (f) obtain shareholder approval for stock option plans and issuance of convertible securities.[99] As with the NYSE and Nasdaq requirements, foreign issuers listing on the AMEX must comply with the "one-share, one-vote" policy unless counsel opines that local laws in the home country do not prohibit the voting policies of the foreign issuer.

D. Foreign Listing Standards

Harmonization and mutual recognition of stock exchange listing standards in Europe was supposed to have been accomplished through European Union (EU) directives establishing disclosure standards for offerings and listing of securities.[100] But there is no obligation for a stock exchange in one country to list an issue because it is listed on an exchange in another

98. *See id.* at §§ 101, 102.
99. *See id.* at §§ 121, 123, 610, 623, and 710-13.
100. *See* Council Directive 90/211, 1990 O.J. (L112) 24; Council Directive 89/298, 1989 O.J. (L124) 8; Council Directive 87/345, 1987 O.J. (L184) 81.

EU member state. In fact, exchanges commonly insist on a translation of listing particulars and often impose additional requirements on issuers desiring to list. These barriers to pan-European capital raising activities are costly and have thwarted the development of pan-European stock markets.[101] Efforts to achieve harmonization and mutual recognition of listing standards are ongoing at the European Commission[102] and in the business world as the result of developing stock exchange alliances.[103] The decision by the European Commission to defer to IASC and IOSCO to accomplish harmonization of accounting standards instead of amending EU accounting directives is an important step toward integration of the capital markets.[104]

In order for alliances between U.S. and European exchanges to be meaningful, harmonization and mutual recognition of listing standards will have to be accomplished. This will be difficult and painstaking work, however, and unless the SEC moves to a regime of harmonization and mutual recognition for financial disclosure, it is unlikely that the SEC will permit exchanges to do so with respect to listing standards.

IV. EXEMPTIONS FROM REGISTRATION

SEC insistence that foreign issuers comply with Securities Act registration requirements if they wish to raise capital in the U.S. or list on a U.S. securities exchange has gone counter to the interests of U.S. investors wishing to diversify their investments to include foreign securities.[105] In order to maintain the principle of national treatment, the SEC therefore crafted exemptions for the benefit of foreign issuers from the SEC Securities Act registration provisions.

101. *See Financial Services: Implementing the Framework for Financial Markets: Action Plan*, com(1999)232, Nov. 5, 1999, at 6.

102. *See id.*

103. *See* Paul Arlman, *European Equity Markets After the Euro: Competition and Cooperation Across Frontiers*, 2 INT'L FIN. 139, 142-44 (1999).

104. *See* European Commission Announcement (June 22, 2000), *at* http://www.iasc.org.uk/-frame/cent1_6_2.htm.

105. Such diversification is in accord with the modern portfolio theory. *See* John Langbein, *The Uniform Prudent Investor Act and The Future of Trust Investing*, 1996 IOWA L. REV. 641, 669 (1996).

A. Rule 144A

Section 4(2) of the Securities Act provides that the registration requirements of Section 5 do not apply to "transactions by an issuer not involving any public offering."[106] In traditional private placements shares are offered to a limited number of sophisticated individual or institutional investors and there can be no solicitation or general advertising. Further, purchasers receive shares that are "restricted" against resale and only can be resold pursuant to a registration statement or exemption from registration.

Rule 144A, designed especially for foreign issuers, provides a safe harbor exemption from Securities Act registration requirements for specified sales of restricted securities to qualified institutional buyers (QIBs).[107] In theory, a U.S. domestic issuer could use Rule 144A so the principle of national treatment is not compromised by this rule, but in fact it was designated for and is utilized by foreign issuers. Rule 144A defines QIBs as institutions that in the aggregate own and invest on a discretionary basis at least $100 million in securities. Registered broker-dealers, whether purchasing for their own accounts, acting as riskless principals for QIBs or acting as agent on a non-discretionary basis, must own at least $10 million of securities.[108] Rule 144A imposes a "reasonable belief" standard on sellers with respect to the status of buyers as QIBs.[109]

Rule 144A is applicable only to securities that, when issued, are not of the same class as securities listed on a national securities exchange or on Nasdaq.[110] In the case of ADRs listed on an exchange or quoted in Nasdaq, both the ADRs and the deposited shares underlying the ADRs are considered publicly traded. Securities of the same class as the deposited securities may not be sold in reliance on Rule 144A.

Rule 144A imposes an information requirement where the issuer of the securities to be resold in reliance on Rule 144A is neither an Exchange Act reporting company nor exempt from

106. 15 U.S.C. § 77d(2).
107. *See* 17 C.F.R. § 230.144A (2000).
108. *See id.* at (a)(1)(ii).
109. *Id.* at (d)(1).
110. *See id.* at (a)(1)(ii).

reporting requirements pursuant to Exchange Act Rule 12g3-2(b).[111] This requirement provides the holder of the security, and a prospective purchaser, with the right to receive specified limited information about the issuer upon request.[112] However, non-U.S. companies which furnish the SEC with financial and business information already made public in their home countries pursuant to Rule 12g3-2(b) need not comply with this requirement.[113]

Securities acquired in reliance upon Rule 144A are deemed "restricted" securities and may be resold only in compliance with the requirements of Rule 144A.[114] Further, if a market for Rule 144A securities develops, it is to be expected that the number of U.S. security holders will increase, subjecting many foreign issuers to the registration and periodic reporting requirements of the Exchange Act.

B. Regulation S

Traditionally, the SEC took the position that the registration requirements of Section 5 of the Securities Act were primarily intended to protect U.S. investors. In 1964 the Commission therefore announced that it would not take any action for failure to register securities of U.S. issuers distributed outside the territory of the U.S. to foreign nationals even though use of the jurisdictional means might be involved in the offering.[115]

Regulation S was designated to clarify the extraterritorial application of Section 5 of the Securities Act.[116] Therefore, although it operates like a private placement exemption to some extent, it is based on a jurisdictional theory rather than a non-public offering exemption theory. Regulation S consists of a general statement providing that Securities Act registration requirements do not apply to offers and sales made outside the U.S.[117] and two non-exclusive safe harbors: one for issuers

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111. *See id.* at (d)(4)(i).

112. *See id.*

113. *See* 17 C.F.R. § 240.12g 3-2 (2000).

114. *See* 17 C.F.R. § 230.144A (prelim. n.6).

115. *See* Securities Act. Rel. No. 4708, 29 Fed. Reg. 9828 (July 9, 1964); *see* Securities Act Rel. No. 5068 (1970).

116. *See* 17 C.F.R. §§ 230.901-904. (2000).

117. *See id.* at § 203.901.

and securities professionals involved in the distribution process and their affiliates ("issuer safe harbor") and the other for resales by all other persons ("resale safe harbor").[118] In addition to the specific requirements of each safe harbor, two general conditions apply to all offers and sales made in reliance on Regulation S: the offer and sale of securities must be made in an offshore transaction, and directed selling efforts in the U.S. are prohibited.[119] To qualify as an offshore transaction, offers may not be made to persons in the U.S. and either (1) the buyer is (or the seller reasonably believes that the buyer is) offshore at the time the buy order is placed; or (2) the sale is made on a foreign securities exchange (for the issuer safe harbor) or through a designated offshore securities market (for the resale safe harbor).[120]

The issuer safe harbor distinguishes among three categories of securities based on the nationality and reporting status of the issuer and the extent of U.S. market interest in the issuer's securities. The first category imposes no restrictions other than the general conditions that the securities be sold in an offshore transaction and there be no directed selling efforts in the U.S.[121] This category applies to offerings by foreign issuers with no substantial U.S. market interest, whether or not the issuer is subject to Exchange Act reporting requirements, and to offerings by foreign issuers targeted at a single foreign country, whether or not the issuer's home country.[122]

The second issuer safe harbor applies to offerings of U.S. reporting issuers, foreign reporting issuers with substantial U.S. market interest, and offerings of debt and other securities of non-reporting foreign issuers.[123] Such offerings may not be sold to U.S. persons for forty days and are required to be made in conformity with specified offering restrictions.[124]

The third issuer safe harbor category is of use primarily for offerings of non-reporting U.S. issuers and equity offerings of foreign issuers with substantial U.S. market interest for the

118. *Id.* § 230.903-904.
119. *See id.* at § 230.903(a).
120. *See id.* at § 230.902(h).
121. *See id.* at § 230.903(b)(1).
122. *See* 17 C.F.R. § 230.903(b)(1) (2000).
123. *See id.* at (b)(2).
124. *See id.*

class of securities offered.[125] This category imposes more restrictive procedures designed to guard against flowback of securities to the United States. Equity offerings in this category may not be sold to U.S. persons for a one-year period, and debt securities are subject to a forty-day restricted period.[126] Specified offering restrictions also apply.[127]

The resale safe harbor is available to persons other than issuers, distributors, and their affiliates and imposes restrictions beyond the two general conditions only where the securities were sold by a dealer or similar person.[128] Resales on established foreign securities exchanges or organized markets are permitted.[129]

Regulation S proved very popular, not only for use by foreign issuers making offerings abroad, but also for use by U.S. issuers attempting to avoid Securities Act registration. The SEC therefore issued an interpretative release describing certain abusive practices under Regulation S,[130] and then proposed to amend the regulation so that it would operate as a private placement exemption in that securities obtained in a Regulation S offering would be restricted securities.[131] Foreign issuers protested against these amendments and when the SEC amended Regulation S, it applied the principle that securities would have to be held for a one year restricted period only to U.S. domestic issuers making offerings abroad.[132]

As thus amended, Regulation S is inconsistent with the principle of national treatment. But it has operated as a safety value, relieving the SEC of pressure exerted by foreign issuers, U.S. institutional investors, U.S. investment bankers and advisors to these groups for relief from SEC intransigence on the issue of reconciling accounting statements to U.S. GAAP before a foreign issuer can tap the U.S. capital market.

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125. *See id.* at § 230.903(b)(3).
126. *See id.* at (2).
127. *See id.*
128. *See* 17 C.F.R. § 230.904 (2000).
129. *See* Securities Act Release No. 6863, 55 Fed. Reg. 18306, 18319 (May 2, 1990).
130. *See* Securities Act Release No. 7190 (June 27, 1995).
131. *See* Securities Act Release No. 7392 (Feb. 20, 1997).
132. *See* Securities Act Release No 7505, 63 Fed. Reg. 96532 (Feb. 17, 1998); *see also* 17 C.F.R. § 230.905 (2000).

V. CROSS-BORDER TAKEOVER AND RIGHTS OFFERINGS

A. *Overview*

The SEC has been considering exemptive rules for cross-border takeover and rights offerings for a decade.[133] At long last, such rules became effective on January 24, 2000 with the promulgation of the Cross-Border Adopting Release.[134] Foreign issuers not registered with the SEC under the Exchange Act[135] can now have their U.S. investors included in takeover and rights offerings, if the percentage of U.S. investors is not significant, without compliance with SEC disclosure and tender offer regulations. Like other developments distinguishing between the treatment of U.S. and foreign issuers, such as Regulation S, the SEC was reluctant to create exemptions even when U.S. investors argued for them. Because the SEC could not reconcile cross-border takeovers and rights offerings by foreign issuers with its regulation of domestic issuers, special exemptions were drafted. But parochial considerations kept those exemptions narrow.

The cross-border exemptive rules do not break new conceptual ground in that the SEC's original concept release set forth the ideas for the rules now adopted. The snail's pace at which the SEC adopted these rules can be explained by the SEC's extreme reluctance to cede its power to dictate the content of disclosure documents for use by U.S. investors and its insistence that foreign issuers wishing to access the U.S. capital markets make SEC-style disclosures. Yet, the SEC was finally worn down by complaints from U.S. investors holding foreign securities who were deprived of the opportunity to participate in foreign issuer takeover and rights offerings by reason of SEC protections they did not desire.

Although the new rules have the effect of establishing a principle of mutual recognition for these types of cross-border

133. *See* Concept Release on Multinational Tender and Exchange Offers, Securities Act Release No. 6866, 55 Fed. Reg. 23751 (June 12, 1990); International Tender and Exchange Offers, Securities Act Release No. 6897, 56 Fed. Reg. 27582 (June 14, 1991).

134. *See* Cross-Border Adopting Release, *supra* note 6.

135. Foreign private issuers may be exempt from Exchange Act registration under Rule 12g3-2(a) or 12g3-2(b). *See* 17 C.F.R § 240.12g3-2(a)(b) (2000).

offerings, the SEC does not concede this point; but has instead justified the exemptions as an effort to balance the need to provide U.S. security holders with the protections of the U.S. security laws against the need to promote the inclusion of U.S. security holders in certain types of cross-border transactions.[136] The new rules apply to foreign issuers of all countries, irrespective of the merits of their securities regulation regime and, accordingly, neither harmonization with U.S. law nor mutual recognition principles were utilized as a relevant predicate to their adoption. Rather, the SEC put forward the rules as a way to encourage issuers and bidders to extend tender and exchange offers, rights offerings, and business combinations, to U.S. security holders of foreign private issuers in order to allow U.S. holders to participate on an equal basis with foreign security holders.

The extent to which U.S. security holders have been excluded from foreign issuer takeover and rights offerings is unclear, but the figures are substantial because of the increasing ownership by U.S. investors of foreign securities and the dramatic increase in cross-border mergers and acquisitions.[137] The legality of excluding U.S. stockholders from tender offers and rights offers has been upheld where U.S. jurisdictional means are not utilized to make the offer.[138] This involves placing special legends on offering documents, requiring representations in acceptance materials and establishing procedures to avoid U.S. contacts. Although the SEC is encouraging the inclusion of U.S. investors in cross-border offers, the Cross-Border Adopting Release recognizes that offers may continue to exclude them. For example, the Cross-Border Adopting Release states that the SEC will not view offering materials posted on the Web as targeted to U.S. persons if the offer prominently

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136. *See* Cross-Border Adopting Release, *supra* note 6, at 61383.

137. In a sample of 31 takeover offers in the U.K. in 1997, U.S. holders were excluded from all offers where U.S. ownership was under 15%. *See id.* at 61382 n.8. There were 403 tender offers for foreign companies by foreign bidders recorded by the Securities Data Corporation in 1998, with an average premium of 42% for 215 transactions. *See id.* at 61397 n.96. Between 1994 and 1998, there were 78 rights offerings made to shareholders of issuers having American or Global depositary receipts held by Bank of New York. In 30 of the rights offerings, U.S. shareholders were excluded entirely. In 48, the Bank of New York sold the rights and provided shareholders with cash, after costs. *See id.* at 61389 n.54.

138. *See* John Labatt Ltd. v. Onex Corp., 890 F. Supp. 235 (S.D.N.Y. 1995); Plessey Co. PLC. v. Gen. Elec. Co. PLC., 628 F. Supp. 477 (D. Del. 1986).

discloses that the offer is being made to countries other than the U.S. and other precautions are taken.[139] Further, the Cross-Border Adopting Release states that no special precautions should be taken to prevent U.S. holders from receiving the merger consideration in a business combination involving a foreign issuer merely because the proxy statement is posted on a Web site available in the U.S.[140]

The SEC's exemptive rules divide foreign issuers into two tiers. Tier I issuers are those in which U.S. security holders hold 10% or less of a class of foreign securities.[141] Tier II issuers are those in which U.S. security holders hold between 10% and 40% of a class of foreign securities.[142] Tender offers for securities of a Tier I foreign private issuer will be exempt from most of both the procedural and disclosure requirements of the Exchange Act. In addition, such Tier I companies can make offers outside of the tender offer. Tender offers for securities of a Tier II foreign private issuer will be granted limited procedural relief from rules and practices that often conflict with foreign tender offer requirements. This relief is largely in accordance with prior SEC no-action letters. Under Rule 801, equity securities issued by Tier I foreign issuers in rights offerings will be exempt from the registration requirements of the Securities Act. Further, under Rule 802, securities issued in exchange offers for the securities of Tier I foreign issuers will be exempt from the registration requirements of the Securities Act and the qualification requirements of the Trust Indenture Act of 1939.

The U.S. anti-fraud and anti-manipulation rules and civil liability provisions will, however, continue to apply to these otherwise exempt transactions.[143] The only concession the SEC made to those commenters who argued that such liability will remain a hurdle to including U.S. investors in foreign issuer takeover and rights offerings is that the omission of information called for by U.S. forms or schedules will not necessarily violate U.S. disclosure requirements. Rather, the omitted information would have to be material in the context of the

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139. *See* Cross-Border Adopting Release, *supra* note 6, at 61395.
140. *See id.*
141. *See id.* at 61384.
142. *See id.* at 61387.
143. *See id.* at 61383 n.10.

transaction and the disclosure provided would have to be misleading as a result of the omitted information. In view of the SEC's ideas about the ever increasing ambit of what is material,[144] and equally expansive court interpretations of materiality,[145] the SEC's formulation may prove of small comfort to foreign issuers.

B. Foreign Private Issuers

The term "foreign private issuer" is a key concept in the cross-border rules. The SEC did not attempt to define this term anew but relied upon the definition previously set forth in §230.405 of Regulation C, as recently amended, to mean any foreign issuer other than a foreign government, unless: (1) the issuer has more than 50 percent of its outstanding voting securities, directly or indirectly owned of record by U.S. residents; and (2) any of the following: (i) the majority of its executive officers or directors are U.S. citizens or residents; (ii) more than 50 percent of the issuer's assets are located in the U.S.; or (iii) the issuer's business is principally administered in the U.S.[146]

The amendment to Rule 405 changed the test of whether more than 50 percent of an issuer's voting securities were held by residents of the U.S. from a record ownership test to one that more closely resembles a beneficial ownership test. This requires an issuer to "look through" the record ownership of brokers, dealers, banks or nominees holding securities for the accounts of their customers to determine the residency of their customers.[147] This same "look through" obligation was utilized in the cross-border rules in order to determine whether a foreign private issuer fits into a Tier I or Tier II category. As was the case with the new foreign issuer disclosure regulations, the SEC limited the look through provisions to securities held of record (1) in the U.S., (2) in the issuer's home jurisdic

144. *See* STAFF ACCT. BULL. No. 99 (Aug. 12, 1999); 17 C.F.R. § 211 (1999).

145. *See* Consol. Gold Fields PLC. v. Minorco S.A., 871 F.2d 252 (2d Cir. 1989), *modified*, 890 F.2d 569 (2d Cir. 1989).

146. *See* IDS Adopting Release, *supra* note 21, at 53905.

147. *Id.* This is accomplished by some convoluted cross-referencing to Exchange Act Rules 12g3-2(a) and 12g5-1. *See* 17 C.F.R. §§ 240.12g3-2(a) and 12g5-1 (2000).

tion and (3) in the issuer's primary trading market if different from the home jurisdiction.

C. The Exemptions

Under the Tier I exemption, tender offerors, whether U.S. or foreign, are no longer subject to the disclosure, filing, dissemination, minimum offering period, withdrawal rights or proration requirements of the Exchange Act.[148] These tender offer rules were designed to ensure that security holders will receive equal treatment and have sufficient time and information to make a decision as to whether or not to tender their shares. As a trade-off for relief from these requirements, the offeror must allow U.S. security holders to participate in the offer on terms at least as favorable as those offered to other holders, including duration, proration and withdrawal rights. However, a cash-only alternative is permitted under certain circumstances. Also, offerors must provide U.S. security holders with tender offer materials or other offering documents, in English, on a comparable basis to those provided to other security holders. If the securities subject to the tender offer are registered under the Exchange Act, the English translation of the offering materials must be submitted to the SEC under new Form CB. This will not be deemed a "filing" for purposes of liability under § 18 of the Exchange Act.

The SEC also has created an exemption for offers for securities of Tier I issuers by an amendment to Exchange Act Rule 14e-5 that permits purchases outside the tender offer if such purchases are permitted in the home jurisdiction. This exemption is conditioned on disclosure in the offering documents about such purchases.

Under the Tier II exemption, an offeror is able to make one offer to U.S. security holders and another to non-U.S. security holders only if the offer to the U.S. holders is at least as favorable as any other offer. Also, an offeror may offer loan notes solely to non-U.S. security holders, since these tax-advantaged notes are of no real use to U.S. persons. In addition,

148. As provided in Exchange Act Rules 13e-3, 13e-4, Regulation 14D and Rules 14e-1 and 14e-2, 17 C.F.R. §§ 240.13e-3, 13e-4, 14d-1 through 14d-101, 14e-1 and 14e-2.

an offeror's home jurisdiction will trump U.S. regulations regarding requirements for prompt payment for, or return of tendered securities, as well as extensions of an offer, and an offeror will generally be able to reduce or waive the minimum acceptance condition of an offer, without extending withdrawal rights during the remainder of the offer.

Securities Act Rules 801 and 802 also provide non-exclusive exemptions from the registration requirements of the Securities Act for securities issued to U.S. security holders of Tier I foreign private issuers in rights offerings and in business combinations and exchange offers. The terms and conditions of the offer must be at least as favorable for U.S. security holders as foreign holders. When any document, notice or other information is provided to offerees, copies translated into English, must be provided to U.S. securities holders.

The Rule 801 and 802 exemptions restrict the transferability of the securities acquired. If the securities that are the subject of the transaction are "restricted" under Rule 144 in the hands of a U.S. investor prior to the Rule 801 or 802 transaction, the securities acquired by that investor also will be restricted. Further, with respect to rights offerings, rights granted to U.S. holders pursuant to Rule 801 will not be transferable except in accordance with Regulation S. This means, in effect, a one year holding period will be required. Although this could put U.S. investors at a disadvantage as compared to foreign investors, the SEC expressed concerns about the development of a U.S. market in rights in the absence of adequate disclosure.

While the SEC should be commended for its comprehensive effort in updating its tender offer regulations and extending its revisions to foreign private issuers, the market may be moving too fast for the SEC to control. Europe is in the throes of an unprecedented takeover boom. Whether the recent SEC rule changes will result in changed practices whereby U.S. investors can finally enjoy the benefits of takeover transactions abroad remains to be seen.

VI. TRADING ON FOREIGN EXCHANGES

Until recently, stock exchanges were floor-based membership organizations that traded primarily domestic securities.

Today, however, stock exchanges compete for international listings.[149] Further, stock exchanges around the world, with the notable exception of the NYSE, have become electronic markets and no longer have floors.[150] The SEC has only begun to address the problems of regulating such cyber-markets.[151]

Domestic electronic communications networks (ECNs) or alternative trading systems (ATSs) have been brought into the national market system regulatory framework through the adoption of Regulation ATS and a revised definition of the term "exchange" under the Exchange Act.[152] In its concept release proposing that ATSs should either register as exchanges or undertake new responsibilities as broker-dealers, the SEC addressed the problem of foreign exchanges wishing to access the U.S. capital markets.[153] Today's technology enables market participants to tap simultaneous and multiple sources of liquidity from remote locations.[154] It is therefore possible for U.S. investors to obtain real-time information about trading on foreign markets from a number of different sources and to enter and execute their orders on those markets electronically from the U.S.[155]

Among the many challenges that permitting trading in foreign securities on foreign exchanges from the U.S. presents to the SEC, is that thousands of foreign issuers with securities that are not registered with the SEC and which do not meet SEC disclosure and accounting standards, would become tradeable.[156] The SEC has suggested several possible solutions to

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149. *See Good-bye to all that*, ECONOMIST, Jan. 30, 1999, at 67.

150. Suzanne McGee, *Trading Places*, WALL ST. J., Jan. 11, 1999, at R42.

151. *See* Paul Cohen, *Securities Trading*, 4 STAN. J. L. BUS. & FIN. 215 (1999); Tamar Frankel, *The Internet, Securities Regulation and Theory of Law*, 73 CHI.-KENT L. REV. 1319 (1998); Jane Kaufman Winn, *Regulating the Use of the Internet in Securities Markets*, 54 BUS. LAW. 443 (1998).

152. Exchange Act Rule 3b-16, 17 C.F.R. § 240.3b-16 (2000). For a criticism of the SEC's approach of imposing more regulation upon ATSs, *see* Mark Klock, *The SEC's New Regulation ATS: Placing the Myth of Market Fragmentation Ahead of Economic Theory and Evidence*, 51 FLA. L. REV. 753 (1999).

153. *See* Regulation of Exchanges, Exchange Act Release No. 38672, 62 Fed. Reg. 30485 (June 4, 1997) [hereinafter ATS Concept Release].

154. *See* Regulation of Exchanges and Alternative Trading Systems, Exchange Act Rel. No. 40760, 63 Fed. Reg. 70844, 70847 (Dec. 22, 1998).

155. *See* ATS Concept Release, *supra* note 153, at 30521 n.213.

156. *See id.* at 30529.

this problem. First, the SEC could subject foreign exchanges to registration as "exchanges" under the Exchange Act and prevent them from trading any securities not registered with the SEC under the Exchange Act. Second, the SEC could limit cross-border trading by ECNs, ATSs, or foreign exchanges seeking U.S. investors to operations through an access provider which would be a U.S. broker-dealer or ECN. Third, the SEC could limit trading in foreign securities by foreign exchanges to transactions with sophisticated U.S. investors so that some exemption from Securities Act registration might be available.[157]

In granting an exemption from registration as an exchange to Tradepoint Financial Networks plc (Tradepoint) so it could operate a limited volume securities exchange in the United States, the SEC combined these various approaches.[158] Tradepoint is an electronic market maker system that will allow investors to trade securities listed on the London Stock Exchange. The company will also operate a specialist system for certain securities. Tradepoint will offer two levels of service to its members: one for the public market and one that will be open only to QIBs as defined in Rule 144A.[159] Bids and offers for securities not registered under the Exchange Act may be made only by QIBs, and any such securities only may be resold outside the United States.[160]

Persons who wish to access the exchange are given a personal identification number. Access in the UK is currently available to an international network of personal computers via a stand-alone PC, through a separate existing Reuters RT terminal, ICV-Topics 3 Trader workstation, through a Liberty InterTrade Direct Screen, or through a Bloomberg terminal. Access to Tradepoint in the U.S. is available through a Bloomberg terminal or "through a direct connection to the

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157. *See id.*

158. *See* Order Granting Limited Volume Exemption from Registration as an Exchange Under Section 5 of the Securities Exchange Act, Exchange Act Release No. 41199, 64 Fed. Reg. 14953 (Mar. 29, 1999) [hereinafter Tradepoint Exemption].

159. *See* 17 C.F.R. § 230.144A (2000).

160. *See* Tradepoint Exemption, *supra* note 158, at 14955. The exchange will be available to U.S. members from 7:30 a.m. to 5:30 p.m. London time (2:30 a.m. to 12:30 p.m. Eastern Standard Time or 11:30 p.m. to 9:30 a.m. Western Standard Time). Hence, for investors residing in New York, most of the allowable trading will be in the early morning hours. While for investors in Los Angeles, most of the allowable trading will be in the middle of the night. *Id.* at 14955 n.18.

exchange through an existing global private data network operator."[161] Therefore, access is effectively limited to broker-dealers and other sophisticated investors.

While the SEC, as a practical matter, currently may be able to limit access to the U.S. markets by foreign exchanges to transactions with QIBs or other institutional investors, or to trading only in Exchange Act registered securities, as ECNs proliferate and retail investors become interested in buying foreign securities on foreign exchanges in the middle of the night, the SEC may find the approach it adopted in the Tradepoint exemption difficult to maintain.

Another possible development in the international markets is linked trading between exchanges in different countries through mergers and alliances among exchanges. An alliance involving the London and German stock exchanges and Nasdaq is one possibility.[162] An alliance is also being worked upon by the Paris, Amsterdam and Brussels stock exchanges and the NYSE, that also would include exchanges in Australia, Tokyo, Hong Kong, Toronto, Sao Paulo, and Mexico.[163] If all securities listed on an exchange in such an alliance could be traded on other allied exchanges, then the exchanges within the alliances could pass the book after hours to another time zone the way securities firms pass the book from a New York to a London trading desk. But if the reciprocal trading privileges between foreign and U.S. exchanges are limited to issuers that are SEC registered and report in U.S. GAAP, these alliances will be limited to securities already dually listed on Nasdaq or the NYSE. Since the purchase of foreign securities by U.S. investors is not illegal, the consequence would be that U.S. exchanges would lose market share in the trading of foreign securities to foreign exchanges and U.S. broker-dealers operating abroad. Even if the SEC were to permit U.S. exchanges to trade foreign listed securities after hours so long as the issuers report in IAS, U.S. exchanges would have to deter-

161. *Id.* at 14954-55. Craig Karmin, *Tradepoint and Swiss Bourse Join to Expand System*, WALL ST. J., July 11, 2000, at C21 (for further developments concerning Tradepoint).

162. *See* Craig Karmin, *Deutshe Bourse Board Votes to Proceed To Next Stage of London-Market Merger*, WALL ST. J., July 13, 2000, at C19.

163. *See The Formation of a Global Equity Market*, EXCHANGE (NYSE), July 2000, at 1.

mine whether foreign listed issuers that do not meet the listing standards of a U.S. exchange could have reciprocal listing privileges.

VII. CONCLUSION

The globalization of capital markets has generated an extensive debate about whether an appropriate regulatory response is for every securities commission to insist on compliance with national standards, or to establish a regime of mutual recognition, or to harmonize its regulations to an international standard.[164] Professor John C. Coffee has argued that global convergence of shareholder protection norms is more likely to come from stock exchange regulation than corporate law.[165] Further, this SEC led harmonization should lead to real economic growth.[166] However, this is a rosy scenario that may not come true. Politics and economics may impel convergence to a European standard or an offshore market standard and U.S. exchanges and securities firms would then lose their competitive edge. Edward F. Greene and other practitioners have argued for more experimentation and some degree of mutual recognization.[167]

The SEC has operated pursuant to a theory of national treatment, and has argued strenuously that this policy is in the interests of the United States.[168] Yet, the SEC has fashioned special rules and exemptions for foreign issuers in order to coax them into the U.S. disclosure framework established by the Securities Act and the Exchange Act. In the case of Canadian issuers, the SEC has selected mutual recognition as

164. *See, e.g.*, James D. Cox, *Rethinking U.S. Securities Laws in the Shadow of International Competition*, 55 LAW & CONTEMP. PROBS. 157 (1992); Merritt B. Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom*, 95 MICH. L. REV. 2498 (1997). *See* Geiger, *supra* note 1, at 248; Marc I. Steinberg & Lee E. Michaels, *Disclosure in Global Securities Offerings: Analysis of Jurisdictional Approaches, Commonality and Reciprocity*, 20 MICH. J. INT'L L. 207 (1999).

165. *See* Coffee, *supra* note 13, at 704.

166. *See id.* at 705.

167. *See* Edward F. Greene et al., *Hegemony or Deference: U.S. Disclosure Requirements in the International Capital Markets*, 50 BUS. LAW 413 (1995).

168. *See, e.g.*, Richard C. Breedon, *Foreign Companies and U.S. Securities Markets at a Time of Economic Transformation*, 17 FORD. INT'L L.J. S77 (1944).

doctrine.[169] Further, the United States has participated actively in harmonization programs sponsored by IOSCO and the IASC, and the new Form 20-F is based upon IOSCO's international disclosure standards. If the SEC adopts IAS, in whole or in part, the SEC will have traveled a long way toward the selection of a harmonized regulatory standard for foreign (but not U.S.) issuers. As a political matter, sooner or later the SEC will have to accept IAS for foreign issuers and perhaps even for some U.S. domestic companies.

The SEC may not be able to maintain its slow paced incrementalist approach for much longer. Foreign stock exchanges are aggressively seeking U.S. investors and U.S. investors are interested in diversification of their portfolios to include foreign equities. In the words of SEC Commissioner Laura Unger:

> International accounting standards would provide a wealth of benefits to every participant in a global securities market. But access to the world is already available through our PCS. Technology has become the great leveler between individual and institutional investors. Direct access to foreign markets and trading in foreign securities are some of the last distinctions that exist between individual and institutional investors. I fully expect these distinctions to fall as well. The only question is how soon.[170]

If foreign exchanges become free to offer their listed securities to U.S. investors, this competition could put pressure on the NYSE and Nasdaq to lower their listing standards for foreign issuers. On the other hand, there are so many foreign companies that meet current listing standards, but have not seen it in their interest to register their securities under the Exchange Act, that such a race to the bottom may not occur.[171]

Although the SEC strives to remain principled and theo-

169. *See* Reporting System for Canadian Issuers, *supra* note 40.

170. SEC Commissioner Laura S. Unger, *The Global Marketplace, Ready or Not Here it Comes, Remarks at the Third National Securities Trading on the Internet Conference, at* http://www.sec.gov/news/speeches/spch344.htm (visited Jan. 24, 2000).

171. *Cf.* Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998).

retically consistent in crafting its regulations, the marketplace is moving too quickly for the SEC to keep pace, and the principle of national treatment has already been undermined by various SEC regulations. The future requirements for foreign issuers entering the U.S. markets is likely to be determined by SEC reactions to marketplace developments rather than by SEC theories about national treatment and harmonization. The SEC is engaged in a difficult balancing act. It is trying to establish, through its participation in IOSCO and the IASC, high standards of financial disclosure for foreign issuers, and at the same time, it does not wish to alter the even more rigorous standards in place for U.S. issuers. From an investor protection perspective this may be admirable, but it does not make for a level playing field between domestic and foreign issuers and between U.S. and foreign exchanges. Currently, competitive advantage seems to be with the U.S. system, but economic developments could cede future competitive advantage to a different corporate finance system.

Despite increasing convergence of financial disclosure standards for world-class issuers, securities regulators have a long way to travel before international harmonization of securities regulation becomes a reality. In the meantime, the SEC continues to fashion a patchwork for the regulation of foreign issuers that is pragmatic but inconsistent in approach. Sometimes the SEC insists on adherence to standards for domestic issuers and markets, sometimes the SEC fashions special exemptions for foreign issuers and sometimes the SEC engages in a harmonization project and then agrees to mutual recognition. Cyber-markets may well upset this regulatory scheme because it does not rest on a solid theoretical foundation.

As the SEC moves to harmonization it needs to think through the implications of doing so. Once international standards become the norm and other mature market economics have financial disclosure regulations that are essentially similar to that of the United States, mutual recognition should be considered as a serious option. The current regulatory regime gives institutional investors an unfair advantage over individual investors and adds to the cost of capital raising. These policies also become unfair to U.S. issuers as issuers elsewhere report in IAS. The SEC frequently pays lip service to international securities regulation and the importance of global capital markets, but its policies are designed to maintain its jurisdiction to dictate standards for U.S. companies and U.S. securities exchanges. As the markets become increasingly global this parochial attitude should give way to greater comity.