

# NEWS

## SECURITIES AND EXCHANGE COMMISSION

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THE SECURITIES AND EXCHANGE COMMISSION  
AND FOREIGN ISSUES IN THE UNITED STATES

An Address By

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Securities and Exchange Commission

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Tokyo, Japan

Some twenty years ago, I served for awhile as a member of the staff of the Securities and Exchange Commission, mostly as Director of the Commission's Division of Corporate Regulation, whose responsibilities then included the administration of the Investment Company Act of 1940. In that capacity, I had the pleasant and rewarding experience of visiting with several groups of Japanese experts who were in Washington to exchange ideas and to learn whatever seemed of value from our experience in securities regulation and, in my case, because of the nature of my responsibilities at the time, our experience in the regulation of mutual funds.

All of us who participated in the discussion during those years gained, I believe, long-lasting respect for each other and for the ability and concern for the general welfare of our financial and business institutions and the men engaged in their management. With due allowance for the peculiarities of our respective societies and traditions, we have watched the growing compatibility of our respective industrial systems and capital markets. Despite certain restrictive features in our respective laws -- in one case primarily our income tax laws -- we have steadily become more involved with one another

in financial matters and more comfortable in dealing with one another. This has contributed great strength to the economic development of the free world.

Now, as we all know, our respective countries are in the throes of new and especially challenging problems. There is, I suppose, some irony in the fact that, at the same time our government has taken, and is taking, steps to further the free flow of capital among nations, our capital markets have become less attractive to investors than they have been at any time since the great depression. Our rate of inflation, the high cost of money, and the low state of the stock market would not appear to make our capital markets promising sources of capital for foreign enterprises any more than they are for domestic companies.

At the same time, the depressed prices at which the stocks of most of our publicly-held companies are selling make those companies vulnerable to take-overs by persons who are not U.S. citizens, as well as to those who are.

As one might expect, this has generated fear in some quarters, and suggestions for protectionist legislation in others, lest too much of our industry come under the control of aliens. I suspect that citizens of other countries who

have lived for years with the threat of domination by huge U.S. corporations are getting some amusement, if not pleasure, from the spectacle of our agony in this regard, but human nature knows no national boundaries. At present, nevertheless, our national policy favoring the free flow of capital has not changed, and I will address myself to my subject on the assumption of its continuation.

In speaking further, I must also assume that in the future our markets will have some attraction to companies of other countries as a source of capital. President Ford has made it very clear that inflation and the state of our economy have the highest claim on his attention. In an effort to promote the widest possible understanding of the present state of affairs and, hopefully, to develop a consensus as to the proper course for the future, the President is holding a series of public conferences which will culminate in what has come to be called an economic "summit" conference, to be held on September 27th and 28th. The preliminary conference on banking and finance has now been set for September 20th in Washington. Because my attendance at the September 20th Conference was requested, I regret that I must cut short my visit in Japan.

It is not my province to discuss the business aspects of investing in the United States, or of seeking capital from our markets. Other speakers at this conference are more informed about these matters than I am. Furthermore, as a matter of policy, persons in my position with the Securities and Exchange Commission carefully refrain from expressing any formal, or public, judgments on such matters. So I will limit my remarks to the legal, or regulatory, aspects of such transactions, and I should like to begin with a brief summary of our laws and procedures -- even at the risk of telling you some things with which you doubtless already are familiar.

As they relate to citizens of other countries, our laws present three areas of major concern. The first area concerns the offering of securities in the United States by foreign companies and governments or governmental bodies. The second area concerns the purchase by foreigners of securities of U.S. companies. And the third area concerns foreign companies whose securities become publicly-held by U.S. citizens.

In passing, let me say a word about my use of the words "foreign" or "alien." In many languages, the equivalent of these words has an unfriendly connotation. Indeed, I learned in school that the Latin term for foreign was the same as the term for enemy. English usage also sometimes confuses the two connotations. Unfortunately, in discussing our present topic, I must necessarily refer to companies organized under the laws of Japan and other countries, and investors who are citizens, or at least residents, of Japan or countries other than the United States, and the only convenient English words available to express their status are "foreign" and "alien." Please accept my use of them in their technical sense, without any emotional overtones.

Turning to the first area of our concern, generally, the offering of securities -- stocks and bonds or their equivalents -- in our country is primarily governed by our Securities Act of 1933. Our several states also have laws relating to the offering of securities and other matters that I will not discuss this morning, and I must caution you to keep this fact in mind. It is quite impractical for me to attempt

to include in my remarks any reference to these state laws, because there is an immense variety. Fortunately, from your point of view, there is a sufficient variety so that prohibitory provisions in the laws or administrative policies of any one state or even group of states will not necessarily impede a successful offering. Beyond this, I can only say that American law firms skilled in financial matters are prepared to render advice on state laws, and a foreign issuer, like a U.S. issuer, should consult one of them on any particular offering.

Returning to our federal law, the Securities Act, much like your Securities and Exchange law, requires that, unless an exemption is available, all securities must be registered with the SEC under that Act before they can be offered or sold to the public. Those of you who are experts in this field will discern some looseness in my language, but I hope you will condone it in the interest of simplicity and clarity. This sort of registration is accomplished by filing a registration statement, including a prospectus, on a prescribed form, together with the copies of documents required as exhibits. This filed material is then examined by the

members of our staff Division of Corporation Finance. Oral or written staff comments are communicated to the registrant or its counsel and, when the staff comments have been satisfied, an order is issued making the registration statement effective. As is the case with your Ministry of Finance, when our staff examines registration statements we do not guarantee the accuracy of the information in the statements and the ultimate responsibility for the truthfulness of the filing is on the issuer. <sup>\*/</sup>

As is apparently true of Japanese law, <sup>\*\*/</sup> securities being registered with us may be offered during the waiting period from the date of filing to the date of effectiveness. Actual sales, however, may not be consummated prior to effectiveness, and it is unlawful to offer, or seek to induce investors to buy, before the filing date.

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<sup>\*/</sup> See Securities and Exchange Law, Articles 16-18, Law No. 25, Apr. 13, 1948, as amended.

<sup>\*\*/</sup> Misawa, Securities Regulation in Japan, 6 Vand. J. Transnational Law 447, 485, 495 (1973).

The purpose of the registration statement and prospectus required by our laws is to make available to investors all of the information which a reasonably intelligent person should have about the securities and the company issuing the securities in order to make an investment decision. In our terminology, the Securities Act and our rules and forms seek full disclosure, not regulation, and not protection against fully informed, but unwise, investment decisions.

Under many of our state laws, however, the state securities administrator may, indeed must, refuse to permit securities to be sold in his state if he finds that the offering is, for any reason, not "fair, just and equitable," regardless of the fullness of the disclosure.

This parental approach is not present in our federal law. Nor is our Commission expected to exercise any judgment on whether the proposed financing reflects sound policy either with respect to investors, or the issuing company, or for our economy in general. We have steadfastly resisted any temptation to intrude ourselves into these matters. We do not have any organization, for example, comparable to your Capital Increase

Coordinating Committee, to review, even on a voluntary basis, a proposed stock issue for purposes of evaluating the market effect that that stock issue might produce. <sup>\*/</sup>

You may be interested in a recent example of our policy at work. Last May, Citibank, the holding company which owns the First National City Bank in New York and certain other companies engaged in financial activities, filed a registration statement for \$200,000,000 aggregate principal amount of so-called "floating rate" notes, the interest on which would vary from time to time according to the interest rate on United States Government Treasury Bills and the notes would be redeemable by the holder at face amount on specified dates at six month intervals. Although your knowledge of Eurodollar markets means you are familiar with floating rates, for our capital markets at the time, and now, this ingenious, limited form of indexing could be expected to have much attraction for investors, and it did.

Our staff proceeded to process the Citibank registration statement in the usual way, and little public attention was paid to the pending offering until, in June and in response to the extraordinary demand the underwriters were encountering, Citibank

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\*/ Misawa, supra p. 7, 6 Vand. J. Transnational Law at p. 453.

amended its registration statement to increase the aggregate amount to \$800,000,000. At that point, everyone seemed to start paying attention. The floating rate notes seemed likely to compete directly (except for the lack of insurance protection) with deposits in savings banks and savings and loan associations which provide most of the financing for building construction, especially residential building, and which were already experiencing a net outflow of funds, contributing to the severe decline in the housing industry. Savings banks and savings and loan associations are limited by law as to how much interest they can pay and, under present laws and circumstances, they cannot compete with the floating rate notes.

This led, in some quarters, to the suggestion, or more accurately to the plea, that we use our power to delay, if not altogether prevent, the effectiveness of Citibank's registration statement because, it was argued, the proposed financing would be harmful to the housing industry by diverting funds from the thrift institutions that finance that industry. We declined, on the ground that it would be a departure from sound policy in the administration of, and inconsistent with the intent of the Securities Act to deny effectiveness because of considerations unrelated to full disclosure.

I have described this episode in some detail because it has some relevance to our processing of securities of foreign issuers. In all candor, I should add that there was not unanimity among other government officials more directly concerned with financial regulation on the desirability of the Citibank offering from a public interest point of view. We were not, therefore, faced with a situation in which all responsible officials agreed that the offering would be bad for the country. We will, nevertheless, continue to resist efforts to enforce other financial policies through the granting or denial of effective registration under the Securities Act. We believe such policies should be achieved more directly through, for example, tax measures -- as was done a decade ago with the now unlamented Interest Equalization Tax on foreign debt securities -- or other forms of control. We propose to process foreign registrations in accordance with that policy.

This is not to say that foreign offerings can, or should, be processed exactly as though they were domestic offerings. Certain adjustments have seemed appropriate in the past and no doubt will in the future.

The Securities Act itself does not expressly distinguish foreign from domestic corporate offerings. The only special treatment based upon nationality is for offerings by foreign governments. But, we have ample authority under the law in the adoption of rules and forms and in our comments on filings to make whatever accommodations of this nature we think appropriate. We have made some in the past. We expect to make fewer in the future because there appears to be less justification, particularly as accounting practices in our respective countries become more similar.

In general, our objective is to require foreign issuers to disclose the same information as domestic issuers for the same type of offering in the same circumstances. The SEC long ago rejected the idea that foreign issues be treated as virtually exempt from our disclosure requirements on the theory that the U.S. investor knows, simply because of the alien nationality of the issuer, that he is not getting information of quality comparable to what would be demanded of a domestic issuer and, therefore, invests at his own risk. The acceptance of such an attitude would, in our opinion, not only have deprived U.S. investors of protections which our Congress evidently intended they should have, but also, in the long run,

would have damaged the attractiveness of foreign issues in our market place. We have also had in mind, of course, the possibility of giving foreign issuers even a marginal competitive advantage over domestic issuers through any special treatment.

In applying this policy, we have had few problems with what we refer to as the narrative portions of the prospectus, meaning all of the prospectus other than the financial statements, including the notes thereto. Issuers in some countries have resisted most strongly the requirement for disclosure of the salaries and other compensation paid to top executive officers. Our own people do not like this either, but they have become used to it and, anyway, they have no choice if they wish to make a public offering. But, with foreign issuers, where such disclosures are not made at home and acute embarrassment is claimed, we have shown some mercy. In all other respects, there is no reason why foreign issuers cannot meet all of the narrative disclosure requirements, and we insist that they do.

Financial statements are somewhat more complex and difficult. Accounting conventions vary among the free countries. Disclosure practices as to detailed statements of financial

results and conditions vary even more, leading to resistance to meeting our standards and, over the years, we have had particular difficulty because of the failure of the foreign certifying accountants to meet our minimum standards of independence. Our accounting rules also may present some difficulties for Japanese issuers who are accustomed to the so-called "parent-only" method of accounting, pursuant to which only the financial statement of a parent company, and not its subsidiaries, must be disclosed. American issuers, which customarily issue their financial reports on a consolidated basis, have had problems with this requirement when offering securities in Japan, <sup>\*/</sup> and I understand the Ministry of Finance is considering possible amendments to this requirement. <sup>\*\*/</sup>

As to these matters, it is frequently expeditious for the prospective foreign issuer to retain the local office of one of the major U.S. accounting firms to do the auditing and certifying required for Securities Act registration. We do

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<sup>\*/</sup> Thrope, The Sale of U.S. Securities in Japan, 29 Bus. Law. 411, 423 (1974).

<sup>\*\*/</sup> Ibid., citing Japan Economic Journal, Feb. 10, 1973.

not require the use of a U.S. public accounting firm, and we have permitted registration statements to become effective with financial statements certified by foreign accountants. Where the foreign firm is well versed in our requirements, including that of independence, it works well enough. Otherwise some time and much grief may be avoided by retaining a U.S. firm for this purpose.

We expect to make few if any concessions for foreign issuers with respect to the forms and context of financial statements and related disclosures. The financial information is generally the most important part of any prospectus, and we think the information supplied by foreign issuers should be comparable to that supplied by our own companies.

I mentioned earlier the possible availability of an exemption from the registration requirements of the Securities Act. The exemption most likely to be available to a foreign issuer is what we generally refer to as a private placement -- or, in terms of the Act, a sale of securities not involving any public offering. In Japan, I understand you have a similar

exemption from registration, <sup>\*/</sup> although apparently great reliance is placed on the number of offerees, with 50 offerees and 20,000 share allotments generally serving as your cutoff point. <sup>\*\*/</sup>

For reasons too technical and too numerous to recite here, the subject of our private placement exemption has become encrusted with such an impractical overburden of metaphysics that the Commission was persuaded to adopt a rule seeking to clarify and rationalize the exemption. After several years of public debate over a proposed rule on the subject, the Commission has adopted Securities Act Rule 146. The rule is not susceptible of easy summary here, but you should know of its existence as, among other things, a topic of conversation with your underwriter as to the best method for handling a particular financing. You should be aware, however, that, under our rule, the availability of the exemption does not depend solely upon the existence of a small number of offerees, as the term "private placement" might suggest.

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<sup>\*/</sup> Misawa, supra p. 7, 6 Vand. J. Transnational Law at 483.

<sup>\*\*/</sup> Ibid. See, also, Thrope, supra p. 14, 29 Bus. Law at 413.

Our total scheme of securities regulation is not limited to the insistence upon full disclosure when securities are being offered to the public. Under certain circumstances the periodic reporting requirements of the Securities Exchange Act of 1934 come into play. That Act generally relates to the trading markets and picks up where the Securities Act leaves off -- post distribution trading. That Act extends the disclosure approach of the Securities Act to the trading markets by requiring periodic disclosure of financial and other material information by most public companies, so that existing shareholders and potential investors will be able to determine, regularly, the results of a public company's operations. In this regard, our periodic disclosure requirements are similar to yours. <sup>\*/</sup> Other provisions of our Securities Exchange Act relate to take-over disclosures, disclosures of holdings of the issuer's equity securities by so-called insiders and liability for profits on

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<sup>\*/</sup> Securities and Exchange Law, Articles 24, 25, Law No. 25, Apr. 13, 1948, as amended.

so-called short swing trades therein, and the rules governing the solicitation of proxies. In applying some of these provisions, we have had to make certain concessions to foreign companies or their directors and officers based on the practicalities of our jurisdiction. Our practical ability to enforce these requirements upon foreign companies and individuals is limited. Our primary weapon is to stop domestic trading in the securities of a non-complying company and to raise the fact of non-compliance if such a company later seeks access to our markets through an offering registered under the Securities Act.

The Exchange Act essentially recognizes three categories of issuers which must periodically disclose financial and other material information. First, there are companies which have registered a securities offering with us under the Securities Act; second, there are companies which voluntarily list their securities on a U.S. securities exchange and are, therefore, required to register the securities with the Commission under Section 12(b) of the Exchange Act; and third, there are companies whose securities are not listed on an exchange but which are required to be registered with us pursuant to Section 12(g) of the Exchange Act because the company has assets of at least \$1 million and an outstanding class of equity securities held by 500 or

more persons. When the number of holders gets below 300 the company may terminate their registration. With respect to numbers two and three, it is the registration under either Section 12(b) or 12(g) which brings into play the periodic reporting provisions of the Act.

As to foreign issuers, we, to some extent, distinguish the last category of issuers -- the so-called Section 12(g) issuer -- from those companies which voluntarily list their securities on an exchange or voluntarily register a securities offering with us. The reason for this distinction is more practical than logical. Listing on a securities exchange or registering a public offering with us are affirmative acts justifying reasonable burdens as conditions. Public ownership alone may occur without an affirmative act by the company and perhaps against its desires. Because of this, the Commission has provided an exemption from the registration requirements of Section 12(g) and the periodic disclosure requirements which arise therefrom.

Rule 12g3-2, adopted in 1967, provides, basically, a two-part exemption. First, it exempts the equity securities of foreign issuers if such class of securities is held by less

than 300 persons resident in the U.S. rather than the 500 securityholder world-wide test of Section 12(g). Second, notwithstanding the number of total U.S. securityholders, the rule generally provides a complete exemption if the foreign issuer or a foreign government official on behalf of the issuer furnishes to, not files with, the Commission whatever material investor information the issuer reports to its own government, to foreign stock exchanges or otherwise makes public to its securityholders.

For those foreign issuers not entitled to an exemption, Form 20 is the basic registration form for foreign private issuers and Form 20K is the annual up-date form. Form 6K, adopted in 1967, is the substitute for the quarterly 10Q reports and the current 8K required of domestic issuers.<sup>\*/</sup> Form 6K, in essence, provides for the furnishing, not filing, of material investor information which the foreign issuer reports to its own government, to foreign stock exchanges or otherwise makes public to its securityholders.

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<sup>\*/</sup> Forms 20, 20K and 6K generally are not available to North American (essentially Canadian) issuers who have had prior Securities Act registration statement or who wish to list securities on an exchange. These issuers would be governed by the requirements applicable to domestic issuers.

The Forms 20 and 20K provide an interesting contrast to their Form 10 and 10K counterparts. The foreign forms do not require disclosure of share ownership by management or 10 percent stockholders but only the presence of direct control by a foreign issuer. Nor is disclosure required with respect to remuneration and similar benefits paid to or provided for individual members of management, transactions of management with the issuer, pending legal proceedings, trading markets and recent issuances of securities. Form 20, by its terms, requires only a "general" description of the character of the business and property of the issuer, a very skimpy requirement compared to Form 10, especially in regard to required information on results by lines of business and the competitive situation. Furthermore, all that is required by Form 20K is an indication of the changes that have occurred in the past year in contrast to the Form 10K, which requires an annual up-date of the complete description of business, including sales and earnings by lines of business.

The fact is that while the Commission has made significant changes in the reporting requirements for domestic companies as part of its efforts to develop a more substantial process of continued disclosure, it has neglected the foreign forms, principally Forms 20 and 20K, and they have not kept pace.

These forms could parallel more closely the domestic forms, certainly in the business disclosure area, without creating undue hardships on foreign issuers who in many instances are subject to more extensive disclosure requirements by their domicile countries. We are considering this prospect.

As for financial statements and related disclosures, basically the same general policies and practices of the Commission as I discussed in connection with registration under the Securities Act are applicable to registration and reporting by foreign issuers under the Securities Exchange Act. Unless exempt, foreign issuers are expected to comply substantially with the same requirements applicable to domestic issuers.

Several other significant accommodations have been made for foreign issuers under the Securities Exchange Act. Registration under either Section 12(b) or 12(g) of the Act automatically triggers the provisions of Sections 14 and 16 of the Act. Section 14 generally provides for the regulation of the solicitation of proxies and the nature and extent of information that must be furnished to securityholders in connection with such proxy solicitations. Section 16 regulates,

and, in essence, prohibits, short-swing trading profits by management and others in the equity securities of the issuer. Although no specific exemption for foreign issuers is contained in either Section 14 or 16 of the Act, the Commission, pursuant to broad exemptive authority otherwise given to it in the Act, adopted Rule 3a12-3 in 1935. This rule, in effect, exempts from the proxy and insider trading provisions of Sections 14 and 16 those securities for which the filing of registration statements on Forms 18 or 20 are authorized. This would include, of course, all foreign governments and most foreign private issuers. The only significant amendment in this rule occurred in 1966, when the exemption was removed for essentially American companies, -- that is, companies 50 percent owned, directly or indirectly, by American residents and whose business is either administered principally in the United States or 50 percent of whose Board of Directors are American residents. We have no present intention to remove or further restrict this exemption. Let me emphasize, however, in connection with Section 16, that the exemption applies only to the reporting and civil recovery for short-term trading provisions; it does not affect the liabilities resulting from the misuse of publicly undisclosed material information available to management and other insiders.

Another significant accommodation provided for foreign issuers is in the one I previously mentioned regarding registration under Section 12(g), and attendant disclosure requirements, for equity securities trading in the over-the-counter market in the U.S. Other miscellaneous exceptions in the Rule are for American Depositary Receipts and temporary exemptions for most foreign issuers which are required to file periodic reports by reason of prior Securities Act or Securities Exchange Act registrations. Again, these exemptions are not available to essentially American companies although foreign formed. Nor are they available to certain North American companies.

Our federal securities laws also may regulate certain purchases, by foreigners, of outstanding American securities.

In general, no unique securities law problems are presented when citizens of foreign countries purchase outstanding securities of our domestic corporations. Under these laws, foreigners are free to participate as investors in our capital markets on a parity with American citizens. On the other hand, no concessions or exemptions are provided for foreigners. In broad terms, purchases of American securities by foreigners, as well as by United States citizens, trigger securities law provisions when they reach 5 percent of a class of equity securities outstanding or the purchaser plans to make a tender

offer for outstanding equity securities. In either circumstance, Americans and foreigners are required to file certain reports with us. These reporting requirements are intended to disclose to the other shareholders the identity of the persons seeking control -- who they really are, not just nominees acting on their behalf -- who is supplying the funds for the offer, and what the offerors intend to do with the company if they are successful in acquiring control. It is the theory of our law that a person being asked to sell his stock is entitled to know, as best he can, not only what he will get if he does sell but also what he can expect if he does not.

There has been concern expressed about increasing foreign ownership of securities, especially voting shares, of U.S. corporations. Part of this is simply a fear of the unknown. Based on the realization that, through the use of various agents and nominees, including bank accounts that preserve the anonymity of the principal, our disclosure laws may be effectively evaded, some people imagine concentrations of stock in our major industries being assembled by foreigners whose interests may be contrary to the best interests of our country. To allay this fear, or at least to make the facts generally known,

Senator Inouye, of Hawaii, has sponsored legislation directing a study of foreign ownership and the establishment of a procedure for keeping such information up to date. We have supported this legislation and there is a fair chance that it will be enacted this fall. Legislation that would restrict foreign ownership has not received our support and does not seem likely to pass in this Congress, but it may well be revived in the next.

Proposals to acquire control through tender offers, accompanied as they are by public disclosures, do not raise sinister fears of the unknown, but they do encounter opposition of a nationalistic nature, especially in these days, when American companies feel unfairly vulnerable because of the depressed prices for their shares. I should note that we recently announced the institution of a general investigation with respect to takeovers and acquisitions by foreign and domestic persons.<sup>\*/</sup> We hope that the investigation will provide a factual basis for determining whether the existing laws, including our own rules, are adequate for investor protection and, if not, where revision may be needed. Whether rule changes or legislation will ultimately treat foreigners differently than domestic persons, I cannot say.

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<sup>\*/</sup> Securities Act Rel. No. 5526 (Sept. 9, 1974).

I can only say that, under our present laws and policies, we process filings for take-over bids for foreigners in the same manner as we do those by our own companies. We sometimes have doubts whether we are getting all of the facts regarding the real persons in interest in such bids because of our inability to get at the sources of information and compel disclosure, but otherwise we do not try to impede foreign offers just because they are foreign.

It is our belief that the free flow of capital among free nations will serve the long-range benefits of us all. Right now, and at least for the coming decade, we expect to need foreign capital and we favor policies that will make it available in ways that do not generate fears and repressive measures. We believe this can best be achieved by all free nations establishing high standards of public disclosure and financial reporting.

In the last quarter century we have come a long way toward this goal. I hope that the economic crises we are all facing do not force our respective governments into regressive and repressive measures which will retard the development of truly international capital markets.