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**INTERNATIONAL COOPERATION IN SECURITIES ENFORCEMENT:  
A NEW UNITED STATES INITIATIVE**

Presented by

Joseph A. Grundfest  
Commissioner  
U.S. Securities and Exchange Commission

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This address was prepared with the assistance of Mr. Max Berueffy, Counsel to Commissioner Grundfest, and Mr. Paul Work, a student at Stanford University Law School. The views expressed herein are those of Commissioner Grundfest and do not necessarily represent those of the Commission, other Commissioners, or Commission staff.

INTERNATIONAL COOPERATION IN SECURITIES ENFORCEMENT:  
A NEW UNITED STATES INITIATIVE

Joseph A. Grundfest\*  
Commissioner  
U.S. Securities and Exchange Commission

It is a pleasure and privilege to address this distinguished gathering on a subject that is, unfortunately, of mutual and growing concern: international securities fraud.

The world's securities markets are highly internationalized. The degree of interdependence is now so great that individual nations no longer have distinct and autonomous securities markets. Each of our markets is, instead, a link in a global chain of financial activity that follows the sun from London, to New York, to Tokyo, and back to London again. Just as pressure on a single link is felt throughout a chain, economic developments in any one of these regional markets reverberate internationally.

Although the free world has benefitted greatly from the improved capital flows that accompany these new global markets, the process of internationalization is not without a dark and ugly side. Whether we like to admit it or not, fraud is and has always been a problem in financial markets. When markets were predominantly local, fraud was also predominantly local. In those simpler days, local frauds could be

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effectively addressed by local authorities operating under the color of a single nation's law. Now, however, markets are international, and the ability of local authorities acting on their own to detect and deter fraudulent behavior is sharply diminished.

In today's marketplace, traders can come from anyplace that has a telephone: they leave no footprints, only the ghosts of electrons. Local authorities are powerless to enforce local standards when violators have no assets in their jurisdiction and never even fly within a thousand miles of the market in which the violation occurred.

Making matters even more difficult is the fact that international securities fraud is not a random event that just happens to accompany international market activity. Those who engage in international fraud may be corrupt, but they are not necessarily stupid. Many violators consciously structure their activities in order to take advantage of perceived weaknesses in domestic securities enforcement procedures. Violators fashion their frauds in order to minimize the probability that they will either be detected, apprehended, or subject to sanctions that are meaningful in light of the illegal profits they have earned. Violators also consciously take advantage of bank secrecy and other privacy laws that may well have been adopted for perfectly legitimate reasons, and eagerly use these "privacy" jurisdictions as havens through which to channel fraudulent activity.

Needless to say, traditional approaches are totally ineffective in dealing with this new generation of international frauds. As securities regulators, we have no choice but to evolve with the market and invent new strategies in response to these challenges. We can no longer go about the business of securities law enforcement the "good old fashioned way," in which each of us simply minded our own backyard with no thought given to problems vexing our neighbors. We must instead become as bold, clever, and internationalized as the new breed of violator cropping up in our midst. If we fail in this mission, we will be granting carte blanche to thieves adept at electronic manipulations who slither through the cracks and crevasses of international practice. None of us can afford to permit this to happen.

In my address, I will outline a new approach to international cooperation recently proposed by the United States Securities and Exchange Commission and adopted by the Congress in the closing hours of its recently completed session.<sup>1</sup> In a nutshell, the Commission has asked for and received authority to provide investigatory assistance to foreign securities authorities. Thus, the United States

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<sup>1</sup>Insider Trading and Securities Fraud Enforcement Act of 1988, 100th Cong., 2d Sess., 134 Cong. Rec. S17218 (daily ed. Oct. 21, 1988). ("1988 Enforcement Act") The 1988 Enforcement Act is discussed infra pp. 28-34. As of the date of this text, the Act has not been signed by the President. It has, however, been actively supported by the Administration, see infra notes 65-67, and there is no publicly perceived reason to expect that the Act would be vetoed.

Securities and Exchange Commission will now be able to conduct formal inquiries in the United States in assistance of British, French, Japanese, or any other securities authorities who have reason to believe (1) that their securities laws have been violated, and (2) that relevant information can be obtained in the United States.

We will be able to provide such assistance even if there are no allegations that United States law has been violated. Sooner, rather than later, we hope that other countries will adopt similar measures and agree to assist in investigations that involve violations of the securities laws of the United States or of other countries. Indeed, the very language of the statute itself requires that "[i]n deciding whether to provide such assistance [to foreign authorities], the Commission shall consider whether \* \* \* the [foreign] requesting authority has agreed to provide reciprocal assistance in securities matters to the Commission."<sup>2</sup>

The essence of this new investigatory assistance approach relies on mutual self-interest and enlightened cooperation rather than forceful attempts to assert national jurisdiction in a manner that could cause friction among trading partners.<sup>3</sup> This new approach is also value neutral in the sense that it

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<sup>2</sup>Id. at sec. 6(b)(2) (to be codified at 15 U.S.C. 78(u)(a)(2)).

<sup>3</sup>Compare, for example, the unilateral assertion of jurisdiction in the Commission's "waiver by conduct" proposal, discussed infra at pp. 16-19, which has now fallen out of favor.

does not define specific practices that violate inchoate standards of a nonexistent international law. Instead, this approach allows each market to set its own standards based on principles of local law and looks to cooperation among trading partners to assure that the internationalization of our markets is not used as an ice pick to chip away at and ultimately destroy each of our domestic regulatory regimes.<sup>4</sup>

To put the matter more bluntly, I have no interest in seeing British, Japanese, or U.S. nationals, or anyone else for that matter, use the United States as a staging area for the manipulation of foreign securities markets or for the violation of foreign securities laws. I also have no interest in seeing U.S. financial institutions used as storehouses for such ill-gotten gains. Indeed, as Attorney General Adderly of the Bahamas explained in connection with Bahamas' decision to permit Bank Leu to provide information to the SEC in the Dennis Levine insider trading investigation, Bahamas' bank

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<sup>4</sup>This approach also does not interfere with efforts to harmonize standards among markets. Thus, efforts continue to allow reciprocal prospectus filing between the United States and Canada, see Sec. Reg. & L. Rep. (BNA), No. 42, at 1628 (Oct. 28, 1988), and steps continue to be taken to ban insider trading in the European community. See, e.g., Revised Insider Trading Draft is Ready For Ministerial Review, 20 Sec. Reg. L. Rep. (BNA) 1528 (Oct. 7, 1988) (Denmark, France and the United Kingdom already ban insider trading and final adoption of the pending EC legislation, which is not expected before the end of 1989, would ban insider trading in the remaining EC countries under a common definition).

secrecy laws "were never intended to protect fraud, never intended to protect a thief."<sup>5</sup>

I am proud that the United States has taken a first step toward assuring that U.S. markets and institutions are not used as staging areas or storehouses in connection with the violation of British or other foreign laws. Down the road, of course, I would also hope that other nations reach analogous conclusions and agree not to shelter violators of U.S. securities laws. We must strive toward that mutual goal if we are to make progress in the battle against international fraud.

Before describing the details of the United States' new investigatory assistance legislation, it might be useful to take a few steps back and review, in summary form, the remarkable extent to which our markets have become internationalized; the unfortunate extent to which international securities fraud has spread across the globe; the progress against fraud that has been made to date under a system that relies on bilateral memoranda of understanding and treaties; and the additional progress we hope to share in the future as a result of our cooperative investigatory initiative.

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<sup>5</sup>Penn, Bahamas Official Suggests He May Waive Bank Secrecy Law Again in Insider Cases, Wall St. J., May 28, 1986, at 12.

The Good News: Our Markets Are Global

Although international investment has a long history, the speed at which international activity in securities markets has expanded in recent years is simply phenomenal. In 1975, foreign purchases and sales of United States securities totalled \$51.9 billion. In 1982, that figure was \$296.4 billion. Last year, foreign activity in U.S. securities skyrocketed to more than \$3.3 trillion and the projected total for this year exceeds \$3.7 trillion, a \$400 million increase over last year's volume.<sup>6</sup>

Increased internationalization of the markets also involves a substantial increase in activity by U.S. investors in Europe and elsewhere. In 1975, purchases and sales of foreign securities by U.S. investors totalled \$14.4 billion. By 1982, U.S. investors' activity abroad had increased to \$76.7 billion. Last year, U.S. investment activity in foreign securities was nearly \$600 billion and projections indicate that, while this activity may fall off somewhat this year, it is likely to remain well in excess of \$500 billion.<sup>7</sup>

Large and sophisticated traders, including commercial and investment banks, maintain and monitor international portfolios on an around-the-clock basis. They stand ready to

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<sup>6</sup>Office of the Secretary, United States Department of the Treasury, Treasury Bulletin (various issues). The figure for 1988 is based upon six-month data extrapolated to an annual figure, without seasonal adjustments.

<sup>7</sup>Id.

act upon trading information in any open market, at any time of any day. For example, the New York Stock Exchange reported that 17 percent of program trading in U.S. stocks done in August of this year was done on foreign markets--mostly in London.<sup>8</sup> In short, as one New York portfolio manager observed, "To trade across borders is trivial in today's age."<sup>9</sup>

This increased level of international activity has been facilitated greatly by advances in communication technology. Although simple voice and data linkages are adequate for most international transactions, some observers predict that the markets themselves will become far more internationalized. These observers point to an expanding network of inter-exchange linkages as the harbinger of this new trend.

For example, the Montreal and Boston Stock Exchanges in 1984 established the first international stock trading link to permit Canadian investors to trade directly from the Montreal Exchange in the Boston market.<sup>10</sup> The link currently generates only 25 to 30 trades per day for 35 to 40 thousand shares, a relatively small volume by today's standards. Exchange officials estimate, however, that there will be a

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<sup>8</sup>London Has Growing Role As A Conduit For The Program Trading Of U.S. Stocks, Wall St. J., Sept. 21, 1988 at 4, col. 1.

<sup>9</sup>Id.

<sup>10</sup>See Securities Exchange Act Release No. 21449 (Nov. 1, 1984).

three- to four-fold increase within the next year as the system is expanded to permit U.S. investors to trade on the Montreal exchange.<sup>11</sup>

Last year, a pilot program began linking the National Association of Securities Dealers' automated quotation system in the United States ("NASDAQ") and the International Stock Exchange here in London.<sup>12</sup> This program permits participants in each market to receive up-to-the-minute quotation information for selected securities in the other market. Earlier this year, a similar pilot was put in place for the exchange of end-of-day quotations between NASDAQ and the Singapore Exchange.<sup>13</sup>

On May 19 of this year, the Swiss Options and Financial Futures Exchange ("SOFFEX") opened.<sup>14</sup> This exchange is the world's first fully-automated exchange in which all trading is done from terminals in its members' offices. The exchange has been so successful<sup>15</sup> that the Swiss Bankers' Association

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<sup>11</sup>See Wall St. Letter, vol. 10, no. 42, at 5 (Oct. 24, 1988).

<sup>12</sup>See Securities Exchange Act Release No. 24979 (Oct. 2, 1987).

<sup>13</sup>See Securities Exchange Act Release No. 25457 (Mar. 14, 1988).

<sup>14</sup>See All Electronic Swiss Trading, N.Y. Times, May 19, 1988, at D-21, col. 6.

<sup>15</sup>See, e.g., Soffex to Introduce Share-Index Options, The Financial Times, June 21, 1988, at 30 ("In its first month of operation [SOFFEX] has surpassed all expectations \*\*\* with better initial volumes than those of any other European options exchange."); Trades on Swiss Options Exchange Soar;

released a report on October 18 calling for, among other reforms, the replacement of the traditional equity floor-trading exchange system with a paperless computerized exchange like SOFFEX.<sup>16</sup> It is a trivial step to expand a SOFFEX-like network from terminals within Switzerland to a network with terminals worldwide. One step in this direction is the EC's planned Interbourse Data Information System which, in the near future, will provide continuous price reporting and trading among the major securities exchanges in Europe.<sup>17</sup>

Private vendors are also offering international securities information. For example, Reuters has developed an Integrated Digital Network known as Equities 2000 that provides real-time prices on more than 100,000 stocks, bonds, mutual funds, futures and options traded on more than 137 exchanges worldwide.<sup>18</sup> Another major provider, Telerate, offers extensive quotes in the fixed income market.<sup>19</sup> Reuters

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Beyond Sponsors' Initial Expectations, Am. Banker, July 11, 1988, at 2.

<sup>16</sup>See Swiss Bankers Call for Capital Reforms to Stay Competitive with Europe of 1992, 51 Banking Rep. (BNA) No. 17, at 768, 769 (Oct. 31, 1988).

<sup>17</sup>See Goelzer, Sullivan & Mills, Securities Regulation in the International Marketplace: Bilateral and Multilateral Agreements, Symposium: Internationalization of the Securities Markets, Michigan Yearbook of International Legal Studies, Vol. IX 53, 80 (1988); Quinn, Europeans Tie the Knot, Institutional Investor, Dec. 1987 at 211, 212.

<sup>18</sup>See The Battle for the Broker's Desk, High Technology Business, Sept. 1988, at 30.

<sup>19</sup>Id.

is also working with the Chicago Mercantile Exchange ("CME") to develop GLOBEX, a worldwide electronic trading network that would allow off-hours trading in futures and options listed on the CME.<sup>20</sup>

The Bad News: Our Frauds Are Also Global

These advances in international trading have also brought increased opportunities for international fraud. To demonstrate the breadth of this fraudulent activity, it is useful to consider just a few recent examples of investigations that have international dimensions.

Zico. In an enforcement action that is notable because it involved transactions in three foreign jurisdictions in connection with a single series of securities law violations in the U.S. market, the Commission alleged that a British Virgin Islands corporation placed orders from France, through an account in London, in order to manipulate the price of a closed-end investment fund traded on the American Stock Exchange.<sup>21</sup> While this transaction may not be the most

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<sup>20</sup>See Futures Scramble Triggers Global Gold Rush, Financial Times, Oct. 28, 1988, at 36.

<sup>21</sup>SEC v. Zico Investment Holdings, Inc., No. 87 Civ. 8487 (S.D.N.Y. filed Dec. 2, 1987), discussed in Lit. Rel. No. 11617 (Dec. 2, 1987), 39 S.E.C. Dkt. 1279 (Dec. 15, 1987) and No. 11763 (June 13, 1988), 41 S.E.C. Dkt. 294 (June 28, 1988). The Commission alleged that, immediately prior to Zico's tender offer for majority control of the fund, the defendants depressed the market price of the fund's common stock. By effecting sales at the close of several days' trading, the defendants controlled the last reported price for the stock thereby creating the impression that the fund's market price was declining. The net effect of these sales was to depress

notorious fraud in the annals of crime, it nicely illustrates the international intricacies that can arise in today's marketplace.

Geoffrey Collier. It is also important to recognize that the United States markets are not the only ones victimized by international fraud. Consider the case of Geoffrey Collier, a Morgan Grenfell director, who traded in the stock of two British companies that were potential targets for bids by British clients of Morgan Grenfell. The trades were executed on the London exchange by Pureve, a Cayman Islands company set up by Mr. Collier. (The name "Pureve," by the way, is "ever up" spelled backwards, a curiosity that may explain the magnitude of the profits Mr. Collier saw in this illegal venture.)<sup>22</sup> The trades were placed by Michael D. Cassell, a senior executive in the Los Angeles office of Vickers da Costa, Inc.<sup>23</sup> Thus, a fraud in the London exchange that affected the rights of British nationals was executed by a British subject trading in his Cayman Islands account through a Los Angeles broker.

The perpetrators of such schemes frequently attempt to avoid detection by structuring their transactions to take

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the fund's market price over the ten days prior to the tender offer.

<sup>22</sup>See Britain Hurriedly Enforces Rules Covering Insider Trading Probes, Wall St. J., Nov. 14, 1986, at 29, col. 1.

<sup>23</sup>SEC v. Collier, Civ. No. 88-4505 WMB (GHK) (C.D. Cal. filed July 26, 1988), discussed in Lit. Rel. No. 11817 (July 26, 1988), 41 S.E.C. Dkt. 837 (Aug. 9, 1988).

advantage of secrecy laws. Dennis Levine, who traded in the securities of 54 companies through a secret Bank Leu account in the Bahamas provides a clear and simple example of such conduct. The only reason that Mr. Levine, a United States citizen who often traded from a pay phone in New York City, used the Bahamian accounts was to hide his United States trading activity from United States authorities.<sup>24</sup> Although the Commission was eventually able to learn Mr. Levine's identity, he avoided detection for an extended period because of the operation of Bahamas' bank secrecy laws. There is unfortunately, reason to believe that many securities law violators trade through accounts located in secrecy jurisdictions specifically for the purposes of avoiding detection and that Dennis Levine's conduct may be, in this regard, hardly unusual.

Euroscam. "Euroscam," as it has been dubbed in the press, is the most recent and perhaps best example of a truly international fraud. According to press reports, salespersons operating in Australia, Canada, France, Luxembourg, the Netherlands, Spain, Switzerland, the U.K., and West Germany sent newsletters providing run-of-the-mill advice on well-known multinational blue chips and touting little known, but

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<sup>24</sup>SEC v. Levine, 86 Civ. 3726(RO) (S.D.N.Y. filed May 12, 1986), discussed in Lit. Rel. No. 11095 (May 12, 1986), 35 S.E.C. Dkt. 1212 (May 27, 1986).

purportedly "hot," U.S. penny stocks.<sup>25</sup> These stocks had little or no trading activity. They were frequently blind pool companies with little or no assets,<sup>26</sup> and had on some occasions been suspended from trading for inadequate disclosure.<sup>27</sup> Press stories suggest that these penny stocks were promoted from "boiler rooms"<sup>28</sup> operating across national borders, and that sales were made as a result of misrepresentations with respect to the companies' assets, prospects, stock prices, and trading activity.<sup>29</sup> After convincing recipients of the newsletters to invest in these stocks, the operators simply folded their tents, leaving thousands of victims scattered across Britain and the Continent.<sup>30</sup> Press reports suggest that the magnitude of this

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<sup>25</sup>See, e.g., U.S.--European Officials Huddle on Investment Fraud Scam, Wall St. Letter, Oct. 31, 1988, at 1; Euroscam: A Stock Scandal Mushrooms, Bus. Wk., Aug. 22, 1988, at 46; Worldwide Stock Scheme Costs Investors \$150 Million, N.Y. Times, Aug. 20, 1988, at 33.

<sup>26</sup>See Blind Pools Prove Fertile for Scams, Chicago Trib., Aug. 28, 1988 at 1.

<sup>27</sup>See Euroscam: A Stock Scandal Mushrooms, supra note 25.

<sup>28</sup>The term "boiler room" is a slang expression describing a "place where high pressure salespeople use banks of telephones to call lists of potential investors (known in the trade as sucker lists) in order to peddle speculative, even fraudulent, securities." Downes & Goodman, Dictionary of Finance and Investment Terms 38 (1985).

<sup>29</sup>See Swiss Ask S.E.C. for Help in Stock Swindle Inquiry, N.Y. Times, Aug. 18, 1988, at D1.

<sup>30</sup>See Swiss Share-pushers busted, Investors Chron., Aug. 12, 1988, at 10.

fraud is enormous, with estimates that more than 10,000 investors have lost as much as (U.S.)\$500 million.<sup>31</sup>

Euroscam also illustrates one of the more frustrating enforcement problems for agencies charged with protecting the integrity of securities markets. Individuals who are adept at fraud and who are apprehended in one jurisdiction can simply pull up stakes and resume their activities in another jurisdiction. Thus, Mr. Thomas Quinn, who is alleged in press reports to have masterminded Euroscam,<sup>32</sup> spent six months in jail in the United States in 1970 for stock manipulation.<sup>33</sup> Mr. Quinn also last year settled charges in a civil injunctive action brought by the Commission involving fraudulent sales of other supposedly "hot" issues.<sup>34</sup> The irony is that this is the very same fraud he is now alleged to have conducted across the Continent.

The press reports describing Euroscam illustrate the extent to which all of us can be victimized by fraud if we fail to cooperate at an international level. Thus, we have

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<sup>31</sup> See Washington Meeting to Co-ordinate OTC Fraud Inquiries, Financial Times, Oct. 8-9, 1988, at 24.

<sup>32</sup> See, e.g., Swiss Stock Scan Swindled Investors Out of \$250 Million, L.A. Times, Sept. 6, 1988, at 1, col. 1; Swiss Share-pushers Busted, supra n.30; Swiss Asks SEC for Help in Stock Swindle, supra n.29.

<sup>33</sup> See United States v. Quinn, 445 F. 2d 940 (2d Cir. 1971), cert. denied, 404 U.S. 850 (1971).

<sup>34</sup> See SEC v. Quinn, 83 Civ. 2794 (TPG) (S.D.N.Y. filed Apr. 12, 1983), discussed in Lit. Rel. No. 9964 (Apr. 14, 1983), 27 S.E.C. Dkt. 1149 (Apr. 26, 1983).

already reached a point in the history of the international securities market at which we face a fundamental choice: either we all cooperate so that each of us is safe against violations of our domestic laws in our domestic markets, or we fail to cooperate and none of us is left with the ability even to detect securities laws violations by our own nationals trading in our own markets. To borrow a refrain from a song that was popular during the American revolution, "by uniting we stand, by dividing we fall" in the battle against international fraud.<sup>35</sup>

Waiver by Conduct: An Approach Out of Favor

Faced with serious difficulties in policing international frauds, the Securities and Exchange Commission in 1984 considered an enforcement strategy based on the notion of "waiver by conduct."<sup>36</sup> Under this theory, the decision to purchase or sell securities on a U.S. market would be deemed an implied consent to disclosure of information relevant to the transaction for purposes of any Commission investigation, administrative proceeding or injunctive action, regardless of any foreign secrecy laws. In addition, the purchase or sale would also be deemed to constitute appointment of the U.S. broker that executed the transaction as agent for service of

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<sup>35</sup>Dickinson, "The Liberty Song," Bartlett's Familiar Quotations 378 (E. M. Buck ed. 1980).

<sup>36</sup>See Sec. Exch. Act Rel, No. 21186 (July 30, 1984), 49 Fed. Reg. 31,300 (Aug. 6, 1984) (proposing release).

process, as well as a implied consent to the exercise of in personam jurisdiction by the Commission and the United States courts.

The Commission received more than 500 pages of comments from representatives of the securities industry and self-regulatory organizations, foreign and domestic banks, attorneys and legal societies, legal scholars, and nine foreign governments. These comments were overwhelmingly negative.<sup>37</sup> In general, the commentators viewed "waiver by conduct" as an extraterritorial extension of United States law to foreign nationals conducting transactions through foreign institutions. The comments expressed the view that the implied waiver and consent to process would not be enforceable under most foreign laws and thus would not resolve any existing conflicts.

British commentators tended to stress difficulties in enforcement of the theory, especially where a chain of trading institutions might be involved. For example, if a determined principal created a complex chain of foreign intermediaries,

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<sup>37</sup>See, e.g., SEC: Conduct Unbecoming?, Economist, Jan. 5, 1985 at 64, 65; Note, Enforcing Securities Regulations Through Bilateral Agreements with the United Kingdom and Japan: An Interim Measure or a Solution?, 23 Tex. Int'l L. J. 251, 263 (1988); See generally Mann & Mari, Current Issues in International Securities Law Enforcement reprinted in 1 Securities Enf. Instit., Corp. Law & Prac. Course Handbook No. 604 (PLI) 7, 80-81 (1988); Bordeaux-Groult, Problems of Enforcement and Cooperation in the Multinational Securities Market: A French Perspective, 9 U. Pa. J. Int'l Bus. L. 453, 462 (1987); Charter & Beck, Problems of Enforcement in the Multinational Securities Market, 9 U. Pa. J. Int'l Bus. L. 467, 484 (1987).

even a waiver by conduct law would eventually hit a "blank wall."<sup>38</sup> Furthermore, the concept was inherently flawed because, as the Commission itself recognized, such a law could have no effect upon foreign blocking laws, which generally cannot be waived by individuals.<sup>39</sup> In addition, some commentators have suggested that application of the waiver by conduct theory could evoke passage of blocking laws in additional foreign jurisdictions.<sup>40</sup> Several commentators also believed that use of the waiver by conduct theory would drive business away from the United States to less regulated markets.<sup>41</sup>

I too have great difficulty with "waiver by conduct," and am glad to see that the Commission has changed its emphasis in this area--though I observe that the "waiver-by-conduct" release has not been formally withdrawn. At a fundamental

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<sup>38</sup>Letter from Jeffrey Knight, Chief Exec., The Stock Exchange, to John Fedders, Dir. of Enf., Securities and Exchange Comm. (Nov. 9, 1984); see also Letter from J. B. Atherton, Sec'y-General, British Bankers' Ass'n, to George A. Fitzsimmons, Sec'y, Securities & Exchange Comm. (Nov. 27, 1984); and Letter from D. F. Gray, Master, The City of London Solicitors' Co., to George Fitzsimmons (Dec. 28, 1984).

<sup>39</sup>Blocking laws, unlike secrecy laws, protect a state's interest in certain information, rather than an individual's interest in confidentiality. Pitt, Hardison & Shapiro, Problems of Enforcement in the Multinational Securities Market, 9 U. Pa. J. Int'l Bus. L. 375, 402-03 (1987).

<sup>40</sup> See Note, supra note 37.

<sup>41</sup>Id.; see, e.g., Letter from Peter J. Wallison, General Counsel, United States Department of the Treasury, to Shirley E. Hollis, Acting Sec'y, United States Securities and Exchange Commission (Nov. 28, 1984).

level, international securities fraud adversely affects all participants in the international securities markets. Because all participants have much to gain from the elimination of international fraud, it stands to reason that cooperative approaches that rely on mutual self-interest are best suited to addressing the problem of international fraud. Indeed, the recognition that cooperative approaches are likely to be more fruitful than unilateral attempts to assert extraterritorial jurisdiction underlies the current Commission philosophy in the area of international securities enforcement.

#### The Beginnings of a Cooperative Effort

The Commission's cooperative efforts to stamp out international securities fraud have their roots in a 1977 treaty between the United States and Switzerland that provides for broad assistance in criminal matters in locating witnesses, production of business records, and service of documents.<sup>42</sup> Unlike the Hague Convention,<sup>43</sup> the Swiss Treaty

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<sup>42</sup>The Treaty on Mutual Assistance in Criminal Matters Between the Swiss Confederation and the United States, done on May 25, 1973 (effective 1977), 27 U.S.T. 2019.

<sup>43</sup>The Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters, 23 U.S.T. 2555, T.I.A.S. No. 7444. The Convention is in force in France, Barbados, Cyprus, Czechoslovakia, Denmark, Finland, The Federal Republic of Germany, Israel, Italy, Luxemburg, the Netherlands, Norway, Portugal, Singapore, Sweden, the United Kingdom, and the United States. It standardized certain procedures by which a judicial authority in one country may request evidence located in another: letters rogatory and evidence-taking by a consular official or private commissioners. For a discussion of the background and limitations of the Hague Convention, see Societe Nationale v.

can be employed during the early stages of an investigation. However, the Swiss Treaty applies only to offenses that are criminal in both nations.

The dual criminality standard has at times raised difficulties where certain actions violate U.S. but not Swiss law.<sup>44</sup> Switzerland's recent enactment of a criminal insider trading law, however, establishes dual criminality for the U.S. securities law violation that most frequently arises

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U.S. District Court for the Southern District of Iowa, 107 S. Ct. 2542, 2545 and n.1 (1987).

The Hague Convention has proved of limited use to the Commission. First, it can be used only in connection with judicial proceedings; thus, it is generally unavailable in the Commission's administrative proceedings or for its formal orders of investigation. Mann & Mari, supra note 37, at 79. Furthermore, most of the signatories have exercised their prerogative under Article 23 of the Convention to refuse to execute letters rogatory for the purpose of pre-trial discovery of documents. See Report on the Second Meeting of the Special Commission on the Operation of the Hague Convention of 18 March 1970 on the Taking of Evidence Abroad in Civil or Commercial Matters, reprinted in 24 I.L.M. 1668 (1985); Mann & Mari, supra note 37, at 65(79); Greene, Cohen & Matlock, Problems of Enforcement in the Multinational Securities Market, 9 U. Penn. J. Int'l Bus. L. 325, 371 (1987).

<sup>44</sup>See, e.g., SEC v. Certain Unknown Purchasers of the Common Stock of, and Call Options for the Common Stock of Santa Fe Int'l Corp., [1983-84 Transfer Binder] Fed. Sec. L. Rep. (CCH) para. 99,424 (S.D.N.Y. 1981). In Santa Fe, the Commission requested assistance under the Swiss treaty to learn the identities of purchasers of Santa Fe stock and options just prior to announcement of a merger. The Swiss court initially denied the Commission's request on the grounds that the Commission failed to establish prima facie the requisite violations of Swiss law. See 22 I.L.M. 785 (1983). Subsequently, however, the Commission alleged additional facts demonstrating that the unknown purchasers were tippees, and had thus violated Swiss law by their trades. Accordingly, the Swiss court granted the Commission's request. See Mann & Mari, supra note 37, at 62-64.

through Swiss channels, and thereby greatly enhances cooperation between Switzerland and the United States.<sup>45</sup>

The U.S. also has three other mutual assistance treaties in force and has negotiated five others that are not yet in force providing for securities law enforcement.<sup>46</sup> In addition to these treaties, the Commission has entered into "Memoranda of Understanding" with Switzerland,<sup>47</sup> the Japanese Ministry of Finance,<sup>48</sup> the provincial Canadian securities commissions of Ontario, Quebec, and British Columbia,<sup>49</sup> the Brazilian

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<sup>45</sup>See Sec. Reg. & L. Rep. (BNA), No. 23, at 878 (June 10, 1988).

<sup>46</sup>The three mutual assistance treaties currently in force are: (1) The Treaty on Mutual Legal Assistance between the Kingdom of the Netherlands and the United States, done June 12, 1981, T.I.A.S. No. 10734; (2) The Treaty on Extradition and Mutual Assistance in Criminal Matters between the United States of America and the Republic of Turkey, done June 7, 1979, T.I.A.S. No. 9891; and (3) The Treaty between the United States of America and the Italian Republic on Mutual Assistance in Criminal Matters, effective November 13, 1985, Sen. Ex. 98-25, 98th Cong. 2d Sess. The five negotiated treaties not yet in force are between the United States and the Bahamas, Columbia, Morocco, Canada, and the Cayman Islands. Mann & Mari, supra note 37, at 58.

<sup>47</sup>Memorandum of Understanding Between the United States and Switzerland on Mutual Assistance in Criminal Matters and Ancillary Administrative Proceedings, entered into November 10, 1987.

<sup>48</sup>Memorandum of the United States Securities and Exchange Commission and the Securities Bureau of the Japanese Ministry of Finance on the Sharing of Information, entered into May 23, 1986, 25 I.L.M. 1429 (1986).

<sup>49</sup>Memorandum of Understanding between the Securities and Exchange Commission and the Ontario Securities Commission, Commission de Valeurs Mobilières du Québec and the British Columbia Securities Commission, entered into January 7, 1988. See SEC, Canadian Provinces Sign Securities Enforcement Accord, Sec. Reg. & L. Rep. No. 1, at 17 (Jan. 8, 1988).

Commission de Valores Mobiliarios,<sup>50</sup> and the Department of Trade and Industry here in the U.K.<sup>51</sup> In addition, the Commission has begun negotiating memoranda of understanding with at least four other countries.

These memoranda play a critical role in the Commission's cooperative international enforcement effort, and it is worthwhile briefly to review the operation of procedures under some of these memoranda.

#### The Swiss MOU

On August 31, 1982, the governments of the United States and Switzerland signed a Memorandum of Understanding to establish "mutually acceptable means" for dealing with certain insider trading problems that, because of the lack of mutual criminality, were not susceptible to resolution under the Treaty on Mutual Assistance. On July 1 of this year, the Swiss insider trading law went into effect, thereby establishing mutual criminality for insider trading, and the MOU was terminated. Nevertheless--and despite the fact that

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<sup>50</sup>Memorandum of Understanding between the Securities and Exchange Commission and the Brazil Comissao de Valores Mobiliarios, entered into July 1, 1988. See SEC, Brazilian Officials Sign Memo to Enhance Enforcement Cooperation, Sec. Reg. & L. Rep. (BNA), No. 27, at 1059 (July 8, 1988).

<sup>51</sup>Memorandum of Understanding on Exchange of Information Between the United States Securities and Exchange Commission, the Commodities Futures Trading Commission, and the United Kingdom Department of Trade and Industry on Matters Relating to Securities, entered into September 23, 1986, [1986-87 Transfer Binder] Fed. Sec. L. Rep. (CCH) para. 84,027 (Sept. 23, 1986), reprinted in 25 I.L.M. 1431 (1986).

the Commission has recently negotiated more comprehensive MOU's--the Swiss MOU remains an excellent example of how an effective relationship can be tailored to the specific bilateral concerns of the participants.

The Swiss MOU mandated the establishment of a provisional arrangement for providing the Commission with assistance in the form of a separate private agreement among members of the Swiss Bankers' Association ("SBA"). That agreement, known as Convention XVI (the "Convention"), provided that, under certain circumstances, banks may disclose information to the SEC without violating the Swiss bank secrecy laws.

Convention XVI applied only to insider trading occurring prior to announcement of an "acquisition" or "business combination," as those terms are defined in the agreement.<sup>52</sup> The Convention required that the board of directors of the SBA appoint a Commission of Inquiry to handle requests by the SEC. If the Commission of Inquiry was satisfied that the SEC had met certain thresholds set out by the Convention,<sup>53</sup> the

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<sup>52</sup>A "Business Combination" was defined as a proposed merger, consolidation, sale of substantially all of an issuer's assets, or other similar business combination. An "Acquisition" was defined as the proposed acquisition of at least 10% of the securities of an issuer by open market purchase, tender offer, or otherwise.

<sup>53</sup>Convention XVI of the Memoranda provided that the MOU's procedures shall be available if, within 25 trading days prior to a public announcement of a "Business Combination," or of the proposed acquisition of at least 10% of the securities of an issuer by open market purchase, tender offer or otherwise ("Acquisition"), a customer gives to a bank an order to be executed in the U.S. securities markets for the purchase or sale of securities or options on securities of any

Commission of Inquiry called for a report from the banks involved concerning the transactions covered by the request. Further, upon receipt of the request from the Commission of Inquiry, the banks froze the relevant customer accounts, up to the amount of the profit realized in the transaction. This procedure assured that the funds at issue could not be dissipated or secreted pending resolution of a case.

As an example of the operation of this arrangement, on August 7, 1986, the Commission settled the Katz-RCA insider trading case, the first case in which it had obtained assistance pursuant to the 1982 Swiss MOU.<sup>54</sup> The Commission there alleged that Marcel Katz ("Marcel") obtained material, nonpublic information relating to a merger between RCA and General Electric Company ("GE") in the course of his employment as an analyst at the investment banking firm of Lazard Freres & Co. ("Lazard"). The Commission further alleged that Marcel subsequently disclosed this information to his father, who then conveyed the information to his father-in-law, Elie Mordo ("Mordo"), who resides abroad, and purchased 100,000 RCA shares through an account at the Geneva office of Union Bank of Switzerland.

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company that is a party to a Business Combination or the subject of an Acquisition. If these criteria were not met, the commission reviewed the information submitted by the SEC to determine whether the SEC had reasonable grounds for its request.

<sup>54</sup>See SEC v. Katz, No. 86 Civ. 6088 (S.D.N.Y. Aug. 7, 1986), discussed in Lit. Rel. No. 11185 (Aug. 7, 1986).

The Commission's request for assistance was reviewed by the Banker's Association, the Swiss Federal Court and the Swiss Federal Council, all of whom affirmed the Commission's right to obtain the evidence sought. During these deliberations, the profits that Mordo later disgorged in the U.S. civil action were frozen in Switzerland pending a final resolution of the case. Altogether, the defendants disgorged profits and paid penalties under the Insider Trading Sanctions Act totalling nearly \$5.5 million.

#### The United Kingdom MOU

On September 23, 1986, the United Kingdom's Department of Trade and Industry signed a memorandum of understanding with the SEC and the United States Commodities Futures Trading Commission ("CFTC").<sup>55</sup> This MOU is the first working arrangement among U.S. and U.K. securities regulators. It provides for assistance in matters involving insider trading, market manipulation, and misrepresentations relating to market transactions.<sup>56</sup> It also provides for exchanges of information in matters relating to the oversight of the operational and financial qualifications of investment businesses and brokerage firms.<sup>57</sup>

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<sup>55</sup>Memorandum of Understanding on Exchange of Information Between the SEC, CFTC, and the United Kingdom Department of Trade and Industry in Matters Relating to Securities and Futures, supra note 51 (the "U.K. MOU").

<sup>56</sup>U.K. MOU sec. 1(b)(i)(A) and (ii)(A).

<sup>57</sup>Id., sec. 1(h)(i)(C) and (ii)(C).

Requests for information under this MOU must state:

(1) the information sought, (2) the general purpose for which the information is sought, (3) the reasons for suspecting a violation,<sup>58</sup> and (4) the identity of the person under investigation.<sup>59</sup> In addition to these safeguards against abuse, the memorandum requires that the parties consult when questions arise regarding its operation, and provides that all documents not previously made public will be returned to the other authority.

The U.S.-U.K. accord was the first negotiated by the Commission to provide assistance for a broad range of regulatory, as well as enforcement, matters. More importantly, this MOU is intended as a first step toward a comprehensive program of cooperative securities regulation between our countries. Indeed, the accord expressly provides that further negotiations toward this end will be conducted.

#### The Canadian and Brazilian MOU's

The most comprehensive memoranda to date negotiated by the Commission are those with the Ontario, Quebec, and British Columbia Securities Commissions (the "Canadian MOU") entered on January 7, 1988, and with the Brazilian authorities entered on July 1, 1988. The substance of these MOU's is largely

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<sup>58</sup>Id. sec. 7(b)(iii).

<sup>59</sup>Id., sec. 7(b)(iv).

identical<sup>60</sup> and each commits the signatories to provide mutual assistance to the fullest extent possible for investigations involving a wide range of securities law violations.<sup>61</sup>

Unlike previous MOU's that have required voluntary cooperation of witnesses or other agreements that have required the initiation of costly and time-consuming litigation, the Canadian and Brazilian MOUs provide that the

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<sup>60</sup>The MOU between the SEC and its Brazilian counterpart, the Comissao de Valores Mobiliarios, is identical in most respects to the Canadian MOU, except that it contains additional language making explicit the parties' intention to use the MOU mechanism to conduct compliance inspections of investment businesses such as brokers and investment companies which engage in business in both jurisdictions.

<sup>61</sup>These MOU's provide that assistance will be made available in cases involving:

- (1) insider trading;
- (2) misrepresentation or the use of fraudulent, deceptive or manipulative practices in connection with the offer, purchase or sale of any security;
- (3) the duties of persons to comply with periodic reporting requirements or requirements relating to changes in corporate control;
- (4) the duties of persons, issuers or investment businesses to make full and fair disclosure of information relevant to investors;
- (5) the duties of investment businesses and securities processing businesses pertaining to both their financial, operational or other requirements and their duties of fair dealing in the offer and sale of securities and the execution of transactions; and
- (6) the financial and other qualifications of those engaged in, or in control of, issuers, investment businesses or securities processing businesses.

See Mann & Mari, supra note 37, at 62-63.

securities regulators in each country will use subpoena power if necessary and if so authorized under domestic law to obtain necessary information on behalf of one another. As of the date these agreements were signed, only the Quebec Securities Commission and Brazil were expressly authorized to conduct an investigation on behalf of a foreign securities authority, absent a domestic violation. At the time of signing, the Commission agreed to seek such legislative authority and the passage of the 1988 Enforcement Act, to which I now turn, marks the rapid fulfillment of the Commission's commitment to its Canadian and Brazilian colleagues.

#### The International Cooperation Act

The most recent and significant step in the United States' campaign against international securities fraud came at two o'clock on the morning of October 22 when the Senate enacted H.R. 5122.<sup>62</sup> Although that legislation deals primarily with domestic U.S. sanctions for insider trading activity,<sup>63</sup> it contains a currently little-known provision

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<sup>62</sup>1988 Enforcement Act, supra note 1.

<sup>63</sup>The legislation:

(1) increases the maximum jail term for criminal securities law violations from five to ten years. It also increases the maximum criminal fines for individuals from \$100,000 to \$1 million and the maximum corporate fine from \$500,000 to \$2.5 million. Id. at sec. 4 (to be codified at 15 U.S.C. 78ff(a)).

(2) provides that firms and other "controlling persons" that "knowingly or recklessly" fail to supervise properly their employees and prevent insider trading violations can be

that authorizes the Securities and Exchange Commission to provide assistance within the United States to foreign securities authorities investigating violations of foreign securities laws.<sup>64</sup>

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liable for treble damages for violations of their employees or other "controlled persons." Id. at sec. 3(a) (to be codified at 15 U.S.C. 78(u)).

(3) requires that regulated securities firms establish and maintain written policies "reasonably designed" to prevent misuse of material, nonpublic information by the firm or any of its employees or associated firms. It also authorizes the SEC to take a more active role in the establishment and monitoring of regulated firms' "chinese wall" procedures. Id., sec. 3(b) (to be codified at 15 U.S.C. 78(o)).

(4) authorizes the Commission to pay bounties to persons who provide information leading to the successful prosecution of insider trading violations. The Commission may, in its discretion, award a bounty up to 10 percent of the penalty imposed through litigation or settlement. Id. at sec. 3(a) (to be codified at 15 U.S.C. 78(u)).

(5) grants an express private right of action against insider traders and tipplers who traded the same class of securities "contemporaneously" with, and on the opposite side of the market from, the insider trader. Id. at sec. 5 (to be codified at 15 U.S.C. 78(t)). This provision reverses the rule of Moss v. Morgan Stanley, Inc., 719 F.2d 5 (2d Cir. 1983), cert. denied 465 U.S. 1025 (1984), which requires a breach of a duty owed to the trader as a precondition to a private party's standing to pursue an insider trading claim.

<sup>64</sup>Section 6 of the legislation, entitled "Investigatory Assistance to Foreign Securities Authorities," provides, in relevant part, that:

On request from a foreign securities authority, the Commission may provide assistance in accordance with this paragraph if the requesting authority states that the requesting authority is conducting an investigation which it deems necessary to determine whether any person has violated, is violating, or is about to violate any laws or rules relating to securities matters that the

Thus, if appropriate British authorities request assistance in gathering information within the United States regarding a violation of British securities laws, we are now authorized to provide that assistance through formal mechanisms, including the issuance of subpoenas. There is no requirement of dual criminality, and the conduct underlying the British request need not constitute a violation of United States law.

The Commission is not, however, automatically obligated to provide such assistance. The Commission is authorized to exercise its discretion and is specifically required to consider whether the provision of such investigatory assistance would "prejudice the public interest of the United States." To assist the Commission in making this determination, arrangements have been made for consultation

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requesting authority administers or enforces. The Commission may, in its discretion, conduct such investigation as the Commission deems necessary to collect information and evidence pertinent to the request for assistance. Such assistance may be provided without regard to whether the facts stated in the request would also constitute a violation of the laws of the United States. In deciding whether to provide such assistance, the Commission shall consider whether (A) the requesting authority has agreed to provide reciprocal assistance in securities matters to the Commission; and (B) compliance with the request would prejudice the public interest of the United States.

with the Executive Branch through the Department of Justice.<sup>65</sup> The provision is supported by the Department of Justice<sup>66</sup> as well as the United States Department of State.<sup>67</sup>

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<sup>65</sup>The Commission and the Department of Justice("DOJ") have agreed that:

(1) Prior to instituting a formal investigation at the request of a foreign securities authority, the Commission will provide DOJ with a copy of the request and permit DOJ an opportunity to comment;

(2) The Commission will notify DOJ if it decides to commence an action pursuant to Section 21(c) of the Securities Exchange Act to enforce a subpoena issued at the request of a foreign securities authority;

(3) The Commission will obtain the concurrence of DOJ prior to seeking criminal sanctions in connection with a witness refusal to comply with a subpoena issued at the request of a foreign securities authority;

(4) The Commission will consult with DOJ's Office of International Affairs regarding the selection of countries for negotiation of Memoranda of Understanding and the content of the Memoranda; and

(5) If DOJ or a United States Attorney wishes to request assistance from the Commission that requires the use of a Memorandum of Understanding, the request will be directed to the Commission staff through DOJ's Department of International Affairs.

See Hearings on S. 2544, The International Securities Enforcement and Cooperation Act of 1988, Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs, 100th Cong., 2d Sess. (June 29, 1988) (statement of Mark M. Richard, Deputy Ass't. Att'y General, Criminal Division, United States Department of Justice).

<sup>66</sup>Id.

<sup>67</sup>See Letter from John C. Whitehead, Deputy Sec'y of State, to the Hon. Donald W. Riegle, Jr., Chairman, Securities Subcomm., Senate Comm. on Banking, Housing and Urban Affairs (June 29, 1988).

In exercising its discretion, the Commission is also specifically directed to consider "whether the requesting authority has agreed to provide reciprocal assistance in securities matters to the Commission." Thus, although there is no mandatory requirement of reciprocity,<sup>68</sup> the Commission could well refuse to provide assistance to a foreign authority that was either unable or unwilling to reciprocate.

It is certainly far too early to draw any conclusions about the operation of the reciprocity provision in practice, I am, however, glad to share my personal and preliminary views on this matter. With the clear understanding that my views do not bind my colleagues and do not necessarily reflect the views of the Commission's staff, I would hope that our major trading partners respond to the 1988 Enforcement Act by adopting parallel legislation that creates effective reciprocal investigative authority that can be used to root out international fraud. We need not wait for a major

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<sup>68</sup>In this respect, the legislation passed by Congress differs from the International Securities Enforcement Cooperation Act of 1988, S. 2544, 100th Cong., 2d Sess. (reported Aug. 8, 1988), that would have required reciprocity as a pre-condition to assistance. The Commission opposed mandatory reciprocity because situations could arise in which the Commission could promote the development of a mutual assistance relationship by granting assistance to a foreign securities authority. In the Commission's view, "a reciprocity requirement could unnecessarily constrain the Commission in its relationships with foreign securities authorities and would limit the Commission's ability to provide assistance even where doing so would be in the Commission's best interest." Memorandum of the Securities and Exchange Commission in Support of the International Securities Enforcement Act of 1988 (June 3, 1988).

international incident to point out the value of such cooperative arrangements--we already have too much experience in that regard.

If, however, a foreign authority seeks SEC assistance under circumstances of less than full reciprocity, I would certainly consider offering such assistance provided that there was reason to believe that steps to attain meaningful reciprocity would be reasonably forthcoming. If there is no basis to believe that the foreign authority is willing to provide such reciprocity, I would be far less enthused about offering any investigative assistance, absent very special circumstances.

In other words, I see this legislation as a first step that the United States has taken toward greater international cooperation. It is not, however, a blank check that promises limitless assistance to our trading partners with nothing expected in return. We must cooperate in an international effort against international fraud. We in the United States are willing to take the first step in that effort, but we will not write a blank check.

### Conclusion

Securities fraud is more than an international problem that requires an international solution. The reality of today's marketplace is that if we fail to develop effective means of international cooperation none of us will be able to enforce even our own laws against our own citizens trading in

our own domestic markets. Thus, either we learn to cooperate in the international arena or we surrender our domestic regulatory regimes and resign ourselves to a world in which securities and other financial regulations are mere statements of symbolic aspirations that are evaded with impunity by international traders.

Progress in this arena requires that we break with tradition and become as bold and imaginative as the international thieves operating in our midst. We must become as adept at removing the barriers at national borders as they are at hiding behind them. The first step in this process involves, I believe, cooperative investigatory arrangements. Without the ability to gather information about international frauds it is impossible to police against and deter these frauds.

The Commission's recently granted authority to conduct investigations in the United States on behalf of foreign securities authorities, even if there is no allegation that U.S. law has been violated, constitutes a significant first step by the United States in the battle against international fraud. I look forward to the opportunity to use that authority in aid of Britain and our other trading partners who have reason to believe that valuable enforcement information might be found in the United States. I also look forward to the day when that favor might be returned so that we all are safer in the battle against fraud.